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

Dear Mr Klinz

On behalf of the German Insurance Association (GDV) we welcome the opportunity to provide our comments on EFRAG's draft comment letter (the 'DCL') in response to the IASB' Exposure Draft "Amendments to the Classification and Measurement of Financial Instrumetns, Proposed amendments to IFRS 9 and IFRS 7 " (the 'ED'), published by EFRAG for comments on the 5 May 2023.

Overall, we generally support the EFRAG's tentative assessment in the DCL. Hence, our comments in this letter will be limited to and focused on some aspekts of it only.

Specifically, and like EFRAG, we greatly appreciate the IASB's responsiveness to concerns raised and issues identified in the preceding Post-implementation Review of IFRS 9. Consequently, we welcome the proposal in the IASB's ED to provide more clarity on how to apply the general solely payments of principal and interest (SPPI) requirements to financial assets with **ESG-related or similar features** (**Question 2**). And like EFRAG, we fully support the approach chosen by the IASB not to provide a specific exception from the requirements on contractual cash flow characteristics in IFRS 9 in this regard. And again like EFRAG, we also consider that the principle-based approach in IFRS 9 should be retained as it "*would provide more flexibility in the future if new instruments with similar types of features would emerge*".

Gesamtverband der Deutschen Versicherungswirtschaft e. V.

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Regarding the proposed new **disclosure requirements** for investments in equity instruments designated at fair value through other comprehensive income (**Question 5**), and as a matter of principle, we would like to reinforce our general view that disclosures in the notes should not be used to overcome issues in accounting which should be resolved first of all. As it is generally known, the German insurers continue to firmly believe that **recycling** of realised gains or losses on equity instruments is essential to resolve the existing deficiency in accounting for FVOCI equities and to ensure a proper presentation of the underlying performance of insurers investing long-term in such instruments. In this regard, we reinforce our recommendation to the IASB to envisage the recycling issue to be an essential element of the future regular Post-implementation Review of IFRS 17 *Insurance Contracts*, specifically because of the inherent linkage between IFRS 9 and IFRS 17.

Finally, there are two **conclusions in the DCL of EFRAG** for which we don't fully understand how the assessments and the rationale provided are leading to them. We would like to respectfuly ask EFRAG to reconsider them when finalising the EFRAG's comment letter to the IASB via a more nuanced approach then.

- Firstly, we don't follow why the relevant and important assessment provided by European constituents from the insurance industry is banished into a footnote (footnote 4 to paragraph 79 of the DCL), while the views expressed by the European constituents from the banking sector are treated with special prominence in the main text of the DCL. We struggle to understand the rationale as the question whether debts instruments are passing the SPPI test is the necessary basic prerequisite for both the amortised cost accounting and the fair value through other comprehensive income accounting for debt instruments in IFRS 9. Hence, we would appreciate an **equal treatment of views** expressed by the European stakeholders in this regard, both impacted by the amendments proposed in the ED.
- Secondly, considering the disclosure requirements proposed in the ED for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event (**Question 6**) we would suggest to reconsider the [tentative] overall positive conclusion of EFRAG. It is not directly clear why in paragraph 186 EFRAG finally agrees with the **ambitious disclosure requirements** as proposed in the ED, while in the preceding paragraphs of the DCL a numer of reasonable concerns in this regard have been properly identified. For the same reason we would like to recommend nuancing the [tentative] positive

assessment provided already in the initial paragraph 177 of the DCL. Further details on our rather critical assessment of the proposed new disclosure requirements as set up in the IASB's ED are provided in the GDV comment letter to the IASB (attached) we would like to kindly refer to.

With regard to our further detailed comments on the IASB's proposals in the ED we refer to the GDV comment letter as submitted to the IASB (attached hereafter).

We would appreciate if our comments and suggestions would be considered when finalising the EFRAG's comment letter on the relevant amendments proposed in the IASB's ED.

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

Yours sincerely,

German Insurance Association (GDV)

Appendix

The comments of the German insurance industry on the Exposure Draft "Amendments to the Classfication and Measurement of Financial Instruments, Proposed amendments to IFRS 9 and IFRS 7" (ED/2023/2), issued by the IASB on 21 March 2023 for public consultation, and the respective rationale are provided in the GDV's comment letter as submitted to the IASB (attached hereafter).

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Exposure Draft: Amendments to the Classification and Measurement of Financial Instruments
Proposed amendments to IFRS 9 and IFRS 7 (March 2023)

Dear Mr Barckow

On behalf of the German Insurance Association (GDV) we welcome the opportunity to comment on the Exposure Draft: Amendments to the Classification and Measurement of Financial Instruments, proposed amendments to IFRS 9 and IFRS 7 ('the ED'), published by the IASB on 21 March 2023 for public consultation.

