STAFF PAPER

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IASB Meeting

Project	**Financial Instruments: Classification and Measurement**		
Paper topic	Summary of feedback from users of financial statements—Proposed Limited Amendments to IFRS 9		
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Introduction

1. On 28 November 2012 the IASB published the exposure draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010))—herein called the 'Limited Amendments ED'. The comment period ended on 28 March 2013.
2. At the May 2013 joint board meeting, the staff presented to the IASB and the FASB a summary of the main points received in the comment letters and the outreach activities on the Limited Amendments ED. At that meeting, the IASB staff noted that the outreach efforts were ongoing and included:
   (a) an online survey for users of financial statements;
   (b) outreach meetings with users of financial statements, including joint outreach with the FASB; and
   (c) joint outreach with the FASB on their proposed Accounting Standards Update *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*—herein called the 'proposed ASU'.
3. The online survey for users of financial statements closed on 31 May 2013—and over 40 users from various backgrounds and jurisdictions participated. In addition, the IASB members and staff have conducted

over 20 outreach meetings with users of financial statements, including meetings with insurance analysts and joint meetings with the FASB members and staff. In addition, we have received 4 comment letters from users of financial statements. Overall, to date the IASB has received feedback on the Limited Amendments ED from over 60 individual users and user groups covering different regions and industries. Appendix A provides an analysis of the users who provided feedback on the proposals by type (eg buy side or sell side), by region(s) and by industry(ies) covered.

Purpose of this paper

4. This paper summarises the feedback received from users of financial statements on the Limited Amendments ED.
    (a) Paragraphs 6-8 summarise the key proposals of the Limited Amendments ED.
    (b) Paragraphs 9-12 discuss the areas in which we specifically sought feedback from users.
    (c) Paragraphs 13-25 summarise users' views on the proposed introduction of the mandatory fair value through other comprehensive income (FVOCI) measurement category for financial assets, including the views of insurance analysts (paragraphs 26-32), and paragraphs 33-34 summarise the key messages we heard in the joint outreach with the FASB.
    (d) Paragraphs 35-38 summarise users' views on other topics.
5. Agenda Paper 6B for this meeting discusses the feedback received by the FASB on their proposed ASU, including feedback received from users of financial statements.

What did the ED propose?

6. The Limited Amendments ED proposed the introduction of a mandatory FVOCI measurement category for financial assets that:
   (a) are held within a business model in which financial assets are managed both in order to collect contractual cash flows and for sale (a 'hold to collect and for sale' business model), and
   (b) have contractual cash flows that are solely principal and interest (P&I), ie are 'simple' debt instruments.
7. The new proposed category would provide fair value information on the balance sheet and amortised cost information in profit or loss. The IASB believed that this measurement category would[1]:
   (a) provide useful information for the financial assets classified in this measurement category, and address the feedback from those who have questioned the appropriate classification for those financial assets under IFRS 9;
   (b) address the interaction between the classification and measurement of financial assets and the accounting for insurance contracts liabilities; and
   (c) increase comparability with the FASB's tentative classification and measurement model.
8. The Limited Amendments ED also proposed additional application guidance and clarifications on both the 'hold to collect' business model and the contractual cash flows characteristics assessment. The Limited Amendments ED also proposed new transition requirements, notably:
   (a) after IFRS 9 is completed, only the completed version of IFRS 9 could be newly early applied (except as described in bullet (b) below)[2], and
   (b) notwithstanding the proposed transition requirement in bullet (a) above, after IFRS 9 is completed, an entity would be permitted to early apply **only** the 'own credit' provisions in IFRS 9, which require an entity to present in other

[1] Limited Amendments ED, paragraph BC17.
[2] At present, more than one version of IFRS 9 can be applied early.

comprehensive income the fair value gains or losses attributable to changes in the credit risk of financial liabilities designated under the fair value option (ie effectively applying the 'own credit' requirements in conjunction with the classification and measurement requirements in IAS 39 *Financial Instruments: Recognition and Measurement*).

What did we ask users of financial statements?

