European Financial Reporting Advisory Group

EFRAG's position on the IASB Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9*

April 2013

EFRAG's overall assessment

	EFRAG's position
EFRAG agrees with	EFRAG welcomes the IASB's decision to consider making limited amendments to IFRS 9 and appreciates the effort made to address accounting mismatches arising from the application of different measurement models to financial assets and insurance liabilities.
… but is concerned	There are still financial assets that would not pass the contractual cash flow characteristics assessment, for different reasons, despite the fact that an amortised cost or fair value through other comprehensive income (FV-OCI) measurement would provide more useful information. As many of these financial assets are held to collect contractual cash flows, we believe that measurement on a basis other than fair value through profit or loss (FV-PL) would result in better financial reporting.
EFRAG disagrees with	EFRAG believes that the ED fails to clearly identify the business model underlying measurement at FV-OCI. In addition, it does not fully address the concerns raised by insurance companies, which was one of the reasons for reopening the classification and measurement requirements in IFRS 9.

EFRAG's overall assessment (Cont'd)

	EFRAG's position
EFRAG recommends the IASB	▪ To clarify that the definition of interest in IFRS 9 is not meant to be inconsistent with how entities determine interest of financial assets in practice. ▪ To introduce bifurcation into IFRS 9 for financial assets, based on an approach consistent with the contractual cash flow characteristics assessment. Entities should bifurcate financial assets that fail the contractual cash flow characteristics assessment, unless entities elect (either at the entity-level or on a portfolio-level) to measure these financial assets in their entirety at FV-PL due to the excessive cost of bifurcation. ▪ To introduce FV-OCI measurement as part of its project on insurance contracts, since EFRAG believes that this measurement (FV-OCI) is necessary as part of a solution to address insurers' concerns about accounting mismatches and performance reporting.

Contractual cash flow characteristics assessment (Questions 1 to 3)

	EFRAG's position
Clarifications for financial assets with modified economic relationship	EFRAG welcomes the clarifications made in the contractual cash flow characteristics assessment. However, the IASB's proposals to modify the assessment do not go far enough. In addition, there exist financial assets other than those with a modified economic relationships that are expected to fail the assessment for different reasons, which are (at least in part) held to collect contractual cash flows.
Definition of interest – for purposes of contractual cash flow characteristics assessment	EFRAG is concerned that if paragraph B4.1.8A of the ED was taken literally, it would require FV-PL measurement in almost all circumstances. EFRAG believes that the IASB should clarify that the definition of interest in IFRS 9 (and the related application guidance) were not meant to be inconsistent with how entities determine interest of financial assets in practice, for example by including a reasonable profit margin and a premium for liquidity risk and considering other entity-specific factors such as the expected future behaviour of customers, provided that the resulting interest reflects market transactions.

Contractual cash flow characteristics assessment (Questions 1 to 3) (Cont'd)

	EFRAG's position
Financial assets with regulated interest rates or early automatic redemption features	Constituents reported that financial assets with regulated interest rates and those with early automatic redemption features would most likely fail the assessment. EFRAG believes that: • Financial assets with regulated interest rates should generally be considered eligible instruments provided that their interest rate represents the pricing basis that is compulsory in the jurisdiction and is intended to provide a reasonable proxy for the time value of money. Significant accounting mismatch could arise if these financial assets are measured at FV-PL. • The current guidance in IFRS 9 should be expanded to clarify that a financial asset with an automatic early (partial) redemption feature linked to credit risk deterioration of the issuer should not be excluded from measurement at amortised cost (or FV-OCI), provided that the financial asset prepays only principal and accrued interest. The accounting effects of prepayment options and automatic redemption features linked to the credit risk of the issuer are identical if not the same.

