

Feedback to respondents – EFRAG Final Comment Letter on the IASB Request for Information – Post-Implementation Review of IFRS 9 – *Classification and Measurement*

February 2022

This Feedback Statement has been compiled by the EFRAG Secretariat to summarise the main comments received by EFRAG on its draft comment letter and explain how those comments were considered by EFRAG during its technical discussions leading to the publication of its Final Comment Letter. The content of this Feedback Statement does not constitute any form of advice or opinion and does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG.

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Introduction

Objective of this feedback statement

EFRAG published its Final Comment Letter on the Request for Information IFRS 9 *Financial Instruments – Classification and Measurement – Post-Implementation Review* (‘the RFI’) on 28 January 2022. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG’s Final Comment Letter.

Background to the RFI

The IASB published the RFI on 28 September 2021. The Post Implementation Review of IFRS 9 (‘the PIR’) is limited to the classification and measurement principles of the Standard. The IFRS 9 approach to classifying and measuring financial assets was developed in response to long-standing and widespread stakeholder views that the approach in IAS 39 was too rule-based and complex. IFRS 9 provides a principle-based approach that applies to all financial assets. That approach aligns measurement with the contractual cash flow characteristics of the assets and the way the entity manages them. Measurement and disclosures aligned to both these factors provides users of financial statements with useful information about the amount, timing and uncertainty of the entity’s future cash flows. The IASB retained the IAS 39 classification and measurement requirements for financial liabilities substantially unchanged in IFRS 9 but addressed the so-called ‘own credit issue’ relating to gains and losses arising from changes in the credit risk of financial liabilities an entity elected to be measured at fair value through profit or loss. Further details are available on the IASB [website](#).

EFRAG’s draft comment letter

EFRAG published a draft comment letter (‘the DCL’) on 8 November 2021. In the DCL EFRAG noted several issues that are prevalent in Europe and might deserve standard-setting activities. Those with highest priorities are the application of the SPPI-test to sustainable finance products, the absence of recycling for FVOCI (fair value through OCI) equity instruments, the treatment of equity-type instruments and reporting on reverse factoring.

Comments received from respondents

EFRAG has received and considered 13 (thirteen) comment letters (and three draft letters) from respondents. The comment letters are available on the EFRAG [website](#). The comment letters received came from one user organisation, national standard setters, preparer organisations, preparers, and one individual.

In addition to the comment letter process, EFRAG consulted the EFRAG FIWG, EFRAG IAWG and EFRAG User Panel and held several one-to-one meetings with respondents belonging to the following categories: associations of preparers, preparers of the banking and insurance industries, auditors, national standard setters, and banking regulators. These meetings were aimed to get more detailed information on financial instruments with ESG (environmental, social and governance) features and equity-type instruments.

Comment letters

Respondents did not provide answers to each question in the RFI. Those that did generally agreed that the classification and measurement requirements provide useful information in most cases and can be applied consistently. Notwithstanding this, most respondents confirmed the issues raised in the DCL or added new

ones where standard setting was thought to be necessary. Other respondents indicated that for modifications, financial guarantees, factoring of trade receivables, administrative rates and supply chain financing practices have now settled, making additional standard setting unnecessary.

Many respondents agreed with EFRAG that issues arise for financial instruments with ESG features and that absence of recycling creates significant concerns. For financial instruments with ESG features it was added that multiple potential solutions exist and that some solutions may not fall within a reasonable cost/benefit trade-off.

Other respondents suggested adding the following issues: loan syndications, energy contracts, own use contracts, purchased or originated credit impaired financial assets (POCI) and hedge accounting for insurers.

Outreach input

Banks generally apply a de minimis approach to ESG features today, but this is not considered a long-term solution as the relative size of these features is expected to rise. An urgent solution was needed from the IASB; there was a need to separate this issue from the PIR of IFRS 9 with the aim to speed up the search for a solution.

