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Mr Hans HOOGERVORST
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International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
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Email: commentletters@ifrs.org

3 April 2013

Re: OIC response to the IASB Exposure Draft Classification and Measurement: Limited Amendments to IFRS 9

Dear Mr Hoogervorst,

We are pleased to have the opportunity to comment on the Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9*.

We appreciate IASB's decision to consider making limited amendments to IFRS 9 to propose changes in the classification and measurement requirements.

However, we have some general concerns about the proposals contained in the ED.

Regarding the "*solely payment of principal and interest*" (SPPI) test the main issues are as follows:

1. we are concerned that the "*more than insignificant*" clause does not provide the flexibility needed to avoid that "true" banking book financial instruments and some debt securities hold as investments by insurance companies will be classified in the FVTPL portfolio, with negative impact on the usefulness of related financial information; a different approach and the improving of the guidance could solve this issue;

2. the definition of interest provided in the ED is too narrow; we believe that there are more components that should be considered in the definition of interest rate;

3. the construction of a “theoretical benchmark” is complex and burdensome; in this regard, a reference to market practice, combined with the use of a reasonable threshold, could be a more practical solution;

4. the elimination of the bifurcation on the assets side, that is not founded on robust arguments, could lead to an increase in the fair valuation of financial assets; besides we believe that is important to ensure the consistency between how embedded derivatives in financial assets and liabilities are accounted for.

With reference to the introduction of the third category:

1. we believe that the FV-OCI category, being based on a business model, could provide useful and meaningful information for financial reporting objectives where an entity holds financial instruments characterized by appreciable high turnover;

2. if the modification proposed in the ED does not solve the accounting mismatch for insurance companies, we believe that the IASB should consider this case and further investigate how to refine the definition of the business model in order to include also the specificities of the insurance sector (i.e. linked to asset-liability management strategies);

3. also in the entity’s business model assessment the ED does not provide reference thresholds; this could lead to some problems in term of comparability and significance.

Finally, as a general remark, we do not believe that a quick completion of the IFRS 9 project with requirements conceptually unexplained gives more benefits that taking the right time to produce an accounting standard robust enough to last for a long time.
We expect that the IASB will assess before the completion of the project that the benefits of adopting IFRS 9 still outweigh the costs of replacing and/or amending IAS 39.

On these points you will find further explanation in the Appendix.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,

Angelo Casò

(Chairman)

CONTRACTUAL CASH FLOW CHARACTERISTICS ASSESSMENT

1. **Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest? Do you agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?**
2. **Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?**
3. **Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features? Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?**

In general we are concerned about the possibility that some financial instruments will not pass the assessment.

On the application of the "solely payment of principal and interest" (SPPI) test, the main concerns are as follows:

1. Regarding the assessing of a modified economic relationship in a financial asset, considering cash flows on a comparable financial asset that does not contain the modification, paragraph B4.1.9.D indicates that, if the modification could result in cash flows that are more than insignificantly different from the benchmark cash flows, the financial asset shall be measured at fair value through profit or loss. We are concerned that the expression "*more than insignificant*" could raise interpretation problems. In fact there is not a reference threshold and this could lead to comparability problems. The same expression has been used in the IAS 39 to indicate the threshold for the so called "tainting rule". We have been told that such a definition has created a number of problems on its application.

   If read in a restricted manner, such an expression, may lead many financial instruments that are effectively managed on long term basis to be classified in the portfolio measured at FVTPL, just because they have characteristics that deviate to some extent from a pure plain vanilla financial instrument. We wonder whether in such circumstances a fair value measurement provides users with more useful information.

   Moreover, the test may be influenced by different shapes and trends in the yield curve existing in different periods. The potential result could be that the same instrument could be classified in different ways depending on the market conditions existing on initial recognition, compromising once again the financial statements comparability.

   To solve this issue, remaining on a pure principle based approach, it could be opportune to use a different wording (e.g. "not significant") and improve the guidance drawn in the ED.

2. Paragraph 4.1.3 provides a narrow definition of interest (as consideration for the time value of money and for credit risk). We believe that there are more components that should be included in the definition of interest rate. For example the paragraph BC4.22 in IFRS 9 (2010) and the paragraph 825.10.25.18 in FASB's Exposure Draft, indicate that credit risk may include a premium for liquidity risk.

3. In November 2009 the IFRS 9 was issued to reduce the complexity of IAS 39 and, in November 2011, the IASB decided to consider limited amendments to IFRS 9 that should be as targeted as possible to minimize the cost. Instead the entities are expected to incur in significant costs and complexity because of the use of benchmark instruments. In fact the paragraph B4.1.9C indicates that an entity may consider either an actual or a hypothetical financial asset as the basis for the assessment, but the ED does not explain how hypothetical benchmark should be constructed. We believe that this will result in a burdensome and complex assessment of each financial asset. If it results too much difficult to provide guidance on how the hypothetical financial asset should be constructed, the IASB should consider to make reference to the market practice (e.g. considering where the product is widely sold), excluding however any case where a leverage effect is created.

