Mr. Jens Berger

Acting Chair of the EFRAG FR TEG

European Financial Reporting Advisory Group

35 Square de Meeûs

Brussels B-1000

Belgium

Re: Questions to Constituents - EFRAG's DCL to PIR: IFRS 9 Financial Instruments – Impairments

Brussels, 13 Sep. 23

Dear Mr. Berger,

We welcome the opportunity to provide input to EFRAG's comment letter to the IASB's post-implementation review of the impairment requirements in IFRS 9 *Financial Instruments*.

Overall, we agree with the issues raised by EFRAG in its draft comment letter. However, in terms of priority classification, we propose to downscale the priority of certain issues raised.

Next to that, we see another matter that the IASB could investigate concerning purchased or originated credit-impaired financial assets.

For our detailed input on the questions to constituent, we refer to pages 2 to 6 of this document.

In case you want to discuss our input, please contact Benno Van der Poorten (benno.vanderpoorten@kbc.be).

Kind regards,

Luc Popelier,

CFO of the KBC Group

KBC

Questions to Constituents

1. Paragraph 29 - 30

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.

KBC Group's input:

§29 – We agree with the priority assessment of 'Application matters on POCI's requirements' (Medium priority). For the issue 'Interaction between modification, impairment and derecognition requirements', we acknowledge that the guidance is not very clear, which might lead to some diversity in practice. However, in our opinion, this is not a major issue, taking into account this is not a new IFRS 9 topic (already existed in IAS 39) and that any change in this regard could have major system implementation costs. Hence, we would classify this only as a medium priority. For the other issues identified, as these do not cause any application questions for our organization (either not relevant or there is common industry practice that sufficiently reduces the application questions) we deem these to be of low priority. In general, given the importance of IFRS 9 to our organization and the potential impact of changes to this standard on our systems and process, our view is that any changes should be carefully considered (i.e., the cost of implementing new guidance that resolves these issues may be substantially higher than the added benefit of reduced uncertainty in application of the standard).

§30 – Yes, we see an issue related to the current POCI requirements in IFRS 9. Namely, the requirements apply to assets that are very different in nature: on the one hand purchased credit-impaired (PCI) financial assets and on the other hand originated credit-impaired (OCI) financial assets. The economic logic behind the transactions that lead to the recognition of PCIs does not resemble the economic rationale that leads to the recognition of OCIs. For PCI's, the entity acquires (a portfolio of) credit-impaired financial assets with the aim of managing the specific risk for such a category of assets to realize a matching return. This clearly is a business model that is dissimilar to the traditional lending business which aims to generate a return by collecting the principal and interest on loans issued. For PCI assets, the POCI measurement and presentation clearly provide useful information for financial statement user:

- the application of the credit-adjusted effective interest rate reflects the entity's expected return on investment
- the recognition of changes in lifetime expected credit losses reflects the entity's performance in managing the return on investment.

On the other hand, OCI's are financial assets that often arise as a consequence of restructurings in light of financial difficulties of the borrower (i.e., forbearance) . In this case, a financial asset is derecognised from the entity's balance sheet as a consequence of a modification to the contract terms and/or contractual cash flows and a new financial asset is recognised that is credit-impaired at origination. The aim of the restructuring is to recover as much as possible of the principle outstanding and interest payments due. In contrast to PCI's, the POCI measurement and presentation requirements do not provide useful information for OCI's in case of forbearance. Specifically, in case that the restructuring is successful and the debtor returns to performing regular payments of principal and interest, this is not reflected in the financial statements of the entity as POCI loans measurement always carry requires lifetime expected credit losses (floored at the amount included in the estimated cash flows on initial recognition) and income is recognised based

on the credit-adjusted effective interest rate (i.e., the POCI model is asymmetrically only capturing adverse changes in credit risk).
A similar issue arises in a M&A transaction whereby e.g. Bank A would buy Bank B (e.g. for geographical expansion or increase in market share) and where Bank B would have some stage 3 loans. The loans and the business model would remain unchanged, but now at consolidated level one would need to show these loans as POCI. We believe that also in this situation, it does not lead to useful information for the financial statement user.

2. Paragraph 67 – 72

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?

KBC Group's input:
§67 – None.
§68 – None
§69 – No, the ongoing cost of applying the general approach is not significantly greater than expected for certain categories of financial instruments.
§70 – No, the cost of auditing is not significantly greater than expected.
§71 – Not relevant for KBC Group.
§72 – Not an important issue.

3. Paragraph 118 - 120

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?

Questions to Constituents (users)

119 To which extent the information about the scenarios used by the entities to estimate ECL is useful for your analysis?

120 What is the major drawback in the information provided in the disclosures to the financial statements you would like to improve?

KBC Group's input:
§118 – No, we do not believe that more guidance is needed on the incorporation of FLI scenarios in the calculation of ECL. In our view, the existing guidance provides an adequate basis to implement the principle-based approach. We concur with EFRAG's view that the lack of comparability is offset by an increased relevance of the resulting information. It should be noted that new guidance in this area may result in additional cost for prepares in case that existing methodologies and processes to include FLI need to be adapted.
§119 – N/A
§120 – N/A

4. Paragraph 126 – 128

Questions to Constituents (users)

126 Could you provide examples where the use of post-model adjustments or management overlays significantly reduced the usefulness of information provided to users of financial statements?

127 Do you consider that existing disclosure requirements of IFRS 7 could be improved to provide more relevant information? How would you improve it?

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?

KBC Group's input:
§126 – N/A
§127 – N/A
§128 – Management overlays are used where it would not be appropriate to depend (solely) on the quantitative models to determine ECL. This occurred for example during the Covid crisis, when unprecedented evolutions in economic variables resulted in models working outside their confidence bounds. Another example is the energy crisis, which drove up inflation to record highs after decades of benign inflation in the markets we operate. Consequently, the predictive value of inflation for credit losses was low in the historic datasets used to build the ECL models and the variable was not withheld as a parameter. A management overlay was required to amend this in the short term and reflect management's assessment of the resulting impact on expected credit losses.

The impact of management overlays on the overall ECL amounts in the financial statements is highly dependent on the specific event for which the management overlay is required.

5. **Paragraph 137 - 139**

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?

KBC Group's input:
§137 –None, in our view there are no types of financial instruments in our organization for which there are significant challenges to apply the exception in paragraph 5.5.20.
§138 – In our view, there is no need for such clarification.
§139 – We agree that it would be useful to include the guidance provided in the IASB educational video in IFRS 9.

6. **Paragraph 153 - 154**

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?

KBC Group's input:
§153 – This is not relevant for our organization.
§154 - This information is not readily available.

7. **Paragraph 162**

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?

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KBC Group's input:
§162 – we believe that the simplified approach reaches its objective.

8. Paragraph 192

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.

KBC Group's input:
§192 – None.