International Organization of Securities Commissions
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المنظمة الدولية لهيئات الأوراق المالية

24 January 2022

International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Our Ref: 2021/O/C1/IASB/MS/181

RE: Request for Information | Post-implementation Review: IFRS 9 *Financial Instruments* - Classification and Measurement

Dear International Accounting Standards Board (IASB or the "Board") Members,

The International Organization of Securities Commissions (IOSCO) Committee on Issuer Accounting, Auditing and Disclosure (Committee 1) thanks you for the opportunity to provide our comments on the Request for Information | Post-implementation Review: IFRS 9 *Financial Instruments* (IFRS 9) - Classification and Measurement.

IOSCO is committed to promoting the integrity of the international markets through promotion of high-quality accounting standards, including rigorous application and enforcement. Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect the general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General Observations

Members of Committee 1 ("members" or "we") consider post-implementation reviews integral to due process and appreciate the opportunity to provide our feedback on the classification and measurement requirements in IFRS 9.

Although this comment letter identifies opportunities for improvement in specific areas, overall members continue to consider the totality of classification and measurement requirements in IFRS 9, including the related disclosure requirements, result in relevant and useful information to users of financial statements for their assessment of the amounts, timing, and uncertainty of an entity's future cash flows.

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Classification

A business model whose objective is to hold assets in order to collect contractual cash flows

Frequency, value, and timing

Paragraph B4.1.2C of IFRS 9 states in "determining whether cash flows are going to be realised by collecting the financial assets' contractual cash flows, it is necessary to consider the *frequency*, *value* and *timing* of sales in prior periods, the reasons for those sales and expectations about future sales activity." (emphasis added). Paragraph B4.1.3B of IFRS 9 further explains that "sales may be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are infrequent (even if significant in value) or insignificant in value both individually and in aggregate (even if frequent)."

In this context, most members consider the concepts of frequency, value, and timing insufficiently explained. For consistent application, these members suggest inclusion of additional guidance to explain:

- the specific time horizon considered when determining frequency (i.e., what is "infrequent");
- the specific reference point considered when determining value (e.g., portfolio size, portfolio total return etc.) including what is considered "insignificant", and
- the specific reference period considered when determining timing (e.g., entire life of the portfolio or comparison on the period-by-period basis).

Some members observe diversity in how Example 4 following paragraph B4.1.4 of IFRS 9 is applied in practice. These members suggest that further guidance would be helpful in identifying when this guidance can be used (i.e., only by financial institutions or by other entities as well).

Sales of financial assets

Paragraph B4.1.3 of IFRS 9 states that "although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus, an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur or are expected to occur in the future."

Some members observe the degree of flexibility in this paragraph has resulted in instances of inappropriate or potentially opportunistic classification into the amortized cost model. These members believe this paragraph should be revised to, more stringently, confine and limit the instances that would permit sales of financial assets.

Financial assets with sustainability linked features

Recent market developments have given rise to loans that are linked to sustainability initiatives, indices, or targets (e.g., a loan with an interest rate that varies based on specific environmental, social or governance (ESG) metrics). Members observe the growing emergence of these loans and expect, that in response to increased attention to ESG matters, such loan features to become common and widespread.

Members observe a degree of uncertainty on whether such contractual terms give rise to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding. As such, members strongly recommend the IASB address this topic through specific application guidance or educational material with an illustrative example.[1]

Non-recourse loans

Paragraphs B4.1.16 - B4.1.17 of IFRS 9 contain limited guidance on whether certain non-recourse loans represent contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Some members observe varying views on this issue (specifically as it relates to certain speculative immovable property financing). These members recommend the IASB address this topic through specific application guidance or educational material with an illustrative example.

De minimis effect

Paragraph B4.1.18 of IFRS 9 explains that a contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a *de minimis effect* on the contractual cash flows of the financial asset.

To support consistent application, members encourage the IASB to describe de minimis in the context of paragraph B4.1.18. In addition, a quantitative example would be helpful.

Financial assets 'held to collect and sell' business model

One member questions whether the fair value through other comprehensive income measurement category is better served as an "exemption" for certain scenarios involving insurance contracts rather than a broad category applicable to all financial assets. In most other cases, this member considers that investors would be best served with information arising from only two measurement categories: amortized cost and fair value through profit or loss.