9. The outreach with users of financial statements was primarily focussed on the proposed introduction of the mandatory FVOCI measurement category. As noted in paragraph 7, the IASB concluded that fair value information on the balance sheet and amortised cost information in profit or loss would be relevant for those financial assets because their performance would be affected by both the collection of contractual cash flows and the realisation of fair values. Accordingly, we asked users of financial statements:
    (a) whether they agreed that:
        (i) it is appropriate to measure simple debt instruments at FVOCI if they are managed both in order to collect contractual cash flows and for sale, and
        (ii) both amortised cost and fair value information is relevant for these debt instruments and should be provided in the primary financial statements;
    (b) And if not, what information would be more useful for these instruments (eg amortised cost or fair value through profit or loss (FVPL)) and why.
10. In the online survey, we also sought users' feedback on whether the legal form of the financial asset (loans and receivables versus debt investments) or/and the asset's level of liquidity would impact users' information needs.
11. When we spoke to insurance analysts, we asked for their views on the interaction of the proposed mandatory FVOCI category for financial assets and the forthcoming proposals for the presentation of interest

expense on insurance contract liabilities in the Insurance Contracts project.[3]

12. Finally, we invited users' views on the transition proposals and welcomed any additional feedback.

Users' views on the proposed introduction of the mandatory FVOCI measurement category

13. *Most* users that provided feedback **supported mandatorily measuring some financial assets at FVOCI.** Additionally, *most* users **did not have different information requirements based on whether the legal form of the financial asset was a loan and receivable or a debt investment**.
14. Whilst a majority of users agreed with measuring some debt instruments at FVOCI, views were mixed and split nearly evenly in three broad groups:
    (a) those who **supported** the introduction of the mandatory FVOCI measurement category **as proposed by the Limited Amendments ED**;
    (b) those who **agreed** in principle with classifying some simple debt instruments at FVOCI **but proposed something different to the proposals in the Limited Amendments ED**; and
    (c) those who **disagreed** with the proposed introduction of the third measurement category into IFRS 9.

[3] In accordance with the tentative decisions in the Insurance Contracts project, an entity would be required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:
(a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects changes, if any, in those returns to affect the amount of those cash flows; and
(b) recognising, in other comprehensive income, the difference between:
  (i) the carrying amount of the insurance contract measured using the discount rates determined at the reporting date; and
  (ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects changes, if any, in those returns to affect the amount of those cash flows.

15. The views expressed and their variations are summarised in the table below and discussed in greater detail in subsequent paragraphs.

FVOCI measurement category—Summary illustration of views		**Debt investments in 'hold to collect' business models**	**Loans and receivables in 'hold to collect' business models**	**Debt investments in 'hold to collect and for sale' business models**	**Loans and receivables in 'hold to collect and for sale' business models**	**Par. ref**
Roughly 2/3 *agree* with measuring some debt instruments at FVOCI	Roughly 1/3 *fully agree* with the proposals	AC[4]	AC	FVOCI	FVOCI	Par. 16
	Roughly 1/3 *agree but with a difference*	FVOCI	AC	FVOCI	AC	Par. 18(a)
		FVOCI	FVOCI	FVOCI	FVOCI	Par. 18(b)
		FVOCI	AC	FVOCI	FVOCI	Par. 18(c)
		FVOCI	no response	FVOCI	no response	Par. 18(d)(i)
		FVOCI	FVOCI	FVPL	FVPL	Par. 18(d)(ii)
Roughly 1/3 *disagree* with measuring any debt instruments at FVOCI		AC	AC	AC	AC	Par. 22(a)
		AC	AC	FVPL	FVPL	Par. 22(b)
		FVPL	FVPL	FVPL	FVPL	Par. 22(c)

16. **The first group of users**—composed of comment letter respondents, survey respondents and participants in the outreach meetings—agreed that simple debt instruments should be mandatorily measured at FVOCI if they are managed both to collect contractual cash flows and for sale. They also agreed that for such financial assets, both amortised cost and fair value information are relevant and should be included in the primary financial statements. They did *not* distinguish between debt investments and loans and receivables.

17. In addition, some of the users in this group explicitly welcomed the increased alignment with the FASB's model.

[4] Amortised cost

18. **The second group of users**—composed only of survey respondents—**agreed** in principle with mandatorily measuring some simple debt instruments at FVOCI **but proposed something different to the proposals in the Limited Amendments ED**. Their views are summarised in the table above and the following paragraphs elaborate on these in greater detail.

    (a) About a third of this group of respondents believed that simple *debt investments* should be measured at FVOCI whereas simple *loans and receivables* should be measured at amortised cost. Based on the comments provided in the narrative section of the survey, these respondents seemed to believe that loans and receivables are more likely to be held for the collection of contractual cash flows and thus would be eligible for amortised cost. For example, some stated that amortised cost provides better information about the future cash flows of simple loans and receivables. Some users also noted that they are often more interested in the amortised cost of loans and receivables because such assets are less liquid than traded debt investments and thus it is more difficult to reliably determine their fair value[5]. In addition, a few survey respondents expressed the view that the assessment of the business model seems to be driven by the *level* of (rather than the reason for) sales and they did not think that approach would be appropriate for loans[6].

