STAFF PAPER

March 2019

IFRS® Interpretations Committee meeting

Project	**Credit enhancement in the measurement of expected credit losses (IFRS 9)**
Paper topic	Agenda decision to finalise

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Objective

1. This paper considers feedback on the IFRS Interpretations Committee's (Committee) tentative agenda decision on IFRS 9 *Financial Instruments*— Credit enhancement in the measurement of expected credit losses. The paper:

   (a) analyses comments received on the tentative agenda decision, and

   (b) asks the Committee whether it agrees with the staff recommendation to finalise the agenda decision.

Introduction

2. The Committee received a submission about the effect of a credit enhancement on the measurement of expected credit losses (ECL) when applying the impairment requirements in IFRS 9. The submission asked whether the cash flows expected from a financial guarantee contract or any other credit enhancement can be included in the measurement of expected credit losses if the credit enhancement is otherwise required to be separately recognised applying IFRS Standards.

3. In the fact pattern described in the submission, the credit enhancement is:

   (a) part of the contractual terms; and

(b) required to be recognised separately by IFRS Standards.

4. In November 2018, the Committee published a tentative agenda decision in which it concluded that:

   (a) for the purpose of measuring expected credit losses, paragraph B5.5.55 of IFRS 9 requires the estimate of expected cash shortfalls to reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity. Accordingly, the cash flows expected from a credit enhancement are included in the measurement of expected credit losses if the credit enhancement is both:

      (i) part of the contractual terms; and

      (ii) not recognised separately by the entity.

   (b) an entity applies the applicable IFRS Standard to determine whether it is required to recognise a credit enhancement separately. Paragraph B5.5.55 of IFRS 9 does not provide an exemption from applying the separate recognition requirements in IFRS 9 or other Standards.

5. There are two appendices to this paper:

   (a) Appendix A—proposed wording of the agenda decision; and

   (b) Appendix B—comment letters.

Comment letter summary

6. We received 7 comment letters reproduced in Appendix B to this paper.

7. Six respondents agree with the Committee's analysis and conclusions. However, although agreeing with the conclusion, Deloitte suggests that the Committee consider providing further guidance on an indirectly related matter (see paragraph 10). In addition, some respondents made other suggestions to improve the clarity of the tentative agenda decision (see paragraph 15).

8. The Institute of Chartered Accountants of India (ICAI) says the tentative agenda decision does not adequately address the matter for the reason explained in paragraph 11.

9. Further details about the comments raised by respondents, together with our analysis, are presented below.

Staff analysis

Separate recognition of a credit enhancement

Respondents' comments

10. Deloitte commented that IFRS Standards do not specify when an entity separately recognises a purchased credit enhancement. It therefore suggests that the Committee consider whether further guidance can be provided on when an entity is required to separately recognise a credit enhancement applying IFRS Standards.

11. Similarly, ICAI says the Committee should consider clarifying the scope of the term 'not recognised separately by the entity' in paragraph B5.5.55 of IFRS 9 in the context of credit enhancements. Using the respondent's description, a clarification should be considered as to whether that term refers to credit enhancements that are explicitly required to be recognised separately by IFRS Standards (for example, credit default swaps that meet the recognition criteria in IFRS 9) or whether it also extends to credit enhancements not explicitly covered by the Standards (for example, a financial guarantee or a credit insurance policy held by the entity as protection against credit risk). In ICAI's view, it may be appropriate for the Committee to recommend an amendment to paragraph B5.5.55 in this regard.

Staff analysis

12. As noted in paragraph 2 of this paper, the fact pattern described in the submission specifies that the entity is required to separately recognise the credit enhancement applying IFRS Standards, and asked about the effect of such credit enhancement on the measurement of ECL. Accordingly, the question discussed by the Committee was

premised on the assumption that the entity is required to separately recognise the credit enhancement. The Committee was not asked to discuss *when* that is the case.

