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Request for Information: Post-implementation Review of IFRS 9 *Financial Instruments* – Impairment (May 2023)

Dear Mr Barckow

On behalf of the German Insurance Association (GDV) we appreciate the opportunity to contribute to the IASB's Post-implementation Review on IFRS 9 *Financial Instruments* – Impairment. We refer our comments to the Request for Information (RFI) document (IASB/RFI/2023/1), released by the IASB on 30 May 2023 for the public consultation.

As a matter of fact, we welcome all the activities undertaken by the IASB to thoroughly evaluate whether there is a need to revisit or to fine-tune the existing impairment requirements in the Standard. Our overall assessment is that the impairment requirements in IFRS 9 generally work as intended. Consequently, the German insurers do not see a need for a fundamental overhaul of the basic design of the current impairment model. Any significant changes to the existing principles of the expected credit loss model might rather have unintended consequences, create the need to re-design the reporting systems again or it might even undermine the proofed robustness of the model. Its implementation was a challenging and costly exercise for the insurance industry, specifically as conducted in combination with the complex adoption of IFRS 17 *Insurance Contracts*.

Moreover, from our perspective the experience gained so far with the current design of the expected loss model under the challenging economic conditions has recently provided the empiric proof that it functions reasonably well, also under circumstances of unexpected increased

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stress, due to the flexibility built into the model. Hence, this flexibility must not be constrained any further, this flexibility must be retained.

Summing up, the current principle-based requirements for the impairment of simple debt instruments in the Standard work as intended; they are robust enough to provide reasonable results as well under conditions of unexpected economic stress/increased economic uncertainty.

Finally, it is already a burdensome and costly exercise for reporting entities to provide the existing disclosure package. Hence, any new additional disclosure requirements should be introduced only after very careful consideration whether the incremental benefits for users would balance the additional costs for preparers.

Our conclusions

The existing impairment requirements work well and do not need any fundamental overhaul. The current principles in IFRS 9 are proper and they are also capable of being applied consistently, though the use of discretion and professional judgment is unavoidable to apply the principle-based requirements to entity-specific facts and circumstances. Neither need the disclosure requirements any significant additions.

Furthermore, and in the context of this post-implementation review, we like to reinforce our firm view that recycling of realised gains or losses at disposal of FVOCI equity instruments continues to be a key concern of the insurance industry. We think that a properly designed impairment model for equity instruments could be incorporated into IFRS 9 to allow the IASB to address the existing accounting deficiency in the Standard as the equity instruments measured at FVOCI are currently not tested for impairment at al.

Our detailed responses to the questions raised in the RFI document are provided in the appendix to this letter. We would greatly appreciate if our comments and concerns would be considered by the IASB when taking decisions in the phase 2 of the Post-implementation Review. If you would like to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,

German Insurance Association (GDV)

Appendix

The views and comments of the German insurance industry on the Post-implementation Review of IFRS 9 *Financial Instruments* - Impairment, based on the consultation document IASB/RFI/2023/1, as released by the IASB on 30 May 2023 for public comments.

Question 1: Impairment

Do the impairment requirements in IFRS 9 result in:

(a) more timely recognition of credit losses compared to IAS 39 and address the complexity caused by having multiple impairment models for financial instruments? Why or why not?

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

Yes, it is our assessment that the impairment requirements in IFRS 9 result in more timely recognition of credit losses compared to IAS 39. Therefore, the IASB's main objective for the switch from the "incurred loss model" to the "expected credit loss model" has been achieved. We also believe that the impairment requirements in IFRS 9 result in providing useful information to investors and other users of financial statements. Overall, and based on the nuanced experience the German insurers have been able to gain so far, the impairment model for simple debt instruments in IFRS 9 works as intended.

Nevertheless, specifically regarding the notion of multiple impairment models for financial instruments we would like to emphasise that as a matter of principle the main accounting objective is to portray the economic reality of activities of a reporting entity in a proper and faithful way. *For example*, if there is a need to have a robust impairment model for equity instruments to introduce recycling for equity instruments measured at fair value through other comprehensive income (FVOCI), the German insurers would be more than happy to support it as it would improve the financial reporting outcome.

Hence, simplicity or only one impairment model in IFRS 9 should not be considered as a desirable objective as such and it should not prevent the IASB from overcoming the existing accounting deficiency for equity instruments. In particular, as those financial instruments are currently not tested for an impairment at all.

