Post-implementation Review of IFRS 9 – Classification and Measurement

Presentation to IFASS

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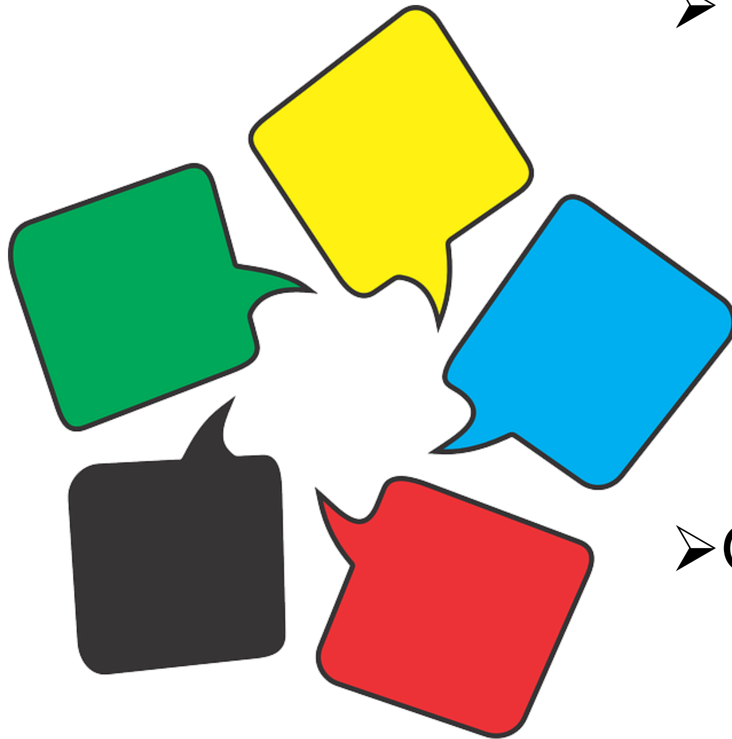
IFRS 9 in Malaysia

- MASB issued MFRS 9 *Financial* Instruments in November 2014
  - MFRS 9 is word-for-word IFRS 9 *Financial Instruments* issued by the IASB, including the effective date of 1 January 2018

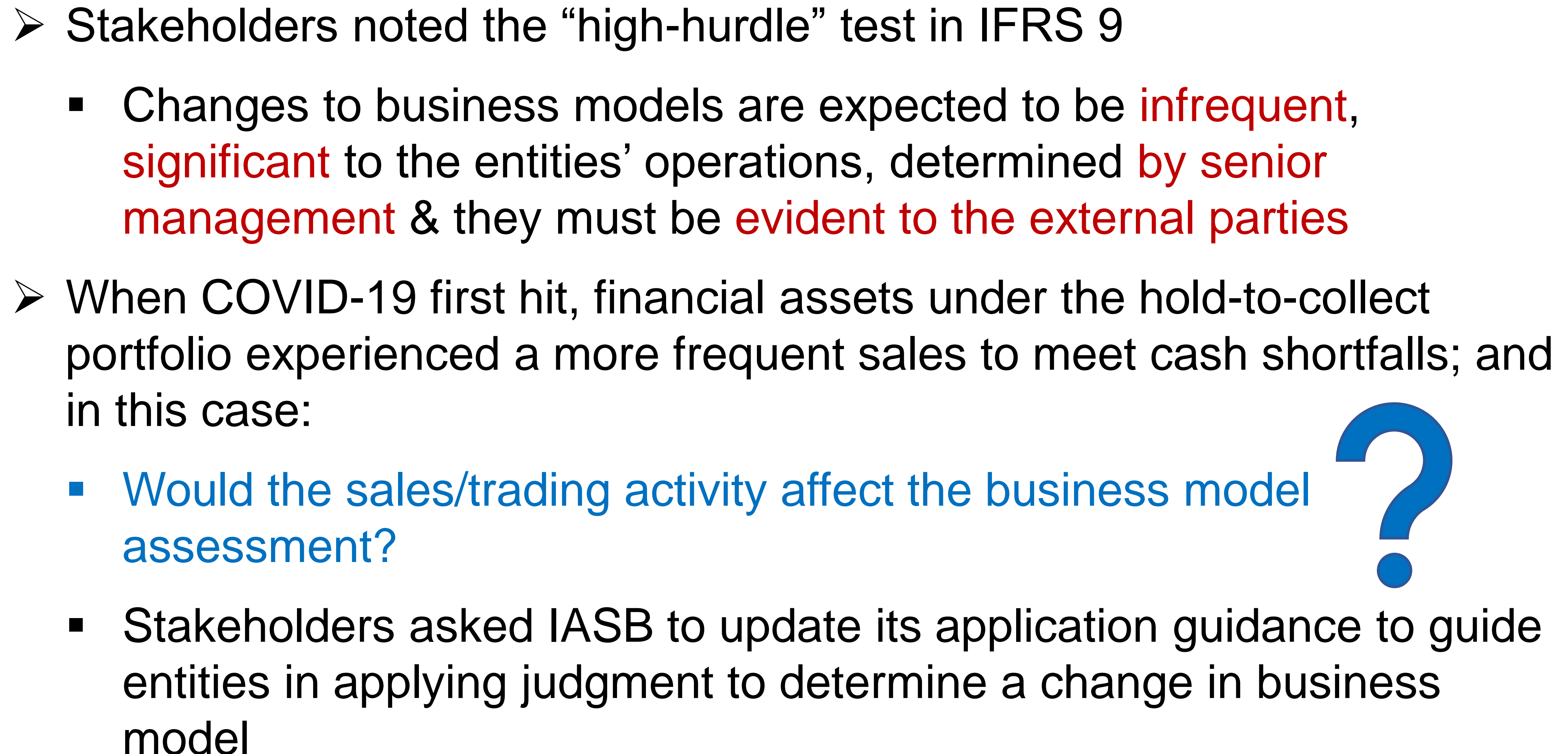
PiR of IFRS 9: What have we heard?



