

Andreas Barckow
Chair, International Accounting Standards Board (IASB)
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD

26 September 2023

Dear Mr.Barckow,

Request for Information – Post Implementation Review of IFRS 9 - Impairment.

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **Request for Information – Post Implementation Review of IFRS 9 - Impairment.**

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors, and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Overall, we believe that the ECL model in IFRS 9 is working well, and we do not any see fatal flaws. We urge the IASB to carefully evaluate any substantial modification to the general model given the implementation costs and potential unintended consequences. We consider that there are certain areas where further guidance may be helpful to improve consistency. However, we recommend that the IASB maintains all the fundamentals of the model which in our view has worked well.

We respond to each of the questions set out in the Request for Information in the Appendix to this letter focusing on the following topics:

- Design and key aspects of the Expected Credit Loss model
- Recognition of Expected Credit Losses
- Significant Increase in Credit Risk
- Measurement of Expected Credit Losses

Association for Financial Markets in Europe

London Office: Level 10, 20 Churchill Place, London E14 5HJ, United Kingdom T: +44 (0)20 3828 2700

Brussels Office: Rue de la Loi 82, 1040 Brussels, Belgium T: +32 (0)2 883 5540

Frankfurt Office: Neue Mainzer Straße 75, 60311 Frankfurt am Main, Germany T:+ 49 (0)69 710 456 660

www.afme.eu

We trust that the above comments are helpful, and we look forward to engaging further with the IASB on the Exposure Draft.

Yours sincerely,

Ian Sandles
Director, Tax and Accounting
ian.sandles@afme.eu
Tel: +44 20 3828 2708

Louise Rodger
Director, Compliance
louise.rodger@afme.eu
Tel: +44 20 3828 2742

APPENDIX

REQUEST FOR INFORMATION

POST-IMPLEMENTATION REVIEW IFRS 9 FINANCIAL INSTRUMENTS - IMPAIRMENT

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?

The Expected Credit Loss Model (ECL model) aims to address concerns that impairment losses recognised under the incurred loss model were too little and were recognised too late. Compared to IAS 39, the forward-looking ECL model does recognise losses earlier as it is more sensitive to changes in the economic and credit cycle. The model brings significant improvements most notably close alignment with the credit stewardship of banks and the ability for entities to exercise judgements that are consistent with the characteristics of their lending book. However, the model is complex and is yet to be subject to further stress and uncertain economic and credit cycles. Despite this, the impairment requirements in IFRS 9 are well understood, implementable and mostly work as intended.

The model has been subject to stressed conditions under the COVID 19 pandemic, but this event cannot be considered representative of a fully distressed credit cycle followed by recovery because of the unprecedented government support provided. Nevertheless, the principles-based requirements in the IFRS 9 impairment model gave adequate flexibility to entities to adapt to the unknown and unexpected events as they arose during the COVID 19 pandemic.

Principles based versus level of judgement.

We note that an impairment model based on ECL is a result of the demand from the leaders of the G20 urging accounting standard setters to consider alternative approaches that would consider more credit and macroeconomic information, and which would have a more forward-looking nature. As such, the exercise of judgments by entities when applying such a model is inevitable.

The ECL model in IFRS 9 is principles-based and has been designed to allow preparers to exercise judgement based on their credit risk practices and for auditors, users, and regulators to assess the appropriateness of those judgements. Its application entails both significant benefits and some challenges:

The benefits are:

- The principles-based approach gives the IFRS 9 ECL model adequate flexibility to be adapted to different contexts and situations, including new scenarios that are not expected such as the COVID 19 pandemic.
- Its flexibility allows entities to use Overlays/Post Model Adjustments (PMAs) which supplement the outputs of the modelling techniques to consider instances which cannot be statistically modelled. An example of this was the adjustments made during the COVID 19 pandemic.
- The model ensures alignment with entity-specific credit risk management practices and stewardship. This allows an entity to 'tell its story', and thereby provide useful information to users of financial statements.

