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PIR IFRS 9 Impairment

Loan commitments and financial guarantee contracts

Objective

1 The objective of this session is to seek EFRAG FR TEG views on the IASB staff feedback analysis and recommendations and the IASB tentative decisions on the application of the impairment requirements in IFRS 9 *Financial Instruments* to loan commitments and financial guarantee contracts (FGCs).

Structure of this paper

2 This paper is structured as follows:

(a) Feedback analysis and the IASB staff recommendations on application questions about loan commitments

(i) What is a loan commitment?

(ii) What is the scope of the exception in paragraph 5.5.20 of IFRS 9?

(iii) How to apply the exception in paragraph 5.5.20 of IFRS 9?

(b) Feedback analysis and the IASB staff recommendations on application questions about financial guarantee contracts:

(i) How to assess if a FGC held is integral to a financial instrument?

(ii) How to account for a non-integral FGC held?

(iii) How to account for a FGC issued if premiums are received over time?

3 Appendix A to this paper summarises other comments received and the IASB staff analysis of those comments.

IASB staff recommendation

4 Based on the analysis in this paper, the IASB staff recommend:

(a) taking no action on matters raised by respondents about loan commitments; and

(b) classifying as low priority the matters raised by respondents about financial guarantee contracts and consider these matters in the next agenda consultation.

The IASB tentative decision

5 14 of 14 IASB members agreed with the IASB staff recommendations.

6 Members noted that the matters on loan commitments were not pervasive enough to justify further actions.

7 Members noted that FGCs are broader and more pervasive than loan commitments and that the three issues should be dealt together comprehensively.

Loan commitments

What is a loan commitment?

Summary of the feedback received by the IASB

8 Some respondents said that the lack of definition for a loan commitment gives rise to various application matters and interpretative issues, resulting in diversity in practice and suggested to add a definition for loan commitments to IFRS 9.

9 These respondents mentioned that, in practice, entities generally apply the impairment requirements in IFRS 9 to an arrangement that meets both the definition of financial instrument in paragraph 11 of IAS 32 *Financial Instruments: Presentation* and the description of a loan commitment in paragraph BCZ2.2[1] of IFRS 9. However, this is insufficient to determine how to account for a commitment to enter into a hybrid or a compound financial instrument - for example, whether a commitment to enter into a convertible bond, that is a compound instrument, represents a loan commitment or should be accounted for as a derivative.

10 IASB staff sought further input on this matter from IFRS IC and ASAF. IFRS IC members reported that, in practice, entities generally have a common understanding of what a loan commitment is and have already developed accounting practices. In their view the incremental benefits of a potential amendment would not outweigh the costs and risk from unintended consequences. IFRS IC members noted that some application challenges could arise in complex fact patterns (for example, a fixed-for-fixed conversion option whereby an entity is committing to pay a premium for equity options), but these types of commitments are not pervasive. ASAF members considered this matter as not pervasive and having no substantial consequences in practice.

EFRAG comment letter

11 EFRAG did not raise this issue in its comment letter.

IASB staff analysis and recommendations

12 Paragraph 2.1(g) of IFRS 9 states that an issuer of loan commitments shall apply the impairment requirements of IFRS 9 to loan commitments that are not otherwise within the scope of IFRS 9.

13 IASB staff noted that most questions arise from complex fact-patterns, for which the IASB would need to develop a more comprehensive description or definition for loan commitments. However, evidence gathered in the PIR does not suggest that such a

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[1] The term 'loan commitment' is not defined, however, paragraph BCZ2.2 of IFRS 9 explains that 'loan commitments are firm commitments to provide credit under pre-specified terms and conditions'.

standard-setting activity would be justified. That is because, the PIR feedback and the input from IFRS IC and ASAF members suggest that these types of commitments are neither pervasive nor result in substantial consequences in practice.

14 Regarding loan commitments to enter into a convertible bond that is a compound instrument, the IASB staff refer to the paragraph 2.3(b) of IFRS 9 that specifies that loan commitments that can be settled net in cash or by delivering or issuing another financial instrument are in scope of IFRS 9 and that these loan commitments are derivatives.

