Comments

Post-implementation Review
IFRS 9 Financial Instruments
Impairment

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Summary

The German Banking Industry Committee (Die Deutsche Kreditwirtschaft – DK) welcomes the Post-implementation Review IFRS 9 Financial Instruments Impairment and comments on the questions below.

Basically, it should be noted that the implementation of the impairment rules of IFRS 9 has been a very high effort for the banks. In many banks, IFRS 9 was the largest project ever for several years. However, the systems are now implemented, and the conversion costs have been processed.

In our opinion, the principles based IFRS 9 rules have proven their worth in practice. The expected credit loss (ECL) model under IFRS 9 generally leads to an earlier recognition of impairments than the incurred credit loss model under IAS 39. For the time being, we do not see any significant need für adjustment.

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?

Please provide information about the effects of the changes to the impairment requirements introduced by IFRS 9, including the ongoing costs and benefits of preparing, auditing, enforcing or using information about financial instruments.

This question aims to help the IASB understand respondents' overall views and experiences relating to the IFRS 9 impairment requirements. Sections 2–9 seek more detailed information on specific requirements.

The expected credit loss (ECL) model under IFRS 9 generally leads to an earlier recognition of impairments than the incurred credit loss model under IAS 39. The extent of the earlier recognition depends on the respective situation and in particular the economic cycle. The impairment rules of IFRS 9 are very complex to apply. This complexity is higher than under IAS 39. However, the calculation of impairments has now become established. Therefore, no major changes should be made to the standard in the near future.

Banks are not only preparers, but also users of IFRS financial statements, for example in their lending decisions. From the user's perspective, the expected credit loss model is seen as more advantageous than the incurred credit loss model. This view is also supported by numerous scientific studies.

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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?

Please explain whether requiring entities to recognise at least 12-month expected credit losses throughout the life of the instrument and lifetime expected credit losses if there has been a significant increase in credit risk achieves the IASB's objective of entities providing useful information about changes in credit risk and resulting economic losses. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the general approach.

(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? If, in your view, the ongoing costs of applying the general approach to particular financial instruments are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those instruments.

There are no fundamental questions regarding the general approach of the expected credit loss (ECL) model and the criteria for the change from impairment level 1 to 2.

The cost of implementing the expected credit loss model was very high. However, the conversion costs have now been processed. The application practice has proven itself; the models and systems are established. No significant need for adjustment is seen.

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?

Please explain whether the principle-based approach of assessing significant increases in credit risk achieves the IASB's objective of recognising lifetime expected credit losses on all financial instruments for which there has been a significant increase in credit risk since initial recognition.

If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the assessment of significant increases in credit risk.

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

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Please explain whether the requirements provide an adequate basis for entities to apply the assessment consistently to all financial instruments within the scope of impairment requirements in IFRS 9.

If diversity in application exists for particular financial instruments or fact patterns, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements.

If you have identified diversity in application of the assessment, please provide your suggestions for resolving that diversity.

In responding to (a) and (b), please include information about applying judgement in determining significant increases in credit risk (see Spotlight 3

There are no fundamental questions regarding the criteria for the change from impairment level 1 to 2. Based on IFRS 9 and the existing requirements, appropriate SICR criteria have been established in practice.

IFRS 9 is principles based. This has proved particularly useful in times of crisis (COVID-19, impact of Ukraine war). Here it was advantageous that the SICR criteria are not completely rigid and conclusively prescribed. In this context, we also explicitly share the IASB's statement of 27.03.2020: "IFRS 9 does not see bright lines or a mechanistic approach to determining when lifetime losses are required to be recognised." In practice, criteria such as forbearance have also emerged. In our opinion, the diversity in application should only be low and applications based on individual data, models and expectations of the entity leads to appropriate results overall and is confirmed by auditors.

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?

Please explain whether the requirements for measuring expected credit losses achieve the IASB's objective of providing users of financial statements with useful information about the amount, timing and uncertainty of an entity's future cash flows. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the measurement requirements.

(b) Can the measurement requirements be applied consistently? Why or why not?

Please explain whether the requirements provide an adequate basis for entities to measure expected credit losses consistently for all financial instruments within the scope of impairment requirements in IFRS 9.

> If diversity in application exists for particular financial instruments or fact patterns, please explain and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements.
>
> If you have identified diversity in application of the requirements, please provide your suggestions for resolving that diversity.
>
> In responding to (a) and (b), please include information about forward-looking scenarios (see Spotlight 4.1), post-model adjustments or management overlays (see Spotlight 4.2) and off-balance-sheet exposures (see Spotlight 4.3), as relevant.

The consideration of historical data, current information and forecast data has proven itself in practice, the processes have become established and, in our view, lead to a more appropriate ECL determination compared to the requirements of IAS 39. Nevertheless, the model construction limits the possibility to adequately reflect unforeseen short-term exogenous effects in the model. In our opinion, the flexibility in choice of methods and if needed the usage of post-model-adjustments and overlays in the impairment rules of IFRS 9 has therefore proved beneficial. In this way, multiple crisis effects that have an influence on risk provisioning can be adequately mapped, even if modelling is not possible due to a lack of valid historical data. This enables preparers to react appropriately to ad-hoc changes in macroeconomic factors and thus provide information that is useful for decision-making.

We understand the requirements for adequate transparency in dealing with overlays in such a way that a potential overlay must be situation-specific, appropriate and comprehensible. Nevertheless, a certain leeway in the determination or calculation of overlays should remain for the preparers in any case, because experience shows that it is very difficult to clearly distinguish the individual effects or causes of risk from each other; this applies in particular if short-term effects are to be taken into account that cannot be integrated into the ECL model (in-model-adjustment) for reasons of time and data.

