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Mr Andreas Barckow
International Accounting Standards Board
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Our ref RD/288

28 January 2022

Dear Mr Barckow,

Comment letter on Request for Information on the Post-implementation Review of IFRS 9 Classification and Measurement

We appreciate the opportunity to comment on the International Accounting Standards Board's (the Board) Request for Information on the Post-implementation Review (PIR) of IFRS 9 *Financial Instruments – Classification and Measurement,* published in September 2021. We have consulted with, and this letter represents the views of, the KPMG network.

We welcome the Board's PIR on the IFRS classification and measurement requirements of IFRS 9. Whilst IFRS 9 has been successful in addressing many of the historical shortfalls of the previous standard, ongoing application has revealed areas that warrant further attention from the Board. We believe the Request for Information has appropriately identified most of these areas, especially on the accounting for modifications to contractual cash flows and the application of the effective interest method. In addition, practice has evolved in the absence of specific guidance. Therefore, we suggest the Board takes into account any current practice where an approach may have evolved to be generally accepted when developing any further guidance in these areas.

In terms of modifications to contractual cash flows, we believe that IFRS 9 lacks guidance in this area, which has caused difficulties in practice. For example, there is almost no guidance on how to determine whether a modification of a financial asset is substantial and leads to its derecognition, which has caused significant diversity in practice.

In addition, if a modification does not result in derecognition, then it is not always clear when paragraph B5.4.5 could or should be applied. IFRS 9 does not define what is meant by a floating rate instrument, which has caused considerable difficulties when applying paragraph 5.4.3. A similar issue arises when financial liabilities are not substantially modified. This also leads to diversity in identifying whether the effective interest rate of the instrument should be adjusted.

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Similarly, we believe that the guidance in IFRS 9 relating to the effective interest method (EIR) is also incomplete. For example, the features to be included in an EIR calculation are not always clear – e.g. it is not clear whether an increase in interest rates applied post default should be anticipated in the EIR calculation as part of the estimated cash flows.

We welcome the discussion on the SPPI assessment of financial assets with ESG features. However, we believe that addressing this issue as part of the PIR process will not result in the timely provision of guidance on this important area. As the volume of these financial assets is growing rapidly, we believe there is an urgent need for the Board to issue guidance as to how ESG features should be analysed to determine whether financial instruments with these features meet the SPPI criterion. We believe the matter should be addressed in an earlier timeframe than the PIR if possible.

We also believe the Board should consider the interactions between IFRS 9 and some other IFRS standards – in particular IFRS 15, IFRS 16 and IAS 10. For example, paragraph 5.1.3 of IFRS 9 requires an entity to measure trade receivables without a significant financing component at their transaction price as defined in IFRS 15. However, in an apparent contradiction, paragraph 108 of IFRS 15 envisages scenarios when the amount of the receivable may differ from the transaction price.

Appendix A to this letter contains our detailed responses to the questions raised in the Request for Information.

Please contact Reinhard Dotzlaw at Reinhard.Dotzlaw@kpmgifrg.com or Colin Martin at Colin.Martin@kpmgifrg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix A

KPMG's responses to the specific questions raised in the Request for Information

Question 1 – Classification and measurement
Do the classification and measurement requirements in IFRS 9: (a) 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? 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. This question aims to help the Board understand respondents' overall views and experiences relating to the IFRS 9 classification and measurement requirements. Sections 2-8 seek more detailed information on the specific requirements.

We believe that the requirements in IFRS 9 generally provide a good basis for distinguishing between financial assets that are measured at amortised cost, FVOCI and FVTPL.

We also believe that, generally, it results in useful information for the users.

However, there are certain areas where guidance is insufficient, which are set out in our answers to the following questions.

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 assets to generate 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).

On the assumption that the Board's intention was to align the accounting for financial assets with the way such assets are managed, as set out in paragraph BC4.15, we believe that, in general, this objective has been achieved.

However, there are certain areas where we believe that guidance is insufficient.

A. Determining whether sales from a held-to-collect (HTC) business model are infrequent or insignificant

IFRS 9 does not have guidance on how to assess whether sales out of a HTC business model are infrequent or insignificant, both are subjective terms. While we do not think that the provision of bright lines would be useful, further guidance on how entities should make the assessment, what factors to consider and some illustrative examples of where it may be concluded that the sales are/are not significant or infrequent would be helpful.

