UKEB
UK Endorsement Board

Summary of the Financial Instruments Working Group meeting held on 20 March 2023 from 2pm to 5pm

Present	
Name	**Designation**
Peter Drummond	Chair, Financial Instruments Working Group (FIWG)
Alan Chapman	FIWG member
Brendan van der Hoek	FIWG member
Conrad Dixon	FIWG member
Fabio Fabiani	FIWG member
Helen Shaw	FIWG member
Kumar Dasgupta	FIWG member (by dial-in)
Mark Randall	FIWG member
Mark Spencer	FIWG member (by dial-in)
Richard Crooks	FIWG member
Robbert Labuschagne	FIWG member
Sarah Bacon	FIWG member (by dial-in)
Silvie Koppes	FIWG member
Ian Mitchell	Observer (by dial-in)

In attendance	
Name	**Designation**
Pauline Wallace	Chair, UK Endorsement Board (UKEB)
Sandra Thompson	Board member, UK Endorsement Board (by dial-in)

Apologies: Tim Dee (Observer)

Relevant UKEB secretariat team members were also present.

Welcome

1. The Chair of the Financial Instruments Working Group (FIWG) welcomed the meeting.

Technical discussion

Introduction

2. The FIWG Chair introduced the meeting topic, the IFRS 9 *Financial Instruments* requirements on impairment. The discussion will inform the UKEB's response to the IASB's Request for Information (RFI) on those requirements, which is scheduled to be published in May 2023 as part of the IASB's Post-Implementation Review (PIR) of IFRS 9. The FIWG Chair outlined the objectives of the IASB PIR.

3. FIWG members agreed IFRS 9 did not contain any 'fatal flaws'.

4. FIWG members noted that although they had not identified any fatal flaws in the impairment requirements in IFRS 9, they had some areas of concern they wished to bring to the IASB's attention. These were principally around staging, modification/derecognition and disclosures.

General approach to recognition of Expected Credit Loss (ECL)

Intercompany loans

5. The UKEB Secretariat invited views on the application of the requirements of the ECL general approach for the impairment of intercompany loans.

6. Some FIWG members noted that these requirements improved on those in the previous Standard (IAS 39 *Financial Instruments: Recognition and Measurement*), observing that intercompany loans were not necessarily a low-risk area. However, one member suggested that additional application guidance would be welcome to address complex transactions, such as those involving securitisations.

7. Even though there was no appetite amongst FIWG members for an exemption from the ECL general approach for intercompany loans, it was noted that the requirement to calculate ECLs for intercompany loans may be disproportionate for corporates who do not model ECLs routinely, unlike banks, and therefore it was suggested that the UKEB gather feedback from corporates.

8. Other than in the case of corporates, it was agreed there were no significant concerns to highlight to the IASB during the PIR response.

Portfolios of assets acquired at fair value

9. The UKEB Secretariat asked for views on the ECL requirements for portfolios of financial assets acquired at fair value. The FIWG group acknowledged the conceptual issue with recognising ECL on initial recognition, which applies to both assets originated and assets acquired at fair value.

10. One member suggested that the IASB could introduce a model similar to that for POCI assets (see below), for assets which are purchased when the credit risk has significantly increased (stage two portfolios). Others reminded the group the application of ECL requirements to acquired assets is a complex area that was previously considered by the IASB during the development of IFRS 9.

11. The FIWG agreed this is not an area of significant concern to raise with the IASB.

Purchased or originated credit-impaired financial assets (POCI)

12. FIWG members acknowledged challenges with the application of the ECL requirements specific for POCI assets. During the discussion it was acknowledged that some challenges relate to POCI assets that arise because of the derecognition and re-recognition of new financial assets due to a substantial modification.

13. However, FIWG members agreed that the ECL issue for POCI assets was not pervasive. It was therefore suggested that the UKEB should not pursue this issue further, as the ECL issues could be addressed by the IASB pipeline project *Amortised Cost Measurement*, which is expected to address the interaction of ECL, modification and derecognition requirements (see below).

Interaction of modification, derecognition, write offs and ECL

14. The UKEB Secretariat asked FIWG members to share their views on the relationship between the IFRS 9 requirements for modification of financial assets, derecognition and impairment.

