POSITION PAPER

WSBI–ESBG Position Paper to the IASB consultation on narrow-scope amendments to the classification and measurement requirements for financial instruments

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General comments

We welcome this ED which provide improvements to IFRS 9 and will clarify that some ESG-indexed loans are eligible to amortised cost.

Besides, the treatment of ESG-indexed loans should be handled by the IASB as a priority topic.

Questions for consultation

Question 1 - Derecognition of a financial liability settled through electronic transfer

Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity.

Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

In our opinion, recognition and derecognition requirements in IFRS 9 work as intended, however we agree with the IASB approach to introduce an option for accounting for derecognition of financial liabilities settled using electronic payment system, before settlement date, only when specified criteria are met, and in particular if from that moment entities no longer have the ability to access that cash.

It is important to highlight that this approach is an option for preparers, and this will allow entities to assess whether the cost/benefit balance of applying this modification is reasonable.

We are of the opinion that the three criteria identified in paragraph B3.3.8. seams robust and understandable for preparers and if the three of them are met it could be stated that payment will be almost certain. We also think that these considerations should be extended to other payment systems that comply with that requirements, not only electronic payment systems but also for example to credit cards.

We appreciate also clarifications included in paragraph B3.3.9. of the ED regarding characteristics of the electronic payments system to qualify the settlement risk as insignificant.

It would be also useful to consider also the asset side of these transactions. Same criteria described in paragraph B3.3.8 could be applied for asset

derecognition, and it would made sense that derecognition of both financial asset and liability is at the same time. It would be relevant for example in intra-group transactions, where differences between derecognition criteria for assets and liabilities could lead to consolidation adjustment and operational challenges.

Finally, as paragraph B3.1.6 of IFRS 9 describes only how to apply settlement date accounting to financial assets, we agree with EFRAG's proposal to amend this paragraph of IFRS 9 to specify how the settlement date accounting should be applied to a financial liability.

Question 2 - Classification of financial assets—contractual terms that are consistent with a basic lending arrangement

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:

(a) interest for the purposes of applying paragraph B4.1.7A;

(b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We welcome the clarification provided by the IASB in B4.1.10A in relation to the issues faced in practice when applying SPPI assessment for financial assets with ESG-linked cash flow variability. In this regard, we also consider as helpful adding the examples for Instrument EA and Instrument I for clarifying on how the requirements relate to ESG features.

However, we consider that wording in paragraph B4.1.8A should be improved in respect of incorporating the "profit margin" notion in and removing the reference to „magnitude".

As explained in AP16A§10 (Sept 2022), paragraph B4.1.8A clarifies that amortised cost as a measurement basis only provides useful information about the amount, timing and uncertainty of future cash flows if the 'what' is consideration for basic lending risks, costs and **a profit margin**. The profit margin element should therefore be included in paragraph B4.1.8A.

Moreover, the requirement that a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the **magnitude** of the change in basic lending risk or costs seems inconsistent both with :

- the second sentence of B4.1.8A which clarifies that the assessment of interest focuses on *what* the entity is being compensated for instead of *how much* the entity receives for a particular element.
- BC47c which explains that an entity is not necessarily required to carry out a quantitative analysis of the different elements of interest to determine whether the contractual cash flows are consistent with a basic lending arrangement;

In order to avoid unnecessarily quantitative demonstration regarding the magnitude of the change in basic risk, cost or margin profit in relation with the change in contractual cash flows, the Board intention would be better reflected by simply requiring that the change in contractual cash flows is **not disproportionate**. This is consistent with BC52 of the ED stating that *the IASB therefore decided to clarify that, for contractual cash flows to be consistent with a basic lending arrangement, a change in contractual cash flows has to be directionally consistent with, as well as proportionate to, a change in lending risks or costs*. For instance, a contingent feature that may double or fully cancel the amount of interest seems disproportionate and it is not likely that such feature would be consistent with a basic lending arrangement.

We therefore propose the following amendments to par. B4.1.8A :
B4.1.8A In assessing whether the contractual cash flows of a financial asset are consistent with a basic lending arrangement, an entity may have to consider the different elements of interest separately. The assessment of interest focuses on *what* an entity is being compensated for, rather than *how much* compensation an entity receives. Contractual cash flows are inconsistent with a basic lending arrangement if they include compensation for risks or market factors that are not typically considered to be basic lending risks, ~~or~~ costs (for example, a share of the debtor's revenue or profit) or profit margin, even if such contractual terms are common in the market in which the entity operates. Furthermore, a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction ~~and magnitude~~ of the change in basic lending risks, ~~or~~ costs or profit margin or appears to be disproportionate.