For example:

1. Does "infrequent" mean in extremely rare circumstances only, as set out in Example 4 in paragraph B4.1.4 of IFRS 9?

Example 4 in paragraph B4.1.4 seems to imply that sales in a stress case scenario (e.g. a run on the banks deposits) would fall under the "infrequent (even if significant)" criterion of the standard. Given the subjectivity of the term, it remains unclear as to how the "infrequent (even if significant)" criterion should be applied in practice. Specifically,

- Is the "infrequent (even if significant)" criterion intended to cover only rare circumstances like the stress case scenario referred to in the standard? If not,
  - What would be other examples of allowable infrequent sales?
  - Does the rationale for the sale matter if it is "infrequent" – for example, could the sale of financial assets to fund a significant restructuring of an entity qualify as an infrequent sale? Would it

matter whether the entity has significant restructurings in the recent past?

2. **Is it relevant for the analysis that a sale is made in response to a regulator's direction?**

   Example 4 in paragraph B4.1.4 states that whether a third party imposes the requirement to sell the financial assets is not relevant to the business model analysis. However, we think sales which were forced by a regulator could still qualify as an example of an infrequent sale, (depending on how often the regulator is expected to require such sales to be made).

3. **Should the insignificant criterion be assessed with reference to the overall size of the business model portfolio or the gains/losses realised on sale, or both?**

   Paragraph B4.1.3B states that sales made to manage credit risk concentration may be "consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if those sales are [...] insignificant in value both individually and in aggregate."

   Some accounting firms have published guidance which indicates that when considering "insignificant in value" in a business model assessment, the volume of sales as a percentage of the business model portfolio would be the primary factor, and gains or losses on sales may be used as a secondary factor. However, we believe that there continues to be diversity in practice in how to make a business model assessment when considering gains and losses. This may be even more complicated when all (or a part of) the assets subject to the assessment are hedged and gains and losses on disposal of assets may be impacted by associated hedging effects.

4. **Does the weighted average life of the portfolio have to be taken into account?**

   While it appears to be clear that the insignificant criterion has to be assessed as per B4.1.3B, it is unclear whether the weighted average life ('WAL') of the portfolio should form part of that analysis. For example:

   — Selling 2% per year of a portfolio per annum with a WAL of 3 years might be acceptable. However,

   — selling 2% per year of a portfolio per annum with a WAL of 10 years, would mean that 20% of the portfolio could be sold during the WAL of the portfolio.

B. Consequences of sales that are inconsistent with the HTC business model

IFRS 9 does not provide guidance on accounting when sales from a particular HTC portfolio are not consistent with the HTC business model, but the reclassification criteria for the portfolio have not been met. For example, would any new assets

acquired for the portfolio have to be measured at FVTPL or FVOCI for as long as the portfolio remains in existence? Or would such assets not be included in that HTC portfolio?

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 characteristics 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 that 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 asset (in particular, if cash flows are subject to variability other than credit risk). (See Section 7 for more questions about applying the 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 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).

On the assumption that the Board's intention was to identify instruments with simple cash flows, as set out in paragraph BC4.172, we believe that, generally, the cash flow characteristics assessment is working as the Board intended and provides users with useful financial information.

However, we have the following matters that we would like to bring to the Board's attention.

A. SPPI assessment on financial assets with ESG features

We believe that the application of the SPPI guidance to financial assets with ESG features may lead to SPPI failures that undermine global efforts to reward more sustainable lending. As the volume of such financial assets is growing rapidly, there is an urgent need for the Board to issue guidance as to how such features should be analysed to determine whether they qualify for amortised cost measurement. We believe that addressing this issue as part of the PIR process will not result in the timely provision of guidance on this important area.

B. When to apply CLI guidance

IFRS 9 B4.1.20 states that CLI guidance should be applied where there are "multiple contractually-linked instruments that create concentration of credit risk (tranches)". It is clear from this requirement that for the CLI guidance to apply, there must be more than one tranche issued. However, it is not clear what should be regarded as a tranche, for example whether the following are tranches:

— Ordinary shares and other equity instruments issued – and whether this depends upon whether such instruments are determined to be financial liabilities pursuant to IAS 32, Financial Instruments: presentation; or

— Liquidity facilities.

We believe that the standard should contain a definition of what is a tranche.