15 As a result, **the IASB staff does not recommend taking any action on this matter.**

What is the scope of the exception in paragraph 5.5.20 of IFRS 9?

Summary of the feedback received by the IASB

16 A few respondents asked to clarify the scope of the exception in paragraph 5.5.20 of IFRS 9. Specifically, whether facilities, such as corporate overdrafts, that are managed on an individual basis are outside the scope of the exception in paragraph 5.5.20 of IFRS 9. This is because, in explaining the characteristics of financial instruments in scope of this exception, paragraph B5.5.39 of IFRS 9 makes a reference to financial instruments generally being managed on a collective basis.

17 The IASB staff inquired IFRS IC and ASAF and they reported that in their experience, this issue is not pervasive, does not have substantial consequences and that the requirements are clear.

EFRAG comment letter

18 EFRAG comment letter is in line with the feedback received by the IASB.

19 EFRAG suggested to clarify the scope of application of paragraph 5.5.20 exception, including what is meant by "managed on a collective basis". EFRAG assigned medium priority to the issues related to loan commitments.

IASB staff analysis and recommendations

20 IASB staff reminded that paragraph 5.5.20 of IFRS 9 sets out the required features of the financial instruments falling within its scope:

(a) that the financial instrument includes both a loan and an undrawn commitment component; and

(b) the entity's contractual ability to demand repayment and cancel the undrawn commitment **does not limit the entity's exposure to credit losses to the contractual notice period**.

21 Paragraph B5.5.39 of IFRS 9 provides application guidance to help identifying such instruments and lists three characteristics including being managed on a collective basis. These characteristics are not determinative, but are consistent with the features identified in paragraph 5.5.20.

22 Therefore, the IASB staff is of view, that **the focus is not purely on the basis in which a financial instrument is managed but on what an entity is able to achieve/enforce with such a management** and on the nature of the available information.

23 The entity needs to assess **whether the way in which it manages a financial instrument means that it can limit its exposure to credit losses to the contractual notice period**. If so,

then the instrument will not fall in the scope of the exception in paragraph 5.5.20 of IFRS 9 and measuring ECL over the contractual life would be a faithful representation of ECL. This would be consistent with paragraph BC5.260 of IFRS 9, which states that for most loan commitments, the contractual period over which an entity is committed to provide credit (or a shorter period considering prepayments) is the correct conceptual outcome.

24 To determine whether its exposure to credit losses is limited to the contractual notice period an entity needs to apply judgement. **For an instrument managed on an individual basis**, **an entity is required to assess whether,** in fact, **its contractual ability to demand repayment and cancel the undrawn commitment would not limit the entity's exposure to credit losses to the contractual notice period.**

25 The IASB further notes that **PIR feedback and the input from the IFRS IC and ASAF members, does not suggest that the matter is necessarily prevalent or resulting in substantial consequences in practice. Therefore, the IASB staff do not think that the characteristics for the IASB to take further action are present. Accordingly, the IASB staff recommend no further action be taken on this matter.**

How to apply the exception in paragraph 5.5.20 of IFRS 9?

Summary of the feedback received by the IASB

26 Some respondents said that it is challenging to determine the period over which to measure ECL for revolving credit facilities (e.g. credit cards and overdraft facilities) that are within the scope of paragraph 5.5.20 of IFRS 9.

27 Therefore, they suggested the IASB provide more explicit application guidance on this matter, in addition to that in paragraph B5.5.40[2] of IFRS 9. Some of these respondents said that the education material issued by the IASB in May 2017 and the discussions of the Transition Resource Group for Impairment of Financial Instruments (ITG) in April and December 2015 contain helpful conclusions and suggested to incorporate them into IFRS 9.

EFRAG comment letter

28 EFRAG in its comment letter also raised this question (medium priority) and asked to provide guidance how to connect existing rules on modification and derecognition with the characteristics of revolving credit facilities or financial instruments composed of a drawn amount and an undrawn commitment.