EFRAG FIWG members noted that the treatment of equity-type instruments was not a pressing issue for the banking community. In contrast, for EFRAG IAWG members this issue was very important; they stressed the importance of broadening the definition of equity-type instruments. EFRAG User Panel members shared mixed views with a slight preference for a measurement at FVPL.

EFRAG User Panel members noted that factored receivables distort the performance of assets and operational flows in the cash flow statement. Companies that make significant use of factoring may

have more liquidity issues during a slowdown scenario; users need to be able to assess this risk. Also, information on historical loss rates on factored receivables was considered useful.

EFRAG’s Final Comment Letter

EFRAG issued its [Final Comment Letter](#) on 28 January 2022.

EFRAG noted that the combination of the cash flow characteristics of the assets together with the assessment of the entity’s business model has proven to generally provide an appropriate basis to align the measurement of financial instruments with how they are managed by the entity. However, some areas which require attention are described in the letter.

In some instances, the business model application is challenging, and more guidance and examples could be useful.

EFRAG further noted that the application of the effective interest method creates application challenges in areas such as TLTRO III loans, ratchet loans and financial instruments with ESG features. EFRAG recommended the IASB to monitor how practice will develop, in particular when applying B5.4.5 and subsequent paragraphs of IFRS 9.

The issues of own use contracts and hedge accounting for insurers were added to the letter as well as the existence of an accounting mismatch given the different treatment of financial guarantees from the issuer and holder side. The priority of factoring of trade receivables was lowered and for supply chain financing a reference was made to EFRAG’s DCL on the IASB ED/2021/10 *Supplier Finance Arrangements*.

EFRAG did no longer consider modifications and financial guarantees as areas for standard-setting activities given the comments received that practice has settled in these fields.

Detailed analysis of issues, comments received, and changes made to EFRAG’s Final Comment Letter

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

EFRAG’s response to respondents’ comments

Question 1 – Classification and Measurement

Proposals in the RFI

IFRS 9 provides a principle-based approach to classification and measurement that applies to all financial assets. That approach aligns measurement with the contractual cash flow characteristics of the assets and the way the entity manages them. Measurement aligned to both these factors provides users of financial statements with useful information about the amount, timing and uncertainty of the entity’s future cash flows.

EFRAG’s tentative position

EFRAG was of the view that the classification and measurement requirements in IFRS 9 generally enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how an entity expects to manage them.

Nevertheless, EFRAG indicated areas of attention, such as the use of administrative rates, financial instruments with ESG features. (Please refer to Question 3).

Respondents’ comments

Comment letters

The majority of respondents agreed that the classification and measurement requirements in IFRS 9 generally enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how an entity expects to manage them and provide

EFRAG’s final position

Considering the feedback received, EFRAG decided to highlight in its response the following issues which need to be addressed by the IASB: measurement rules for equity and equity-type financial instruments, including a possibility of recycling option for financial instruments measured at FVOCI and to refer for more details to Questions 3 and 4.

EFRAG is of the view that the classification and measurement requirements in IFRS 9 generally enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how an entity expects to manage them.

EFRAG considers that on overall the classification and measurement requirements of IFRS 9 provide information that is useful for users to assess the amounts and timing of future cash flows.

Nevertheless, EFRAG suggests that the IASB addresses the issues of financial instruments with ESG features, measurement rules for equity and equity-type financial instruments, including recycling for equity instruments measured at FVOCI, and the use of administrative rates. (Please refer to Questions 3 and 4).

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

information that is useful for users to assess the amounts and timing of future cash flows.

Respondents, nevertheless, highlighted the following issues:

- Current IFRS 9 measurement rules for equity and equity-type financial instruments do not always adequately reflect the holders’ applicable business model for long-term investments. This issue is particularly relevant for insurance entities;
- Inability to account for equity instruments and investments in puttable instruments at FVOCI with recycling when they do not pass the SPPI test, although they meet the business model condition; and
- Application of the SPPI cash flow criterion to financial instruments with contractual cash flows linked to ESG target achievements may be challenging.

