

# POSITION PAPER



## **ESBG response to the EFRAG consultation on the IASB agenda and on the EFRAG research agenda**

**ESBG (European Savings and Retail Banking Group)**

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## **PART A - EFRAG'S DRAFT RESPONSE TO THE IASB'S 3RD AGENDA CONSULTATION**

### **Consultation's questions:**

In addition to your comments on EFRAG's tentative responses to the four questions contained in the IASB's RFI, we invite you to express your view on the tentative priority assignment presented by EFRAG in Attachment A.

- **Which are the 6 priority projects that the IASB should undertake as new projects for the period 2022-2026 (you may select from the two lists in Attachment A or suggest other projects)? If you suggest other projects, please specify the scope.**

ESBG considers as priority projects:

1. **Hedge accounting for insurers:** ESBG proposes including as a new project Hedge accounting for insurers. Once IFRS 17 becomes effective, insurers are interested in applying hedge accounting in certain insurance liabilities or some of them will already apply hedge accounting requirements as from 1 January 2023 using a set of principles which are currently more focused on the banking industry. Nowadays, insurers have mechanisms under IFRS 4 and IAS 39 to avoid accounting mismatches and mitigate volatility in OCI/PL and other mechanisms with a similar effect using hedge accounting are necessary. The project should focus on how the existing practice for hedging strategies in the banking sector can be extended and applied to the insurance sector.
2. **Intangible assets + Variable and contingent consideration:** ESBG considers that a comprehensive review of IAS 38 Intangible assets is necessary. The importance of intangibles is growing in the companies and are an important part of how businesses create value. However, on many occasions, IAS 38 does not adequately cover changes in the technology sector, new types of agreements, the diversity of payment methods, the use of and journey to the cloud, digitalization,..., causing lack of comparability in financial information as a result of the different accounting treatment between companies. At the same time, the comprehensive review of the Standard could permit developing a consistent approach to reporting variable and contingent consideration that could be easily extensible to the rest of the Standards. That is, the IASB could avoid having a separate project for variable and contingent consideration if the main principles are developed under this project.
3. **Connectivity between financial and non-financial reporting:** ESBG considers that this project should be explored by IASB and EFRAG, respectively, as a separate area of activity but in an aligned way. Each IASB and EFRAG are considering to establish new boards to set sustainability reporting standards, therefore, ESBG considers that any of these boards would be a good opportunity to also address the connectivity between both reports. Sustainability reporting and financial reporting are currently not formally connected, and it is important to improve this connectivity to provide a full picture of companies. This will provide companies with an incentive to embrace sustainable business models, regardless to whether it is EFRAG or the IASB who sets in the future the Sustainability standards. It would be also a good opportunity for the Reporting and new Sustainability Boards to work together to achieve a single objective.

4. **Climate-related risks:** ESBG considers that climate-related risks could be addressed by the IASB in its work plan as they relate to the effects of climate-related risks to financial reporting. The issues raised in RFI paragraph B11 (a) y (b) would be some of them, but could also address define how spreads and sustainability components that are incorporated in determining the interest rate of credit operations should be analyzed and considered in order to provide guidance to entities so that they can determine whether a financial asset passes the test SPPI or not. Given that there are operations that except for this particularity would be SPPI compliant and currently entities have decided to choose to justify that the effect of the sustainability clauses is minimal, observing the market trend, it does not seem reasonable to continue maintaining this approach in the long term and it would be important to find a solution, at least providing more guidance to companies applying IFRS 9.
5. **Commodity transactions:** ESBG believes that it is important to address the accounting approach that should be applied to these assets and transactions, some examples are:
  - Establish a guide to define the classification (tangible, intangible, financial,...) and how these assets should be register and measurer.
  - Establish the accounting treatment that must be applied to certain commodities (emission rights, cryptocurrencies,...) by those entities that only participate as depositaries but not as holders.
  - Define the accounting approach for financial operations whose underlying asset is a commodity such as loans in cryptocurrencies or emission allowances, treatment of derivatives on commodities (hedging and trading), financial instruments referenced to the evolution of certain commodities and their impact on the SPPI test.
  - Determine the possibility of formalizing accounting hedges on certain commodities and if these can be considered as hedging elements under certain assumptions.
6. **Cryptocurrencies and related transactions:** ESBG considers that the scope of this project should be extended to crypto-assets (and liabilities), not just crypto-currencies. As the EFRAG explains in its document *“Accounting for crypto-assets (liabilities): holder and issuer perspective”*, the growth potential and diversity of this assets/liabilities has highlighted the need for regulatory enhancement and legal clarity on crypto-assets necessitates, and the same time, a parallel and complementary review, and where needed, the development of accounting requirements that can contribute to transparency and quality of information on entities exposure and in so doing support the overall investor protection regime.

