



EUROPEAN CENTRAL BANK

EUROSYSTEM

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Frankfurt am Main, 30 June 2015

EFRAG draft endorsement advice on the adoption of IFRS 9 *Financial Instruments*

Dear Mr Marshall,

The International Accounting Standards Board (IASB) published IFRS 9 *Financial Instruments* in July 2014. In December 2014, the European Commission officially requested the European Financial Reporting Advisory Group (EFRAG) to provide advice on the endorsement of IFRS 9 in accordance with the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards. In its draft endorsement advice, EFRAG recommends IFRS 9 for endorsement without further delay as it meets the endorsement criteria, including the criterion of "European public good".

The ECB, as an observer in the EFRAG Board, is pleased to provide input on the EFRAG's endorsement advice. The ECB has a keen interest in accounting standards that properly reflect the economic substance of transactions and do not compromise financial stability, and our assessment of IFRS 9 therefore focuses on "transparency" and "financial stability".

Overall, the ECB believes that IFRS 9 is based on clear principles in the areas of classification and measurement of financial instruments, impairment and general hedge accounting, and constitutes an improvement over the rather rules-based IAS 39. Furthermore, the ECB is not aware of any objective reason suggesting that IFRS 9 is not conducive to the European Public Good. On the contrary, some aspects of IFRS 9 may be an improvement from a financial stability perspective.

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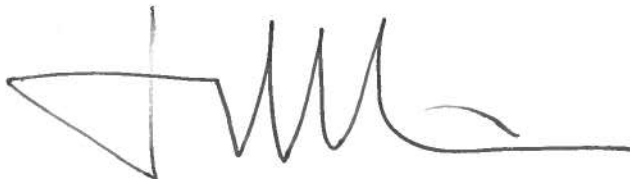
From a **transparency perspective**, the ECB welcomes the principles-based approach to the classification and measurement of financial instruments that retains a “mixed-measurement model”, with some assets measured at amortised cost and others at fair value. We believe that the classification rules of IFRS 9, which are based on the business model and the features of the financial instruments’ cash flows, provide more useful information to stakeholders. In addition, we believe that the single impairment model of IFRS 9 that is based on expected credit losses would enhance comparability across the relevant classification categories, reduce complexity and result in a better reflection of credit risk in the financial statements. Overall, the new impairment model seems to strike the right balance between the provision of relevant accounting information and practical feasibility. Finally, the ECB expects that the new general hedge accounting model will better align accounting with how entities actually manage their risks. On the other hand, the IASB could better explain the rationale for introducing a prohibition to recycle to P&L gains and losses on equity instruments that are accounted for at fair value through other comprehensive income (OCI). The ECB also notes that the boundaries between the various classification categories are not always straightforward. Moreover, a lot of management judgement can be involved when estimating expected credit losses. Consequently, the ECB highlights the crucial role of the auditors and welcomes EFRAG’s recommendation that the implementation of IFRS 9 is closely monitored.

From a **financial stability perspective**, the ECB has come across no evidence suggesting that the use of fair value accounting will be significantly expanded by applying the classification and measurement requirements of IFRS 9. However, the ultimate classification and measurement of financial instruments depends on various factors, including the respective business models and the features of the cash flows of financial instruments that are held by financial institutions. Against this background, we deem it necessary to closely monitor the application of IFRS 9 in practice. As regards the impairment of financial instruments, the ECB views the new expected credit loss model under IFRS 9 as a good compromise between the objectives of transparency and safeguarding financial stability. We believe that the new model, if properly applied, would result in a more timely recognition of credit losses, in line with the G20 request in April 2009, and may therefore contribute to mitigating pro-cyclicality in the financial system. However, we recognise the importance of monitoring the application of IFRS 9 to ensure that the rules are appropriately interpreted by users, and that there are no unintended cyclical consequences of its implementation. As regards hedge accounting, the ECB expects that the new general hedge accounting model will reduce “artificial” volatility in the profit and loss account by expanding the range of potential hedging strategies.

Finally, the ECB acknowledges that an assessment of IFRS 9 must consider any interactions with the upcoming new IFRS on Insurance Contracts. The ECB does not feel compelled to take a strong view on the matter. There are pertinent arguments that support both the deferral of IFRS 9 for insurance businesses for a maximum period of two years and the upholding of IFRS 9 and its timely application. The ECB takes note that the IASB considers, at this stage, the preparation of interpretation guidance on how IFRS 4 should be applied to mitigate potential effects of the introduction of IFRS 9, should no deferral be granted.

We trust that the ECB views on IFRS 9 will be considered by EFRAG in finalising its endorsement advice.

Yours sincerely,

A handwritten signature in black ink, consisting of a series of loops and a long horizontal stroke at the end.

Cc:

Mr Jonathan Faull, Director General of the Directorate General for the Internal Market and Services,
European Commission

Ms Valérie Ledure, Deputy and Acting Head of the Accounting and Financial Reporting Unit, of the
Directorate General for the Internal Market and Services, European Commission

Mr Steven Maijoor, Chair of the European Securities and Markets Authority (ESMA)

Mr Gabriel Bernardino, Chair of the European Insurance and Occupational Pensions Authority (EIOPA)

Mr Andrea Enria, Chair of the European Banking Authority (EBA)

Ms Françoise Flores, Chair of the EFRAG Technical Expert Group (TEG) and CEO