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IFRS 9 Post-implementation Review
Issue paper

Objective

1 The objective of this meeting is to:

(a) Update the EFRAG FR TEG on the IASB Staff preliminary views and IASB discussions in the June 2022 meeting on equity instruments and other comprehensive income (OCI). Obtain early feedback from EFRAG TEG members on these preliminary views and discussions.

(b) Update the EFRAG FR TEG on the IASB Project plan for amendments to IFRS 9 Contractual Cash Flow Characteristics of Financial Instruments.

2 The previous update was provided to EFRAG FR TEG on 18 May 2022 (Paper 08-01, 08-02, 08-03 and 08-04).

a) FVOCI for equity instruments

Background of the IASB project

3 On October 2022, the IASB decided to begin the PIR of the IFRS 9 classification and measurement requirements. The Request for Information on IFRS 9 was published on 30 September 2021 with comments to be provided by 14 January 2022.

4 In its March 2022 meeting, the IASB discussed a summary of the feedback received on its consultation and a plan for how to deliberate feedback. The IASB members did not make any decisions but provided their views on the feedback received.

5 The IASB members welcomed the feedback that in general the classification and measurement principles of IFRS 9 worked well in practice and result in measurement of financial instrument that provides useful information to users of financial statements about amount, timing, and uncertainty of an entity's future cash flows.

6 In the meeting of April 2022, the IASB analysed feedback on the requirements for assessing a financial asset's contractual cash flow characteristics. The IASB discussed the two main topics raised in the feedback – contractually linked instruments and financial assets with ESG-linked features.

Developments after the last EFRAG FR TEG meeting

7 In the meeting of May 2022, the IASB tentatively decided to start a fast-track standard setting project to clarify particular aspects of the requirements for assessing a financial asset's contractual cash flow characteristics.

8 The IASB has agreed to the following indicative timetable:

Topics for discussion	Timing 2022	Decisions
1. Contractual cash flow characteristics		
a. General	April	Decided actions on 6 application questions (4 actions, 2 no actions)
b. ESG-linked features	April–May	Decided to start project to clarify aspects of SPPI requirements
c. Contractually linked instruments		
2. Equity instruments and OCI	**June**	**Initial staff analysis on feedback and potential actions**
3. Equity instruments and OCI	July	Prioritisation of any potential further actions
4. Modifications to contractual cash flows	Q3	
5. Amortised cost and the effective interest rate method	Q3	
6. Business model assessment	Q3	
7. Other matters	Q3	

9 In June 2022 meeting, the IASB discussed the project plan for Amendments to IFRS 9 Contractual Cash Flow Characteristics of Financial Assets (Agenda Paper 16). In addition, the IASB board had an initial discussion on feedback received on equity instruments and OCI and received the IASB Staff preliminary views (reported on the Agenda Paper 3A). The IASB was not asked for any decisions.

Equity instruments and other comprehensive income

IASB Staff preliminary views

10 In the initial discussion on feedback received on equity instruments and other comprehensive income the IASB Staff presents preliminary views on the following topics:

(a) Consistent application of the OCI election: the IASB staff considers that there is a need to clarify the scope of the equity instruments to which the OCI presentation election can be applied;

(b) Request to broaden the scope of the OCI presentation election: based on PIR feedback, the IASB Staff is of the view that who believe the OCI presentation election should be available for a wider scope of instruments tend to strongly favour recycling of amounts presented in OCI. For this reason, the requests for OCI recycling should not be categorised as requests to amend the current OCI presentation election in IFRS 9, but as request for a new classification category for equity instruments that they think would better reflect a long-term business model or strategy;

(c) Request to amend IFRS 9 to add a new classification category: the IASB Staff is of the view that this would add complexity and would only be justified if there is evidence that there is a significant deficiency in the information that investors are being provided. The IASB Staff indicate that they do not think that this is the case since recycling would not result in users of financial statements receiving more or better information about "realised" gains and losses. Rather, recycling would change how that information is presented to users of financial statements; and

(d) Request to open the OCI presentation election to "equity-like" instruments: the IASB Staff is of the view that it would not be appropriate to extend the OCI presentation option to "equity-like" instruments that do not meet the definition of an equity instrument in IAS 32. They observe that the rights and obligations of an entity as an investor in a fund that trades equities and other instruments is different to those of an entity's that directly purchases the shares of a company.

