IFRS

STAFF PAPER

September 2017

IFRS® Interpretations Committee Meeting

Project	**IFRS 9 *Financial Instruments*—Financial assets eligible for the election to present changes in fair value in other comprehensive income**
Paper topic	Agenda decision to finalise

CONTACT(S) Craig Smith csmith@ifrs.org +44 (0)20 7246 6410

Introduction

1. The IFRS Interpretations Committee (Committee) received a request to clarify whether particular financial instruments are eligible for the presentation election in paragraph 4.1.4 of IFRS 9 *Financial Instruments*. That election permits the holder of particular investments in equity instruments to present subsequent changes in fair value in other comprehensive income, rather than in profit or loss. The submitter asked whether financial instruments are eligible for that presentation election if the issuer would classify them as equity applying paragraphs 16A–16D of IAS 32 *Financial Instruments: Presentation*.

2. The Committee observed that the presentation election in paragraph 4.1.4 of IFRS 9 refers to particular investments in *equity instruments*. ‘Equity instrument’ is a defined term, and Appendix A of IFRS 9 specifies that it is defined in paragraph 11 of IAS 32. IAS 32 defines an equity instrument as ‘any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities’. Consequently, a financial instrument that meets the definition of a financial liability cannot meet the definition of an equity instrument.

3. The Committee also observed that paragraph 11 of IAS 32 specifies that, as an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument by the issuer if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of IAS 32.

4. Accordingly, the Committee concluded that a financial instrument that has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of IAS 32 is not eligible for the presentation election in paragraph 4.1.4 of IFRS 9. This is because such an instrument does not meet the definition of an equity instrument in IAS 32. This conclusion is supported by the Board's explanation in paragraph BC5.21 of IFRS 9 of its decision in this respect.

5. The Committee concluded that the requirements in IFRS 9 provide an adequate basis for the holder of the particular instruments described in the submission to classify such instruments. In the light of the existing requirements in IFRS Standards, the Committee tentatively determined that neither an IFRIC Interpretation nor an amendment to a Standard was necessary. Consequently, the Committee tentatively decided not to add this matter to its standard-setting agenda.

6. The purpose of this paper is to:

   (a) analyse the comments received on the tentative agenda decision; and

   (b) ask the Committee if it agrees with our recommendation to finalise the agenda decision.

Comment letter summary and staff analysis

7. We received three comment letters, reproduced in Appendix B to this paper.

8. Deloitte agree with the Committee's decision not to add this issue to its standard-setting agenda for the reasons outlined in the tentative agenda decision.

9. ANC and Mazars also agree with the Committee's analysis of the relevant requirements in IFRS 9 and IAS 32, and the conclusion that the particular financial

instruments described in the submission are not eligible for the presentation election in paragraph 4.1.4 of IFRS 9. However, those respondents raise a wider concern about the accounting treatment for long-term investments and encourage the Board to reopen discussions on that matter. In addition, ANC says that important guidance on that presentation election is set out in the Basis for Conclusions on IFRS 9 rather than in the Standard itself.

10. Respondents' comments, together with our analysis, are presented below.

Explanation in the Basis for Conclusions

Concern raised by respondent

11. ANC says that there is 'significant guidance' on the application of the presentation election set out in the Basis for Conclusions on IFRS 9—most notably in paragraph BC5.21.

Staff analysis

12. We acknowledge that paragraph BC5.21 in the Basis for Conclusions on IFRS 9 is helpful because it directly addresses the particular instruments described in the submission, and explains that such instruments are not eligible for the presentation election in paragraph 4.1.4 of IFRS 9. However, we think the requirements in IFRS 9 and IAS 32 provide a clear and adequate basis for the holder to classify those instruments.

13. As noted in paragraph 2 of this paper, the presentation election in paragraph 4.1.4 of IFRS 9 refers to particular investments in *equity instruments.* 'Equity instrument' is a defined term, and Appendix A of IFRS 9 specifies that it is defined in paragraph 11 of IAS 32. Thus the presentation election applies only to instruments that meet the definition of an equity instrument in IAS 32. The instruments described in paragraphs 16A–16D of IAS 32 (ie puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation) do not meet the definition of an equity instrument. That is

because, as stated in paragraph 11 of IAS 32, they meet the definition of a financial liability (emphasis added):

> As an exception, an instrument that **meets the definition of a financial liability** is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

14. As described in paragraph 17 of Agenda Paper 2 for the May 2017 Committee meeting, the Board explained this outcome in paragraph BC5.21 of the Basis for Conclusions on IFRS 9 to respond to a request from some interested parties for additional clarity. We think that paragraph merely confirms a particular effect of the Board's decisions.

