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Our Response to the Request for Information -
Post-Implementation Review: IFRS 9 *Financial Instruments* Classification and Measurement

1. The Accounting Standards Board of Japan (the "ASBJ" or "we") welcome the opportunity to provide our response to the Request for Information (RFI) - Post Implementation Review (PIR): IFRS 9 *Financial Instruments* Classification and Measurement. This comment letter is based on the feedback that the ASBJ staff received through its outreach with stakeholders in our jurisdiction, and does not represent only the views of the ASBJ on the questions in the RFI.

Overview of the outreach

2. The ASBJ staff reached out to stakeholders in our jurisdiction with a limited scope to obtain specific feedback on their experience with applying IFRS 9. Specifically, the ASBJ staff made written enquiries with financial statement users (hereinafter referred to as 'users'), financial statement preparers (hereinafter referred to as 'preparers'), auditors and academics. Additionally, the ASBJ and its related Technical Committee, both consisting of users, preparers, auditors, and academics, discussed the abovementioned feedback.

Key messages from the outreach

(Messages that has been continuously raised from the past)

3. During the outreach, we have received the key messages from stakeholders

(including users) regarding the following issues, which have been continuously raised from the past:

- Recycling of fair value changes in other comprehensive income (OCI) of equity instruments subject to an irrevocable option to present fair value changes in OCI (the "FVOCI option")
- Fair value measurement of equity instruments

Recycling of fair value changes in OCI of equity instruments subject to the FVOCI option

4. IFRS 9 prohibits the recycling of gains and losses on investments in equity instruments for which an entity has elected to present fair value changes in OCI. However, the relationship between gains and losses recognised in OCI and recycling is a very important topic in relation to profit or loss (hereinafter referred to as 'net income').

5. As the ASBJ has long argued that net income represents the entity's performance and that it provides useful information in combination with comprehensive income measured by changes in net assets over the period, and fair value information, which is stock information. Many users support the presentation of two measures, net income and comprehensive income, and we believe that such presentation in the financial statements is appropriate. However, each measure is an independent measure and reconciliation (that is, recycling) is necessary as a mechanism if they are to be presented in the same statement.

6. In our jurisdiction, net income is considered to be more useful than comprehensive income as an indicator of the entity's performance. In this context, some note that, if net income does not reflect the results of business activities, such as the sale of shares accompanied with cash flows, it would not faithfully represent the entity's performance, and thus it would be a significant problem from the perspective of dividends and shareholder returns.

7. In addition, we note that recycling is required for debt instruments measured at fair value through other comprehensive income. We believe that the IASB should redefine impairment losses on equity instruments and consider requiring recycling for consistency with the accounting for debt instruments.

Fair value measurement of equity instruments

8. We believe that, if equity instruments are not held for the purpose of earning capital gains from changes in fair value but are held for the purpose of establishing, maintaining and enhancing relationships with business partners in conducting business and thus are effectively restricted from sale, changes in the fair value of such equity instruments should not be recognised in net income as a result of an entity's investment activities.

9. In most cases, unlisted shares have the characteristics of equity instruments described in the preceding paragraph. When measuring such unlisted shares at fair value, entities consider a variety of unobservable inputs, including estimates made by management, in accordance with the requirements of IFRS 9, because such unlisted shares are generally subject to transfer restrictions and there is no market to trade such unlisted shares. As a result, the fair value of unlisted shares has a very high degree of estimation uncertainty.

10. For equity instruments measured at fair value with such a high degree of uncertainty, changes in the fair value of such instruments would be recognised in net income unless the entity elects the FVOCI option or holds the instrument for trading purposes (which is not normally expected). In this regard, some stakeholders in our jurisdiction have expressed strong concerns about the risk of arbitrary income being recorded.

11. Therefore, we believe that the IASB should consider whether changes in fair value should continue to be recognised in net income for equity instruments referred to in paragraph 8. Within these equity instruments, we particularly think that the IASB should review whether unlisted shares should be treated as financial assets at fair value through profit or loss.

(Feedback received during the outreach)

12. In addition to the issues that have been raised from the past, referred to in paragraph 3, the main feedback the ASBJ staff received during the outreach are summarised below.

(1) Classification and measurement

Characteristics of contractual cash flows

13. In recent years, new types of financial instruments, which incorporate features that were not envisaged at the time the standard was set (for example, sustainability-linked variables), have been originated in our jurisdiction as well as other jurisdictions. Therefore, we think the IASB should clarify the accounting treatment for such new financial instruments.