29 EFRAG also suggested to include guidance and the key messages provided by the IASB educational video in IFRS 9.

[2] Paragraph B5.5.40 of IFRS 9 provides application guidance about determining the period that an entity is exposed to credit risk and ECL would not be mitigated by credit risk management actions, noting that an entity considers factors such as historical information and experience about:

(a) the period over which the entity was exposed to credit risk on similar financial instruments;

(b) the length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and

(c) the credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

IASB staff analysis and recommendations

30 The IASB staff acknowledged the usefulness of the education material, including the ITG discussions, but noted that determining the period over which to measure ECL for different revolving facilities would depend on specific facts and circumstances and would involve judgement.

31 In the IASB staff view, **paragraph B5.5.40 of IFRS 9 provides adequate guidance for entities to apply judgement specific to the contractual terms** of a financial instrument and other facts and circumstances to determine the period for measuring ECL. Entities are required to consider all three factors set out in paragraph B5.5.40 of IFRS 9, including the impact of credit risk management actions as required by B5.5.40(c).

32 The IASB staff further noted that **adding additional application guidance would be a standard-setting activity,** i.e. following the same due process as amendments to an Accounting Standard. In the IASB staff view, **the PIR feedback has not provided evidence that paragraph B5.5.40 of IFRS 9 is insufficient or unclear and hence that a standard-setting activity is warranted.**

33 In the IASB staff view, **the costs of such a standard-setting action**, including the risk of unintended consequences, **are likely to outweigh the incremental benefits** of the resulting information.

34 In addition, the **PIR feedback does not provide evidence that the issue results in substantial operational or financial reporting consequences**. **Therefore, the IASB staff recommend no action be taken on this matter.**

EFRAG Secretariat assessment

35 The EFRAG Secretariat notes the IASB arguments that there is no evidence that the matters raised by respondents on loan commitments when regarded in isolation are not prevalent and do not have significant financial reporting consequences.

36 However, the EFRAG Secretariat finds useful the IASB argumentation which connects the way how financial instrument is managed with possibility to limit its exposure to credit losses to the contractual notice period.

Financial guarantee contracts

How to assess if a FGC held is integral to a financial instrument?

Summary of the feedback received by the IASB

37 Many respondents reported the lack of application guidance to determine whether a FGC is part of, or integral[3] to, the contractual terms of a financial instrument, which results in diversity of ECL measurement and reduction of the usefulness of information to users of financial statements.

[3] In Appendix A of IFRS 9, the definition of credit loss states that the cash flows that are considered in measuring ECL shall include cash flows from credit enhancements that are integral to the contractual terms of a financial instrument.

38 These respondents suggested to add application guidance for determining the FGCs that are considered part of (or integral to) the contractual terms for the purposes of measuring ECL applying paragraph B5.5.55[4] of IFRS 9.

39 The IASB staff discussed this matter with the IFRS IC members. They were generally of the view that this issue does not currently result in substantial consequences, even though application questions frequently arise in practice. However a few IFRS IC members said this matter represented significant application challenges in the past, especially because IFRS Accounting Standards are not explicit in how to account for the FGCs held that are not part of (integral to) a financial instrument (see next subtopic for more details).

40 IFRS IC members said that although entities have developed the accounting policies, diversity in practice remain and sometimes result in arbitrary accounting outcomes. For example, some entities generally include in the measurement of ECL cash flows from FGCs that are acquired simultaneously with issuing a loan but account for such cash flows separately when acquiring a similar FGC subsequently.

41 However, IFRS IC members acknowledged that it would be difficult to provide helpful guidance given that the economic substance is often dependent on the legal terms and conditions and the effect of laws and regulations in particular jurisdictions.

42 This matter was also discussed with ASAF, with some members saying this gives rise to application challenges in practice, including the accounting for the related transaction fees and suggested the IASB provide application guidance. A few other ASAF members shared the view that the matter does not warrant standard-setting.

EFRAG comment letter

43 The feedback received by the IASB is mostly in line with the EFRAG comment letter assigning medium priority for the issue of financial guarantees.

44 EFRAG noted that significant differences in practice in defining whether a credit enhancement is integral or not when it is not mentioned in the contractual terms of the loan. EFRAG also noted that December 2015 ITG discussion does not answer the question of how to interpret when a financial guarantee is "integral to the contractual terms" when it is not mentioned in the contractual terms of the loan.

