International Accounting Standards Board (IASB)
IFRS Foundation
Columbus Building, 7 Westferry Circus
Canary Wharf, London E14 4HD
United Kingdom
Submitted electronically

September 27, 2023

Re: IIF's Public Comment Letter on the IASB Request for Information on the Post-Implementation Review IFRS 9 *Financial Instruments* Impairment

Dear Sir or Madam,

The Institute of International Finance (IIF)[1] and its members, which broadly represent the global financial services industry, are pleased to submit industry perspectives in response to the International Accounting Standards Board (IASB or the "Board") "Request for Information (RFI) on the Post-Implementation Review of IFRS 9 *Financial Instruments* – Impairment."[2]

We appreciate the objective of the IASB to introduce a forward-looking expected credit loss (ECL) model that aims to provide useful information on changes in credit risk and resulting economic losses and address certain limitations and complexities in comparison to the impairment requirements under IAS 39 *Financial Instruments: Recognition and Measurement*. Overall, we believe that the impairment requirements in IFRS 9 are working well and achieve the objectives associated with moving to a forward-looking ECL model. We believe that principles-based requirements remain fundamental, providing financial institutions with the flexibility to produce results that are aligned with internal credit risk management practices, responsive to a changing macroeconomic environment and appropriately capture differences between portfolios which can vary significantly by entity and geography. While we do not note any fundamental concerns with the general approach, we have identified opportunities for greater flexibility in the application of the requirements which would result in better alignment of the financial results with internal credit risk management practices, without sacrificing the

[1] The Institute of International Finance (IIF) is the global association of the financial industry, with about 400 members from more than 60 countries. The IIF provides its members with innovative research, unparalleled global advocacy, and access to leading industry events that leverage its influential network. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial, and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, professional services firms, exchanges, sovereign wealth funds, hedge funds, central banks, and development banks.
[2] IASB 2023. [IFRS - Request for Information and comment letters: Post-implementation Review of IFRS 9–Impairment](), May 2023

usefulness of the information and while still achieving the objectives of the standard. The remainder of this letter provides comments, concerns, and suggestions along the sections of the RFI and refers to the outlined questions if applicable.

Related to question 1, the application of the IFRS 9 impairment requirements generally result in more timely recognition of credit losses, addressing the problem of delayed recognition of those losses by financial institutions. In addition, the IFRS 9 requirements address certain complexities, such as multiple impairment models, in comparison to IAS 39. For example, the application of the requirements during the COVID-19 pandemic resulted in increases in provisions during the peak of the pandemic given the global economic uncertainty at the time. This was followed by subsequent releases in provisions during the recovery period as expectations on expected losses tempered in the wake of government support, demonstrating that the core objectives of IFRS 9 are appropriate for this scenario. We do acknowledge that the impairment model has yet to be practically applied during a severe recession scenario, suggesting that a comprehensive assessment will take some further time. Nevertheless, the flexibility in the guidance that enables financial institutions to exercise management judgment, including the assessment of what is considered a significant increase in credit risk (SICR) and the use management overlays, in order to respond to changing macroeconomic conditions and unprecedented events, remains critical and was fundamental to the outcomes observed for COVID-19. Additionally, we note that there are certain aspects of the requirements that could be enhanced through greater flexibility in the application guidance, specifically how credit enhancements and risk mitigation tools are incorporated in the calculation of ECL for a financial instrument, and the provisioning for below-market loan commitments. Furthermore, we believe that further guidance in certain areas, such as provisioning for modified or derecognized revolving facilities, could increase comparability between peers.

Specific observations and recommendations are outlined in our responses to questions 3, 4, 7 and 9.

Related to question 2, the IIF acknowledges that the IFRS 9 requirements are generally working well and result in more timely recognition of credit losses in comparison to IAS 39. We have not observed any fatal flaws with the general approach and support a principles-based standard. We would emphasize the need for continued flexibility in certain areas. Specifically, the assessment of whether credit risk has increased significantly for a financial instrument is complex and involves significant judgment, including the use of different estimation approaches to assess SICR across different organizations, jurisdictions, portfolios, and products. There is a continued need for flexibility as the lack of it can lead to financial results that are volatile and not necessarily consistent with financial institutions' views of credit risk management for certain portfolios.