14. On the other hand, the IASB has been addressing practical issues by issuing various guidance focusing on the characteristics of contractual cash flows. As a result, some note that, because the guidance has become complex, situations where a high level of judgment is required in the application of the standard are increasing and that has led to diversity in practice.

15. We are of the view that it would be inappropriate for all financial assets with new features, such as sustainability-linked financial instruments, to be measured at fair value rather than amortised cost. Even if the current framework based on the characteristics of contractual cash flows were to be maintained, we believe that existing guidance needs to be revisited (which may include simplification of the guidance).

(2) Equity instruments and other comprehensive income

Applicable scope of the FVOCI option

16. The Basis for Conclusions regarding the FVOCI option in IFRS 9 (paragraph BC5.21 of IFRS 9) states that puttable instruments (or financial instruments that impose an obligation on an entity 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, implying that they are not eligible for the FVOCI option.

17. Some stakeholders in our jurisdiction noted that the IASB should review the statement referred to in the preceding paragraph, which would limit the scope of the FVOCI option. This is because it would be consistent to treat puttable instruments as equity instruments in accordance with IAS 32 *Financial Instruments: Presentation*, and that it is questionable whether the accounting should be different for equity instruments held directly and those held through a fund merely for administrative

purposes.

18. Also, some stakeholders in our jurisdiction noted that there is no need to limit the scope of the FVOCI option to equity instruments, as the FVOCI option is an accounting choice permitted after taking into account the characteristics and purpose of the investment.

(3) Other matters

Embedded derivatives

19. We are of the view that hybrid contracts where the financial asset is the host contract should be bifurcated and accounted for separately if certain conditions are met. We are of the view that separate accounting would lead to a more faithful representation of the economics that an instrument is composed of elements with different risk characteristics. From this perspective, hybrid contracts should not be treated differently depending on whether the host contract is a financial asset or a financial liability. Also, we believe that the bifurcation of hybrid contracts where the financial asset is the host contract may reduce certain accounting mismatches.

Accounting for differences between the fair value at initial recognition and the transaction price

20. The difference between the fair value at initial recognition and the transaction price is required to be deferred unless the fair value at initial recognition is based on evidence of quoted prices in active markets (Level 1 inputs) or on valuation techniques that use only observable market data (Level 2 inputs). Subsequent measurement, on the other hand, requires changes in the fair value of a financial instrument due to changes in data that are not observable in the market (Level 3 inputs) that give rise to the deferred treatment of the difference to be recognised in net income, resulting in inconsistencies in the accounting treatment between initial recognition and subsequent measurement. In addition, some of the requirements in IFRS 9 are inconsistent with the fair value hierarchy in IFRS 13 *Fair Value Measurement*.

    The rationale for deferring the difference between the fair value at initial recognition and the transaction price is not clear in the standard, and some stakeholders in our jurisdiction noted that the treatment should be reviewed in light of the characteristics of the difference itself.

21. For other comments on individual questions in the RFI, please see the Appendix.

22. Although not included in the individual questions in the RFI, some stakeholders in our jurisdiction noted that the treatment of the holder of a financial guarantee contract should be clarified in IFRS 9.

23. We hope our response will contribute to the IASB's deliberations. Please contact us if you have any questions.

Yours sincerely,

Yasunobu Kawanishi
Vice Chair

Accounting Standards Board of Japan

Appendix

Comments on Specific Questions in the RFI

Our comments on the specific questions sought in the RFI are as follows.

Question 1—Classification and measurement
Do the classification and measurement requirements in IFRS 9: (a) enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not? (b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not? Please provide information about the effects of the classification and measurement changes introduced by IFRS 9, including the ongoing costs and benefits in preparing, auditing, enforcing or using information about financial instruments. This question aims to help the Board understand respondents' overall views and experiences relating to the IFRS 9 classification and measurement requirements. Sections 2–8 seek more detailed information on the specific requirements.

Questions (a) and (b)

1. With regard to the classification approach in IFRS 9, we are of the view that taking into account the business model under which an entity manages its financial assets is an approach that clarifies how an entity's activities, even if they are in the same contract or form, can affect the forecast of future cash flows and provides useful information for investment decision-making.

2. However, some stakeholders in our jurisdiction note a number of operational challenges, particularly around the contractual cash flow characteristics. These challenges are discussed in Paragraphs 3 to 8.

Question 2—Business model for managing financial assets
(a) Is the business model assessment working as the Board intended? Why or why not?

