IFRS

STAFF PAPER

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IASB® meeting

Project	**Rate-regulated Activities**
Paper topic	Scope—Financial instruments within the scope of IFRS 9

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Objective

1. This paper sets out staff analysis and recommendations on whether the scope of the final Standard should exclude regulatory assets or regulatory liabilities related to differences in timing that may arise from financial instruments within the scope of IFRS 9 *Financial Instruments*.

2. At a future IASB meeting, we will discuss whether the final Standard should provide a scope exclusion for regulatory assets or regulatory liabilities related to insurance contracts within the scope of IFRS 17 *Insurance Contracts*.

Summary of staff recommendations

3. We recommend:

   (a) the final Standard does not exclude from its scope regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9; and

   (b) the Basis for Conclusions on the final Standard explains that regulation of interest rates is typically limited to the setting of a cap or floor on interest rates. This type of regulation is not expected to give rise to differences in timing.

Structure of the paper

4. This paper is structured as follows:

   (a) proposals in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft) (paragraphs 6–8);

   (b) summary of comments received (paragraphs 9–17); and

   (c) staff analysis (paragraphs 18–30).

5. This paper does not cover specific topics dealing with clarifying the boundary between financial instruments within the scope of IFRS 9 and regulatory assets or regulatory liabilities. The staff will bring these topics to a future IASB meeting.[1]

Proposals in the Exposure Draft

6. Paragraph 3 of the Exposure Draft proposes that an entity applies the [draft] Standard to all its regulatory assets and all its regulatory liabilities. The Exposure Draft does not provide any scope exclusion.

7. Paragraph 6(c) of the Exposure Draft specifies that a regulatory asset or a regulatory liability can exist only if differences in timing arise, that is when:

   […]

   (c) part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period.

8. The Exposure Draft describes differences in timing as differences between revenue recognised by applying IFRS 15 and total allowed compensation. For example, paragraph 12 of the Exposure Draft states that the amount of **revenue an entity recognises in a period applying IFRS 15** *Revenue from Contracts with Customers* differs from the total allowed compensation for the goods or services supplied in that period if:

[1] Agenda Paper 9A of the February 2022 IASB meeting summarises these items.

(a) differences in timing arise […]; or

(b) the entity supplies goods or services in one period but, by applying IFRS 15, recognises part or all of the resulting revenue in a future period.

Summary of comments received

9. This section is structured as follows:

   (a) feedback received during the comment period of the Exposure Draft (paragraphs 10–13); and

   (b) targeted outreach undertaken after the comment period (paragraphs 14–17).

Feedback received during the comment period of the Exposure Draft

10. Many respondents expressed concerns that the proposed scope may be broader than intended. Many respondents also said that the scope proposals are not sufficiently clear to help them determine whether a regulatory agreement is in the scope of the Exposure Draft in specific circumstances.

11. A few respondents said that these concerns are partly caused by a lack of clarity about whether the proposed model is intended to provide information that supplements *only* the information provided by applying IFRS 15 or whether it is also intended to supplement the requirements of other Accounting Standards—for example IFRS 9.

12. A few banking associations in Europe and national standard-setters in Europe and North America suggested the IASB exclude from the scope of the final Standard all regulatory assets and regulatory liabilities related to financial instruments within the scope of IFRS 9.

13. Those European banking associations explained that applying the fair value or amortised cost measurement requirements in IFRS 9 already provides useful information because these measurements already reflect the effects of any adjustment to future regulated interest rates. One of these respondents also said that the IASB had concluded when developing the requirements of IFRS 9 that amortised cost would provide useful information about regulated interest rates as long as the contractual

cash flows do not introduce risks or volatility that are inconsistent with a basic lending arrangement.[2]

Targeted outreach undertaken after the comment period

14. After the comment period ended, the staff spoke to one of the European banking associations mentioned in paragraph 13 and to four accounting firms. The objective of the outreach was to gather evidence about:

    (a) the existence of financial instruments within the scope of IFRS 9 that may give rise to regulatory assets and regulatory liabilities; and

    (b) how widespread these financial instruments might be and how material the regulatory assets or regulatory liabilities might be.

15. These stakeholders have not identified financial instruments within the scope of IFRS 9 that are likely to be affected by the proposals in the Exposure Draft.

16. One of the European banking associations mentioned in paragraph 13 cited an example of social rental loan with regulated interest rate. In this case the loan was a preferential rate loan to promote the financing of social rental housing in areas where the real estate market is tight. The interest rate was a variable rate loan indexed to the interest rate calculated by the local central bank for regulated savings accounts. The interest rates are revised annually during the life of the loan. Any change in the interest rate is immediately applicable to the loan and is binding on the bank and the customer. The stakeholder has determined that this particular interest rate regulation does not give rise to differences in timing.

17. A few of these stakeholders said that including the existence of a regulator in the scope requirements of the final Standard would reduce the probability of the final Standard affecting financial instruments within the scope of IFRS 9. This is because requiring that the interest rate is determined by a regulator would remove from the scope of the final Standard any regulatory assets and regulatory liabilities that would

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[2] Paragraphs BC4.179–BC4.180 of the Basis for Conclusions on IFRS 9.

arise from financial instruments with market-based interest rates (that is, interest rates that are not regulated).

Staff analysis

18. As mentioned in paragraph 12, the feedback suggested the IASB exclude from the scope of the final Standard all regulatory assets and regulatory liabilities related to financial instruments within the scope of IFRS 9 (scope exclusion).

19. The staff think that any recommendation to provide a scope exclusion should be accompanied by an understanding of the regulatory assets or regulatory liabilities that would be subject to the scope exclusion. This includes whether those regulatory assets or regulatory liabilities exist and if so, how widespread and how material they might be.

