

28 Jan 2022

Dr. Andreas Barckow
Chair
International Accounting Standards Board
7 Westferry Circus
Canary Wharf London, E14 4HD
United Kingdom

Dear Dr. Barckow,

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the International Accounting Standards Board (IASB) Request for Information (RFI) on Post-implementation Review of the classification and measurement requirements of IFRS 9 *Financial Instruments*. In formulating these comments, the views of the constituents within each jurisdiction were sought and considered.

The AOSSG currently has 27 member standard-setters from the Asian-Oceanian region: Australia, Bangladesh, 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. The intention of the AOSSG is to enhance the input to the IASB from the Asia-Oceania region and not to prevent the IASB from receiving the variety of views that individual member standard-setters may hold. This submission has been circulated to all AOSSG members for their comment. In responding to the RFI, AOSSG members have provided their responses to the questions in the RFI as described in Appendix of this submission.

The AOSSG acknowledges the efforts of the IASB to assess the effect on stakeholders of the new classification and measurement requirements in IFRS 9 and identify lessons learned that could be helpful for future standard-setting projects.

Most of the AOSSG members that responded agreed that in most cases classification and measurement requirements of IFRS 9 are working as intended and provide useful information. However, the members raised several concerns and observations in which they require further consideration including further guidance or illustrative examples. The most common areas of concern are summarised below:

Contractual cash flow characteristics

Most of the members that have responded raised concerns in relation to the sustainability-linked financial instruments and noted potential diversity in practice how the ‘solely payments of principal and interest’ (SPPI) criterion is applied to these instruments. These members also noted that if some of these instruments fail the SPPI test, the resulting measurement at fair value through profit or loss may not provide the most useful and relevant information to the users of the financial statements.

Another commonly observed area of complexity in application was in respect of contractually linked instruments and non-recourse lending where members have requested further guidance or illustrative examples to improve consistency of application.

Modifications to contractual cash flows

Most of the feedback from the members requested further guidance on the modifications of financial assets, including clarification of what constitutes modifications to contractual cash flows (paragraph 5.4.3) and how qualitative assessment should be applied in addition to the quantitative assessment that is required by paragraph B3.3.6.

Amortised cost and effective interest rate

In respect of the assessment of the change of the contractual cash flows, members noted potential inconsistent application of paragraphs B5.4.5 and B5.4.6 as a common area of concern and required further clarification through additional guidance or illustrative examples.

Derecognition of the financial assets

Some members noted application issues in relation to the financial assets derecognition requirements, including application of ‘pass-through’ considerations and continuing involvement. Given the increasing prevalence of risk-sharing arrangements, the members recommended the IASB to consider examining this area of IFRS 9 as part of this PIR.

The Appendix to this submission provides detailed comments by the respective AOSSG members on the questions in RFI.

If you have any questions regarding this submission, please contact either one of us.

Yours sincerely



Nishan Fernando

Chair of the AOSSG



Dr Keith Kendall

Leader of the AOSSG Financial Instruments
and Liabilities Working Group

Appendix – Comments from AOSSG members

IASB Request for Information - Post-implementation Review of IFRS 9 *Financial Instruments* – Classification and Measurement

Questions for respondents

Question 1—Classification and measurement

Do the classification and measurement requirements in IFRS 9:

- (a) enable an entity to align the measurement financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not?**
- (b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not?**

Please provide information about the effects of the classification and measurement changes introduced by IFRS 9, including the ongoing costs and benefits in preparing auditing, enforcing or using information about financial instruments.

[Australia]

The AASB agrees that the IFRS 9 classification and measurement requirements do, in most cases, enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them, which results in an entity providing useful information to the users.

However, we encourage the IASB to review several areas where the lack of guidance and the level of judgement involved may unnecessarily add to the cost of financial statements' preparation and may result in diversity of the application of the IFRS 9 requirements. Specific requests for further improvements to IFRS 9 through potentially additional standard setting, application guidance, or illustrative examples are in Questions 2 – 9.

[China]

Generally, we believe that the classification and measurement requirements in IFRS 9 work well and can enable an entity to align the measurement of financial assets with the cash flow characteristics of the financial assets and how the entity expects to manage them, and result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows. However, there are still some practical concerns and issues in the application of these requirements in IFRS 9. Please see our detailed responses on questions 2 to 9.

[Sri Lanka]

We agree that IFRS 9 allows only the financial instruments which meet SPPI characteristics to be classified at amortised cost. Further, it provides clear guidelines supporting entities in maintaining consistency in recognition and measurement of financial instruments acquired to achieve different business objectives by providing stringent rules on initial classification and subsequent reclassifications. Subsequent carrying amounts of financial instruments are largely based on the initial classification except in instances of changes in business model, where reclassification is permitted by the standard. This resulted in providing useful and comparable information to users of the general-purpose financial statements.

The classification criteria under IFRS 9 considers the intention of holding the financial assets, (SPPI test), it provides an indication to the financial statement users for which purpose the asset is held and based on the category users can determine the timing of the cashflows can be received through the assets. New requirements of the IFRS 9 does not hitherto result in additional cost except at the initial implementation.

[Malaysia]

Our stakeholders generally found that the classification and measurement requirements in IFRS 9 have worked well and produce information that are useful to users of the financial statements.

On the effects of the classification and measurement changes introduced by IFRS 9, our stakeholders noted the following:

- (a) the requirements have enabled banks and corporates to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them. The commonly seen areas impacted by the changes are:
 - (i) the cash flow characteristics requirements in IFRS 9 which resulted in the following instruments been measured at fair value through profit or loss (FVTPL):
 - Hybrid instruments (i.e., convertible bonds) that were bifurcated under IAS 39
 - Instruments that were accounted for under IAS 39 available-for-sale (AFS) category (i.e., unit trust / money market funds)
 - (ii) investment in equity instruments that were classified as AFS under IAS 39 are no longer allowed to recycle gain / loss to income statements under IFRS 9 Fair Value through Other Comprehensive Income (FVOCI).
- (b) the ongoing cost and effort to adhere to the classification and measurement requirements of IFRS 9 were minimal after the transition to IFRS 9. Nonetheless, new processes such as SPPI checklist is implemented for new products to ensure the classification of any new assets is in line with IFRS 9 requirements. In addition, business units were also required to continue monitoring the business model framework determined during the implementation of IFRS 9 and report any changes to the business model. This stakeholder

also observed that change in business model and reclassification of financial assets is infrequent.

Question 2—Business model for managing financial assets

(a) Is the business model assessment working as the Board intended? Why or why not?

Please explain whether requiring entities to classify and measure financial assets based on the business model assessment achieves the Board's objective of entities providing users of financial statements with useful information about how an entity manages its financial asset to general cash flows.

(b) Can the business model assessment be applied consistently? Why or why not?

Please explain whether the distinction between the different business models in IFRS 9 is clear and whether the application guidance on the evidence an entity considers in determining the business model is sufficient.

If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

(c) Are there any unexpected effects arising from the business model assessment? How significant are these effects?

Please explain the costs and benefits of the business model assessment, considering any financial reporting or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a) – (c), please include information about reclassification of financial assets (see Spotlight 2).

[Australia]

The AASB supports the principle-based approach to the classification and measurement of financial assets and agrees that the business model assessment generally works as intended, can be applied consistently in most cases and provides useful information about how the entity manages its financial assets to generate cash flows. However, we request the IASB to consider the need for further standard setting, application guidance or additional illustrative examples in the following specific areas:

- (a) Additional guidance regarding the assessment of when sales would be considered 'infrequent' or 'insignificant in value' in the context of a held-to-collect contractual cash flows business model. IFRS 9 paragraph B4.1.2C notes that an entity must consider information (such as the frequency, value and timing) within the context of the reasons for those sales and the conditions that existed at that time. However, additional guidance in this area, for example to illustrate whether the size or frequency of sales is compared to the size of a portfolio (instead of total assets) and whether they should be considered

within the reporting period, or the life of the portfolio may improve consistency of application of the requirements and reduce the cost to preparers.

