HKAB's comments on IASB Post-implementation Review of IFRS 9 - Classification and Measurement

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<tr><th>IASB Questions</th><th>HKAB Comments</th></tr>
<tr><td colspan="2">Question 1—Classification and measurement</td></tr>
<tr><td>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.</td><td>Generally, we agree that IFRS 9 enables 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. IFRS 9 also provides useful information to the users of the financial statements.

We believe there are certain enhancements that can be made to IFRS 9 in our responses below to enhance consistency in application and would encourage the IASB to consider revisions to the address the observations included herein.</td></tr>
<tr><td colspan="2">Question 2 — Business model for managing financial assets</td></tr>
<tr><td>(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?</td><td>For questions (a) and (b):

Generally, we agree that business model assessment can achieve the Board's objective. Meanwhile, we believe that there can be certain enhancements that could enhance the consistency.

For example, we note that there is common debate on how to account for liquidity management in business model assessment and reclassification of financial assets. For instance, a bank may be required to sell or purchase financial assets in order to meet the liquidity requirements. Para B4.1.4 of IFRS 9 provides that "if an entity holds financial assets to meet its everyday liquidity</td></tr>
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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).
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needs and meeting that objective involves frequent sales that are significant in value, the objective of the entity’s business model is not to hold the financial assets to collect contractual cash flows”. We suggest practical examples can be issued to supplement para B4.4.2 and B4.4.3 in order to reduce the diversity in practice.
Another example would be the limitation in permitting reclassifications to demonstrably significant events does not provide sufficient flexibility and based on the IFRS 9 examples limit reclasses to acquisitions or a business exit. It is common for transactions to be traded within an entity across business models. For instance, a sale of a financial asset from a Hold to Collect business to a Trading business, permitting a reclass in such instances would be helpful where the management of the asset is clearly on a different basis to the historical model.
Guidance related to changes to business models on the back of internal restructurings within an entity would be helpful. For example, where we merge one business model with another and how we treat the new combined business model versus the legacy including how we consider future sales activity related to the legacy business.
(c) We note that the business model assessment requires additional assessment and discussion with the auditor, especially for non-routine circumstances such as sudden sales due to liquidity issue during pandemic.
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<tr><td colspan="2">Question 3 — Contractual cash flow characteristics</td></tr>
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(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
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For questions (a) and (b):
Generally, we agree that cash flow characteristics assessment can achieve the Board’s objective. However, it is believed that certain enhancements could be made in enhancing the consistency. Areas to be addressed related to SPPI include prepayment penalties, ESG linked adjustments to margins, application of non-recourse guidance versus the contractually linked guidance, and the definition of “basic lending arrangement” described in para B4.1.7A.
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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 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).	It is believed that penalty fees earned on early repayment of loans should be to cover the cost of termination; nevertheless, we have noted diversity in practice and peers passing SPPI where the prepayment penalty is based on market practice and within the regulatory guidelines. In addition, it is believed that there is inconsistency in practice where a loan's fixed margin is adjusted based on whether ESG KPI is met. Generally, such adjustments are de minimis. We are doubtful that whether such terms form part of basic lending arrangement and should the IASB determine otherwise it should be clarified as a broader principle not solely limited to adjustment for ESG KPIs. There can also be inconsistency in the determination of SPPI depending on whether the non-recourse guidance or the contractually linked guidance should be applied, hence, we propose to the Board that to reconsider this guidance. SPPI assessment using non-recourse assets guidance focuses on ensuring that the instrument's payoff is mainly based on repayment principal and interest and ensuring there is sufficient loan to value ratio on the collateral vs. the loan and existence of credit enhancements. The collateral under a non-recourse asset can be financial and non-financial instrument (i.e. do not require to meet SPPI) and a loan can pass SPPI provided there is sufficient buffer in the structure to absorb price risk and payment is limited to principal and interest. However, SPPI assessment for contractually linked instruments require the underlying pool of assets to meet SPPI. This means if we are investing in the senior tranche where the underlying asset is mainly a non-financial instrument, the instrument shall fail SPPI regardless of whether there are sufficient junior and equity tranche to absorb price risk. (c) We note that cash flow characteristics assessment requires additional assessment and discussion with auditor, especially for judgement of basic leading arrangement.

