EFFAS | The European Federation of Financial Analysts Societies

Sophienstraße 44 DE – 60487
Frankfurt am Main, Germany
Direct number: +49 69 98959519
Fax number: +49 69 98957529
E-mail: office@effas.com
Internet: www.effas.com

Contact: Phillip Liriano

4th January 2022

Mr. Jean-Paul Gauzes
EFRAG Chairman
35 Square de Meeûs
1000 Brussels (fifth floor)
Belgium

Re: PiR – IFRS 9 *Financial Instruments Classification and Measurement*

Dear Jean-Paul,

EFFAS Commission on Financial Reporting ("Commission", "we") would like to share with you its views on EFRAG's *Draft* Comment Letter (DCL*)* Request for Information on *PiR IFRS 9 Classification and Measurement.*

EFFAS supports EFRAG's comprehensive and high-quality documents albeit it reiterates the need to prepare documents avoiding density and complexity. Following the revision of the DCL, the Commission would like to address the following points.

Q1.- Classification and Measurement

We agree with EFRAG's response. Companies and mainly financial institutions classify and measure financial instruments, particularly traditional bank lending, at amortized cost following IFRS 9. From a user's perspective, we continue to support this approach principally for financial assets not held for sale.

Also, as noted in DCL's paragraph 11, we agree that classification and measurement based on the business model provides information that is useful for users to assess primarily the amounts and timing of future cash flows. Moreover, disclosures should be clear regarding the period and how the standard has been applied by the entity.

Q2.- Business model for managing financial assets

The Commission considers that the evaluation of the business model of an entity generally provides useful information about the use of financial instruments. This view, in line with EFRAG's response, also considers that no further standard settings should be contemplated.

Regarding reclassification, companies should report situations in which an event has occurred, *in the classification and measurement of financial assets after initial recognition.* As indicated in the PiR document in the Spotlight 2- Reclassification, page, 11, we agree with the IASB that entities do not change business models regularly, on the contrary they rarely do.

Regarding the business model, however, we think that EFRAG's comment arguing that in some circumstances the business model cannot be consistently applied remains unclear. We suggest a more concrete explanation to clarify this statement.

Q3.- Contractual cash flow characteristics

The Commission agrees with EFRAG's view contending that the application of the SPPI requirement provides useful information for users about the amount, timing, and uncertainty of future cash flow. We also agree that when a financial asset originates cash flows that are not only payments of principal and interest fair value should be considered the most appropriate measurement basis. We think that from this perspective IFRS 9 provides useful information for users.

Regarding financial instruments with contractual cash flows that are linked to ESG features and/or KPIs and comply with the SPPI test, we believe that these financial instruments should continue to be measured at amortized cost. No change in the measurement basis should be applied if the estimated cash flows remain largely unchanged based on the contractual agreement.

Therefore, if the interest rate on a loan is adjusted because certain ESG investments or criteria have not been met, and there is a penalization implying an adjustment in the interest rate, the loan could in our view remain at amortized cost.

On the other hand, if a different type of penalization becomes applicable, we think the measurement basis should be adjusted to fair value. We would like to point out that guidelines should be introduced to avoid the potential need of a new standard.

Changes in the features of the initial contract, i.e., interest rate adjustments due to changes to comply with certain sustainability criteria or KPIs should in any case be disclosed (e.g., in the notes) to understand the requirements for contractually linked instruments and their application.

Q4- Equity instrument and other comprehensive income

We think that preparers should be addressing most of these points.

For users, the key point is that if realized gains or losses are not reflected in the profit and loss statement the performance of the equity portfolio might remain undisclosed as equity. This will make it difficult to understand how equity has evolved over the period despite the statement of changes in equity and it will not contribute to the principle of good financial reporting.

5.- Financial liabilities and own credit

The Commission agrees with the current approach to liabilities and no changes should be introduced to this approach. Most liabilities should be measured at amortized costs while liabilities that are held-for-sale should continue to be measured at fair value.

6.- Modification to contractual cashflows

No specific comments.

7.- Amortized cost and the effective interest method

We agree with EFRAG's comments that the effective interest rate method provides useful information for users. Moreover, we are also aware that the continuous evolution and development of new financial instruments with different structures, i.e., premiums, costs, etc., can make the consistent application of the EIR difficult.

As EFRAG notes in paragraph 104 we think that as more and more financial instruments incorporate conditions that might affect the future contractual interest cashflows, entities should disclose the specific changes and adjust KPIs as needed.

8.- Transition

No further comments.

9.- Other matters

The Commission considers that the information provided by the reporting standards is very useful and believes that the benefit of their implementation outweighs the cost. The consistent monitoring of the implementation of the standards is key for their proper application (preparers) and usefulness (users). Given the scope of the projects undertaken by the IASB, we consider that at this point the completion of some of the ongoing projects should be a priority.

The commission encourages EFRAG to continue reviewing and commenting on the Standards to improve their implementation albeit avoiding increasing their complexity.

If you would like to further discuss the views expressed in this letter, please contact us.

Javier de Frutos, Chairman
On behalf of EFFAS Commission on Financial Reporting

EFFAS was established in 1962 as an association for nationally based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 15-member organizations representing more than 16,000 investment professionals. The Commission on Financial Reporting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. CFR members are Javier de Frutos (Chairman, IEAF-Spain), Jacques de Greling (Vice-Chairman- SFAF, France), Friedrich Spandl (ÖVFA, Austria), Henning Strom (NFF, Norway), Serge Pattyn (BVFA/ABAF, Belgium), Luca D'Onofrio (AIAF, Italy), Dr. Carsten Zielke (DVFA, Germany) and Andreas Schenone (SFAA, Switzerland).