German Banking Industry Committee

Die Deutsche Kreditwirtschaft

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Our ref
Ref. DK: IASB
Ref. DSGV: 8007

IASB Request for Information – Post-implementation Review of IFRS 9 *Financial Instruments* – Classification and Measurement

January 28, 2022

Appendix 1

Dear Dr. Barckow,

On behalf of the German Banking Industry Committee we welcome the opportunity to contribute to the IASB's request for information regards the IFRS 9 post implementation review on classification and measurement requirements.

Please find our general comments and our answers to your detailed questions attached to this letter.

If you have any questions or would like to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,
on behalf of the German Banking Industry Committee
German Savings Banks Association

by proxy	by proxy
Dr. Maik Grabau	Eric Eispert

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Comments

to Request for Information
Post-implementation Review
IFRS 9 *Financial Instruments* - Classification and Measurement

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Berlin, January 28, 2022

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 1,700 banks.

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General comments

We are pleased to take this opportunity to share with you our experience implementing the requirements of IFRS 9 from the perspective of German credit institutions as users within the framework of the PiR – Classification and Measurement. The new processes established in the context of initial application have meanwhile proven themselves at our institutes and have become routine. This is the case at least where standardised routines are applicable or possible. Initial teething problems have been overcome. Nevertheless, the introduction of IFRS 9 has led to significant implementation costs. Ongoing procedural expenses and complexity have also increased significantly in some areas.

On the whole, the new classification requirements of IFRS 9 have not led to significant changes in the presentation of financial assets. We consider the requirements for determining the business model to be suitable and also good in practical application. The reclassification options provided for in exceptional cases are narrowly defined and thus rarely applied. More detailed explanations, for instance, additional examples in the standard, would be welcomed. This concerns, for instance, the more frequently found case of failed syndications at credit institutions. We would like to see a suitable presentation for this case separate from the existing reclassification options. One option could be a reclassification exception at the level of the specific financial instrument.

With a view to the application of the SPPI criterion, we find the criteria to be good in practical application, especially for standardised contracts. However, the review processes for special financing or individual contracts in corporate client business are much more complex and time-consuming. The test processes do not bear a reasonable cost-benefit ratio in relation to the result actually identified, i.e., that the SPPI criterion was not fulfilled in just a small number of cases.

Another aspect that is becoming increasingly important in the context of the SPPI test is the increasing linking of the contractual design of financial instruments with ESG criteria, compliance with which can impact the level of interest. At present, 'de minimis' rules can still be applied here. The volume of corresponding sustainable financing will expand strongly in the future in order to meet the global political goals towards complete transformation of the global economic cycle. It is essential that the IFRS accounting requirements create the conditions for this, so that these ESG-linked financial instruments can be adequately presented together with useful information in the financial reports.

However, in our view, the current SPPI test system is extremely time-consuming and could lead to a large number of instruments that do not fulfil the SPPI-criterion as a result of ESG linking. This means that these portfolios would have to be measured at fair value in the future. However, this would result in a wide range of market volatilities for ESG parameters being carried into the balance sheets and, correspondingly, into the annual result. This would make it much less attractive for credit institutions to offer such ESG financing on a large scale, thus running counter to global policy goals. We would welcome principle-based solutions here, i.e., developing the existing SPPI test regulations towards a new holistic 'ESG SPPI concept'. In our opinion, it is possible to expand the existing SPPI test concept to include suitable ESG criteria in order to identify a 'basic ESG lending arrangement' in the future, which will continue to allow accounting at amortised cost, also for ESG-linked financial instruments. In the sense of a holistic 'ESG consideration' of the accounting for financial instruments, this expanded 'ESG-SPPI concept' should, in addition to the SPPI test, also include or consistently formulate the impacts on the effective interest rate as well as on the modification test.

Against the background that ESG-linked financial instruments in the entire financing and securities business will gain in importance more extensively and much faster in the future, we would like to urge

the IASB to separate this topic from the regular PiR for IFRS 9 and to address it in a separate project (similar to the IBOR reform). We are concerned that addressing this topic within the PiR, in addition to other, also very complex issues, can only lead to major delays in developing suitable solutions. From our point of view, timely treatment of the ESG issue is crucial and indispensable.

