Febelfin feedback to the EFRAG draft comment letter on IFRS 9 Post Implementation Review

Febelfin welcomes the opportunity to provide feedback to the draft comment letter of EFRAG in response to the IASB request for information as a part of the Post-implementation Review (PIR) of the classification and measurement requirements of IFRS 9 Financial Instruments and on how the IFRS 9 is working in practice.

The below table provides the Febelfin responses to the most relevant questions raised to constituents by the EFRAG in the draft comment letter.

EFRAG draft comment letter	Febelfin feedback
Question to constituents - Prioritisation The issues of sustainable finance-SPPI test, recycling changes in FV accumulated in OCI for equity instruments, treatment of equity-type instruments and supply chain financing are indicated as high priorities. Modification of cash flows, contractually linked instruments – non-recourse, factoring of trade receivables and use of administrative rates are indicated as medium priorities. Finally, financial guarantees are indicated as a low priority. Do you agree with the issues raised and their prioritisation as indicated above? Please explain. Do you consider that there are other issues that deserve standard-setting activities? Please provide an illustration.	In general, we can agree with the issues raised and their prioritisation. However, we fail to see why supply chain financing and factoring of trade receivables would be indicated as high respectively medium priority, as to our knowledge IFRS 9 has not substantially changed anything in this regard and we consider it as an established practice. Next to the mentioned issues, we would like to add two other issues for standard-setting activities with medium priority: loan syndications and POCI's. - The issue on loan syndications is addressed in §19 of EFRAG's draft comment letter, but we fail to see why it is not maintained as an issue requiring standard-setting activities as, if the entity decides to ultimately retain the unsold portion, amortised cost would provide more useful information. - The POCI issue is linked to restructured loans whereby there is an unclear distinction between derecognition and modification. Economically, there is often no difference, but accounting is very different. In addition, in case a POCI cures you are confronted with a negative ECL, which is conceptually strange. Finally, POCI accounting causes the loss in accounting of

	the amount and start date of the original loan, which disturbs the follow-up of the customer's performance.
Questions to constituents – Question 3 (a) In addition to the issue of the application of the SPPI test to financial instruments with ESG features and to the requirement to classify at FVTPL mutual funds and other puttable instruments (see our answer to Question 4 below) that have been identified in this DCL, are there other fact patterns for which you think the cash flow characteristics assessment is not leading to an appropriate measurement outcome? Please consider, in particular, financial assets that are required to be measured at FVTPL, for which a different measurement approach (amortised cost or FVOCI) would be in your view more appropriate. Please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk).	We refer to for example Hungarian loans within a government program to help with the growth of the population ("babyboom loans"). The product includes a leverage factor that fails SPPI (i.e. interest formula is as follows: Interest = 1.3 x (5Y government bond yield at disbursement) + 200 bps). Amortised cost classification would be a more appropriate classification since the leverage is imposed by the government. In this respect we would propose to delete the last half sentence of IFRS9. B4.1.9E: "In some jurisdictions, the government or a regulatory authority sets interest rates. For example, such government regulation of interest rates may be part of a broad macroeconomic policy or it may be introduced to encourage entities to invest in a particular sector of the economy. In some of these cases, the objective of the time value of money element is not to provide consideration for only the passage of time. However, despite paragraphs B4.1.9A–B4.1.9D, a regulated interest rate shall be considered a proxy for the time value of money element for the purpose of applying the condition in paragraphs 4.1.2(b) and 4.1.2A(b) if that regulated interest rate provides consideration that is broadly consistent with the passage of time."
Questions to constituents – Financial instruments with ESG features When applying the SPPI test to financial instruments held to collect that have contractual cash flow variability linked to ESG targets specific to the borrower, what additional approach could be considered in order to avoid failures of the SPPI test? Approaches used currently include considering the 'de minimis' and the possible link to the credit spread.	Some banks currently consider the cash flow variability resulting from ESG-features as part of the profit margin, but this is likely not very sustainable in the long run if variability because of ESG-features increases. Most banks consider the link with credit risk, but currently the data is lacking to underpin this point of view. The comments often focus on the 'E' aspect, but one should certainly not forget the 'S' and 'G' as the evolution is towards a sustainable <u>and</u> inclusive society. In addition, there is also a need for

