



**BNP PARIBAS**

Deputy Chief Financial Officer

Paris, January 28<sup>th</sup>, 2022

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### **Comments on the IASB Post-implementation Review of IFRS 9 – Classification and Measurement (“PIR”)**

We are pleased to provide BNP Paribas’s comments on the IASB Post-implementation Review of IFRS 9 – Classification and Measurement.

Overall, the IFRS 9 classification and measurement requirements are working well but there are some areas where improvements would be welcome. These are set out in our answers below and we would like to highlight the following key messages:

- Financial assets with contractual cash flows linked to ESG targets (such standard as sustainability linked loans and bonds) should be eligible for amortised cost classification as this provides the most useful information for financial assets managed in a held to collect business model with basic lending cash flows. There are different technical arguments about the most appropriate way to assess these features within the framework of IFRS 9 but we urge the IASB to keep in mind the bigger picture of which classification provides the most useful information.
- Carrying equity instruments at fair value through other comprehensive income with no recycling of gains and losses through profit or loss does not adequately depict performance. This is because realised gains and losses are a key indicator of the performance. This is a particular concern for when our insurance entities first apply IFRS 9 together with IFRS 17 *Insurance Contracts* from 1 January 2023. We ask the IASB to consider reintroducing recycling together with an appropriate impairment model as well as the possibility to apply this classification to ‘equity type’ investments whether held directly or not.
- The rules based contractually linked instruments guidance is not working well. The guidance is not always clear which leads to uncertainty and lengthy debate about how to apply it. The level of analysis of the underlying instruments in the pool is excessive in some



situations and economically similar instruments with similar cash flows can be classified differently depending on whether they are considered within the scope of this guidance. We ask the IASB to consider revising this guidance to address these issues and we suggest a potential solution below.

Should you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'V. Cotten', written over a faint, illegible background.

Véronique Cotten



### **Question 1 – Classification and measurement**

**Do the classification and measurement requirements in IFRS 9:**

**(a) enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not?**

**(b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not?**

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

This question aims to help the Board understand respondents' overall views and experiences relating to the IFRS 9 classification and measurement requirements. Sections 2–8 seek more detailed information on the specific requirements.

As noted in Spotlight 1, IFRS 9 classification and measurement requirements have had limited overall effect on our accounting for financial instruments. In most cases, the classification and measurement requirements enable an entity to align the measurement of financial assets with the cash flow characteristics and how the entity expects to manage them. The exceptions to this are set out in the responses to the specific questions below.

### **Question 2 – Business model for managing financial assets**

**(a) Is the business model assessment working as the Board intended? Why or why not?**

Please explain whether requiring entities to classify and measure financial assets based on the business model assessment achieves the Board's objective of entities providing users of financial statements with useful information about how an entity manages its financial assets to generate cash flows.

**(b) Can the business model assessment be applied consistently? Why or why not?**

Please explain whether the distinction between the different business models in IFRS 9 is clear and whether the application guidance on the evidence an entity considers in determining the business model is sufficient.

If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

**(c) Are there any unexpected effects arising from the business model assessment? How significant are these effects?**

Please explain the costs and benefits of the business model assessment, considering any financial reporting or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.





In responding to (a)–(c), please include information about reclassification of financial assets (see Spotlight 2).

### **Question 2(a)**

We believe the business model assessment is generally working as the board intended. Requiring entities to classify and measure financial assets based on the business model assessment provides useful information about how an entity manages its financial assets to generate cash flows. The principles for reclassification are however difficult to apply which in some cases leads to a disconnection between the actual business model and the one documented for accounting purposes (see our response to Question 2(c)).

### **Question 2(b)**

Although the business model assessment requires judgement, there is sufficient application guidance and the level of judgement is reasonable within the judgement based IFRS framework.

### **Question 2(c)**

The business model assessment results in issues in certain areas such as loan syndications and internal sales.