IASB staff analysis and recommendations

45 IASB staff noted that this matter was discussed with ITG in December 2015 and IFRS IC in March 2019 and that most questions arise for FGCs acquired subsequent to issuing a financial instrument and that these FGCs are widespread.

46 Consistent with the ITG discussions in December 2015, IASB staff think an entity would be required to apply judgement in determining whether a FGC is 'integral to the contractual terms' and in making that assessment, an entity is required to consider relevant facts and circumstances.

[4] Paragraph B5.5.55 of IFRS 9 requires that for the purposes of measuring ECL, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements (e.g. a FGC) that are part of the contractual terms and are not recognised separately by the entity.

47 Accordingly, if the IASB were to consider adding application guidance in IFRS 9, such a guidance could not be conclusive / exhaustive. Therefore, it would not eliminate the need to exercise judgement relevant to specific facts and circumstances. This is in line with IFRS IC feedback.

48 The IASB staff noted that some feedback indicates that application questions arise frequently in practice and particularly, in times of economic crisis whereby the effect from these FGCs is more prominent.

49 Furthermore, the IASB staff note that the phrase 'integral' is used not only in the context of ECL measurement in IFRS 9, but also in other IFRS Accounting Standards. Therefore, any potential clarifications or amendments with regards to how this phrase is applied also need to consider those other Accounting Standards and the risk of unintended consequences.

50 Therefore, the IASB staff considers that some of the PIR prioritisation characteristics are present to some extent but the remainder of the prioritisation characteristics are not met. Accordingly, they recommend **classifying it as a low priority matter, which means it would be considered in the next agenda consultation and explored if the IASB decides, in its deliberations on the feedback to that agenda consultation, to take action.**

EFRAG Secretariat assessment

51 The EFRAG Secretariat acknowledges the IASB arguments but continues to be of the view that this matter should be classified as medium priority, given it pervasiveness.

How to account for a non-integral FGC held?

Summary of the feedback received by the IASB

52 As mentioned earlier, IFRS 9 or other IFRS Accounting Standards do not provide explicit requirements about the accounting for FGCs held by an entity that are not part of (or integral to) the contractual terms of a financial instrument, hence they cannot be reflected in the measurement of ECL.

53 Many respondents suggested the IASB introduce specific requirements about the accounting for non-integral FGCs held.

54 Respondents said that, in absence of more specific requirements, entities generally apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to account for non-integral FGCs they hold. However, in some respondents' view, IAS 37 does not always faithfully depict the economic substance of the transaction. This is because of the different recognition thresholds between IAS 37 (i.e. virtually certain) and IFRS 9 (i.e. expected credit losses), an entity recognises a reimbursement asset applying IAS 37 in a different reporting period to recognition of ECL for the related financial instrument (i.e. a timing mismatch). Respondents however did not provide specific fact patterns in which they observe substantial financial reporting consequences from this timing mismatch.

EFRAG comment letter

55 In its comment letter EFRAG did not mention the timing mismatch, but noted significant diversity in practice with how the 12-months ECL reimbursement asset is recognised. In addition, EFRAG noted that if the 12-months ECL reimbursement asset is not recognised, the accounting of integral and nonintegral credit enhancements results in different impacts on the statement of profit or loss (while the economic substance of the transaction is the same). The issue was classified as medium priority.

56 Hence, EFRAG suggested to add application guidance to reduce diversity in practice and provide relevant information to the users of financial statements.

IASB staff analysis and recommendations

57 The IASB staff notes that this matter is beyond the scope of this PIR which focuses on the impairment requirements in IFRS 9. Developing requirements to separately account for FGCs held might have implications not only in the context of IFRS 9, but also other IFRS Accounting Standards (e.g. IAS 37).

58 The PIR feedback indicates that FGCs held are widespread and lack of specific requirements gives rise to some diversity in practice and application challenges. However, feedback also indicated that the consequences might not be substantial because many entities ultimately apply IAS 37 requirements.

59 In the IASB staff view, the fact that applying IAS 37 might result in recognition of a reimbursement asset at a different reporting period to recognition of ECL for a financial instrument does not automatically mean unfaithful representation of the economic substance. For example, this accounting outcome might be a faithful representation of the economic substance if there is no clear relationship between an FGC and a particular financial instrument.