	a certain ring fencing to allow, for example, leverage elements to fail SPPI. In addition, if plain-vanilla ESG features would cause failure of SPPI, it would further increase the asymmetry of measurement between the holder and issuer of the instrument, given the inherent differences between the SPPI-test and the closely or not-closely related embedded derivative criteria on the liability side.
Do you think that failing the SPPI test (and a resulting measurement at fair value through profit or loss) is an appropriate outcome for these financial instruments? Please specify. What do you consider the economic nature of the ESG-linked variability to be?	No, we believe that sustainability aspects are increasingly gaining importance in corporate governance but also among investors, and are therefore become part of basic lending arrangements. Hence, we believe that amortised costs is the most appropriate measurement. As such, from an economic point of view, ESG will manifest itself through credit risk in the longer term.
Question to constituents – Question 3 (b) In addition to financial assets which are in the scope of the contractually linked or non-recourse guidance identified in this DCL, are there other fact patterns to which you think the cash flow characteristics assessment cannot be applied consistently?	We are not aware of any other fact patterns.
Question to constituents – Question 3 (c) In addition to the unexpected costs of applying the SPPI test to instruments with administrative rates identified in this DCL, are there other fact patterns that show unexpected effects arising from the cash flow characteristics assessment?	The application of the CLI guidance to confirm that the underlying pool of assets meets the SPPI requirement is a particular challenge. In most cases it is impracticable or not possible at all to confirm that every asset in the pool is SPPI. A relaxation or amendment of this element of the CLI guidance may remediate the issue. We would be in favour of a simpler test especially for the senior tranches. This is also referred to in §45(a) in EFRAG's draft comment letter.
Questions to constituents – Questions 4 (a) and (b) FVOCI option for equity instruments For which equity instruments has the option to present fair value changes in the OCI been applied? What are the reasons for choosing to use the option	FVOCI option for equity instruments The FVOCI option is often chosen for long term investments for which P&L volatility is undesired. Currently IFRS 9 does not allow recycling of

for those instruments? What is their proportion of the overall investment portfolio? From a user perspective, do you think the absence of recycling of gains or losses of equity instruments designated at FVOCI provides useful information? Please explain.	unrealized gains/losses into profit & loss upon realization of equity instruments designated at FVOCI. The classification of equity investments at fair value through profit or loss (FVPL) or at fair value through other comprehensive income (FVOCIE) may be an impediment to long term investments. Therefore, Febelfin supports the re-introduction of recycling, which could solve the dilemma of choosing between FVOCI and FVPL. The re-introduction of recycling would entail that essentially the measurement of IAS 39 for equity instruments would be reapplied, but where targeted improvements to the impairment model could be made to improve the divergence in practice that was observed previously under IAS 39. The reintroduction of recycling is necessary for equities measured at FVOCI since it would significantly improve the faithful representation of the financial performance of companies. Just as dividends, gains and losses realized on disposal of equity instruments measured at FVOCI are an integral part of a company's performance and should be shown in the results. As such, there is no conceptual reason to make a distinction between these different sources of profits and loss. In addition, the current requirements entail the risk that equity markets may include the dividend policy in their pricing models and in this way put additional pressure on companies to maximize dividend distribution. In addition, there might be an impact on the pricing of high dividend yield equities versus growth equities. Financing start-up and young companies will also suffer competitive disadvantage as typically they are unable to distribute dividends in the early years of their activities. Reporting consistently all the components of the performance of equity instruments in profit and loss will provide complete and appropriate information to users about the performance of the related investments. This will also ensure consistency with the accounting treatment of debt instruments accounted for at FVOCI for which interests payments as well as gains and losses upon realization are recognized in profit and loss.
<u>Treatment of equity-type financial instruments</u>	<u>Treatment of equity-type financial instruments</u>

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Please consider paragraphs 65/67 above. If you consider that equity-type financial instruments should be accounted for similarly to equity instruments, how would you define 'equity-type'? What type of underlying investments should be considered? How a classification test could be structured, taking into consideration among other things the need to assess the characteristics of the underlying assets? From a user perspective, do you think that expanding the possibility to use FVOCI for equity-type financial assets provides more useful information? Please explain.	Instruments which contain a "put feature" give the right to the investor to sell back its share in an entity to the entity itself. Typically, these entities are known as open-ended funds (variable amount of capital). Since the investor has the right to redeem the share to the issuer of the share, the issuer has therefore an obligation to redeem which triggers a liability classification from the perspective of the issuer (unless conditions of IAS32§16A apply), and simultaneously it triggers a debt classification from the perspective of the investor. By simple application of IFRS9, the debt would have to be measured at FVPL (because of SPPI-failure) as most likely there will be equity risk inherent in the funds. FVOCI designation is not an option when the SPPI-test fails and since equity classification is not possible from the perspective of the investor. This treatment does not make sense, for banks that also invest in equities indirectly, for example through investment funds. It is important not to create competitive disadvantage because the same assets are held through different mechanisms. Therefore, to provide relevant information for the performance of long-term investors, we believe that the accounting treatment of equity-like instruments such as UCITS should also be eligible to the FVOCI category under IFRS 9. It also reflects the fact that the investor is fully exposed the equity risk; e.g. the underlying investments of EFT funds is equity risk and therefore the accounting treatment should be identical to equities. <u>*Example:*</u> *In the Belgian market, there is a typical type of UCITS called 'BEVEK'/'SICAV' which is a fund with variable capital that increases or decreases its capital based on investors stepping in or out of the funds. The funds generally invest in equity instruments, but because of the puttable feature, the investor would need to classify its investment in this UCITS as a debt instrument at FVPL, since it fails the SPPI-test. This creates a competitive disadvantage of the funds compared to directly investing in shares.* We believe that classifying puttable instruments as debt from the perspective of the issuer depicts also a misleading view because the put option has no intrinsic value as the put option is merely there to provide liquidity to the investor. The put will be exercised at the pro rata amount of the NAV of the

