A response to the

IASB's Amendments to the Post-implementation Review IFRS 9 Financial Instruments Impairment

September 2023

Introduction

1. UK Finance is the collective voice for the banking and finance industry. Representing around 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

2. We welcome the opportunity to comment on IFRS 9 /2023/5 Post-implementation Review IFRS 9 Financial Instruments Impairment published in May 2023.

3. We set out our key messages below and have referenced our responses to questions in the Request for Information (RfI) which provide further details

Key points

4. **There are no fundamental flaws but there are areas for improvement (Q2)**: Whilst we have not identified any fundamental flaws, the standard has not been tested by a global financial crisis or prolonged economic recession, as the most recent significant event of the Covid-19 pandemic saw any impacts from IFRS 9 being partially offset by significant government support measures. In the rest of this section, we highlight some of the challenges and less well understood aspects of the standard and hence impact on preparers, auditors and users.

5. **Procyclicality (Q1; Q10):** The Covid-19 pandemic highlighted the procyclicality of the standard with initial over-estimation of expected credit losses (ECL) followed by significant releases. Procyclicality potentially masks the underlying risk and has unintended consequences such as reduced credit availability and financial stability. We suggest the IASB provide guidance and educational materials to help users, particularly around simpler approaches to scenarios.

6. **Complex calculation and modelling (Q1):** Multiple economic scenarios and the use of complex impairment modelling approaches when implementing IFRS 9 involves a wide range of assumptions and judgements. Simplifications are required to avoid future potential fatal flaws and to encourage implementation approaches that better align with the direction of travel of other regulatory reforms e.g., prudential capital regimes for banks which is moving away from internal modelling to standardised approaches.

7. **Significant increase in credit risk (SICR) is not well understood and is inconsistent with credit stewardship (Q3):** Relative approach and 'significant' are not well-defined in the standard or associated guidance and hence it is difficult for users to understand how it has been applied thereby hindering comparability across firms. Relative approach for SICR requirement is also inconsistent with credit stewardship in banks.

8. **Simplification of disclosures and guidance on key areas (Q1; Q2; Q4; Q6; Q9):** We recommend the IASB produce additional educational guidance around judgements and assumptions used in ECL, sensitivity analysis and post model adjustments. There should also be more flexibility for disclosures on less risky or material aspects, such as intra-group exposures and purchased or originated credit-impaired assets.

We would be happy to discuss the above and the responses to specific questions.

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Answers to specific 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 financial statements about the effect of credit risk on the amount, timing and uncertainty of future cash flows? Why or why not?*

Earlier recognition of credit losses but IFRS 9 is untested

The ECL model does lead to earlier recognition of credit losses, as most notably seen during the Covid 19 crisis. The model more closely aligns with the internal credit stewardship within banks, hence results in more relevant and useful information than the information resulting from the impairment requirements in IAS 39. There is an important caveat that there has not been a full economic recession since IFRS 9 was introduced, so any assessment of the implementation of the ECL must acknowledge that we have not genuinely seen a full stressed and prolonged credit cycle. As such, it remains possible that the ECL model will not hold up at all points in the credit cycle, but the indications are that it should perform better than IAS 39.

Key concerns

We have highlighted our main concerns affecting the application of ECL:

(i) **Procyclicality**

The ECL model has shown signs of over-estimating losses, most notably during Covid 19 pandemic. This feature arises most clearly when there is a significant movement in macroeconomic inputs which can create performance issues with models used to estimate future defaults. However, the vast majority of these increased provision for credit losses were subsequently released and not utilised. To some extent this mirrored the effects seen from mark-to-market accounting during the financial crisis when book values significantly mis-represented asset recoverable values because of stresses seen in the underlying models. Earlier recognition of losses is useful information, but significant procyclicality does not accurately portray business risk and creates a brake on lending activity. The latter could lead to actual negative economic outcomes – as such there is a risk that ECL models could exacerbate economic cycles rather than reflect them. We suggest the IASB provide guidance and educational materials to help users, particularly around simpler approaches to scenarios.