We believe that the current requirements for modifications are too complex and offer very little added value in terms of information for the report users.

Please find below our detailed comments which are assigned to the individual questions from the Request for Information.

Question 1—Classification and measurement

Do the classification and measurement requirements in IFRS 9:

(a) enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not?

(b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not?

Please provide information about the effects of the classification and measurement changes introduced by IFRS 9, including the ongoing costs and benefits in preparing, auditing, enforcing or using information about financial instruments.

This question aims to help the Board understand respondents' overall views and experiences relating to the IFRS 9 classification and measurement requirements. Sections 2–8 seek more detailed information on the specific requirements.

We basically welcome the fact that the classification and measurement requirements of IFRS 9 are based on the selected business model and cash flow characteristics of the specific financial asset. First-time application of IFRS 9 had the following main impacts on the classification and measurement of financial assets:

- Loans and advances: no significant changes, in individual cases fair value measurement through profit or loss due to SPPI violation
- Securities: increased measurement at amortised cost due to intention to hold and the elimination of the classification requirement 'not quoted in an active market' (original category in IAS 39: 'available for sale')
- Equity instruments: increased measurement at fair value through profit or loss (original category in IAS 39: 'available for sale')
- Derivatives: no changes

The new classification and measurement requirements have in principle not had any significant impact on the content of the financial statements compared to IAS 39 due to the limited consequences for the accounting. However, the effort needed for the classification ratings has increased somewhat due to the two criteria (business model and SPPI test). Furthermore, in contrast to IAS 39, IFRS 9 requires the entire instrument, including the host, to be recognised at fair value through profit or loss if the SPPI criterion is not fulfilled. This increases the volatility of profit or loss, which has been demonstrated at some banks, for instance, in the wake of the economic impact of the COVID-19 pandemic in 2020.

Question 2—Business model for managing financial assets

(a) Is the business model assessment working as the Board intended? Why or why not?

Please explain whether requiring entities to classify and measure financial assets based on the business model assessment achieves the Board's objective of entities providing users of financial statements with useful information about how an entity manages its financial assets to generate cash flows.

(b) Can the business model assessment be applied consistently? Why or why not?

Please explain whether the distinction between the different business models in IFRS 9 is clear and whether the application guidance on the evidence an entity considers in determining the business model is sufficient.

If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

(c) Are there any unexpected effects arising from the business model assessment? How significant are these effects?

Please explain the costs and benefits of the business model assessment, considering any financial reporting or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about **reclassification** of financial assets (see Spotlight 2).

The requirements for the business model have largely proven themselves. Derived from the examples in the standard, they are very restrictive. Therefore, according to our assessment, there have been almost no reclassifications to date.

However, changes in the business model of portfolios may make economic sense and be necessary. The requirements thus limit business opportunities, for instance, in the case of market opportunities. In addition, changes in the business model can also have regulatory reasons. We would therefore welcome an addition to the examples in the standard to include situations independent of company takeovers and discontinuation of business areas.

Another example is syndications where the original target syndication rate is not achieved. It is especially questionable whether the permanent fair value measurement of failed syndications truly serves the informative value of financial statements. The reclassification option currently provided for in IFRS 9 is only used in rare circumstances, when the business model for a particular portfolio has changed. Failed syndications, however, do not affect entire portfolios, but only individual shares of a syndicated loan that could not be placed on the market and are now taken over into the bank's own portfolio as an 'emergency solution'. So, the level of change of intention here is the specific financial instrument involved. However, the requirements of IFRS 9 do not yet provide a solution for this.

Failed syndications are by no means regular business transactions, but they are also not rare exceptions in the banking industry that affect a single institution only. In this respect, we believe it makes sense to add a solution for this specific issue in the form of a reclassification exception in IFRS 9. This would have the advantage that the basic classification model with the existing reclassification option would remain unchanged because, in our view, it has proven itself in application and would not offer a solution in this particular case here (financial instrument level vs. portfolio management level). The possibility of a reclassification exception would, in our opinion, increase the informative usefulness for users of financial statements, as the loan portions that have not been placed can often no longer be sold after a certain period of time due to market changes (and thus a lack of market demand) and the intention to sell no longer exists.