	equity funds, which would generally be the same price as the market price for the pro rata amount of shares in the funds (which are mostly tradable on the market). If we would classify these instruments as debt instruments purely because of the puttable feature, this would not represent the economic substance as the investor is fully exposed to equity risk at any time. It has no protection against a decrease in share price unlike a true put option. Furthermore, a lot of those UCITS appear to have put options which are not genuine (unlike the BEVEK/SICAV). Instruments such as ETFs may perhaps be puttable according to the prospectus, but they are never redeemed directly to the issuer in reality. The reason is often that the board of directors of the funds needs to decide on each redemption request and will consider the impact on the viability of the funds. If the funds are unable to redeem (because of liquidity issues, solvability issues etc.), there might not be a redemption after all. Next to the typical equity funds, also funds in real estate or infrastructure should be considered. As a definition for ‘equity-type’, we would propose to fall back on: equity-type instruments could encompass any form of financial instrument that entitles the holder to a return based on the net assets of the fund.
Question to constituents - Modifications Do you think that standard-setting activities from the IASB are required to deal with modifications of the cash flow characteristics? Please explain.	Yes, we believe standard-setting activities are required. The requirements for modifications to contractual cash flows are not working as intended when it concerns the restructuring of loans. Based on the modification of the contractual terms, it should be analysed whether the financial instrument should be derecognised or not. On the liability side the 10% test is clear but on the asset side this assessment is not so straightforward. In practice, it is very complex to implement and therefore very little used. There is also a wide diversity in practice. It would be easier and more consistent if the change in effective interest rate could be applied on a prospective basis.

Question to constituents – Amortised cost and the effective interest method How significant are these catch-up adjustments in accordance with paragraph B5.4.5 or B5.4.6 of IFRS 9 (please provide nominal amounts and expressed as a percentage compared to the interest revenue and expense calculated using the EIR – as disclosed per IFRS 7, 20(b))? Please provide information for the following reporting periods: 2018, 2019 and 2020.	/
Questions to constituents – Other matters Would you have other fact patterns about factoring of trade receivables that in your view should be considered and/or have you experienced challenges in other aspects of both accounting and disclosing information on trade receivables factoring? Please explain. Do you agree that additional illustrative examples specifically on trade receivables factoring would be helpful in ensuring consistent application of IFRS 9 derecognition principles?	In our opinion, the guidance under IFRS 9 with regard to factoring is not new compared to IAS 39 and we believe that practice has been established, hence we feel it is not necessary to undertake standard-setting activities in this area.
Questions to constituents – Other matters How would additional guidance on (i) the principal agent area and (ii) derecognition benefit you in accounting for reverse factoring transactions? Please explain. As users of financial statements, do you currently lack information on reverse factoring transactions? If yes, which information is missing? In your view does the bank act as an agent in these situations or as a debtor? Please explain.	In our opinion, the guidance under IFRS 9 with regard to reverse factoring is not new compared to IAS 39 and we believe that practice has been established, hence we feel it is not necessary to undertake standard-setting activities in this area.
Questions to constituents – Other matters Do you think that the IASB should provide educational guidance or make amendments to the standard-for financial guarantees? Why or why not?	In our opinion, the guidance under IFRS 9 in this area is not new compared to IAS 39 and we believe that practice has been established, hence we feel it is not necessary to undertake standard-setting activities in this area.

Other feedback	Related to question 8 (Transition) we would like to make the following additional remarks: - We fully concur that the transition requirements worked as intended and were very useful for the users. This questions the usefulness of the need for restatements of prior year comparatives in case of future IFRS changes, which are very burdensome. - We question the usefulness of the continued transition disclosures, specifically referring to the need to disclose what the fair value of assets would have been which have been transferred to AC and which were previously measured at fair value for that specific portfolio at the moment of transition.