In addition to the possibility that some financial instruments will not pass the assessment, we are concerned about the elimination of the bifurcation on the assets side.
With regard to bifurcation, we are aware that its requirements are currently quite applied and it is not seen as a complex exercise by preparers. However, the IASB has rejected the bifurcation on the asset side because it is perceived as complex but will remain in IFRS 9 for hybrid contracts with non financial hosts and financial liabilities. It has to be considered that preventing bifurcation on the asset side leads potentially to an increase in the fair valuation of financial assets with the consequence of a greater use of fair value also for financial liabilities, aimed to avoid an accounting mismatch. While we recognize that it is useful to know how many banking book products and insurance investments (debt securities) should be transferred to the fair value category in the light of the changes in current rules (i.e. from IAS 39 to IFRS 9), we also believe that every problem should be addressed following a robust accounting logic, considering the performance of the standard over time (even if today the impact is minimal, tomorrow the phenomenon could be relevant again). In this respect, we believe that is important to ensure the consistency between how embedded derivatives in financial assets and liabilities are accounted for and also managed. More generally, it would be beneficial for the overall consistency of the "IFRS framework" to adopt an univocal approach for the unit of account: in fact, in some cases (e.g. revenue recognition) the IASB starts from the contract and requires the unbundling of it in order to properly recognize each performance obligation/right inside; in other cases (financial instruments), the approach is the opposite (i.e. the contracts is seen and accounted for as a single transaction, even if it is composed of several elements). At least we do not see strong conceptual arguments from the IASB that convince us on the opportunity to confirm the elimination of bifurcation from the asset side. In the absence of such convincing arguments we believe that the IASB should retain the current bifurcation requirements on the asset side as well.

Concluding, we believe that the proposed amendment of IFRS 9:

- on the SPP&I ("*more than insignificant*" clause) does not provide the flexibility needed to avoid that financial instruments managed on a long term basis will be classified in the FVTPL portfolio, with negative impact on the usefulness of related financial information. Reading the ED, we have got the perception that the "*more than insignificant*" limit is too narrow and would prevent preparers to properly classify lending products and insurance investments (debt securities) in the amortized cost category. This perception could be wrong and different from that developed by other European constituents. Therefore, without additional specification or guidance the amended SPP&I test could significantly reduce the comparability of financial statements (where to draw the line between what is "more than insignificant" and other cases?);
- is based on an approach highly abstract (i.e. no direct link to how entities actually manage and price their financial instruments) and overly complex, especially when – lacking any real life financial instruments – it requires the use of a "theoretical benchmark". In this regard, a reference to market practice, combined with the use of a reasonable threshold, could be a more practical solution;
- confirms the elimination of the bifurcation on the assets side. This, while not due to major difficulties arisen in the implementation of IAS 39, is not founded on robust arguments. We see in the IASB projects oscillating approaches: in some projects (e.g. revenue recognition), a contract is divided in its basic components (for each performance) and each component is recognized and accounted for separately; in other projects (e.g. financial instruments), a contract is the "unit of account", even if it embeds several elements. If the elimination of bifurcation will be confirmed by the IASB, this would make the reinstatement of bifurcation over and over more important.

BUSINESS MODEL ASSESSMENT

4. Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that:
  (a) interest revenue, credit impairment and any gain or loss on derecognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and
  (b) all other gains and losses are recognised in OCI?

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

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

With reference to the introduction of a third category, we believe that an additional business model in IFRS 9 could provide useful and meaningful information for financial reporting objectives where an entity holds financial instruments characterized by appreciable high turnover.

However, we understand that the IASB objective in introducing such a new portfolio was to solve the issue of the accounting mismatch for insurance companies that apply IFRS 4. Perhaps, in the insurance sector there is another business model (i.e. other than that considered when dealing with banks' liquidity portfolios), which requires the use of the FVTOCI (i.e. without this portfolio the accounting representation would be "mismatched", while risk management of assets and liabilities is coordinated). If the modification proposed in the ED does not solve the insurance sector issue, we believe that the IASB should further investigate this issue, adequately adopting the definition of business model that should be more closely linked to asset-liability management strategies.

Some paragraphs in the ED indicate that in assessing the entity's business model consideration should also be given to the frequency and volume of sales. Also in this case, the absence of reference thresholds could lead to some problems in terms of comparability and significance of the financial statements. On the definition of the thresholds the comments made above for the SPPI test are still valid also for the third portfolio.

EARLY APPLICATION

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

OIC agrees with the proposal in the ED that after IFRS 9 is finalised, an entity early applying IFRS 9 should be required to apply IFRS 9 in its entirety. We also agree with the six-month transition period.

OWN CREDIT PROVISIONS

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

OIC believes that entities should be permitted to early apply the 'own credit' provisions in IFRS 9.

FIRST-TIME ADOPTION

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

We do not have any specific comments regarding first-time adoption