IASB discussion

11 During its June 2022 meeting, the IASB board had an initial discussion on feedback received on equity instruments and OCI and received the IASB Staff preliminary views. The IASB was not asked for any decisions.

12 **IASB members were overall supportive to the IASB Staff preliminary views and welcomed the feedback that in general the option to present FV changes on investments in equity instruments in OCI works as the IASB intended**.

13 Several IASB members noted that reintroduce the recycling of gains and losses to profit or loss would create something similar to the available-for-sale category in IAS 39 and would create the requirement to assess the equity instrument for impairment, which had created application problems. If recycling will be permitted or required, a robust impairment model would be needed, which would add complexity and be difficult to develop.

14 Some IASB member considered that the feedback provided by stakeholders highlighted that the scope for the OCI presentation election that the IASB had in mind when the Standard was published is not applied consistently. Particular considerations should be discussed in relation to the insurance companies and the connection with the IFRS 17 requirements.

15 One IASB member noted that a possible way forward could be to clarify in the Standard the scope of the OCI presentation election by referring to the indications described on the Basis of Conclusions of IFRS 9.

16 Another IASB member considered valuable to expand the perimeters of the OCI presentation election to include a narrow scope of puttable instruments and funds that invest in equity instruments. He noted that, from the holder perspective, these types of instruments have equity risks, and it seems to be reasonable to consider them in the scope of the OCI presentation election.

17 Some IASB members asked IASB Staff to conduct further analyses on information users' needs and how to improve consistently the impairment test.

18 One IASB member was in favour of further discussion on the potential inconsistency in IFRS 9 between the requirements in paragraph B5.1.2.A[1] (i.e., day 1 gain or loss)

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[1] IFRS 9 B5.1.2.A states: "*The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also IFRS 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:*

and the requirements in paragraph 5.7.1(b)[2] for the presentation of fair value changes. He was also noted that in practice there are several issues regarding the estimation of the fair value of unquoted instruments, therefore the reintroduction of the IAS 39 exemption to fair value measurement could be reconsidered.

Observations by the EFRAG Secretariat

19 The IASB Staff observes that there is no evidence that the information produced by the absence of recycling is significant deficiencies.

20 On the basis of a consultation run in 2019, it is evident that the European financial sector has expressed a concern about the information produced by the absence of recycling.

21 Most respondents [57% of the total respondents or 84% of those who respond that there is a need for an alternative accounting treatment] justified the need for an alternative accounting treatment in IFRS 9 by highlighting the limitations of accounting for equity instruments either at FVPL or at FVOCI without recycling in accordance with IFRS 9 (consistently with previous EFRAG's consultations on the accounting for equity instruments under IFRS 9). In particular, respondents considered that:

(a) *FVPL is not appropriate to adequately depict the financial performance of LTIBM, particularly for insurance companies, as it increases the volatility in the statement of profit or loss and generates a mismatch between the liabilities and the assets*;

(b) *the use of FVPL for equity instruments does not reflect the business intention of holding equity investments for strategic reasons and market-to-market estimates fail to provide a faithful representation of the real strategy underlying long-term equity investments*;

(c) *the use of FVOCI without recycling creates the false impression that the cumulative gains and losses at the time of disposal of equity instruments are not economically relevant and not a part of the financial performance. This is preventing entities, particularly insurance companies, to properly reflect their investment performance on non-trading equity instruments*;

(d) *both dividends and gains on disposal of equity instruments represent a form of realisation of the fair value of the instruments. Therefore, both events should be presented in the same way; and e) the ability to identify realised vs. unrealised gains or losses is fundamental and highly relevant to the users of financial statements.*

*22 (…) The majority of respondents [52% of the total respondents or 78% of those who respond that there is a need for an alternative accounting treatment] which called for an alternative accounting treatment, particularly from the financial sector(*) , supported fair value measurement of equity and equity-type instruments in the statement of financial position but called for the reintroduction of recycling in the FVOCI approach (please see table below for more details).*

(a) *at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.*

(b) *in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability*".

[2] IFRS 9 5.7.1(b) states: "*A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in profit or loss unless: …*

(b) *it is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive income in accordance with paragraph 5.7.5…*".

23 In its Annex to the Advice released in April January 2020 EFRAG provided an illustration of how the impairment model could be improved if recycling was to be reintroduced.

24 *In the 2019 public consultation, 52% and 78% of those who supported the need for an alternative accounting treatment to the current IFRS 9 treatment for equity instruments proposed the introduction of recycling using the impairment model in IAS 39 as a basis for a new model, with improvements. EFRAG supports such an approach in principle*.

