Comments on Exposure Draft titled Amendments to the Classification and Measurement of Financial Instruments

Question 1—Derecognition of a financial liability settled through electronic transfer
Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity. Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal. Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

We agree with the proposed paragraphs B3.3.8 and B3.3.9. However, we have our reservations with the way paragraph B3.1.2A has been worded. The problem was with derecognition of financial instruments and not recognition. However, paragraph B3.1.2A has made the amendments applicable to recognition too.

IFRS 9 talks of three dates:

Commitment date;

Trade Date; and

Settlement date

Para 3.1.1. requires financial assets and financial liabilities to be recognised when the entity becomes a party to the contract. Para B3.1.2 provides guidance on application of para 3.1.1 with examples of different types of financial assets and financial liabilities such as unconditional receivables and payables, firm commitments to buy or sell a non-financial item, forward contract, option contract and planned future transactions. In case of firm commitment to buy or sell a non-financial item and forward contract, para B3.1.2 requires recognition on commitment date. However, standard does not explain or define commitment date. In normal parlance, commitment date is the date when a party commits itself to the contract. Therefore, reading para 3.1.1 and B3.1.2, we understand that financial assets and financial liabilities are to be recognised on commitment date.

Para 3.1.2 states that a regular way purchase or sale shall be recognised and derecognised using either trade date or settlement date accounting. Therefore, the notion of trade date and settlement date arises from the requirement to differentiate regular way purchase or sale from other financial assets and financial liabilities. Other financial assets and financial liabilities are to be recognised on commitment date which may be either trade date or settlement date.

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Para B3.1.5 explains trade date as the date an entity commits itself to purchase or sell an asset. Thus, reading this, one would conclude that trade date is commitment date and therefore, all financial assets and financial liabilities other than regular way purchase or sale are recognised on trade date. However, para B3.1.5 also says the title does not pass on trade date. Title passes on settlement date. Para B3.1.6 explains settlement date as the date an asset is delivered to or by an entity. Now reading this, one is confused whether commitment date is trade date or settlement date. A commitment has no meaning if no title passes and no asset is delivered to or by an entity on the commitment date. Therefore, one may conclude that commitment date is the settlement date when title passes because recognition of financial asset or financial liability other than regular way purchase or sale happens when title passes. However, specifying that recognition happens on settlement date in a new para below para B3.1.2 which requires recognition on commitment date makes the recognition requirements extremely confusing.

The issue was with derecognition of financial assets and financial liabilities. It is not clear why the IASB is then proposing changes to date of recognition. Proposed para B3.1.2A will only increase the confusion because para B3.1.2 uses commitment date and not settlement date. Clarifying that commitment date is settlement date could have other consequences. Para B3.1.1 says that a transferred financial asset can be recognised by the transferee only if derecognised by the transferor. Derecognition happens on settlement date. Thus, transferred financial assets can be recognised only on settlement date. However, originated financial assets and financial liabilities are recognised on commitment date. To remove the confusion, we recommend that IASB may specify in proposed para B3.1.2A as follows:

When ~~recognising or~~ derecognising a financial asset or financial liability, an entity shall apply settlement date accounting (see paragraph B3.1.6) unless paragraph B3.1.3 applies or an entity elects to apply paragraph B3.3.8.

Question 2—Classification of financial assets—contractual terms that are consistent with a basic lending arrangement

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:

(a) interest for the purposes of applying paragraph B4.1.7A; and

(b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

The proposals only increase the complexity. Paragraph B4.1.8A states that the assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives. The same para at the end states that a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks and costs. The term 'magnitude' looks into how much compensation an entity receives. Thus, the paragraph is internally inconsistent. On one hand, it asks entities to not look into the magnitude of compensation whereas on the other hand it asks entities to look into the magnitude of compensation.