In addition we consider that there are other projects that could be tackled by EFRAG using information they has previously collected. These will be:

1. **Discount rates:** several IFRS Standards permit or require entities to measure assets or liabilities by discounting estimates of future cash flows to their present values. However, the discount rates used in each of them is different or there are inconsistencies in the approach to set the discount rates. EFRAG could use previous research work on this topic to eliminate variations in present value measurement techniques.
2. **Employee benefits:** the requirements of IAS 19 do not effectively address the variety of plans that currently exist on the market. In addition, there are problems derived from the discount rates mentioned in the previous project, so it is necessary undertake a comprehensive review of IAS 19.

3. **Discontinued operations and disposal groups:** undertake a comprehensive review of IFRS 5 it is necessary to address concerns that arise in practice when applying this standard, e.g. how to account the difference between the carrying amount and the fair value less cost to sell of a disposal group exceeds the carrying amount of non-current assets in the disposal group. In a more conceptual approach, it could also be reviewed the interaction between IFRS 5 and IFRS 9 for assets that are recurrently being measured at fair value with changes recognized in OCI, as could be confusing to have presentation based on IFRS 5 whereas changes in the fair value recognized under IFRS 9 in OCI.
4. **Other comprehensive income:** ESG believes that the non-recycling treatment of equity instruments and equity-type instruments needs to be revised. Several market participants with long-term investment business models have expressed the need to reintroduce recycling, for example insurance companies in the context of the entry into force of IFRS 17, or companies that want to make investments related to sustainability.

As a last point, we would mention the **operating segment project**. We know that the IASB is working in a new IFRS related to Primary Financial Statements. ESG considers that this new IFRS needs consistency with the requirements in IFRS 8 Operating Segments, so it is important that during the redeliberations that the IASB is taking related to this new IFRS, they consider any consequential amendment to IFRS 8.

- **Regarding the suggested project on ‘Connecting financial and sustainability reporting’ (paragraphs 41 and following), do you consider that the consideration of climate-related financial implications should be part of that project or be addressed as a separate project?**

As we have mentioned in the previous question, we consider that ‘Connecting financial and sustainability reporting’ should be a separate project.

## **QUESTION 1 – STRATEGIC DIRECTION AND BALANCES OF THE IASB’S ACTIVITIES**

**3 Paragraphs 14–18 and Table 1 of the RFI provide an overview of the IASB’s main activities and the current level of focus for each activity. We would like your feedback on the overall balance of our main activities.**

- a) **Should the IASB increase, leave unchanged or decrease its current level of focus for each main activity? Why or why not? You can also specify the types of work within each main activity that the IASB should increase or decrease, including your reasons for such changes.**
- b) **Should the IASB undertake any other activities within the current scope of its work?**

ESBG considers that in general, the current level of focus for each main activity is appropriate, however, we support the comment made by EFRAG that the activities in relation to digital reporting could be increased.

In relation to paragraph 13 of EFRAG's Draft Responses ESBG consider that it could be positive include a comment about this capacity to react would have to be in line with what is has done during the Covid-19 crisis, where the IASB has reacted in an agile manner. It is important that the IASB has the ability to respond fast and swiftly to important emerging issues, considering the relevance and urgency for the stakeholders impacted.

## **QUESTION 2 – CRITERIA FOR ASSESSING THE PRIORITY OF FINANCIAL REPORTING ISSUES THAT COULD BE ADDED TO THE IASB'S WORK PLAN**

**17 Paragraph 21 discusses the criteria the IASB proposes to continue using when assessing the priority of financial reporting issues that could be added to its work plan.**

- a) **Do you think the IASB has identified the right criteria to use? Why or why not?**
  
- b) **Should the IASB consider any other criteria? If so, what additional criteria should be considered and why?**

In general, ESBG considers that the criteria used by IASB are appropriate when deciding whether to add a potential project to its work plan.

In relation to paragraph 25 of EFRAG's Draft Responses, ESBG notices that in the "Due Process Handbook" is mentioned that the Board's discussion of potential projects takes place in public Board meetings, so perhaps the stakeholders could access to these discussions to understand how the IASB apply these criteria.