25 In 2018, EFRAG noted also that the IASB concluded that the IAS 39 impairment model was unduly subjective, and ESMA 's findings confirmed that it was not applied consistently in practice.

26 As a result, EFRAG suggests improvements to the IAS 39 impairment approach, such as clarifying the terms 'prolonged' and 'significant decline'. Feedback to the previous EFRAG survey, highlighted that there was no consensus on how to reach an appropriate balance between relevance of the resulting financial information and comparability of accounting policies among preparers. Some respondents stressed the need to achieve a sufficient level of comparability which could likely be achieved only if the Standard included general quantitative thresholds or rebuttable presumptions.

27 Some respondents to the 2019 public consultation proposed thresholds for the decline in fair value, such as longer than six months and more than 20%, below cost for longer than 12 months or more than a specified quantitative trigger. Others opposed this because they consider that the impairment solution should prioritise relevance over comparability, and therefore that each entity should set its own thresholds.

28 EFRAG considers that a degree of rigour in the use of the election or the impairment model would be essential to ensure comparability and therefore suggests combining quantitative indicators and the exercise of judgement within appropriate limits and with appropriate disclosures in the notes.

29 EFRAG also concluded that, contrary to the IAS 39 model, the new impairment model should allow reversal of impairment losses. If a decline in the value of an equity instrument is recognised in profit or loss because it results from an adverse change in the economic condition of the issuer, subsequent recoveries in value that result from a reversal of that adverse change should similarly be recognised in profit or loss. This was confirmed in the current consultation as mentioned above.

Background of the EFRAG discussions

30 In January 2020 EFRAG issued its Advice to the European Commission (EC) on alternative accounting treatments to measurement at fair value through profit or loss for equity and equity-type instruments held in long-term investment business models. In particular, EFRAG advised that the EC recommend to the IASB an expeditious review of the non-recycling treatment of equity instruments within IFRS 9.

31 On 28 January 2022 EFRAG published its Final Comment Letter (FCL) in response to the IASB request for information as a part of the Post-implementation Review of the classification and measurement requirements of IFRS 9 Financial Instruments.

32 EFRAG brought to the attention of the IASB the following points:

(a) The IASB should expeditiously review the non-recycling treatment of equity instruments within IFRS 9, testing whether the Conceptual Framework would justify the recycling of FVOCI gains and losses on such instruments when realised.

(b) If recycling will be reintroduced, the IASB should also consider the features of a robust impairment model, including the reversal of impairment losses.

(c) Any changes to the accounting for mutual funds and puttable instruments, aimed at allowing for equity and equity-type[3] instruments to be treated similarly for accounting purposes, would require careful consideration. It would be necessary to evaluate the challenges of developing an appropriate standard setting solution and considering knock-on effects on the classification and measurement model under IFRS 9.

33 The EFRAG FIWG discussed the topic in its meeting on 21 June 2022. Member generally did not support the IASB Staff preliminary views. During the meeting it was noted that:

(a) In some jurisdictions, financial conglomerates will face challenges and the IASB staff proposal will have significant impact on the banks.

(b) Special rules should be incorporated in IFRS 17 for insurers.

(c) A recent study provides evidence for the importance of recycling.

Questions for EFRAG FR TEG members

Do EFRAG FR TEG members have comments to the IASB Staff preliminary views on the consistent application of the OCI election?

Do EFRAG FR TEG members have comments to the IASB Staff preliminary views on the request to broaden the scope of the OCI presentation election? And on the impairment model?

Do EFRAG FR TEG members have comments to the IASB Staff preliminary views on the request to amending IFRS 9 to add a new classification category for equity instruments election?

Do EFRAG FR TEG members have comments to the IASB Staff preliminary views on the request open the OCI presentation election to "equity-like" instruments?

Next steps

34 The EFRAG Secretariat will continue to monitor the IASB discussions.

b) Project plan for amendments to IFRS 9 Contractual Cash Flow Characteristics of Financial Instruments

Proposed project objective

35 The IASB Staff think that it is unnecessary to create an exception from the SPPI requirements for financial assets with ESG-linked features. The IASB Staff think adding more explanations of the overall objective of the SPPI requirements and providing additional application guidance through standard-setting will address the issue effectively and efficiently. The IASB Staff is of the view that many of the questions around the application of the CLI requirements are symptomatic of the lack of understanding of the scope of instruments to which the requirements apply. The IASB Staff think that most of these questions could be resolved by providing a

[3] As a working assumption, EFRAG considered that the definition of equity-type instruments should be limited to units of funds and puttable instruments that invest in equity instruments, associated derivatives and necessary cash holdings.

clear description of CLIs and the requirements applicable to the underlying pool of instruments.