13. The Staff think the request for guidance on when an entity is required to separately recognise a credit enhancement is different from the question asked in the submission. It is therefore beyond the scope of the question asked and the Committee's discussion. The Staff also think it is not necessary to address this request in order to answer the question raised by the submitter. The Staff therefore, recommend that the Committee finalise the Agenda Decision with no changes made in this regard.

Other Comments

14. Respondents also made suggestions to improve the clarity of the agenda decision. The following table summarises these comments, along with our analysis and recommendations:

Respondent comments	**Staff analysis**
Wording suggestion Deloitte suggests replacing the wording 'is required to be recognised separately by IFRS Standards' with 'is recognised separately' to reflect the absence of specific requirements on the recognition of purchased credit enhancements.	In reaching its conclusion, the Committee included the word 'required' to clarify that, if credit enhancements (for example, a credit default swap) are required to be recognised separately applying IFRS Standards, entities cannot choose to instead include them in the measurement of ECL. The Committee highlighted that paragraph B5.5.55 of IFRS 9 does not provide an exemption from applying the separate recognition requirements in IFRS 9 or other Standards. The Staff think the inclusion of the term 'required' is a more faithful depiction of the

	Committee’s discussion and the conclusion reached. Accordingly, the Staff recommend no change in this respect.
Related discussion at the ITG The November 2018 IFRIC Update included a reference to a related discussion by the Transition Resource Group for Impairment of Financial Instruments (ITG). The Global Financial Reporting Collective raised concerns about incorporating other documents into Agenda Decisions by reference, highlighting the ITG agenda paper is not subject to the same due process as the Committee’s agenda decision.	The reference to the ITG discussion was included in IFRIC® Update, but did not form part of the tentative agenda decision for reasons similar to those highlighted by the respondent. The ITG discussed a related but separate matter and, accordingly, the Committee did not reach their conclusions based on the ITG discussion. Nonetheless, the Committee considered it would be helpful to include a reference in IFRIC® Update to highlight it to readers of the tentative agenda decision. This is because the ITG’s discussion related to the same paragraph of IFRS 9 as that discussed by the Committee (ie paragraph B5.5.55). Accordingly, the Staff recommend no change in this respect—ie we recommend no reference is made to the ITG discussion in the agenda decision.

Staff recommendation

15. On the basis of our analysis, we recommend finalising the agenda decision as published in November 2018 IFRIC® Update with no changes. Appendix A to this paper sets out the proposed wording of the final agenda decision.

Question 1 for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision set out in Appendix A to this paper?

Appendix A—Proposed wording for tentative agenda decision

A1. We propose the following wording for the final agenda decision, which is unchanged other than to remove the square brackets in the final sentence.

> **Credit enhancement in the measurement of expected credit losses (IFRS 9 *Financial Instruments*)**
>
> The Committee received a request about the effect of a credit enhancement on the measurement of expected credit losses when applying the impairment requirements in IFRS 9. The request asked whether the cash flows expected from a financial guarantee contract or any other credit enhancement can be included in the measurement of expected credit losses if the credit enhancement is required to be recognised separately applying IFRS Standards.
>
> For the purposes of measuring expected credit losses, paragraph B5.5.55 of IFRS 9 requires the estimate of expected cash shortfalls to reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity.
>
> Accordingly, the Committee observed that the cash flows expected from a credit enhancement are included in the measurement of expected credit losses if the credit enhancement is both:
>
> a. part of the contractual terms; and
> b. not recognised separately by the entity.
>
> The Committee concluded that, if a credit enhancement is required to be recognised separately by IFRS Standards, an entity cannot include the cash flows expected from it in the measurement of expected credit losses. An entity applies the applicable IFRS Standard to determine whether it is required to recognise a credit enhancement separately. Paragraph B5.5.55 of IFRS 9 does not provide an exemption from applying the separate recognition requirements in IFRS 9 or other IFRS Standards.
>
> The Committee concluded that the requirements in existing IFRS Standards provide an adequate basis for an entity to determine whether to include the cash flows expected from a credit enhancement in the measurement of expected credit losses in the fact pattern described in the request. Consequently, the Committee ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda.

