

4 April 2013

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Hans

AOSSG comments on Exposure Draft ED/2012/4
Classification and Measurement: Limited Amendments to IFRS 9

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the Exposure Draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9*. In formulating its views, the AOSSG sought the views of its constituents within each jurisdiction.

The AOSSG currently has 26 member standard-setters from the Asian-Oceanian region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Syria, Thailand, Uzbekistan and Vietnam.

To the extent feasible, this submission to the IASB reflects in broad terms the collective views of AOSSG members. Each member standard-setter may also choose to make a separate submission that is consistent or otherwise with aspects of this submission. The intention of the AOSSG is to enhance the input to the IASB from the Asian-Oceanian region. This submission has been circulated to all AOSSG members for their comment after having been initially developed through the AOSSG Chair's Advisory Committee.

AOSSG members support the IASB's efforts to address early application issues relating to IFRS 9 and, overall, most members are supportive of the IASB proposals to amend IFRS 9 *Financial Instruments*.

In particular, AOSSG members support the proposal to broaden the notion of what is 'solely payments of principal and interest' (SPPI) to include contractual cash flows of financial assets which could not be more than insignificantly different from cash flows of a benchmark instrument. However, AOSSG members recommend that the IASB should apply a more principle-based approach to the notion of SPPI and provide additional guidance on what would be the appropriate benchmark for the types of assets described in paragraph 2 of the Appendix.

Most AOSSG members also broadly support the proposal to introduce a new fair value through other comprehensive income (FVOCI) measurement category due to some of the concerns from constituents about the amortised cost category being too narrow and fair value through profit or loss (FVPL) not being the most useful category for some financial assets. However, some of these members are concerned about the accounting complexity that might be introduced along with this new measurement category. Accordingly, the support of these members for a FVOCI measurement category is subject to the FVPL option also being extended to these financial assets. Other AOSSG members are not supportive of the overall proposal to introduce the FVOCI measurement category in line with the views in paragraphs AV3 and AV4 of ED/2012/4.

Our views are explained in more detail in the Appendix.

If you have any queries regarding any matters in this submission, please contact me.

Yours sincerely



Kevin M. Stevenson
AOSSG Chair and Financial Instruments Working Group Leader

Appendix

AOSSG detailed comments on IASB ED/2012/4 ***Classification and Measurement: Limited Amendments to IFRS 9***

Contractual cash flows - modified economic relationship [relates to Questions 1, 2 and 3 of ED/2012/4]

- 1 Most AOSSG members support the proposal in ED/2012/4 to broaden the notion of what is ‘solely payments of principal and interest’ (SPPI) to include contractual cash flows of financial assets which could not be more than insignificantly different from cash flows of a benchmark instrument. These members have previously commented on IASB ED/2009/7 *Financial Instruments: Classification and Measurement* that they considered the SPPI condition to be too narrow and that it would inappropriately result in classification of some instruments that are managed on a contractual yield basis being measured at fair value.
- 2 In relation to the proposed modified economic cash flows approach, feedback from constituents indicates there still may be some financial assets for which the contractual cash flows would not be considered to be SPPI. For example:
 - (a) as noted in paragraph BC 44 of ED/2012/4, interest rates on retail and corporate loans in some jurisdictions in our region are set by a regulator or government agency without regard to a market-based link between interest rates and maturities. The IASB’s proposed guidance in this instance is to compare the regulated assets with a ‘benchmark’ instrument and if the difference in cash flows is no more than insignificant, these regulated assets would meet the SPPI condition. Some AOSSG members believe that most market-oriented benchmark interest rates would result in a more than insignificant difference in cash flows as interest rates are generally higher for loans with a longer tenor (for example, three years) compared to those with a shorter tenor (for example, one year). Accordingly, the difference between the contractual cash flows of a three-year loan with a remaining one-year maturity and a market rate for a one-year instrument would most likely be more than insignificant.
 - (b) Islamic banks provide financing based on partnerships (‘musharakah’ and ‘mudarabah’) between a bank and its customer. These types of financing typically include a supplementary contract that stipulates the terms of revision to the bank and customer’s profit-share throughout the partnership. Effectively, the revisions would reflect cash flows that approximate repayment of principal and interest. In some cases, the cash flows could be more than insignificantly

different from a benchmark cash flow due to, for example, an imposed pricing premium to reflect liquidity risk¹ or a lag in profit revision.

