EFRAG Board meeting
6 October 2021
Paper 08-01
EFRAG Secretariat: Almudena Alcalá, Didier Andries (team leader)

Post-Implementation Review of IFRS 9 *Classification and Measurement*
Cover Note

Objective

1 The objective of this session is for the EFRAG Board to be updated on the preparatory work and suggestions from EFRAG TEG, EFRAG FIWG and EFRAG IAWG on the issues to be reported in EFRAG's response to the Request for Information on IFRS 9 *Classification and Measurement*.

Background

Due Process

2 The effective date of IFRS 9 was set as annual reporting periods beginning on or after 1 January 2018. Insurers and EU financial conglomerates have the possibility to defer the application date of IFRS 9 till 1 January 2023 (subject to fulfilling particular conditions).

3 In October 2020, the IASB decided to begin the PIR of the IFRS 9 classification and measurement requirements, but not to begin the PIR of the Standard's impairment and hedge accounting requirements.

4 During February – March 2021, the EFRAG Secretariat consulted EFRAG TEG and EFRAG working groups (Academic Panel, FIWG, IAWG, User Panel, CFSS) and had an exchange with the IFRS 9 Task Force of Accountancy Europe. This consultation has allowed to prepare a first comprehensive list of issues that have been reported to the IASB Staff, including at the ASAF meeting in March 2021.

5 On 9 June 2021, the EFRAG Board decided that the future EFRAG response to the Request for Information (RFI) on IFRS 9 *Financial Instruments* should include views about the technical merits of the key issues reported. The remaining issues are to be reported to the IASB without an accompanying assessment.

6 The EFRAG Board further decided that the technical assessment should be focused on providing indications as to whether standard setting is considered necessary to solve the issue, without providing indications of the possible standard setting solution itself.

7 When assessing the technical merits, to the extent possible, the EFRAG response to the RFI should also provide indications of the type of standard setting activity needed (e.g. amendments to the standard, educational material).

8 The EFRAG Board suggested the following indicators on how to identify key issues and to consult also on these indicators and on the resulting prioritisation of the issues:

(a) Issues where the current requirements lead to unintended consequences;

(b) Issues where there is an inconsistency or lack of clarity in IFRS 9; and

(c) Issues that are newly emerging, including issues with a possible relevance for European Public Good (such as the recycling of OCI for equity instruments and the treatment of green bonds).

9 It was noted that for some issues EFRAG has already developed views and it would be sufficient to repeat the existing positions. This relates to:

(a) Recycling the changes in FV accumulated in OCI for equity instruments; and

(b) FVTPL treatment for equity-type instruments (e.g. units of funds).

10 The preliminary list of issues has been assessed by EFRAG TEG in June, July and September 2021, with inputs from EFRAG FIWG and EFRAG IAWG.

11 Paper 08-02 provides a description of the issues that EFRAG TEG found to be the most prevalent in Europe to be addressed in the PIR of IFRS 9.

12 The Request for Information on IFRS 9 was published on 30 of September 2021 with comments to be delivered by 28 January 2022.

Financial instruments with ESG features

13 One of the concerns that was raised relates to financial instruments (bonds, loans, project financing, ..) with ESG[1]-features. More and more financial instruments are issued whereby the interest rate charged can change depending on whether particular ESG targets have been or will be achieved. Inclusion of such features into the cash flow characteristics is meant to promote environmentally sustainable activities or other sustainability goals such as gender equality or ensuring professional integrity.

14 Depending on whether proposed targets are achieved, a step up or step down in interest rates is applicable at particular moments in time to the interest rate charged. While for now these step up/step down charges are limited in size they are expected to grow with the increasing interest of achieving ESG goals.

15 The accounting issue with these features is that these rates may not always qualify for the SPPI-test in IFRS 9 (unless passing as de minimis), and thus would fail to qualify for an amortised cost or FVOCI measurement. In short, there is a risk that these financial instruments would have to be measured at fair value through profit or loss even when they are seen as a basic lending instrument.

16 EFRAG TEG has assessed this issue as prevalent in Europe and of high priority. Considering the relevance of the topic for European stakeholders, EFRAG Secretariat will continue to investigate whether possible approaches could be identified. However, consistently with the decision of the EFRAG Board, the EFRAG DCL will not elaborate on possible future standard setting approaches at this stage.

17 So far no solutions have been found.

18 In their meeting of 28 September 2021 EFRAG TEG members agreed to separate this issue from the PIR IFRS 9 scope given the ***urgency*** and ***prevalence***. Waiting for a solution under the PIR IFRS 9 process is likely to take a few years and therefore EFRAG TEG members are of the view that this issue should be treated separately as an urgent matter by the IASB.

[1] ESG : Environmental, Social, Governance

Questions for EFRAG Board

19 Does EFRAG Board have comments on the list of issues as described in paper 08-02? Please explain.

20 Does EFRAG Board consider that the issue of sustainable finance – SPPI-test should be separated and submit to the IASB as a high priority issue? Please explain.

21 Does EFRAG Board has suggestions on the work EFRAG Secretariat should continue to do on the topic of the ESG features possibly failing the SPPI test?

Agenda Papers

22 In addition to this cover note, agenda paper 08-02 – *PIR IFRS 9 - Overview of issues assessed as prevalent* – has been provided for the session.