Deloitte Touche Tohmatsu Limited
2 New Street Square
London
EC4A 3BZ
United Kingdom

Tel: +44 (0) 20 7936 3000
Fax: +44 (0) 20 7583 1198
www.deloitte.com

Direct: +44 20 7007 0884
Direct fax: +44 20 7007 0158
vepoole@deloitte.co.uk

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
United Kingdom
EC4M 6XH

Email: commentletters@ifrs.org

28 March 2013

Dear Mr Hoogervorst

Exposure Draft ED 2012/4 – Classification and Measurement: Limited Amendments to IFRS 9

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ('the IASB's' or 'the Board's') Exposure Draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* ('the ED').

We welcome the Board's initiative to address practical issues in the application of the current version of IFRS 9 *Financial Instruments* and to consider the interaction with its tentative approach to accounting for insurance contracts. In addition, we welcome the continued efforts of both the IASB and the US Financial Accounting Standards Board (FASB) to seek convergence in this important area of accounting and urge both boards to reconcile any remaining differences in their respective classification and measurement models as far as possible.

We support the objective of the proposed amendments and the introduction of a third business model as it better captures the spectrum of business models that exist in reality. However, we believe that the third business model would be better defined as a residual category for assets that do not meet the conditions to be considered as held to collect contractual cash flows or as held to sell. This should facilitate the production of simpler, clearer application guidance. Additionally, we encourage the IASB and the FASB ('the boards') to reconcile the differences that currently exist between their proposed application guidance in this area as this would enhance international comparability of financial statements.

We note that the introduction of a benchmark test adds an additional layer of complexity to the cash flow characteristics criterion. Instead of trying to fix particular concerns over the accounting treatment for specific instruments on a piecemeal basis, we suggest that the boards clearly articulate the principle of when amortised cost provides useful information and provide consistent application guidance for applying the principle of 'solely payments of principal and interest' to different types of features. Furthermore, we are concerned that the IASB does not address the accounting for financial instruments in economies where rates are not set by the forces of supply and demand, but by the government or related agencies.

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Finally, we ask the Board to reconsider the effective date of IFRS 9. In light of the delays in completing IFRS 9 a signal from the IASB as to whether they intend to consider a deferral of the effective date and the period of time they consider would be reasonable between finalisation of the standard the effective date. This would help constituents, particularly preparers plan their implementation.

Our detailed responses to the questions in the ED are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole or Andrew Spooner in London at +44 20 7007 0884 or +44 20 7007 0204 respectively.



Yours sincerely

Veronica Poole
Global IFRS Leader
Technical

Deloitte.

Appendix: Responses to the Invitation to Comment

Question 1

Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest? Do you agree that this could be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?

Whilst we agree with the boards' objective to provide guidance for applying the principle of 'solely principal and interest' to instruments with modified economic relationships, we are concerned that the proposed guidance is not sufficiently clear, is difficult to operationalise, does not cover all situations where we believe instruments contain cash flows that are solely payments of principal and interest and will potentially lead to divergence in practice. Instead of proceeding with the proposed guidance, we recommend that the boards develop convergent, coherent and consistent application guidance that embodies similar criteria for evaluating different types of features. See our response to question 3 on an alternative approach the Board might wish to pursue.

We welcome the boards' attempt to address the accounting for instruments where the economic relationship between principal and interest is modified but where amortised cost still provides useful information. In many economies, interest rate-setting mechanisms differ from the "normal" pricing mechanisms considered by the Board. For example, there are territories in which government or other public authorities set the rate for certain types of instruments (in particular, loans). However, we doubt whether the proposed benchmark instrument test along with the application guidance in the ED is the best way to resolve this issue.

Although we appreciate the Board's view that materiality is a concept universally present in IFRS, we suggest providing additional guidance on how the "insignificance" test for modified economic relationships relates to the concept of materiality established in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. E.g. is the benchmark test not applied if the entity concludes that the feature is not material? If it is applicable, is it applied on a post-materiality basis?

