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Mr. Wolf Klinz
EFRAG Financial Reporting Board Chair
35 Square de Meeûs
1000 Brussels
Belgium

Comment letter on the EFRAG Draft Comment Letter on the Request for Information – Post-implementation Review IFRS 9 Financial Instruments

Dear Mr Klinz,

Thank you for the opportunity to comment on the EFRAG draft comment letter (DCL). In general, we agree with the DCL. However, we would like to increase the prominence of addressing the POCI topic to "high". Please find below our comments on the specific questions raised by EFRAG.

Kind regards,

Gabriele Tauböck
Head of Group Accounting

Questions to Constituents

29 Do Constituents agree with the assessment of priority for Europe of issues identified as proposed in the EFRAG's response?

30 In addition to the issues reported in the EFRAG's response, are there any further matters that you think the IASB should examine as part of the post-implementation review of the impairment requirements in IFRS 9 and the related disclosure requirements in IFRS 7? Please explain.

We agree with the priority assessment of the identified issues. However, we would like to give more prominence to the POCI topic and increase it to "high". As EFRAG raises no specific question to constituents in respect of POCI we discuss the reasons below in the answer to this question.

Erste Group has concerns about the POCI treatment for financial assets which result from derecognition of non-performing loans as a result of their restructuring. Banks apply different accounting policies for derecognition of restructured distressed loans. Some banks do not derecognise non-performing loans at all which results in no application of the POCI model for originated loans. Other banks derecognise substantially modified loans which result in applying for the POCI model for these. We are among these banks. This diversity impairs the comparability among entities. We appreciate that this is mentioned in paragraph 166 of the DCL.

From preparers perspective the complexity relates to application of the POCI model by banks which derecognise certain restructured loans. These banks, when measuring the initially recognised loan after the restructuring, must determine the fair value. The valuation starts with estimating cash flows adjusted for specific credit risk. In this step, the level of estimation uncertainty is similar to what banks apply when measuring the impairment for Stage 3 financial assets (individual cash flows estimates by work-out departments).

However, there is additional uncertainty component which is significant. It relates to determining the appropriate discount rate. The discount rate is composed of a risk-free rate plus a premium. This premium does not contain the specific credit risk component as it is included in the estimated cash flows. It mainly relates to the price for bearing recovery uncertainty and is extremely difficult to estimate. Few transactions, if any, with publicly known data can be observed for similar loans. One study examining such a premium in relation to defaulted US loans and bonds in the period from 1987 to 2005 showed that for bank debt the range was, with 90% confidence interval, between -1.5% to 20.3% (most likely estimate 9.4%).[1] Hight dispersity of the premium estimates, combined with the cash flow estimates in step 1, would lead to the overall fair value whose reliability is very questionable. We note that the situation is different to POCI loans which are purchased because the fair value does not have to be estimated.

Further, practical application of the POCI model as such is cumbersome. The carrying amount is completely independent from amounts which are legally due. This is an operational complexity for banks which originate such loans and have the due amount in their core banking systems. In contrast, Stage 3 accounting is less complex and this difference is easier to address. The respective systems have been implemented by banks.

[1] Brroks, B., Chang, P., Miu, P., Ozdemir, B., and Schwartz, D., 2006, "Discount Rate for Workout Recoveries: An Empirical Study", https://www.fdic.gov/analysis/cfr/bank-research-conference/annual-6th/miup.pdf

As a result, Erste Group has a view that restructured non-performing loans would be much better captured by continuation of Stage 3 accounting rather than the POCI treatment. This would recognise the loss in relation to the original loan terms which was restructured (including booking of modification gain/loss). Interest income would be accrued in respect of the net carrying amount which is substantiated since such restructured assets normally stay in the category of non-performing/defaulted after the restructuring. Changing the treatment would be especially relevant for banks which do not purchase or originate non-performing loans as part of their core business but such assets are accidental to restructuring of existing financial assets. Similar outcome could also be achieved by requiring Stage 3 accounting for restructured credit-impaired loans.

Questions to Constituents – Question 2(a)

67 Do Constituents have any fundamental questions about the general approach of IFRS 9 to recognising ECL?

68 In addition to the issue reported in the EFRAG's response, are there other fact patterns for which you consider the general approach of IFRS 9 does not provide useful information about changes in credit risk and resulting economic losses?

Questions to Constituents – Question 2(b)

69 Do Constituents consider that the ongoing costs of applying the general approach to particular financial instruments are significantly greater than expected? Please explain.

70 Do Constituents consider that the costs of auditing and enforcing the application of the general approach are significantly greater than expected? Please explain.

