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PIR IFRS 9 *Classification and Measurement* – Business Model Assessment
Issues Paper

Objective

1 To obtain the EFRAG FIWG members views on:

(a) the IASB staff analysis of the feedback received on the RFI on PIR *IFRS 9 - Classification and Measurement* in respect of the application of the business model requirements to the classification of financial assets; and

(b) the IASB staff recommendations and the IASB decisions in respect of the application of the business model requirements.

Information for EFRAG FIWG

2 In its October meeting, the IASB considered the IASB staff analysis and recommendations on the feedback received on the RFI on PIR *IFRS 9 - Classification and Measurement* in respect of the application of the business model requirements to the classification of financial assets.

3 Based on the analysis performed, the IASB staff recommended not take any further action on the matters identified with regards to the business model requirements in IFRS 9.

4 All the 11 IASB members agreed with the IASB staff recommendation.

General feedback summary

5 The feedback confirmed that generally the business model assessment achieves the IASB's objective of providing users of financial statements with useful information about how an entity manages its financial assets to generate cash flows.

6 However, mixed views were expressed on consistent application with some respondents asking for additional guidance on how to:

(a) determine the level at which to assess the business model;

(b) consider sales of financial assets, for example, how to quantify 'frequent' and 'significant' sales and how to consider past sales due to one-off events;

(c) distinguish between the business models. A few respondents suggested the IASB remove the 'held to collect and sell' ('HTCS') business model; and

(d) understand the difference between a business model for managing financial assets and management's intention for a financial asset.

Application questions

Level at which business model is assessed

Feedback

7 The feedback showed that the business model can be determined at different level by different entities. In itself it does not necessarily result in inconsistent application but causes diversity in practice as an asset could be managed at different levels within the entity which might result in a difference in classification.

8 Also, business model assessment for the same assets can be different between consolidating entity and its subsidiaries. The respondents asked to clarify how to determine the level at which to assess the business model both within an entity and at a consolidated entity level because the classification can be different depending on the level of aggregation.

IASB Staff analysis and recommendation

9 The IASB staff considered if additional guidance would help to resolve any diversity in practice that arise from the application of the business model requirements as opposed to differences in how entities are managing financial assets to realise cash flows and concluded that:

(a) IFRS 9 already provides detailed application guidance on making a business model assessment;

(b) any further guidance would risk being based on particular fact patterns or become rule-based;

(c) the benefit of additional guidance and illustrative examples would not necessarily outweigh the costs of developing and implementing new guidance.

10 Based on the above the IASB staff **did not recommend to add any further application guidance in this respect.**

How to consider sales in the business model assessment

Feedback

11 Respondents asked for more application guidance concerning how to consider 'sales' in the determination of the business model for a portfolio of asset. For examples a few respondents suggested to explain the terms 'infrequent' and 'insignificant', and to eventually provide a threshold for each of them to be used as a rebuttable presumption.

12 A few other respondents also said that the IASB should amend those requirements to include the rebalancing of portfolios for reasons other than changes in credit risk, for example in case of shifting of portfolios toward ESG investments and increased sales caused by unexpected circumstances such as COVID-19.

IASB Staff analysis and recommendation

13 The IASB staff noted that IFRS 9 does not prohibit sales of financial assets in the held to collect business model or impose a threshold for permissible sales. Neither is there a 'tainting' effect on future classifications of financial assets into the business model.

14 Therefore, an entity may rebalance its portfolio within the held to collect business model for reasons other than changes in credit risk, such as managing credit concentration risk or changes in regulatory policy and requirements that shifts towards new types of financial assets. For example, entities might be required to increase their investment in ESG-type instruments and decrease other types of investments.

15 The IASB staff also noted that the business model assessment is not based on scenarios that an entity does not reasonably expect to happen (paragraph B4.1.2A of IFRS 9). Therefore, if there is a change in circumstances that the entity did not reasonably expect to occur (e.g. the COVID-19 pandemic) such changes do not affect the business model assessment. Similarly, if cash flows are realised in a way that is different from the entity's expectations at the date the business model assessment was done (i.e. there were more sales than expected), it does not change the business model for the remaining financial assets.

16 It is important to note that the judgement is involved when assessing the entity's business model. Therefore, in the IASB staff view, adding a quantitative threshold of 'sales' to distinguish between business models, would not only be arbitrary, but also inappropriate considering the different ways the entities conduct business and use financial assets to achieve their objectives.

Distinction between the business models

Feedback

17 A few respondents mentioned difficulties distinguishing between held to collect ('HTC') and HTCS business models as the frequency of sales or any other thresholds are not defined.

18 Some others mentioned difficulties distinguishing between HTCS business model measured at FVOCI from other business models that require measurement at FVTPL. They asked to clarify the difference between a 'significant' buying and selling activity in the HTCS business model and an 'active' buying and selling in other business model.

19 Some respondents considered that HTCS business model with its FVOCI measurement adds more complexity and that users will be better served with information from only two measurement categories (FVTPL or amortised cost).

IASB Staff analysis and recommendation

20 The IASB staff reminded that FVTPL was a residual category in IFRS 9 compared to FVOCI in IAS 39. Therefore, the following assets could be measured at FVTPL:

(a) those that are managed on a fair value basis;

(b) those that are held for trading;

(c) those that do not have cash flows that are solely payments of principal and interest; and

(d) those for which an entity cannot determine the business model at initial recognition.

21 With regards to distinguishing between the HTC and the HTCS business models, the IASB staff noted that paragraphs B4.1.2C–B4.1.4C of IFRS 9 provide application guidance and examples on determining the business model based on the activities that are integral to achieving the entity's objectives.

