

STAFF PAPER

13–14 May 2014

IFRS Interpretations Committee Meeting

IFRS IC Jan, May and Sep 2013
IASB Feb, Oct and Nov 2013

Project	Annual Improvements to IFRSs 2012-2014 Cycle (ED/2013/11)—Comment letter analysis		
Paper topic	IFRS 7 <i>Financial Instruments: Disclosures</i> —Servicing Contracts (Staff draft of the proposed amendments to IFRS 7)		
CONTACT(S)	Kenichi Yoshimura	kyoshimura@ifrs.org	+44 (0)20 7246 6905

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Staff draft of the amendment to IFRS 7

1. This Agenda Paper presents the staff draft of the proposed amendments to IFRS 7 derived from our recommendations in Agenda Paper 17B.
 - (a) **Appendix A** shows the staff draft of the proposed amendments, including our recommendations in Agenda Paper 17B, highlighting differences from the currently effective IFRSs. The new text is underlined and deleted text is struck through; and
 - (b) **Appendix B** shows revisions to the wording in the Exposure Draft ED/2013/11 *Annual Improvements to IFRSs 2012-2014 Cycle* published in December 2013. The new text is underlined and deleted text is struck through.

Appendix A—Changes for finalising the amendment¹

Amendments to IFRS 7 *Financial Instruments: Disclosure*

Paragraph B30 is amended and paragraphs 44Z and B30A are added. New text is underlined.

Effective date and transition

...

44Z Annual Improvements to IFRSs 2012–2014 Cycle, issued in [date], amended paragraphs 44R and B30 and added paragraph B30A. An entity shall apply the amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2016. However, an entity need not apply the amendment to paragraph B30 and the addition of paragraph B30A for any period presented that begins before the annual period for which the entity first applies those amendments. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

...

Continuing involvement (paragraph 42C)

...

B30 An entity does not have a continuing involvement in a transferred financial asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the transferred financial asset nor acquires any new contractual rights or obligations relating to the transferred financial asset. An entity does not have continuing involvement in a transferred financial asset if it has neither an interest in the future performance of the transferred financial asset nor a responsibility under any circumstances to make payments in respect of the transferred financial asset in the future. The term ‘payment’ in this context does not include cash flows of the transferred financial asset that an entity collects and is required to remit to the transferee.

B30A When an entity transfers a financial asset the entity may retain the right to service that financial asset for a fee that is included in, for example, a servicing contract. The entity must assess the servicing contract in accordance with the guidance in paragraphs 42C and B30 to decide whether the entity has continuing involvement as a result of the servicing contract for the purposes of the disclosure requirements. For example, a servicer will have continuing involvement in the transferred financial asset for the purposes of the disclosure requirements if the servicing fee is dependent on the amount or timing of the cash flows collected from the transferred financial asset. Similarly, a fixed fee that is not paid in full because of non-performance of the transferred financial asset will also lead to the conclusion that the servicer has continuing involvement for the purposes of the disclosure requirements. In these examples, the servicer has an interest in the future performance of the transferred financial asset. This assessment is independent of whether the fee to be received is expected to compensate the entity adequately for performing the servicing.

¹ An amendment to paragraph 44R that is referred to in paragraph 44Z is a separate amendment to IFRS 7, which is fully discussed in Agenda Paper 17C

Consequential amendment to IFRS 1 *First-Time Adoption of International Financial Reporting Standards*

Paragraph 39V is added.

Effective date

...

39V *Annual Improvements to IFRSs 2012–2014 Cycle*, issued in [date], added paragraph E4A. An entity shall apply that amendment for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

In Appendix E, paragraph E4A and a footnote are added.

Disclosures about financial instruments

...

E4A A first-time adopter may apply the transition provisions in paragraph 44Z of IFRS 7.*

* Paragraph E4A was added as a consequence of *Annual Improvements to IFRSs 2012–2014 Cycle* issued in [date]. To avoid the potential use of hindsight and to ensure that first-time adopters are not disadvantaged as compared with current IFRS preparers, the IASB decided that first-time adopters should be permitted to use the same transition provisions permitted for existing preparers of financial statements prepared in accordance with IFRSs that are included in *Annual Improvements to IFRSs 2012–2014 Cycle*.

Basis for Conclusions on the amendments to IFRS 7 *Financial Instruments: Disclosure*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Paragraphs BC65O-BC65R and BC72A are added.

Disclosures relating to transfers of financial assets

Transferred financial assets that are derecognised in their entirety

...

Application of the disclosure requirements to a servicing contract

BC65O Paragraphs 42A–42H to IFRS 7 require an entity to provide disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred

asset, existing at the reporting date, irrespective of when the related transfer transaction occurred.