(ii) **Complexity of calculation**

Generally, the IFRS 9 ECL requirements are complex and non-prescriptive. In moving to the ECL model, banks were encouraged to apply advanced calculation techniques, including models, that mirrored the approaches taken for prudential capital calculation. This resulted in a wide range of assumptions and judgements. The current impairment model infrastructure means organisations face comprehensive complications with 'over-sophisticated' quantitative assessment methods when assessing financial instruments. Being over-reliant on models could create complications for organisations, such as possessing the resources to analyse complex datasets. The calculation requirements are a heavy burden and for those

without existing sophisticated modelling capabilities, such as in prudential capital related internal rating based (IRB) or Stress testing models, the burden for ECL calculation will continue to be disproportionate in adequately meeting the requirements of IFRS 9. Implementing simpler models would promote flexibility and ease of use, rather than having a model that is too complex to comprehend which may inadvertently lead to a 'fatal flaw'.

(iii) Lack of comparability

The use of macroeconomic assumptions and forecasts, particularly in relation to the use of downside scenarios, mean that portfolios performing consistently can have widely fluctuating ECLs. The use of downsides and the asymmetry of downsides, particularly for mortgage or secured portfolios, results in calculating provisions that will almost always significantly exceed losses that are expected from the base forecast. This, combined with the complexity highlighted in (i) above, have resulted in a wide range of assumptions and judgements, leading to methods and outcomes which are not always fully comparable between banks.

(iv) Aligning with other standard setters' approaches

In the years since the global financial crisis, banking prudential regulators have acknowledged that over-complex models were not accurately reflecting underlying risks, often resulting in an over optimistic position compared to the reality. As a result, there is a concerted move from Basel Committee to revert to simpler approaches, as evidenced through the greater application of standardised approaches in '*Basel III: Finalising post-crisis reforms*', issued in December 2017, around the same time as when IFRS 9 was being implemented. There is a risk that ECL, if IFRS 9 implementation continues with rigidly complex modelling, these issues may not be addressed and not adequately apply the learnings recognised by banking prudential regulators. While this does not undermine the wider aspects of the ECL model, as organisations have generally used post-model adjustments to reflect weaknesses evident in their models, it does mean there could be some merit in considering and even promoting simpler approaches.

Simpler approaches for ECL

(i) **Reducing the focus on running multiple economic scenarios and increasing emphasis on the capture of non-linearity**. The use of multiple economic scenarios is generally not understood by users and can be difficult to compare between organisations. There is significant value in the presentation of the base case for ECL modelling and this has been one of the most beneficial impacts of IFRS 9, but users appear to be more interested in understanding the effect of adverse outcomes that significantly increase loss rates. Consequently, we believe the focus should be on disclosing those scenarios that are most relevant for IAS 1 sensitivity analysis disclosures rather than including many other scenarios that have limited impact on the overall ECL outcomes.

(ii) While the SICR model generally aligns with credit stewardship, it is ultimately not possible to back-test or "prove" that the correct assets are allocated to stage 2 and as such introduces significant complexity. Consequently, we believe that opportunities should be considered to **simplify its application so that it presents a simpler view of asset underperformance**.

(iii) Firms appreciate the simplified approach for **intra-group lending** that was implemented 5 years ago. However, we suggest the IASB implements possible exemptions (like that under US Generally Accepted Accounting Principles).

Valuable information for users

There is no doubt that the implementation of IFRS 9 led to a broadening of reporting on the judgements regarding credit provisioning as well as more information on credit risk generally. For UK banks, this has been extended through the work of the Taskforce on Disclosures about Expected Credit Losses (DECL), which has issued three reports to date setting out a number of disclosure recommendations. The aspects of information relating to ECL that were identified as providing the greatest value are:

- Information on the base case economics informing likely future credit losses;
- Greater granularity on coverage and risk quality of lending;
- Flow tables showing write offs, stage migration and actual defaults;
- Disclosures on post-model adjustments and their application;
- Sensitivity analysis pointing to the range of losses experienced under extreme adverse scenarios; and
- Additional disclosures introduced to demonstrate use of and performance of lending subject to government guarantees under Covid-19.

Whilst the DECL reports have contributed to a degree of disclosure consistency between UK banks, there is also a recognition that this information comes at some cost with the volume of ECL disclosures taking up about 15% of total annual report size and running to 50-60 pages for UK banks. There is concern that this is too much information, making it difficult for users to extract the most important information and to meaningfully compare between different organisations.

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?*

Fundamental flaws in general approach

Our members have not identified any fundamental flaws in the general approach to recognition of expected credit losses in IFRS 9.