Please explain whether requiring entities to classify and measure financial assets based on the business model assessment achieves the Board's objective of entities providing users of financial statements with useful information about how an entity manages its financial assets to generate cash flows.

(b) Can the business model assessment be applied consistently? Why or why not?

Please explain whether the distinction between the different business models in IFRS 9 is clear and whether the application guidance on the evidence an entity considers in determining the business model is sufficient.

(c) Are there any unexpected effects arising from the business model assessment? How significant are these effects?

Please explain the costs and benefits of the business model assessment, considering any financial reporting or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about reclassification of financial assets (see Spotlight 2).

Questions (a), (b) and (c)

3. During the outreach, some stakeholders in our jurisdiction noted the following views:

   (1) Under IFRS 9, an entity is required to determine the entity's business model for managing financial assets on the basis of its portfolio, rather than on the purpose for which individual financial instruments are held. The entity's business model for the management of financial assets is supposed to be a matter of fact and not a mere assertion. However, in practice, there may be multiple management objectives for a single portfolio, and the lack of a clear method for determining the management objective may lead to a choice and prevent the consistent application of the assessment of the business model.

   (2) The assumption that changes in business models should be expected to be extremely rare events is unrealistic in the current economic environment. For example, the accounting treatment of gradual changes in the purpose for which financial assets are held in a business model in response to changes in market

conditions should be clarified.

Question 3—Contractual cash flow characteristics
(a) Is the cash flow characteristics assessment working as the Board intended? Why or why not? Please explain whether requiring entities to classify and measure a financial asset considering the asset's cash flow characteristics achieves the Board's objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows. If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain: (i) why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI). (ii) which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk). (See Section 7 for more questions about applying the effective interest method.) (b) Can the cash flow characteristics assessment be applied consistently? Why or why not? Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features). If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements. (c) Are there any unexpected effects arising from the cash flow characteristics

assessment? How significant are these effects?

Please explain the costs and benefits of the contractual cash flow assessment, considering any financial reporting effects or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about financial instruments with sustainability-linked features (see Spotlight 3.1) and contractually linked instruments (see Spotlight 3.2).

Questions (a), (b) and (c)

4. In recent years, new types of financial instruments, which incorporate features that were not envisaged at the time the standards were set (for example, sustainability-linked variables), have been originated in our jurisdiction as well as other jurisdiction. However, it is pointed out that such financial instruction with new features may be measured at fair value rather than amortised cost, because they do not meet the requirements of the contractual cash flows characteristics. We believe that this conclusion is inappropriate. As the financial instruments with these features are increasing due to social demands, we think the IASB should clarify the accounting treatment for such new features.

5. On the other hand, the IASB has been addressing practical issues by issuing various guidance focusing on the characteristics of contractual cash flows. As a result, some note that, because the guidance has become complex, situations where a high level of judgment is required in the application of the standard are increasing and that has led to diversity in practice.

6. Some stakeholders in our jurisdiction note that applying the following particular guidance and examples are cumbersome and could be problematic.

   (1) Guidance on the modification of the time value of money[1]

   (2) Guidance on prepayment elements[2] and the example of financial instrument E in IFRS 9 B4.1.13

      Some financial instruments that comply with the new regulations are subject

[1] IFRS 9, paragraphs B4.1.9A to B4.1.9E
[2] IFRS 9, paragraphs B4.1.10 to B4.1.12A

to diversity in accounting treatment because there is room for interpretation in the way the effects arising from the laws and regulations of each jurisdiction are captured, even if the economic reality is not different.

(3) Guidance on contractually linked products[3]

① For example, where the underlying asset is real estate, the application of the requirements for non-recourse financial instruments that do not have multiple tranches of similar economic substance[4], or the requirements for contractually linked instruments, could result in very different accounting treatments.

② When real estate is incorporated, it is not always clear what is assumed to be the "underlying financial instrument pool" and the relationship between the term "underlying financial instrument pool" and the lessor's lease (lease receivable) in IFRS 16.

7. In addition, some stakeholders in our jurisdiction expressed concerns about the operational impact due to the considerable cost burden of collecting and classifying the information required to determine the characteristics of contractual cash flows.

8. As referred to in paragraphs 4 to 7, we are of the view that it would be inappropriate for all financial assets with new features, such as sustainability-linked financial instruments, to be measured at fair value rather than amortised cost. Even if the current framework based on the characteristics of contractual cash flows were to be maintained, we believe that existing guidance needs to be revisited (which may include simplification of the guidance).