- (b) IFRS 9 paragraph B4.1.2 notes that an entity's business model does not depend on management's intentions for an individual financial instrument and that classification should be determined at a higher level of aggregation. The AASB recommends the IASB to consider providing additional guidance or illustrative examples of the circumstances when an entity is permitted to create a new classification for an individual financial instrument if it were (for example) sufficiently material and would represent a new business model for the entity. This is particularly relevant for non-financial services entities.
- (c) In 2016, the IFRS Interpretations Committee discussed a request to clarify how a reporting entity applies the business model assessment in its consolidated financial statements when a subsidiary is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Accordingly, we request that the IASB confirm whether a reporting entity performs the business model assessment required by IFRS 9 from a group perspective in its consolidated financial statements rather than from the subsidiary's perspective.
- (d) Applying the business model assessment first at reporting entity level (or lower) as required by paragraph B4.1.2 and again at group level can introduce operational complexity and counterintuitive results. For example, where for practical purposes, all loans are originated by one group entity and a portion of those loans will be transferred to another group entity (e.g., for capital management purposes), the business model at the originating entity level may be both collecting contractual cash flows and selling financial assets. However, at group level all loans may in fact be held to collect. The AASB recommends the IASB to consider providing additional guidance or illustrative examples on making business model assessments for groups where there are intra group transfers. A related point, stakeholders had different views on the application of paragraph B4.4.3(c) with respect to transfers between business units with different business models when there is no change in the intention for managing the asset on an on-going basis.
- (e) Similarly, we request further guidance in respect of transfers of assets (such as receivables) to third parties in an arrangement where the transferor legally transfers the assets but does not achieve derecognition under IFRS 9 because of a continuing involvement (e.g., a credit guarantee). Some stakeholders noted there are different views about whether the transferred assets (that have not achieved derecognition) should be assessed by the transferor as 'held to collect' or as 'held to collect or sale'.

- (f) A financial asset can be originated unintentionally, for example, the unsold portion of a syndicated loan. In such cases, the business model may not be known at initial recognition. Accordingly, we request further application guidance about the timing of the determination of the business model on initial recognition as required by IFRS 9, sections 4.1 and B4.1, specifically paragraph B4.1.2A.

[China]

Paragraphs B4.1.1 to B4.1.16 and paragraph B4.4.1 of IFRS 9 provide guidance about the assessment of business model for managing financial assets and the reclassification of financial assets resulted from the change of business model. However, the relevant guidelines are relatively principle-based, resulting in different understandings and diverse accounting treatments in practice. For example:

1. When considering what constitutes a “sale” for the purpose of business model assessment, is it a legal ownership transfer of contractual cash flows or an accounting derecognition of the transferred assets, or can entity make policy choice and apply consistently?
2. When applying paragraph B4.4.1 of IFRS 9 to assess whether a change of business model leads to reclassification of financial assets, there is no clear guidance about the implementation of “significant to the entity’s operation” and “demonstrable to external parties”.

We suggest the Board provide more detailed guidance or illustrative examples to solve the above application issues.

[Hong Kong]

The HKICPA and its respondents considered that the business model assessment in IFRS 9 is generally working as intended.

Nevertheless, practical challenges were noted in complex situations and diversity in practice exists. We recommend that the IASB provide guidance and/or clarification on applying the business model assessment to the following situations:

1. Due to the recent changes in business and economic environment as a result of the Covid-19 pandemic, there has been an increase in the frequency and value of sales of financial assets that are categorised within a ‘hold to collect’ (HTC) business model. Questions arise as to whether and how such unexpected increase in frequency and value of sales would affect the business model assessment of financial assets, including the existing financial assets and those that will be subsequently purchased.

Some respondents noted that IFRS 9.B4.1.2B-B4.1.3B provide certain guidance, but considered that it is not clear how to apply those guidance to the above situations, specifically whether the accounting treatment should reflect how an entity *would manage* the financial assets (as specified in IFRS 9.B4.1.2B), or how an entity *actually managed* its financial assets as evidenced by actual sales (as specified in IFRS 9.B4.1.2C). Accordingly, we recommend that the IASB clarify the interaction between IFRS 9.B4.1.2B and B4.1.2C, e.g. whether IFRS 9.B4.1.2B takes precedence over IFRS 9.B4.1.2C and whether the latter paragraph only provides indicators to assist the

assessment required in IFRS 9.B4.1.2B.

2. Many respondents noted that bills discounting and factoring of trade receivables are common in Mainland China and Hong Kong, and diversity in practice exists in assessing the business models for these financial assets. For example, an entity factors a portion of its trade receivables to a bank and receives cash in advance of settlement by its customers. Questions arise as to whether such arrangement would be regarded as a “sale” of the trade receivables for the purpose of business model assessment, and whether this would prohibit the receivables, including those that are not factored, from categorising within the HTC business model. Some respondents considered that measuring trade receivables at fair value would not provide useful information to users of financial statements because these receivables are derived from normal business operation. In this regard, we recommend that the IASB provide guidance on how the business model assessment should be applied to discounted/factored receivables and whether the conclusion would be different if entities factor their receivables with or without recourse.
3. Respondents in the banking industry considered that the language in IFRS 9.B4.4.3(c) is unclear as to whether and how an internal transfer of financial assets between group companies or within an entity would affect the business model assessment in the following situations, and suggested that the IASB clarify the requirement.
 - (a) Internal transfers of financial assets between parts of an entity or within a group with different business models is common in the banking industry, e.g. a sale of a financial asset from an investment desk (i.e. HTC business model) to a trading desk. Respondents considered that the financial statements of the entity and the group should reflect the change in how the financial assets are managed going forward. However, IFRS 9.B4.4.3(c) seems to suggest that such transfer is not a change in business model.
 - (b) An entity undergoes an internal restructuring where it merges one business model with another to form a new combined business model. Questions arise as to whether and how such restructuring would affect the business model assessment of the transferred financial assets and those acquired after the restructuring.
4. Some respondents considered that the interaction between the business model assessment, the SPPI test and the derecognition requirements is unclear. In particular, they noted that the derecognition requirements in IFRS 9.3.2.2 could be applied to a part of a financial asset (with specifically identified cash flows) and questioned whether the business model assessment and the SPPI test could also be applied to a portion of a financial asset that is not legally separable¹. Examples include a trade receivable with a portion that has sub-participation rights, and a syndicated loan partly held to collect contractual cash flows and partly held for sale. We suggest that the IASB clarify the unit of account for the business model and SPPI assessments in these cases.

¹ Other than hybrid contracts with financial asset hosts that are required by IFRS 9 to be classified and measured in their entirety.

[Sri Lanka]

Classification decision should be made at inception and hence subsequent changes or developments in the external environment will not permit entities to reclassify its financial instruments to hinder the impact of initially assumed business model. However, infrequent significant sales or frequent insignificant sales would not result in casting doubts on the initial classification and hence no reclassification is required. This resulted in consistent classification over the term of the instrument and hence the useful and comparable information to the users owing to due cognizance on the classification decision since inception.

An entity's business model refers to how an entity manages its financial assets in order to generate cash flows. The business model reflects the objectives of the business, and we are of the view that business model assessment can be applied consistently subject to the necessary modifications to align with the changes take place in the objectives of the business.

The changes took place in the market due to COVID 19 which is an unexpected situation resulted the unexpected losses from instruments which were held under fair value. In such cases, the business model assessment needed to be revisited.

[Malaysia]

Our stakeholders noted that in practice, it is challenging to determine when a business model change occurs in view of the 'high hurdle' as set out in IFRS 9. Based on the reading of IFRS 9.B4.4.1, changes to business models are expected to be infrequent, significant to the entities' operations, determined by the senior management as well as they must be evident to the external parties.

However, changes to business strategies and operations during the COVID-19 are rather fluid and these changes might not necessarily result in an acquisition, disposal or termination of a business line but it might affect how financial assets were managed. For example, sales happened more frequently for assets under 'hold to collect' portfolio to meet cash shortfalls of the business or to finance the entity's operations due to responses to changing needs or to repair balance sheets, and in this regard, whether such occurrence would be construed as a change in business model of the portfolio followed by a change in classification of the financial assets.

Our stakeholders believe that updating the application guidance for business model assessment would be helpful, particularly to articulate the thought process of and the principles behind how changes to business strategies that might happen more frequently at certain times (particularly during periods of stress) would affect the business model assessment.

In terms of costs of the business model assessment, a few stakeholders shared that the assessment of the business model involves judgment of facts and circumstances, and hence, additional effort to track and justify whether sales of a financial asset would change the classification of business model or otherwise. For others, it was highlighted that the assessment of business model was consistent with their business units' objectives.

Question 3—Contractual cash flow characteristics

(a) Is the cash flow characteristics assessment working as the Board intended? Why or why not?

Please explain whether requiring entities to classify and measure a financial asset considering the asset's cash flow characteristic achieves the Board's objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows.