The cause of these issues is the restriction in paragraph B4.43 that does not allow for reclassifications in the case of a change in management intention related to a particular financial asset or in the case of transfers of financial assets between parts of the entity with different business models. If the business model used to manage a particular asset changes then the restrictions against reclassifying the asset seems to be an exception to the basic principle in IFRS 9 that financial assets should be classified based on the business model used to manage these assets as at the reporting date.

This point is explained in paragraph BC4.113 of the Basis for Conclusions on IFRS 9, *‘almost all respondents (including most users) argued that prohibiting reclassification is inconsistent with a classification approach based on how an entity manages its financial assets. They noted that in an approach based on an entity’s business model for managing financial assets, reclassifications would provide useful, relevant and comparable information to users because it would ensure that financial statements faithfully represent how those financial assets are managed at the reporting date. [...]’*

We understand this exception to the principal of classifying financial assets based on the business model used to manage them is due to concerns raised relating to the complexity and the potential for earnings management. However, this exception can result in outcomes that we consider do not provide useful information as described further in the examples below.



### **Internal sales (transfer of financial assets between parts of the entity with different business models)**

For certain securities (such as government bonds), the same securities may be held by different parts of our Group under clearly distinct and different business models. For example, a trading desk may hold a portfolio of the securities for the purposes of market making (buying and selling the securities to different clients to meet client demand) and these securities are clearly 'held for trading' as defined by IFRS 9. Similar securities may be held by a clearly distinct and different treasury desk where they are managed under a 'held to collect' business model.

If the treasury desk purchases additional securities internally from the trading desk then the rules preventing reclassifications do not result in useful information (the securities would have to remain classified at fair value through profit or loss even though they are managed in a 'held to collect' business model). This is particularly the case for liquid assets that can be easily bought and sold in the market with small bid offer costs.

A different more appropriate accounting classification would be achieved if the trading desk sold the securities in the market and the treasury desk then separately purchased the same securities in the market. However this is not economically rational for the Group if bid offer costs can be saved by the treasury desk buying the securities internally from the trading desk. The trading desk may also have better market access as this is its primary activity.

### **Loan syndications (change in management intention in relation to particular assets)**

The Group may underwrite a loan with the intention of syndicating part of the risk on the loan during an initial syndication period. IFRS 9 requires that the business model must be defined at inception. The business model for the part of the loan which the group intends to retain is clearly 'held to collect'; however the definition of the business model for the part the Group intends to syndicate results in issues. The syndication of the risk could be achieved through the sale of the loan or through a synthetic transfer of the risk (through insurance for example). The share of each type of syndication will only be known at the end of the syndication as it depends on market appetite. Being obliged to define the part to be synthetically syndicated (which could remain in a 'held to collect' business model) from inception is not aligned with risk management and market practices.

In addition, even in those cases where the syndication will be through sale of the loan, at the end of the relatively short syndication period in some cases the Group may not have been successful in selling all of the part it originally intended to. The Group may then formally decide to change its management intention for this unsold part and also manage it within the 'held to collect' business model for the remaining life of the loan (which could be long relative to the initial short syndication period).

In light of these issues we ask the IASB to reconsider the requirements on reclassifications. For liquid assets the concerns in relation opportunistic reclassifications and earnings management do not seem valid (as described above highly liquid assets could easily be bought and sold in the market). For less liquid assets these concerns are more valid. However, allowing reclassifications would be more consistent with the principle in IFRS 9 of classifying assets based on the real business model under which they are managed as at the reporting date. The concerns about opportunistic reclassifications could potentially be addressed with disclosure requirements for any reclassifications of less liquid assets.





The reclassification requirements in paragraph B4.4.1 only apply in very restricted infrequent circumstances and so they generally do not apply. The scenarios where we actually see changes in the business model used to manage financial assets are those described above (changes in intention for particular financial assets or internal sales of financial assets between different parts of the Group with different business models).