Question 4—Equity instruments and other comprehensive income
(a) Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not? Please explain whether the information about investments in equity instruments prepared applying IFRS 9 is useful to users of financial statements (considering both (i) equity instruments measured at fair value through profit and loss; and (ii) equity instruments to which the OCI presentation option has been applied).

[3] IFRS 9, paragraphs B4.1.20 to B4.1.26
[4] IFRS 9, paragraph B4.1.18

For equity instruments to which the OCI presentation option has been applied, please explain whether information about those investments is useful considering the types of investments for which the Board intended the option to apply, the prohibition from recycling gains and losses on disposal and the disclosures required by IFRS 7.

(b) For what equity instruments do entities elect to present fair value changes in OCI?

Please explain the characteristics of these equity instruments, an entity's reason for choosing to use the option for those instruments, and what proportion of the entity's equity investment portfolio comprises those instruments.

(c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?

Please explain whether the requirements introduced by IFRS 9 had any effects on entities' investment decisions. If yes, why, how and to what extent? Please provide any available evidence supporting your response which will enable the Board to understand the context and significance of the effects.

In responding to (a)–(c), please include information about recycling of gains and losses (see Spotlight 4).

Questions (a) and (c)

(Irrevocable option to show changes in the value of investments in equity instruments not held for trading in OCI (the "FVOCI option"))

Recycling

9. IFRS 9 prohibits the recycling of gains and losses on investments in equity instruments for which an entity has elected to an application of the FVOCI option. However, the relationship between gains and losses recognised in other comprehensive income and recycling is a very important topic in relation to net income.

10. As the ASBJ has long argued that, net income represents the entity's performance and

that it provides useful information in combination with comprehensive income measured by changes in net assets over the period, and fair value information, which is stock information. Many users support the presentation of two measures, net income and comprehensive income, and we believe that such presentation in the financial statements is appropriate. However, each measure is an independent measure and reconciliation (that is, recycling) is necessary as a mechanism if they are to be presented in the same statement.

11. Furthermore, some stakeholders in our jurisdiction noted the following views:

    (1) The outcome of the business activity of selling shares with flows of cash would not be reflected in net income. Therefore, the current treatment in IFRS 9, which prohibits the recycling of other comprehensive income into net income for financial instruments subject to the FVOCI option, produces results that would not faithfully represent the entity's performance.

    (2) Many companies use a dividend payout ratio based on net income attributable to the parent company as a measure of shareholder return, and for users who invest with the aim of earning dividend income in particular, the fact that net income attributable to the parent company does not include some profit/loss with cash inflows will influence their investment decisions.

    (3) Many investors use net income rather than comprehensive income as an indicator of the entity’s performance. Therefore, it is more harmful to investment decisions if gains and losses on the sale of shares with cash flows are not included in net income, rather than double counting of a gain, which is one of the reasons for non-recycling.

12. We believe that the opinion in the preceding paragraph is based on the fact that in our jurisdiction, net income has been considered more useful rather than comprehensive income as an entity's performance from the past.

13. In addition, we note that recycling is required for debt instruments measured at fair value through other comprehensive income. We believe that the IASB should redefine impairment losses on equity instruments and consider requiring recycling for consistency with the accounting for debt instruments.

Scope of applicability

14. The Basis for Conclusions regarding the FVOCI option in IFRS 9 (paragraph BC5.21 of IFRS 9) states that puttable instruments (or financial instruments that impose an obligation on an entity 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, implying that they are not eligible for the FVOCI option.

15. Some stakeholders in our jurisdiction noted that the IASB should review the statement referred to in the preceding paragraph, which would limit the scope of the FVOCI option. This is because it would be consistent to treat puttable instruments as equity instruments in accordance with IAS 32, and that it is questionable whether the accounting should be different for equity instruments held directly and those held through a fund merely for administrative purposes.

16. Also, some stakeholders in our jurisdiction noted that there is no need to limit the scope of the FVOCI option to equity instruments, as the FVOCI option is an accounting choice permitted after taking into account the characteristics and purpose of the investment.

Accounting treatment

17. Even for equity instruments to which the FVOCI option is applied, if the fair value and the transaction price are different on initial recognition, some stakeholders in our jurisdiction noted that on the potential inconsistent accounting treatment of the difference between the fair value and the transaction price which could be eventually recognised in net income in accordance with the requirements for initial measurement but would not under the requirements for subsequent measurement according to IFRS9 B5.1.2A

Disclosure requirements

18. For equity instruments subject to the FVOCI option, disclosure by issue is required (IFRS 7 paragraph 11A (1)), but some stakeholders in our jurisdiction asked us that the information is not highly useful and that we should consider removing the disclosure requirement or changing to another disclosure method.