If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain:

- (i) Why the asset is required to be measured at fair value through profit or loss (that is, why applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI).
- (ii) Which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the assets (in particular, if cash flows are subject to variability other than credit risk). (See section 7 for more questions about effective interest method.)

(b) Can the cash flow characteristics assessment be applied consistently? Why or why not?

Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features). If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

(c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?

Please explain the costs and benefits of the contractual cash flow assessment, considering any financial reporting effects or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about financial instruments with sustainability-linked features (see Spotlight 3.1) and contractually linked instruments (see Spotlight 3.2).

[Australia]

The AASB agrees that in most cases, requiring entities to classify and measure their financial assets according to the asset's cash flow characteristics provides users of financial statements with useful information about the amount, timing, and uncertainty of future cash flows.

However, whilst applying the cash flow characteristic requirements works well most of the time, there are times when the assessment of whether the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) seems unnecessarily complex, or the degree of judgement required may result in a diversity of application. Several stakeholders, including representatives of preparers and auditors found the level of detail that must be considered in evaluating the terms and conditions of some instruments can be significant and result in counterintuitive outcomes. We request the IASB to consider the need for further standard setting, application guidance, or illustrative examples in the following areas:

- (a) Most stakeholders that responded to our outreach considered that financial assets with contractual cash flows linked to sustainability targets specific to the borrower should represent a basic lending arrangement and accordingly, amortised cost measurement would provide the most useful information to the users. However, such arrangements may often fail the SPPI criterion. Given the increasing prevalence of sustainability-linked features in lending arrangements, we think it is important for the IASB to consider this matter, including additional guidance on when such loans are 'basic lending arrangements' and whether the current application of IFRS 9 consistently results in information that is useful to users of financial statements. Some stakeholders suggested that it would be useful to be able to consider some of these features on a materiality basis for the purposes of the SPPI test beyond the de minimis assessment. However, the AASB would not support arrangements linked to external sustainability targets such as changes in an index or equity price be measured at amortised cost unless the effects are de minimis.
- (b) Our stakeholders find the guidance for contractually linked instruments (CLIs) difficult to understand and apply, and we recommend the IASB to consider providing more explicit guidance. For example, confirmation that more than one tranche would constitute 'multiple' tranches even when a tranche does not exist in the form of a note or security (e.g., if a special purpose vehicle (SPV) issues a single note with the excess spread retained by the SPV, whether the latter would constitute a tranche and further, whether the two tranches would be considered as multiple tranches).
- (c) We request clarification on applying the SPPI requirements to intercompany loans with non-market interest rates or flexible repayment terms (including prepayment features). To the extent that interest cash flows are 'off-market', this will be reflected in determining the initial fair value of the financial instrument. Some stakeholders noted that the interaction between the requirements of paragraphs B5.1.1 and B5.1.2A including references to the prevailing market rates for similar instrument with similar credit rating, and valuation techniques using only data from observable inputs, is not clear. Further, an interest-free or below-market rate loan often contains a prepayment

feature that is exercisable at par and any prepayment features need to be analysed for compliance with the SPPI criterion. Stakeholders noted lack of clarity about what constitutes 'reasonable compensation' for early termination or extension of a contract, as this term is not defined.

- (d) The interaction between contractual versus non-contractual bail-in powers and non-viability requirements beyond the current example of Instrument E in paragraph B4.1.13 is not clear. For example, there may be inconsistency in application and judgment applied in the assessment of whether the contract merely acknowledges such legislation (as is sometimes required in Australia) and does not create additional rights or obligations and how such a reference impacts the SPPI test.
- (e) Concerning non-recourse loans, paragraph B4.1.17 stipulates an asset does not satisfy the SPPI criterion if the terms of the agreement give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest. We request guidance on the practical application of these requirements. For example, if an entity makes a non-recourse loan, the distinction between asset risk and credit risk may be assessed based on the extent of collateral held for the loan, but it is not clear at what point the fair value of collateral held would allow the loan to pass the SPPI test (because the interest rate will be assumed to mainly reflect ordinary lending risks). Without guidance, different entities may apply this requirement differently.

[China]

We generally agree that the cash flow characteristics assessment can provide useful information about the amount, timing and uncertainty of future cash flows and the relevant requirements can be applied consistently. However, as the development of the new economy and the emergency of new business with complex contract terms, the assessment of cash flow characteristics is becoming more and more challenging in the following aspects:

1. The IFRS 9 doesn't provide sufficient implementation guidance on applying the cash flow characteristics assessment requirements to financial assets with sustainability features. With the development of sustainable economy, there will be more and more bonds with coupon rates linked to the sustainable development target of the issuers and the linkage mechanism may also be diversified. It is confusing about how to apply the general principles of cash flow characteristics to assess the cash flow characteristics of green loans, for example, how to assess whether the incorporated sustainability features are consistent with a basic lending arrangement or not. Moreover, it is anticipated that most bonds with sustainability features would fail the SPPI test under existing assessment framework as illustrated in IFRS 9, thus will fall into the classification of FVPL. However, FVPL measurement may not be consistent with the business model of managing these financial assets and may not provide the most useful and relevant financial information to users. We suggest the Board develop specific guidance for loans with sustainability features to provide more practical guidance and conform to the development to the world

economic development.

2. The application scope of paragraph B4.1.20 of IFRS 9 related to the contractually linked instruments (“CLI”) is not clear. Some common seen issues are described as below, and we suggest the Board provide more guidance about the application of paragraph B4.1.20.
 - (a) There are diverse views about “tranche” as described in paragraph B4.1.20 of IFRS 9. For example, a special purpose vehicle (SPV) holds financial assets that can pass SPPI test and issues one type of note to its investors. Each note holder will earn fix return of 5% per annum without any priorities among them, whereby the remaining spread from the underlying assets will be paid to the asset manager as service fee. Will the designed payment structure to the investors and the asset manager make the right of service fee held by the asset manager to be a tranche in substance and create concentration of credit risk thus the CLI guidance should be applied?
 - (b) There are different understandings of "concentration of credit risk" in practice. For example, the underlying assets of a limited partnership may include equity instruments and debt instruments, and all cash flows of the limited partnership are generated from these underlying assets. The limited partners have priority for payment of principals and fixed interest and only when all the principals and interest are paid to the limited partners, the general partner can have the right to the remaining cash flows. As equity instruments bear market risk, whether the designed payment structure eliminates the market risk and create "concentration of credit risk", there are diverse views. Some stakeholders view that both the market risk and credit risk will pass through to the investors and it creates concentration of credit risk and market risk and then the CLI guidance should not be applied while others view that the payment structure creates concentration of credit risk and CLI guidance should be applied.
 - (c) There are concerns on how to understand an “instrument”. For example, an SPV holds equity instruments that cannot pass SPPI test and issues two tranches with different ranking of payment to its investors. The higher-ranking holders have the right to principal and fixed return of 8% per annum from the cash flows generated from the underlying equity instruments, while the lower-ranking holders have the obligation to make up the shortage of cash flows to the high-ranking holders if the underlying equity instruments can’t generate sufficient cash flows. The higher-ranking is actual a debt with fixed return. Some stakeholders think that the underlying equity instruments and the shortage guarantee obligation provided by the lower-ranking holders should be regarded as one instrument and the CLI guidance should be applied, while others think the non-recourse guidance as described in B4.1.16 of IFRS 9 should be applied.
3. The application scope of paragraph B4.1.16 of IFRS 9 regarding the non-recourse is unclear. There is concern about whether the non-recourse related guidance is only applicable to financial assets in the legal form of loan arrangement, or can also be applied to other arrangements, such as investments in equity with cash flows passing through to the investor through an SPV. For example, investors hold units in a one-year trust plan with one-year loans (assuming SPPI test is passed) as underlying assets. The underlying assets cannot be sold during the duration of the trust plan. Upon the expiry of the trust

plan, the cash flows generated from the disposal of the underlying assets are directly passed through to all unitholders on a proportional basis after deducting fixed managing expense. There is concern about whether the non-recourse requirements can be applied to this transaction as there is an arrangement of passing through of cash flows. We suggest the Board provide further guidance for application of non-recourse requirements after considering the comments related to CLI.