### **Question 3 – Contractual cash flow characteristics**

#### **(a) Is the cash flow characteristics assessment working as the Board intended? Why or why not?**

Please explain whether requiring entities to classify and measure a financial asset considering the asset's cash flow characteristics achieves the Board's objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows.

If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain:

(i) why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI).

(ii) which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, 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). (See Section 7 for more questions about applying the effective interest method.)

#### **(b) Can the cash flow characteristics assessment be applied consistently? Why or why not?**

Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features).

If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

(c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?

Please explain the costs and benefits of the contractual cash flow assessment, considering any financial reporting effects or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about financial instruments with sustainability-linked features (see Spotlight 3.1) and contractually linked instruments (see Spotlight 3.2).



### **Question 3(a)**

We think that broadly the SPPI requirements are working as the board intended; however, we have concerns with the requirements for contractually linked instruments and financial assets with contractual cash flows linked to environmental, social and governance (ESG) targets. These are described further below.

Below we refer to a financial asset with SPPI cash flows as a financial asset that ‘meets’ or ‘passes’ the SPPI ‘test’. We refer to a financial asset that does not have SPPI cash flows as a financial asset which ‘does not meet’ or ‘fails’ the SPPI test.

### **Contractually linked instruments**

We think the IASB should consider revising the complex rules based contractually linked instrument (CLI) guidance as it is not working well.

In order to assess whether a CLI meets SPPI there is a requirement to look through to the underlying pool of assets. If any of the underlying assets in the pool do not themselves meet the SPPI requirements, then the CLI will not meet SPPI. This is the case even if the CLI is senior and any variability caused by the underlying ‘non-SPPI’ asset would be absorbed by the more junior tranches in all but the most extreme economic scenarios.

This also creates emphasis on the scope of the CLI requirements as if a financial asset is assessed as a non-recourse financing (NRF) rather than as a CLI then the fact that the underlying assets are not all SPPI will not automatically lead to the NRF failing SPPI. This creates issues as the scope of instruments captured by the CLI guidance is not clearly defined.

### *Example*

We try to illustrate these points with a stylised example. Assume the only assets held by a Special Purpose Vehicle (SPV) are a pool of auto lease receivables. The pool of lease receivables amortise down as the fixed lease payments are received. The SPV is exposed to the residual value risk on some of the lease contracts. On these leases the lessee has the option to return the vehicle at the end of the lease. The vehicle would be disposed of and the proceeds would be used to pay down the outstanding balance on the lease. The residual value risk is the risk of the lessee returning the vehicle when the used vehicle markets are depressed.

Assume in the first scenario the SPV is funded through senior debt held by the entity and equity held by the transaction sponsor. Given the SPV has issued only one tranche of debt the entity does not consider the senior debt as a CLI. The entity assesses senior debt for SPPI as a NRF taking into account that it only has recourse to the underlying auto lease assets held by the SPV. The entity ‘looks through to’ the auto lease assets to determine whether the senior debt is SPPI (in accordance with the requirements in paragraph B4.1.17). The main risks on these auto lease assets are credit risk (the risk of the lessee defaulting) and residual value risk. The risk analysis by the entity concludes that the senior debt has structural protections (notably the equity in the SPV that would absorb losses before they impact the senior debt) which are sufficient to absorb credit and residual value losses in severe stress events. In light of these structural protections the entity





considers that the residual value exposure does not prevent the senior debt from meeting SPPI.

Alternatively assume in the second scenario that the same SPV is funded through issuing multiple tranches of debt instruments in a public securitisation. The entity holds the most senior (AAA) tranche. The level of structural protection against the credit and residual losses provided by the junior tranches is similar to the structural protection provided by the equity in the first scenario. Accordingly the residual value losses would not be expected to impact the cash flows on the senior tranche even during severe stress events. The entity considers the CLI guidance to determine whether the senior tranche has SPPI cash flows and concludes the condition in paragraph B4.1.21 (b) is not met as a result of the residual value exposure in the underlying pool. Accordingly in this scenario the residual value exposure (which is similar to the residual value exposure in the first scenario) prevents the senior tranche from meeting SPPI.