These members consider that even if there could be a difference in cash flows (as described in paragraphs 2(a) and 2(b) above), (i) the bank's business model is to hold the assets for the collection of contractual cash flows; and (ii) the asset's cash flows are an approximation of payments of principal and interest. Accordingly, these members consider measuring these types of assets at amortised cost would provide more useful information as compared to measuring them at fair value.

- 3 Most AOSSG members note the concerns expressed in paragraphs 2(a) and 2(b) above, and consider that:
 - (a) the IASB should apply a more principle-based approach to the notion of interest to enable assets that economically represent SPPI to be measured at amortised cost (subject to meeting the business model condition); and
 - (b) if the IASB proceeds with the proposed amendments in its current form, the IASB should provide additional guidance concerning what should be the appropriate benchmark for assets identified in 2(a) and 2(b) above, in order to clarify whether the IASB's intention is that such assets should not be measured at amortised cost.
- 4 In addition, some AOSSG members recommend that the IASB clarify whether the SPPI assessment is only required at initial recognition, or at initial recognition and subsequently at the end of every reporting period. Some AOSSG members also recommend that the IASB clarify whether a significant change in the contractual cash flows of the asset's contract (that is measured at amortised cost) would warrant derecognition of the asset under the old terms and re-recognition of the asset under the new terms (at amortised cost); or would the significant change require reclassification to fair value through profit or loss (FVPL).

Business model for fair value through other comprehensive income (FVOCI) [relates to Questions 4 and 5 of ED/2012/4]

- 5 AOSSG members are divided in their views about the proposal to introduce a FVOCI measurement category. Most members are, on balance, willing to support the proposal (paragraphs 6 to 10 below); and other members are not supportive of the overall proposal (paragraph 11 below).

1 As acknowledged in paragraph BC4.22 of IFRS 9 *Financial Instruments* (2010), some AOSSG members consider that interest should include other components integral to financing, for example, consideration for liquidity risk, in addition to time value of money and credit risk.

- 6 Most AOSSG members are, however, concerned that the IASB's original aim of simplifying financial instrument accounting is being undermined by the proposals. Consistent with paragraph AV5 of ED/2012/4, these members note that the proposals would involve greater need for judgement in determining the appropriate business model and dealing with reclassifications on a change in business model even though examples have been provided in ED/2012/4. For instance, some of these AOSSG members note that:
- (a) the level of aggregation in a portfolio would determine whether the portfolio would meet the business model objective of 'holding to collect contractual cash flows with frequent but *insignificant* sale' (consistent with paragraph B4.1.3 of ED/2012/4), or an objective of 'holding to collect contractual cash flows with greater frequency and volume of sales' (consistent with paragraph B4.1.4A of ED/2012/4).
 - (b) the proposals would require (i) entities that manage an investment portfolio with the objective to maximise return through opportunistic selling and reinvestment to measure the portfolio at FVOCI (subject to meeting the SPPI condition); but (ii) entities that manage an investment portfolio where assets are managed and performance evaluated on a fair value basis (and the collection of contractual cash flows being incidental) to measure the portfolio at FVPL. These members consider the distinction between the objective of managing to maximise return and managing on a fair value basis is not sufficiently clear in ED/2012/4.
 - (c) notwithstanding that the examples provided in ED/2012/4 are not exhaustive, one member considers a more general circumstance where a 'non-financial institution's business model objective is not to actively trade but to maximise returns of its debt investments when the opportunity arises' should be included as an example. This member considers the examples in ED/2012/4 are too focussed on circumstances where an entity holds a financial asset for liquidity or funding purposes, and that could imply that only in those circumstances would an entity meet the business model condition for FVOCI recognition.