Appendix B—Comment Letters

Deloitte.

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6 February 2019

Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom

Dear Ms Lloyd

Tentative agenda decision – IFRS 9 *Financial Instruments*: Credit enhancement in the measurement of expected credit losses

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the November IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for clarification on whether the cash flows expected from a financial guarantee contract or any other credit enhancement recognised separately in the financial statements can be included in the measurement of expected credit losses of the financial asset to which it relates.

We agree with the IFRS Interpretations Committee's conclusion that if a credit enhancement is required to be recognised separately by IFRS Standards, an entity cannot include the cash flows expected from it in the measurement of expected credit losses. However, we note that IFRS Standards do not specifically address when separate recognition of a purchased credit enhancement is required. We believe that without clarification in that respect, divergence of views may persist on whether a purchased credit enhancement is required to be separated and so indirectly could lead to divergence in the extent to which entities include the expected cash flows from such arrangements in the measurement of expected credit losses. We encourage the IFRS Interpretations Committee to consider whether further guidance can be provided on when it is that a credit enhancement is required to be recognised separately under IFRS Standards.

In any case, if finalised, the agenda decision should be revised to remove references to the fact that the credit enhancement "is required to be recognised separately by IFRS Standards" because of the absence of such requirements and instead simply referred to credit enhancement that "is recognised separately".

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

MAZARS

Mrs Sue Lloyd
IFRS Interpretations Committee
Columbus Building,
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

La Défense, February 6, 2019

Tentative Agenda Decisions – IFRIC Update November 2018

Dear Sue,

MAZARS is pleased to comment on the various IFRS Interpretations Committee tentative agenda decisions published in the November 2018 IFRIC Update.

We have gathered all our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

We would like to draw your attention to two issues that are worth considering:

- The tentative decision on physical settlement of contracts to buy or sell a non-financial item (see Appendix 2 to this letter) is contrary to the practice applied by large companies in the energy sector, and we think it necessary to undertake a comprehensive analysis of the issue and the rationale for their current practice before finalizing any decision;
- The issue of the accounting for the curing of a credit-impaired financial asset is not an easy one, and when diving into examples, it appears that there exist within IFRS 9 some unclear requirements or even inconsistencies between the definitions involved. We have tried to develop examples evidencing those difficulties, and we stand ready to present them and our concerns in a dedicated meeting with IFRS IC Staff / members.

Should you have any questions regarding our comments on the various tentative agenda decisions, or should you want us to participate in a meeting as proposed above, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin
Financial Reporting Advisory

Edouard Fossat

Appendix 5

Credit enhancement in the measurement of expected credit losses (IFRS 9* Financial Instruments*)—Agenda Paper 6

We agree with the Tentative Agenda Decision as drafted.

1 February 2019

Ms. Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Ms. Lloyd

IFRS Interpretations Committee Tentative Agenda Decisions

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the following Tentative Agenda Decisions published in IFRIC Update December 2018:

(1) Credit enhancement in the measurement of expected credit losses (IFRS 9 *Financial Instruments*).

(2) Curing of a credit-impaired financial asset (IFRS 9 *Financial Instruments*).

(3) Physical settlement of contracts to buy or sell a non-financial item (IFRS 9 *Financial Instruments*).

(4) Sale of output by a joint operator (IFRS 11 *Joint Arrangements*).

(5) Customer's right to access the supplier's software hosted on the cloud (IAS 38 *Intangible Assets*).

We agree with the Committee's decision not to take these issues onto its agenda and we agree with the Tentative Agenda Decisions.

If you need further clarification, please contact the undersigned by email at beeleng@masb.org.my or at +603 2273 3100.

Thank you.