IASB Questions	HKAB Comments
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).	(a) Generally, we agree that the option of presenting fair value changes on investments in equity instruments in OCI works as the Board intended. Whilst there is no recycling of amounts from OCI to profit or loss on sale of an equity investment, the entity can transfer the cumulative gains or losses within equity. We consider this may not fully reflect the management strategy of fund investment and may distort the investment result, i.e. how to reflect the gain. (b) One of our member banks apply FVOCI accounting to equities for strategic investments that have nexus with our business, in all other instances we apply FVTPL for equities. (c) We are not aware of any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI. However, we recommend the Board to consider allowing irrevocable options of measuring equity investments under IFRS 9 at NAV, if holding such investments are solely for strategic purpose, to better reflect the economic substance of the investment strategy behind and ease the burden of preparers.

IASB Questions	HKAB Comments
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.	For questions (a) and (b): We agree that the requirements for presenting the effects of own credit in OCI achieved the Board's objective.
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?	(a) We believe modifications to contractual cash flows are materially consistent with Board expectations. (b) Changes in the contractual arrangements will generally result in modification accounting. Diversity in practices to apply modification accounting may arise due to system limitations and the inability to determine the impact of modification or the application of derecognition to modified financial assets. IFRS 9 does not clearly clarify where derecognition arises for modified financial assets. As such, we believe there is significant divergence in practice on whether such modifications are deemed to achieve derecognition for financial assets and guidance is sought on the same. There may be less diversity when considering financial liabilities. While IFRS 9 does not have explicit guidance regarding modification and derecognition of financial assets, most companies have to develop their accounting policies (commonly by referring the 10% rule suggested in financial liabilities and introducing different kinds of qualitative indicators) which leads to diversity in practices, for example, whether the gross carrying amount or net

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If diversity in practice exists, please explain how pervasive the diversity is and its effects on entities' financial statements.	carrying amount after impairment should be used in applying the 10% rule. Speaking of practical challenges, the worldwide pandemic makes this assessment more challenging. For example, whether forbearance event, such as negotiated payment holiday due to Covid-19, triggers derecognition.
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 questions (a)–(b), please include information about **interest rates subject to conditions and estimating future cash flows** (see Spotlight 7).	(a) We believe the EIR method is materially consistent with Board expectations. (b) We observe that there is challenge in identifying fees that are an integral part of the effective interest rate. For example, in practice it is difficult to distinguish fees and costs that are EIR from transaction fees relating to service. Besides, in many instances not all systems comply with the EIR methodology. Companies use the contractual rate as a proxy for EIR and manually assess whether the application is materially consistent with IFRS 9. Judgement is applied in estimating future cash flows in relation to contingent events. Usually, these are prescribed NIL value. Banks would expect for ESG loans, the cash flows for the adjustment would not be adjusted unless triggered as banks will not be able to reliably measure the probability of events happening - third party confirmation. The adjustment is a modification but there may be system limitations in applying this accounting. We will apply the contractual life in the absence of expected life information. Any adjustment as a result of modification accounting would be recognized in interest income for financial assets or interest expense for financial liabilities.
Question 8—Transition	
(a) Did the transition requirements work as the Board intended? Why or why not?	For questions (a) and (b):

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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 do not have any comments.
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?**	For questions (a) and (b): Entities that have adopted IFRS 9 for hedge accounting benefit from IFRS 9.6.7, which allows entities to designate a credit exposure as FVTPL where we use derivatives to hedge credit risk. Banks that continue to apply IAS 39 for hedge accounting would benefit from this election. It is not uncommon for a desk to sell assets between HTC portfolios and trading portfolios which currently do not have the ability to reclassify such loans under IFRS 9 (as noted above) and ultimately when transferred to a trading book they would commonly be managed on a fair value basis. We consider that it would be helpful to the extend this option to hedging instruments not mandatorily required to be accounted as FVTPL (such as risk participations).