Costs are greater than expected

Whilst there are no fundamental flaws in the general approach, the costs of applying IFRS 9 have been greater than expected, building on points discussed in response to Q1. This is driven by:

- Design and implementation - whilst the standard does not mandate specific approaches, initial design decisions by banks and encouragement from regulators have led to the implementation of complex modelling environments that requires continuous monitoring and development;
- Rapid changes in the macroeconomic environment requiring investment in more agile model and control frameworks;

- Expanded audit requirements from increased use of 'expert judgements' to supplement modelled outcomes; and
- Increased focus from supervisors on improving consistency and comparability in the application of IFRS 9.

Model limitations

The Covid-19 pandemic exposed some model limitations. IFRS 9 ECL models were built on data where a deterioration in macroeconomic variables led to stressed customers which in turn led to increased delinquencies. UK Government support measures interrupted this statistical relationship requiring banks to consider factors broader than raw model outputs when quantifying credit impairment provisioning. This gave rise to the use of material 'expert judgements'. Moreover, this required banks to utilise new sources of data and to advance sensitivity analysis to adequately interpret the situation, which required expanded governance and control frameworks.

Lessons learned from this have helped to shape bank preparers and supervisory agendas in the UK. For example:

- The PRA identified areas of focus ranging from model redevelopment to data integration;
- The Financial Reporting Council guided audit firms and banks towards expanded and deeper controls - for example through the incorporation of feeder models into IFRS 9 control assessments; and
- The DECL Taskforce set out further recommendations to enhance the comparability and consistency of disclosure in the UK market, particularly around judgements and sensitivities, further increasing the volume of disclosure.

In response, UK banks have invested in streamlining processes, in particular for models, including developing, monitoring, maintaining, and validating models; enhancing end-to-end controls; and building out strategic reporting capabilities over and above those set out at the inception of IFRS 9.

Benefits of IFRS 9

There should be increased investor/regulator confidence that the initial recognition of ECL provides a credit loss buffer that did not exist under IAS 39 and hence ultimate default 'shocks' are not as pronounced. However, while this could be seen as a benefit of IFRS 9, this additional ECL has an adverse impact on capital and therefore can have some limiting effect on growing the business.

There are a number of practical application questions which are dealt with elsewhere in this response:

- The interaction between impairment and modifications (see response to Q4)
- How to determine whether a financial guarantee is integral to a loan or not (see response to Q4)
- Given the increased relevance of climate matters, the IASB should consider providing guidance on how to distinguish which elements of (ECL directly relates to climate-risk. This area is an area of growing concern as users expect to receive useful information concerning ECL in tandem with discerning the elements of ECL that relates to climate risk.

Question 3 – Determining significant increases in credit risk
(a) *Are there fundamental questions (fatal flaws) about the assessment of significant increase 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?*

Fundamental flaws of SICR assessment

There are no fundamental flaws in the use of SICR and the identification of under-performing (stage 2) assets has been a strong driver in allowing users to better understand a company's credit stewardship and to be able to identify and observe potential emerging credit issues and concentrations. Against this, some users assert that the SICR model is too judgemental, especially in its use of relative rather than absolute thresholds.

Poorly understood and complex areas of SICR

UK banks continue to support the use of SICR and the principles-based nature of the requirements, but would also acknowledge that certain aspects of SICR represent a high level of complexity/judgment that are poorly understood by users:

- **Relative v absolute**: a key consideration of the IASB in finalising the ECL model was to specify that the application of SICR was a relative rather than an absolute measure since this is seen as a better capture of the origination choices of the lender. This distinction remains challenging for users to understand and is one aspect of ECL that remains inconsistent with the credit stewardship employed by most banks. While SICR has arguably led to greater alignment between risk methodologies and impairment decisions, there continues to be some tension about those instances where SICR triggers stage migration on cases where management has no genuine concern about non-payment. This is particularly true of high-quality credit instruments and debt securities. While most organisations do not feel the "low credit risk" exemption is appropriate in relation to customer lending, there remains a disconnect between bank application and its usefulness either for management or for users. In addition, the relative approach means that it is not at all possible to compare between banks because individual assets will trigger SICR at different times.