Further, the stated threshold for acceptable modifications ("insignificantly") appears to be low (compared to, for example, "substantially" in the context of the '10 per cent test' in IAS 39:AG62 (IFRS 9:B3.3.6) or the 'double-double test' in IAS 39:AG33). Interpreting 'insignificantly' in this manner could lead to situations where under IAS 39 embedded derivatives did not have to be separated and therefore the entire instrument being accounted at amortised cost while under IFRS 9 the same instrument would be required to be measured at fair value through profit or loss as the contractual cash flows are more than insignificantly different from the benchmark cash flows. We recommend that the Board provide application guidance on the interpretation of this term to assist users and to reduce the possibility of divergence in practice.

Question 2

Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?

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In summary, we do not think the guidance is sufficiently operational or understandable and are concerned that it adds to the complexity of the model. As stated above, while we understand the Board's objective, we think the proposed application guidance is not sufficiently robust to provide consistent and appropriate results.

As noted in our responses to question 1 and question 3 respectively, we believe that application guidance on the interpretation of the term 'insignificant' in this context would be helpful and that clarifying the objective of when amortised cost measurement provides useful information as well as providing convergent, coherent and consistent application guidance for applying the resulting principle on what financial instruments qualify for that measurement attribute would improve the existing guidance without the drawbacks laid out in the following paragraphs.

A significant concern is a lack of clarity as how the test should be performed. Under the proposed amendments it is not clear whether the test should be performed on an undiscounted cash flow basis, change in effective interest rate or present value basis. These alternatives will deliver different test results and can therefore lead to different measurement of the instrument. We believe that only a present value comparison will render results that are in line with the definition of interest. Although we welcome the principle that no detailed assessment needs to be performed if it is clear with little or no analysis whether the cash flows on the financial asset could or could not be more than insignificantly different from the benchmark cash flows, the benchmark instrument must still be replicated in the systems in order to perform the assessment. This can prove challenging if a large number of items have to be processed under this model.

We note that preparers would find it difficult to determine the benchmark instrument in certain jurisdictions, where pricing of financial assets is extensively regulated by the government or another authority (e.g. a central bank). In such cases, official interest rates which are set by the central bank represent the basis for pricing retail and commercial loans denominated in the local currency of the respective jurisdiction. The standard lacks guidance on whether in such a jurisdiction, the appropriate benchmark in, for example, the circumstances described in proposed paragraph B4.1.9B would be an asset reset monthly to the official monthly interest rate or to a monthly rate from another jurisdiction without such pricing regulation.

Furthermore, preparers might have general operational difficulties in finding the appropriate benchmark instrument. It would be particularly hard to find a benchmark instrument for instruments that have several underlyings such as interest rate and inflation rate. The standard offers limited guidance for this problem which is increased by the lack of clarity on the basis on which the test is performed.

In our view the objective of interest-related leverage guidance is not sufficiently clear. In particular, it is unclear whether the analysis suggested is qualitative or quantitative and therefore what would be acceptable. For example, an inverse floating-rate note might qualify for amortised cost measurement from a quantitative point of view if the inversing feature is limited and hence does not alter the cash flows significantly. However from a qualitative point of view it support the measurement at fair value through profit or loss under the principle of not solely payments of principal and interest as the interest return is not directional in line with the amount advanced. We suggest that guidance be provided on whether under the benchmark instrument model a qualitative assessment might prevail if it is clear that the feature is at odds with the underlying principle of solely payments of principal and interest.

The final guidance should be clear that no reassessment is required if reasonably possible outcomes change, i.e. the assessment is only done on initial classification or on a reclassification resulting from a

change in the entity's business model. If a reassessment is performed on reclassification, an entity should perform the assessment considering the facts and circumstances existing at the date of reclassification as defined in the standard.

Question 3

Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features? Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?