Based on this stylised example we make the following observations.

- Given the financial assets held by the entity in the two scenarios have similar contractual cash flows and a similar economic exposure more useful information would be provided if they had the same accounting classification
- The accounting classification depends on whether the financial asset is assessed within the scope of the CLI guidance. IFRS 9 does not clearly define which instruments are within the scope of the CLI guidance. Accordingly we have had lengthy discussions with auditors over whether particular financial assets are CLI and we do not think these requirements can be applied consistently.
- Where the entity holds the most senior tranche the level of analysis of whether the underlying assets in the pool meet SPPI is excessive and not justified from a cost benefit perspective. The variability as a result of certain assets in the pool not meeting SPPI may be highly unlikely to impact the cash flows of the senior tranche.

#### *Possible amendments to explore*

Many of the issues above could be simply and directly addressed if the scope of the CLI guidance was reduced to capture only those tranches that provide credit protection to other tranches. Under that proposal the most senior tranche, which only receives credit protection from other tranches, should be analysed using a similar approach to other economically similar senior NRF. This would reduce the emphasis on scope and it is also consistent with some of the ideas in the original 2009 ED which included the notion of tranches that provide credit protection to other tranches. Under this proposal these subordinated tranches would continue to be analysed under the CLI guidance; however, the most senior tranche would not be under the scope of the CLI guidance and would instead be analysed in a similar way to other economically similar NRF.

#### **Financial assets with contractual cash flows linked to ESG targets**

This is a growing product where the Group grants Sustainability Linked Loans (SLL) and the interest rate can vary by a relatively small number of basis points depending on whether the borrower meets certain predefined ESG targets. The expectation is that the demand for such features will be growing in number and potentially in magnitude while the banking sector is exhorted to help clients transitioning to a more sustainable economy. In addition, this is also emphasized by the considerations of potential capital requirements for climate-related risks and





funding costs depending on the level of green asset ratio considered for the banks.<sup>1</sup>

We think a solution should be found to allow standard SLL instruments to be accounted for at amortised cost when - beside such feature - the contractual cash flows are consistent with a basic lending arrangement (subject to conditions such as, for example, that the SLL is commensurate to the borrowers sustainability performance).

We do not think it provides useful information to the users of the financial statements if all such instruments are mandatorily classified and measured for at fair value through profit or loss solely as a result of this feature. Firstly, the change in fair value may bring some inappropriate volatility in profit or loss as each component of this basic lending arrangement (interest rate risk, credit risk, liquidity risk) should be taken into account in the fair value. Secondly, the ESG feature is not an observable variable per se; and therefore, the valuation of such feature may be complex and may not result in reliable information. Where the standard SLL is managed in a 'held to collect' business model then we consider effective interest rate measurement with impairment provides the most useful information. This is comparable to the treatment of other basic debt instruments which are managed in 'held to collect' business models. These instruments are lending instruments and the purpose of the ESG feature is to help the client fulfil its ESG targets. The ESG feature is not intended to add leverage into these lending instruments (such as an index to commodity price or equity price for example).

Also, as for the issuer, we understand that financial liabilities which contain this feature are generally accounted for at amortised cost and there is no embedded derivative (the ESG target is a non-financial variable which is specific to a party to the contract and so it does not meet the definition of a derivative). As these financial liabilities are accounted for at amortised cost using the effective interest rate method, we think it provides evidence that the effective interest rate method can provide useful information for measuring these instruments. If this measurement basis is considered appropriate on the financial liability side then it should also provide useful information on the financial asset side.

We are supporting an interpretation where the ESG interest rate adjustment is considered part of a basic lending arrangement. IFRS 9 accepts that including other basic lending risks (such as liquidity risk) and costs (for example, administrative costs) within interest is consistent with a basic lending arrangement. Under this more open interpretation of the current requirements, no major amendments to the current IFRS 9 requirements would be needed as this is based on the existing guidance. Presumably, some supplementary guidance or illustrative example would be needed to formalize this interpretation.