15. The group noted diversity in practice in distinguishing a modification that is substantial enough to lead to derecognition, from one that it is not. Another area where diversity is noted is when cash flows are forgiven. Entities may apply modification accounting, (partial) derecognition or write off these amounts. The accounting applied may have a significant impact on the ECL outcome, as it affects staging and therefore whether a 12-month or lifetime loss is used for ECL purposes. It may also have an impact on presentation of any resulting effects in profit or loss.

16. The FIWG would welcome clearer guidance on the distinction between each of these concepts, the order in which the requirements should be applied and the corresponding line items for presentation of results in profit or loss. The FIWG would encourage the IASB to address these concerns as part of their pipeline

project *Amortised Cost Measurement*. The group felt that if the IASB addressed the topics raised in the PIR of IFRS 9 *Classification and Measurement*, which gave rise to the pipeline project, the impairment treatment to be followed would be clearer.

Determining significant increases in credit risk (SICR)

17. The UKEB Secretariat asked FIWG members for their thoughts on SICR and on their analysts' views of it.

18. FIWG members valued the link between IFRS 9 ECL accounting and credit risk management, but also noted the complexity of the SICR requirements and existing diversity in practice. Although it was acknowledged that a full lifetime ECL approach could be simpler, there was no appetite amongst the group to change the overall SICR approach. It was also noted that an element of judgement would always be present.

19. During the discussion it was noted that it was not clear whether users of accounts understood the complexities and the analytical value that SICR provides.

20. In the discussions, the following suggestions were made:

    a) Clarifying IFRS 9 concepts, such as what is considered 'significant', would facilitate consistency in the application of the SICR requirements. However, the challenges in doing so were acknowledged. It was noted that the IASB had to design an approach that would be used by a wide range of entities (from small corporates to large multinational financial institutions) and therefore the IASB intentionally decided not to prescribe what a SICR was.

    b) Considering adding to IFRS 9 the IASB guidance issued in March 2020 '*IFRS 9 and covid-19*' and potentially other guidance such as that issued by relevant international regulators.

    c) Enhancing disclosures as a priority, to assist analysts and other users of accounts, by improving understandability and comparability (see further information in the Disclosures section below).

21. One FIWG member noted that, in the insurance industry, there seems to be a mismatch between the ECL requirements and the measurement of the IFRS 17 insurance liability. It was agreed to highlight this to the IASB when reporting the interaction with other IFRS standards and, more specifically, to recommend it be considered as part of the IASB Post-implementation Review of IFRS 17 *Insurance Contracts*.

Measurement of ECL

22. The UKEB Secretariat asked the group for their views on forward-looking scenarios and judgemental overlays.

23. In the discussion, FIWG members raised the following points:

Forward-looking scenarios

24. Members noted that the IASB could consider adding to IFRS 9 relevant guidance issued by the '*IFRS Transition Resource Group for Impairment of Financial Instruments*' (ITG) on incorporation of forward-looking scenarios. However, they also noted that the audit firms' guidance largely agreed on this point and that practice has therefore evolved.

25. Members agreed that good disclosure was important. One member noted that the UK Prudential Regulatory Authority has done research resulting in specific recommendations to drive consistency in the way multiple economic scenarios were presented, which may also assist in driving consensus and in improving disclosures in this area. It was considered that this is something the IASB might find useful.

Judgemental adjustments

26. FIWG members noted that IAS 1 and IFRS 7 require disclosure on critical judgements, such as judgemental adjustments, but practice was diverse in this pervasive area, with some preparers disclosing very little. New disclosure requirements could potentially be informed by the UK Taskforce on Disclosures about Expected Credit Losses (DECL) recommendations in this area (see Disclosures section below). Members agreed that adding the concept of 'judgemental adjustments' to the Standard and potentially either adding an explicit statement in IFRS 7 clarifying that existing disclosure requirements apply equally to 'judgemental adjustments' or requiring specific disclosures on those would be useful. It may be helpful to share key recommendations from the Taskforce with the IASB.

Expected credit losses – definition and IFRS IC

27. Members observed that a recent IFRS Interpretations Committee (IFRS IC) discussion highlighted that in practice many consider expected credit losses to cover only losses arising from credit events, but in fact the Standard defines '*credit loss*' as covering all losses arising for any reason. In defining credit loss as any cash shortfall, some members questioned whether the IFRS IC decision fully reflected current practice. The UKEB Chair noted that consideration should be given to whether there were potential unintended consequences arising from the IFRS IC decision.