We agree that the proposed amendment will result in some instruments with minor interest rate mismatch features, which often are included as a result of market practices or for operational reasons, being eligible for amortised cost accounting. However, we refer to our remarks in questions 1 and 2 with regard to implementing the proposed guidance. With regard to the second question, we think the proposed guidance does not identify appropriately the relevant set of instruments that have solely payments of principal and interest. This is due to a lack of clarity on the principle underpinning the amendment. As an alternative approach to address the concerns by constituents we think the boards could more clearly articulate under what guiding principle amortised cost provides useful information based on the improved principle and provide coherent and consistent application guidance for applying the principle.

To achieve this we believe some of the Board's thinking when developing IFRS 9 and ED/2009/12 *Financial Instruments: Amortised Cost and Impairment* can be leveraged. The objective of requiring amortised cost accounting, which is inextricably linked with the effective interest rate method, subject to instruments being held in the appropriate business model was "to allocate interest revenue or expense to the relevant period. Cash flows that are interest always have a close relation to the amount advanced to the debtor (the 'funded' amount) because interest is consideration for the time value of money and the credit risk associated with the issuer of the instrument and with the instrument itself." [IFRS 9:BC4.23] We agree with the Board's observation in IFRS 9:BC4.23 that "if a financial asset contains contractual cash flows that are not principal or interest on the principal amount outstanding then a valuation overlay to contractual cash flows (fair value) is required to ensure that the reported financial information provides useful information." ED/2009/12 adds that the objective of amortised cost measurement is to provide users of financial statements with information of an effective return from the instrument. When developing both IFRS 9 and ED/2009/12 and considering the term "basic loan features" used in the ED leading to the original version of IFRS 9 we think the Board had normal lending arrangements in mind when it tried to define the subset of financial instrument that should potentially qualify for amortised cost. We concur with this thinking. In our view, it would be important to use the underlying idea of "normal lending arrangements" as this is consistent with the original objective of amortised cost accounting and also consistent with the notion of cash flows that solely represent payments of principal and interest. We suggest the boards consider the following areas to achieve this:

- The objective for amortised cost measurement as stated in the IASB's ED *Financial Instruments: Amortised Cost and Impairment* should be included in the main body of the standard: "The objective of amortised cost measurement is to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument."
- The principle of "solely payments of principal and interest" should explicitly refer to the objective.