15. We think no further action is required by the Committee in this respect.

Long-term investments

Concern raised by respondent

16. Both ANC and Mazars express wider concerns about the accounting requirements in IFRS 9 for the instruments described in the submission. Specifically, these respondents express concern that the scope of the presentation election in paragraph 4.1.4 of IFRS 9 could result in a different outcome for a direct investment in an equity instrument compared to an indirect investment (ie through an investment fund). Those respondents question the reasonableness of such a distinction when both instruments are held for long-term investment purposes.

17. Both ANC and Mazars ask the Board to reconsider the accounting for such long-term investments. ANC highlights that the European Commission has asked EFRAG to issue a report on the impact of IFRS 9 on long-term investments.

Staff analysis

18. We think these concerns are outside the scope of the question submitted—the accounting for long-term investments is a broader issue than that addressed in the tentative agenda decision.

19. As noted in paragraph 19 of Agenda Paper 2 for the May 2017 Committee meeting, the Board intentionally designed the presentation election in paragraph 4.1.4 of IFRS 9 to apply to a narrow population of investments in equity instruments. We understand that the Board is aware of both the concerns described in paragraph 16 of this paper and the ongoing analysis being undertaken by EFRAG relating to the accounting requirements for long-term investments. Furthermore, we update the Board on all matters discussed by the Committee after each Committee meeting, and will include this matter in the next such update.

20. We think that no further action is required by the Committee in this respect.

Staff recommendation

21. Based on our analysis, we recommend confirming the tentative agenda decision as published in the IFRIC Update in May 2017 with no changes. Appendix A to this paper outlines the draft wording for the final agenda decision.

Question for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision outlined in Appendix A to this paper?

Appendix A—Proposed wording for final agenda decision

A1. We propose the following wording for the final agenda decision, which is unchanged from the tentative agenda decision except to remove the square brackets in the last paragraph.

IFRS 9 *Financial Instruments*—Financial assets eligible for the election to present changes in fair value in other comprehensive income

The Committee received a request to clarify whether particular financial instruments are eligible for the presentation election in paragraph 4.1.4 of IFRS 9. That election permits the holder of particular investments in equity instruments to present subsequent changes in fair value in other comprehensive income, rather than in profit or loss. The submitter asked whether financial instruments are eligible for that presentation election if the issuer would classify them as equity applying paragraphs 16A–16D of IAS 32 *Financial Instruments: Presentation*.

The Committee observed that the presentation election in paragraph 4.1.4 of IFRS 9 refers to particular investments in equity instruments. ‘Equity instrument’ is a defined term, and Appendix A of IFRS 9 specifies that it is defined in paragraph 11 of IAS 32. IAS 32 defines an equity instrument as ‘any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities’. Consequently, a financial instrument that meets the definition of a financial liability cannot meet the definition of an equity instrument.

The Committee also observed that paragraph 11 of IAS 32 specifies that, as an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument by the issuer if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of IAS 32.

Accordingly, the Committee concluded that a financial instrument that has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of IAS 32 is not eligible for the presentation election in paragraph 4.1.4 of IFRS 9.

This is because such an instrument does not meet the definition of an equity instrument in IAS 32. This conclusion is supported by the Board's explanation in paragraph BC5.21 of IFRS 9 of its decision in this respect.

The Committee concluded that the requirements in IFRS 9 provide an adequate basis for the holder of the particular instruments described in the submission to classify such instruments. In the light of the existing requirements in IFRS Standards, the Committee ~~[~~determined~~]~~ that neither an IFRIC Interpretation nor an amendment to a Standard was necessary. Consequently, the Committee ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda.

Appendix B—Comment letters

Deloitte.

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

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

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

13 June 2017

Sue Lloyd
Chair
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Dear Ms Lloyd

Tentative agenda decision – IFRS 9 *Financial Instruments*: Financial assets available for the election to present changes in fair value in other comprehensive income

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the May IFRIC Update of the tentative agenda decision not to take onto the Committee's agenda the request for clarification on whether financial instruments are eligible for the election to present changes in fair value in other comprehensive income in other comprehensive income if the issuer would present them as equity applying paragraphs 16A-16D of IAS 32 *Financial Instruments: Presentation*.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

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RÉPUBLIQUE FRANÇAISE

AUTORITÉ DES NORMES COMPTABLES
5, PLACE DES VINS DE FRANCE
75573 PARIS CÉDEX 12
Phone (+ 33 1) 53.44.28 53
Internet http://www.anc.gouv.fr/
Mel patrick.de-cambourg@anc.gouv.fr

Paris, the 5th July 2017

Chairman

PdC N° 67

Mrs Lloyd
IFRS Interpretations Committee
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

May 2017- IFRS-IC tentative agenda decision – IFRS 9 Financial Instruments – Financial assets eligible for the election to present changes in fair value in other comprehensive income

Dear Mrs Lloyd,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned IFRS IC tentative decision published in May 2017 IFRIC Update regarding "IFRS 9 Financial Instruments – Financial assets eligible for the election to present changes in fair value in other comprehensive income". This letter sets out some of the most critical comments raised by interested stakeholders involved in ANC's due process.