[1] A few members observe that if the effect of the sustainability-linked feature on the contractual cash flows of the loan is more than de minimis, the SPPI criterion is not met and therefore fair value through profit or loss (FVTPL) classification would result. These members request the IASB to consider, among other things, feedback from investors in determining the classification that would result in the most relevant information.

Financial assets held for trading

Part of the definition of a held for trading financial assets includes one that "is acquired or incurred principally for the purpose of selling or repurchasing it in the near term". IFRS 9 BA.6 explains that "trading" generally reflects active and frequent buying and selling, and financial instruments held for trading are normally used with the objective of generating a profit from short-term fluctuations in price or a dealer's margin.

A few member questions whether this definition prevents an entity with an equity investment purchased with the possible, but *not* principal, intention of being sold in the near term from making an irrevocable election to present in other comprehensive income subsequent changes in the fair value of such an investment. These members suggests that IFRS 9 BA.6 be expanded to address this point.

Puttable instruments

Paragraph BC 5.21 of IFRS 9 includes explanatory guidance that, among other things, notes "in particular circumstances a puttable instrument (or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation) is classified as equity. However, the IASB noted that such instruments do not meet the definition of an equity instrument."

Some members observe that investments in puttable instruments are often designated as at fair value through profit or loss because they cannot be regarded as equity instruments for IFRS 9.[2] Some of these members understand that this accounting has resulted in some potentially unintended consequences including the extension to circumstances beyond IFRS 9 such as those under IAS 28 *Investments in Associates and Joint Ventures* (IAS 28) where it has been asserted that equity method cannot be applied because there is no "equity" investment.

These members recommend that the IASB clarify whether such extension (referred to above) is appropriate or address the issue in the current project on the Equity Method.

Reclassification of financial assets

Paragraph 4.4.1 of IFRS 9 requires an entity to reclassify financial assets if the entity changes its business model for managing those financial assets. Such changes are, among other things, result from external or internal changes and must be significant to the entity's operations and demonstrable to external parties.

To support consistent application and minimize inappropriate reclassifications, some members believe additional guidance or illustrative examples are needed on the types of external or internal changes envisioned and how these changes are demonstrable to external parties.

[2] These members observe that although these investments are investments in debt, it is unlikely that they will meet the "SPPI criterion".

In addition, some members consider it important to clarify whether the reference to "next reporting period" in paragraph B4.4.2 of IFRS 9 refers to an annual or interim reporting period.

Measurement

Modification - financial assets

IFRS 9 acknowledges that in some circumstances the modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset. However, it does not provide further guidance for when a modification of a financial asset should result in derecognition. Historically, the IFRS Interpretations Committee (IFRC) noted that in the absence of explicit guidance on when a modification of a financial asset results in derecognition, an analogy might be made to the guidance on modifications of the financial liabilities.[3]

Members recommend that specific guidance be developed for modification of a financial assets that mirror, to the extent appropriate, the existing requirements for financial liabilities – promoting congruent accounting for both lender and borrower.[4]

Modification – qualitative characteristics

IFRS 9 does not provide specific guidance on when modifications to the terms of financial assets or liabilities might be substantial on a qualitative basis. In the October 2019 IASB Agenda Paper 14A, IASB Staff outline examples of modifications that could be substantial on a qualitative basis and those that would not. Many members believe these examples are useful and should be incorporated into IFRS 9.[5]

Subsequent measurement of the financial liability at amortised cost

Interest rate elements

Members observe that a need exists to clarify the guidance in and interaction between paragraph B5.4.5 and B5.4.6 of IFRS 9 on how an entity accounts for changes in estimated future cash flows.

Specifically, these members note that the recent IFRIC discussions regarding targeted longer-term refinancing operations (TLTROs) of the European Central Bank (ECB) highlights this need. As highlighted in our August 16, 2021 comment letter on TLTRO III Loans, we encourage the IASB to provide guidance for assessing how to account for the uncertainty that arises from conditions attached to

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[3] IFRIC Update – September 2012

[4] Many members consider the guidance in paragraph B3.3.6 of IFRS 9 (i.e., "10% test") to be helpful and believe it should be applied equally to financial assets.

[5] A significant change in the terms and conditions such that immediate derecognition is required with no additional quantitative analysis. A common example of this type of modification is issuing new debt in a different currency from the old debt.

interest rates and whether they should be reflected in the estimate and revisions of expected future cash flows when calculating the effective interest rate.