- **Loans vs securities**: the model is applied to all amortised cost positions. In practice, users are primarily concerned with decisions on customer loans and are therefore far less interested in debt securities. As such, it is likely that simpler approaches could helpfully be applied to positions other than customer loans without detracting from the use and value of information and disclosure.

- **Definition of "significant"**: the IASB purposely set a principle-based model for the meaning of significant. One of the consequences of this is that there is no well-defined articulation of what a significant deterioration is and hence users struggle to understand the boundaries chosen by companies – this leads to assumptions that bank approaches are the same (and therefore misunderstanding actual choices) and confuses users as to whether changes in stage 2 balances are down to prudence or poor credit. In a UK context, a doubling of credit risk (in probability of default terms) is in general usage as a threshold for wholesale lending, but different approaches are used for retail positions. Improvements to SICR could be made to expand examples or

provide additional guidance around the meaning and intention of significant, taking advantage of the choices preparers have made in setting their boundaries:

1. To simplify the application and approach to non-customer balances that removes the need for so much judgment and reduces “noise” in reporting and early triggers on positions that remain fundamentally sound in credit risk terms. This also recognises that banks do not take different choices in exit for such positions – as such the identification of increased ECL for stage 2 cases does not represent useful or relevant information.
2. To align the consideration of thresholds for stage 2 more closely with credit stewardship and to acknowledge that absolute triggers are generally more meaningful than relative thresholds.

Other observations

- **Default:** For UK banks, default is most usually aligned to banking regulatory definitions meaning that there is little divergence in approach (especially now that PRA has removed exemptions to 90 days past due (DPD) model) and this appears to work well. The IASB could consider using banking regulatory definitions in guidance or educational material.

- **Backstop**: The backstop is the only broadly consistent measure, with 30 DPD or one month in arrears (1MIA) as the lagging trigger.

- **Range of stage 2 densities:** Judgement of probability of default thresholds, additional quantitative measures and qualitative triggers from firms means that we observe a wide range of stage 2 densities for the similar portfolios originated in a similar period and performing at a similar level.

- **Consistency through benchmarking only:** There is a significant amount of flexibility granted to firms by the IFRS 9 standard, although audit firms do try and gauge consistency through benchmarking and continuity of observation. Unless there is some further guidance in the IFRS 9 standard or auditing standards applied by audit firms, diversity in the interpretation and application is inevitable.

Question 4 – Measuring expected credit losses
(a) Are there fundamental questions (fatal flaws) about 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?

Fundamental flaws in measuring ECL

We do not believe there are fatal flaws for measuring ECLs but there are areas where improvements could be made. On each of the spotlight topics in the RfI, we provide the following comments where we believe further guidance from the IASB would be useful to improve more consistent application.

Forward-looking scenarios

This is a complex area. There is a distinct lack of detailed guidance in IFRS 9 on this topic that had meant that a broad range of different practices are being followed, even amongst those entities for whom the measurement of ECLs is fundamental and has led to inconsistency.

In terms of published disclosures, there is often little similarity between scenarios (other than the base case) used by different entities, who apply a broad range of possible approaches to determining their probability-weighted average of credit losses. Some entities use sophisticated Monte Carlo simulations while others use more discrete economic scenarios. For those entities who use the latter, the number of economic scenarios is varied (although normally within a range of 3 to 6 scenarios).

While some of these differences are due in part to the approaches applied by entities to their credit risk management and/or the differences in their underlying credit portfolios, the subject of forward-looking scenarios has become inherently more complicated and more pronounced where the economic data changes rapidly and the relationships between economic indicators are not static. This inevitably leads to different approaches and outcomes.

While we support that IFRS 9 should continue to be principles-based, it needs to accommodate these variations, some of the current approaches that entities have adopted (for example, the use of multiple economic scenarios or that loans cannot be split across stages). The Transition Resource Group for Impairment of Financial Instruments (ITG) dealt with core matters where the standard was either silent or unclear.

There is also a view that the use of multiple scenarios is in practice seeking to incorporate and explore the effects of significant downside scenarios in the probability weighted average calculation. We have seen the situation where paragraph 5.5.18 led to an entity deriving a loss scenario notwithstanding the credit risk was so low that the entity's own risk management processes would not have considered. We believe however the original aim was to explore non-linearity in the portfolios (as discussed in the ITG's December 2015 meeting).