71 From a user perspective, do Constituents consider that the benefits of the resulting information to users of financial statements are significantly lower than expected? Please explain.

72 To what extent is the issue of joint and several guarantees relevant for your entity/jurisdiction?

Erste Group does not have fundamental questions about the general IFRS impairment approach. We have implemented the requirements as part of IFRS 9 project and continuously further improve their application. After extensive initial implementation effort we are ably to apply the requirements at reasonable costs now.

Regarding the issue of joint and several guarantees we understand that they mainly relate to intragroup transaction. However, wo do not apply them in our intragroup business. When saying this we do question relevance of the topic to other entities and consider that additional guidance addressing intragroup loans and guarantees could be helpful.

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Questions to Constituents (preparers)

118 Do you consider that more guidance is needed on the incorporation of forward-looking scenarios in the calculation of ECL? If yes, in which areas?

We have implemented the requirements for the forward-looking information and incorporated them in our models in line with the ITG discussions and general market practice for banks of our size. We also provide detailed sensitivity analysis disclosures of the effects of specific forward-looking scenarios. We do not consider that an additional guidance would be necessary in this area.

Question to Constituents (preparers)

128 Does your entity use post-model adjustments or management overlays when modelling ECL? What is the reason for their use and the impact on overall ECL amounts in the financial statements?

Erste Group has never used lump-sum management estimate overlays even in the high macroeconomic uncertainty which we experienced over the past years. We have always applied post-model adjustments based on transparent criteria which we have developed specifically for the situation. From this perspective we should rather refer to such adjustments as collective assessment adjustments. Examples are that for transfer in Stage 2 we used parameters such as industry heat map or certain PD level.

Such adjustments reflect our best effort to take account of the current economic conditions and forward-looking implications in the level of impairment.

Questions to Constituents

137 Please describe the types of financial instruments (and their characteristics) that cause significant challenges to apply the exception in paragraph 5.5.20? Are they managed on a collective basis?

138 Do you think that interaction of the life of revolving credit facilities with modification and derecognition requirements of IFRS 9 needs clarification? If yes, in which areas?

139 Do you think it would be useful to include guidance and the key messages provided by the IASB educational video in IFRS 9?

Erste Group applies the exception in paragraph 5.5.20 for considering the behavioural rather than contractual life of the instruments to products such as credit cards, overdrafts and revolving facilities which result to drawing a loan on a revolving basis. We apply the requirement for collective management in paragraph B5.5.39(c) as a determining factor, i.e. in order to qualify for the exception the instruments must be managed on a collective basis.

We consider that an additional guidance for derecognition of revolving credit facilities would be helpful since the derecognition moment sets the boundary for considering the behavioural life.

We think it would be helpful to include the guidance provided by the 2017 educational video directly in IFRS 9. The existing Illustrative Example 10 in IFRS 9 does not provide much aid for implementation of the requirements from practical perspective.

Questions to Constituents (preparers)

153 To what extent is the issue of financial guarantee contracts and other credit enhancements relevant for your entity?

154 Could you quantify the impact on a profit and loss statement if a financial guarantee is integral or non-integral to the contract?

Erste Group considers that the issues of financial guarantees and other credit enhancements and the distinction between integral of not-integral guarantees deserve further guidance in IFRS 9 since insufficient existing requirements may result in lack of comparability.

Question to Constituents

162 Do you consider that simplified for trade receivables, contract assets and lease receivables achieve their objective of decreasing the burden for preparers without hindering the usefulness of the information provided to users?

Erste Group applies the simplified approach only where it is mandatory. As a result, we are not in the appropriate position to assess its application.

Question to Constituents

192 In addition to the issue reported in the EFRAG's response, are there other fact patterns for which you consider there are specific questions about how to apply the impairment requirements alongside other requirements? Please explain.

We do not have other specific questions regarding application of the impairment requirements.

Questions to Constituents

200 Did you have any unexpected effects from applying transition requirements retrospectively?

201 Did you apply any of the transitional reliefs proposed by the IASB? Which ones and why? Did the benefits from applying the reliefs exceed the costs?

Erste Group did not experience unexpected effects from applying the IFRS 9 model. Except for not restating the comparative 2017 period we did not apply the transitional reliefs.

Questions to Constituents

216 Do you consider that additional credit risk disclosures are needed to improve the relevance of information to users of financial statements?

If so, please list what (those) additional disclosure requirement(s) you consider is (are) needed, explain why, and if possible, provide supporting evidence.

217 With what priority (low, medium, or high) do you consider the IASB should address this topic? Please explain.

Erste Group does not consider that any additional disclosures would be necessary. The existing IFRS 7 requirements provide a sufficient basis for entities to choose relevant disclosures.