IFRS-IC's conclusion relies on basis for conclusions expressing the Board's decision

The IFRIC Update reports that "*the Committee observed that the presentation election in paragraph 4.1.4 of IFRS 9 refers to particular investments in equity instruments. 'Equity instrument' is a defined term, and Appendix A of IFRS 9 specifies that it is defined in paragraph 11 of IAS 32*." IAS 32.11 specifies that, *"as an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument by the issuer if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D"* of IAS 32.

Supported by paragraph BC 5.21 of IFRS 9, the Committee concluded that it was the Board's decision to consider that, even if such instrument "*is classified as equity*", it does "*not meet the definition of an equity instrument*".

ANC goes along with the IFRS-IC referring to a Board's decision (IFRS 9.BC 5.21) to exclude such instruments from the election to present changes in fair value in OCI. ANC is however concerned that such significant guidance is expressed in the basis for conclusions instead of the standard itself. A clear distinction between board's decisions (expressed in the standard) and basis for conclusions (explaining that decision) would provide clarification on the initial intent of the board introducing "an exception to the definition" (as expressed for instance in IAS 32.BC 67, not referring to classification). This would as well enhance the endorsement process. In ANC's view the "classification" vs. "definition" issue could be clarified in the FICE project.

Long-term investment

Moreover, this issue brings to light one aspect of a broader concern raised during the endorsement process regarding long-term investment. Indeed, asset managers often use puttable instruments (such as shares in mutual funds) to manage their portfolios. The IFRS-IC decision confirms an accounting treatment according to which puttable instruments not only will not benefit from the § 4.1.4 equity treatment, but also would not pass the SPPI test and therefore would have to be measured at fair value through P&L. This would increase the volatility in the P&L deterring assets managers with long term liabilities from using such tools.

These concerns have already been raised during the IFRS 9 endorsement process and have led the European Parliament to request a careful impact assessment of the standard on long-term investment. In a recent letter, the European Commission has requested the EFRAG to issue a detailed report. We therefore encourage IASB to shortly address that issue and reopen discussions on it.

Yours sincerely,

Patrick de Cambourg

MAZARS

Mrs Sue Lloyd
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

La Défense, July 05, 2017

IFRIC Update May 2017 - Tentative Agenda Decisions – IFRS 9 Financial Instruments - Financial assets eligible for the election to present changes in fair value in other comprehensive income

Dear Sue,

Mazars is pleased to comment on the IFRS Interpretations Committee tentative agenda decision published in the May 2017 IFRIC Update.

We agree that, as IFRS 9 is drafted, a financial instrument that does not meet the definition of an equity instrument according to IAS 32 is not eligible for the presentation election in paragraph 4.1.4 of IFRS 9. Indeed, it is our understanding that paragraphs 16A and 16B or paragraphs 16C and 16D of IAS 32 provide presentation exceptions for financial instruments that do not meet the definition of an equity instrument. We agree that paragraph 4.1.4 of IFRS 9 uses the reference to the defined term "equity instrument" as a reference to IAS 32 definition that does not include the presentation exception for puttable instruments.

Beyond this technical question, we share the fundamental concern of the submission on the accounting treatment of UCITS funds and equity mutual funds under IFRS 9. When limiting the FVTOCI option to equity instruments that are not held for trading, IFRS 9 introduced a significant difference between investing in UCITS and equity mutual funds, and the direct investment in the underlying equity instruments, for which the option is available. We are concerned that for an identical performance and management process, IFRS 9 provides so different impacts within comprehensive income.

Paragraph BCE.67 of IFRS 9 also states that reflecting changes in fair value to profit and loss would not be relevant for some equity investments, when such investments are held for strategic purposes. The paragraph adds that this presentation choice was designated for circumstances in which these fair value changes were not relevant to profit and loss, but was not limited to these circumstances.

We consider that the circumstances identified by paragraph BCE.67 of IFRS 9, for which the Board has concluded that information about fair value may not be relevant to profit or loss, could occur on UCITS funds and equity mutual funds investment. This is particularly the case within specific business model of long-term investors.

We therefore encourage the Board to address this issue.

Should you have any questions regarding the above comments, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin **Edouard Fossat**

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