The challenges are:

- Significant level of judgement leading to entity-specific views which may not be comparable across entities.
- The need for complex modelling techniques required by banking regulators which need significant development, data gathering, maintenance, and analysis.
- The need for complex governance processes to assess the outputs of the model. The ECL model is data driven which creates challenges when dealing with specific items which are not possible to model to a statistically significant level.
- The model has an inherent element of procyclicality which needs to be critically assessed through appropriate PMAs. This is subject to appropriate governance and disclosure which is embedded and well understood by preparers. However, the extent of those PMAs despite being a critical element of consistency within the model might be complex and is sometimes difficult to explain.
- Being over-reliant on models is costly and may create complications for organisations, such as possessing the resources to analyse complex datasets. The calculation requirements apply equally to all asset classes and for some of them (intercompany loans, collateral, short-term receivables, and loan commitments) these requirements are complex to apply without adequate data gathering and modelling infrastructure. The model would benefit from additional guidance acknowledging that the credit cycle is made of different asset classes which have different risk characteristics. For certain asset classes such as intercompany loans a simplified model may provide information which is equally useful when compared to the one produced by a complex modelling technique with the added benefits that the costs of running the model could be reduced.

- The use of economic forecasts (multiple economic scenarios) while being a useful tool to capture the future dynamics of expected losses requires significant disclosure and is not always well understood by users. It also has the unintended consequence that portfolios which perform consistently across the credit cycle can have widely fluctuating ECLs which may not reflect the true performance of the book. This requires critical assessment by preparers to ensure consistent outcomes. Again, PMAs play a key role in this regard.
- The application of Significant Increase in Credit Risk ('SICR') criteria has had significant benefits most notably the alignment to the credit stewardship of banks. However, the SICR requirements could be subject to further alignment by supplementing the already well understood requirements with further elements which are integral to such process such as the use of absolute thresholds as a way to assess SICR.

The level of disclosures required by the model is significant, takes up a sizeable portion of the Annual Report and Accounts (ARA) and varies across jurisdictions. We do not consider that additional disclosures are required. However, we would highlight that the diverse views expressed by national regulators makes cross-jurisdictional comparability difficult. For example, in the UK significant effort was made by the Prudential Regulation Authority to establish a Disclosure of ECL Task Force to identify areas that should be presented on a consistent basis, but other regulators have taken different approaches.

Question 2—The general approach to recognising expected credit losses.

- (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?*

We do not think there are any fatal flaws with the general approach. However, as noted above significant judgement is required in applying the ECL requirements. This is mostly felt in areas like the forward economic guidance and SICR. The latter has an inherent inconsistency which is a direct consequence of the relative threshold i.e., pools that were originated in distress move to stage 2 slower than the ones that were originated in a good cycle. This while not being an issue has to be critically assessed to ensure consistent outcomes and appropriateness of Stage 2 balances. In addition, our members believe that certain items require further consideration as follows:

- the interaction between modification/extinguishment of a financial asset and SICR. Where an instrument has been modified due to credit issues affecting the borrower and modification leads to extinguishment, SICR will not take this into account which seems inconsistent. This also has a read-across to the recognition and de-recognition of purchase credit impaired financial assets (POCI). This should be considered holistically in the context of the project on modification and derecognition of financial assets which will inevitably have a close interaction with the ECL model.

- the effect that the transition to a low carbon economy has on the model. Given the pressure from governments and regulators for a move towards a more sustainable future, we suggest that the IASB considers this point in the project “Climate-related Risks in Financial Statements.”

Question 3—Determining significant increases 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 do not believe that there are any fundamental questions about the assessment of SICR. These requirements are well understood and have been mostly aligned with the credit stewardship process of Banks. This is beneficial and allows users to understand the underlying risk of an entity’s credit cycle. However, we consider that further alignment is possible if the current requirements are supplemented by items which are integral to the credit risk management process. These include but are not limited to consideration of absolute thresholds when assessing SICR.