Furthermore, there are financial instruments that can change their character over time. AT1 bonds are one example. Initially, if structured appropriately, these bonds may meet the IAS 32 definition of equity. An investor could therefore classify these bonds as an equity instrument and exercise the option of IFRS 9.4.1.4 (measurement at fair value through other comprehensive income) for this bond. However, when the issuer calls the bond, this financial instrument changes from an equity to a debt instrument. The right to call is included in the bond terms and conditions from the outset. Termination of the bond is therefore not caused by a modification. The investor now has two options:

1. It now recognises a debt instrument, but still according to the requirements for equity instruments.
2. It reclassifies the debt instrument and then records this debt instrument according to the requirements for debt instruments.

In both cases, the investor would, in our view, be in breach of applicable IFRS requirements. Therefore, we would like to suggest that this example also be included in the IASB’s review of the ‘business model and reclassification’ system and, if necessary, be fleshed out here at an appropriate point.

Question 3—Contractual cash flow characteristics

(a) **Is the cash flow characteristics assessment working as the Board intended? Why or why not?**

Please explain whether requiring entities to classify and measure a financial asset considering the asset's cash flow characteristics achieves the Board's objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows.

If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain:

(i) why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI).

(ii) which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk). (See Section 7 for more questions about applying the effective interest method.)

(b) **Can the cash flow characteristics assessment be applied consistently? Why or why not?**

Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features).

If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

(c) **Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?**

Please explain the costs and benefits of the contractual cash flow assessment, considering any financial reporting effects or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about **financial instruments with sustainability-linked features** (see Spotlight 3.1) and **contractually linked instruments** (see Spotlight 3.2).

The cash flow characteristic assessment can in principle be applied consistently to all financial assets and, in our view, works as intended by the Board. Compared to IAS 39, no very significant changes resulted from the application of the cash flow characteristic assessment in the classification of financial assets.

However, the initial implementation of the new processes required for checking SPPI compliance was found to be very time-consuming and complex.

The ongoing effort required, especially for the classification of loans and advances, depends heavily on the structure of the contracts. As far as standard loan agreements are concerned, the SPPI test can be easily managed in the processes that have been established in the meantime. However, the processes for checking SPPI compliance are far more complex and time-consuming for new types of contracts or individual contracts, such as those increasingly found in corporate lending business or special financing. User practice has shown that in light of the large number of contracts to be examined, SPPI violations can only be found in exceptional cases. Another exception to the practicability of the cash flow characteristic assessment is 'non-recourse financing'. In order to be able to prove SPPI conformity, additional extensive individual tests are also required here.

Treatment of ESG-linked financial instruments

Another increasingly important factor impacting the SPPI criterion is the ESG link in financial instruments. Against the backdrop of the global goal of transforming the worldwide economic system into a fully sustainable one, the pending changes in the way business is conducted must also be increasingly taken into account in the design of financial instruments. It is the task of the financial sector to provide the participants in the real economic processes with sufficient financial resources. At present, it is primarily conservative and transition projects (in the sense of 'non-ESG') that are being financed. However, 'green' and ESG projects are also becoming more important across the board.

In our view, the current SPPI requirements can still be applied to ESG-linked financial instruments due to their currently limited scope. Financial assets with an interest rate linked to the achievement of ESG targets are often structured in such a way that the borrower receives a discount on the margin amounting to a few base points when proof of target achievement is provided (usually through certifications). For the bank, this margin reduction means a partial waiver of the profit margin. In the case of the currently minor margin variability, both upwards and downwards, the 'de minimis' requirements of IFRS 9 can be applied. In our opinion, however, this approach is no longer operable in the future when the volume of ESG-linked financial instruments increases as expected. In addition to commercial banks, national development banks have a special role to play here. With a view to financing conditions, these banks have even more extensive options, such as repayment subsidies, which result in a correspondingly high variability of the effective interest rate. It is to be feared that, also in view of the developing variance in ESG contract designs, a large number of ESG-linked financial instruments will no longer be able to fulfil the SPPI criterion and would thus have to be measured at fair value. The transformation from non-green to green products is a process that will take several years. What is still the exception today will be the norm in just a few years and vice versa. However, this does not usually change the business model, which for most institutions is based on collecting interest and is decisive for accounting.