IFRS 9.5.5.18. generally, requires the consideration of at least two scenarios when determining the risk provision. However, if the risk provision is calculated in Level 3 according to the DCF (discounted cash flow) method, one scenario may be sufficient under certain circumstances, for example on the basis of a "going concern" assumption. In some cases, a further subdivision into probability-weighted "best" or "worst case" CF scenarios can be made; however, this is not mandatory. The requirement described in IFRS 9.5.5.18 to consider a scenario without the occurrence of an "expected credit loss" cannot be interpreted as a mandatory requirement for Level 3 DCF either.

In our view, it should generally be possible to use several scenarios for the ECL calculation in Level 3. In exceptional cases (e.g. 100% cash flow coverage or complete loss), a single individual cash flow scenario may be sufficient.

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?

Does applying the simplified approach achieve the IASB's objective of reducing the costs and complexities of applying IFRS 9 impairment requirements to trade receivables, contract assets and lease receivables?

If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the simplified approach.

(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?

If, in your view, the ongoing costs of applying the simplified approach are significantly greater than expected, or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment.

The simplified approach is used much less in the banking industry than in other sectors. Nevertheless, the banking industry welcomes this simplification option.

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?

Please explain whether the requirements can be applied consistently to these types of financial assets and lead to accounting outcomes that faithfully reflect the underlying economic substance of these transactions.

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.

Please refer to our comments on questions 7 and 9.

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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?

If there are specific questions about how to apply the impairment requirements alongside other requirements, please explain what causes the ambiguity and how that ambiguity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. Please describe the fact pattern and:

(a) indicate the requirements in IFRS 9 or in other IFRS Accounting Standards to which your comments relate;

(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.

In responding to this question, please include information about matters described in this section of the document.

As we already pointed out in our statement on PiR IFRS 9 "Classification and Measurement", the application of the modification test and accounting is associated with a high procedural effort, especially for financial instruments that are subject to impairment (level 3). In our view, the potential information benefit for the users of the financial statements is not proportionate to the costs for the preparer of the financial statements. Regarding modified or purchased or originated credit-impaired financial instruments (POCI), we do not consider their separate disclosure according to impairment to be balanced in terms of costs and benefits. From our perspective, there should be no difference in assessing the credit risk of an asset whether it is a POCI or a modified financial instrument in comparison to a normal Level 3 asset. Moreover, there have been no queries from analysts about the POCIs or their separately shown information in the notes. Against this backdrop, we advocate dispensing with the separate disclosure of POCIs.

Furthermore, it is often difficult to determine the book value adjustment because the changed conditions of a financial instrument usually only apply to future periods. Therefore, extensive interventions in the IT infrastructure are often necessary, which in turn increase the complexity and costs of accounting, sometimes considerably, and additionally slow down closing processes.

In our view, only substantial modifications to Level 3 exposures and POCI financial instruments are relevant for users of financial statements. Despite the considerations in IFRS 7.BC48Z, we are in favour of limiting the disclosure requirements on modifications here to purely credit-related modifications. The definition of impaired exposures should be left to the discretion of the preparers of the financial statements. In the case of banks, this delimitation should normally be based on supervisory requirements and could be made transparent through additional disclosure requirements. This measure could relieve the burden on the preparers of the financial statements, in some cases considerably.

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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?

The answer to the question of whether the costs for IFRS 9 implementation were higher or lower than expected depends heavily on the initial budgeting of the costs. Overall, the implementation costs were very high due to the complexity of the IFRS 9 regulations. In many banks, IFRS 9 was the largest project ever for several years. However, the implementation costs for IFRS 9 are now sunk costs.

In the meantime, the systems have been implemented and the processes established. We therefore consider continuity in accounting under IFRS 9 and in the impairment rules to be very important, especially since we do not see any significant need for adjustment.

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?

Please explain whether the combination of disclosure objectives and minimum disclosure requirements for credit risk achieves an appropriate balance between users of financial statements receiving:

(i) comparable information—that is, the same requirements apply to all entities so that users receive comparable information about the risks to which entities are exposed; and

(ii) relevant information—that is, the disclosures provided depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks.

If an appropriate balance is not achieved, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the disclosure requirements.

(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?

If, in your view, the ongoing costs of providing specific credit risk disclosures are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those disclosures. Please provide your suggestions for resolving the matter you have identified.

If, in your view, the IASB should add specific disclosure requirements for credit risk, please describe those requirements and explain how they will provide useful information to users of financial statements.

Please also explain whether entities' credit risk disclosures are compatible with digital reporting, specifically whether users of financial statements can effectively extract, compare and analyse credit risk information digitally.

We consider the current structure of the disclosure requirements, which includes a combination of disclosure targets and defined minimum disclosures, to be fundamentally tried and tested and suitable for providing relevant and company-specific information for stakeholders. For this purpose, banks individually select the most suitable method for determining the ECL in accordance with the requirements of IFRS 9 in order to then supplement the calculated risk provision with company-specific information. In this respect, any further expansion of the disclosure requirements should be carried out with a sense of proportion and be strictly based on a cost-benefit analysis.

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?

Please explain why those matters should be considered in the context of this post-implementation review and the pervasiveness of any matter raised. Please provide examples and supporting evidence.

(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?

We do not see any further points that have not already been addressed in the Post-Implementation Review.