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?*

We do not believe there any fundamental questions about requirements for measuring expected credit losses. However, some elements of the measurement exercise are highly judgemental and vary in application, although this is well understood and implicit in a principles-based approach. Some of the areas where this can be observed are outlined below.

- the application of multiple economic scenarios differs significantly across entities in terms of number, severity, and probability of occurrence. This may lead to significant differences in the ECL estimate. It also requires benchmarking and back-testing which is complex and does not provide a comparable view across entities. We also note that there is a multitude of approaches for measuring ECL varying from discrete probability weighted scenarios to more advanced techniques such as Monte Carlo simulation. While we agree with the principles-based approach used in the ECL model, we consider the application of any technique should continue to be supported by the current disclosures of the sensitivity analysis and related judgements in line with the disclosure requirements in IAS 1 and IFRS 7. This will provide useful

information to users and ensures that entities continue to be able to exercise judgement.

- The use of PMAs, which aim to address specific issues which statistical models cannot consider in a meaningful way, is an important feature for entities when applying the ECL. PMAs are an essential part of the model as they bring an element of consistency between reporters. While we understand the call by certain constituents for appropriate disclosures, we nevertheless request that they should not impede flexibility. This will provide better information to users and acknowledge the importance of overlays in the context of the overall model.

Question 5—Simplified approach for trade receivables, contract 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 do not have any comments on this question other than the ones noted above in relation to the use of simplified approaches for other asset classes.

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?

If there are specific application questions about these requirements, please describe the fact pattern and:

(a) explain how the IFRS 9 requirements are applied;

(b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect);

(c) explain how pervasive the fact pattern is; and

(d) support your feedback with evidence.

We consider the requirements for POCI are well understood. We believe that these should be considered holistically in the context of the modification and extinguishment of financial assets as noted in question 2 above.

Our members have identified a narrow scope issue which would benefit from additional guidance. This relates to how should the initial recognition of POCI and Stage 1 assets acquired in the context of business combinations or asset acquisitions be considered by the ECL model. Credit risk management tends to look at business combinations and asset acquisitions differently from origination. As a result, it is often difficult to explain to users why stage 1 assets included in a business combination (or asset acquisition) are subject to day one impairment while POCI assets that are also acquired in the business combination (or asset acquisition) are not. The issue relates to the further discounting to the purchase price of Stage 1 assets which is viewed as inconsistent with the economics of the transaction. However, this narrow-scope guidance should not change the overall principles of the ECL impairment model in IFRS 9.

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?

The interaction between the ECL requirements in IFRS 9 and standards is mostly clear and well understood. We would nevertheless suggest certain areas where further guidance would be helpful as follows:

Derivatives valuation and interaction with IFRS 13: We consider that the IASB should consider providing additional guidance on the interaction between the ECL model and the requirements in IFRS 13.56. These require entities to include the effect of the entity's net exposure to the credit risk of a counterparty (net financial asset) or the counterparty's net exposure to the credit risk of the entity (net financial liability) in the measurement of derivatives if there are legally enforceable arrangements that mitigate credit risk exposure in the event of default. As a result, entities are required to take the effect of collateral into account when pricing derivatives i.e., assessing the likelihood that collateral will not be returned.

Where cash collateral (Initial Margin (IM) and Variation Margin (VM) receivables) is held at Amortised Cost in accordance with the classification and measurement requirements these are required to be assessed for impairment.

As the fair value of derivatives is calculated on the basis of the net credit risk (i.e., the derivative fair value factors in the collateral that offsets the derivative credit risk and its recoverability) in accordance with the requirements of IFRS 13 it seems that calculating the ECL on the IM and VM measured at amortised cost would be double counting.

Interaction with IFRS 15: the current definition of credit loss in Appendix A of IFRS 9 refers to all cash shortfalls. Our members view this definition as too wide which creates unintended consequences in certain scenarios. For example, where debtor balances are written-off for reasons not relating to credit (e.g., due to a relationship issue, commercial reasons, rebates or offer), we have observed instances where expected cash shortfalls are taken into the calculation of ECL, where the reason for these shortfalls is not credit-risk related. We recommend that the Board considers the extent of the current definition, amends it, or provides additional guidance to address instances such as the one above.