Green contract components represent the current status of the transformation. At present, a client could negotiate a slightly better margin on green financing. In a few years, there will probably be a surcharge for non-green financing. This means that non-green financing could then be SPPI-damaging. This clearly shows that these contract components are 'basic lending arrangements'.

With the majority of financial instruments being linked to ESG targets in the future, the applicability of the at-cost measurement method would be massively restricted in large parts of the relevant business. This would result in these financial assets being accounted for at fair value with the associated volatilities

reflected in the result for the period. This would give third parties distorted information if – as expected – ESG-linked financial instruments are standard products in the future.

The amortised cost measurement is accompanied by extensive disclosures in the notes on risk provisioning, which provide users of financial reports with decision-relevant information which would not be provided with a fair value measurement.

Measuring instruments with ESG components at fair value through profit or loss would put ESG-linked financial instruments at a clear disadvantage compared to conventional financing. The transformation towards a sustainable economy would be thus massively hindered, which runs counter to global political and societal goals. This cannot be the aim of appropriate accounting requirements. Instead, we believe that it is now important to interpret and further develop the existing SPPI concept so that it continues to provide for an 'ESG Basic Lending Arrangement' even with the inclusion of an ESG link, thus enabling measurement of ESG-linked financial instruments at cost.

The updated concept should basically be principle based, easy to understand and enable good applicability in practice (low degree of complexity, reasonable cost-benefit ratio). In this context, flexibility should also be kept in mind, making it possible in the future, within the framework of this concept, to track the developments of a future market standard for ESG products where necessary, also for accounting requirements.

In our view, contracts with ESG features that can result in a change in interest rate should be accounted for at amortised cost if certain ancillary conditions are met. These could be, for instance:

- There is no leverage
- A correlation exists between the ESG feature and the interest rate
- Market conformity exists (consideration at the level of specific market segments, such as the market for promotional loans)

The examples of SPPI compliance that are already available in the guidelines could be supplemented with further suitable 'ESG examples' if necessary. From our point of view, it should be examined whether an ESG component could be added to the components of an interest rate (credit risk taken, payment for the liquidity risk, for administrative costs and also a profit margin). The list in IFRS 9 B4.1.7A is in principle not exhaustive and could thus provide a useful starting point. This is particularly true in view of the fact that ESG components are already increasingly a pricing-relevant feature on the market. This would also be consistent with the regulatory requirements already adopted or under development. Among other things, these already provide for the inclusion of ESG risks in the business strategy, in risk management or in the supervisory and reporting obligations (especially here from the perspective of the credit institutions).

In our opinion, the ESG issue should be considered holistically. In addition to the ESG impact on the SPPI test, the potential ESG impact on the effective interest rate and likewise on modifications should also be included. Thus, in our view, the coming into effect of an ESG margin component does not constitute a modification issue. This component should also not affect discounting when determining impairments.

We would use a modified definition of the term 'effective interest rate' and the components to be taken into account. In our opinion, the calculation of the effective interest rate should be based exclusively on cash flow components that are already fixed at the beginning of the term, i.e., premiums/discounts, fees

for concluding the contract, fees fixed at the time of conclusion or step-up margins. As a result, all other components that are subject to estimation as well as uncertainties regarding their occurrence would only be recognised in the current interest rate when they actually occur, such as effects from termination or extension options, margin premiums due to increased credit risk and interest rate adjustments depending on the fulfilment of certain conditions (for instance, TLTRO III or ESG criteria). This would give the effective interest rate calculation a higher degree of reliability and consistency.

In addition, on the liabilities side, the assessment of ESG components with a view to a possible derivative character with the resulting obligation to separate them would have to be included in order to create a coherent and permanently viable accounting concept. However, it should be noted here that we consider ESG components to be an integral part of the instrument. For this reason, we would strongly recommend that the topic of ‘Accounting for ESG-linked financial instruments’ be removed from the PiR of IFRS 9 and placed in a separate targeted project (similar to the IBOR projects, phases I and II of the IASB). We consider the thematic treatment within the scope of the PiR of IFRS 9 to be too lengthy, since this PiR examines numerous other important and complex sub-topics. Furthermore, from our point of view and in light of the currently observable expansion of the volume of ESG-linked financial instruments in securities and lending business, a certain urgency seems to be called for.