(Fair value measurement of equity instruments)

19. In our jurisdiction, investments in equity instruments that are not held for the purpose

of earning capital gains from changes in fair value but are held for the purpose of establishing, maintaining and enhancing relationships with business partners in conducting business and thus are effectively restricted from sale, are not in rare circumstances.

20. As well as the IASB, we also believe that financial assets held for trading should be measured at fair value through profit or loss. However, we believe that changes in the fair value of such equity instruments should not be recognised in net income as a result of the entity's investment activities.

21. In our view, even if the fair value as stock information provides relevant information, when the changes in fair value as flow information do not provide relevant information, such changes should not be recognised in net income. For the equity instruments described in paragraph 19, if an entity does not choose the FVOCI option, it would be measured at fair value through profit or loss, but we believe that it would not necessarily provide relevant information from the perspective of a faithful representation of the entity's business activities.

22. In most cases, unlisted shares have the characteristics of equity instruments described in paragraph 19. When measuring such unlisted shares at fair value, entities consider a variety of unobservable inputs, including estimates made by management, in accordance with the requirements of IFRS 9, because such unlisted shares are generally subject to transfer restrictions and there is no market to trade such unlisted shares. As a result, the fair value of unlisted shares has a very high degree of estimation uncertainty.

23. For equity instruments measured at fair value with such a high degree of uncertainty, changes in the fair value of such instruments would be recognised in net income unless the entity elects the FVOCI option or holds the instrument for trading purposes (which is not normally expected). In this regard, some stakeholders in our jurisdiction have expressed strong concerns about the risk of arbitrary income being recorded. In addition, it has been argued that this leads to excessive cost burdens from a cost-effectiveness perspective.

24. Therefore, we believe that the IASB should consider whether changes in fair value should continue to be recognised in net income for equity instruments referred to in paragraph 19. Within these equity instruments, we particularly think that the IASB should review whether unlisted shares should be treated as financial assets at fair

value through profit or loss.

Question (b)

The extent to which we apply the FVOCI option in our jurisdiction

25. For listed companies applying IFRS in our jurisdiction, the FVOCI option is applied to equity instruments (specifically, shares) held for the purpose of primarily maintaining or enhancing business relationships with investees.

26. As indicated in the preceding paragraph, the accounting treatment of the FVOCI option affects a wide range of entities and we believe that the IASB should initiate a review of the treatment of this option.

Question 5— Financial liabilities and own credit
(a) Are the requirements for presenting the effects of own credit in OCI working as the Board intended? Why or why not? Please explain whether the requirements, including the related disclosure requirements, achieved the Board's objective, in particular, whether the requirements capture the appropriate population of financial liabilities. (b) Are there any other matters relating to financial liabilities that you think the Board should consider as part of this post-implementation review (apart from modifications, which are discussed in Section 6)? Please explain the matter and why it relates to the assessments the Board makes in a post-implementation review.

Questions (a) and (b)

27. We did not receive any specific feedback regarding above questions.

Question 6— Modifications to contractual cash flows
(a) Are the requirements for modifications to contractual cash flows working as the Board intended? Why or why not? Please explain what changes you consider to be modifications of a financial asset for the purpose of applying paragraph 5.4.3 of IFRS 9 and as a modification of a financial liability for the purpose of applying paragraph 3.3.2 of IFRS 9. Does the

application of those paragraphs, and the disclosure requirements related to modifications, result in useful information for users of financial statements?

(b) Can the requirements for modifications to contractual cash flows be applied consistently? Why or why not?

Please explain whether the requirements enable entities to assess in a consistent manner whether a financial asset or a financial liability is modified and whether a modification results in derecognition. Have the requirements been applied differently to financial assets and financial liabilities?

If diversity in practice exists, please explain how pervasive the diversity is and its effects on entities' financial statements.

Questions (a) and (b)

28. As there is no definition of "modification" in IFRS 9, some stakeholders in our jurisdiction noted that this may lead to diversity in practice. In order to clarify which circumstances constitute "modification", they noted that the IASB should consider defining "modification".

Question 7—Amortised cost and the effective interest method

(a) Is the effective interest method working as the Board intended? Why or why not?

Please explain whether applying the requirements results in useful information for users of financial statements about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest method.

(b) Can the effective interest method be applied consistently? Why or why not?