60 Hence, given the connection with the previous issue of accounting for FGCs integral to a financial instrument, **the IASB staff recommend assigning this matter a low priority and considering it at the next agenda consultation.**

EFRAG Secretariat assessment

61 The EFRAG Secretariat acknowledges the IASB arguments but continues to be of the view that the existing diversity in practice on accounting for credit enhancements justifies providing additional guidance.

How to account for a FGC issued if premiums are received over time?

Summary of the feedback received by the IASB

62 A few respondents suggested to provide application guidance on how to apply paragraph 4.2.1(c) of IFRS 9 to FGCs for which premiums are received over time, rather than upfront.

63 Specifically, the question is whether the issuer of such a FGC accounts for it by recognising two separate amounts - a receivable for future premiums not yet due and a separate corresponding liability for its obligation to provide protection to the holder (gross approach) - or whether the issuer recognises a single net amount in accordance with paragraph 4.2.1(c) of IFRS 9, hence it does not separately account for the components of such a contract (net approach).

64 These respondents noted that different interpretations developed over time (including differences in the guidance developed by accounting firms) which ultimately resulted in diversity in practice.

65 IFRS IC and ASAF members generally agreed that there is some diversity in practice in accounting for these types of FGCs. However, these members were not aware if this matter resulted in substantial consequences in practice.

66 IFRS IC members expressed differing views on this matter and noted in particular US GAAP which requires gross approach and IFRS 17 *Insurance Contracts* which can be applied to a FGC and requires net approach.

67 One IFRS IC member noted that resolving this matter would require considerable consultation and standard-setting efforts and considered that it was not a high priority.

EFRAG comment letter

68 In its comment letter EFRAG considered that the accounting differences based on the payment methods of the premium received (upfront or over time) may not provide useful information to users of financial statements given that the risks to which the issuer is exposed are the same in both cases.

69 Medium priority was assigned to all the issues related to accounting for FGCs.

IASB staff analysis and recommendations

70 The IASB staff notes that this matter relates to requirements about classification and measurement of a FGC and its root cause is not the impairment requirements of IFRS 9. The appropriate course of action to resolve this matter might require broader consultation and consideration of other IFRS Accounting requirements, including, for example, IFRS 17.

71 Therefore, **the IASB staff recommend assigning this matter (accounting for FGCs issued by an entity) a low priority and considering it at the next agenda consultation together with other matters on FGCs.**

EFRAG Secretariat assessment

72 The EFRAG Secretariat acknowledges the IASB arguments but continues to be of the view that the three above matters on FGCs should be classified as medium priority.

EFRAG FIWG feedback

73 One EFRAG FIWG member commented that loan commitments to enter into convertible instruments from a borrower perspective could be more prevalent than evaluated by the IASB, but further noted that they are mostly common to private equity and not to listed entities. This member questioned whether the loan commitment scope exclusion would apply to convertible loans in most cases.

74 Another EFRAG FIWG member noted that illustrative example 10 on revolving credit facilities is not helpful and expressed disappointment that the IASB decided not to replace it by the guidance in the IASB educational material or ITG discussions.

75 One EFRAG FIWG member agreed with the IASB decision not to perform any standard-setting because it is a complex area and it would be difficult to develop guidance without a risk of unintended consequences. In this member view, companies should apply judgement and should have already developed accounting policies to address complex issues.

Questions to EFRAG FR TEG

76 Does EFRAG FR TEG agree with the IASB staff analysis and the IASB tentative decision not to take standard-setting action on matters raised by respondents about loan commitments?

77 Does EFRAG FR TEG agree with the IASB staff analysis and the IASB tentative decision to classify as low priority the matters raised by respondents about financial FGCs and consider these matters in the next agenda consultation?

