Erste Group Bank AG
Am Belvedere 1
1100 Vienna
www.erstegroup.com

Gabriele Tauböck
+43 (0) 50100 - 10100
gabriele.tauboeck@erstegroup.com

Commercial Court Vienna
Commercial Register No.: 33209m
Bank Code: 20100
Swift Code / BIC: GIBAATWWXXX

Date: 28.06.2023
public

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

Comment letter on the EFRAG Draft Comment Letter on IASB ED/2023/2 Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)

Dear Mr Klinz,

Thank you for the opportunity to comment on the EFRAG draft comment letter (DCL). We agree with the solution the IASB proposes for clarifying contractual terms that are consistent with a basic lending agreement. We consider that it will address the issues which our bank currently faces when classifying loans with ESG features. These loans constitute a significant portion of our large corporate lending portfolio. Without the solution we face a strict interpretation by our auditors that such features are not SPPI unless they are de-minimis. We also appreciate that in several places of the draft comment letter EFRAG stresses the need for delivering the solution as early as possible.

On the other hand, we do not consider the proposed new disclosures about contractual terms that change the timing or amount of contractual cash flows as appropriate. They relate to features which are SPPI even based on the existing IFRS 9 requirements (such as margin ratches), these are basic lending arrangements and IFRS 9 provides sufficient mechanism for capturing the cash flow variability. The application of IFRS 9 over six years has not revealed the need for this kind of disclosures. Financial institutions would incur high cost for collecting this kind of data for producing information with a limited value to users.

Kind regards,

Gabriele Tauböck
Head of Group Accounting

Question 1 - Derecognition of a financial liability settled through electronic transfer

Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity.

Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

Questions to Constituents

51 Do you agree with limiting the scope of the proposed accounting alternative to electronic payment transfers when specified criteria are met? If not, do you consider that the IASB should broaden the scope of the amendments to include other types of disbursements (e.g., cheques and credit cards)?

52 Do you consider that the asset side of such transactions should also be addressed by the IASB as part of these amendments?

53 Do you agree with the proposed criteria for derecognising a financial liability before the settlement date?

Erste Group agrees with the answer as drafted in the EFRAG DCL.

Question 2 – Classification of financial assets – contractual terms that are consistent with a basic lending arrangement

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:

(a) interest for the purposes of applying paragraph B4.1.7A; and

(b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

Questions to Constituents

95 Can you apply the clarifications provided in the ED to your financial assets with ESG-linked or similar features? Do you have any difficulties? If yes, please elaborate.

96 Does application of these clarifications result in your financial assets with ESG-linked or similar features meeting SPPI requirements? If not, please explain which instruments fail and why.

97 In your opinion, do the proposed clarifications have an impact on the classifications of other financial assets? If yes, which ones and why?

We appreciate that EFRAG stresses urgency of bringing the solution for SPPI compliance for ESG features. In the DCL EFRAG encourages the IASB to prioritise the publication of the proposed clarifications on the general SPPI requirements before the other amendments, allowing entities to apply them as early as possible. This is mentioned not only in the answer to question 2 but also to questions 3 and 4. This is in line with the message Erste Group has recently communicated through ESBG to the IASB and EFRAG and we can confirm that its relevance persists. Our bank faces a high risk that, without the solution, loans with the ESG features exceeding the de-minimis threshold are interpreted by auditors as non-SPPI compliant and would need to measure them at fair value through profit or loss. Loans with the ESG features constitute a significant portion of our large corporate lending portfolio and their volume is expected to increase.

As a result, we welcome the clarification provided by the IASB in B4.1.10A in relation to the issues faced in practice when applying SPPI assessment for financial assets with ESG-linked cash flow variability. We consider this to be a good solution to the urgent issue. In this regard, we also consider as helpful adding the examples for Instrument EA and Instrument I for clarifying on how the requirements relate to ESG features.

In this respect, we agree with the proposed answer to question 2 in the EFRAG draft comment letter. It supports the solution proposed by the IASB and raises certain issues which we consider valid and should be further clarified. We would stress especially the “magnitude” issue discussed in paragraphs 84 and 85 of the DCL since this could have unintended consequences of an increased need for a quantitative assessment of the elements of interest.

Question 3 - Classification of financial assets - financial assets with non-recourse features

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term 'non-recourse'.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Questions to Constituents

121 Do you consider the updated application guidance for financial assets with non-recourse features clear and easy to apply? If not, please explain.

122 In your opinion, do the proposed clarifications have an impact on the current classifications of your existing financial assets? If yes, which ones and why?

Erste Group agrees with the answer as drafted in the EFRAG DCL.

Question 4 - Classification of financial assets - contractually linked instruments

The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21 – B4.1.26 of IFRS 9.

The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9.

Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Questions to Constituents

159 Do you consider the updated application guidance for contractually linked instruments clear and easy to apply? If not, please explain.

160 In your opinion, do the proposed clarifications have an impact on the current classifications of your existing financial assets? If yes, which ones and why?

Erste Group agrees with the answer as drafted in the EFRAG DCL.

Question 5 – Disclosures – investments in equity instruments designated at fair value through other comprehensive income

For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to:

(a) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period; and

(b) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period.

Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

Question to Constituents

171 Do you consider that these disclosure requirements will provide useful information? Please explain.

Erste Group agrees with the answer as drafted in the EFRAG DCL.

Question 6 – Disclosures – contractual terms that could change the timing or amount of contractual cash flows

Paragraph 20B of the draft amendments proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

Questions to Constituents

188 Do preparers consider that they will be able to provide these disclosure requirements at a reasonable cost? Please explain.

189 Do users consider that these disclosure requirements will provide useful information? Please explain.

We have concerns about the potential scope of the disclosures on contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. We note that the proposed disclosures would relate not only to financial assets with ESG features. Cash flow variability conditional upon event specific to the debtor also relates to features such as margin ratchets whereby the margin is adjusted by reference to certain financial ratios of the debtor. Other examples may be cross-selling clauses or penalty interest. Such margin adjustments are considered to be SPPI based on the existing requirements. Over six years of IFRS 9 application users have not expressed the need for having additional disclosures for such features. We consider that once features are SPPI they relate to simple basic lending and there is sufficient accounting mechanism in IFRS 9 for capturing their variability.

Systems for identifying these features in respect of carrying amounts and tracking the range of the potential changes have not been developed during IFRS 9 implementation and afterwards. The IFRS 9 classification process at Erste Group is regularly reviewed and ensures a high quality of classification with alignment among different departments to immediately reflect new market changes. Collection of quantitative data is not part of these processes. It would not improve the quality of the assessment and would involve high implementation but also ongoing costs. As a result, we consider that the costs for producing these disclosures are not reasonable considering limited value of the information. If users view this information is useful it may appropriate to question whether it is not just in the category of 'nice to have'.

Question 7 – Transition

Paragraphs 7.2.47 – 7.2.49 of the draft amendments to IFRS 9 would require an entity to apply the amendments retrospectively, but not to restate comparative information. The amendments also propose that an entity be required to disclose information about financial assets that changed measurement category as a result of applying these amendments.

Paragraphs BC105 – BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Erste Group agrees with the answer as drafted in the EFRAG DCL.