Outreach input

Please refer to Questions 3 and 4.

EFRAG’s response to respondents’ comments

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Question 2 – Business model for managing financial assets

Proposals in the RFI

In the context of IFRS 9, a 'business model' refers to how an entity manages its financial assets to generate cash flows - by collecting contractual cash flows, selling financial assets or both. Consequently, classification and measurement based on the business model provides information that is useful in assessing the amounts, timing and uncertainty of an entity's future cash flows.

An entity's business model is typically observable through the entity's activities to achieve its business objective. An entity considers all available relevant evidence to determine the business model.

IFRS 9 requires financial assets to be reclassified between measurement categories when-and only when-the entity's business model for managing them changes. In accordance with IFRS 9, a change in business model is a significant event and is expected to be rare.

EFRAG’s tentative position

EFRAG considered that the combination of cash flow characteristics of the assets together with the assessment of the entity’s business model generally provide an appropriate basis to align the measurement of financial instruments with how they are managed by the entity.

EFRAG had been informed that in some circumstances the business model could not be applied consistently, however EFRAG did not consider that further standard-setting activity was needed as the existing IFRS 9 requirements result in appropriate outcomes.

EFRAG’s response to respondents’ comments

EFRAG’s final position

Considering the feedback received, EFRAG decided not to make any changes to its tentative position other than asking for more guidance and examples.

EFRAG considers that the combination of the assessment of cash flow characteristics of the assets and the assessment of the entity’s business model generally provides an appropriate basis to align the measurement of financial instruments with how they are managed by the entity.

EFRAG has been informed that in some circumstances the business model could not be applied consistently, and more guidance and examples could help to drive greater consistency of application.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Respondents’ comments

Comment letters

Six respondents agreed that no further standard-setting activities should be contemplated as there is sufficient guidance to conduct a consistent and sustainable business model assessment.

However, one respondent noted that the IASB should undertake standard setting to consider permitting reclassifications in circumstances other than those specified in paragraph B4.4.1 of IFRS 9.

Another respondent did not report any diversity in practice and did not experience unexpected effects from the business model assessment.

Outreach input

Not applicable.

EFRAG’s response to respondents’ comments

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Question 3 – Contractual cash flow characteristics

Proposals in the RFI

In the IASB’s view, amortised cost can provide useful information only if the contractual cash flows do not introduce risks or volatility that are inconsistent with a basic lending arrangement. Only financial assets with SPPI cash flows are eligible for measurement using amortised cost or FVOCI, subject to the business model.

The effective interest method, combined with the expected credit loss impairment model, provides relevant information for financial assets with SPPI cash flows. IFRS 9 does not require or permit embedded derivatives to be separated from financial asset hosts. Thus, one assesses the contractual cash flow characteristics of a financial asset in its entirety.

EFRAG’s tentative position

EFRAG considered that the principle underlying the SPPI requirement generally leads to useful information. However, the SPPI test guidance required a re-evaluation in the light of specific financial instruments such as financial instruments with ESG features or contractually linked financial instruments. EFRAG proposed that the issue of financial instruments with ESG features is removed from the IFRS 9 PIR process and treated separately as an urgent issue resulting in potential targeted improvements to IFRS 9.

Respondents’ comments

Comment letters

Five respondents agreed that the cash flow characteristics assessment is working as the IASB intended. Four respondents added that it (generally)

EFRAG’s response to respondents’ comments

EFRAG’s final position

Considering the feedback received, EFRAG notes that the principle underlying the SPPI requirement generally leads to useful information. However, the IASB should consider whether the classification and measurement guidance in IFRS 9 adequately caters for recent market developments, ESG features and the use of administrative rates. Another issue to consider is the guidance on contractually linked financial instruments. EFRAG proposes that the issue of financial instruments with ESG features is addressed as a separate and urgent issue resulting in potential targeted improvements to IFRS 9.