The ESG interest rate adjustment reflects a deterioration or an improvement of the ESG KPIs of the borrower that may impact the credit risk borne by the lender or other costs. Indeed, the lender may incur regulatory costs for sustainable finance (such as cost of capital related to climate risk or cost of funding related to the level of green asset ratio). As such, this component of the interest is

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<sup>1</sup> In 2017, the European Banking Federation published a report ("Towards a Green Finance Framework") that assesses the role of the banking sector in the context of the discussion on green finance.



representative of other basic lending risks and costs and should be considered as meeting SPPI. While it is too early and complex to demonstrate a direct link between the ESG KPIs fulfillment by the borrower and the costs incurred by the lender for regulatory requirements or credit risk, this may change in the future. In the meantime, we believe there should be an amendment to the requirements of IFRS 9 to allow these instruments to be accounted for at amortised cost.

If a solution is not found to account for these instruments at amortised cost, the operational constraints and costs to account for significant volumes of SLL at fair value through profit or loss could slow the issuance of such instruments and potentially the transition towards a more sustainable economy.

#### **Question 4 – Equity instruments and other comprehensive income**

**(a) Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not?**

Please explain whether the information about investments in equity instruments prepared applying IFRS 9 is useful to users of financial statements (considering both (i) equity instruments measured at fair value through profit and loss; and (ii) equity instruments to which the OCI presentation option has been applied).

For equity instruments to which the OCI presentation option has been applied, please explain whether information about those investments is useful considering the types of investments for which the Board intended the option to apply, the prohibition from recycling gains and losses on disposal and the disclosures required by IFRS 7.

**(b) For what equity instruments do entities elect to present fair value changes in OCI?**

Please explain the characteristics of these equity instruments, an entity's reason for choosing to use the option for those instruments, and what proportion of the entity's equity investment portfolio comprises those instruments.

**(c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?**

Please explain whether the requirements introduced by IFRS 9 had any effects on entities' investment decisions. If yes, why, how and to what extent? Please provide any available evidence supporting your response which will enable the Board to understand the context and significance of the effects.

In responding to (a)–(c), please include information about recycling of gains and losses (see Spotlight 4).

The Group is convinced that the business model should be considered to determine the appropriate classification and measurement principles for equity instruments. Furthermore, we think that comparability should not be the main objective pursued to the detriment of relevance and faithful representation which are the main fundamental characteristics of financial information as defined in the revised conceptual framework.





The Group is a long term investor in equity investments notably through the following activities:

- Insurance activities: BNP Paribas Cardif holds financial assets including debt instruments but also equity instruments to hedge its commitments towards policyholders
- Investment activities: the Group manages a portfolio of minority interests in listed and unlisted industrial and commercial investments with a view to supporting clients and extracting value over the medium and long term. The group also provides indirect financing support for the economy through private equity funds

The purpose of investment activities is to hold positions in order to create value in the medium and long term, and realised gains and losses is a key indicator of the performance of these activities. Thus, the global performance is assessed not only on dividends received but also on gains or losses realised on sales.

The IFRS 9 category “fair value through OCI for equities” therefore does not faithfully reflect the business model and thus the performance of these activities.

Furthermore, the “fair value through profit or loss” category introduces undue volatility and fails to reflect the long term investment business model as unrealised gains and losses cannot be considered as similar to realised gains and losses. Indeed, fair value, does not reflect necessarily only the intrinsic value in the timeframe of our intended holding period for this investment as it can be affected by other “short term information/phenomenon”.

Thus, we consider that the reintroduction of recycling of the changes in fair value of equities previously recorded in OCI according to IFRS 9 is necessary to appropriately depict the performance of instruments held in a business model which is not a trading business. This is all the more important as most stakeholders are more familiar with performance representation through profit or loss. Recycling should be accompanied by an appropriate robust impairment model together with the introduction of an impairment reversal mechanism.