Royalty-based financing

Some members observe the increasing prevalence of loans, which meet the definition of a financial liability, in which payments are based on the borrower's performance (e.g., future revenue). These loans are sometimes referred to as "royalty-based financing arrangements".[6] Due to the inherent measurement uncertainty and the ongoing changes to estimates, diversity in accounting practices has been observed. These members suggest the IASB address this topic through specific application guidance or educational material with illustrative an example.

Disclosure of equity instruments designated at fair value through other comprehensive income

If an entity has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.7.5 of IFRS 9, it discloses in accordance with paragraph 11A(a) of IFRS 7 which investments in equity instruments have been designated to be measured at fair value through other comprehensive income.

Some members have observed diversity in how such disclosure is made, particularly in situations where the name of the investee is considered sensitive information. These members believe it would be helpful if paragraph 11A(a) of IFRS 7 was revised to clarify whether disclosure is required by name of investee or if other identification would suffice, including examples such identification.[7]

Exception from fair value measurement for some unquoted equity instruments

Unlike IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39), IFRS 9 does not contain an exception from fair value measurement for investments in equity instruments that do not have a quoted price in an active market and whose fair value cannot be reliably measured.[8]

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[6] For examples of such loans - https://www.findventuredebt.com/types-of-venture-debt/royalty-based-financing. Other related examples include financing-type carried interest arrangements in the development phase of a project.

7 For example, KPMG in their Annual Illustrative Financial Statements 2021 (page 91) states: "When disclosing which investments in equity instruments have been designated as at FVOCI, it appears that an entity should apply judgement in determining what disclosures would provide the most useful information for financial statement users. We believe that in most cases, disclosing the names of individual investees would be appropriate – e.g., if an entity has a small number of individually significant investments, particularly if this disclosure enables users to access additional information about those investees from other sources. However, in some cases disclosure at a higher level of aggregation and disclosures other than the names of investees may provide more useful information. For example, if an entity has a large number of individually insignificant investments in a few industries, then disclosure by industry may be appropriate. Similarly, if an entity holds investments for which no public information is available, then disclosure about the nature and purpose of those investments may be relevant."

[8] In general, equity instruments within the scope of IFRS 9 are measured at fair value. Paragraph B5.2.3 of IFRS 9 acknowledges that in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to

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Consistent with paragraph BC5.15 to the Basis for Conclusion on IFRS 9, most members continue to agree that fair value provides useful information to investors. Some of these members also observe that the historical exception in IAS 39 was inconsistently applied.

However, a few members hold a different view and echo the sentiments previously shared by other stakeholders as outlined in paragraph BC5.16 to the Basis for Conclusion on IFRS 9. These members recommend that an exception be introduced to IFRS 9, akin to the exception previously contained in IAS 39 for investments in equity instruments that did not have a quoted price in an active market and whose fair value could not be reliably measured.

Other

Cryptocurrencies

As outlined in our September 2021 comment letter on the Request for Information – *Third Agenda Consultation*, most members strongly encourage the IASB to address the accounting for cryptocurrencies. In relation to IFRS 9, we highlight the following extract from our comment letter:

> *Many members echo the observations identified in paragraph B14 of the Agenda Consultation and several members would extend those observations beyond "holdings" to include accounting issues surrounding "lending" activities.[9] As such, these members support amendments to either IAS 38 Intangible Assets (IAS 38) or IFRS 9 Financial Instruments (IFRS 9) as described in paragraph B15(b)(ii) or (c) of the Agenda Consultation. Ideally, these amendments would address both the holding and lending of cryptocurrency.*

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We appreciate your thoughtful consideration of the views provided in this letter.

If you have any questions or need additional information, please do not hesitate to contact Cameron McInnis, Chair of the Accounting Subcommittee of Committee 1 at +1 416-593-3675 or myself. In case of any written communication, please mark a copy to me.

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determine fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range. For the avoidance of doubt, paragraph B5.2.6 of IFRS 9 emphasizes that cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments).

[9] These members appreciate that cryptocurrency lending could be akin to some commodity loans and therefore acknowledge that some commonality exists with the observations in paragraph B12 of the Agenda Consultation.

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Yours sincerely,

Makoto Sonoda

Chair
Committee on Issuer, Accounting, Audit and Disclosure
International Organization of Securities Commissions