Generally, the message was softened on the link between the cash flow characteristics assessment and the existence of ESG features.

Regarding financial instruments with ESG features EFRAG included more information on the profit margin approach and noted that other approaches than the credit risk or profit margin approaches should also be considered by the IASB. In addition, EFRAG noted that the treatment of these financial instruments should be looked at both from holder and issuer side.

EFRAG specified that while banks generally would prefer to keep these financial instruments at amortised cost in their banking book, insurers would measure these financial instruments at FVOCI to reduce or eliminate accounting mismatches.

EFRAG reported other fact patterns to the IASB for which respondents had suggested standard-setting activity. These were Sukuk investments and notes/bonds associated with emissions made through

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

leads to useful information. One respondent was of the view that the cash flow characteristics assessment does not entirely work as intended because of how financial instruments with ESG features are assessed. In addition to this, 13 (thirteen) respondents noted issues arise for financial instruments with ESG features and provided different arguments.

Respondents also provided other examples where in their view the cash flow characteristics assessment does not lead to useful information.

Outreach input

Banks generally apply a de minimis approach to ESG features today, but this is not considered a long-term solution as the relative size of these features is expected to rise. An urgent solution is needed from the IASB; there is a need to separate this issue from the PIR of IFRS 9 with the aim to speed up the search for a solution.

Proponents of the profit margin approach argued that lower profit margins are accepted by banks as they have a specific interest in increasing the volume of business in this area.

Proponents of the credit risk approach noted that they do not lose margin on green lending. Instead, they noted that the funding for those loans is cheaper, so both sides of the margin move.

EFRAG IAWG and EFRAG User Panel members did not consider that “green” bonds had different credit risk compared to other financial instruments as their holders will not be paid earlier.

EFRAG’s response to respondents’ comments

a special purpose vehicle within the framework of supply-chain financing programs.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Question 4 – Equity instruments and other comprehensive income

Proposals in the RFI

Equity instruments do not have SPPI cash flows and therefore are measured at fair value through profit or loss as it provides the most useful information about the amount, timing and uncertainty of the cash flows arising from investments in equity instruments.

The IASB acknowledged that, in a narrow set of circumstances, presenting fair value gains and losses from equity investments in profit or loss may not be indicative of the entity’s performance. Therefore, IFRS 9 permits an entity to make an irrevocable election at initial recognition to present in OCI changes in the value of an investment in an equity instrument not held for trading. Those gains and losses are not ‘recycled’ to profit or loss on disposal of the investment, and the investment is not subject to impairment requirements.

Some respondents questioned whether non-recycling for investments in equity instruments in IFRS 9 is consistent with the *Conceptual Framework for Financial Reporting*. The Conceptual Framework explains that, in principle, income and expenses included in OCI in one period are reclassified into profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information or providing a more faithful representation of the entity’s financial performance for that future period. However, if, for example, there is no clear basis for identifying the period in which reclassification would have that result, or the amount that should be reclassified, the IASB may, in developing Standards, decide that income and expenses included in OCI

EFRAG’s response to respondents’ comments

EFRAG’s final position

Considering the feedback received, EFRAG decided to keep the main message of its draft response and, in addition, in its final response:

- To highlight the increasing need for recycling of equity instruments measured at FVOCI for insurance industry accompanied by rebuttable quantitative impairment triggers in an impairment model for FVOCI.
- To list different suggestions from respondents on how to broaden the equity-type definition.
- To note that classifying puttable instruments as debt from the perspective of the issuer was misleading and would not represent the economic substance as the investor was fully exposed to equity risk at any time.
- To highlight the importance of recycling of equity instruments measured at FVOCI for insurance business model(s) for long-term investments.

The absence of recycling has raised significant concerns by respondents. EFRAG considers that the IASB should expeditiously review the non-recycling treatment of equity instruments within IFRS 9, testing whether the Conceptual Framework would justify the recycling of FVOCI gains and losses on such instruments when realised. If recycling was to be reintroduced, the IASB should also consider the features of a robust impairment model, including the reversal of impairment losses.