Yours sincerely,

TAN BEE LENG
Executive Director

Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany

DRSC

ASCG • Zimmerstr. 30 • 10969 Berlin

Sue Lloyd
Chair of the IFRS Interpretations Committee
7 Westferry Circus, Canary Wharf
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IFRS Technical Committee
Phone: +49 (0)30 206412-12
E-Mail: info@drsc.de

Berlin, 06 February 2019

Dear Sue,

RE: The IFRS IC's tentative agenda decisions in its November 2018 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the tentative agenda decisions taken by the IFRS Interpretations Committee (IFRS IC) and published in the November 2018 IFRIC Update.

We agree with four of the tentative agenda decisions. However, in respect of two tentative agenda decisions we have concerns with the decision and the reasons cited, namely the tentative decisions on physical settlement of contracts (IFRS 9) and cloud computing (IAS 38).

Please find our detailed comments in the appendix to this letter. If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

6th February, 2019

To,
Ms Sue Lloyd,
Chair, IFRS Interpretations committee,
IFRS Foundation,
London, UK

Dear Ms Sue,

Subject: Tentative Agenda Decision (TAD) Nov 2018 – Public Comments by Feb 6th, 2019

Thank you for giving us an opportunity to comment on the six tentative agenda decisions of IFRS Interpretation Committee published in Nov 2018. Our comments and concerns on TADs are given in the attachment and we hope you will find those useful and relevant. IFRIC Interpretation Committee is requested to consider our concerns appropriately to depict true and fair view and economic substance of the transactions/events.

The Institute of Chartered Accountants of India (the ICAI) , is the premier accounting body of India established way back 1949 as one of the primary building block of nation building, of Independent India. Over the last seven decades, the ICAI has grown in many professional areas and today it is second largest body of accountants in the World. The ICAI with its great vision and relentless mission to serve the public interest, domestic and global, has earned title of "Partner in Nation Building" in an emerging economy which is sixth largest by GDP and the fastest growing capital market in Asia.

Please feel free to contact CA. Vidhyadhar Kulkarni, Head, Technical Directorate, (email: vidhyadhar.kulkarni@icai.in or asb@icai.in) for any clarifications or discussion.

Thanking you,

Yours faithfully,

CA.S.B.Zaware,

Chairman, ASB, ICAI

New Delhi, India

Tentative agenda decision (TAD): Credit enhancement in the measurement of expected credit losses (IFRS 9)

In our view, the TAD has not adequately addressed the issue particularly in relation to the following aspects:

There is lack of clarity about the meaning and intention of the requirement of paragraph B5.5.5 of IFRS 9 Financial Instruments which is highlighted in bold & italic " For the purposes of measuring expected credit losses, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and **are not recognised separately by the entity.**" Does it mean the credit enhancements that are recognised as assets/liabilities based on explicit requirements of any IFRS Standards or does it extend to instruments/transactions not explicitly covered by IFRS Standards, such as financial guarantee held or credit insurance policy held to cover the credit risk of a loan or portfolio of loans? Examples of former category could be contracts like credit default swaps that meet the definition of Derivative under IFRS 9. On the other hand, there are no specific IFRS Standards that address the accounting requirements of instruments that are obtained as protection against credit risk such as financial guarantee held by an entity or credit insurance policy held by an entity, but the commission paid or premium paid to obtain such credit risk protection is often recognised and accounted as prepaid expense and amortised over the tenor of the protection. In such a situation, does it fail the requirements of B5.5.5, i.e., it is recognised separately and, therefore, entities will not be able to include such credit enhancements in the measurement of Expected Credit Loss (ECL). In our view, this may not have been the intention of the International Accounting Standards Board (IASB) in the context of paragraph B5.5.5 referred above, rather intention is to exclude only those financial instruments that are required to be recognised separately by other IFRS Standards. Therefore, it may be appropriate for IFRS Interpretation Committee (IFRS IC) to recommend a minor clarificatory amendment to paragraph B5.5.5. Otherwise, the TAD of IFRS IC may have unintended consequences on the measurement of ECL, particularly in the Banking and Financial Services Industry.