Should the IASB proceed with this proposal, these members recommend that robust application guidance on identifying business models is provided in the standard.

- 7 Most AOSSG members are also concerned about the interaction of the proposals with the other phases of IFRS 9 which are yet to be completed, that is, hedge accounting and impairment. These members are concerned that until entities undertake a comprehensive review of IFRS 9 it may not be apparent whether there are unintended consequences arising from introducing a mandatory FVOCI category.

- 8 Notwithstanding paragraphs 6 and 7 above, on balance, these AOSSG members broadly support the proposal to introduce a mandatory FVOCI measurement category for financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale (subject to the contractual cash flow characteristics assessment). Feedback from constituents suggests that having only two measurement categories, that is, amortised cost and FVPL, for debt assets is too limiting. Introducing this FVOCI category would address some of the concerns about the amortised cost category being too narrow and FVPL not being the most useful category for some financial assets (such as those held to satisfy regulatory liquidity requirements, and those held for asset liability management purposes).
- 9 However, the support of some of these members for a FVOCI measurement category (in paragraph 8 above) is subject to the fair value option also being extended to these financial assets (see paragraphs 12 to 16 below).
- 10 Some AOSSG members support the rationale in paragraph BC23 of ED/2012/4 as a basis for the proposed requirement to recycle previously accumulated gains or losses in OCI to profit or loss on derecognition of debt assets measured at FVOCI. However, some of these members are not convinced there is a conceptual justification for having different recycling requirements on derecognition of debt assets measured at FVOCI compared with equity instruments designated at FVOCI (see paragraphs 22 and 23 below). Should the IASB proceed with this proposal, AOSSG members recommend including paragraph BC23 of ED/2012/4 as a rationale in its standard, which includes acknowledging the rationale for prohibiting recycling for equity instruments that are designated at FVOCI.
- 11 Other members do not support the FVOCI measurement category as proposed in ED/2012/4. Consistent with the views in paragraphs AV3 and AV4 of ED/2012/4, these members are of the view that the IASB should settle on either an amortised cost or a fair value model. The current proposal puts part of the changes to a financial asset in the profit or loss using the amortised cost model, and ‘other’ changes from applying a fair value model into OCI. These members consider that IFRS 9 would benefit users by providing a clear measurement model rather than a hybrid measurement model. They also consider that the proposed business model condition introduces unnecessary complexity in the measurement that would lead to presenting amounts that are not useful in the statement of comprehensive income.

Extension of the fair value option [relates to Question 6 of ED/2012/4]

- 12 Some AOSSG members agree that the fair value option should be extended to financial assets that would otherwise be mandatorily measured at FVOCI.

- 13 IFRS 9 requires that, in order to be eligible to apply the fair value option, the fair value designation must eliminate or significantly reduce a measurement or recognition inconsistency (sometimes referred to as an ‘accounting mismatch’) [IFRS 9 paragraph 4.1.5]. AOSSG members note that IFRS 9 contains limited guidance on how an entity should determine whether an accounting mismatch exists.
- 14 In the context of its insurance contracts project, the IASB has tentatively decided that certain components of insurance liabilities (remeasurements due to changes in discount rates) would be recognised through OCI. The IASB intends that introducing the mandatory FVOCI category would reduce the mismatch between financial assets and insurance liabilities. However, some AOSSG members consider that, as well as a mismatch arising from changes in discount rates used in measuring insurance liabilities there could also be a mismatch from changes in inflation rates (relating to assets backing those liabilities). Some AOSSG members believe that the mandatory FVOCI asset category together with taking insurance liability remeasurements due to discount rate changes through OCI would create new accounting mismatches that have no basis in economic substance. Feedback from some insurers and regulators is that they want the ability to measure both insurance liabilities (in their entirety) and the assets backing those insurance liabilities at FVPL.
- 15 These AOSSG members recommend that the IASB clarify whether insurers would be eligible to use the fair value option for both financial assets that would otherwise be mandatorily measured at FVOCI and insurance liabilities (in their entirety), that is, whether insurers would qualify for the ‘accounting mismatch’.
- 16 These members also recommend that the IASB clarify how the ‘accounting mismatch’ should be determined for portfolios of instruments and when there is a mismatch in the tenor of financial assets and liabilities.