We believe investors find the base case disclosures helpful however they struggle with the disclosures of other scenarios and in particular the downside scenarios as there is no consistency between entities.

We believe the IASB should consider incorporating into IFRS 9 some or all of the ITG comments/guidance into the standard. These comments, which filled the perceived gaps in the standard, would provide a sounder footing for the approaches being adopted in practice.

We also suggest the IASB considers additional requirements for disclosures of the sensitivities of the significant judgments in the base case. This would more closely align the standards with similar requirements for example, in IFRS 13 '*Fair Value Measurement*' and IAS 19 '*Employee Benefits*'. We would also suggest that there only needs to be disclosure of alternate scenarios where they explicitly explore and provide information on the risks of non-linearity in the portfolios.

We believe entities with complex credit portfolios may find themselves needing to produce and disclose multiple scenarios to understand the non-linearity in the portfolio. This may however help alleviate the burden on smaller and less complex entities.

Post-model adjustments (PMAs)

Since applying IFRS 9, ECL calculations for banks have incorporated PMAs, more significantly to deal with the impact of events including Covid-19, the war in Ukraine and the cost-of-living crisis.

We believe that there will always be a case for PMAs in ECL measurement. The extent to which they will be used in any one period will be determined by the extent to which future expectations can be modelled using past data, whether sufficient data exists to model losses (as with low default credit), or whether there is a sufficient cost benefit trade off to justify modelled over more simplified approaches.

Our perception is that the use of PMAs generally work well in the UK and there is little critical investor feedback on the disclosures that are made by UK banks. We believe this is due to the UK's disclosure regime, which is relatively well developed, largely because of the work of the DECL Taskforce which goes beyond the requirements of IFRS 7.

One possible area for the IASB to consider improving around PMAs is to improve disclosures. It is not always clear which parts of ECL disclosures PMAs have been applied against and which parts they have not. This is particularly the case for the sensitivity analysis and how PMAs react under the different scenarios.

We suspect this to be an area where investors may struggle. In many cases PMAs are in response to a specific fact pattern that is more often unique to the entity. The IASB could usefully consider the application of PMAs outside of the base case scenario in a way that could be made more understandable but without becoming overly onerous.

We suggest the IASB considers adding some additional clarification and/or guidance to indicate the disclosure requirements which cover key assumptions and the inputs that apply to PMAs. PMAs are another form of judgement that is made in measuring ECLs and, as such, there should be sufficient disclosure to understand the effect and impact of PMAs on the ECL calculation.

Off-balance sheet exposures

In practice entities including banks undertake their ECL calculation for their on-balance sheet exposures. The off-balance sheet element of any loan commitment is then assessed and recognised in accordance with IAS 37 '*Provisions, Contingent Liabilities and Contingent Assets*'. We do not believe there is necessarily a problem with the measurement of the ECL in respect of off-balance sheet exposures. The issue is more that the interaction of the two standards, IFRS 9 and IAS 37, is not perhaps as well understood as it could be, especially when firms produce ratios based on total ECL, irrespective of the fact that the related ECL exposure reside in two different places on the balance sheet.

We think it could be helpful for the IASB to consider providing further guidance on how to determine whether a financial guarantee (FG) contract is integral to a loan or not. In certain circumstances a financial guarantee could be considered integral to the originated loan, while in some cases the FG is not considered integral. Guidance would be useful as to when an FG would be considered integral and how to account for FGs that are not integral from the perspective of the holder of the FG.

Interaction between impairment and modifications

In addition to the spotlight topics, it would be helpful for the IASB to accelerate their EIR and modifications project to provide clarity on what a modification is, for when an instrument is

considered modified vs partially derecognised, and the interaction of these with the IFRS 9 impairment rules.

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?

We believe that both preparers and users would benefit from a simplification to the approaches to assessing trade receivables, as there is currently no guidance on how the users of financial statements should evaluate them.

We think the significant effort required to evaluate the allowance for inter-company receivables outweighs the marginal decision usefulness of that information to financial statement users, given the specific nature of the receivables. We note that the FASB specifically excluded intercompany receivables from the scope of CECL and would urge the IASB to consider doing something similar.