EFRAG supports that similar fact patterns should be treated similarly,

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

are not to be subsequently reclassified.

EFRAG’s tentative position

The absence of recycling has raised significant concerns by respondents. EFRAG considered the IASB should expeditiously review the non-recycling treatment of equity instruments within IFRS 9, testing whether the Conceptual Framework would justify the recycling of FVOCI gains and losses on such instruments when realised. If recycling was to be reintroduced, the IASB should also consider the features of a robust impairment model, including the reversal of impairment losses.

EFRAG supported that similar fact patterns should be treated similarly, and noted that some mutual funds and puttable instruments, respond to movements in market variables in a similar way to equity instruments even though these do not meet the definition of an equity instrument under IAS 32 *Financial Instruments – Presentation*. Any changes to the accounting for these instruments, aimed at allowing for equity and equity-type instruments to be treated similarly for accounting purposes, would require careful consideration. It would be necessary to evaluate the challenges of developing an appropriate standard-setting solution and considering knock-on effects on the classification and measurement model under IFRS 9. Possible consequences could include structuring opportunities and the ability to assess the nature of the underlying assets and business model at the level of the fund itself. As a working assumption, EFRAG considered that the definition of equity-type instruments should be limited to units of funds and puttable instruments that invest in equity instruments, associated derivatives, and necessary cash holdings.

EFRAG’s response to respondents’ comments

and notes that some mutual funds and puttable instruments, respond to movements in market variables in a similar way to equity instruments. Any changes to the accounting for these instruments, aimed at allowing for equity and equity-type instruments to be treated similarly for accounting purposes, would require careful consideration. As a working assumption, EFRAG considers that the definition of equity-type instruments should be limited to units of funds and puttable instruments that invest in equity instruments, associated derivatives, and necessary cash holdings.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Respondents’ comments

Comment letters

Many respondents confirmed that the absence of recycling raised significant concerns.

Many respondents also agreed that similar fact patterns should be treated similarly and believed that classifying puttable instruments as debt from the perspective of the issuer was misleading because the put option had no intrinsic value as it was merely there to provide liquidity to the investor. They proposed that ‘equity-type instruments could encompass any form of financial instrument that entitles the holder to a return based on the net assets of the fund’.

A few respondents emphasised that the need for recycling of equity instruments will increase when IFRS 17 *Insurance Contracts* is implemented and suggested including rebuttable quantitative impairment triggers in an impairment model for FVOCI.

Two respondents suggested that to provide relevant information about the performance of long-term investments, the accounting treatment of equity-type instruments should be extended to instruments such as UCITS.

Outreach input

Most of the users were in favour of a FVTPL measurement for equity instruments.

The preparers from the insurance industry highlighted as a priority a possibility to measure equity instruments at FVOCI with recycling. They stressed that in the absence of recycling mismatches for the insurance activities would occur.

Banks were divided about this issue as equity is not a significant part of the portfolio of a commercial bank and when active in private equity, banks use FVTPL.

EFRAG’s response to respondents’ comments

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Banks with insurance activities did not see why dividends and realised gains should be treated differently.

Finally, it was noted that when fair value is not reliable, keeping equity at cost (IAS 39) or at the net asset value (US GAAP) was better than having a recycling solution.

Preparers from the insurance industry expressed a need to extend FVOCI treatment to equity-type instruments which should cover structured finance, real estate, infrastructure and investments in windfarms for example.

For investment funds with underlying debt instruments some added that – based on a look through approach – if all the underlying debt instruments meet SPPI, then also the fund can meet the SPPI criterion.