Question 2: The general approach to recognising expected credit loss

(a) Are there fundamental questions (fatal flaws) about the general approach? If yes, what are those fundamental questions?

(b) Are the costs of applying the general approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?

We are not aware of any fundamental questions (fatal flaws) about the general approach to recognising expected credit losses as set up in the Standard. And we continue to support its design as is. Specifically, it continues to be conceptually a reasonable approach to require the recognition of life-time expected credit losses generally only if there has been a significant increase in credit risk since the initial recognition. Till then only a loss allowance at an amount equal to 12-month expected credit losses throughout the life of the instrument is recognised. Overall, the requirements and objectives of the general approach are conceptually clear and specific enough to be applied consistently and also to be understood properly by investors and other users of financial statements.

The *ongoing* costs of applying the general approach for reporting entities are indeed significant, but it was expected to be the case from the start. And, as a matter of fact, those costs are not significantly greater than expected. Nevertheless, we would like also to emphasise that the initial entity-specific adoption of the general approach - and ensuring its audibility - caused a significant *one-time* effort for reporting entities. Specifically the foundation of data and processes necessary to determine the specific intputs for the models applied was a time- and cost-consuming task. But finally, the necessary data and systems and the reporting processes are defined, established and in place. Any significant changes in this regard should be avoided.

Finally, we believe that the benefits to investors and other users of financial statements are as expected if they are willing to explore the numbers – and the disclosures accompanying them – provided by the reporting entities. We don't have any (not even an anecdotal) evidence that it would not be the case.

Question 3: Determining significant increase in credit risk

(a) Are there fundamental questions (fatal flaws) about the assessment of significant increases in credit risk? If yes, what are those fundamental questions?

(b) Can the assessment of significant increases in credit risk be applied consistently? Why or why not?

We are not aware of any fundamental questions (fatal flaws) about the approach with the assessment of significant increases in credit risk. And we continue to fully support the principle-based nature of the approach in this regard, where applying judgment is inherent to it.

It is also our firm view that the assessment, whether a significant increase in credit risk occurs, can be applied consistently. In particular, we fully share the IASB's view in the RFI document that "applied *consistently*" does not mean "applied *identically*". Therefore, we are absolutely not in favour of the IASB providing any detailed application guidance on what is considered a significant increase in credit risk for particular fact patterns. It would risk undermining the principle-based nature of the Standard and it might lead to rules-based requirements in the long run. Moreover, it is not given that the real incremental benefits of a detailed application guidance would then automatically outweigh the costs of standard setting and the costs of preparers obliged to follow them then.

It is inherent to a principle-based Standard that professional judgment would still need to be applied as no guidance can cover the whole variety of the reality, specifically when considering the global scale of IFRS 9's use.

Finally, in the German insurance sector, investing mainly in fix-income securities, the clause for low credit risk instruments (paragraph 5.5.10 of IFRS 9) is of essential importance, specifically from an operational perspective. It's its existence which contributes to consistent accounting practice in the insurance market.

Overall, we continue to have the view that the particular requirements in IFRS 9 are providing an adequate basis to determine the appropriate accounting and any add-ons are not necessary in this regard.

Question 4: Measuring expected credit losses
(a) Are there fundamental questions (fatal flaws) about requirements for measuring expected credit losses? If yes, what are those fundamental questions? **(b) Can the measurement requirements be applied consistently? Why or why not?**

The main idea of 'expected credit loss' model is to compare the expected and the contractual cashflows, basing it on the present-value concept. In this regard we generally support IFRS 9 setting out only the main principles for measuring expected credit losses, but not prescribing a particular specific technique to implement those principles. We fully agree that a reporting entity is obliged to adjust its specific measurement approach in various circumstances to reflect reasonable and supportable information, available without undue cost or effort. In this regard we are not aware of any fundamental questions (fatal flaws) about the requirements for measuring expected credit losses. Therefore, we continue to fully back the view that "*adopting a principle-based, instead of prescriptive, approach to measuring expected credit losses helps reduce complexity and mitigate operational challenges for stakeholders by allowing an entity to use techniques that work best in its specific circumstances*" (Spotlight 4.1, page 19). Moreover, we believe that the requirements, as they are, achieve the IASB's objective of providing users with useful information.

Regarding the reflection of particular risks such as "**climate risk**" we understand that (1) the general principles of the expected credit loss model apply and (2) the IASB has already initiated the specific project "Climate-related Risks in the Financial Statements " (link) to address these issues in a more comprehensive way. Hence, we would not encourage the IASB to deal with these issues in isolation and only in the narrow context of IFRS 9's requirements.