- The standard contains no definition of what it considers as 'principal' – different definitions could be used that would render different outcomes in certain situations. The Basis for Conclusions implies that this was considered to be the 'funded' amount by the Board (BC4.23). In its exposure draft, the FASB proposes to define "principal" instead as "the amount transferred by the holder at initial recognition" (ASC 825-10-15-18). We urge the boards to agree on a common definition of principal amount. In defining principal, the boards should consider the interaction with the definition of "interest" and the guidance on prepayment and term extension features. We would be concerned with a definition of "principal" as the amount transferred at initial recognition if that would result in purchased credit impaired assets being disqualified from amortised cost solely because they are prepayable on the basis of the amount originally funded to the debtor rather than the amount transferred by the investor (creditor) at initial recognition. To address this issue, the boards could indicate that a prepayment term that gives the debtor a right to accelerate the payment of the debt on terms that would give the investor more than adequate compensation for the time value of money does not disqualify the feature from meeting the 'solely payment of principal and interest' principle provided the prepayment feature is exercisable only by the debtor (and not by the investor), since the debtor cannot be forced to pay that high return. For similar reasons, we believe a prepayment term that gives the investor a right to accelerate the payment of the debt on terms that would not give the investor adequate compensation for the time value of money should not disqualify the feature from meeting the principle provided the feature is only exercisable by the investor (and not by the debtor), since the investor cannot be forced to accept that low return.
- The definition of 'interest' should be modified. In the current version of IFRS 9 'interest' is defined as "consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time". We think any definition should be clear that other components could form part of interest, such as liquidity premia or profit margins, that do not contradict the notion of "normal lending arrangements". We note that the FASB's exposure draft indicates that interest "may include a premium for liquidity risk." In practice, entities use pricing methodologies, in particular for loan arrangements that use a building block approach (which also reflects the refinancing cost of the entity). We further believe that a further clarification of the concept of 'time value of money' is necessary, in particular whether that concept should reflect the way pricing mechanisms work in the economy where the financial instrument is originated.
- For instruments with contingent cash flows (including prepayment and extension features), we believe the guidance can be improved by noting that any contingent cash flows must be consistent with the objective of amortised cost measurement – e.g., prepayments should only lead to cash flows that represent principal and interest outstanding (which may include an appropriate prepayment penalty – which should be based on market conventions in the respective market) and in the case of extension options, the cash flows after extension must be consistent with the notion of 'principal and interest'. We recommend that the guidance for evaluating contingent features be consistent irrespective of whether they result from a contingent prepayment option, contingent extension option, or other contingent feature. We also note that IFRS 9 refers to 'options' and therefore inadvertently might lead to a conclusion that automatic rights of prepayment are treated differently. We do not think they should, though clarity on this would be helpful. Under our proposed approach, we think the 'ring-fencing' and special rules in IFRS 9 for prepayment and term extension options should be removed.
- The boards should consider providing guidance on what features cannot be subsumed under the heading 'normal lending arrangements'. To achieve that goal we suggest that the boards consider examples of features that it believes should disqualify an instrument from receiving amortised cost treatment, such as equity-linking features, interest multiples, inverse features or inappropriate inflation features. We note that we support the specific guidance on contractually-linked instruments also under our proposed alternative approach.

- The boards should also clarify that non-substantive or non-genuine features, i.e. features that affect the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur, should not be included in the assessment. Similarly, the boards should exempt features that could only have a minimal impact on the cash flows from the assessment.
- While we consider the guidance on contractually linked instruments has been improved, there are several practical issues that are still not covered by this guidance. It should be clarified whether the guidance applies only to beneficial interests in securitised financial assets as defined in ASC 325-40-20. This is relevant to lending transactions with waterfalls outside securitisations (e.g. loan syndications where credit risk is disproportionately shared amongst lenders), which often feature a cash waterfall, but not a loss waterfall. We note that the FASB exposure draft explicitly limits the application of the guidance on contractually linked instruments to beneficial interests in securitised financial assets (see proposed ASC 815-10-55-26). Furthermore it should be clarified whether liquidity facilities or excess spreads provided are considered tranches, even if reallocation takes place in a "single tranche" ABS transaction with a liquidity facility or fund. Also, the proposed amendments give no guidance on whether the actual seizure of collateral in the pool leads to measurement at fair value through profit or loss. In our view, seizing collateral to protect the lender with the intent of monetising the collateral as soon as practically possible should not be precluding amortised cost treatment (assuming the instrument is held within a 'hold to collect' business model).
- Furthermore, we recommend that the boards acknowledge that there are circumstances in which 'normal lending transactions' are not strictly 'at market' (e.g. some subsidised loans may still be considered normal lending transactions).
- Finally, the Board should consider the interaction with the guidance on non-recourse assets and strengthen the guidance so it is clear to constituents when asset-specific risk becomes so significant that in fact the originating entity does not provide lending but is de facto purchasing the risk and/or rewards inherent in an asset. We note that credit risk always includes some form of asset risk, regardless of non-recourse provisions.

Question 4

Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that:

(a) interest revenue, credit impairment and any gain or loss on derecognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and
(b) all other gains and losses are recognised in OCI? If not, why? What do you propose instead and why?

Pending further work by the boards to determine what is the conceptual basis and purpose of other comprehensive income, we support the boards' proposal to introduce a new business model where fair value in the statement of financial position and amortised cost in profit or loss provide useful information.