Definition of Contractually Linked Instruments (CLIs)

Since the definition of CLI is so difficult to apply in practice, we would be supportive of a wider amendment to the scope to the most senior tranche in any structure.

The most senior tranche has very stable and predictable cash flows e.g. benchmark rate plus a spread and it is highly likely to receive these contractual cash flows. Amortised cost measurement provides useful predictive information for these instruments in a Hold to Collect business model. For the most senior tranche in a structure we recommend the SPPI analysis is performed as for a non-recourse financing and only apply the more involved CLI guidance to the more subordinated tranches in a structure. This approach would ease the pressure on the CLI definition since it would apply to fewer positions and those where the cash flows are more variable. Additionally, it would reduce the operational effort required by preparers to assess these instruments which are generally AAA rated and have cash flows that are more stable and predictable than many corporate loans.

This approach has similarities with the proposal in the original exposure draft on IFRS 9. There were some concerns at the time around structuring opportunities with CDO^2 structures but these could be mitigated with anti-abuse rules that this would only apply where the underlying instruments themselves were not CLI instruments. Additionally, there might be concern that not all securitisation senior tranches have very high credit rating but that risk would be mitigated since the rules around NRF instruments would need to be followed which would consider the level of subordination in the structure.

Question 4—Equity instruments and other comprehensive income

(a) **Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not?**

Please explain whether the information about investments in equity instruments prepared applying IFRS 9 is useful to users of financial statements (considering both (i) equity instruments measured at fair value through profit and loss; and (ii) equity instruments to which the OCI presentation option has been applied).

For equity instruments to which the OCI presentation option has been applied, please explain whether information about those investments is useful considering the types of investments for which the Board intended the option to apply, the prohibition from recycling gains and losses on disposal and the disclosures required by IFRS 7.

(b) **For what equity instruments do entities elect to present fair value changes in OCI?**

Please explain the characteristics of these equity instruments, an entity's reason for choosing to use the option for those instruments, and what proportion of the entity's equity investment portfolio comprises those instruments.

(c) **Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?**

Please explain whether the requirements introduced by IFRS 9 had any effects on entities' investment decisions. If yes, why, how and to what extent? Please provide any available evidence supporting your response which will enable the Board to understand the context and significance of the effects.

In responding to (a)–(c), please include information about **recycling of gains and losses** (see Spotlight 4).

We welcome the introduction of the FVOCI option and are generally of the opinion that exercising the FVOCI option for equity instruments provides users of financial statements with clearer information about the financial performance of long-term investments in such financial assets than an FVtPL measurement would.

That being said, however, we believe that it would provide the users of financial statements with an even better insight into a group’s earnings if, at the time of disposal of such an asset, the amounts accumulated in OCI were recycled into the statement of profit or loss, as was the case for the ‘available for sale’ category under IAS 39. Because at this point in time, these amounts have in fact been realised. Moreover, this is the only way that actual total profit achieved over the entire holding period would be fully recognised in profit or loss. We do not consider the current disclosure of cumulative disposal proceeds in accordance with IFRS 7.11B(c) only in the notes to be equivalent.

In the past technical discussion as part of the introduction of IFRS 9, the return to recycling was rejected due to a lack of an adequate requirement for an objective impairment model for equity instruments. However, we see options for completing recycling with an effective impairment regulation that is easy to handle in practice. In our view, the following criteria could be used as a basis for this: An impairment loss must be recognised in the statement of profit or loss if the fair value falls below the acquisition cost. Reversals of impairment losses determined in the future are to be recognised in profit or loss up to the acquisition cost. Reversal amounts exceeding the original acquisition costs (fair value exceeds acquisition costs), on the other hand, would have to be recognised in OCI and not in profit or loss. This would avoid delayed impairment. Similarly, such a model could lead to practical, uniform implementation.

Question 5— Financial liabilities and own credit

(a) **Are the requirements for presenting the effects of own credit in OCI working as the Board intended? Why or why not?**

Please explain whether the requirements, including the related disclosure requirements, achieved the Board's objective, in particular, whether the requirements capture the appropriate population of financial liabilities.