Question 6 – Purchased or originated credit-impaired financial assets

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

We would acknowledge and accept the comments in the background section to this question that the general approach to purchased or originated credit-impaired (POCI) financial assets was substantially carried forward from IAS 39. However, the staging criteria requirements of IFRS 9 and related disclosures under IFRS 7 brings greater prominence and heightened visibility of this complex area that can be challenging to articulate clearly to readers of annual reports.

Our response covers the following issues relating to:

a) ‘Purchased’ credit-impaired financial assets;
b) ‘Originated’ credit-impaired financial assets;
c) The acquisition of financial assets more generally; and
d) Inconsistency between day 1 recognition of stage 3 and stage 1 loans

a) ‘Purchased’ credit-impaired financial assets

As highlighted above, this is a complex area of accounting that has been given greater disclosure prominence under IFRS 9/IFRS 7. This is especially the case when considering the requirement to recognise the cumulative changes in lifetime expected credit losses since initial recognition (which is widely interpreted as the date the financial assets were acquired) as a loss allowance.

Explaining this difficult concept both internally and externally can be challenging and is perhaps an area the IASB could look to issue additional educational material to aid understanding, or perhaps spotlight the issue through one of the IASB’s ‘Investor Update’ publications. Either (or both) of these measures would be welcomed and greatly assist in clearly articulating the requirements.

As there is no prospect under IFRS 9 for 'purchased' credit-impaired assets to cure, they remain isolated under the 'POCI' heading until final derecognition which, depending on the nature of the financial assts acquired, means they could be held there for a significant period of time (mortgages are the obvious example of this).

We believe this could result in the relevance and value of disclosures reducing over time with operational complexities starting to outweigh potential disclosure benefits to users of the financial statements. We would ask the IASB to consider whether any 'cut-off' period would be beneficial – where the acquirer ceases to disclose these 'purchased' credit-impaired assets as POCI at a point in time (say 5 years post acquisition) with the financial assets and any resultant changes being subsumed into the Stage 3 portfolios. Disclosure of this would naturally have to be made in the period of change.

For example, a review of the latest available Annual Report and Accounts for the 8 lending institutions that are signatories to the UK Finance Code for Financial Reporting Disclosure highlighted that only some $28m of lending was classed and disclosed as originated credit impaired financial assets (these were debt securities and not customer lending related). Of those that disclosed POCI financial assets, the lending institution with the largest value of POCI financial assets (c.2% of gross lending at amortised cost and fair value through other comprehensive income) removed the POCI disclosure for underlying reporting purposes, to provide a better indication of the credit performance of the assets purchased as part of the acquisition.

We also note with interest the current FASB consultation on *Purchased Financial Assets*[1] which would see the use of the 'gross up method' in acquisitions being expanded beyond purchased financial assets with credit deterioration (the FASB equivalent of POCI). Under the proposals, an acquiror would record an ECL allowance at the date of acquisition with an offsetting entry to the asset's gross carrying amount. This 'gross up method' for POCI financial assets was considered by the IASB in the lead up to issuing IFRS 9 (see paragraphs BC5.219 – BC5.220 of the Basis for Conclusion document that accompanied the publication of IFRS 9) but the concept was rejected on the basis that POCI financial assets are initially recognised at fair value and that the gross-up for the loss allowance balance would result in a carrying amount above fair value. We understand and appreciate the IASB's view at that time; however, we believe there may be some merit in the IASB revisiting this decision in light of the experiences of firms in accounting for POCI financial assets over the past 5 years or so since the introduction of IFRS 9. It might be the case that using a 'gross up method' would be helpful and more easily understood as it places POCI financial assets on the same disclosure footing as all other financial assets.

b) 'Originated' credit-impaired financial assets

The practical experience of our members highlight that it is extremely rare for a firm to originate a credit-impaired financial asset outside of it being as a result of a modification; with the current guidance contained in IFRS 9 B5.5.25 – B5.5.27 relating solely to modifications and noting that this is only possible (i) where there are unusual circumstances following a modification; and (ii) it would need to be a substantial modification for the new financial asset to be classed as credit-impaired at origination.

[1] Prop ASU—Financial Instruments—Credit Losses (Topic 326)—Purchased Financial Assets (fasb.org)

For those firms that have assessed this high threshold to have been met and to consequently treat the new financial asset as POCI, the amounts involved have been immaterial and therefore not separately disclosed as POCI.