    (b) Roughly a quarter of this group of respondents favoured measuring *all* simple debt instruments—that is, both loans and receivables and debt investments—at FVOCI if they are managed within *either* a 'hold to collect' business model *or* a 'hold to collect and sell' business model. In other words, these respondents did not support measuring *any* financial assets at amortised cost and essentially proposed merging the amortised

[5] This point was also raised by some of the participants in the user outreach meetings. However, that didn't lead them to prefer amortised cost for all simple loans and receivables.

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cost category into the FVOCI category.

(c) Roughly another quarter advocated the approach described in (b) above for *all simple debt investments* (but not for simple loans and receivables). In other words, they favoured measuring all simple debt investments managed within either 'hold to collect' or 'hold to collect and sell' business models at FVOCI, and measuring simple *loans and receivables* based on the relevant business model.

(d) Finally, the remaining respondents to the online survey that agreed with measuring simple debt investments at FVOCI suggested either that:

(i) all simple debt investments should be measured at FVOCI (and did not specify how loans and receivables should be measured); or

(ii) all simple debt instruments (both debt investments and loans and receivables) that are managed in a 'hold to collect' business model should be classified at FVOCI (instead of amortised cost) and debt instruments managed in a 'hold to collect and for sale' business model should be classified at FVPL (ie merging the proposed FVOCI category into the FVPL category).

19. Similar to the view described in paragraph 18(d)(ii), a few participants in the user outreach meetings agreed with measuring some debt instruments at FVOCI, but they felt strongly that there should only be two measurement categories in IFRS 9. Some stated they did not have a strong preference as to what these two categories should be as long as there are only two.

20. Finally, a few participants in the user outreach meetings expressed a concern that financial assets held by investment entities would be required to be measured at FVOCI if some of those financial assets are held and others are sold, *even if* the financial assets are managed and their performance is reported on a fair value basis. These respondents noted that measuring these financial assets at FVPL would provide more useful information. This is consistent with the messages received in the

Investment Entities project.[7] The staff note however that IFRS 9 already requires that financial assets managed on a fair value basis are measured at FVPL.[8] The staff think that this is already the intention and that this requirement could be clarified in finalising the amendments to the application guidance.

21. **The third group**—composed of comment letter respondents, survey respondents and participants in the outreach meetings—**disagreed** with measuring debt instruments at FVOCI.

22. Of that third group, most respondents to the online survey stated a preference for a classification and measurement model without the FVOCI measurement category. These respondents were relatively evenly split as follows:
    (a) financial assets managed in a 'hold to collect' business model **and** financial assets managed in a 'hold to collect and for sale' business model should **both** be measured at amortised cost (this was the most common suggestion of the three)—this would result in a larger amortised cost category than currently required by IFRS 9;
    (b) financial assets managed in a 'hold to collect' business model should be measured at amortised cost whereas financial assets managed in a 'hold to collect and for sale' business model should be measured at FVPL—this would be consistent with the current requirements in IFRS 9; or
    (c) financial assets managed in a 'hold to collect' business model **and** financial assets managed in a 'hold to collect and for sale' business model should **both** be measured at FVPL—essentially *all* financial assets would be measured at FVPL.

[7] See paragraphs BC217-BC219 of IFRS 10, which were added in October 2012 by *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27)

[8] Paragraph B4.1.6 of IFRS 9, and the amendments to this paragraph proposed by the Limited Amendments ED

23. Comment letter respondents and participants in the user outreach meetings who disagreed with the FVOCI measurement category generally favoured the original two-category model in IFRS 9. They noted one or more of the following:
    (a) Introducing a third measurement category would add too much complexity to IFRS 9. They did not express a concern that the proposed FVOCI category per se is complex but they believed that having two measurement categories is less complex than having three.
    (b) A concern that entities might be able to selectively sell financial assets that are mandatorily measured at FVOCI in order to achieve a particular result in profit or loss for the period (ie as a result of recycling).
    (c) They did not think that the use of OCI should be expanded pending the consideration of OCI in the IASB's Conceptual Framework project.

24. Finally, a few who disagreed with the proposed FVOCI category— both survey respondents and participants in the outreach meetings—noted that they believed that amortised cost or fair value information should be provided consistently in the financial statements, ie one set of information should be provided in both the balance sheet and profit or loss (ie similar to the view expressed in paragraph AV4 of the Alternative Views in the Limited Amendments ED).
25. None of the users who disagreed with the introduction of the FVOCI measurement category distinguished between loans and receivables and debt investments. However some did note that they think fair value is more reliable when a debt instrument is more liquid or when the fair value measurement uses more observable inputs.