C. Interaction of CLI guidance with non-recourse guidance

Sometimes, accounting for very similar transactions may lead to different outcomes depending on whether the CLI or the non-recourse guidance is applied. For example, when an issuer seeks financing for non-financial assets held and;

— Issues more than one funding tranche then the CLI guidance applies, with the result that the instruments when held will not meet the SPPI criterion as it will fail paragraphs B4.1.21(b);

— Issues only one tranche then the SPPI criterion may be met, depending on the assessment under paragraph B4.1.17

In addition, as explained in B, it is not clear what should be regarded as a tranche, which could lead to structuring opportunities where an entity may avoid fair value measurement.

We believe that such inconsistency is not desirable and recommend that the Board reconsiders the CLI and non-recourse requirements, both independently and in combination with each other.

D. How to assess whether a prepayment feature is "reasonable"

For financial assets with prepayment features, paragraph B4.1.11(b) requires the holder to make an assessment of whether such a feature includes "reasonable compensation for the early termination of the contract". IFRS 9 does not elaborate further on how the assessment can be made of whether a compensation is reasonable. Some hold the view that any contractual term agreed in an arm's length transaction should be viewed as reasonable, because they are viewed as such by the parties to the contract (one may assume that parties would not normally enter into a contract that contains unreasonable terms). Further, terms of retail contracts in many jurisdictions are subject to regulatory requirements and some could conclude that if a term does not contravene such regulatory requirements it must be deemed reasonable. Others consider that whether a compensation is reasonable should be assessed with reference to its relative size – i.e. the larger the penalty, the less likely it is that it is reasonable. These views have led to diversity in practice, e.g. resulting in some retail contracts being accounted for as SPPI, while other similar contracts are accounted for as FVTPL.

We believe that the standard does not contain sufficient guidance to result in consistent application of this guidance and recommend that the Board explains how entities should assess whether a prepayment penalty is reasonable by providing factors to consider.

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).

The IASB noted arguments that presenting fair value gains and losses in profit or loss for some equity investments may not be indicative of the performance of the entity, particularly if the entity holds those equity instruments for non-contractual benefits, rather than primarily for increases in the value of the investment.

On the assumption that the Board's intention was to enable an entity to avoid presenting fair value gains and losses in profit or loss for equity investments held in order to realise non-contractual benefits rather than primarily for increases in the value of the investments, as set out in paragraph BC5.22, we believe that, generally, it provides users with useful financial information.

In some geographies, fair value changes are accumulated in OCI and presented in a separate component of equity, and once disposed of, the accumulated gains and losses are reclassified into retained earnings. Such accounting has been adopted to avoid the volatility of presenting such fair value changes in earnings, but nevertheless providing users with information about the aggregate retained earnings of the entity.

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 modification, 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.

When assuming that the Board's intention is to reflect the circumstances where an entity generally does not realise the effects of changes in the liability's credit risk unless the liability is held for trading, as stated in paragraph BC5.35, we believe that, generally, it provides users with useful financial information.

To determine when split presentation (of changes in fair value attributable to own credit risk) would create or enlarge an accounting mismatch in profit or loss, an entity assesses whether it expects the effects of changes in the financial liability's credit risk to be offset in profit or loss by a change in the fair value of another financial instrument measured at FVTPL. Such an expectation is required to be based on an economic relationship between the characteristics of the financial liability and the characteristics of the other financial instrument.

One area where believe that users may find further guidance useful is in establishing how to assess the economic relationship between the liability and the other financial instrument. For example, should they be priced off the same index, or is it sufficient that they should be priced off correlated indices?

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.

We believe that the guidance in IFRS 9 in this area is insufficient as the standard lacks guidance, which causes considerable difficulties in practice, especially in respect of the following areas. In addition, practice has evolved in the absence of specific guidance.

Therefore, we suggest the Board takes into account any current practice where an approach may have evolved to be generally accepted when developing any further guidance in these areas.

A. Cancellation of certain cash flows on a financial asset

Whether cancellation of certain cash flows on a financial asset should be analysed under paragraph 3.2.3(a) or treated as a modification (the same issue applies to financial liabilities in respect of paragraph 3.3.1 or 3.3.2).

B. How to assess whether modification of a financial asset is substantial and should lead to its derecognition

In contrast to financial liabilities, IFRS 9 does not include any guidance on how to determine whether a modification of a financial asset is substantial and leads to its derecognition. Some entities analogise to the guidance on financial liabilities, in particular to the 10% test. However, this could have undesirable consequences, particularly where the modification is of an instrument issued to a distressed borrower and the lender provides relief. Derecognition can mean that assets that were in stage 2 prior to modification would move back to stage 1 once modified. In addition, Example 11 (paragraph IE 66 – 73) illustrates that an asset is not derecognised even when there is a 30% reduction in the contractual cash flows, which is not consistent with analogising to the 10% test for financial liabilities.