Please explain the types of changes in contractual cash flows for which entities apply paragraph B5.4.5 of IFRS 9 or paragraph B5.4.6 of IFRS 9 (the 'catch-up adjustment') and whether there is diversity in practice in determining when those paragraphs apply.

Please also explain the line item in profit or loss in which the catch-up adjustments

are presented and how significant these adjustments typically are.

If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

In responding to questions (a)–(b), please include information about interest rates subject to conditions and estimating future cash flows (see Spotlight 7).

Questions (a) and (b)

29. Some stakeholders in our jurisdiction noted that, depending on the characteristics of the transaction costs included in the calculation of the effective interest rate, there may be practical difficulties in applying the effective interest method. Also, some had a suggestion that the standard permit transaction costs that are paid in instalments over the expected life of the instrument and that vary in amount to be expensed on a pay-as-you-go basis from a cost-benefit perspective.

Question 8—Transition

(a) Did the transition requirements work as the Board intended? Why or why not?

Please explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements.

Please also explain whether, and for what requirements, the Board could have provided additional transition reliefs without significantly reducing the usefulness of information for users of financial statements.

(b) Were there any unexpected effects of, or challenges with, applying the transition requirements? Why or why not?

Please explain any unexpected effects or challenges preparers of financial statements faced applying the classification and measurement requirements retrospectively. How were those challenges overcome?

Questions (a) and (b)

30. We did not receive any specific feedback regarding above questions.

Question 9—Other matters
(a) Are there any further matters that you think the Board should examine as part of the post-implementation review of the classification and measurement requirements in IFRS 9? If yes, what are those matters and why should they be examined? Please explain why those matters should be considered in the context of the purpose of the post-implementation review, and the pervasiveness of any matter raised. Please provide examples and supporting evidence when relevant. **(b) Considering the Board's approach to developing IFRS 9 in general, do you have any views on lessons learned that could provide helpful input to the Board's future standard-setting projects?**

Questions (a) and (b)

31. As a result of our outreach, market participants in our jurisdiction noted on the following issues.

(Embedded derivatives)

32. We are of the view that hybrid contracts where the financial asset is the host contract should be bifurcated and accounted for separately if certain conditions are met. We are of the view that separate accounting would lead to a more faithful representation of the economic reality that an instrument is composed of elements with different risk characteristics. From this perspective, a hybrid contract should not be treated differently depending on whether the host contract is a financial asset or a financial liability.

33. In some entities (mainly financial institutions), the host contract and the embedded element are managed separately, and the entity also trades derivative instruments with similar characteristics to the embedded element independently, and the derivative instrument and the embedded element are managed collectively. The bifurcation of hybrid contracts where the financial asset is the main contracts in such entities

concerned may also reduce certain accounting mismatches.

34. Under US GAAP, embedded derivatives that meet requirements of the accounting standards are to be accounted for separately, regardless of whether the host contract is a financial asset or not. From the perspective of global convergence, we are of the view that IASB should review the treatment of embedded derivatives. In addition, the separation of embedded features for hybrid contracts where the financial asset is the host contract would help to resolve the issues relating to the complexity of the guidance of the contractual cash flows characteristics of the financial asset referred to in paragraphs 5 to 7.

(Accounting for differences between the fair value at initial recognition and the transaction price)

35. The difference between the fair value at initial recognition and the transaction price is required to be deferred unless the fair value at initial recognition is based on evidence of quoted prices in active markets (Level 1 inputs) or on valuation techniques that use only observable market data (Level 2 inputs). Subsequent measurement, on the other hand, requires changes in the fair value of a financial instrument due to changes in data that are not observable in the market (Level 3 inputs) that give rise to the deferred treatment of the difference to be recognised in net income, resulting in inconsistencies in the accounting treatment between initial recognition and subsequent measurement.

36. Some of the requirements in IFRS 9 are not consistent with the fair value hierarchy in IFRS 13. Furthermore, some stakeholders in our jurisdiction noted that the basis for accounting for the deferral of the difference between the fair value and the transaction price at initial recognition is not clear in the standard.

37. In addition, under US GAAP, if the fair value at initial recognition differs from the transaction price, the difference between these prices is to be recognised in net income. From the perspective of global convergence, some stakeholders in our jurisdiction noted that the IASB should consider reviewing the treatment of such differences in light of the characteristics of the differences themselves.

(Financial guarantee contract)

38. Although not included in the individual questions in the RFI, some stakeholders in our jurisdiction noted that the treatment of the holder of a financial guarantee contract

should be clarified in IFRS 9.