Feedback from insurance analysts

26. During our outreach, *most* insurance analysts expressed the view that measuring simple debt instruments at FVOCI would provide useful information when considered in combination with the proposal for the presentation of interest expense on insurance contract liabilities. This is because these proposals, in combination, could substantially reduce the accounting mismatch between financial assets and insurance contract liabilities. Some noted that the IASB's proposals (in the Limited Amendments ED) and tentative decisions (in the Insurance Contracts project) would reduce the accounting mismatches *present today* and would be a sufficient improvement.
27. Similar to the views expressed by other user respondents, the views of insurance analysts fell into three broad groups as follows:
    (a) Slightly over half supported the FVOCI category as proposed by the Limited Amendments ED;
    (b) Nearly half supported a FVOCI category with a variation; and
    (c) A few did not support the FVOCI category.

28. Those in the first group (paragraph 27(a)) wholeheartedly supported the introduction of the mandatory FVOCI measurement category for financial assets and agreed with the 'hold to collect and for sale' business model, as well as the relevance of both amortised cost and fair value information in the financial statements. In addition they noted that measuring simple debt instruments at FVOCI would be useful when combined with the tentative decisions in the Insurance Contracts project (paragraph 11, footnote 3).

29. Those in the second group (paragraph 27(b)) either:
    (a) had a different 'first choice' for addressing accounting mismatches (by measuring both sides of the balance sheet either at FVPL or using a cost-based measure),
    (b) advocated a FVPL option for the insurance contracts liabilities, in addition to the FVOCI category for financial assets, to address accounting mismatches, or
    (c) did not feel strongly about where value changes were reported, as long as accounting mismatches were mitigated.

30. Notwithstanding their 'first choice', respondents in this second group also agreed that measuring simple debt instruments at FVOCI would be useful when combined with the tentative decisions in the Insurance Contracts project.

31. A few disagreed with the proposed introduction of a mandatory FVOCI measurement category for debt instruments (paragraph 27(c)). There was no consensus on what they would propose instead[9], however they did still support the reduction of accounting mismatches between financial assets and insurance contracts liabilities.

[9] Similar to the views described in paragraph 27(a), their suggestions included measuring both sides of the balance sheet either at FVPL or using a cost-based measure.

32. Although insurance analysts' views varied as described in paragraph 27, it is worth noting that all of the analysts we spoke with to date shared the view that accounting mismatches between financial assets and insurance contract liabilities should be reduced.

Outreach on Limited Amendments ED and FASB's proposed ASU

33. A detailed summary of the feedback received by the FASB on their proposed ASU is provided in Agenda Paper 6B; however for the purposes of this paper the staff would like to emphasise that the key messages received from users by the FASB were consistent with those received by the IASB and included the following:
    (a) Most users agreed that simple debt instruments should be measured at amortised cost if they are held to collect the contractual cash flows.
    (b) Most users agreed that simple debt instruments should be measured at FVOCI if they are managed both to collect the contractual cash flows and for sale.
    (c) Most users did not distinguish between debt investments and loans and receivables, although many noted that loans and receivables are more likely to fall into the 'hold to collect' business model whereas debt investments are more likely to fall into the 'hold to collect and sell' business model.
34. Moreover, the staff note that many of the users analyse companies that report under both IFRS and US GAAP.

Other comments

Own credit

35. Most of the users who expressed a view on the transition proposals supported the early application of just the 'own credit' requirements for financial liabilities. Some specifically requested that the 'own credit'

requirements are incorporated into IAS 39 so that they can be adopted as quickly as possible.

Contractual cash flow characteristics of financial assets

36. Only a few users commented on the proposed clarifications to the 'solely P&I' principle. These users expressed a view that (depending on the business model) financial assets should be measured at amortised cost if they are 'plain vanilla' or reflect 'normal lending'. They supported the principle-based approach in IFRS 9 and in the Limited Amendments ED and indicated that they would not support a rules-based approach to classifying financial assets.

Reclassifications

37. A few outreach participants expressed concern that entities might be able to abuse the reclassification requirements in IFRS 9. They noted that entities might able to change their business model more frequently than the boards anticipated, which would decrease comparability and might give rise to the manipulation of profit or loss. Some specifically stated that reclassifications should be prohibited.

Convergence

38. Some users of financial statements explicitly noted their support for convergence. Some of the outreach participants asked the staff to explain the level of convergence achieved in the boards' respective exposure drafts and urged the boards to pursue even greater convergence. A few provided specific examples where they thought convergence is particularly important. The most common example was the reporting of investments in equity instruments. The users who commented on this did not discuss a preference for presenting changes in fair value in P&L or OCI but noted that such presentation should be consistent between IFRS and US GAAP.

Appendix A: User feedback by type, primary regions and industries covered