Finally, and specifically regarding the **post-model adjustments** or management overlays, we do not agree with the view that the use of post-model adjustments or management overlays "*significantly reduces the usefulness of information provided to users of financial statements (…)*" (Spotlight 4.2, page 20). In particular, we would like to emphasise that the flexibility inherent to the principle-based set-up of expected credit loss model is important to reflect entity-specific circumstances in the most appropriate way. In addtition, no model is capable of incorporating fully unexpected events or unusual economic developments

without adjustments. Consequently, the increased economic uncertainty in the recent times made it absolutely necessesary to adjust the models, but also to use the post-model adjustments oder management overlays to properly reflect the given unusual situations. Therefore, the use of those measures does not reduce the usefulness of the information provided. **On the contrary**, their use only ensures that the information provided leads to a proper reflection of the entity's professional assessment and ensures that information provided is faithful, meaningful and useful.

Consequently, we strongly believe that the current **flexibility is a proper element of the set-up of the expected credit loss model in IFRS 9 and it ensures its applicability in tough times**, under conditions of increased economic stress, not covered by the model design as not expected at that time its development/adoption had taken place. And not all of the unique, non-recurring events can immediately be reflected/built-in into the model. Hence, the post-model adjustments, based on documented thought-processes, need to be retained as an important and inherently necessary element of the expected credit loss model design in IFRS 9. These adjustments based on professional judgment and discretion are essential as they allow the model to work as intended, i.e. to result in reasonable financial reporting outcomes in entity-specific circumstances.

Moreover, as a matter of principle and to avoid any potential misunderstanding, we view that **disclosures** in the notes to financial statements are intended by their very objective to allow users to understand how the aggregated amounts are determined and to assess their impact on the financial position and performance of the reporting entity. But the disclosures provided in the notes to the financial statement do not have the objective to provide such a deep insight that it would enable users of financial statements to evaluate, i.e. recalculate the aggregated numbers provided by preparers and already audited by the responsible auditor. If however the disclosure provided are inadequate, as not being in line with the already existing requirements of IFRS 7 *Financial Instruments: Disclosures*, it does not mean automatically that the standard-setting activity of the IASB is required.

Finally, we do believe that the current measurement requirements can be applied consistently, though also here we like to highlight that consistency in applying common principles does not mean for us uniformity of methods or inputs used.

Question 5: Simplified approach for trade receivables, contracts assets and lease receivables

(a) Are there fundamental questions (fatal flaws) about the simplified approach? If yes, what are those fundamental questions?

(b) Are the costs of applying the simplified approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?

We are not aware of any fundamental questions (fatal flaws) about the simplified approach.

In our assessment, the costs of applying/auditing the simplified approach are not significantly greater than expected.

We think that the simplified approach provides the intended operational relief for reporting entities in relevant cases as envisaged by the IASB, specifically as it removes the need for the reporting entity to track whether the significant increase in credit risk occurred.

Question 6: Purchased or originated credit-impaired financial assets

Can the requirements in IFRS 9 for purchased or originated credit-impaired financial assets be applied consistently? Why or why not?

Although the purchased or originated credit-impaired debt instruments are not in the focus of investment activities of insurers as institutional investors, we view that the current relevant requirements in the Standard are appropriate and that they can be applied consistently.

Question 7: Application of the impairment requirements in IFRS 9 with other requirements

Is it clear how to apply the impairment requirements in IFRS 9 with other requirements in IFRS 9 or with the requirements in other IFRS Accounting Standards? If not, why not?

We don’t have any specific comments. If there were questions on the interplay between different requirements, we have the impression, that proper solutions have been identified in the accounting practice.

Question 8: Transition

Were the costs of applying the transition requirements and auditing and enforcing their application significantly greater than expected? Were the benefits to users significantly lower than expected?

The relevant reliefs provided in the Standard, like the option to recognise lifetime expected credit loss at each reporting date until derecognition or the regularly applicable low credit risk simplification in paragraph 5.5.10 of IFRS 9, were very helpful to adopt the expected credit loss model in due time.