4. The illustrated instrument E in paragraph B4.1.13 of IFRS 9 need clarification. In the illustrated instrument E, it is described that “the contractual cash flows would not meet SPPI if the contractual terms of the financial instruments permit or require the issuer or another entity to impose losses on the holder as long as those contract terms are genuine, even if the probability is remote that such a loss will be imposed” and “that analysis will not consider the payments that arise only as a result of the national resolving authority’s power to impose losses on the holders because that power and the resulting payments are not contractual terms of the financial instruments”. In practice, some of the tier-2 capital bonds issued by commercial banks usually made a general reference to the statutory bail-in power or have a contractual terms of non-viability requirements without providing more rights or obligations than the applicable legislations. Under this circumstance, the related contractual terms of non-viability requirements may have no substance, and there are some voices to ask the Board to clarify whether these non-substance contractual terms are determinative factors to make these tier-2 capital bonds fail SPPI test. There are also concerns that not considering the probability of imposed loss when assessing whether instrument E pass SPPI test is consistent with paragraph B4.1.18 of IFRS 9 or not. We suggest the Board clarify the points raised related to instrument E.
5. There are different understandings about “de minimis” and “not genuine” in practice, which is described in paragraph B4.1.18 of IFRS 9 due to lack of application guidance. We suggest the Board provide further guidance to eliminate the diverse practice and improve the comparability of financial information.

[Hong Kong]

The HKICPA considers that the SPPI test is generally working as intended for most situations. However, challenges were encountered in applying the SPPI test to emerging and complex financial instruments, e.g. financial instruments with sustainability-linked features and contractually-linked instruments (CLIs).

Sustainability-linked features

We and our respondents noted that financial instruments with sustainability-linked features are becoming prevalent in Hong Kong and Mainland China. There are many types of financial instruments with sustainability-linked features, and differing views on how the SPPI test should be applied to these instruments are noted. For example, for financial assets with interest rate adjustments linked to environmental, social and governance (ESG) targets, some took the view that these instruments could be SPPI compatible because the predominant features might represent consideration for the credit risk of the financial assets or a profit margin, or those features have a de minimis impact on cash flows. However, the application of judgement on these and other factors has led to different outcomes given the same facts and circumstances.

Some respondents noted that entities often hold financial instruments with sustainability-linked features to collect contractual cash flows (i.e. within the HTC business model). Measuring these instruments at fair value through profit or loss (FVTPL) would not align with how entities manage their financial assets and therefore, would not provide useful information to users.

If the IASB would like to promote sustainability-linked financial assets by allowing them to be measured at amortised cost, a few respondents suggested the IASB consider either:

1. incorporating an exception for sustainability-linked financial assets, similar to the exception for regulated interest rates in IFRS 9.B4.1.9E; or
2. adding requirements similar to those on modified time value of money element in IFRS 9.B4.1.9B-B4.1.9D.

However, these respondents acknowledged the difficulties in defining sustainability-linked financial instruments that should be within the scope of the above suggestions given the various types of such instruments in the market.

In light of the above, we recommend that the IASB carry out standard-setting activities on sustainability-linked financial instruments, including:

1. clarifying how the SPPI test should be applied to these financial assets and considering whether the accounting outcomes would provide useful information to users; and
2. adding disclosures about sustainability-linked financial instruments, e.g. significant contractual terms and the potential impact of the instruments on the entities' cash flows. On this note, we also suggest that the IASB work closely with the ISSB on how the accounting disclosures would interact with the sustainability disclosures in order to provide users with comprehensive and relevant information.

Contractually-linked instruments

The HKICPA observed that it is generally challenging to apply the CLI requirements due to the complexity of CLI structures.

A few respondents noted that there are cases where the senior tranche note of CLIs and non-recourse arrangements might achieve economically similar results, yet IFRS 9 sets out different requirements for CLIs (IFRS 9.B4.1.21) and non-recourse arrangements (IFRS 9.B4.1.17) when applying the SPPI test, which could result in different accounting outcomes.

For example, a special purpose entity issues different tranches of notes with credit concentrations such that there is a waterfall structure which falls within the scope of CLIs. The underlying pool of investments include both financial and non-financial instruments that do not all meet the SPPI test. The senior tranche note has contractual terms that indicate the holders should receive principal plus interest on the amount outstanding. Applying the CLI requirements, the senior tranche note does not meet the SPPI test because the underlying pool of investments include instruments that do not fulfil SPPI (i.e. fail IFRS 9.B4.1.21(b)). However, for an instrument that is structured as a non-recourse loan with payments ring-fenced to the amount received from the underlying investments, in which the economic returns are similar to the senior tranche note as described above, applying the non-recourse requirements the loan may meet the SPPI test.

Given the above, we recommend that the IASB clarify whether such differences in accounting outcomes for economically similar situations are intended, and provide examples to illustrate how to apply the relevant requirements in those cases for consistent application.

[Malaysia]

Our stakeholders generally found that the cash flow characteristics is working as intended and provides information that is useful to users of the financial statements.

Our stakeholders' implementation experiences specific on the cash flow characteristics assessment are as set out below.

Financial assets with contractual cash flows linked to ESG targets

While the contractual cash flows assessment is relatively simple for instruments with basic lending risk, our stakeholders noted challenges in applying the SPPI cash flows assessment to financial instruments with ESG features or sustainability-linked instruments (*'these instruments'*). The IASB should examine whether the classification and measurement principles in the Standard have accommodated *'these instruments'* during the development of IFRS 9 which at that time *'these instruments'* might not be prevalent.

The PIR provides an opportune time for the review considering *'these instruments'* are gaining traction and there is a push from governments and regulators for businesses to consider impacts of their operations to the environment. For example, the Central Bank of Malaysia recently issued guidance on climate change taxonomy for financial institutions to assess the extent businesses meet climate objectives and generate positive and sustainable impacts to the economy, community and environment. Some stakeholders posit that this would ultimately create a link between climate risk and borrowers' credit risk and repayment ability, hence affecting the assessment of SPPI cash flows. Accordingly, some stakeholders believe that the ESG element would form part of the assessment of borrowers' credit risk and hence, cash flows arising from *'these instruments'* would represent consideration for the time value of money and credit risk, i.e., SPPI cash flows. On the contrary, some other stakeholders believe the current principles did not cater for *'these instruments'*, and hence additional clarity or guidance would be helpful. *'These instruments'* might not be prevalent or be considered rare during the development of IFRS 9.

In addition, some stakeholders observe that by applying the existing IFRS 9 requirements without considering ESG element as part of the cash flows which are SPPI, *'these instruments'* are likely to be measured at fair value through profit or loss, and whether such classification represents the substance of *'these instruments'* and provide useful information to users of the financial statements. However, others highlighted that the related issue in classifying *'these instruments'* at amortised cost is the determination of their effective interest rates. They think the principles in accounting for floating-rate loans requiring fixed payments on fixed dates bearing interest at a floating market rate, might be applied by analogy to determine the effective interest rate for *'these instruments'*.

SPPI assessment for non-recourse loan and contractually linked instruments

One stakeholder expressed concerns on the practical application of SPPI assessment for a loan with a pool of underlying assets. Diversity was noted in the outcome of the SPPI assessment when an entity refers to non-recourse guidance and contractually linked instruments guidance in the Standard. SPPI assessment applying the non-recourse guidance (paragraphs B4.1.16 and B4.1.17 of IFRS 9) focuses on ensuring the contractual cash flows represent repayment of principal and interest. In practice, this is done by ensuring there is a sufficient loan-to-value ratio on the collateral against the loan and the existence of credit enhancements. The collateral could be a financial or non-financial asset and the non-recourse asset would meet the SPPI test provided there is sufficient ‘buffer’ to absorb the price risk and payment is limited to principal and interest.

On the other hand, applying the contractually linked instruments guidance (paragraphs B4.1.20 to B4.2.16 of IFRS 9) would require assets in the underlying pool to meet SPPI test in order for the instrument to pass SPPI test. To illustrate this, if an entity invests in a senior tranche instrument where the underlying assets are not financial instruments, the instrument fails the SPPI test regardless of whether there are sufficient junior and equity tranches to absorb the price risk.

In this regard, clarification and further guidance from the IASB are sought to enable entities to apply the SPPI principles in the Standard in a consistent manner.

Question 4—Equity instruments and other comprehensive income

(a) Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not?

Please explain whether the information about investments in equity instruments prepared applying IFRS 9 is useful to users of financial statements (considering both (i) equity instruments measured at fair value through profit and loss; and (ii) equity instruments to which the OCI presentation option has been applied).

For equity instruments to which the OCI presentation option has been applied, please explain whether information about those investments is useful considering the types of investments for which the Board intended the option to apply, the prohibition from recycling gains and losses on disposal and the disclosures required by IFRS 7.

(b) For what equity instruments do entities elect to present fair value changes in OCI?