The dividing line between the business models in IFRS 9(2010) does not leave room for business models in between (e.g. liquidity portfolios of financial institutions). The proposed fair value through OCI business model reflects the duality of some business models: effective interest and impairments as well as gains and losses on derecognition are recognised in profit or loss while the fair value in the statement of financial position delivers the best information on the investing activities.

While we welcome the IASB's intention to resolve some of the accounting issues for insurers, we see challenges in applying the fair value through OCI business model on some assets purchased to match insurance liabilities. The newly introduced business model does not cater for duration mismatched assets that back insurance liabilities where the duration gap is closed using derivatives, as the derivatives will always be held in a fair value through profit or loss business model. The offered fair value option for assets held in a business model at fair value through OCI helps only partially, as it is not revocable. The Board's decision to require a "mirroring approach" for the measurement of the participating insurance liability has partially mitigated the issue because these types of insurance liabilities will be measured with reference to the IFRS amount of the associated assets. We ask the board to consider, as part of its marco hedge accounting project, the use of derivatives by insurers to hedge the duration mismatch arising between financial assets and insurance liabilities. The use of macro hedge accounting could alleviate some of the income volatility that cannot be resolved by the introduction of the third measurement category as proposed in this exposure draft.

In addition, we suggest defining the new category as a residual as this better reflects the dual nature of the model. The remaining business model is neither fully held for sale nor managed primarily on a fair value basis respectively, nor fully held to collect and is therefore between the two. Having the FVTOCI business model as one of the defined business model will unavoidably lead to interpretation issues and potentially divergence in practice. A robust definition of the fair value through profit or loss business model would be helpful in this context and we would suggest as a starting point, "a business model whose primary objective is to obtain cash flows other than via the contractual terms of the asset itself by selling, lending, or other means."

Although we welcome the clearer definition of 'held to collect', there is already divergence in practice about the population of the 'held to collect' business model as a result of applying and interpreting the business model test (e.g. for liquidity portfolios). This is not only an issue within financial institutions. Corporates with a more active treasury function might experience a large impact from the changed definition as a large portion of their portfolios could be subsumed under 'held to collect' in accordance with IFRS 9(2010) but now might be 'held to collect and for sale'. In our view, the dividing line between the 'held to collect' business model and the 'held to collect and for sale' business model is not clear enough and will lead to significant divergence in practice and numerous application questions. We would therefore appreciate clearer application guidelines for transactions and scenarios, such as liquidity portfolios. We note that the FASB has included additional, helpful application guidance in its exposure draft, e.g., on sales that would not be inconsistent with the objective of amortised cost classification (see proposed ASC 825-10-55-31 through 34). We recommend that any application guidance should be in line with the proposed FASB model to avoid creating divergence where the principles are converged.

Additional difficulties arise from having two types of 'fair value through OCI' measurement – one optional for certain equities and one mandatory for certain debt instruments. In our view, without a conceptual basis for OCI, it is still difficult to assess the appropriateness of recognising gains or losses in and recycling them out of OCI upon realisation, in particular when recycling is prohibited for equities accounted for using the option to measure at fair value through OCI and for own credit gains and losses on financial liabilities elected under the fair value option. Hence, we encourage the IASB to address the conceptual basis and the purpose of OCI as well as when and why recycling is appropriate as part of their ongoing conceptual framework project as this has been an area of significant concern of many stakeholders in the past.

Question 5

Do you believe that the Exposure Draft proposes sufficient, operational application guidance on how to distinguish between the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the guidance provided to describe those business models? If not, why? What additional guidance would you propose and why?

We believe that the distinction between the business models is difficult, even under the proposed application guidance. The dividing lines between the models are not sufficiently clear which may lead to significant divergence in practice.

We see difficulties for preparers in distinguishing between the fair value through OCI and the fair value through profit and loss model. In our opinion, the IASB's assumption that in the fair value through profit and loss model the collection of contractual cash flows is incidental is overly simplistic.