Paragraph BC62 states that in addition to knowing what would give rise to a change in cash flows, the entity must also know what the adjustment to the cash flows would be in order for it to conclude that contractual cash flows are SPPI. Thus, paragraph BC62 contrary to para B4.1.8A requires entity to equally focus on how much compensation an entity receives. Therefore, in our view, the proposals in paragraph B4.1.8A only add to the confusion already prevailing over the assessment of 'basic lending arrangement.'

The IASB may consider removing the inconsistencies in proposed paragraph B4.1.8A and the inconsistency with basis for conclusions with regard to magnitude of compensation or how much compensation an entity receives. To clarify 'basic lending arrangement', the IASB may considering incorporating the following in application guidance which is currently specified in BC52 of the Exposure Draft:

In a basic lending arrangement, a lender lends a principal amount to a borrower for a specified term (which may be contractually shortened or extended) in exchange for the contractual right to receive payments of principal and interest representing compensation for risks and costs associated with holding the financial asset. There is, therefore, a relationship between the perceived risk the lender is taking on and the compensation it receives for that risk. For example, an increase in the credit risk of a borrower is reflected in an increase, and not a decrease, in the interest rate of the financial asset.

Paragraph B4.1.10A states that a change in contractual cash flows to be consistent with a basic lending arrangement, the occurrence (or non-occurrence) of the contingent event must be specific to the debtor. The occurrence of a contingent event is specific to the debtor if it depends on the debtor achieving a contractually specified target, even if the same target is included in other contracts for other debtors. However, the resulting contractual cash flows must represent neither an investment in the debtor nor an exposure to the performance of specified assets. An example to para B4.1.13 has been added where a loan with an interest rate that is periodically adjusted by a specified number of basis points if the debtor achieves a contractually specified reduction in greenhouse gas emissions is regarded as specific to the debtor. The analysis further states that the contractual cash flows represent neither an investment in the debtor nor an exposure to the performance of specified assets.

We are at a loss to understand that

a. change in contractual cash flows based on achievement of reduction in greenhouse gas emission represents compensation for risks and costs associated with holding the financial asset (See Para BC52); and

b. the achievement of contractually specified reduction in greenhouse gas emissions is not an exposure to the performance of assets that emit the greenhouse gases.

In substance, the loan changes the cash flows of the contract based on performance of the assets because the gases are to be emitted from the assets and not by the debtor as such. The achievement of the contractually specified target is based on performance of the assets for which the loan is granted. Does the IASB require entities not to look at the substance but at the form of the contract? Does the IASB mean that the borrowing must not be for specified assets but must be general in nature for the achievement of contractually specified target to be related to the debtor rather than to the performance of assets of the debtor? If that be so, the IASB must clarify the same in para B4.1.10A. In our view, a contractually specified target can be said to be specific to the debtor and not to performance of assets of debtor when the contract does not specify or identify the assets for which the loan is granted. Therefore, for loans where the assets are specified or identified and target for reduction of greenhouse gas emissions change the contractual cash flows, the same cannot be regarded as specific to the debtor and thus would fail the SPPI test. The IASB must clarify the above by specifying in the example whether the loan specifies / identifies the assets for which the same is granted. The IASB must clarify by adding further examples to differentiate between loans granted as specific to the assets and loan granted generally. This is because for specific borrowings the contractually specified target of reduction of greenhouse gas emissions is related to the performance of those assets and not specific to the debtor. However, in case of loans granted as general

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borrowings the target for reduction of greenhouse gas emissions is related to performance of overall assets of the debtor and thus, specific to the debtor and not to the performance of specified assets.

Question 3—Classification of financial assets—financial assets with non-recourse features

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term 'non-recourse'.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

The proposals though clarify the meaning of 'non-recourse loan' do not provide sufficient clarity as regards when an entity must apply look through approach and examples of non-recourse financial assets. For example, company in India has reclassified investment in mutual funds from fair value through profit or loss to amortised cost looking through the underlying assets and churn in the underlying assets of the fund claiming that the cash flows generated from underlying assets meet SPPI criterion. An extract of the accounting policy disclosed by the company audited by one of the firms associated with big 4 firms is given below:

> In case of fixed maturity plans (FMP), they are measured at amortised cost, if the Company intends to hold the FMPs to maturity. Further, the Company applies amortised cost for those FMPs where the Company is able to demonstrate that the underlying instruments in the portfolio would fulfill the SPPI test and the churn in the underlying portfolio is negligible. These conditions are assessed at each Balance Sheet date. If these conditions are not fulfilled, then FMPs are valued at FVTPL.