Please explain the characteristics of these equity instruments, an entity’s reason for choosing to use the option for those instruments, and what proportion of the entity’s equity investment portfolio comprises those instruments.

(c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?

Please explain whether the requirements introduced by IFRS 9 had any effects on entities' investment decisions. If yes, why, how and to what extent? Please provide any available evidence supporting your response which will enable the Board to understand the context and significance of the effects.

In responding to (a)–(c), please include information about recycling of gains and losses (see Spotlight 4).

[Australia]

We agree that the option to present fair value changes on investments in equity instruments in other comprehensive income (FVOCI) provides useful information. However, we consider the lack of a clear underlying principle for the classification category to be a drawback.

Specific types of equity instrument our stakeholders have seen designated into this category include:

- (a) high dividend-paying investments where the lack of recycling of gains from other comprehensive income to profit or loss does not significantly impact the information needs of users;
- (b) equity investments of some not-for-profit entities where the recognition of gains and losses on these investments in profit or loss would not provide more useful information to users of the financial statements, such as grantors; and
- (c) government equity investments (including some investments in private funds and corporations) generally held for policy reasons rather than for trading and investment returns.

Stakeholders had mixed views on the issue of recycling gains and losses from OCI to profit or loss. In some cases, stakeholders identified the lack of an underlying principle or distinction between non-recycling of the fair value gains and dividend income recognised in profit or loss as an issue. Others said the requirement in paragraph B5.7.1 that a dividend is not recognised in profit or loss if it clearly represents a recovery of the part of the cost of the investment, without further specifying how 'cost' is determined may result in diversity in practice in some cases.

If recycling were to be introduced, stakeholders noted that they would not support the reintroduction of the impairment testing that caused significant application issues under IAS 39 *Financial Instruments: Classification and Measurement*.

The AASB recommends further work on presenting fair value changes on investments in equity instruments in OCI and the issue of OCI and recycling more broadly. While OCI seems relevant

to understanding an entity's financial performance, there is a lack understanding of the principles underlying the classification category and further research may be needed.

[China]

We observed that entities usually designate the equity instruments with the following features as FVOCI: (i) strategic investments that are not expected to be sold in near future; (ii) equity instruments with stable dividend policy to provide stable cash flows to the investors for a long-term; (iii) equity instruments with anticipated significant fluctuation of market price, to avoid the impact to the statements of profit or loss; (iv) equity instruments that held passively through debt-equity swap.

We generally agree that presenting the fair value changes in OCI can provide useful information about the equity investments to users of financial information. But in practice, stakeholders have following concerns:

1. The stakeholders do not think that there is sufficient technical basis of not recycling OCI to profit or loss when disposal or de-recognition of the equity investments measured at FVOCI, and there are also doubts that whether the non-recycling of OCI is consistent with the paragraphs 7.16 to 7.19 of *Conceptual Framework for Financial Reporting*. There are voices from accounting practice of permitting the recycling of OCI to profit or loss upon disposal or derecognition to reflect the actual investment gain or loss. We suggest the Board reconsider the appropriateness of the recycling of OCI to profit or loss to meet the information needs of users of financial information.
2. The definition of “held for trading” is vague and IFRS 9 only described the features of “held for trading” as “principally for the purpose of selling or repurchasing in near term”. Material judgement involved in determining whether a financial instrument is held for trading, which leads to arbitrary designation of equity instruments as FVOCI. In practice, entities have the motivation of designating the equity investments with loss in near future as FVOCI. Such subjective designation may not provide faithful presentation of financial information that consistent with the business model of managing the financial assets. We suggest the Board provide further guidance on “held for trading” to enhance the comparability and faithful presentation of financial information.
3. According to paragraph B5.7.1 of IFRS 9, dividends on equity investments designated as FVOCI are recognized in profit or loss unless the dividend clearly represents a recovery of the part of the cost of the investment. There are diverse accounting practices as there is no sufficient guidance about when a dividend constitutes a clear recovery of investment cost, which lead to diverse accounting and the chance of earnings management. We suggest the Board provide further guidance on what is a “clearly represents a recovery of the part of the cost of the investment” to eliminate the diversity and enhance the comparability of financial information.
4. Due to lack of guidance in IFRS 9, there are diverse accounting regarding the transaction costs, VAT and income tax incurred upon disposal of financial assets designated as FVOCI. Some entities record these costs in profit or loss while other entities match these costs in OCI. We suggest the Board provide guidance to guide the accounting for these related costs to enhance the comparability of financial information.

[Hong Kong]

Our respondents generally welcome the measurement option in IFRS 9.5.7.5 because presenting fair value changes on investments in equity instruments that are not held for trading in other comprehensive income (OCI), instead of profit or loss, would not distort the financial performance of the entities and would allow users to identify easily the associated fair value changes.

A majority of our respondents considered that the prohibition from recycling gains and losses presented in OCI to profit or loss upon disposal of the equity investments is appropriate, while a small minority considered that such a prohibition does not reflect the true performance of the entities and negatively affects the performance evaluation and incentives of management.

The HKICPA agrees with the IASB's views and its rationale as explained in IFRS 9.BC5.25(b) and the RFI for the prohibition from recycling gains and losses on disposal. In particular, recycling OCI balances to profit or loss would impose on entities the need to assess the impairment of equity instruments. Such assessment created significant application issues for entities applying IAS 39 *Financial Instruments: Recognition and Measurement* in the past. In addition, there is no new evidence to support the reintroduction of recycling OCI balances to profit or loss upon the disposal of equity investments.

[Sri Lanka]

We agree that the users of the financial statements can get an understand about where the ultimate gain will be parked when those instruments are disposed. Based on that they can judge the expected impact to bottom line.

Equity instruments held as strategic investments are categorized under this category. Those investments are held for long term investment purpose and not for obtaining gain on mark to market change by disposing in short run.

As the disposal gains from equity instruments recognized under fair value through OCI cannot be recognized to Profit or Loss when the disposal is taken place, the investment decision on equities where the recognition is carried out through Profit or Loss is taken with considering thorough market analysis. Sometimes such investment decision is more towards risk averse as the any negative volatility is directly impacting the Profit or Loss.

[Malaysia]

Our stakeholders found that the option to present fair value changes on investments in equity instruments in Other Comprehensive Income (OCI) is working as intended and are not aware of significant challenges in applying the principles and requirements of the Standard relating to the classification of investments in equity instruments. We observed that certain reporting entities disclose information on equity investments carried at fair value through OCI relevant for the readers' understanding of financial performances.

A few stakeholders highlighted that the FVOCI option was applied to long-term and strategic-purpose investments in equity instruments. They found that the FVOCI election is working as

intended, but also highlighted there were challenges in determining fair value for unlisted equity investments despite the guidance in the Standard and Education Guidance on IFRS 13 *Fair Value Measurement: Unquoted Equity Instruments within the Scope of IFRS 9*.

However, we wish to bring to the IASB's attention on the interaction between *equity instruments* in paragraph 4.1.4 of IFRS 9 and financial instruments classified as *equity instruments* by virtue of paragraphs 16A and 16B or 16C and 16D of IAS 32 *Financial Instruments: Presentation*. In particular, we refer to the IFRIC decision in September 2017 on this matter in which it was concluded that a holder of the instrument classified as equity in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D of IAS 32 is not eligible for the presentation election in paragraph 4.1.4 of IFRS 9 because *such an instrument does not meet the definition of an equity instrument in IAS 32*. We fully understand the technical reason behind the decision reached by IFRIC, that is, for the FVOCI election to work, it has to be *equity instruments* as defined in IAS 32 and the explanation provided in BC5.21 of IFRS 9. However, one of our stakeholders have expressed concern that this principle has caused additional complexity in determining whether financial assets would be eligible for the FVOCI election. This is because, by disallowing the FVOCI election, an entity would have to classify its equity (or equity-like) instruments differently although these instruments are managed in the same way; such that they are made for long-term strategic reasons. As such, the different classification might not provide useful information to users of the financial statements. As an alternative, FVOCI election should be extended to investment in an equity instrument (otherwise classified as a financial liability by the issuer, but as an exception, it is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of IAS 32), subject to additional disclosures about the features and the reasons for the election.

Question 5—Financial liabilities and own credit

- (a) Are the requirements for presenting the effects of own credit in OCI working as the Board intended? Why or why not?**

Please explain whether the requirements, including the related disclosure requirements, achieved the Board's objective, in particular, whether the requirements capture the appropriate population of financial liabilities.