Global Financial Reporting Collective
incorporating the Pacioli Initiative

globalfrcollective@gmail.com

4 February 2019

IFRS Interpretations Committee
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD
United Kingdom

The Global Financial Reporting Collective is pleased to offer its comments on the Tentative Agenda Decision—Credit enhancement in the measurement of expected credit losses enhancement in the measurement of expected credit losses.

We agree with conclusions reached by the Committee. We also think the tentative Agenda Decision is a significant improvement on the version in the Staff paper. The staff should be congratulated for reflecting comments made at the meeting.

We do have one concern.

The important point in the decision is that if a credit enhancement is required to be recognised separately by IFRS Standards an entity cannot include the cash flows etc. The IFRS Interpretations Committee avoided discussing what is meant by "part of the contractual terms" because this was discussed by the ITG.

As a principle, we think you should avoid incorporating other documents into Agenda Decisions by reference. By referring to Agenda Paper 5 of the December 2015 ITG meeting you risk giving that paper the same status as an Agenda Decision. Although Agenda Decisions are not integral to IFRS Standards, they are acknowledged in the Due Process Handbook of the IASB and have some formal due process around them. Staff papers that are discussed by the ITG do not. Furthermore, the ITG's discussion is not in that paper. It is, as far as we can tell, a recording. We think that if the ITG's discussion is important then the Agenda Decision should quote from it. You can say that you did not consider this because it had been discussed by the ITG. Not only would this give it more formality, but it has the practical advantage of helping anyone who read the Agenda Decision from having to find the paper and the discussion.

Thank you for considering our comments.

Global Financial Reporting Collective

Global Financial Reporting Collective

4 February 2019

About the Global Financial Reporting Collective

The **Global Financial Reporting Collective** is a coalition of academics who support global financial reporting standards and who are motivated to help the IASB to develop high quality standards. The Collective does not have a jurisdictional base. It operates as a virtual, global network.

The Collective was established in 2018. In its initial phase it is managed by a small group of volunteers who analyse IASB proposals and collate comments into comment letters to the IASB. In the second phase the Collective plans to develop a website that will enable a broader range of academics, and practitioners, to provide analysis of proposals. Any comments and input received will not be attributed to an individual. We plan to provide mechanisms to allow individuals to make observations which can then be assessed on their merits, rather than be influenced by the reputation of the submitter—a blind review process.

The primary focus of comments from the Collective is on the clarity and internal and conceptual consistency of proposals, mainly informed from experience with teaching from IFRS Standards or applying them in practice. The Collective does not represent any sector and will not lobby on behalf of any entity or sector to support a particular view.

The purpose of the **Pacioli Initiative** is to make research and learning resources available to the broader community of people using global financial reporting standards. A portal for sharing these resources is being developed as part of the second phase of the Collective. We welcome any input on IFRS-related matters that could be helpful to those who teach or research in this area.

Rio de Janeiro, February 06, 2019

CONTRIB 0008/2019

Ms Lloyd
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD, UK.

Subject: Tentative agenda decision

Reference: Credit enhancement in the measurement of expected credit losses

Dear Ms Lloyd,

Petróleo Brasileiro S.A. - Petrobras welcomes the opportunity to comment on the IFRS Interpretations Committee's tentative agenda decision - Credit enhancement in the measurement of expected credit losses. We believe this is an important opportunity for all parties interested in the future of IFRS and we hope to contribute to the progress of the Board's activities.

We generally agree with the Interpretations Committee's conclusion and we support the decision not to add this item to its agenda

If you have any questions in relation to the content of this letter please do not hesitate to contact us (contrib@petrobras.com.br).

Respectfully,

/s/Rodrigo Araujo Alves

Rodrigo Araujo Alves

Chief Accounting and Tax Officer