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المنظمة الدولية لهيئات الأوراق المالية

22 September 2023

International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Our Ref: 2023/O/C1/IASB/PM/843

RE: Request for Information | Post-implementation Review: IFRS 9 *Financial Instruments* - Impairment

Dear International Accounting Standards Board ("IASB" or "the Board") Members,

The International Organization of Securities Commissions ("IOSCO") Committee on Issuer Accounting, Audit and Disclosure ("Committee 1") thanks you for the opportunity to provide our comments on the Request for Information | Post-implementation Review: IFRS 9 *Financial Instruments* – Impairment.

IOSCO is committed to promoting the integrity of the international markets through promotion of high-quality accounting standards, including rigorous application and enforcement. Members of Committee 1 ("members" or "we") seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect the general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General observations

Members consider post-implementation reviews (PIR) integral to due process and appreciate the opportunity to provide our feedback on the impairment requirements in IFRS 9 *Financial Instruments* (IFRS 9).

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Overall, members believe the impairment requirements for financial instruments in IFRS 9 are working as the Board intended and provide financial statement users with relevant and useful information about timing and uncertainty of an entity's future cash flows. However, we have identified areas in the standard that could be enhanced in response to the PIR process. Specifically, members have identified the need for more relevant and comparable credit risk disclosures, in addition to the need for more guidance around the determination of significant increases in credit risk, the accounting for credit enhancements, and the use of management overlays in determining the allowance for credit losses.

In addition, the Board should not lose sight of the application questions that arise from the interplay between the impairment requirements of IFRS 9 and the requirements on modifications of financial assets and other requirements.

These topics are further highlighted in our responses to the questions below.

Responses to the Board's Questions

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?

Response:

We believe the impairment requirements in IFRS 9 result in providing more timely recognition of credit losses as compared to the incurred loss model in IAS 39 *Financial Instruments: Recognition and Measurement*. In addition, we note that, on balance, IFRS 9 provides useful information to users of the financial statements about the effect of credit risk on the amount, timing, and uncertainty of future cash flows. However, some members have observed diversity in the application of the impairment requirements in IFRS 9 that extend beyond differences that exist due to differing credit risk management practices and diversity in the quality of credit risk disclosures, which we will discuss further in our responses to Questions 3, 4, and 9.

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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?

(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?

Response:

Members have not identified fundamental questions about the general approach. We believe that the recognition of lifetime expected credit losses if there has been a significant increase in credit risk, and the recognition of 12-month expected credit losses for other financial assets, can provide useful information for users of the financial statements.

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?

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

Response:

Members have observed diversity in how entities assess and determine significant increases in credit risk (SICR) resulting in inconsistent application of the principles from one entity to another. For example, some entities define SICR using relative thresholds, others absolute thresholds, and others a combination of absolute and relative thresholds despite the discussion in BC5.160 of IFRS 9 which appears to indicate that the IASB considered and rejected the use of absolute thresholds. However, BC5.161 acknowledges that in certain circumstances an entity could use maximum credit risk accepted on a portfolio basis to determine if SICR exists. In addition, some members have noted a lack of or inconsistent use of the collective SICR assessment by some entities. Some members have also noted diversity in the definition of default.

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We acknowledge that the principles-based nature of the requirements is fundamental to the IASB's objective of providing information about expected credit losses that is considered useful to users of the financial statements. However, we believe the IASB should provide additional application guidance on how to determine SICR so the principles are applied more consistently. For example, the illustrative examples in IE38 and IE39 provide examples on the 'bottom up' and 'top down' approaches, respectively. We suggest including these two approaches as part of the standard to provide additional guidance on the assessment. In addition, we suggest consideration of whether further clarity is needed on how an entity would determine SICR when considering the example provided in BC5.161.

Question 4 – Measuring expected credit losses

(a) Are there fundamental questions (fatal flaws) about the requirements for measuring expected credit losses? If yes, what are those fundamental questions?

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

Response:

We have observed the increased use of "post-model adjustments" or "management overlays" when measuring expected credit losses, which may involve a high degree of subjective management assessments. The subjective nature of the adjustments and lack of transparent disclosures reduce the comparability of expected credit losses between entities. We acknowledge that these adjustments may be necessary in certain circumstances to ensure the allowance for expected credit losses adequately reflects the actual expectations about credit losses and meets the objective of the standard. However, given the extent and significance of management overlays, we suggest the IASB consider providing application guidance, illustrative examples, or education materials on the use of management overlays to adjustments to the final allowance for credit losses amount as well as for adjustments to the SICR assessment. In addition, we suggest that the IASB enhance transparency of credit risk disclosures in IFRS 7 by providing specific requirements for disclosures about management overlays, which we address further in Question 9.

In addition, some members identified questions about how entities should incorporate climate-related risks into the measurement of expected credit losses. The inherent complexities and uncertainties involved in incorporating climate-related matters into the measurement may result in the further use of management overlays. We suggest that the IASB specifically address whether, and if so, how entities should incorporate

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climate-related risks into the measurement through application guidance, illustrative examples, or other educational material.