- (b) Are there any other matters relating to financial liabilities that you think the Board should consider as part of this post-implementation review (apart from modifications, which are discussed in Section 6)?**

Please explain the matter and why it relates to the assessments the Board makes in a post-implementation review.

[Australia]

The AASB did not receive any significant feedback on the issue of financial liabilities and own credit, but some stakeholders noted that measuring fair value changes due to own credit is

evolving, and differing approaches in practice to measuring and isolating such changes and inputs into the measurement techniques are possible.

Regarding question 5(b), our feedback on the related topics of derecognition, continuing involvement, modifications, movements in market rates of interest, and other changes in estimates (catch-up adjustments) is in our response to Questions 6, 7 and 9.

[China]

We generally believe that the requirements for presenting the effects of own credit in OCI and the relevant disclosure requirements work as the Board intended, while we also heard some voices from stakeholders that the current guidance and illustrative examples are too limited, and in accounting practice it is difficult to identify the changes of own credit risk and split the fair value changes attributable to the changes of own credit risk from the fair value changes of the instrument. We suggest the Board provide more detailed guidance on the application of these requirements.

[Hong Kong]

The HKICPA generally considered that the requirement for presenting the fair value changes of a financial liability that is attributable to changes in its own credit risk in OCI is operating as intended for financial institutions and is a welcome change from IAS 39.

Nevertheless, many respondents shared that there are significant practical difficulties for non-financial institutions (or corporates) to determine the change in fair value of an entity's own credit risk.

1. In general, corporates do not have the same valuation capabilities as financial institutions to measure their own credit risk.
2. The measurement method provided in IFRS 9.B5.7.18 only applies to simple instruments with fixed rate and terms, but not for complex financial instruments, e.g., hybrid instruments with embedded derivatives. Some corporates use the alternative method in IFRS 9.B5.7.16(b); however, such method is difficult to apply in practice because corporates often do not have observable credit risk data for these instruments.
3. Corporates often use the FVTPL option in IFRS 9.4.3.5 to avoid the complexity of bifurcating hybrid instruments with embedded derivatives; however, the requirement to separately account for credit risk puts the corporates back into a position where they need to separately account for components of financial liabilities which defeats the purpose of the FVTPL option in the first place.

In view of the above concerns, some respondents suggested the IASB consider providing an option for entities to choose to apply the accounting requirements in IFRS 9.5.7.7. Some suggested that the IASB provide examples illustrating how to measure changes in own credit risk in complex situations such as hybrid instruments.

We acknowledge our respondents' concerns regarding the practical challenges of presenting changes in own credit. While we agree with our respondents' suggestion of making the accounting requirements in IFRS 9.5.7.7 optional, we consider that such option should be limited to only those entities that have applied the FVTPL designation option for embedded

derivative in IFRS 9.4.3.5 because of the complexity of bifurcating hybrid instruments as stated in point 3 above. We consider that entities who have designated their financial liabilities at FVTPL under IFRS 9.4.2.2 should generally be able to present the effects of own credit in OCI because they manage and evaluate their financial liabilities on a fair value basis, and should have the relevant valuation capabilities.

[Malaysia]

Our stakeholders generally found that the requirements for presenting the effects of own credit in OCI, and classification and measurement of financial liabilities are working as intended.

However, there is an element of subjectivity in applying IFRS 9.5.7.7(a), in relation to the measurement and valuation of the fair value change attributable to changes in the entity's own credit risk that should be presented in OCI.

Question 6—Modifications to contractual cash flows

(a) Are the requirements for modifications to contractual cash flows working as the Board intended? Why or why not?

Please explain what changes you consider to be modifications of a financial asset for the purpose of applying paragraph 5.4.3 of IFRS 9 and as a modification of a financial liability for the purpose of applying paragraph 3.3.2 of IFRS 9. Does the application of those paragraphs, and the disclosure requirements related to modifications, result in useful information for users of financial statements?

(b) Can the requirements for modifications to contractual cash flows be applied consistently? Why or why not?

Please explain whether the requirements enable entities to assess in a consistent manner whether a financial asset or a financial liability is modified and whether a modification results in derecognition. Have the requirements been applied differently to financial assets and financial liabilities?

If diversity in practice exists, please explain how pervasive the diversity is and its effects on entities' financial statements.

[Australia]

The AASB supports further standard setting or additional guidance regarding the definitions and accounting treatment of non-substantial modifications to the contractual cash flows of financial assets and liabilities to clarify the Board's intentions and improve the consistency of application.

Our stakeholders requested more guidance on operationalising the distinction between substantial and non-substantial modifications for financial assets, and to a lesser extent,

liabilities. Although IFRS 9 notes a 10% change in the present value of a financial liability is a substantial modification (paragraph B3.3.6), such guidance does not exist for financial assets. Further, there is no qualitative guidance for either assets or liabilities. This has led entities to develop their own accounting policies for what constitutes a significant modification which may have resulted in the diversity in practice.

Our stakeholders note that in practice, modifications are generally limited to changes in contractual terms resulting from a bi-lateral agreement of the parties to the contract and not (for example) to changes to the underlying calculation of indexes used as the basis of the contractual terms, as was highlighted in the Board's deliberations on accounting for the effects of interest rate benchmark reform. If such changes were required to be accounted for under paragraph B5.4.6, leading to an immediate impact in profit or loss, it could represent a change in practice as many entities may take the view that such changes in a calculation of the index are changes to a market rate in scope of paragraph B5.4.5.

Paragraph 5.4.3 requires recalculation of the gross carrying amount of the financial asset, discounted at the original effective interest rate, and recognition of a modification gain or loss immediately in profit or loss. The requirement to discount at the original effective rate can lead to unintuitive results, for example when a 'blend and extend' arrangement on commercial terms is considered a non-substantial modification. That is, when a fixed rate loan is extended prior to maturity with the extension period priced at market rate, but the contractual interest rate is amended so that an economically neutral 'blended' rate applies from the date of the modification to the new extended maturity, paragraph 5.4.3 requires the modified cash flows to be discounted at the original effective interest rate. This results in the recognition of a modification gain or loss which would unwind over the new extended term. Some stakeholders noted that the gain or loss recognised upon modification is unlikely to provide useful information to financial statements users as the lender has renegotiated the terms at market rate.

[China]

We generally believe that the requirements related to modification to contractual cash flows in IFRS 9 and the related disclosure requirements in IFRS 7 can provide useful information to users of financial information, can generally be applied to assess modification to contractual cash flows of financial assets or financial liabilities and whether a modification will lead to derecognition of financial instruments in a consistent manner. However, there are still some practical issues as following:

The IFRS 9 do not provide sufficient guidance about the modification to contractual cash flows that leads to derecognition of financial assets. In practice, some entities apply the 10% quantitative threshold by reference to the derecognition guidance of financial liabilities as described in paragraph B3.3.6 of IFRS 9, while others may apply the qualitative assessments. This causes accounting diversity as the conclusion of qualitative assessment may be different from that of quantitative assessment for the same transaction. We suggest the Board provide

further guidance on the derecognition of financial assets that resulted from the modification of contractual cash flows.

[Hong Kong]

The HKICPA and its respondents consider that the modification requirements are not working as intended to ensure consistency, and note significant concerns and debate in this area. The following application issues and questions are noted:

1. IFRS 9 is unclear as to what constitutes a modification of financial instruments, i.e., whether it refers to changes in contractual terms of the financial instruments, or changes in contractual cash flows. Some respondents shared that before the Interest Rate Benchmark Reform (IBOR Reform) project, entities normally consider that changes in contractual terms constitute a modification. However, the IBOR Reform project discussions seemed to broaden modification to the exercise of existing clauses in the contracts, which caused further confusion about what a modification is.
2. In applying the modification requirements in IFRS 9, we have questions on:
 - (a) Whether a qualitative test could (or should) be applied in addition to the 10% test for financial liabilities. Some respondents considered that applying the 10% test alone may not capture the change in characteristics of the risks associated with the instruments in certain situations. For example, changing the currency of the debt (e.g. from RMB to HKD), or restructuring the payment terms (e.g. from cash to partial shares settlement), or switching interest rates (e.g. from floating to fixed) could change the risk profile. Therefore, specific facts and circumstances and qualitative factors should be considered in addition to performing the quantitative test.
 - (b) Whether the 10% test in IFRS 9.B3.3.6 could be applied by analogy to financial assets. Some respondents noted that because IFRS 9 is not clear on when derecognition arises for renegotiated / modified financial assets, most companies develop their own accounting policies, e.g. by referring to the 10% rule for financial liabilities and/or introducing different qualitative factors. However, it is not clear how these factors are incorporated into the test based on reviewing companies' accounting policies. In addition, the increasing number of debt restructurings due to the IBOR Reform and negotiated payment holidays as a result of Covid-19 create additional complexity and diversity in this area.
 - (c) When to apply IFRS 9.B5.4.6 to recalculate the carrying amount of the financial instruments or apply IFRS 9 B5.4.5 (see the related comments in question 7 point 1 below).