This treatment should also apply to ‘equity type’ instruments such as investments in funds where the underlying assets are equities as similar assets should be accounted for in a similar way irrespective of whether they are held directly or indirectly. Indirect holding of equities is often made through funds whose shares are ‘puttable financial instruments’ or financial instruments that impose on the entity that issued those instruments an obligation to deliver to the holder a pro rata share of the net assets of the entity only on liquidation.

This is primarily a concern for the BNP Paribas Cardif (our insurance activities) who will first apply IFRS 9 together with IFRS 17 *Insurance Contracts* from 1 January 2023.

#### **Question 5 – Financial liabilities and own credit**

**(a) Are the requirements for presenting the effects of own credit in OCI working as the Board intended? Why or why not?**



Please explain whether the requirements, including the related disclosure requirements, achieved the Board's objective, in particular, whether the requirements capture the appropriate population of financial liabilities.

**(b) Are there any other matters relating to financial liabilities that you think the Board should consider as part of this post-implementation review (apart from modifications, which are discussed in Section 6)?**

Please explain the matter and why it relates to the assessments the Board makes in a post-implementation review.

### Question 5(a)

We have two points that we would ask the IASB to consider. These are based on the comments in our response to the Exposure Draft '*ED/2010/4 Fair Value Option for financial liabilities*'.

- We consider that unrealised changes in the fair value of a financial liability as a result of changes in the entities own credit risk (own credit gains and losses) should not be recognised in the profit or loss whatever the accounting category may be. Accordingly own credit gains and losses should be treated the same way for all financial liabilities that are carried at fair value (recognised in OCI).
- The only time own credit gains and losses should be recognised in the profit or loss is when they are realised such as where financial liabilities are bought back at a price that reflects the movement in credit risk. In these cases the own credit gains and losses should be recycled into the profit or loss (similar to how own credit gains and losses which are realised upon the repurchase of amortised cost liabilities would naturally be recognised in the profit or loss). The current treatment creates a perverse incentive as where the entities own credit risk improves the entity could buy back the liability realising the loss due to own credit which would not be recycled to profit or loss. The entity would typically finance the buy back by issuing a new liability at a lower interest rate (due to the improvement in own credit risk). The reduction in the interest expense due to issuing the new liability at a lower rate will be presented in profit or loss (i.e. the initial realised loss due to buying back the initial liability at a higher price is not presented in profit or loss, while the subsequent reduction in the interest due to issuing the new liability at a lower rate is presented in profit or loss).

### Question 5(b)

We have no other matters that we think the board should consider in relation to financial liabilities.

### Question 6 – Modifications to contractual cash flows

**(a) Are the requirements for modifications to contractual cash flows working as the Board intended? Why or why not?**

Please explain what changes you consider to be modifications of a financial asset for the purpose of applying paragraph 5.4.3 of IFRS 9 and as a modification of a financial liability for the purpose of applying paragraph 3.3.2 of IFRS 9. Does the application of those paragraphs, and the disclosure





requirements related to modifications, result in useful information for users of financial statements?

**(b) Can the requirements for modifications to contractual cash flows be applied consistently? Why or why not?**

Please explain whether the requirements enable entities to assess in a consistent manner whether a financial asset or a financial liability is modified and whether a modification results in derecognition. Have the requirements been applied differently to financial assets and financial liabilities?

If diversity in practice exists, please explain how pervasive the diversity is and its effects on entities' financial statements.

The guidance on modifications has largely been carried forward from IAS 39 so we have not encountered issues in this area as a result of the application of the classification and measurement requirements in IFRS 9.

Although the IFRS 9 guidance on accounting for modifications of financial assets is not very detailed we have established accounting policies on how to apply the requirements based on precedent and previous interpretations (such as the September 2012 IFRS Interpretations Committee agenda decision on derecognition of financial instruments upon modification). Accordingly, we are comfortable with the existing requirements and concerned that any amendment may disrupt existing practice.