Moreover we disagree with the board's proposed amendment that a portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis never would be viewed as managed both to collect contractual cash flows and to sell assets (and therefore could not fall in the fair value through OCI business model). This statement seems appropriate only if the portfolio is managed and its performance is evaluated *primarily* on a fair value basis.

We are concerned that, without reconsideration of this guidance, diversity in practice could occur as the difference between a management based on total return and a management based on fair value is unclear.

The boards should add guidance for trading portfolios where some or even many of the assets are held until maturity as it is the opportunistic decision-making process that triggers the sales. From our point of view it would therefore be more appropriate to define the fair value through OCI business model as a residual business model instead of having the fair value through profit or loss business model as the residual model. As noted in our response to Question 4, a clear definition of the fair value through profit or loss business model would be helpful in this context.

In an amortised cost business model the only justified reason for selling instruments regardless of frequency, volumes or remaining maturity is credit deterioration. The reasoning behind this guidance is the presumed impaired ability to collect the contractual cash flows. We find it difficult to understand whether this can be seen as a principle and therefore sales that are made on grounds of an increased country risk or restrictions imposed by governments to transfer funds would also be permissible. We suggest clarifying that it is permissible to sell assets in an amortised cost business model as a result of potential inability to collect contractual cash flows, which may occur in circumstances other than default by the issuer. These circumstances would be exceptional situations that are not in the normal course of business and could include a major liquidity crisis or a major change a regulation. In this course, it would be helpful if the IASB provided guidance on the terms "frequent", "unanticipated liquidity needs", "stress test scenarios" and "volume". We note that some consider the proposed guidance as being stricter than the existing guidance for 'held to maturity' financial assets in IAS 39. We believe that this has not been the Board's intention. Again, we note that the FASB has included additional, helpful application guidance in its exposure draft, e.g., on sales that would not be inconsistent with the objective of amortised cost classification (see proposed ASC 825-10-55-31 through 34) and recommend that the IASB incorporate this guidance in the final standard.

It should also be clarified whether sales from a portfolio held in an amortised cost business model trigger reclassification of the entire portfolio or if only new business can no longer qualify for an amortised cost

business model as well as whether internal transfers of instruments between portfolios can be indicative of a change in business model and can therefore trigger reclassification or whether the guidance only relates to external trades. Similarly, we believe that clarification is needed that an anticipated sale of an entire business that includes instruments under an amortised cost business model does not trigger reclassification of these instruments.

In summary, we suggest the boards clarify the objective and principle behind the three business models and reconcile their guidance with the principle. We appreciate as this is a fairly judgemental assessment, there might be an increased need for guidance on how to apply that judgement in specific situations.

Question 6

Do you agree that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI? If not, why and what would you propose instead?

We agree with the extension of the fair value option to financial assets that would otherwise be measured at fair value through OCI. We note, however, that the FASB also have a fair value through profit or loss option for debt instruments held that would be classified as at fair value through OCI but does not include a qualifying criteria, yet the IASB's has an accounting mismatch qualifying criteria. Our preference is that the boards should retain a fair value through profit or loss option for debt instruments held that would otherwise be measured at amortised cost or fair value through OCI but that option be unrestricted (like proposed by the FASB for fair value through OCI assets). As the option can only be designated at initial recognition and is irrecoverable we see little ability for the option to be subject to abuse. We are therefore not supportive of the need for entities to have to prove whether an accounting mismatch is eliminated or significantly reduced. Our preference is for entities that use the fair value option to instead disclose why they have chosen the option. At a minimum, in light of the difference between the boards, we urge the boards to reconsider their respective proposed requirements in this area.

Question 7

Do you agree that an entity that chooses to early apply IFRS 9 after the completed version of IFRS 9 is issued should be required to apply the completed version of IFRS 9 (ie including all chapters)? If not, why? Do you believe that the proposed six-month period between the issuance of the completed version of IFRS 9 and when the prohibition on newly applying previous versions of IFRS 9 becomes effective is sufficient? If not, what would be an appropriate period and why?