The independent auditor's report has reported the following as key audit matter:

Key Audit Matter

The Company has investments aggregating Rs.17,936.64 crore in equity shares, bonds, liquid mutual funds, short term funds, fixed maturity plans ('FMPs') and commercial papers as at 31 March 2019. These investments are measured either at amortised cost, Fair Value through Profit and Loss ('FVTPL') or Fair Value through Other Comprehensive Income ('FVTOCI') based on fulfilment of required criteria which involve management judgment. Of the above total investments, the Company's investments in FMPs as at 31 March 2019 amounted to Rs.12,338.10 crore (63% of total investments). These investments were measured at FVTPL till 31 March 2018. The Company applies amortised cost, where it has ability to demonstrate that the underlying instruments in the portfolio fulfil the solely payments of principal and interest ('SPPI') test and

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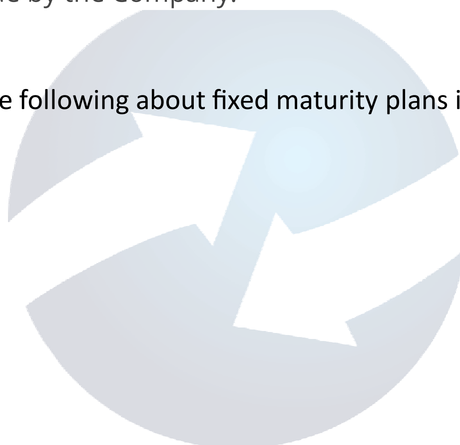
the churn in the portfolio is negligible. As these conditions have been fulfilled effective from 1 April 2018, the Company, has classified FMPs, as subsequently measured at amortised cost.

How was the matter addressed by auditor?

Our audit procedures included the following:

+ Read the minutes of the meetings of the Investment Committee.
+ Performed test of controls on a sample basis on the operating effectiveness of internal controls on investments.
+ Tested on a sample basis, the investments underlying the FMPs to ascertain whether those investments would satisfy the conditions of Ind AS.
+ Compared on a sample basis the indicative yields used by the Company for accounting for interest income on amortised cost basis, with the actual yields earned by the Company on those FMPs at the time of redemption.
+ Tested on a sample basis the portfolio churn in case of FMPs to ascertain whether majority of the instruments in the FMP are held till maturity.
+ Obtained management representations on the judgments exercised, including indicative yields and maturity periods considered for amortised cost workings.
+ Tested the disclosures made by the Company.



The company has disclosed the following about fixed maturity plans in notes:

	In Fixed Maturity Plans				
	Unquoted:				
20,000,000	(13,468,504) Units of Axis Fixed Term Plan Direct Growth	21.23	–	–	18.84
2,062,000,000	(1,756,838,585) Units of Aditya Birla Sun Life Fixed Term Plan Direct Growth	2,196.77	1,077.61	24.15	922.58
615,000,000	(295,000,000) Units of DSP Blackrock Fixed Maturity Plan Direct Growth	666.52	303.84	–	–
2,060,000	(244,042,741) Units of DHFL Pramerica Fixed Maturity Direct Plan Growth (Formerly known as DWS)	204.83	148.46	24.20	318.37
911,000,000	(384,000,000) Units of HDFC Fixed Maturity Plan Direct Growth	904.38	262.18	64.16	165.46
1,976,000,000	(1,552,000,000) Units of ICICI - Prudential Fixed Maturity Plan Direct Growth	1,958.49	1,216.76	219.53	511.52
213,000,000	(225,184,414) Units of IDFC Fixed Term Plan Direct Growth	233.27	163.94	–	89.87
1,653,000,000	(1,160,790,148) Units of Kotak Fixed Maturity Plan Direct Growth	1,634.27	770.03	152.11	549.14
170,000,000	(44,224,052) Units of L & T Fixed Maturity Plan Direct Growth	178.17	15.27	–	40.48
1,622,000,000	(1,506,393,253) Units of Reliance Fixed Horizon Fund Direct Growth	1,408.70	987.80	414.95	739.87
315,000,000	(400,000,000) Units of Religare Invesco Fixed Maturity Plan Direct Growth	339.43	173.52	–	289.90
922,000,000	(749,788,719) Units of SBI Debt Fund Direct Growth	847.99	296.45	151.20	586.30
125,000,000	(300,000,000) Units of Sundaram Fixed Term Plan Direct Growth	75.03	89.30	68.74	268.59
100,000,000	(109,908,036) Units of Tata Fixed Maturity Plan Direct Growth	106.32	25.13	–	119.40
408,000,000	(624,000,000) Units of UTI Fixed Maturity Plan Direct Growth	428.00	225.54	15.67	502.42
	Amortised cost as at 31 March 2019/ Fair value through P&L as at 31 March 2018	11,203.40	5,755.83	1,134.71	5,122.74

As can be seen there is no movement in the units of the fund. Thus, the company has reclassified the funds once measured at fair value through profit or loss without applying look through approach to amortised cost by applying look through approach in the next year.

We want the IASB to focus on the appropriateness of the judgements made to reclassify the investment in fixed maturity plans as at amortised cost and the application of look through approach for investment in mutual fund. Whether such a reclassification is proper? Whether the assessment of contractual cash flow characteristics is done at the beginning of every reporting period? In the given case, the funds are the same in the previous year and current year. Therefore, there was no change in contractual cash flow characteristics of the financial asset. The company classified the funds as at fair value through profit or loss because it was not able to demonstrate that the underlying instruments in the portfolio fulfil the solely payments of principal and interest ('SPPI') test and that the churn in the portfolio is negligible when it recognised those funds. The company obtained that demonstration ability subsequently and reclassified based on the demonstration at the beginning of the current year. Whether the determination of contractual cash flows meeting SPPI criterion is a matter of demonstration by the entity of the actual movement in cash flows regardless of what the

contractual terms may be? Whether an entity is required to apply look through approach for investment in mutual fund? If the cash flows of the mutual fund depend on the gains realised from sale of underlying assets, can that mutual fund be regarded as meeting SPPI criterion looking through the cash flows of the underlying assets and the actual or estimated churn in those assets while ignoring the contractual terms giving rise to cash flows of the mutual fund as such? Whether actual or estimated churn in underlying assets of mutual fund needs to be looked at for determining SPPI criterion?

Paragraph 4.1.17 requires an entity to apply look through approach in situation of financial assets having non-recourse features. However, paragraph BC76 suggest that entities must look through each and every financial asset to understand whether the financial asset has non-recourse features. Thus, as per paragraph BC76, the application of look through approach happens to assess whether the financial asset has non-recourse and SPPI features and not only to assess whether the financial asset has SPPI features. That is, the look through approach is not restricted to only financial assets with non-recourse features. It is applicable to all. Therefore, the requirement in paragraph B4.1.17 that the entity apply look through approach only in case of financial assets with non-recourse features is inconsistent with BC76.

The IASB is requested to clarify the following:

1. Whether an entity can reclassify by considering the contractual cash flow characteristics at the end of every reporting period?
2. Whether the determination of contractual cash flows meeting SPPI criterion is a matter of demonstration by the entity of the actual movement in cash flows regardless of what the contractual terms may be?
3. Whether an entity is required to apply look through approach for all financial assets and, in particular, for investments in mutual funds?
4. When would an investment in mutual fund require the investor entity to look through the contractual cash flows of the underlying assets and the actual or estimated churn in those underlying assets?
5. Whether look through approach is required only where the entity assesses that the financial asset has non-recourse features to determine whether the contractual terms meet SPPI criterion (See para B4.1.17)?
6. Whether churn in underlying assets of a mutual fund needs to be looked into to determine whether an investment in mutual fund meets SPPI criterion?