**Question 7 – Amortised cost and the effective interest method**

**(a) Is the effective interest method working as the Board intended? Why or why not?**

Please explain whether applying the requirements results in useful information for users of financial statements about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest method.

**(b) Can the effective interest method be applied consistently? Why or why not?**

Please explain the types of changes in contractual cash flows for which entities apply paragraph B5.4.5 of IFRS 9 or paragraph B5.4.6 of IFRS 9 (the 'catch-up adjustment') and whether there is diversity in practice in determining when those paragraphs apply.

Please also explain the line item in profit or loss in which the catch-up adjustments are presented and how significant these adjustments typically are. If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

In responding to questions (a)–(b), please include information about interest rates subject to conditions and estimating future cash flows (see Spotlight 7).



### **Question 7(a)**

We consider that the effective interest method is working and it results in useful information for the measurement of amortised cost financial instruments.

Spotlight 7 discusses how to calculate the effective interest rate for SLL (product discussed in Question 3) where the interest rate in future periods can step up or step down depending on whether the borrower meets pre-determined ESG KPIs (non-financial variables specific to a party to the contract).

It is more practicable, intuitive and operationally straightforward to consider the change in the rate as a result of the ESG KPIs as a change to the effective interest rate (as applied to for floating-rate assets and floating-rate liabilities in paragraph B5.4.5). The effective interest rate would then be updated for each period to reflect whether the ESG KPI's have been met for that period and the interest that will consequently actually be received for that particular interest period.

However some consider that if a direct link cannot be made between the ESG KPIs and the market rate of interest (for instance by linking the ESG KPIs to credit risk or other costs such as funding costs) then paragraph B.5.4.6 should be applied to these changes. This is an unfortunate outcome as it is more complex and it is difficult to make firm forecasts of expected cash flows (given they will vary due to a non-financial variable specific to the borrower). In the absence of any firm expectations of whether the ESG KPI will be met the practical application of paragraph B.5.4.6 may result in an outcome which is ultimately quite similar to what would have been achieved from applying paragraph B.5.4.5.

This may also depend on the reasoning decided to explain whether the SLL has SPPI cash flows (discussed in Question 3).

### **Question 7(b)**

Below we explain the types of changes in contractual cash flows for which we apply paragraph B5.4.5 of IFRS 9 or paragraph B5.4.6 of IFRS 9 (the 'catch-up adjustment')

#### *B5.4.5*

This would be applied to re-estimations of cash flows to reflect movements in market rates of interest for floating rate financial instruments. e.g. re-estimates due to benchmark LIBOR rate for a loan referencing LIBOR Typically this would also be applied where the credit spread is increased by a predetermined amount upon the occurrence of certain predetermined events linked to the borrower's financial situation. The increase in the credit spread is considered as a movement in the 'market rate of interest' in the loan to reflect the increased credit risk.

#### *B5.4.6*

These would be applied where the entity revises its estimates of payments and receipts for reasons other than changes in the market rate (for example due to changing expectations in relation to prepayment options, extension options or call options).





### Question 8 – Transition

(a) Did the transition requirements work as the Board intended? Why or why not?

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 also explain whether, and for what requirements, the Board could have provided additional transition reliefs without significantly reducing the usefulness of information for users of financial statements.

(b) Were there any unexpected effects of, or challenges with, applying the transition requirements? Why or why not?

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

We have no comments to raise.

### Question 9 – Other matters

**a) Are there any further matters that you think the Board should examine as part of the post-implementation review of the classification and measurement 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 the purpose of the post-implementation review, and the pervasiveness of any matter raised. Please provide examples and supporting evidence when relevant.

**(b) Considering the Board's approach to developing IFRS 9 in general, do you have any views on lessons learned that could provide helpful input to the Board's future standard-setting projects?**

We have no further comments to raise.