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?

Please explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements.

Please explain any unexpected effects or challenges preparers of financial statements faced applying the impairment requirements retrospectively. How were those challenges overcome?

We do not have any comments on this question.

Question 9—Credit risk disclosures

(a) Are there fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk? 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 do not believe that there are any fundamental questions (fatal flaws) about the disclosure framework in IFRS 7.

The ongoing costs of providing specific credit risk disclosures are significant. They also take a sizeable portion of the ARA and provide an entity specific view of ECL. There is significant audit work going into the disclosure requirements due to the underlying complexity of the models and judgements. Nevertheless, we consider that disclosure of judgements and sensitivity analysis remains a cornerstone of the disclosure model as well as the support from the IASB to the consistency efforts around the world. If the Board considers reviewing the

disclosure requirements this should focus on the costs and benefits as well as the usefulness of information to the users of the financial statements. The Board should also consider the significant investment made by preparers and the regulators efforts to bring consistency to the ECL disclosures which in our view provide useful information to the users.

Question 10 - Other matters

- a) 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? 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 in developing its future IFRS Accounting Standards?*

In addition to the items outlined above where our members consider that further guidance could be provided, we believe that further clarifications to the requirements on below-market interest rate loan commitments are required. Although the topic is not very common, current guidance can result in complex accounting outcomes and is detached from credit risk management practices.

Current guidance in IFRS 9.4.2.1(d) requires that the issuer of below-market loan commitments measures the commitments at the higher of (i) the amount of the loss allowance determined in accordance with IFRS 9 and (ii) the amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with IFRS 15. As a result, banks are effectively required to run two parallel calculations for these commitments – one for the ECL calculation and one for the amortization of the amount recognized on day one. Assuming (ii) is higher, at least for part of the life of the commitment, the issuer will not recognize an ECL.

This requirement becomes increasingly complex when there is a subsequent draw-down. In this instance, the bank will recognize ECL on the financial asset consistent with the requirements of IFRS 9. Further complications arise when the loan commitment is on a revolving facility. More specifically, when the loan is repaid, the lender will need to revert to the 'below-market loan commitment' model, at which point it may stop (depending on the results of the 'higher of' test set out in IFRS 9.4.2.1(d)(ii) recognizing ECL). Considering that revolving facilities involve frequent drawdowns and repayments, the lender may be required to recognise ECL and release it within short amount of time, which may create unnecessary income statement volatility that is difficult to explain, understand, and is not representative of risk management views.

Additionally, we believe there is diversity in practice on where the related amounts are presented in the income statement. More specifically, although the requirements in IFRS 9 specify the balance sheet presentation of below-market loan commitments, the income statement presentation is not specified. It is unclear whether the amortisation of the amount

specified in IFRS 9.4.2.1(d)(ii) should be presented in income statement as revenue (e.g., fee and commission) with a separate additional remeasurement for the ECL allowance or whether a single net amount should be presented in the revenue or ECL line depending on the outcome of the 'higher of' test.

Although originating loan commitments at below-market interest rates is not common, large portfolio acquisitions and business combination may involve significant volumes of these transactions. In these cases, the limitations set out above may create operational challenges for banks and diminish the usefulness of the reported information.

We would recommend the IASB should explore a simpler accounting model for below-market loan commitments that is consistent with risk management practices at banks, which would always calculate and monitor expected credit losses. Consistent with risk management practices, that model would introduce uninterrupted recognition of the ECL irrespective of whether the loan commitment is drawn or undrawn. As an alternative, we would request the IASB to develop an illustrative example to clarify how the 'higher of' test interacts with subsequent drawdowns and to demonstrate the application of the current IFRS 9 accounting for below market interest rate loan commitments on revolving facilities throughout their life cycle, that involves the 'higher of' test resulting in no recognition of the ECL on the undrawn facility, and subsequent draw followed by repayment and the commitment becoming undrawn again.