We support the objective of the Board to reduce the number of versions of IFRS 9 that can be applied to improve comparability going forward. We also support the six month period granted after the publication of the final standard for existing IFRS preparers until the prohibition to apply previous versions becomes effective given the expected timeframe for phase 2 (impairment) and phase three (general hedge accounting) of IFRS 9. However, we ask the boards to reconsider this decision depending on progress on the other phases of the project. Furthermore, please refer to our concerns on the proposed restriction with regard to first-time adopters in question 9.

We ask the boards to provide clarity to constituents regarding the effective date of IFRS 9. While we do not favour providing a specific effective date before all phases are finalised, we suggest communicating the envisaged period between finalisation of the standard and the effective dates.

Question 8

Do you agree that entities should be permitted to choose to early apply only the 'own credit' provisions in IFRS 9 once the completed version of IFRS 9 is issued? If not, why and what do you propose instead?

While we agree with the Board that the amended guidance on the accounting for 'own credit', which we believe provides the superior accounting outcome, should be available as soon as possible we think the way forward chosen by the Board is not appropriate. Firstly, IAS 39 will remain the applicable standard on financial instruments accounting for a prolonged period, in particular as there is a risk of deferral of the effective date due to delays in finalising the standard and potentially from the interaction with the insurance project. Secondly, we think that permitting early application of a particular part of IFRS 9 defeats the objective of comparability and also will lead to request to make other parts of IFRS 9 available for early application without having to adopt the full suite of IFRS 9 provisions.

For these reasons, we suggest introducing the 'own credit' provisions via an amendment to IAS 39. We believe that such an amendment would improve current financial reporting and could be made on a timely basis without suggesting any undue delay to the completion of IFRS 9 as other amendments have been made to IAS 39 (for example, the current proposals on hedge accounting and the novation of derivatives) since the issuance of the first phase of IFRS 9.

We also note that under the proposals in the ED entities that are already applying IFRS 9 in the version published in November 2009 would be precluded from applying early the improved accounting for 'own credit'. We suggest that the Board draft the transition provisions in a way to also enable those entities to apply the new accounting requirements for 'own credit'.

Question 9

Do you believe there are considerations unique to first-time adopters that the IASB should consider for the transition to IFRS 9? If so, what are those considerations?

First-time adopters might have difficulties applying IFRS 9 early if the IASB does not provide some relief from the prohibition to use previous versions of IFRS 9 six months after the publication of the final version of IFRS 9. For example, assume the final version of IFRS 9 (then including the impairment provisions) was issued 30 September 2013, which means that from 31 March 2014 only the latest version of IFRS 9 could be applied early. If an entity's date of transition to IFRSs was 1 April 2012 and, hence, its first IFRS reporting period ends 31 March 2014 it could either:

(a) Choose to apply IAS 39 in full and face the challenge of applying a second transition from IAS 39 to IFRS 9 once IFRS 9 becomes mandatorily effective; or
(b) Choose to apply IFRS 9 in full and face the challenge of having to implement the new impairment provisions within a 6-months timeframe

Given that the new impairment model, as acknowledged by the IASB, requires significant lead time, many first-time adopters might be forced to use IAS 39 in such situations. This seems unsatisfactory given the cost of facing two rounds of implementation and keeping entities from adopting as early as possible a supposedly better standard.

Hence, we ask the IASB to provide relief for first-time adopters of IFRS by permitting them with a choice to apply previous versions of IFRS 9. Such a transition relief should have a limited life only as the concerns above are valid only for a limited period of time.

In addition, as noted in our response to Question 7, we encourage the Board to revisit these provisions as each phase of IFRS 9 is completed.