EFRAG’s response to respondents’ comments

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Question 5 – Financial liabilities and own credit

Proposals in the RFI

The fair value of an entity’s own debt is affected by changes in the entity’s own credit risk (own credit). This means that when an entity’s credit quality declines the value of its liabilities fall and, if those liabilities are measured at fair value, the entity recognises a gain (and if the entity’s credit quality improves, the entity recognises a loss). Many users of financial statements and others found this result counterintuitive and confusing.

To address concerns about counterintuitive and confusing results for those financial liabilities voluntarily designated at FVTPL, IFRS 9 requires changes in the fair value of an entity’s own credit risk to be recognised in OCI rather than in profit or loss (unless doing so would create or enlarge an accounting mismatch in profit or loss).

EFRAG’s tentative position

EFRAG was of the view that the requirements work as intended and had not received information that contradicted this view.

Respondents’ comments

Comment letters

Many respondents agreed that the requirements for presenting the effects of own credit risk in OCI are working as intended.

One respondent highlighted the significant judgement involved in measuring own credit spread and auditing the calculations and noted that it might be difficult for users of financial statements to understand the rationale underlying the effects of own credit risk presented in OCI.

EFRAG’s response to respondents’ comments

EFRAG’s final position

EFRAG acknowledges the comments received about the significant judgement involved in measuring the own credit spread and auditing the calculations, leading to difficulties of users to understand the rationale of the amounts held in OCI. Also, practical difficulties were reported by a few respondents with the separation of the credit risk component. However, most respondents did not raise concerns with this requirement.

Further, paragraph 5.7.8 of IFRS 9 states that “If the requirements in paragraph 5.7.7 (to present the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability in OCI) would create or enlarge an accounting mismatch in profit or loss, an entity shall present all gains or losses on that liability (including the effects of changes in the credit risk of that liability) in profit or loss”. This, in EFRAG’s view, addresses the concern expressed by the respondent.

Considering that the majority of respondents agreed that the requirements work as intended, EFRAG decided to keep the draft response unchanged.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Another respondent highlighted that for some contracts within the fair value option, that contain one or more embedded derivatives it might be difficult to present the effects of own credit risk in OCI. This respondent suggested to consider allowing an option to measure the whole instrument at FVTPL in such circumstances.

Outreach input

Not applicable.

EFRAG’s response to respondents’ comments

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Question 6 – Modifications to contractual cash flows

Proposals in the RFI

When contractual cash flows are renegotiated or otherwise modified, the modification could result in the entity derecognising or recalculating the carrying amount (gross carrying amount for financial assets) of the financial instrument.

IFRS 9 does not define a ‘modification’ of a financial asset or financial liability. Paragraph 5.4.3 of IFRS 9 refers to the modification or renegotiation of the contractual cash flows of a financial asset, while paragraph 3.3.2 of IFRS 9 refers to the ‘modification of the terms’ of a financial liability.

When amending IFRS 9 to account for the effects of the interest rate benchmark reform, the IASB acknowledged the omission of a description of a ‘modification’ in IFRS 9. The IASB also admitted that the use of different wording to describe a modification of a financial asset and a financial liability, could lead to diversity in practice. The IASB suggested it might be helpful to clarify the requirements for modifications and to consider making a possible narrow-scope amendment to IFRS 9.

EFRAG’s tentative position

EFRAG understood that the absence of a definition of “substantial modification” and of derecognition thresholds for financial assets in IFRS 9, has led to some diversity in practice of when a financial asset is derecognised or modified.

However, EFRAG also noted that practice has now been established and some do not consider that undertaking standard-setting activities is

EFRAG’s response to respondents’ comments

EFRAG’s final position

Given the feedback received, EFRAG notes that standard setting in this area is either not supported or not indicated as high priority. The majority of respondents, including banking associations, do not support standard setting in this area (as practice has now been established by preparers), while some propose a narrow scope amendment (to explicitly extend to assets the treatment currently applied to liabilities).

EFRAG, therefore, informs the IASB about the diversity in practice and the additional issues collected in the consultation, however with a conclusion that there is no compelling case for standard setting.