We recommend that any guidance on modifications of financial assets should include specific guidance for forbearance scenarios. This is because in such cases the objective and nature of the modification is usually to maximise recovery of the original contractual cash flows rather than to originate a new asset on market terms. Accordingly, derecognition is likely to be less appropriate and in our experience practice has generally evolved in that direction.

C. What EIR to use (i.e. in what circumstances could or should paragraph B5.4.5 be applied) in assessing whether modification is substantial, in calculating modification gains or losses when the original asset is not derecognised and for use in the modified asset subsequent to modification

This issue is connected to Question 7, in terms of when paragraph B5.4.5 should or can be applied. However, where a modification does not result in derecognition, there are further issues to consider on which there is no guidance in IFRS 9.

In principle, it seems that the original effective interest rate should be adjusted, when the rate is considered to be a floating rate of interest and the new modified rate is a market rate. However, this is not clear in the standard. What is also not clear is:

- How to determine whether the original rate (or a component of it) is a floating rate – this is considered further in Question 7 below

- How to determine whether the new interest rate is a market rate (and indeed what is a market rate for this purpose)
- How to incorporate any unamortised fee prior to modification and any fees received as part of modification into the analysis of market rate
- How to account for any unamortised transaction costs in either circumstances
- What the meaning of the phrase "fees and costs incurred" is in paragraph 5.4.3, in particular whether they include fees received, fees paid and costs paid by both lender and the borrower and what the difference is between fees paid and costs paid
- In what circumstances the EIR after modification should be adjusted and how, including when the basis of calculation of interest changes from fixed to floating rate or vice versa

D. Allocation of the carrying amount between the part of financial instrument derecognised and the part retained

It is unclear how to allocate the gross carrying amount for financial instruments to the part derecognised and retained when some cash flows have been cancelled. – i.e. what approach should be used, relative fair values or amortised cost accounting principles? If relative fair values are used, then there may be further gain or loss in re-estimating cash flows unless EIR going forward is changed. We have seen that entities in practice have used allocation based on relative carrying values (i.e. amortised cost accounting principles).

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.

In responding to (a) – (b), please include information about interest rates subject to conditions and estimating future cash flows (see Spotlight 7).

Similar to our comment on question 6, we believe that the guidance in IFRS 9 in this area is incomplete, particularly for the following areas.

A. Calculation of EIR at initial recognition of a financial instrument

The standard lacks guidance on how various contingent features should be incorporated into the determination of the EIR on initial recognition. If, for financial liabilities, such features are not separated as embedded derivatives then there may be substantial potential variability in cash flows, for example when the variability is linked to a non-financial variable specific to a party (e.g. linked to the issuer's profits or sales). We recommend that the Board provides some guidance in this area.

B. Re-estimation of cash flows

The standard is not clear when entities should or could apply paragraph B5.4.5 to re-estimation of cash flows, i.e. when the interest rate is a floating rate.

C. Inclusion of cash flows arising on default

The standard does not discuss whether and how cash flows arising on borrower's default should be included in calculation of EIR and subsequent re-estimation of cash flows. For example, the contract for some financial assets may require that on default the interest rate increases. It is unclear whether such a potential increase should be taken into account when calculating the EIR for the asset initially and/or when it should be taken into account when re-estimating contractual cash flows during the life of the asset.

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?

We believe that, generally, the transition requirements strike the right balance between providing users with useful information and providing relief to preparers where information may be particularly difficult to obtain.

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?

We believe that the following additional matters should be examined as part of PIR of IFRS 9.

A. Interaction between IFRS 9 and IFRS 15 – whether a trade receivable is always recognised at the transaction price

Paragraph 5.1.3 of IFRS 9 requires an entity to measure trade receivables without a significant financing component at their transaction price (as defined in IFRS 15) – i.e. IFRS 9 does not seem to envisage scenarios in which the amount of a receivable may differ from the transaction price. In contrast, paragraph 108 of IFRS 15 envisages scenarios in which an entity may recognise a receivable for an amount which will be subject to refund in the future if it has a present right to payment – i.e. the amount of the receivable may differ from the transaction price. This is illustrated in Example 40 in IFRS 15. We recommend that the Board resolves this inconsistency between IFRS 9 and IFRS 15.