Furthermore, while we acknowledge the significant enhancements introduced by IFRS 9, the IIF notes that the ongoing costs and effort incurred to apply the requirements are significantly higher than expected. For example, significantly more internal and external costs and effort are required to maintain and audit the production of the ECL estimate and related reporting and governance processes (including a complex control environment and operational complexity for disclosures) relative to IAS 39. This is in addition to the need to

continuously refine models and develop complex overlay methodologies to meet IFRS 9 requirements.

In addition, some members observe that applying the requirements to calculate the allowances for intercompany receivables and loans can take a disproportionate amount of effort compared to the usefulness of information provided to users of the financial statements as some of these can be seen more as a capital contribution than a loan that is being repaid. As such, we suggest more permissive requirements in this area, providing financial institutions with an optional election to remove intercompany receivables and loans from the scope of IFRS 9 impairment requirements.

Related to question 3, we do not observe any fatal flaws regarding the assessment of significant increases in credit risk since origination. We believe the principles-based requirements in this area remain fundamental and applying the principles of assessing SICR in practice involves a significant level of judgment. The complexity and interdependency of the inputs involved in assessing SICR can result in different estimation approaches including across different organizations, jurisdictions, portfolios and products as noted in the RFI. There is a continued need for flexibility in this assessment to avoid outcomes where the SICR assessment is inconsistent with how financial institutions view credit risk management and not reflective of expectations around true economic losses expected to be incurred for some portfolios. Inconsistency between the SICR assessment and a financial institution's view on credit risk management would diminish the meaningfulness of the results.

For example, we note scenarios where the changes in probability of default (PD) for borrowers can be highly sensitive to broad-based economic conditions, such as changes in macroeconomic information, despite the underlying risk of the borrower not having changed significantly from a risk management perspective (particularly for certain retail loan portfolios). In these scenarios, besides using the change in PD in assessing SICR, financial institutions may consider other inputs, such as internal borrower risk ratings, which qualitatively take into account many of the same factors as lifetime PD, when they better align with the financial institution's credit risk management views of the portfolio.

Furthermore, consistent with the RFI, the IIF observes that there are varying approaches in the application of the SICR requirements among financial institutions leading to diversity in practice. **However, the IIF believes that the principles-based requirements in this area remain important, allowing entities to exercise judgment as necessary given differences in portfolios and changes in circumstances over time.** As noted above, this assessment involves a high degree of judgment, and as such, there can be vastly different estimation approaches across different organizations, jurisdictions, and products to determine these complex and interdependent inputs. Given the level of complexity of this assessment, we would expect these factors to differ across organizations and do not expect them to be applied identically.

Regarding question 4, the IIF recommends further clarification on the requirements for below-market loan commitments (not measured at fair value through profit or loss), as the current level of guidance is very limited and can lead to a disconnect between accounting and risk management practices. The current guidance (as stated in IFRS 9 4.2.1(d) requires the issuer of below-market loan commitments to subsequently measure the

commitment 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.

In our view, this requirement leads to financial institutions having to run two calculations in parallel for these commitments, both the ECL calculation and the amortization of the amount recognized on day 1. Assuming (ii) is higher, at least for part of the life of the commitment, the lender will not recognize ECL. However, when there is a subsequent draw, the financial institution will recognize ECL consistent with the requirements of IFRS 9. In situations when the loan commitment is on a revolving facility and the loan is repaid, the financial institution will need to revert to the 'below-market loan commitment' model', at which point it may stop recognizing ECL (depending on the results of the 'higher' of test set out in IFRS 9 4.2.1(d)). Considering that revolving facilities implicitly involve frequent draws and repayments, the lender may be required to recognize ECL and release it within a short amount of time, which may create income statement volatility that is difficult to explain on the one hand and to understand on the other hand. Furthermore, it is also disconnected from risk management views.