(b) **Are there any other matters relating to financial liabilities that you think the Board should consider as part of this post-implementation review (apart from modifications, which are discussed in Section 6)?**

Please explain the matter and why it relates to the assessments the Board makes in a post-implementation review.

The requirements for reporting fair value changes due to the bank’s own credit rating have proven their worth, despite the rather high effort required to determine this in individual cases, and in our opinion work as intended by the Board.

Question 6— Modifications to contractual cash flows

(a) **Are the requirements for modifications to contractual cash flows working as the Board intended? Why or why not?**

Please explain what changes you consider to be modifications of a financial asset for the purpose of applying paragraph 5.4.3 of IFRS 9 and as a modification of a financial liability for the purpose of applying paragraph 3.3.2 of IFRS 9. Does the application of those paragraphs, and the disclosure requirements related to modifications, result in useful information for users of financial statements?

(b) **Can the requirements for modifications to contractual cash flows be applied consistently? Why or why not?**

Please explain whether the requirements enable entities to assess in a consistent manner whether a financial asset or a financial liability is modified and whether a modification results in derecognition. Have the requirements been applied differently to financial assets and financial liabilities?

If diversity in practice exists, please explain how pervasive the diversity is and its effects on entities' financial statements.

Overall, we consider the requirements for modifications to be very complex in their application. Moreover, we do not consider them to be suitable for all types of financial instruments. The high technical and procedural implementation costs required to identify possible modifications are offset by very limited added value in terms of information for users of financial statements. The catalogue of possible modification issues is very extensive, especially since IFRS 9 does not provide a specific definition of the term 'modification'. In practice, there are numerous use cases for a modification test; but the resulting modification effects are in fact very small. The different derecognition rules for financial assets and financial liabilities also make it difficult to apply a uniform approach to all financial instruments.

In our view, the assessment of a modification should be based solely on the contractual cash flows and should not be extended to include legal changes affecting the cash flows of the financial instrument. With regard to the informative value of financial statements, it does not make sense to generally consider legal changes, which affect all preparers of financial statements equally and are thus not the starting point for individual contract negotiations, as modifications and to account for them as such. This also applies to changes in cash flows that result exclusively from the fact that a calculation basis for a contractual component is changed without this change being based on an adjustment of the contractual regulations.

Contract modifications are part of the daily business of credit institutions. Experience shows that most contract modifications are of a non-substantial nature and often do not even lead to a change in the carrying amount because the contractual cash flows remain unchanged. In practice, the suspension of certain contractual consequences in the event of acute or already foreseeable breaches of the borrower's information obligations is a common contract modification without a change in the carrying amount. In most cases, the borrower is granted a contractual extension to submit the agreed documents. The contract is supplemented in these cases, but the interest and principal payments remain unchanged. Nevertheless, such contract modifications do sometimes entail considerable analysis and documentation, which in our view does not seem justified, because this does not appear to provide any added value in

terms of information for users of financial statements. If contractual conditions are changed which affect future cash flows, they should only be recognized when they are actually applied (analogous to the procedure under IFRS 9.B5.4.5). In future, this would also eliminate the ambiguity about the period to be chosen over which any book value adjustments are to be amortized (by the end of the interest period or by the end of the fixed interest period or over the remaining term of the financial instrument).

In addition, the application of modification testing and accounting, especially for financial instruments subject to impairment requirements (Level 3), also involves a high level of procedural effort. In our view, the potential gain in terms of information for the user of the financial statements is out of proportion to the costs for the preparer of the financial statements. For example, in the case of non-substantial modifications of financial instruments of Level-3 impairment, where the contractual cash flows are adjusted to the expected cash flows as a result of the credit rating-related modification, this leads to recognition of a modification of profit or loss and, at the same time, an offsetting effect on profit or loss from the adjustment of the existing risk provision to the same amount. The consequence is therefore only a shift in the reporting of profit or loss components. Despite the considerations in IFRS 7.BC48Z, we are in favour of limiting the disclosure requirements for modifications to those modifications that are related to credit rating. This measure could lessen the burden on preparers of financial statements, in some cases considerably.