While we do not provide detailed comments on all the questions raised in the ED, we would like to share our overall assessment and comments on some of the important issues approached by the IASB in the ED.

In general, we appreciate that the IASB decided to address with the ED some of the issues raised during the preceding IASB's Post-implementation review of IFRS 9. The GDV provided with its comment letter of 12 January 2022 (link) detailed comments on the relevant Request for Information (RFI) document. Overall, we agree with the proposed amendments to the classification and measurement of financial instruments in the ED. Nevertheless, we firmly regret that the recycling issue on equity instruments accounted for at fair value through other comprehensive income (FVOCI), being the priority issue for the insurance industry, is not addressed in an appropriate manner in the ED. The German insurers continue to have the firm view that realised gains or losses on equity instruments should be ultimately presented in the profit or loss statement once realised. A robust impairment model had been proposed.

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In the following paragraphs we provide more detailed comments on the questions raised in the ED and our related rationale.

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

We acknowledge the IASB's rationale as provided in the ED and support the proposal to introduce an option to allow the derecognition of financial liabilities that are settled using an electronic payment system before the settlement date if certain conditions are met. We think that it might help to address the practical concerns raised as a consequence of the agenda decision the IFRS Interpretations Committee concluded on in its meeting in June 2022 (link). We also support the IASB's decision to approach the concerns raised regarding the significant practical implications of the agenda decision for impacted stakeholders via the standard setting with an explicit lead time and transitional requirements.

It is our assumption and expectation that those interested stakeholders will provide their detailed assessment whether the three conditions envisaged by the IASB in the ED for paragraph B3.3.8 of IFRS 9 would be practical or rather too burdensome from the operational perspective or not. In case of the insurance industry the settlement date accounting is applied, i.e. the liabilities are generally derecognised only once the contractual obligations towards policyholders are fulfilled. Any additional clarifications or rules-based requirements in this regard are not necessary from our perspective. Hence, we appreciate and support the IASB's intention to not provide any.

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

As a matter of principle, we are overall supportive of the general direction of the proposed amendments in the ED in this regard. From our perspective, they are capable of addressing the controversy and providing more clarity in which cases the financial instruments with ESG-related features in their contractual terms have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, i.e. are meeting the SPPI test, that is - beyond the business model assessment - the other necessary basic prerequisite for both the amortised cost accounting and the fair value through other comprehensive income accounting for debt instruments in IFRS 9.

In addtion, we strongly agree with the general and principle-based approach proposed in the ED, hence support neither incorporating any detailed rule-based guidelines nor providing any special treatment for

financial instruments with ESG-related or similar features in their contractual terms. The additional general and principles-based clarification in which cases the contractual terms are consistent with a basic lending arrangement provide an useful additional point of reference.

In some more detail:

We think that the intended clarifications in paragraph B4.1.10A regarding the initial assessment of contractual terms that change the timing or amount of contractual cash flows are appropriate and useful and they correspond well to the examples in paragraphs B.4.1.13 (Instrument EA) and B4.1.14 (Instrument I). While the proposed examples might be indeed considered to be very simplistic, they are still helpful to better understand the general intention of the IASB regarding the treatment of financial instruments with ESG-related or similar features in IFRS 9. It seems to us that a decisive element of the analysis is to assess at the initial recognition whether the contractual cash flows before and after the occurrence of a debtor-specific event remain determinable.

However, we are unsure whether the proposed amendments to paragraph B4.1.8A are intended to change the interaction between the SPPI test as such and the basic lending arrangement idea which has been considered so far rather as a point of reference, i.e., those contractual cash flows that are solely payments of principal and interest on the principal amount outstanding have been considered to be consistent with a basis leding arrangement concept. The additional clarifications in paragraph B.4.1.8A seem to change the nature of this reference, introducing an element of circularity. We would like to refer to the following sentence:

> "*Contractual cash flows are inconsistent with a basic lending arrangement if they include compensation for risks or market factors that are not typically considered to be basic lending risks or costs (...), even if such contractual terms are common in the market in which the entity operates.*"

Summing up, we are fully supportive of the IASB's decision **not** to fundamentally change the design of the SPPI test, not to provide an exceptional treatment or any other kind of a new specific solution for simple debt instruments which would lead to the need to overall verify or re-do the IFRS 9 implementation work just recently conducted and successfully completed by insurers. Therefore, we are fully supportive of the 'clarification approach' envisaged in the ED. In particular, regarding the accounting of financial assets with ESG-related or similar features we generally support the proposed clarification that general principles need to be used, applying professional judgment, including the useful clarifications proposed in the ED.