EFRAG
European Financial Reporting Advisory Group

Contractual cash flow characteristics assessment (Questions 1 to 3) (Cont'd)

	EFRAG's position
Other financial assets	Constituents also identified a number of other instruments that are expected to fail the assessment, including financial assets that are currently measured at amortised cost under IAS 39 which are (at least partially) managed to collect the contractual cash flows. EFRAG recommends that the IASB introduces bifurcation into IFRS 9 for financial assets based on an approach consistent with the contractual cash flow characteristics assessment as described in paragraphs BC63-BC67 of the ED. In our view, entities should bifurcate financial assets that fail the contractual cash flow characteristics assessment, unless entities elect (either at the entity-level or on a portfolio-level) to measure these financial assets in their entirety at FV-PL due to the excessive cost of bifurcation. This would ensure measuring financial assets that fail the contractual cash flow characteristics assessment more consistently with how entities manage them.

Business model assessment (Questions 4 to 6)

	EFRAG's position
FV-OCI measurement	EFRAG believes that any additional business model that requires a different treatment for financial reporting purposes should be supported by a robust definition. However, we believe that the definition of the additional business model proposed by the ED is not sufficiently clear so as to differentiate it from the existing business model in IFRS 9 to 'hold-to-collect' and the residual category of FV-PL (which includes assets 'held for trading'). At the same time, the ED does not fully address the concerns raised by insurance companies regarding accounting mismatches and performance reporting, which was one of the reasons for reopening the classification and measurement requirements in IFRS 9. EFRAG recommends that the IASB introduces FV-OCI measurement (for financial assets) as part of its project on insurance contracts rather than proceeding with the ED. We believe that insurers should use FV-OCI measurement for financial assets in certain circumstances to be defined once the interaction between IFRS 9 and the future IFRS on insurance contracts is clear enough.

Business model assessment (Questions 4 to 6) (Cont'd)

	EFRAG's position
Recommendations to make amortised cost category more operational	• The ED puts too much emphasis on the volume of sales that are consistent with the 'hold-to-collect' business model. We believe that it would be helpful to clarify that entities need to take into consideration the reasons why a sale occurred rather than simply the amount of sales and their frequency. • Sales required by regulators should not preclude entities from measuring financial assets at amortised cost and the IASB should clarify how to assess the significance of sales. • We also believe that sales before an external downgrade should be allowed, since this would be consistent with the current proposals on impairment, and sales for reasons other than credit deterioration (e.g. in the case of concentration risk) when this is consistent with entity's documented investment policy. • It would be helpful to clarify various aspects related to the unit of account (e.g. whether portfolios could be split at inception).

Business model assessment (Questions 4 to 6) (Cont'd)

	EFRAG's position
If the IASB were to proceed with FV-OCI	EFRAG believes that it should move away from the level of sales and characterise the various business models in a way that is relevant for financial reporting purposes. It should also make explicit the link between the characteristics of the business models and the differential financial reporting treatments adopted. The IASB should also further enhance the related application guidance, in particular the proposed examples, so as to ensure consistent application in practice and comparability between entities. For example: • How to differentiate between (i) managing financial assets with the objective to maximise return through selling and reinvesting and (ii) managing financial assets and evaluating their performance on a fair value basis with incidental collection of contractual cash flows • Whether managing financial assets on a fair value basis always leads to measurement at FV-PL, or this measurement basis could be overcome depending on facts and circumstances.

Early application (Question 7), Own credit provisions (Question 8) and First-time adoption (Question 9)

	EFRAG's position
Early application	Considering the complexity arising from a phased application, EFRAG agrees with the proposal in the ED that after IFRS 9 is finalised, an entity early applying IFRS 9 should be required to apply IFRS 9 in its entirety. However, entities should be able to make this election irrespective of whether they choose to apply IAS 39 or IFRS 9 to their hedge relationships until the macro hedging project is completed. We also agree with the six-month transition period.
Own credit provisions	EFRAG believes that entities should be permitted to early apply the 'own credit' provisions in IFRS 9. EFRAG reiterates its request to amend IAS 39 so as to bring immediate improvement in financial reporting. EFRAG is concerned that the relief being provided would only be available as an option once the remaining phases of IFRS 9 have been finalised.
First-time adoption	EFRAG does not have any specific comments regarding first-time adopters.