B. Interaction between IFRS 9 and IFRS 16

1. Accounting for financial assets and financial liabilities resulting from failed sale and leaseback transactions

IFRS 16.103 says "If the transfer of an asset by the seller-lessee does not satisfy the requirements of IFRS 15 to be accounted for as a sale of the asset … the buyer-lessor shall not recognise the transferred asset and shall

recognise a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IFRS 9."

The difficulties in applying IFRS 9 are as follows:

— For the buyer – it is not clear whether the SPPI criterion is met for such an asset

— For the seller – it is not clear how to construct the contractual cash flows to estimate an EIR for the liability – in particular how to treat an option of the lessee to either pay an amount and retain the asset or to hand the asset back at the end of the lease.

2. Interaction of modification requirements of IFRS 16 with derecognition requirements of IFRS 9

Lease liabilities are subject to the derecognition requirements of IFRS 9. At the same time, IFRS 16 has specific requirements relating to modifications for lease liabilities. So, it is not clear what standard should be applied when some lease payments have been cancelled.

— IFRS 9.2.1(b) states that lease liabilities recognised by a lessee are subject to the derecognition requirements in IFRS 9.3.3.1.

— IFRS 9.3.3.1 states that a financial liability is derecognised "when, and only when, it is extinguished – i.e. when the obligation specified in the contracts is discharged, cancelled or expires."

— In particular, IFRS 9.2.1(b) does not refer to the following paragraphs providing guidance on derecognition of a financial liability:

  — IFRS 9.3.3.2 that discusses exchanges and modifications;

  — IFRS 9.3.3.3 that gives guidance on accounting when part or the entire financial liability is extinguished.

— Accordingly, measurement of the amounts derecognised under IFRS 9.2.1(b) and accounting for such amounts are debatably within the scope of IFRS 16.

C. Interaction between IFRS 9 and IAS 10 – to what extent estimates under IFRS 9 B5.4.6 are adjusting post-balance sheet events

It is unclear how to distinguish adjusting post balance sheet events and non-adjusting events when estimating cash flows under paragraph B5.4.6 in cases when information regarding period end estimated cash flows comes to light between the reporting date and the date that the financial statements are authorised for issue.

D. Accounting for financial guarantee contracts (FGC)

1. FGC held

IFRS 9 does not discuss accounting for FGC held and excludes such contracts from its scope (see paragraph 2.1(e)). The Transition Resource Group for Impairment of Financial Instruments discussed in December 2015 when FGC held should be included in the measurement of expected credit losses. We recommend the Board include guidance in IFRS 9 on the accounting for FGCs held, both for scenarios when the FGC is accounted for together with the related financial asset, and when it is accounted for separately, together with guidance on when accounting as part of the related financial asset is appropriate.

We note that accounting for FGCs held where such instruments qualify as reinsurance contracts is addressed in IFRS 17.3(b) and any new guidance should take into account consistency with the existing model.

2. FGC issued - application of paragraph 4.2.1(c) if the issuer does not receive all of the premiums on initial recognition

It is difficult to apply the guidance in paragraph 4.2.1(c) to scenarios where the issuer of a FGC receives the premium in instalments over time or as a single amount in arrears, rather than upfront. The standard requires an issuer to subsequently measure a FGC at the higher of:

- the amount of the loss allowance determined in accordance with IFRS 9; and
- the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15.

However, when the premium is paid in instalments or in a single amount in arrears, “the amount initially recognised” is a single premium recognised when entering in to the FGC and this paragraph does not seem to envisage adding subsequent instalments to the measurement amount, as it only refers to adjusting this initial amount by “the cumulative amount of income recognised in accordance with the principles of IFRS 15”. It is possible that the following approaches could be taken for the subsequent accounting:

- Gross approach: Under this approach, the issuer recognises both:
  - a liability for its obligation to provide protection to the holder that is measured in accordance with paragraph 4.2.1(c) – i.e. the obligation to provide protection is measured at fair value on initial recognition. This fair value is likely to equal the sum of the premiums received and the fair value of the future premiums receivable; and

  - a financial asset in scope of IFRS 9 for the future premiums receivable.
- Net approach: Under this approach, the issuer generally recognises a single net amount that is measured in accordance with paragraph 4.2.1(c).

As an additional complication, under the net approach the ongoing recognition of income in accordance with the principles of IFRS 15 may cause, at particular points in time, the cumulative amount of income recognised to date to exceed the cumulative amount of premiums received to date. It is unclear how the “higher of” measurement in the paragraph 4.2.1(c) should be applied in such circumstances.

We recommend the Board address accounting for FGC issued in a more comprehensive manner.