EFRAG notes that the absence of a definition of “substantial modification” and of derecognition thresholds for financial assets in IFRS 9 may lead to some diversity in practice.

However, EFRAG also notes that practice has now been established and addressing this issue is not seen as a priority.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

appropriate at this stage. EFRAG consulted its constituents on the need of standard setting for this issue.

Respondents’ comments

Comment letters

The feedback from respondents on this issue was mixed.

Some respondents agreed that the absence of a definition of “substantial modification” and of derecognition thresholds for financial assets in IFRS 9, has led to some diversity in practice. However, they noted that practice has now been established by preparers and no further guidance is needed.

Some respondents, although agreeing that the requirements for modifications work as intended, supported a narrow scope amendment to introduce consistent wording for the description of a modification of a financial asset and a financial liability.

Some other respondents mentioned that the requirements for modifications did not work as intended and results in difficulties identifying whether an interest rate change is within the contractual terms or results in a modification and on restructuring of loans.

Outreach input

Not applicable.

EFRAG’s response to respondents’ comments

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Question 7 – Amortised cost and the effective interest method

Proposals in the RFI

The effective interest method is used to calculate the amortised cost of a financial asset or liability and in the allocation and recognition of the interest revenue or expense in profit or loss over the relevant period.

When calculating the effective interest rate, an entity estimates the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but does not consider the expected credit losses (for financial assets). The calculation includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

EFRAG’s tentative position

EFRAG considered that the effective interest rate method generally provides useful information and noted that IFRS 9 includes scope limitations or corrections to the method for particular financial instruments. EFRAG further noted that more and more financial instruments incorporate conditions such as TLTRO related loans and ratchet loans. The financial instruments including such conditions were pervasive in Europe. EFRAG noted that the application of the EIR poses practical challenges both for the initial and subsequent measurement.

EFRAG’s response to respondents’ comments

EFRAG’s final position

EFRAG considers that the effective interest rate method generally provides useful information. However, EFRAG notes recent application challenges for instruments that incorporate conditional cash flows; the IASB should monitor how the practice will develop, specifically regarding the application of B.5.4.5 and subsequent paragraphs of IFRS 9.

Generally, the message was softened on the link between the cash flow characteristics assessment and the existence of ESG features.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

EFRAG’s response to respondents’ comments

Respondents’ comments

Comment letters

Two respondents agreed that the effective interest rate method provides useful information for users. One respondent noted that the effective interest method cannot be entirely applied consistently. The guidance regarding certain issues is not clear, which causes diversity in practice. Examples of these were provided.

Four respondents believed the effective interest method is working as the IASB intended (and can be applied consistently).

One respondent noted implementation difficulties related to the requirements in paragraph B5.4.6. The respondent noted that no IT system currently exists to automatically (i) determine the revised amount of the modified asset or liability and (ii) recognise the catch-up adjustment arising thereof. This is a manual process which, if applied to large population of contractual modifications, would be highly costly to implement.

Outreach input

Please refer to the answer to Question 3.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Question 8 - Transition

Proposals in the RFI

Upon their transition to IFRS 9, entities were required to apply the Standard retrospectively, but with some reliefs. Also, the effect on classification of financial instruments of the transition to IFRS 9 was required to be disclosed. An (i) entity’s business model and (ii) the criterion for designation under the fair value option was based on circumstances at the date of initial application of IFRS 9 rather than at the date the related financial instrument was initially recognised.

Entities were permitted but not required to present restated comparative information on initial application and entities did not apply IFRS 9 to financial instruments derecognised before the date of initial application.

EFRAG’s tentative position

EFRAG had no evidence that the transition requirements of IFRS 9 were not working as intended by the IASB.

Respondents’ comments

Comment letters

Few respondents reacted to this question. The ones that did were generally positive. One respondent questioned the usefulness of the continued transition disclosure of the fair value of assets transferred to amortised cost.

Outreach input

Not applicable.