However, we would like to recall that the transitional requirements of IFRS 9 regarding comparative information were unfortunately not fully aligned with transitional requirements of IFRS 17 *Insurance Contracts* as IFRS 17 did require the presentation of restated comparative information while IFRS 9 did not. In this regard the insurance industry has greatly appreciated the targeted amendments to the transition requirements in IFRS 17 that the IASB had provided on 9 December 2021 (link). This pragmatic additional relief provided by the IASB on a timely basis had enabled insurance undertakings to provide more meaningful comparative information at transition to IFRS 17 and IFRS 9.

Overall, in our assessment the necessary adoption of reporting systems and the *initial* implementation of the expected credit loss model requirements had required significant efforts and was a challenging and costly project for insurance undertakings, often ultimately more costly than expected. Also, the *ongoing* application of the expected credit loss model is a costly exercise and requires dedicated resources and qualified staff to be allocated to this task. In this regard the German insurers urge the IASB to not undertake any essential changes to the current requirements.

Question 9: Credit risk disclosures
(a) Are there fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risks? If yes, what are those fundamental questions? **(b) Are the costs of applying these disclosure requirements and auditing and enforcing their application significantly greater than expected? Are the benefits to users significantly lower than expected?**

We are not aware of any fundamental questions (fatal flaws) about the disclosures required in IFRS 7 for credit risks. Further, we believe that investors and other users of financial statements are receiving relevant information. Moreover, the information provided to users is definitely comparable as the same requirements apply to all reporting entities, incl. the same objectives and the same minimum disclosure requirements. *For example*, paragraph 35G of IFRS 7 requires an entity to explain the inputs, assumptions and estimation techniques used to apply the impairment requirements of IFRS 9. For this purpose, IFRS 7 specifies in some further details what needs to be disclosed. *For example*, in paragraph 35G (b) of IFRS 7 is prescribed that an entity must also disclose "*how the forward-looking information has been incorporated into the determination of expected credit losses*".

Regarding the costs of applying the disclosure requirements as currently prescribed by IFRS 7 we would like to observe that still essential efforts on ongoing basis are necessary to properly comply with the existing disclosure requirements. But overall we don't think that these costs are significantly greater than expected. And, we also assess that the benefits are as intended by the IASB and they are providing the intended deep insight to users, specifically the required reconciliations from the opening balance to the closing balance of expected credit losses (paragraph 35H of IFRS 7) or the sensitivity analysis (paragraph 40 of IFRS 7).

Overall, we don't assess that adding new additional minimum disclosure requirements about credit risk should be considered by the IASB as a follow-up activity to this Post-implementation Review. The current package of requirements is sufficient and strikes the proper balance between the users' needs and the operational and cost burden on preparers.

Finally, we don't have any information that the current disclosure requirements would not be compatible with digital reporting needs.

Question 10: Other matters

(a) Are there any futher matters that you think the IASB should examine as part of the post-implementation review of the impairment requirements in IFRS 9? If yes, what are those matters and why should they be examined?

(b) Do you have any feedback on the understandability and accessibility of the impairment requirements in IFRS 9 that the IASB could consider developing its future IFRS Accounting Standards?

In the specific context of the post-implementation review of the impairment requirements in IFRS 9 we would like to emphasise that no impairment requirements are existent in the Standard for equity instruments measured at fair value through the other comprehensive income (FVOCI). We perceive such a circumstance as a problematic one, specifically as valid recommendations, how a robust impairment model for FVOCI equity instruments could look like, has be developed and provided to the IASB over the recent years.

And again, also in the specific context of this particular post-implementation review, we would like to reinforce our firm view that recycling of realised gains or losses at disposal of FVOCI equity instruments continues to be a key concern of the insurance industry. And we continue to believe that a robust and non-complex impairment model for equity instruments could be easily incorporated into IFRS 9 as it has been identified by the IASB as one of the preconditions for the reintroduction of recycling for equities.

Consequently, we continue to have the view that the IASB could address this important issue and remove both existing deficiencies in the accounting for FVOCI equity instruments in IFRS 9. We acknowledge however the recent Board's decision of October 2022 not to approach the matter when considering targeted clarifying amendments to IFRS 9 (link). We would therefore like to reinforce our recommendation to reconsider the issue of concern as part of the post-implementation review of IFRS 17. The recycling issue should be an essential element of the future post-implementation review of IFRS 17 because of the well-known inherent linkage between IFRS 9 and IFRS 17. And finally, as a matter of principle, we strongly believe that only adding new disclosure requirements is generally not a proper remedy to address the firm concerns expressed above. For further details we respectfully refer to our comment letter of 15 June 2023 on the recent Exposure Draft (link).