We consider that IFRS 9 is not sufficiently clear on when and how to apply the modification requirements. We question whether the existing requirements (i.e. the 10% test alone) would be able to fully capture the changes in the risk profile as a result of a modification of a financial liability, and hence provide useful information to users in all circumstances. In reconsidering the modification accounting requirements for financial assets, we would also suggest that the IASB include the concept of a substantial modification in the derecognition criteria for financial assets, similar to that for a financial liability.

We consider that the concerns and issues on modification requirements are broad in scope, and cover both the conceptual rationale for and the practical application of the existing requirements in IFRS 9. In this regard, we strongly recommend that the IASB carry out a fundamental and thorough review of the modification requirements in IFRS 9 in a separate project to address this matter holistically

[Sri Lanka]

If the original terms of the contractual cash flows are changed due to the deterioration in credit quality, such changes are considered as modifications to the contractual cash flows for impairment computation purpose.

As the modification is identified based on the credit deterioration of such assets, it is consistently applied.

[Malaysia]

The requirements for modifications to contractual cash flows of financial assets have generally worked well during the ‘normal’ circumstances. However, during the COVID- 19 pandemic which resulted in unprecedented government actions imposed by law such as the imposition of moratorium or payment holiday period, differing views arose as to whether such intervention constitutes a modification to the contractual terms between financial institutions and their customers.

There is a lack of explicit guidance on what constitutes a modification to contractual cash flows in IFRS 9 and some stakeholders noted challenges in applying the principles to assess whether the modification would result in derecognition of financial assets and have sought further clarity to be provided. These stakeholders found that the derecognition principles for financial liabilities were clearer as opposed to that for financial assets and noted that the ten percent guidance for financial liabilities was sometimes applied by analogy to financial assets, particularly when the assets and liabilities belong to the same group of companies.

Questions also arose as to whether during the development of IFRS 9 in regard to the modifications to contractual cash flows principles, it has anticipated for possible government interventions, or only intended to changes in contractual terms by parties to the contractual provisions.

Some stakeholders strongly believe that to consider government actions imposed by law, such as the moratorium or payment holiday period as a modification to the contractual cash flow in a way that would give rise to a ‘modification gain or loss’ addressed in IFRS 9.5.4.3 would result in the misunderstanding of the concept of ‘economic loss’ as they believed in such a case, the government action should be considered as costs incurred for the financial institutions to continue holding the financial assets over the extended terms of the contract and consequently, the impact of the moratorium should be amortised over the remaining life of the loans. In other words, a new effective interest rate should be determined that equates the revised remaining cash flows to the carrying amount of the original debts and is applied prospectively for the remaining term instead of recognising a modification gain or loss.

Question 7—Amortised cost and the effective interest method

(a) Is the effective interest method working as the Board intended? Why or why not?

Please explain whether applying the requirements results in useful information for users of financial statements about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest method.

(b) Can the effective interest method be applied consistently? Why or why not?

Please explain the types of changes in contractual cash flows for which entities apply paragraph B5.4.5 of IFRS 9 or paragraph B5.4.6 of IFRS 9 (the ‘catch-up adjustment’) and whether there is diversity in practice in determining when those paragraphs apply.

Please also explain the line item in profit or loss in which the catch-up adjustments are presented and how significant these adjustments typically are. If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities’ financial statements.

[Australia]

Based on the outreach performed, in straightforward cases, amortised cost and the effective interest rate method is easy to apply and provides users with useful information. However, when there is a change in contractual cash flows, the decision to apply paragraph B5.4.5 (the prospective adjustment) versus paragraph B5.4.6 (the catch-up adjustment) is not always straightforward, including identifying whether a change is a change in market rates. Some stakeholders noted that the lack of guidance and a lack of clear principle as to why some adjustments to contractual cash flows are accounted for prospectively whilst others are accounted for with a cumulative catch-up in current year profit or loss likely results in diversity in practice with entities determining their own accounting policies in this area.

Our responses to Questions 6 and 9 describe related issues to the above.

The AASB supports the IASB to consider further standard setting or additional guidance regarding the treatment of modifications, movements in market rates of interest, and other changes in estimates (catch-up adjustments) of the contractual cash-flows for financial assets and financial liabilities.

[China]

We generally agree that applying the requirements of amortised cost and effective interest rate of IFRS 9 can provide useful information to users about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest method. However, entities need to estimate the future cash flows when calculating the effective interest rate. There is not sufficient guidance on how to estimate the future cash flows when there are various uncertain factors that may impact the future contractual cash flows, such as contractually early repayment terms, repurchase option, and cash flows that are linked to

sustainability features and so on. We suggest the Board provide more guidance on how to estimate the future cash flows when there is uncertainty.

We also noted that the application scope of paragraph B5.4.5 and paragraph B5.4.6 of IFRS 9 is not clear, due to inconsistent understandings of “floating rate” and “market rate”. For example, there is a bond with interest rate linked to inflation index. When the inflation rate changes, the estimated future cash flows will change accordingly. There are different views about whether the changes of inflation index are features of a floating rate or reflect the changes of market rate. We suggest the Board clarify the “floating rate” and “market rate” to enhance the comparability of financial information.

[Hong Kong]

We and our respondents noted that the following application issues / questions, and recommend that the IASB provide guidance or clarification on how the requirements should be applied.

1. Application of IFRS 9.5.4.3, IFRS 9.B5.4.5, and IFRS 9.B5.4.6

We observed diversity in practice in the application of IFRS 9.5.4.3, IFRS 9.B5.4.5, and IFRS 9.B5.4.6 due to the lack of clarity on the scope and definition of what constitutes a floating rate instrument under IFRS 9.B5.4.5. The following examples were shared by respondents:

(a) *Loans with ratchet feature*

Fixed rate loans sometimes include a ratchet feature in which different fixed interest rates would apply depending on whether specified financial covenants are met. When such a change in interest rate occurs, a question arises as to whether an entity should apply IFRS 9.B5.4.6 and remeasure the loan using the original effective interest rate, or whether the entity could apply IFRS 9.B5.4.5 to reset the effective interest rate (EIR) of the loan by viewing the ratchet feature as a floating element in the original loan agreement to reflect movements in market interest rates to compensate for the increased credit risk associated with the loan.

(b) *Modification of loans prepayable by the borrowers*

For loans that are prepayable at principal plus interests at the option of the borrowers, it is common that borrowers would negotiate with the lenders for a lower interest rate (e.g. to reset the interest to market) when market interest rates decline. Questions arise as to whether such changes could be considered as “reflecting the movements in the market rates of interest” under IFRS 9.B5.4.5, given that the original term of the loan includes a prepayment feature (i.e. the lender anticipated such a modification – either reduce rate or lose business), or whether IFRS 9.5.4.3 should be applied. Some respondents considered that applying IFRS 9.5.4.3, an entity might need to recognise a significant adjustment in profit or loss which may not reflect the economic substance of the transaction nor provide useful information to users in these cases, as the rate is adjusted in response to market interest rate changes.

We consider that it is practically challenging to assess when to apply IFRS 9.5.4.3, IFRS 9.B5.4.5, and IFRS 9.B5.4.6. Therefore, we recommend that the IASB clarify what a

floating rate instrument is and provide illustrative examples on the application of paragraphs IFRS 9.5.4.3, IFRS 9.B5.4.5, and IFRS 9.B5.4.6 to enhance consistent application.

2. *Cash flows subject to conditions or contingent events*

Most respondents noted differing views on how future cash flows that are subject to conditions or contingent events affect the determination of the EIR assuming amortised cost measurement is appropriate for the instrument. For example, in cases where instruments have prepayment options or ESG-linked features, some consider that the EIR (both at initial recognition and subsequently) should reflect an assessment of whether the entity will exercise these options or meet the targets. Others are of the view that entities should apply IFRS 9.B5.4.6 and recognise a catch-up adjustment upon the occurrence of the events. Preparers from the banking industry also shared that in practice, banks would not adjust the cash flows for ESG features unless the event has been triggered as they cannot reliably measure the probability of events occurring.