36 The proposed objective of this project would therefore be to make clarifying amendments to the application guidance in paragraphs B4.1.7 to B4.1.26 of IFRS 9 to enable the consistent application of the SPPI requirements and to consider whether additional disclosure requirements are needed.

Proposed project scope

37 The IASB Staff's view is that objective for this project will be best achieved by clarifying the following aspects of the SPPI application guidance:

(a) the concept of a basic lending arrangement (paragraph B4.1.7A);

(b) whether and how the nature of a contingent event (i.e., the trigger for a change in the timing or amount of contractual cash flows) is relevant to determining whether the cash flows are SPPI (paragraphs B4.1.10 and B4.1.11);

(c) examples in paragraphs B4.1.13 and B4.1.14 of applying the SPPI requirements to specific fact patterns (including adding additional examples for financial assets with ESG-linked features);

(d) the meaning and characteristics of non-recourse features (including rearticulation of the need to assess the underlying assets or cash flows);

(e) the meaning and scope of instruments to which the CLI requirements are applied (paragraph B4.1.20); and

(f) the requirements for the underlying pool of instruments for a CLI to meet the SPPI requirements (paragraphs B4.1.23 and B4.1.25).

38 The IASB Staff also propose assessing whether additional disclosure requirements are needed regarding contractual terms that could affect the amount or timing of contractual cash flows.

39 At this stage, the IASB Staff do not expect the project to clarify or amend other areas of IFRS 9, including:

(a) the underlying principles of classifying financial assets (paragraphs 4.1.1 to 4.1.5);

(b) subsequent measurement of financial assets measured at amortised cost and applying the effective interest rate method (paragraphs 5.4.1 to 5.4.2 and B5.4.1 to B.5.4.7);

(c) the requirements for classifying financial liabilities (paragraphs 4.2.1 to 4.2.2);

(d) the requirements related to embedded derivatives (paragraphs 4.3.1 to 4.3.7); and

(e) any other aspects of the SPPI requirements, including considerations around the modified time value of money and probability of contingent events.

Initial reaction of the FIWG

40 The IASB's project is not aimed at avoiding that the green products are classified at amortised costs, it rather aims at clarifying which of them are allowed to be classified at amortised cost, according to their contractual characteristics. Members expressed concerns that the issue might be underestimated and that simple clarifications might not be sufficient to cater for the instruments with ESG features.

41 The project plan looked realistic. If the standard needs modification it might take at least till 2024 (or even later) including EU endorsement before it could be (early) applied, but a solution might already be needed for the two coming years.

42 Priority should be given to a solution for ESG-linked instruments whereas CLI and non-recourse issues can be dealt with later.

High-level project timing

43 The table below summarises the indicative timing and key areas for discussion that will require decisions from the IASB at future meetings.

Preliminary timeline	Topics for discussion / Publication
Q3 2022	Consideration of potential clarifications
Q4 2022	Consideration of potential clarifications (continued) Permission to ballot
Q1 2023	Publication of Exposure Draft

44 The proposed clarifications for non-recourse features and CLIs are not high priority matters, but there is an interaction with the general SPPI requirements. The IASB Staff do not think it would be appropriate for the potential clarifications to the general SPPI requirements to be unduly delayed if there is an indication that the proposed clarifications for CLIs (as listed in paragraph 8(e) and (f)) would require more extensive analysis. If this would appear to be the case, the IASB Staff will prioritise the work on the general SPPI requirements to ensure the publication of the exposure draft is not delayed beyond Q1 2023

45 In June 2022 meeting, the IASB discussed the project plan for Amendments to IFRS 9 Contractual Cash Flow Characteristics of Financial Assets (Agenda Paper 16). The IASB was not asked for any decisions.

46 IASB members were overall supportive to the scope and direction of the project proposed by IASB Staff, and the indicative timeline.

Question to EFRG FR TEG members

47 Do EFRAG FR TEG members agree with the scope and timing of the IASB project?

Next steps

48 The EFRAG Secretariat will continue to monitor the IASB discussions.