78 Does EFRAG FR TEG have any comments on the EFRAG Secretariat analysis?

Appendix A - Analysis of other comments

Feedback	The IASB staff analysis	Conclusion
Practice of rolling over loans with short contractual period		
One respondent reported that, in Japan, there are loans whose contractual periods are set for short periods (e.g. one month or three months) but that are expected to be collected over a long term, because the entity has a practice of rolling them over. They explained that contractual periods are set as short-term for protective reasons by creating an opportunity for the creditor to amend contractual terms. In the respondent's view, the end of a formal contractual period for such a loan is merely the timing of reassessing a covenant for the loan and ECL should be measured over a longer period ie not limited to contractual period. Therefore, this respondent suggested the IASB amends the exception in paragraph 5.5.20 of IFRS 9 so that these financial instruments also fall in scope of that exception (ie similar to revolving facilities).	By virtue of being an exception, the scope of paragraph 5.5.20 of IFRS 9 is intentionally narrow and designed to address specific issues. As explained in paragraphs BC5.254–BC5.261 of the Basis for conclusions on IFRS 9, the exception in paragraph 5.5.20 of IFRS 9 intends to address specific concerns—that, for revolving credit facilities, the contractual ability to demand repayment and cancel the undrawn commitment does not necessarily prevent an entity from being exposed to credit losses beyond the contractual notice period. If the loans identified in the feedback are set for protective reasons and reviewed by the creditor at the end of contractual period, the creditor's exposure to credit losses is likely to be limited to the contractual period. In such a case, measuring ECL over the contractual life would be a faithful representation of the entity's exposure to credit risk and the resulting measurement of ECL. Accordingly, extending the exception in paragraph 5.5.20 of IFRS 9 would not be justified.	No action.
Difficulty of estimating ECL for loan commitments		
One respondent said estimating ECL for loan commitments can be challenging due to the lack of historical data and the reliance on forward-looking information. In the respondent's	Paragraph B5.5.13 of IFRS 9 notes the default patterns in the past for comparable financial instruments are considered in estimating ECL. In accordance with paragraph B5.5.51 of IFRS 9, an entity does not need to	No action.

Feedback	The IASB staff analysis	Conclusion
view, this raises questions about the accuracy and reliability of the credit loss estimates for such instruments.	undertake an exhaustive search for information and is required to consider reasonable and supportable information that is available without undue cost or effort. Furthermore, as noted in Agenda Paper 27A of the IASB's February 2024 meeting, IFRS 9 requires no bright lines nor mechanistic approaches to estimate ECL. Information does not necessarily need to flow through a statistical model or credit ratings process. Qualitative and non-statistical quantitative information available may be sufficient in some cases. Therefore, the IASB staff think the requirements in IFRS 9 provide an adequate basis for entities to estimate ECL based on the information an entity has available.	
Significant increase in credit risk (SICR) for a loan from a draw-down from a credit card		
Two respondents said it is unclear what is considered 'the date of initial recognition' for the purpose of assessing SICR for a financial asset that is recognised following a draw down from a credit card or a similar facility. Specifically, whether an entity assesses changes in credit risk at the reporting date compared to the date the credit card facility (ie the loan commitment) is issued or to the date that the draw down asset is recognised. Furthermore, these respondents said there are diverse views on whether the issue of a new credit card or a new credit review constitutes a 'new originated loan' or 'an extension of the existing loan' which in turn affects SICR assessment. These respondents however did not provide particular fact patterns on which such diversity is observed.	Regarding the date of initial recognition for the purpose of assessing SICR, in our view, the requirements in IFRS 9 are clear. Paragraph B5.5.47 of IFRS 9 states that, for the purpose of applying the impairment requirements, a financial asset that is recognised following a draw down on a loan commitment shall be treated as a continuation of that commitment instead of as a new financial instrument. The ECL on the financial asset shall therefore be measured considering the initial credit risk of the loan commitment from the date that the entity became a party to the irrevocable commitment. This is consistent with the ITG conclusion (see paragraph 47 of April 2015 meeting summary notes). Regarding the question of whether the issue of a new credit card or a new credit review constitutes a 'new originated loan' or 'an extension of the existing loan', we think the answer would depend on particular facts and circumstances. For example, whether the requirements for derecognition of a financial instrument in Section 3 of IFRS 9 are met with	No action.

Feedback	The IASB staff analysis	Conclusion
	respect to the 'old credit card'. Furthermore, the credit risk management actions that an entity takes upon the issue of a new credit card, or a new credit review would also need to be considered. This is consistent with the ITG conclusion (see paragraphs 48-49 of April 2015 meeting summary notes).	