- BC65P The IASB received a request to clarify whether servicing contracts constitute continuing involvement for the purposes of applying the disclosure requirements in paragraphs 42E–42H of IFRS 7. More specifically, the question was raised as to whether paragraph 42C(c) excludes servicing contracts from the scope of those disclosure requirements.
- BC65Q The IASB observed that paragraph 42C(c) discusses arrangements whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities; ie a ‘pass-through arrangement’. Paragraph 42C(c) confirms that the cash flows collected to be passed through are not themselves continuing involvement for the purposes of the transfer disclosure requirements. Consequently, the IASB observed that the servicer’s obligation to pass through to one or more entities the cash flows that it collects from the transferred financial asset is not in itself continuing involvement for the purposes of the disclosure requirements, because the activity of passing through cash flows does not in itself constitute an interest in the future performance of the transferred financial asset. The IASB observed, however, that a servicing contract is generally continuing involvement for the purposes of the transfer disclosure requirements because, in most cases, the servicer has an interest in the future performance of the transferred financial assets as a result of that contract. That would be the case if the amount and/or timing of the servicing fee depend on the amount and/or timing of the cash flows collected from the transferred financial asset. This would be true irrespective of how the servicer receives its servicing fee; ie whether the servicer retains a portion of the cash flows collected from the transferred financial asset as its fee or it passes through all of the cash flows collected and receives its fee separately from the transferee or another entity.
- BC65R On the basis of these observations, the IASB noted that paragraphs 42C and B30 need to be considered to determine whether a servicing contract is continuing involvement for the purposes of the transfer disclosure requirements. The IASB decided to add additional guidance to the Application Guidance of IFRS 7 to make clear how the guidance in paragraph 42C is applied to servicing contracts.

Effective date and transition (paragraphs 43 and 44)

...

- BC72A *Annual Improvements to IFRSs 2012-2014 Cycle*, issue in [date], amended paragraph B30 and added paragraph B30A. The IASB considered whether the amendment should apply to any period presented that begins before the annual period for which the entity first applies the amendment. The IASB noted that paragraph 42E(b) of IFRS 7 requires disclosure of the fair value of the assets and liabilities that represent the entity’s continuing involvement in the derecognised financial assets. Application of the amendment to such a period might therefore require an entity to determine the fair value as at the end of the period for a servicing asset or servicing liability, which the entity might not have previously determined. It might be impracticable for an entity to determine the fair value of such a servicing asset or servicing liability without using hindsight. The IASB also noted that paragraph 44M provides transition relief by which the entity need not apply the transfer disclosure requirements to comparative periods. Consequently, to avoid the risk of hindsight being applied, the IASB decided to require the application of the amendment only to annual periods beginning on or after the beginning of the annual period for which the amendment is applied for the first time. Furthermore, for the same reason, the IASB observed that those transition provisions should be available to first-time adopters. Accordingly, the IASB decided to amend IFRS 1 *First-Time Adoption of International Financial Reporting Standards* to ensure that first-time adopters are not disadvantaged as compared with current IFRS preparers.

Appendix B—Changes from the Exposure Draft published in December 2013 following our recommendations in this paper²

Amendments to IFRS 7 *Financial Instruments: Disclosure*

Paragraph B30 is amended and paragraphs 44Z and B30A are added.

Effective date and transition

...

44Z *Annual Improvements to IFRSs 2012–2014 Cycle*, issued in [date], amended paragraphs 44R and B30 and added paragraph B30A. An entity shall apply the amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2016. However, an entity need not apply the amendment to ~~of~~ paragraph B30 and the addition of paragraph B30A for any period presented that begins before the annual period for which the entity first applies those amendments. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

...

Continuing involvement (paragraph 42C)

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B30 An entity does not have a continuing involvement in a transferred financial asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the transferred financial asset nor acquires any new contractual rights or obligations relating to the transferred financial asset. An entity does not have continuing involvement in a transferred financial asset if it has neither an interest in the future performance of the transferred financial asset nor a responsibility under any circumstances to make payments in respect of the transferred financial asset in the future. The term ‘payment’ in this context does not include cash flows of the transferred financial asset that an entity collects and is required to remit to the transferee.

B30A When an entity transfers a financial asset the entity may retain the right to service that financial asset for a fee that is included in, for example, a servicing contract. ~~The right to earn a fee for servicing the financial asset is generally continuing involvement for the purposes of applying the disclosure requirements.~~ The entity must assess the servicing contract in accordance with the guidance in paragraphs 42C and B30 to decide whether the entity has continuing involvement as a result of the servicing contract for the purposes of the disclosure requirements. ~~make that determination.~~ For example, a servicer will have continuing involvement in the transferred financial asset for the purposes of the disclosure requirements if the servicing fee is dependent on the amount or timing of the cash flows collected from the transferred financial asset. Similarly, a fixed fee that is not paid in full because of non-performance of the transferred financial asset will also lead to the conclusion

² An amendment to paragraph 44R that is referred to in paragraph 44Z is a separate amendment to IFRS 7, which is fully discussed in Agenda Paper 17C

that the servicer has continuing involvement for the purposes of the disclosure requirements. In these examples, the servicer has an interest in the future performance of the transferred financial asset. This assessment is independent of whether the fee to be received is expected to compensate the entity adequately for performing the servicing.