In addition, we observe that although the requirements in IFRS 9 specify the balance sheet presentation of below-market loan commitments, the income statement presentation is not specified. This can lead to diversity in practice as it is unclear whether the amortization of the amount specified in IFRS 9 4.2.1(d) (ii) should be presented in income statement as revenue (e.g., fees and commissions) 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' test.

Although origination of loan commitments at below-market interest rates is not a common practice for many financial institutions, large portfolio acquisitions and business combinations may involve significant volumes of these transactions. In these cases, the limitations set out above may create operational challenges for financial institutions and diminish the meaningfulness of the results.

We would appreciate it if the IASB could explore a simpler accounting approach for below-market loan commitments that introduces uninterrupted recognition of ECL regardless of whether the commitment is drawn or undrawn, consistent with internal credit risk management practices at financial institutions, which would continuously monitor expected credit losses on the entire facility.

With respect to post-model adjustments or management overlays, we appreciate and support the flexibility in the guidance to exercise management judgment through the use of such adjustments/overlays. The recent COVID-19 pandemic was a prime example of a scenario where historical information on which the ECL models were developed did not take into consideration unprecedented conditions that can impact current and future periods (e.g., the impact of government support). For ECL models developed on historical information, there will always be a need to assess whether adjustments to modelled results are necessary in order to reflect management's best estimate of ECL given current and forecasted conditions. Therefore, we believe the ongoing use of post-model adjustments or management overlays is

necessary to address model limitations and they serve to increase the usefulness of information provided to users of financial statements.

Finally, other than the concerns raised in our responses above, the IIF does not note any fatal flaws in the requirements for measuring ECL and we appreciate the flexibility that the current principles-based guidance provides. While we do observe diversity in practice in how financial institutions apply macroeconomic information in forward looking scenarios, we acknowledge the significant level of judgment required to determine these inputs, including the consideration of multiple quantitative and qualitative factors and the extent to which various macroeconomic variables may impact each financial institution. The diversity, particularly with the number of scenarios, the severity of downside scenario(s) and associated probability weightings, results from differences in the nature of the underlying portfolios, credit risk profile and geographies in which each financial institution operates. As such, we believe having the flexibility to include variables and adopt techniques that work best in the specific circumstances of a respective business model will lead to more meaningful results.

With respect to <u>question 7</u>, the IIF would like to raise concern about the inconsistencies created because of the interaction between the IFRS 9 impairment requirements and IAS 37 *Provisions, contingent liabilities, and contingent assets,* relating to the treatment of credit enhancements. The requirements of IFRS 9.B5.5.55 currently allow entities to include expected cash flows from credit enhancements in the measurement of ECL when it is 'integral' to the underlying financial instrument, specifically when (a) it is part of the contractual terms of the financial instrument and (b) not recognized separately by the entity. This is further confirmed by the decision reached by the IFRS Interpretations Committee in its March 2019 Update with respect to "Credit Enhancement in the Measurement of Expected Credit Losses (IFRS 9 Financial Instruments) – Agenda Paper 12". Consequently, credit enhancements that are not considered 'integral', such as a financial guarantee contemplated or entered into after the initial recognition of the related financial instrument, would not be taken into account in determining the ECL for related debt instruments, and the carrying amounts would need to be presented separately in another asset category on the balance sheet (i.e., the ECL of the debt instrument would be gross of a separately recognized reimbursement asset).

However, in the absence of specific guidance in IFRS standards on accounting for non-integral credit enhancements where the financial institution is the beneficiary (e.g., financial guarantees held), it is a common practice to apply the 'reimbursement asset' accounting in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* by analogy. Specifically, from an income statement perspective, the expected payoff from a financial guarantee meets the characteristics of a 'reimbursement' as described in IAS 37.53 and is recognized as an asset by the holder separately from the financial instrument. The guidance for reimbursements in IAS 37.54 clearly states that "the expense relating to a provision may be presented net of the amount recognized for a reimbursement", which allows for net presentation with the provision of credit losses (PCL) on the related debt instrument. As such, the interaction between the requirements of IFRS 9 and IAS 37 results in a disconnect between the balance sheet and income statement presentation of credit losses, with the impacts of the standalone reimbursement asset (for the credit enhancement) recognized outside of ECL on the balance sheet but netted against PCL in the income statement. This also diminishes the usefulness of the related disclosures whereby the change in ECL during a period would be disconnected from the corresponding PCL recognized in the same period.