- IFRS 9 has been working as intended
- Some of the key challenges as highlighted by our stakeholders:
  - Assessment of a change in business model
  - *Solely payment of principal and interest* (SPPI) test on ESG-linked instruments
  - Modification of contractual cash flows
- Other issues
  - Equity instruments for FVOCI election
  - Lesson learned

Business model change

- Stakeholders noted the "high-hurdle" test in IFRS 9
  - Changes to business models are expected to be infrequent, significant to the entities' operations, determined by senior management & they must be evident to the external parties
- When COVID-19 first hit, financial assets under the hold-to-collect portfolio experienced a more frequent sales to meet cash shortfalls; and in this case:
  - Would the sales/trading activity affect the business model assessment?
  - Stakeholders asked IASB to update its application guidance to guide entities in applying judgment to determine a change in business model



SPPI test for ESG-linked instruments

- Financial instruments with ESG features might not be prevalent during IFRS 9 development time
- Issuance of ESG-linked instruments is gaining traction; governments and regulators urged businesses to consider their impacts on ESG
- Two views emerged based on the current reading of IFRS 9

Pass SPPI (Amortised cost)	• Meeting ESG targets affects borrower's credit risk & repayment ability • Compensation for relevant risk is consistent with the SPPI principles in IFRS 9
Fail SPPI (FVTPL)	• ESG elements are beyond "interest" as defined in IFRS 9

SPPI test for ESG-linked instruments

- Applying the existing requirements of IFRS 9:
  - Some noted challenges to determining the effective interest rate (EIR) for these instruments
    - ✓ the principles in accounting for floating rate-loans might apply by analogy to determine EIR
  - Others thought that FVTPL classification might not always reflect the substance of these instruments
    - ✓ IASB to consider providing additional clarity in applying SPPI to these instruments

Modification of contractual cash flows

- Stakeholders noted lack of guidance on what constitutes modification of financial assets that would lead to derecognition
  - The 10% guidance for financial liabilities was found to be helpful and applied the same by analogy to financial assets
- Is government a party to the contractual provisions?
  - Some questioned whether IFRS 9 was developed in anticipation of government interventions or whether the focus has been on changes affected by parties to the contractual provisions
  - Some believed that government-imposed moratoriums or payment holidays should not give rise to modification gain or loss as per IFRS 9.5.4.3

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Modification of contractual cash flows

- Based on the reading of IFRS 9.5.4.3, coupled with the lack of guidance on what constitutes modification of financial assets, stakeholders have mixed views:

Government intervention affects the contractual cash flows

- The moratorium 'forces' parties to the contract to agree to revised terms (for e.g. extending the term of the contracts)
- modification gain or loss is recognised (IFRS 9.5.4.3), original EIR remains

Government intervention does not affect the contractual cash flows

- Government is not a party to the contractual provisions
- The moratorium is an 'additional cost' to the lender for agreeing to continue holding the assets (it is an **'economic loss'**)
- New EIR is determined for the revised cash flows, the effect is amortised over the extended remaining term of the contract

Equity instruments for FVOCI election

- FVOCI election is applicable only for investment "equity instrument" as defined in IAS 32
  - "financial liability classified as equity instrument" in accordance with IAS 32 (paragraphs 16A and 16B or paragraphs 16C and 16D – puttable instruments) is not "equity instrument"
- From an investor's stand point, a concern was raised on the complexity in determining financial assets eligible for FVOCI election
  - Investment in equity or equity-like instruments are made for long term strategic reasons - the different classification might not provide useful information to users of the financial statements
- IASB might consider extending to FVOCI election, subject to additional disclosures about features and reasons for the election

Lesson learned: SPPI test for loan with social/philanthropic reasons

- **Facts:**
  - the entity is a corporate providing student loans as part of its social objective
  - student loans contain a clause whereby the loans could be converted to scholarships if the students meet qualifying conditions
  - Conversion is not automatic – and it rests solely at the discretion of the lender

YES

- Loan is a basic lending arrangement with a business model to hold and collect contractual cash flows
- Conversion feature is "de minimis"

NO

- The conversion feature changes the nature of the loan – not SPPI cash flows
- The loan is to discharge social objective and not to hold and collect contractual cash flows

THANK YOU