20. The following two conditions are necessary for regulatory assets or regulatory liabilities to arise from financial instruments within the scope of IFRS 9:

    (a) the interest rate of a financial instrument is determined by a regulator (paragraph 21); and

    (b) the way in which the interest rate is determined would give rise to differences in timing (paragraphs 22–24).

21. In February 2022, the IASB tentatively decided to include the existence of a regulator in the scope requirements.[3] That means the model only applies to financial instruments that attract an interest rate that is determined by a regulator (regulated interest rate). For example, governments may regulate the interest rate of some financial instruments (for example, business or consumer loans) to achieve certain financial, economic or social outcomes.

22. The scope proposals are clear that for a regulatory asset or a regulatory liability to exist a difference in timing needs to arise (paragraph 7). Our research indicates that

[3] Agenda Paper 9C discussed at the IASB meeting in February 2022.

the regulation of interest rate is typically limited to the setting of caps for lending rates, and less frequently, the setting of caps or floors for deposit rates.[4]

23. When regulation is limited to setting *caps or floors on the interest rates* entities can charge, that type of regulation does not give rise to differences in timing. This is because that regulation only prevents an entity from charging rates outside the bounds of the regulatory caps or floors. For example, if an entity is subject to regulation that only caps the interest rate charged, the entity can charge any interest rate up to that cap but cannot charge a rate above the cap. Therefore, that type of regulation does not give rise to differences in timing (that is, the entity does not have an enforceable right or an enforceable obligation to adjust future rates). In theory, if a particular type of regulation existed that required an entity to adjust amounts above a cap, or amounts below a floor, in the rates charged in the future, that type of regulation would give rise to differences in timing.[5] However, we have not identified any examples of such regulation existing.

24. Consequently, we would not expect regulatory assets or regulatory liabilities to arise from financial instruments within the scope of IFRS 9. This is further confirmed by the evidence gathered from the targeted outreach undertaken after the comment period of the Exposure Draft (paragraph 15), and also during the development of IFRS 9 and the post-implementation review of the classification and measurement requirements of IFRS 9.[6]

25. Although we do not expect regulatory assets or regulatory liabilities would arise from financial instruments within the scope of IFRS 9, we analyse the benefits and costs of providing a scope exclusion. The analysis is structured as follows:

    (a) reasons supporting a scope exclusion (paragraphs 26–27);

    (b) reasons against a scope exclusion (paragraphs 28–29); and

    (c) conclusions (paragraph 30).

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[4] The regulation can also impose a cap on fees entities can charge.

[5] Agenda Paper 9B discussed at the IASB meeting in February 2022.

[6] The IASB discussed at its April 2022 meeting the feedback to Request for Information *Post-implementation Review of IFRS 9—Classification and Measurement* on the requirements for assessing the contractual cash flow characteristics of financial assets (Agenda Paper 3A).

Reasons supporting a scope exclusion

26. We have not identified any examples of situations in which a regulatory asset or a regulatory liability would arise from financial instruments that have a regulated interest rate. However, if such situations do exist:

    (a) it may be difficult for entities to apply the requirements to financial instruments.[7] This is because interest income does not contain the components of total allowed compensation proposed in the Exposure Draft.

    (b) it may be costly for entities to identify regulated financial instruments and apply the requirements to those instruments. Entities such as financial institutions may hold a large number of financial instruments in many different jurisdictions. These entities would need to assess whether there are regulatory assets or regulatory liabilities that arise from regulation of interest rates in each jurisdiction.

    (c) applying the requirements to financial instruments may not provide more useful information than simply applying the requirements of IFRS 9. For example, entities such as financial institutions may be subject to regulation of interest rates that affects both interest income and interest expense. However, the requirements would not supplement interest expense these entities recognised by applying IFRS 9. Moreover, some stakeholders in the banking industry said that applying the fair value or amortised cost measurement requirements in IFRS 9 already provides useful information (paragraph 13).

27. Consequently, excluding regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9 from the scope of the final Standard would avoid the issues described in paragraph 26 if those regulatory assets or regulatory liabilities existed.

[7] Paragraphs B3–B27 of the Exposure Draft.

Reasons against a scope exclusion

28. Scope exclusions are generally provided when there is an identified population of items or transactions that fall within the scope of an Accounting Standard, but for which an explicit scope exclusion is necessary (for example, to avoid unintended consequences). However, as discussed in paragraphs 19–24, we have not identified any examples of situations in which a regulatory asset or a regulatory liability would arise from financial instruments that have a regulated interest rate. Consequently, excluding regulatory assets and regulatory liabilities related to financial instruments within the scope of IFRS 9 from the scope of the final Standard would at best be unnecessary and could, at worst, result in items that meet the definition of regulatory assets or regulatory liabilities not being accounted for as such.

29. Rather than providing a scope exclusion, we could address the concerns described in paragraph 11 by explaining in the Basis for Conclusions on the final Standard that regulation of interest rates is typically limited to the setting of a cap or floor on interest rates. This type of regulation is not expected to give rise to differences in timing.

Conclusions

30. On balance, the staff do not recommend excluding from the scope of the final Standard regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9. Given that we have been unable to identify any examples of situations in which such regulatory assets or regulatory liabilities would arise, we do not think that there is a compelling reason to provide a scope exclusion.

Question for the IASB
Does the IASB agree that: (a) the final Standard does not exclude from its scope regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9; and

(b) the Basis for Conclusions on the final Standard explains that regulation of interest rates is typically limited to the setting of a cap or floor on interest rates. This type of regulation is not expected to give rise to differences in timing.