As a result, we believe it would be desirable to make the modification concept currently contained in IFRS 9 more practicable. The information to be made available to users of financial statements should be directly relevant for decision-making, without losing sight of the effort required on the user side. A modification concept that is sustainable in the long term should only require the absolutely necessary degree of complexity in the future and allow for good applicability.

Based on this, the derecognition test for modifications should in principle be uniformly based on exclusively qualitative criteria for financial assets and financial liabilities. In our view, this should be achieved by changing the most essential, decisive contract parameters (such as a currency change, the introduction of contract clauses that do not fulfil the SPPI-criterion, etc.). In the event of a such a qualitative criterion, a substantial modification then exists and the transaction is to be derecognised. All other modifications are considered non-substantial modifications. The identified non-substantial modifications are recognised on an ongoing basis, i.e., adjusted cash flows are mapped as they occur (for instance, an increase in margin leads to higher interest income in the period of payment) and are not disclosed. Transactions that are not substantially modified are no longer labelled in the IT systems and processes. Consequently, the information on non-substantial modified transactions in the notes is also omitted.

In the case of waivers of existing contractual claims (for instance, a pro-rata waiver of the nominal), which almost without exception only concerns Level-3 transactions or POCI, complete mapping is carried out through risk provisioning and a corresponding adjustment of the carrying amount. The artificial separation of the credit rating effect (in risk provisioning) and a modification result on the other side is omitted. If waived, disclosure would also be conceivable in the context of the notes on risk provisioning. In our view, however, this would then be limited to Level 3 and POCI and the issue of waiving existing claims.

Question 7—Amortised cost and the effective interest method	
(a)	**Is the effective interest method working as the Board intended? Why or why not?** Please explain whether applying the requirements results in useful information for users of financial statements about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest method.
(b)	**Can the effective interest method be applied consistently? Why or why not?** Please explain the types of changes in contractual cash flows for which entities apply paragraph B5.4.5 of IFRS 9 or paragraph B5.4.6 of IFRS 9 (the 'catch-up adjustment') and whether there is diversity in practice in determining when those paragraphs apply. Please also explain the line item in profit or loss in which the catch-up adjustments are presented and how significant these adjustments typically are. If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.
In responding to questions (a)–(b), please include information about **interest rates subject to conditions and estimating future cash flows** (see Spotlight 7).	

The determination of the effective interest rate can, in principle, be applied as intended by the Board and with reasonable effort. However, this does not apply to all circumstances. If the interest on a financial asset is linked to compliance with certain conditions that only be met in the future and are thus subject to a high degree of uncertainty, recognition of these effects is significantly more difficult. These issues already came to light in the search for appropriate accounting for the ECB's TLTRO III operations and will become much more important in the future with the increasingly relevant ESG-linked financial instruments. We consider an adjustment analogous to IFRS 9.B5.4.5 to be practically feasible and suitable for this type of contingent interest transactions and refer in this context to our comments on the effective interest method under question 6.

Question 8—Transition	
(a)	**Did the transition requirements work as the Board intended? Why or why not?** Please explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements. Please also explain whether, and for what requirements, the Board could have provided additional transition reliefs without significantly reducing the usefulness of information for users of financial statements.
(b)	**Were there any unexpected effects of, or challenges with, applying the transition requirements? Why or why not?** Please explain any unexpected effects or challenges preparers of financial statements faced applying the classification and measurement requirements retrospectively. How were those challenges overcome?

Overall, the initial implementation of the new provisions of IFRS 9 involved very high expenses for the companies applying them. Here, however, the transitional arrangements/ facilitation provisions have helped to reduce the implementation effort somewhat.

Question 9—Other matters	
(a)	**Are there any further matters that you think the Board should examine as part of the post-implementation review of the classification and measurement requirements in IFRS 9? If yes, what are those matters and why should they be examined?** Please explain why those matters should be considered in the context of the purpose of the post-implementation review, and the pervasiveness of any matter raised. Please provide examples and supporting evidence when relevant.
(b)	**Considering the Board's approach to developing IFRS 9 in general, do you have any views on lessons learned that could provide helpful input to the Board's future standard-setting projects?**

GBIC has no comments to this question