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Question 4—Classification of financial assets—contractually linked instruments
The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21–B4.1.26 of IFRS 9. The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9. Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We agree with the proposals and have no further comments on the proposals relating to contractually linked instruments.

Question 5—Disclosures—investments in equity instruments designated at fair value through other comprehensive income
For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to: (a) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period; and (b) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period. Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We do not agree with the removal of the word 'each' in paragraph 11A of IFRS 7. We have further comments to offer in this regard as follows:

Paragraph B5.7.1 of IFRS 9 states that the choice to designate an equity investment as subsequently measured at fair value through other comprehensive income is on an instrument-by-instrument (i.e. share-by-share) basis. Thus, an entity X that holds 500 equity shares of another entity Y can designate 250 shares of entity Y as at fair value through other comprehensive income. The entity X will be disclosing as per para 11A(a) of IFRS 7 that it has designated equity investment in entity Y to be measured at fair value through other comprehensive income. However, in absence of disclosure of fair value of this investment of 250 shares in entity Y, it becomes difficult to verify the realised or unrealised gain or loss reported as per the amendment proposed in para 11A(f) for this investment. The proposed change would let entities disclose the fair value of investments designated at fair value through other comprehensive income in aggregate which could reduce the verifiability of financial statements. As the option to designate equity investments at fair value through other comprehensive income is on share-by-share basis, it is important that entities disclose a reconciliation of movement of fair values of each such investment identifying realised and unrealised changes in each such investment in tabular format disclosing also the movement in the number of shares designated at fair value through other comprehensive income for each such investment.

Question 6—Disclosures—contractual terms that could change the timing or amount of contractual cash flows

Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

We welcome this proposal. However, a lot needs to done with IFRS 7.

We have seen companies measuring investment in redeemable preference shares of subsidiaries as equity investment at cost. There is no requirement in IFRS 7 or Ind AS 27 for such an entity to disclose how the investment in redeemable preference shares which are debt instruments are regarded as investment in subsidiaries measured at cost. Paragraph B86(b) of IFRS 10 require elimination of carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary. Thus, only equity investments can be regarded as investment in

subsidiary to be measured at cost in accordance with IAS 27. Accordingly, debt instruments are within the scope of IFRS 9. However, companies have been accounting for investments in debt instruments in subsidiaries not in accordance with IFRS 9. There is no disclosure requirement to understand why the investment was regarded as out of scope of IFRS 9 though not equity investment.

We have also seen companies apply slit accounting for investments in debt instruments of subsidiaries with equity component being measured at cost and debt component being measured at amortised cost. There is no disclosure requirement in IFRS 7 for entities to disclose the rationale for such split accounting though para 4.1.4 of IFRS 9 would require entire debt instrument to be measured at fair value through profit or loss.

The disclosures relating to financial guarantees are also absent in IFRS 7. Companies in India have disclosed details of financial guarantee, recognised and unrecognised, as contingent liabilities despite paragraph 2 of IAS 37 making it clear that financial instruments in the scope of IFRS 9 are excluded from the scope of IAS 37. The IASB may clarify whether disclosure of financial guarantees in the scope of IFRS 9 as contingent liabilities is proper. If not proper, which standard contains disclosure requirements for financial guarantee contracts other than paragraph 31 and 112(c) of IAS 1.

Question 7—Transition

Paragraphs 7.2.47–7.2.49 of the draft amendments to IFRS 9 would require an entity to apply the amendments retrospectively, but not to restate comparative information. The amendments also propose that an entity be required to disclose information about financial assets that changed measurement category as a result of applying these amendments.

Paragraphs BC105–BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We agree with the proposals and have no further comments on the proposals relating to transition.