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

We generally support the intended clarification in paragraph B4.1.16A, i.e. to emphasise the need to distinguish between an exposure to the specified asset's performance risk and the one to the debtor's credit risk.

Question 4: Classification of financial assets – contractually linked instruments

We generally support the intended clarifications. We have no specific comments.

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

As a matter of principle, we would like to reinforce our general perspective that disclosures in the notes should not be used to overcome issues in accounting which should be resolved first of all. As mentioned above, the German insurers continue to firmly believe that recycling of realised gains or losses on equity instruments is essential to resolve the existing deficiency in accounting for FVOCI equities and to ensure a proper presentation of the underlying performance of insurers investing long-term in such instruments. This is specifically an issue when considering the interaction with insurance contracts accounting in IFRS 17.

Hence, as a matter of fact, the proposed additional disclosure requirements do not address the key concern of the insurance industry, specifically because of the different prominence of presentation in the profit or loss statement compared to disclosures in the notes and its interaction with insurance contracts accounting. Therefore, while acknowledging the Board's decision in its October 2022 meeting (link) not to address the issue at this time in the ED, we reinfoirce our recommendation to envisage the recycling issue to be an essential element of the future PIR of IFRS 17 Insurance Contracts, specifically because of the inherent linkage between IFRS 9 and IFRS 17.

Finaly, although the adoption of the additional disclosure requirements proposed in the ED might not be a significant operational challenge for insurers, we are not aware of preceding relevant users' requests in this regard. In addtion, the existing disclosure requirement in paragraph IFRS 7.11B (c) refers to the cumulative gain or loss on disposal, which is superior from the informational perspective to the proposal in the ED

for the paragraph IFRS 7.11A (f) to disclose the realised fair value gains or losses "during the period" only.

With regard to the implicit assumption in the illustrative example proposed in the ED for paragraph IG11B of IFRS 7 we would like to note that the assumed transfer of any cumulate gains or losses on equity instruments from other comprehensive income to retained earnings is currently not mandatory. Hence, only in the case in which such a transfer takes place, the relevant information is disclosed.

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

Although we acknowledge the rationale for the proposed disclosure requirements to provide relevant information on the potential effect of the contractual terms that could change the timing and amount of contractual cash flows, we do believe that it would be operationally burdensome to provide them. In particular, IFRS 9 requires currently to classify financial assets only at inception of the contract based on the assessment of the entity's business model for managing the financial assets and the contractual cash flow characteristisc of the financial asset. The proposed disclosure requirement in paragraph 20B (b) of IFRS 7 would however obliged entities to provide on a period by period basis "*quantitative information about the range of changes to contractual cash flows that could result from those contractual terms*". It would lead to the need for a substantial update of reporting systems to enable reporting entities to collect and track the information necessary to prepare and to provide this disclosure "*separately for each class of financial assets measured at amortised cost or fair value throught other comprehensive income and (…).*" (paragraph 20C of IFRS 7).

From our perspective and considering the origin and the aim of the ED, the IASB should review whether such a far-reaching substantial extension of the disclosure requirements would be justifiable from the cost-benefit perspective. As the IASB's intention was to clarify the current requirements, we would recommend to limit the proposal on paragraph 20B (a) and (c) only, while omitting the letter (b). It would eliminate the need for yearly review of all relevant contractal terms and conditions.

Consequently, we suggest to verify again whether the disclosure objectives could be designed in a less burdensome way, while still providing real incremental benefits for investors and other users of financial statements. It applies specifically to financial instruments accounted for at FVOCI where the fair value measurement already captures the effects of changes in timing and amount of contractual cash flows. Hence, the

proposed quantitative disclosures might be of limited added-value for users in these cases or would at least require a more substantiated justification if ultimately endorsed as proposed.

Question 7: Transition

We agree with the proposed transitional requirements.

Summery / Our conclusions

We generally support the IASB's intention to address the requests raised regarding the accounting for financial instruments with ESG-related or similar features in a principle-based way by clarifying the existing SPPI test principles in the standard. And the proposed option for derecognition of financial liabilities is capable of addressing the practical concerns raised by stakeholders in this regard. Nevertheless, the proposed disclosure requirements need to be verified again whether they could be designed in a less burdensome way, while still providing real incremental benefits for investors and other users of financial statements. Finally, we reinforce our view that recycling of gains or losses at disposal of FVOCI equity instruments continues to be a key concern of the insurance industry; the proposed additional disclosure requirements for IFRS 7 does not address this important issue.

We would greatly appreciate if our comments and concerns would be considered by the IASB when taking decisions on the way forward with the amendmets proposed in the ED.

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

Yours sincerely,

German Insurance Association (GDV)