Consequently, we are unsure whether this separate category of 'originated' financial assets is relevant and ultimately useful to users of annual reports and believe it could be withdrawn with any relevant financial assets treated easily under the existing staging requirements of IFRS 9. This would in all probability result in the financial asset being placed in either Stage 2 or Stage 3 on origination, consistent with how the firm's view on how the financial asset is being managed for credit risk purposes.

Should the IASB continue with the separate category for 'originated' financial assets, we would ask that greater guidance and illustrative examples be added to IFRS 9 for firms to better understand the IASB's preferred treatment for these financial assets. We noted with interest at paragraph BC5.216 of the Basis for Conclusion document that accompanied the publication of IFRS 9, the Board did consider including an example in which a substantial modification of a distressed asset resulted in derecognition of the original financial asset and that it was possible for the modification to constitute objective evidence that the new asset is credit-impaired at initial recognition. No explanation was offered as to why this was rejected but it may have been a missed opportunity that would have benefited both preparers and users of financial statements.

c) The acquisition of financial assets in general

When a portfolio of financial assets has been acquired, either in isolation or as part of a business combination, and as stated earlier, it is generally accepted that the date of acquisition is taken as the 'new' origination date by the acquiring entity.

Those assets that are not POCI on acquisition (which by definition will be those acquired financial assets that were in Stages 1 and 2 of the acquired entity) are generally all regarded as being Stage 1 financial assets immediately on acquisition as there has been no observable significant increase in credit risk from origination (which is the date of acquisition). As such, a 12-month expected credit loss is booked on these financial assets that will have already been adjusted to their fair value as part of the acquisition process.

We are unsure whether this gives a faithful representation of the credit risk attached to the acquired financial assets as there will be a proportion of these that will migrate to Stage 2 in the month following acquisition (these will more likely than not represent the majority of the acquired Stage 2 population) as at the very least the 30 days past due backstop will have been reached and a lifetime expected credit loss calculation will be required. There is also the possibility that some of these original Stage 2 financial assets in the acquired entity would have moved into Stage 3 and be credit-impaired had the acquisition not taken place.

We believe this artificial delay in the recognition of lifetime expected credit losses is fundamentally at odds with the spirit behind IFRS 9 and its early recognition of expected credit losses.

With there being no scope within IFRS 9 to treat these acquired financial assets in any other way, we believe that IFRS 9 as currently written does not adequately reflect the economic reality of these acquired financial assets. We appreciate that some firms may conclude that the introduction of a management adjustment to increase the level of expected credit loss held against these financial assets is sufficient to address this issue but consider that this does not fully address the

fact that the financial assets would remain in Stage 1 and may distort the coverage ratio metrics that firms publish as part of their credit risk disclosures.

We therefore believe that the IASB should re-consider how these acquired financial assets are treated, with one possible solution being to allow the acquirer to use all reasonable and supportable information that was available at the acquisition date to determine the expected credit loss status of these non-credit impaired financial assets. It is probable that the majority of these acquired financial assets would continue to be classed as Stage 1 on acquisition. However, by allowing the acquiror this flexibility – backed up with some detailed disclosures on the rationale behind their conclusions – would, we believe, result in better quality information to the user of the financial statements and more faithfully represent the acquiror's true credit management strategy for those acquired financial assets that are or could be classed in Stage 2 or even Stage 3 on acquisition.

d) Inconsistency between day 1 recognition of stage 3 and stage 1 loans

Overall, we are not convinced POCI delivers what was intended and consider that POCI does not work. Given the inconsistent outcomes on initial recognition - impaired assets have no ECL whereas non-impaired assets do have ECL, we believe that the FASB's gross presentation, as discussed section a) above, is a better approach. We do consider that there is potentially a limited case for business acquisitions to apply a POCI style model but we think this degrades over time meaning the "permission" needs to be time bound, as we suggest in section b) above or removed altogether.

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

We would recommend the IASB consider interaction between IFRS 9 and other significant standards issued since then, including:

- **IFRS 17** '*Insurance contacts'*

- International Sustainability Standards Board **(ISSB) standards** IFRS S1 '*General Requirements for Disclosure of Sustainability-related Financial Information*' and IFRS S2 '*Climate-related Disclosures'*. Financial institutions and larger corporates are increasingly incorporating sustainability features. However, given the value-chain implications of sustainability and climate change considerations, there is a need for the IASB and ISSB to collaborate to undertake stakeholder outreach to identify inter-linkages and to provide guidance, examples and educational material.