Consequential amendment to IFRS 1 *First-Time Adoption of International Financial Reporting Standards*

Paragraph 39V is added.

Effective date

...

39V *Annual Improvements to IFRSs 2012–2014 Cycle*, issued in [date], added paragraph E4A. An entity shall apply that amendment for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

In Appendix E, paragraph E4A and a footnote are added.

Disclosures about financial instruments

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E4A A first-time adopter may apply the transition provisions in paragraph 44Z of IFRS 7.*

- * Paragraph E4A was added as a consequence of *Annual Improvements to IFRSs 2012–2014 Cycle* issued in [date]. To avoid the potential use of hindsight and to ensure that first-time adopters are not disadvantaged as compared with current IFRS preparers, the IASB decided that first-time adopters should be permitted to use the same transition provisions permitted for existing preparers of financial statements prepared in accordance with IFRSs that are included in *Annual Improvements to IFRSs 2012–2014 Cycle*.

Basis for Conclusions on the amendments to IFRS 7 *Financial Instruments: Disclosure*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Paragraphs BC65O-BC65R and BC72A are added.

Application of the transfer disclosure requirements to a servicing contract—Disclosures relating to transfers of financial assets

Transferred financial assets that are derecognised in their entirety

...

Application of the disclosure requirements to a servicing contract

- BC65O1 In October 2010, the IASB issued *Disclosures—Transfers of Financial Assets* (Amendments to IFRS 7). The amendment included the addition of paragraphs 42A–42H to IFRS 7 *Financial Instruments: Disclosures*. Those paragraphs require an entity to provide disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset, existing at the reporting date, irrespective of when the related transfer transaction occurred.
- BC65P2 The IASB received a request to clarify whether servicing contracts constitute continuing involvement for the purposes of applying the disclosure requirements in paragraphs 42E–42H of IFRS 7. More specifically, the question was raised as to whether paragraph 42C(c) excludes servicing contracts from the scope of those disclosure requirements.
- BC65Q3 The IASB observed that paragraph 42C(c) discusses arrangements whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities; ie a ‘pass-through arrangement’. Paragraph 42C(c) confirms that the cash flows collected to be passed through are not themselves continuing involvement for the purposes of the transfer disclosure requirements. Consequently, the IASB observed that the servicer’s obligation to pass through to one or more entities the cash flows that it collects from the transferred financial asset is not in itself continuing involvement for the purposes of the disclosure requirements, because the activity of passing through cash flows does not in itself constitute an interest in the future performance of the transferred financial asset. The IASB observed, however, that a servicing contract is generally continuing involvement for the purposes of the transfer disclosure requirements because, in most cases, the servicer has an interest in the future performance of the transferred financial assets as a result of that contract. That would be the case if the amount and/or timing of the servicing fee depend on the amount and/or timing of the cash flows collected from the transferred financial asset. This would be true irrespective of how the servicer receives its servicing fee; ie whether the servicer retains a portion of the cash flows collected from the transferred financial asset as its fee or it passes through all of the cash flows collected and ~~separately~~ receives its fee separately from the transferee or another entity.
- BC65R4 On the basis of these observations, the IASB noted that paragraphs 42C and B30 need to be considered to determine whether a servicing contract is continuing involvement for the purposes of the transfer disclosure requirements. The IASB decided ~~proposes~~ to add additional guidance to the Application Guidance of IFRS 7 to make clear how the guidance in paragraph 42C is applied to servicing contracts.

Effective date and transition (paragraphs 43 and 44)

...

- BC72A5 *Annual Improvements to IFRSs 2012-2014 Cycle*, issue in [date], amended paragraph B30 and added paragraph B30A. The IASB ~~also~~ considered whether the amendment should apply to any period presented that begins before the annual period for which the entity first applies the amendment. The IASB noted that paragraph 42E(b) of IFRS 7 requires disclosure of the fair value of the assets and liabilities that represent the entity’s continuing involvement in the derecognised financial assets. Application of the amendment to such a

period might therefore require an entity to determine the fair value as at the end of the period for a servicing asset or servicing liability, which the entity might not have previously determined. It might be impracticable for an entity to determine the fair value of such a servicing asset or servicing liability without using hindsight. The IASB also noted that paragraph 44M provides transition relief by which the entity need not apply the transfer disclosure requirements to comparative periods. Consequently, to avoid the risk of hindsight being applied, the IASB ~~decided~~ ~~proposes~~ to require the application of the amendment only to annual periods beginning on or after the beginning of the annual period for which the amendment is applied for the first time. Furthermore, for the same reason, the IASB observed that those transition provisions should be available to first-time adopters. Accordingly, the IASB ~~decided~~ ~~proposes~~ to amend IFRS 1 *First-Time Adoption of International Financial Reporting Standards* to ensure that first-time adopters are not disadvantaged as compared with current IFRS preparers.