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?

(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?

Response:

Members generally believe that the simplified approach has reduced complexity in measuring expected credit losses and is widely used by non-financial institutions. However, the integration of forward-looking information into the simplified approach varies. We suggest the IASB provide application guidance or illustrative examples to provide more consistency in application by non-financial institutions.

Question 6 – Purchased or originated credit-impaired financial assets

(a) Can the requirements in IFRS 9 for purchased or originated credit-impaired financial assets be applied consistently? Why or why not?

Response:

Members do not have any observations on purchased or originated credit-impaired financial assets.

Question 7 – Application of the impairment requirements in IFRS 9 with other requirements

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(a) 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?

Response:

Some members believe there is insufficient clarity around the assessment of whether a modification of a financial asset indicates that there has been a significant increase in credit risk and any resulting impact on the measurement of expected credit losses. We note that Paragraph 5.5.12 of IFRS 9 states that if the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognised, an entity shall assess whether there has been a significant increase in the credit risk of the financial instrument by comparing the risk of default occurring at the reporting date (based on the modified contractual terms) and the risk of default occurring at initial recognition (based on the original, unmodified contractual terms). However, the standard does not provide further guidance on how this guidance should be applied. In this regard, we suggest the IASB consider providing application guidance for clarity in the application of the standard.

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?

Response:

Members do not have any observations on the transition requirements.

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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?

(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?

Response:

We agree with the noted stakeholder feedback that there is a lack of consistency in the type and granularity of information disclosed by different entities about credit risk, which may reduce the comparability and the overall quality of information provided to users of the financial statements. We agree that the lack of consistency in the type and granularity of information is most prevalent in credit risk disclosures relating to the determination of significant increases in credit risk, management overlays, credit risk management practices, forward-looking information, and sensitivity analyses. In addition, some members highlighted the usefulness of vintage disclosures, sensitivity analyses and aging information (i.e., days past due) to users of the financial statements, even if this information is not the primary basis for how the entity manages its credit risk on an annual and interim basis.

A few members have observed modifications made by entities that include extending the term of the loan receivable close to the maturity date because of the debtor experiencing financial difficulty. In practice, entities often conclude that these are "new loans" and therefore not past due, resulting in a lack of disclosure about these modified loans even though these loans are risker than the rest of the portfolio. These members believe users of the financial statements would benefit from disclosure regarding these types of modifications. We suggest that the IASB address this issue by providing more prescriptive qualitative and quantitative disclosure requirements. In developing disclosure requirements, the IASB could consider the existing requirements in ASC 310-10-50-42 through 50-44 under U.S. GAAP, the objective of which is to provide users of the financial statements with information about the type and magnitude of certain modifications of receivables made when debtors are experiencing financial difficulty, the financial effect of those modifications, and the degree of success of the modifications in mitigating potential credit losses, regardless of whether the modification results in a "new loan."

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Further, as noted above, we believe there is a need for improved disclosure of management overlays. Management overlays involve highly subjective management assumptions resulting in the need for additional qualitative and quantitative disclosures that enable users of the financial statements to ascertain how those assumptions were derived and incorporated into the measurement of expected credit losses. Specifically, we suggest the Board require the disclosure of the adjustment to the credit loss from any management overlay that is recognized in the financial statements, including the underlying rationale, the description of the methodology used to compute the adjustment, and any changes in the methodology from one year to another.

We suggest that the IASB address each of the aforementioned issues by providing more prescriptive disclosure requirements in IFRS 7 (i.e., require items of information that satisfy specific disclosure objectives), adding application guidance, illustrative examples, and/or educational material to require entities to explain inputs, assumptions (i.e., forward-looking information), and estimation techniques used to determine significant increases in credit risk and the measurement of expected credit losses.

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?

(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?

Response:

A few members have a perception that IFRS 9 was primarily written with large financial institutions in mind and therefore can be complex to apply by smaller financial institutions and corporate issuers. Although these members acknowledge that IFRS 9 is principles-based and not an industry specific standard, the fact remains that some smaller financial institutions and corporate issuers have experienced challenges in understanding and applying IFRS 9 and the associated disclosures in IFRS 7.

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A few members have observed diversity in the application of the allowance for credit losses requirements and notable diversity in the quality of credit risk disclosures among non-financial institutions (i.e., corporates) which hinders the comparability and overall usefulness of the information provided to users of the financial statements.

Given these observations, we believe more application guidance, examples, and illustrations are needed to support the quality and consistent application of IFRS 9 and IFRS 7 by these entities.

Members do not have any further matters that have not been previously addressed.

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We appreciate your thoughtful consideration of the views provided in this letter.

If you have any questions or need additional information, please do not hesitate to contact Jonathan Wiggins, Chair of the Accounting Subcommittee of Committee 1 at +1 202-551-3694 or me. In case of any written communication, please mark a copy to me.

Yours sincerely,

Paul Munter

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