Furthermore, the application of the current requirements results in inconsistencies of the accounting treatment for similar credit enhancements entered into by an entity depending on the timing at which they are transacted. For example, a financial institution that entered into a financial guarantee concurrently with the origination of the related debt instrument would meet the definition of 'integral' and thus be presented as part of ECL (i.e., the ECL on the balance sheet for the debt instrument would be net of the expected cash flows from the credit enhancements). In contrast, the same financial guarantee contemplated and purchased by a financial institution for the same debt instrument but subsequent to origination with a third party would not be included in the debt instrument's ECL even though from a risk management view, the exposure to losses is the same as in the example above (i.e., the debt instrument's ECL would not include the expected cash flows from the credit enhancements, and instead, the present value of the expected cash flows from the credit enhancements would be presented as a standalone reimbursement asset).

Delineating the impact of such credit enhancements from the ECL of the related financial instruments is not necessarily consistent with the financial institution's risk management perspective, where for credit risk assessment and monitoring purposes, a financial institution's credit risk management team would evaluate its overall credit risk exposure by incorporating its overall strategies used to manage such exposures, which would include credit enhancements beyond those that are considered 'integral'.

Based on the considerations presented above, we recommend making the requirements of IFRS 9 (or IFRS 7 *Financial Instruments: Disclosures*) more permissive in this area, such that financial institutions have the option to measure and present credit enhancements that are not considered 'integral' to the associated loan as a part of its ECL (i.e., mirroring the balance sheet requirement with the guidance for reimbursements in IAS 37 on the income statement side). We believe this will help to resolve inconsistencies between IFRS 9 and IAS 37, and result in more faithful and internally consistent presentation of ECL and PCL that is aligned to risk management, which will increase the usefulness of information provided to users of financial statements.

Furthermore, the IIF notes that IASB has initiated a project to re-assess the IFRS 9 modification and derecognition requirements. The outcome of this project will directly impact IFRS 9 impairment requirements, in particular the staging and provisioning of both funded and revolving facilities. This is particularly important in determining when a financial instrument without a fixed maturity date, such as credit cards and overdraft facilities, is modified or has been derecognized. IFRS 9 provides guidance on the behavioral life of such instruments (IFRS 9 B5.5.39), without clarifying the factors to consider when determining whether such instruments are modified or derecognized which impacts the date of inception and therefore the SICR assessment. The October 2019 IASB Staff Paper released in relation to IBOR Reform suggested factors to consider, noting that whether a financial institution has undertaken a new underwriting/pricing assessment was an important factor in determining whether such an instrument is derecognized or not. We encourage the IASB to expedite this project and to include application guidance on this topic specific to products without a fixed maturity date, such as overdrafts and credit cards, as this would allow for better comparability between peers for transactions with similar circumstances.

Lastly, with respect to question 9, the IIF supports the current guidance on credit risk disclosures which we believe achieves an appropriate balance between users of financial statements receiving both comparable and relevant information and the costs and benefits for an entity to produce such information. We acknowledge and agree with the IASB that credit risk disclosures are unlikely to be fully comparable between entities given the diversity and complexity involved with how entities view and manage credit risk, including the large volume of interdependent quantitative and qualitative factors. We also agree that it is necessary to strike a balance between providing useful information that is not obscured by extensive aggregation and overburdening the financial statements with excessive details which may not assist users of the financial statements in better understanding the results nor facilitate comparability given the complex interdependencies noted above.

We thank the IASB for its consideration of our comments and welcome any additional stakeholder engagement around this topic. If you have any questions, please do not hesitate to contact Martin Boer at mboer@iif.com or Tim Steinhoff at tsteinhoff@iif.com.

Sincerely,

Martin Boer
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