In view of the mixed views expressed and operational complexities associated with incorporating conditions and contingent events in the calculation of EIR, we recommend that the IASB clarify how to apply the effective interest method to future cash flows that are subject to conditions and contingent events.

3. *Estimation of the expected cash flows applying the effective interest method*

Some respondents noted that IFRS 9.5.5.17 requires expected credit losses to be calculated based on an unbiased and probability weighted amount. However, IFRS 9 does not specify how the expected cash flows are estimated applying the effective interest method (i.e. whether it should be based on the most likely scenario or be based on a probability-weighted average). Hence, we recommend that the IASB clarify how expected cash flows should be estimated in order to enhance consistent application across entities.

4. *Interest-free related party loans and trade receivables without significant financing components*

We noted that for interest-free related party loans that are repayable on demand, practices have been developed to apply a zero EIR to these instruments. This is because applying the definition of EIR, the fair value of the loans on initial recognition is the amount repayable on demand which equals the full nominal value of the loan (even though the estimated cash flows in the EIR calculation are only expected to be received in the future). For trade receivables without significant financing component, entities apply IFRS 9.5.1.3 which requires them to measure such trade receivables at their transaction price, again resulting in a zero EIR. However, respondents generally considered that measuring these instruments at face value without discounting does not reflect the time value of money and reduces the information value of recognised expected credit losses. Hence, we suggest that the IASB clarify this matter as these instruments are very common in Hong Kong.

5. *Extension option in a fixed-rate debt instrument*

We noted that the IFRS Interpretations Committee (IC) discussed an application question

regarding the accounting for an extension option in a fixed-rate debt instrument at its March 2012 meeting². Specifically, the question is whether the extension option should be separated and accounted for as a derivative, or be treated as an embedded loan commitment that is outside the scope of IFRS 9. We noted that this issue was not addressed by the IC at that time, and therefore suggest that the IASB clarify the accounting for such instruments.

[Sri Lanka]

We agree that the users of the financial statements can obtain an understanding about the total amount due, its timing and uncertainty of the cash flows. However, there are practical difficulties to identify customer pay off balances and amount lost for the period, improvements etc. In order to capture this it is required to have significant changes in the systems.

We agree that the requirements can be applied consistently. The rate volatility is not significant. Further maintaining records and capturing interest income based on effective interest rate is highly complex.

[Malaysia]

Other than those highlighted in our response to Question 6, our stakeholders found that the effective interest method works as intended.

Question 8—Transition

(a) Did the transition requirements work as the Board intended? Why or why not?

Please explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements.

Please also explain whether, and for what requirements, the Board could have provided additional transition reliefs without significantly reducing the usefulness of information for users of financial statements.

(b) Were there any unexpected effects of, or challenges with, applying the transition requirements? Why or why not?

Please explain any unexpected effects or challenges preparers of financial statements faced applying the classification and measurement requirements retrospectively. How were those challenges overcome?

² <https://www.ifrs.org/content/dam/ifrs/meetings/2012/march/interpretations-committee/111203ap11ias39termextendingoptionsindebthostcontracts.pdf>

[Australia]

For many entities, the application of transition requirements was straightforward; however, implementing the requirements required considerable effort for others. This was mainly due to the phased approach taken with IFRS 9 and the interaction with other accounting standards.

The AASB recommends the IASB to consider field testing when the transition requirements for a new standard are expected to be complex and to avoid a phased approach to standard setting in future where possible.

[China]

We generally agree that the transition requirements of IFRS 9 work as the Board intended, and the combination of the relief from mandatorily restating comparative information and the requirement for transition disclosures achieve an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements. We observed that most of the entities applied the simplified transition approach as permitted by IFRS 9.

[Sri Lanka]

In principally change of incurred loss model to expected loss model cannot be apply retrospectively because carrying value of opening balance sheets cannot be tested at present scenario, which should have been adjusted with forward looking information. In such case, the retrospective application is not relevant in initial transition.

[Malaysia]

Our stakeholders found that the transition requirements work as intended.

Question 9—Other matters

- (a) Are there any further matters that you think the Board should examine as part of the post-implementation review of the classification and measurement requirements in IFRS 9? If yes, what are those matters and why should they be examined?**

Please explain why those matters should be considered in the context of the purpose of the post-implementation review, and the pervasiveness of any matter raised. Please provide examples and supporting evidence when relevant.

- (b) Considering the Board's approach to developing IFRS 9 in general, do you have any views on lessons learned that could provide helpful input to the Board's future standard-setting projects?**

[Australia]

The matter our stakeholders raised most frequently that was not included in this post-implementation review was the difficulty of applying the recognition and derecognition requirements of IFRS 9, particularly for ‘pass-through’ and continuing involvement transactions. In this regard, reference was also made to the increase in risk-sharing transactions and complex factoring and reverse factoring arrangements that adds to the need to further application guidance.

The AASB notes that in May 2016, the [Interpretations Committee](#) considered and declined to undertake a narrow-scope project to clarify when a modification or exchange of financial assets results in derecognition of the original asset because of the broad nature of the issue.

The AASB recommends the IASB to consider further standard setting work or guidance on this area.

[China]

We noted that the Board do not include the post-implementation review of the derecognition of financial assets in any stage of the post-implementation review of IFRS 9. But there are some practical issues related to the derecognition of financial assets. The prominent issue about derecognition of financial assets is the accounting for the continuing involvement of transferred assets. IFRS 9 only provides some illustrative examples for some specific forms of continuing involvement, and do not setup any basic principle for the recognition of continuing involvement assets and associated liabilities, which cannot ensure consistent accounting for other forms of continuing involvement transactions. We encourage the Board to include the post-implementation review for the derecognition of financial assets in its post-implementation review of IFRS 9.

In addition, we suggest the Board maintain the stability of accounting standards and but not ignore the operability of standards and implementation guidance when developing new standards.

[Malaysia]

- (a) In general, our stakeholders found that IFRS 9 has been working as intended and it reflects on the interplay between applying the requirements and making judgments to the principles of the Standard based on evaluation of the facts and circumstances that exist at a particular point in time.

The IASB should re-evaluate whether IFRS 9 have kept up with the recent market developments, specifically the application classification and measurement principles on financial instruments with ESG features or sustainability-linked instruments, as well as application of the modification to contractual cash flows principles in unprecedented circumstances, such as during the COVID-19 pandemic whereby government actions imposed by law is not uncommon.

- (b) One of the lessons learned is accounting for a loan that is provided for social / philanthropic reasons. Divergent views exist on whether cash flows from this type of loan are considered SPPI. In this example, the entity is a corporate providing student loans as part of its social objective. The student loans contain a clause whereby the loans could be converted to scholarships if the students meet the qualifying condition. However, the conversion is not automatic. The entity has the discretion to determine if the loan will be converted to scholarship or not after considering other factors. Under IAS 39, the loan was classified as ‘loans and receivable’.

On transition to IFRS 9, diverse views emerged on whether cash flows from this loan are SPPI.

- View 1: The loan fails the SPPI test and therefore it should be measured and carried at fair value through profit or loss. The convertible feature of the loan changes the nature of SPPI cash flows and that entity’s business model is not to hold and collect contractual cash flows but to discharge its social responsibility. The fact that the loan could be waived (wholly or partially) under the contract deviates from SPPI cash flow characteristic, as the study performances and result of a student has got nothing to do with credit risk, time value of money as well as the profit margin of a normal / typical loan.
- View 2: The loan meets the SPPI test and therefore be measured and carried at amortised cost. The main objective of the loan is to collect the principal and interest, despite the social objective, and hence it should be treated like any other loan where the lender has the discretion to forgive or waive the loan at any time. The discretion of the lender under the contract to waive (wholly or partially) the loan is not relevant to the analysis of SPPI as the waiver or conversion is not automatic upon the triggering event happens, for example, when the students graduated with top honours. Consequently, the loan falls within the category of ‘basic lending arrangement’ as discussed under IFRS 9.B4.1.7A. Additionally, it could be argued that the conversion feature (which is at the discretion of the entity) is immaterial to the overall assessment of the loan, analogised to the de minimis effect as discussed in IFRS 9.B4.1.18. The conversion or waiver is recorded only as and when the entity has decided on a case-by-case basis.

Therefore, it would be helpful for additional guidance to be provided in IFRS 9, specifically on the SPPI assessment, for example, how would an entity assess a situation of when a term is included in the contract that binds both the lender and borrower, but the lender has the discretion to determine the effect of the term such as to waive the loan or to convert it to a scholarship.