EFRAG’s response to respondents’ comments

EFRAG’s final position

EFRAG has no evidence that the transition requirements of IFRS 9 are not working as intended by the IASB.

EFRAG did not change its view on the transition requirements given the general positive comments received [from those respondents that responded to this question]. Given the existence of sunset clauses in IFRS 7 *Financial Instruments: Disclosures* for transition disclosures, the comment received from one respondent was not integrated in EFRAG’s Final Comment Letter.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Question 9 – Other matters

Proposals in the RFI

The IASB is asking to share any information that would be helpful to them in assessing whether:

- (a) The objectives of the standard-setting project have been met;
- (b) Information provided by the Standard is useful to users of financial statements;
- (c) The costs are as expected for preparing, auditing, enforcing or using the information entities provide when applying the Standard; and
- (d) The Standard can be applied consistently.

EFRAG’s tentative position

EFRAG noted a number of issues that arise when applying the requirements of IFRS 9 to some financial instruments that were prevalent in Europe. In addition to the ones discussed in other parts of the DCL, the following issues were described: factoring of trade receivables; supply chain financing – reverse factoring and financial guarantees.

Respondents’ comments

Comment letters

One respondent noted that the information provided by the reporting Standards is very useful and believed that the benefit of their implementation outweighs the cost. Two respondents saw no further matters to be addressed.

EFRAG’s response to respondents’ comments

EFRAG’s final position

EFRAG notes a few issues that arise when applying the classification and measurement requirements of IFRS 9 to some financial instruments that are prevalent in Europe.

Most of these topics have already been discussed in our answers to the above questions. Topics that have not been mentioned before are: factoring of trade receivables (IASB to explore whether standard setting is needed), financial guarantees (for which there is no compelling case for standard setting), supply chain financing, own use contracts (deserving standard setting activities), hedge accounting for insurers (to consider in the forthcoming post-implementation review on hedge accounting).

For financial guarantees the feedback received was included on application from both issuer and holder side to avoid accounting mismatches.

For supply-chain financing reference was made to the EFRAG DCL on *Supplier Finance Arrangements*.

For factoring of trade receivables, the priority was decreased to low; additionally, it was specified that the IASB is to consider whether standard setting is needed.

EFRAG’s tentative views expressed in the draft comment letter and respondents’ comments

Two respondents provided examples of energy contracts for which additional standard-setting activities were requested.

One respondent noted that further standard-setting activities were necessary for own use contracts.

For factoring of receivables opposing views were provided: one respondent was of the view that no standard-setting activities were useful but another one thought it could be helpful.

One respondent noted that in contrast to the issuer of financial guarantees, the holder of a financial guarantee is currently not allowed to account for financial guarantees received under IFRS 4/IFRS 17. Especially for insurance companies this different treatment of received and issued financial guarantees may result in an accounting mismatch.

Outreach input

EFRAG User Panel members noted that factored receivables distort the performance of assets and operational flows in cash-flow statement, therefore, the disclosures helping to estimate how the accounts would look like without financing arrangements would improve the comparability with peers not using such arrangements. Companies that make significant use of factoring may have more liquidity issues during a slowdown scenario; users need to be able to assess this risk. Also, information on historical loss rates on factored receivables was considered useful.

EFRAG’s response to respondents’ comments

Appendix 1: List of respondents

Table 1: List of respondents

Name of respondent	Country	Type / Category
EFFAS	Germany	User Organisation
SFRB	Sweden	National Standard Setter
EBF	Belgium	Preparer Organisation
DASC	Denmark	National Standard Setter
Febelfin	Belgium	Preparer Organisation
GDV	Germany	Preparer Organisation
Assuralia	Belgium	Preparer Organisation
ESBG	Belgium	Preparer Organisation
Allianz	Germany	Preparer
IE-CFO Forum	Belgium	Preparer Organisation
Ermelindo Varela	Belgium	Individual
Erste Bank	Austria	Preparer
ICAC	Spain	National Standard Setter