PIR IFRS 9 – Views of EFRAG FIWG and IAWG members
Issues Paper

Objective

1 This paper summarises the views from EFRAG FIWG and IAWG members with regard to the issues that should be identified as requiring standard setting in EFRAG's comment letter to the PIR IFRS 9.

Views from FIWG and IAWG on prevalence and priority

2 The following table provides a summary of the EFRAG FIWG and IAWG views.

Nº	Topic	Prevalence in Europe		Priority in Europe	
		FIWG	IAWG	FIWG	IAWG
(2)	Sustainable finance – SPPI test	Prevalent issue in Europe.		High	
(3)	SPPI – use of administrative rates	Prevalent issue in Europe.		Medium	
(5)	Business model – sales – COVID 19	Prevalent issue in Europe.		Medium	
(6)	Contractually linked instruments – non-recourse	Prevalent issue in Europe.		Medium	Low
(20)	Supply chain financing – reverse factoring	Prevalent issue in Europe.		High	Medium
(12)	Modifications of cash flows	Prevalent issue in Europe.		Medium	High
(21)	Financial guarantees	Prevalent issue in Europe.		Low	
(9 ***new***)	Factoring of trade receivables	Prevalent issue in Europe.		Medium	
(10 ***new***)	FVOCI business model	Prevalent issue in Europe		Low	Not to report
	Recycling changes in FV accumulated in OC for equity instruments	Prevalent issue in Europe		High	High
(16)	Benchmark test for last reset rates due to IBOR reform	Not prevalent issue in Europe.		Low	

(4)	Business model – boundary HTC/HTCS (liquidity buffers banks – loan syndicates)	Prevalent issue in Europe		Low	
(7)	Reclassification and IFRS 5 – scope of IFRS 9	Not prevalent issue in Europe		Low	
(8)	Credit risk	Not prevalent issue in Europe		Low	
(11)	Prepayment	Not prevalent issue in Europe		Low	
(15)	Reporting gains on gross basis	Not prevalent issue in Europe		Low	
(17)	Measurement of derivatives to meet obligations to policyholders	Not prevalent issue in Europe	Prevalent issue in Europe	Low	Out of scope

Sustainable finance – SPPI test

3 FIWG and IAWG members disagreed on the view that an ESG feature could be considered as one or more intangible assets. One IAWG member mentioned that for Solvency II that would negatively impact capital.

4 Some FIWG members argued why the initial fair value of this ESG feature would not match the consideration transferred at initial recognition, which would be the prerequisite to arrive at a separate transaction involving an intangible. Most FIWG and IAWG members questioned whether the ESG feature could be defined as a separate asset and whether the bank would have control over it. In case the ESG feature would qualify as an asset, it should be considered as an internal generated asset and, in that case, it should not be recognised.

5 Many of the FIWG and IAWG members considered that the solution of this topic should relate to whether these instruments pass the SPPI test or to expand the scope of SPPI test, so the ESG features can be included.

6 Many EFRAG IAWG members considered that accounting should not encourage or promote neither discourage the use of any financial instrument. They noted that any feature (including ESG) that may impact on cash flows of the instrument and risk adjustments should be visible and considered in the accounting treatment. Also it was noted that one should look at the economic/financial characteristics of the instrument rather than the ESG label of the product, as similar financial instruments should be treated similarly.

7 Also, it was noted that it is difficult to define whether ESG features have an impact on credit risk (i.e., the instrument is compatible with an SPPI concept). For securitised bonds backed by mortgage loans which finance high energy efficient houses a high investor demand exists, so their fair value is also high. But there is no clear linkage between a higher market houses price and their high energy performance certificate rating.

8 One EFRAG IAWG member mentioned that the IASB should consider specific disclosures on ESG financial instruments.

SPPI – use of administrative rates

9 EFRAG FIWG members from affected jurisdictions advocated a relaxation of the SPPI criteria for such rates unless the blended rate contains elements that do not fit with a basic lending instrument. They indicated that educational material would be useful.

10 Other EFRAG FIWG members cautioned against standard setting and noted that if banks replicate their funding costs in the interests they charge, this would possibly

fit within the SPPI test. Also, one EFRAG IAWG member noted there were no issues with these instruments.

Business model – sales – COVID

11 EFRAG FIWG and IAWG members generally agreed with EFRAG conclusions on the IFRS 9 endorsement advice in 2015, where that reclassification triggered solely based on a change in intentions due to market conditions would create tension in terms of reliability of the information. However, during COVID 19 some considered an actual change in the business model of the assets held (e.g., hospitality) triggered by market conditions, which is different.

Contractually linked instruments – non recourse

12 EFRAG FIWG members agreed that the guidance on contractually linked instruments and non-recourse lacks clarity in some situations, especially on the application of the look-through approach. Some FIWG members called for additional guidance or educational material. Although this was an area of structured finance FIWG members agreed this lack of guidance needs to be addressed.

13 EFRAG IAWG members did not encounter issues with this type of instruments.

Modifications of cash flows

14 EFRAG FIWG members mentioned that diversity in practice exists. However, both EFRAG FIWG and IAWG members mentioned that banks and insurers have implemented some internal guidance to decide whether those modification were significant or not and as a result some FIWG members did see not merit in starting a standard setting process.

15 Some EFRAG FIWG members noted that some of the difficulties to define whether a modification was significant or not derived from the interaction with NPL and PL regulatory requirements. In particular, when a re-estimation or a derecognition of the cash flows of a NPL interacted with ECL calculations.

Supply chain financing

16 EFRAG FIWG members acknowledged there were still issues to clarify in the cash flow statement but added there was already a lot of existing guidance in addressing the other issues raised and suggested not to deal with this topic in the PIR of IFRS°9.

17 EFRAG IAWG members did not comment on these transactions.

Financial guarantees

18 EFRAG FIWG members noted that in practice there was a lack of guidance for financial guarantees that are an integral element of another financial instrument in IFRS. However, the accounting firm' books have dealt with this issue and EFRAG FIWG members recommended not to include this issue on the list to report in the RFI.

19 One IAWG member noted this issue was not material for insurance companies.

Factoring of trade receivables

20 EFRAG FIWG members were cautious about putting this topic on the list and noted that disclosures should be used to provide information about the factoring operations.

21 EFRAG IAWG members did not comment on these transactions.

FVOCI business model

22 FIWG and IAWG members disagreed with the removal of the FVOCI business model for bonds. Even an insurance only application of the business model was

not supported by EFRAG IAWG members as insurers did not support to describe this business model as industry specific.

23 Two EFRAG IAWG members noted that about 90-95% of their financial assets would qualify for the FVOCI business model. Even if a part of these financial assets would be measured at FVPL in order to avoid accounting mismatches with the insurance liabilities under the VFA-approach, still a significant part of the financial assets would be measured at FVOCI (matching non-VFA insurance contracts).

24 Some FIWG members noted that this business model was more complex but the objective was to show amortised cost performance (including impairments) in profit or loss (with any other fair value changes recognised in other comprehensive income) and fair value information in the statement of financial position.

25 One user noted, while having sympathy for the proposal to remove the FVOCI business model, that this was an old debate and as decisions had been made in the past it was now too late (i.e. with most insurers applying IFRS 9 as from 2023) to make such significant changes to the standard.

Questions for EFRAG TEG

26 Does EFRAG TEG agree with the comments of FIWG and IAWG members?