Application of versions of IFRS 9 and considerations for first time adopters [relates to Questions 7, 8 and 9 of ED/2012/4]

- 17 Most AOSSG members agree that, in the interest of increasing comparability between entities, an entity that chooses to early apply IFRS 9 after the completed version of IFRS 9 is issued should be required to apply that completed version of IFRS 9. The six-month withdrawal period between issuance of the completed version and the introduction of the prohibition on newly applying previous versions of IFRS 9 appears reasonable.
- 18 Other members consider that first-time IFRS adopters should be provided the option to apply the previous versions of IFRS 9. In addition, these members consider the six-month withdrawal period to be insufficient, as first-time adopters would need time to prepare comparative information.

- 19 In addition, some AOSSG members recommend that, should the IASB proceed with the proposals in ED/2012/4, the amendments should be made concurrently with the issuance of the impairment requirements in IFRS 9. This would limit the number of versions of IFRS 9 available for early adoption and increase comparability between entities.
- 20 Some AOSSG members also consider that entities should be permitted to choose to early apply only the ‘own credit’ provisions in IFRS 9 once the completed version of IFRS 9 is issued. In addition, some AOSSG members consider that the current prohibition in IFRS 9 relating to recycling of own credit amounts previously recognised in OCI does not reflect the economic substance of realising fair value gains or losses on settlement of those financial liabilities. These members urge the IASB to also amend IFRS 9 to require recycling of previously recognised own credit amounts in OCI to profit or loss on derecognition.
- 21 IASB staff acknowledged in the Q&A webcast relating to ED/2012/4 that the mandatory effective date might be deferred again depending on the completion of IFRS 9 in its entirety. AOSSG members support the IASB’s plan to defer the mandatory effective date. Some AOSSG members consider that a lead time of three years from the date of completion of IFRS 9 would be necessary.

Other comments

Reclassifying previously recognised cumulative OCI amounts to profit or loss for equity instruments

- 22 The Asia-Oceania region includes many emerging economies—financial markets in these jurisdictions are not as developed as compared to those in the US and Europe. Debt instruments such as high quality bonds are not widely available as funding and liquidity management options, and accordingly, many entities in the region have had to invest in equity instruments². Some AOSSG members believe that the changes in fair value of those equity investments should not be recognised in profit or loss as those unrealised amounts would not provide a ‘pure’ reflection of the business’ performance, and accordingly, these members agree that those amounts should be recognised in OCI. These members are also concerned that the current IFRS 9 prohibits recycling of amounts previously recognised in OCI to profit or loss when these FVOCI designated equity instruments are derecognised—feedback from their constituents suggests that this restriction would not provide a complete picture of the overall performance of these investments.

² Equity instruments include those in the form of shares of an entity and investments in special-purpose entities that are structured as equity but are in substance debt.

- 23 These AOSSG members acknowledge the complexity relating to FVOCI designated equity instruments if the recycling of fair value changes from OCI to profit or loss on derecognition is permitted. However, these members note that the IASB has not provided a conceptual rationale for prohibiting recycling of those amounts on derecognition for equity instruments designated at FVOCI. They consider that if the current proposals in ED/2012/4 (relating to the accounting for debt assets measured at FVOCI) were to proceed, the standard would become complex in any case. Accordingly, these members request that the IASB reconsider the current prohibition in IFRS 9 relating to the recycling of amounts previously recognised in OCI to profit or loss for FVOCI designated equity instruments on derecognition. Some of these members would even support doing so if it meant requiring impairment assessment on those equity instruments.

Bifurcation of embedded features in financial assets

- 24 Some AOSSG members recommend that the IASB reconsiders its previous decision to permit bifurcation of embedded features in financial assets. These members consider that bifurcation is vital to portray the economics of the hybrid instruments with different risk characteristics. These members note that bifurcation is included in the Revenue Recognition and Insurance Contracts projects.