Other issues

We urge the IASB and FASB to reconcile any remaining differences in their respective classification and measurement models as far as possible. On the following issues, we generally believe the FASB's proposed approach is superior and recommend that the IASB adopts it, as appropriate:

- *Reclassification date for financial assets.* Proposed ASC 825-10-35-23 specifies that a financial asset be reclassified as of the last day of the reporting period in which the change in business model occurs rather defining the reclassification date as the first day of the next reporting period as in Appendix A of IFRS 9. We believe financial statements are more useful if a change in business model is reflected in the financial statements and disclosed in the period in which the change occurs, rather than on a delayed basis.
- *Loan commitments, revolving lines of credit, and commercial letters of credit (proposed ASC 825-10-35-20 through 35-21).* Unless the likelihood that a loan commitment, revolving line of credit or commercial letter of credit will result in the extension of credit is remote, the creditor would account for the contract on the same basis as the resulting loan (that is, at fair value through net income, fair value through OCI, or amortised cost, as appropriate.

We also note that the FASB's exposure draft contains helpful guidance in the following area and recommend that the IASB consider incorporating this guidance into IFRSs, as appropriate:

- *Identifying an amortised cost business model (proposed ASC 825-10-55-30 through 55-34)*. The FASB has included additional, helpful application guidance in its exposure draft, e.g., on sales that would not be inconsistent with the objective of amortised cost classification.

In the following areas, we generally favour the IASB's approach over the FASB's approach and, accordingly, recommend that the FASB adopts the IASB's guidance, as appropriate:

- *Method for computing foreign currency gains and losses on monetary items in the fair value through OCI category.* We believe IASB's method (IFRS 9:B5.7.2 and IG E3.4) is conceptually superior to the FASB's fair value based method (proposed ASC 825-10-45-15), since the FASB's method is inconsistent with how foreign currency gains and losses are computed for financial instruments measured at amortised cost.

On the following issues we disagree with both boards' approaches and favour an alternative approach:

- *Fair value option.* The IASB require an accounting mismatch to be eliminated or significantly reduced in order designate a financial asset at fair value through profit or loss that would otherwise be measured at fair value through OCI or amortised cost. The FASB permits an asset that would be measured at fair value through OCI to be measured at fair value through profit or loss but does not have a qualifying criterion. Our preference would be retain an unrestricted irrecoverable fair value through profit or loss option for debt instruments held that is designated at initial recognition only for assets that would be measured otherwise at amortised cost or fair value through OCI. In all cases disclosure should be required as to the reasons why the entity has chosen to use the fair value option.

Finally, we recommend that the boards work together to reach agreement on converged guidance on the following issues:

- *Initial measurement of financial instruments.* While the resulting amounts may be similar in many cases, IFRS 9 and the FASB's exposure draft contains different guidance for how to determine the initial measurement of financial assets and financial liabilities not subsequently measured at fair value through profit or loss. We note that questions have been raised in practice around the initial measurement of loans given by development banks and would welcome further guidance in this area.
- *Ability to account for investments in associates at fair value through profit or loss.* The FASB proposes that equity investments that are held for sale when they initially qualify for the equity method of accounting should be required to be accounted for at fair value through net income unless they qualify for a practical expedient (proposed ASC 323-10-15-4(e)). The IASB does not include this requirement.
- *Ability to account for equity investments at fair value through OCI.* Unlike IFRS 9:5.7.5, the FASB is not proposing to permit an entity to account for equity investments at fair value through OCI. As stated in our September 2009 comment letter on IASB ED 2009/7, we do not believe it is meaningful to recognise fair value gains and losses on equity investments in OCI without subsequent recognition in the income statement. Although our preference is for the measurement of equity investments at fair value through profit or loss, we believe that, if equity investments are eligible for classification as fair value through OCI, gains and losses initially recognised in OCI should be reclassified to profit or loss on derecognition of the instrument.
- *Practicability exception from fair value measurement for equity investments without readily determinable fair values (proposed ASC 825-10-35-17).* Under the practicability exception, an entity would be permitted to elect to measure an equity investment without a readily determinable fair value at its cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical investment or a similar investment of the same issuer.