## **QUESTION 3 – FINANCIAL REPORTING ISSUES THAT COULD BE ADDED TO THE IASB'S WORK PLAN**

**30 Paragraphs 24–28 of the RFI provide an overview of financial reporting issues that could be added to the IASB's work plan.**

- a) **What priority would you give each of the potential projects described in Appendix B of the RFI—high, medium or low—considering the IASB's capacity to add financial reporting issues to its work plan for 2022 to 2026 (see paragraphs 27–28)? If you have no opinion, please say so. Please provide information that explains your prioritisation and whether your prioritisation refers to all or only some aspects of the potential projects. The IASB is particularly interested in explanations for potential projects that you rate a high or low priority.**

We have indicated in Appendix A to this letter our priority for each project.

b) Should the IASB add any financial reporting issues not described in Appendix B of the RFI to its work plan for 2022 to 2026? You can suggest as many issues as you consider necessary taking into consideration the IASB's capacity to add financial reporting issues to its work plan for 2022 to 2026 (see paragraphs 27–28). To help the IASB analyse the feedback, when possible, please explain:

- (i) the nature of the issue; and
- (ii) why you think the issue is important

ESBG provides in the first question to constituents of EFRAG Consultation their evaluation of all 6 high priority projects.

In addition, ESBG would encourage the IASB to start planning the Post-implementation review of IFRS 17 Insurance Contracts given that it is expected to be endorsed at EU level by the end of 2021. In particular, if a carve-out regarding the annual cohort requirement was decided at EU level, ESBG would recommend aiming for an alignment and a pragmatical solution at IASB level to be adopted.

#### **QUESTION 4 – OTHER COMMENTS**

**59 Do you have any other comments on the IASB's activities and work plan? Appendix A of the RFI provides a summary of the IASB's current work plan**

No comments.

## **PART B - EFRAG'S REQUEST FOR INPUT ON ITS PROACTIVE RESEARCH AGENDA**

### **Consultation's questions:**

**9 Do you agree that the most important projects for which EFRAG should perform proactive activities, would be those:**

- a) European constituents consider most important to address in relation to the IASB's agenda consultation (that is the projects listed in Attachment A (on page 18 above) and in Attachment B (on page 21 above); and/or**
- b) Those projects that are considered important by European constituents and for which European input is particularly important.**

**If you do not agree, how should EFRAG select the projects for its proactive agenda?**

No comments.

**10 Do you agree with the list of projects in paragraph 4(b) above that are particularly important to provide European input on? If not, what four projects would you include on the list?**

ESBG notes that 4 projects are mentioned to be considered important and particularly suitable for an EFRAG proactive research project: *"Connectivity between financial and non-financial reporting"*, *"Digital Reporting"*, *"Operating segments"* and *"Supply chain financing (including reverse factoring)"*.

Regarding the *"Connectivity between financial and non-financial reporting"* project, as we have mentioned before, we believe that it is important that to be addressed by both EFRAG and the IASB.

On the contrary, the *"Operating segments"* project should be analyzed together with the new standard of Primary Financial Statements to achieve consistency.

**Apart from the projects mentioned above, ESBG considers that the Hedge accounting for insurers should be addressed by EFRAG if the IASB does not include it in its work plan.** As EFRAG is already aware, this is an important area of concern for life insurers that was raised by the industry during the IFRS 17 FEA and which has not yet been resolved. Although an interim solution should be established for the entry into force of IFRS 17, to improve the comparability of information is necessary to assess how the current practice that exists for hedging strategies in the banking sector can be applied to the insurance sector.

**11 Do you agree that EFRAG should follow the procedure described in paragraphs 4–7 when selecting projects to be included on its proactive agenda? If not, why?**

No comments.

**12 On average, what do you think the ratio between resources EFRAG spend on proactive work and reactive work should be?**

No comments.

## **APPENDIX A**

<b>Project</b>	<b>Priority</b>
Borrowing costs	Low
Climate-related risks	<b>HIGHEST PRIORITY (Scope C)</b>
Commodity transactions	<b>HIGHEST PRIORITY (Scope XX)</b>
Cryptocurrencies and related transactions	<b>HIGHEST PRIORITY (Scope D)</b>
Discontinued operations and disposal groups	HIGH (Scope B)
Discount rates	HIGH (Scope A)
Expenses—Inventory and cost of sales	Low
Employee benefits	HIGH (Scope C)
Foreign currencies	Low
Going concern	Low
Government grants	Low
Income taxes	Low
Inflation	Low
Intangible assets	<b>HIGHEST PRIORITY (Scope C)</b>
Interim financial reporting	Medium
Negative interest rates	Medium
Operating segments	Medium
Other comprehensive income	HIGH
Pollutant pricing mechanisms	Low
Separate financial statements	Low
Statement of cash flows and related matters	Low
Variable and contingent consideration	<b>HIGHEST PRIORITY (jointly with Intangible assets)</b>





## About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 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 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.



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