Simplified approach for trade receivables, contract assets and lease receivables

28. Overall, the FIWG did not have significant concerns because the simplified approach was not as relevant to them as it is to corporates.

Loan commitments

29. FIWG members saw this as a difficult area of IFRS 9 to apply. Challenges included assessing the behavioural life of revolving credit facilities for both retail and wholesale banking.

30. Members understood there is diversity in the interpretation of the criteria for application of the exception in IFRS 9 5.5.20 and therefore would welcome clarification, for example:

    a) Can the exception be applied to fully drawn loan commitments?

    b) Is B5.5.39(c) '*the financial instruments are managed on a collective basis*' a requirement or an example only? Is the exception only allowed when credit risk is managed collectively?

Financial guarantees

31. FIWG members often experienced difficulty assessing whether guarantees were integral to an instrument, because IFRS 9 did not define "integral". If a guarantee is not integral, there are further application questions and increased diversity in practice.

32. There were mixed views on the way forward on this topic: one member would welcome further guidance in relation to the definition of 'integral', another member asked whether the reference to 'debt instrument' in the definition of financial guarantees should be looked at, as debt instrument is not defined in IFRS 9, while other FIWG members felt that there were higher-priority items for the banking sector. These members also noted that practice has developed.

Disclosures

33. One FIWG member observed that it was difficult for users of accounts to compare credit risk exposures of different banks and that providing a sensitivity analysis could be a way to improve this situation.

34. One FIWG member observed that there was diversity in practice in different countries about disclosure of sensitivity analysis. In FIWG members' experience, in the UK the Financial Reporting Council has an expectation that sensitivity analysis disclosures should be provided; but that might not be the case in other jurisdictions.

35. During the discussion it was noted that IFRS 7 does not specifically require disclosure of sensitivity analysis for credit risk (it is required for market risk). Considering that two other IFRS Accounting Standards, IFRS 13 *Fair Value Measurement* and IAS 19 *Employee Benefits*, require sensitivity analysis, members felt that this requirement could be added to IFRS 7 credit risk

disclosures. However, another FIWG member highlighted the many practical questions that would arise, should the IASB mandate sensitivity analysis.

36. Some FIWG members were concerned about the lack of definition of asset class, which they understood was due to differences across sectors. However, others expressed concern that if mandatory application guidance were introduced, it would likely require some entities to make significant changes.

37. It was noted that the quality of UK banking sector disclosures on credit risk was already well regarded due to the work of the UK Taskforce on Disclosures about Expected Credit Losses (DECL). Some of the DECL recommendations include:

    a) Producing groupings, so analysts can compare asset classes.

    b) A roll forward table, presenting gross amounts and the corresponding ECL, allowing users to understand the coverage ratio.

    c) Sensitivity analysis.

38. FIWG members agreed that it would be helpful to share key recommendations from the DECL with the IASB for their consideration.

Interaction between IFRS 9 and other Standards

39. Some FIWG members would welcome guidance on how entities should incorporate climate risk within macroeconomic assumptions. However, it was acknowledged that this issue might be better addressed within the UKEB's work on connectivity between the IASB and ISSB standards.

40. One FIWG member observed that if an asset does not consist solely of payments of principal and interest because of its residual value, that may indicate that it should be accounted for under IFRS 16 *Leases*. Overall, however, the FIWG did not have significant concerns on the interaction of IFRS 9 and IFRS 16 to be brought to the IASB's attention.

41. One FIWG member commented that the interaction of IFRS 9 with IFRS 17 *Insurance Contracts* needed to be addressed as part of the IASB Post-implementation Review of IFRS 17 and this should be reflected in the feedback to be provided to the IASB.

Horizon scanning

42. Two recent IFRS Interpretations Committee discussions were mentioned. The first, on lease modifications, did not appear to clarify whether IFRS 9 or IFRS 16 applied in that situation for the lessee. The second noted that either IFRS 9 or IFRS 17 could be applied to premiums receivable by an insurer from an intermediary.

43. No specific actions for the FIWG or for the UKEB were agreed arising from the discussion. Some FIWG members were continuing to monitor both these developments.

AOB

44. At the next meeting (24th April), Seema Jamil-O' Neill, the UKEB Technical Director, would give a presentation on the Freedom of Information Act.