22 On suggestion to remove the FVOCI measurement category, the IASB staff referred to the reasons to include this category when developing IFRS 9 and reminded that FVOCI measurement category better reflects the performance of financial assets that are managed both in order to collect contractual cash flows and sell the financial assets and addresses the potential mismatch between the classification and measurement of financial assets and insurance contract liabilities (paragraph BC4.138 of IFRS 9).

23 Therefore, the IASB staff are of the view that although the additional FVOCI category might cause complexity compared to having two measurement categories (FVTPL and amortised cost), there is no evidence the benefit of removing FVOCI category will outweigh the cost of maintaining the current three measurement categories.

Reclassification and management's intention vs business models

Feedback

24 There was a general support for the reclassification and changes in business model requirements acknowledging that it was a high hurdle under IFRS 9.

25 Although under IFRS 9 the business model does not depend on management's intention for an individual instrument, a few respondents asked how to understand the difference between business models and management's intention, especially in the rare circumstances when management intention for particular financial assets change.

26 A few respondents reported difficulties in applying the reclassification requirements in practice and asked for more guidance on how to determine when changes in the way financial assets are managed qualify for reclassification.

27 Other respondents (mostly preparers) asked for less restrictive requirements in respect of some particular situations, such as:

(a) loan syndications - when an entity intends to sell a portion of a loan portfolio to another entity but is ultimately unsuccessful in selling that portion. Measurement of an unsold at FVTPL was not considered as providing useful information;

(b) factoring arrangements - whether the sale of trade receivables to a factoring service provider represent a change in the business model and what the appropriate business model would be;

(c) internal transfers - within an entity or a group, for example, for liquidity management purposes; and

(d) economic environmental changes including the COVID-19 pandemic - changes in sales or prudential regulatory treatment resulting from the changing economic conditions.

IASB Staff analysis and recommendation

28 The business model assessment does not depend on management's intentions for an individual instrument (paragraph B4.1.2 of IFRS 9). An entity's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective, not on an instrument-by-instrument basis. In addition, an entity should reclassify financial assets only when the entity changes its business model for managing those financial assets (paragraph 4.4.1 of IFRS 9). A business model is about how business activities are actually managed and does not relate to a choice.

29 In the IASB staff view the requests for less restrictive reclassification requirements are akin to requiring classification based on management's intentions. However, management intentions are influenced by various factors and can change frequently. Therefore, requiring or permitting reclassifications in such cases would lead to frequent changes to the measurement basis of financial assets which will not result in useful information to users.

30 The IASB staff reiterated its view that it was not possible to develop a principle-based solution for when reclassifications should be required, other than for changes in the business model and, therefore, on balance, decided **not to not recommend any changes to be made to the reclassification requirements in IFRS 9**.

Other Application Questions

31 The IASB explored also other application questions and decided that no further actions should be taken on them as there is no evidence that the requirements of IFRS 9 do not work as intended, costs are greater and the benefits are lower than expected.

32 The table below summarised the issues.

Application questions	IASB staff responses
A particular financial asset contains a feature which expires with the passage of time. After the feature expires, the characteristics of the asset has changed and reclassification would be necessary considering the current cash flow characteristics.	Paragraph BC4.117 explains the IASB's reasons for rejecting reclassifications based on changes in the contractual cash flow characteristics. **Therefore, no further action should be taken.**
A request to amend the reclassification accounting out of the FVOCI measurement category into the amortised cost measurement category to measure the financial assets at the fair value on the reclassification date. Any previous gain or loss in equity would be amortised or recognised in profit or loss.	As explained in paragraph BC4.214, the IASB noted that because amortised cost information is provided in profit or loss for financial assets that are measured at FVOCI, reclassifications between the amortised cost measurement category and the FVOCI measurement category do not change the recognition of interest revenue or the measurement of expected credit losses. **Therefore, no further action should be taken.**
Paragraph B4.4.2 of IFRS 9 requires that a change in the objective of the entity's business model must be effected before the reclassification date. Reclassification date is 'the first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets'. Does 'reporting period' include interim reporting periods?	Where the requirements in IFRS 9 are required to be applied to an annual reporting period only, the Standard deliberately refers to 'annual reporting' period. Other references to reporting period therefore apply to any reporting period as determined by the entity. **Therefore, no further action should be taken.**
When assets and liabilities are managed together and the maturities of financial assets are shorter than those of financial liabilities, how to assess the business model of those financial assets? The financial assets are reinvested after the maturities until the maturities of financial liabilities, so the business model should be assessed considering the reinvestment period.	The business model refers to how an entity manages its financial assets in order to generate cash flows from collecting cash flows, selling financial assets or both over the life of the financial asset as explained in paragraph B4.1.2A of IFRS 9. Financial assets cannot be classified based on facts and circumstances that arise beyond their contractual maturities. **Therefore, no further action should be taken.**

The EFRAG Secretariat analysis

33 The EFRAG Secretariat agrees with the IASB staff analysis and recommendations. IFRS 9 already provides sufficient guidance on the business model assessment and allows a flexibility for reclassifications in case of a change of a business model. The EFRAG Secretariat agrees that adding any rule-based guidance for assessing the business model at this stage will be unhelpful.

34 The EFRAG Secretariat acknowledges certain interconnection between management intention and business model changes but considers it important to differentiate between the two for the purposes of proper classification of financial instruments.

Questions for EFRAG FIWG

35 Does EFRAG FIWG agree with the IASB decision not to take any further action on the business model and reclassification requirements on IFRS 9?