Brussels, 27th January 2022

EACB comments on IASB Request for Information for the Post-implementation Review of IFRS 9 *Financial instruments*: Classification and Measurement

General comments

The EACB welcomes the opportunity to comment on the IASB Request for Information (RFI) for the Post Implementation Review (PIR) on the classification and measurement requirements in IFRS 9: *Financial Instruments,* as well as the related disclosure requirements.

While in principle the classification and measurement requirements in IFRS 9 work as intended, there is however a number of important issues that EACB members would like to underline. Please see below our answers to some of the specific questions on which this RFI seeks the feedback.

Q1 - *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?

(a) Our members generally agree that the classification and measurement requirements of IFRS 9 enable the measurement of financial assets to be based on cash flow characteristics.

(b) Yes.

Q2 - *Business model for managing financial assets*

(a) Is the business model assessment working as the Board intended? Why or why not?

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

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

(a) and (b) For members concerned by the application of IFRS 9, we agree that in principle the business model assessment working as intended as well as the business model assessment can be applied in a clearly structured manner across all areas. However, we would like to highlight the treatment of "syndication in the lending business" as problematic. We believe that the evidence of the AC-compliant cash flows must be provided on a regular basis, due to the fundamentally questionable mandatory assignment of syndications to sales transactions. For the purpose of minimising the risk of an FV measurement, appropriate procedural and technical implementations were carried out (question (c)).

(c) No (with the exception of the above-mentioned case).

Q3 - Contractual cash flow characteristics

(a) Is the cash flow characteristics assessment working as the Board intended? Why or why not?

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

(b) Can the cash flow characteristics assessment be applied consistently? Why or why not?

(c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?

(a) In general, the cash flow characteristics assessment is working as the Board intended. However, the implementation of the necessary processes for checking the SPPI conformity is very time-consuming and complex, whereas in our view the effects compared to IAS 39 are marginal. As an exception to the practicability of the cash flow characteristics, the "non-recourse financing" has been defined (to prove the AC capability, additional complex individual tests are required).

The EACB members believe that the ESG linked financial instruments will gain increasing importance in practice. The assessment of SPPI criterion for such instruments that were not prevalent when IFRS 9 was developed, is challenging in practice. In the future, the structures of these instruments may no longer withstand the SPPI test since the application of the "de minimis" regulation will no longer be possible. Moreover, establishing a demonstration that supports the ESG targets specified on a particular loan affect the probability of the borrower defaulting on that loan is complex to operationalize.

ESG risks are expected to be integrated in the traditional prudential risk categories (credit, market and operational risks). As a result, from EACB view, they are intended to be incorporated in the component of interest of a basic lending arrangement. Since the ESG linked loans are going to be mostly held in an HTC business model, the amortized classification will give the most faithful measurement basis to these instruments.

In this regard, the IASB would be required to undertake the standard-setting to be able to continue guaranteeing the AC classification for those instruments, that is crucial to the transition of green economy.

(b) Yes.

(c) Please see answer to (a). In addition, new product processes are sometimes much more complex when it comes to identifying and evaluating new SPPI-relevant features. There is a growing need for auditor evaluations in order to establish security for the accounting-related processes on a regular basis.

Q4 - *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?

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

(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?

(a) While in principle exercising the FVOCI option for equity instruments should make the balance sheet addressees more aware of the contribution to the success of long-term investments in such participations, however, in our opinion, the readers of the balance sheet could get a better insight into the Group's earnings position if the amounts accumulated in the OCI would be recycled through profit or loss in the income statement at the time of the disposal of such an asset. This was the case for the "available for sale" category under the regime of IAS 39, because at that point in time these amounts were actually realised. In addition, this is the only way to fully record the overall profit over the entire holding period and reflect the

effective performance of this investments. We do not consider the information in accordance with IFRS 7.11B (c) in the notes to be equivalent.

We recommend therefore the introduction of recycling for such instruments, coupled with the introduction of a robust impairment test. Furthermore, there is an asymmetry classification between the direct investment in equity instruments or indirect one, throughout shares in funds. The latter are classified as debt instruments in IAS 32 from holder's perspective and measured in fair value in P&L which introduces volatility.

To eliminate this bias in favor of direct holding, we believe that an equity instrument type should be introduced for shares in equity fund held in long term perspectives provided the fund performance is not leveraged.

(b) Some EACB members concerned elect to present fair value changes in OCI for long term investments.

(c) Yes. Some financial institutions decide to classify equity instruments held as long-term investments as fair value in P&L, in order to reflect more adequately the performance of these instruments. This disregards the way equity instruments are really managed.

Q5 - *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?

(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)?

(a) For the EACB members, the determination of the effects of own credit is associated with considerable effort. Indeed, in our view, the cost-benefit ratio between the effort of the preparers and the benefit for the addressees is questionable.

(b) No.

Q6 - *Modifications to contractual cash flows*

(a) Are the requirements for modifications to contractual cash flows working as the Board intended? Why or why not?

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

(a) From our point of view, high technical and procedural implementation costs required to identify possible modifications are offset by what we consider to be only a low added value of the information. Furthermore, the catalogue of defined possible modification issues is very large, in comparison to a very small number of practical use cases as well as the resulting effects.

(b) Our members consider that the requirements for modifications to contractual cash flows are applied consistently.

Q7 - *Amortised cost and the effective interest method*

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

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

We consider that the EIM requirements in IFRS 9 are working as intended.

Nevertheless, within its tentative agenda decision issued in June 2021, the IFRS Committee considered several accounting issues on the European Central Bank (ECB) targeted longer-term refinancing operations (TLTRO III) and specified some of these issues as part of a broader matter that should be considered in the IFRS 9 Post Implementation Review.

The EACB members recommend that the Board provides further clarification on these issues.

According to the agenda decision of November 2021 (paragraph 82), the IFRS Committee states that IFRS 9. B5.4.5 applies to floating-rate financial liabilities which can periodically be adjusted to reflect general movements in the market rates of interest (such as benchmark interest rate) not specific to particular entity.

The EACB members are convinced when the reset at market rates involves the floating rate but also, given the exceptional circumstances of Covid-19 crisis, the fixed 50 basis points discount given by the ECB on some of the TLTRO III tranches for a fixed period. This fixed component was reset unilaterally by the ECB to facilitate financing in the period of Covid crisis and reflect market conditions at this time.

Q8 – *Transition*

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

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

It is the EACB members' experience that the relief provisions have resulted in lower implementation costs.

Q9 – *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?

(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?

It would be important for the EACB members to allow the representation of the economic results' generation in the commercial law (by considering internal transactions).

Contact:

For further information or questions on this paper, please contact:

- Mr. Volker Heegemann, Head of Department (v.heegemann@eacb.coop)
- Ms. Maryia Sulik, Adviser (maryia.sulik@eacb.coop)