While we welcome the proposal outlined in paragraph B4.1.10A, we believe that certain unintended consequences of this should be addressed by the IASB. The clarification that for a change in contractual cash flows to be consistent with a basic lending arrangement, the occurrence (or non-occurrence) of the contingent event must be specific to the debtor is useful, especially for ESG-linked loans. However, some loans may include contingent event related to the creditor. For instance, some loans may include an increased cost clause (e.g. additional costs directly linked to the loan following to change in law or regulation).

Question 3 - Classification of financial assets—financial assets with non-recourse features

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term ‘non-recourse’.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We support clarification in paragraph B4.1.16A to help preparers to distinguish between an exposure to the specified asset’s/pool of financial instruments’ performance risk and exposure to the debtor’s credit risk. That would help to assess the SPPI test to non-recourse financial assets.

We believe the IASB has responded to concerns raised during the PIR, including more clarity on the “look through” approach required in paragraph B4.1.17 for non-recourse financial assets and in particular for contractually linked instruments.

Question 4 - Classification of financial assets—contractually linked instruments

The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21– B4.1.26 of IFRS 9.

The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9.

Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

From our point of view, proposed modifications in paragraphs B4.1.20 and B4.1.20A provide adequate clarifications both on the definition of contractually linked instruments and on requirements for investments in these instruments with respect to the application of the SPPI requirements.

Question 5 - Disclosures—investments in equity instruments designated at fair value through other comprehensive income

For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to:

(a) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period;

(b) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period.

Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We consider that realised gains and losses from investments are better presented in profit and loss, whereas unrealized fair value movements are better presented in OCI until they are realized.

However, considering latest decisions of the IASB not to address the recycling issue for FVOCI instruments, we believe that at least with the proposed amendments, disclosures related to changes in fair value during the period and amounts recognized in OCI will help users of financial statements to evaluate the performance of equity investments at FVOCI upon disposal and to disaggregate changes in fair value related to investments derecognized at the end of the reporting period and changes in FV related to investments held.

Question 6 - Disclosures—contractual terms that could change the timing or amount of contractual cash flows

Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

We are concerned by the potential scope of the disclosures on contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event.

We note that the proposed disclosures would relate not only to financial assets with ESG features. Cash flow variability conditional upon event specific to the debtor also relates to features such as margin ratches whereby the margin is adjusted by reference to certain financial ratios of the debtor. Other examples may be cross-selling clauses, penalty interest. Such margin adjustments are considered to be SPPI based on the existing requirements. Over six years of IFRS 9 application users have not expressed the need for having additional disclosures for such features. We consider that once features are SPPI they relate to simple basic lending and there is sufficient accounting mechanism in IFRS 9 for capturing their variability. Systems for identifying these features in respect of carrying amounts and tracking the range of potential changes have not been developed by financial institutions during IFRS 9 implementation and afterwards. Banks have set up IFRS 9 classification processes with focus on high quality and these are regularly reviewed so they can reflect changes in the market. Collection of quantitative data is not part of these processes and would involve high implementation but also ongoing costs. It would not add up to the quality of the assessment process. As a result, we consider that the costs for producing these disclosures are not reasonable considering limited value of the information.

If, however, the IASB decides to keep these disclosures we suggest that paragraph 20B is limited to contingent events non-specific to the debtor other than those related to the time value. For example, prepayment features are specific to the debtor and would be excluded from these disclosures.

Question 7 - Transition

Paragraphs 7.2.47–7.2.49 of the draft amendments to IFRS 9 would require an entity to apply the amendments retrospectively, but not to restate comparative information. The amendments also propose that an entity be required to disclose information about financial assets that changed measurement category as a result of applying these amendments.

Paragraphs BC105–BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals.
Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We agree with these proposals.

About WSBI (World Savings and Retail Banking Institute)

Founded in 1924, WSBI brings together savings and retail banks from 67 countries, representing savings and retail banks worldwide. WSBI focuses on international regulatory issues that affect the savings and retail banking industry and provides a platform for knowledge exchange between member banks. Its aim is to achieve sustainable, inclusive, and balanced growth and job creation. Supporting a diversified range of financial services to meet customer needs, WSBI favours an inclusive form of globalization that is just and fair. It supports international efforts to advance financial access and financial usage for everyone. WSBI recognizes that there are always lessons to be learned from savings and retail banks from different environments and economic circumstances. It, therefore, fosters the exchange of experience and best practices among its members and supports their advancement as sound, well-governed, and inclusive financial institutions.

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About ESBG (European Savings and Retail Banking Group)

ESBG is an association that represents the locally focused European banking sector, helping savings and retail banks in 16 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 871 banks, which together employ 610,000 people driven to innovate at 41,000 outlets. ESBG members have total assets of €6.38 trillion, provide €3.6 trillion billion in loans to non-banks, and serve 163 million Europeans seeking retail banking services.

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