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

We do not have any observations on the transition requirements set out in the standard.

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?

We do not consider that there are fundamental questions about the IFRS7 disclosure requirements (paragraphs 35A-38) and confirm our view that these should remain principle based, such that they are better able to reflect the credit risk management practices of each institution. The ultimate value of credit risk disclosures to entities, regulators, analysts and investors differs greatly depending on the type of industry/sector. That being said, we believe that the disclosures in their current format are more than adequate for the majority of businesses.

However, to promote greater consistency, additional educational guidance could be provided to supplement the existing requirement in IFRS7.35G(b) and (c) around the types of judgements and assumptions used in determining ECL that could be disclosed to meet this requirement. This would include the macroeconomic assumptions used and the period over which the forward-looking information has been provided and the type and amount of significant estimates included in the ECL, including judgemental post-model adjustments and other management adjustments.

In common with the proposed simplifications around the application of SICR, there should be more flexibility to provide less granular disclosure where ECL may not be material, for example for debt securities, intra-group lending and would support more educational guidance on the application of IFRS7.35D in this context to ensure disclosures remain proportionate.

We do not consider that the costs of applying the IFRS 7 disclosures were greater than expected. We are not aware of the impact on audit and enforcement. The IASB will be familiar with the work in the UK of DECL, who first reported in November 2018 (it should be noted that this first report was issued when IFRS 9 and the new credit risk disclosures under IFRS 7 had yet to experience a full annual reporting cycle), with subsequent updates provided in December 2019 and latterly September 2022. UK Finance members have been heavily involved in DECL since its inception and whilst the disclosure recommendations developed by the DECL Taskforce were comprehensive, these were primarily focussed on large, sophisticated financial institutions and therefore less suited to the set of generally applied, principles-based disclosures set out in IFRS 7. On that basis, other than as suggested above, we do not believe it would be appropriate for the IASB to consider adding any of the extended DECL credit risk disclosure requirements to a revised IFRS 7. Within the additional educational guidance referred to above, the IASB could make reference to DECL as an example of how some of the more sophisticated sectors have chosen to extend the required disclosures under IFRS 7.

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?

IFRS 9 ECL related considerations

We suggest that the IASB address the points below:

- The use of forward-looking information as a feature of the standard creates significant complexity and judgment and this this brings significant disclosure.

- While we believe the standard works generally for banks, it does not appear to be the case for the wider preparer community.

- Given the complexity and lack of understandability of IFRS 9, we would recommend IASB undertake simplifications as discussed in our responses above. Where simplification is not possible, the IASB should provide additional guidance and educational material to ameliorate.

Impact of procyclicality and cessation of banking regulatory transition relief on financial stability

The change in accounting standards from IAS 39 to IFRS 9 for measuring and reporting credit losses does not impact the overall amount of credit losses a bank incurs over time. However, it changes the timing of when those losses are recognised – bringing them forward.

The change in accounting recognition increases the amount of capital that banks need to hold:

- In normal / benign times credit provisions are larger than under the previous standard, reducing regulatory capital
- At the onset of a stress, additional credit provisions are taken based on a forward-looking view of the economic scenario. This depletes capital rapidly. To combat this, firms need to hold more capital in advance of the stress.

The Basel Committee recognised this capital impact of IFRS 9 and introduced a phased transitional relief in respect of banks' IFRS 9 credit provisions, by allowing these to be added back on a phased basis over 5 years. As Covid-19 significantly impacted the way that banks dealt with ECL, the Basel Committee amended the phasing of the regulatory transitional relief which will cease by the end of 2024; with the UK regulator exploring an enduring solution for beyond 2024. The procyclicality of IFRS 9 has significant implications for the banking industry, with sudden reductions in regulatory capital very likely to cause financial instability, even from an elevated start point. Without any form of regulatory capital relief, the potential for volatility in banks' CET1 capital in the early parts of even a mild stress due to increased IFRS 9 provisions is likely to increase the probability and speed of loss of confidence. We recommend that the IASB work with the Basel Committee to address this conundrum for the banking industry as the standard's procyclicality could have unintended consequences.