GDV
DIE DEUTSCHEN VERSICHERER

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Date
12.01.2022

Post-implementation Review of IFRS 9 *Financial Instruments*
– Classification and Measurement –
IASB's Request for Information (September 2021)

Dear Mr Barckow

On behalf of the German Insurance Association (GDV) we greatly appreciate the opportunity to contribute to the IASB's Post-implementation Review on IFRS 9 Financial Instruments, based on the Request for Information (RFI) document, released by the IASB on 30 September 2021 for the public consultation. We are fully supportive of the IASB's decision to focus this consultation on the classification and measurement of financial instruments only, while the issues related to the areas impairment and hedge accounting are envisaged to be subject of an additional review at a later stage.

As a matter of fact, we welcome all the activities undertaken by the IASB to thoroughly evaluate whether there is a need and potentially how to fine-tune classification and measurement principles of the standard.

- In general, from our current perspective the related classification and measurement requirements in the standard are working as intended. In our present assessment the core elements of the standard, (i.e., the business model assessment and the SPPI test) are robust enough to be applied consistently and to ensure faithful representation of most **debt instruments** the German insurers are currently investing in.
- Nevertheless, we continue to believe that the IASB should revisit the ban of **recycling for equities** accounted for at fair value through other comprehensive income (FVOCI). It would allow the transfer to profit or loss of gains and losses accumulated in other comprehensive income (OCI) on such instruments when realised. We acknowledge the need to complement the introduction of recycling with an impairment test for equities. In our response to Question 4 we provide a **proposal for a robust impairment model** which would be capable of being applied consistently and not complex to understand.

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- In the context of the recycling discussion, we also believe that the treatment of equity-like instruments should be reassessed likewise. Specifically, puttable instruments as defined in IAS 32 should not be excluded from the scope of the FVOCI option in IFRS 9. There is a need to fix and to properly align the accounting treatment for investments in **private equity** structures to achieve consistency between the issuers' perspective and the investors' perspective.
- Furthermore, we are fully aware of the numerous requests towards the IASB to approach urgently the accounting of **green bonds** and other **ESG-related debt instruments** at the standard setting level. We acknowledge these requests and recall that indeed this specific context had not been evaluated at the time the standard was developed. Hence, we would fully support the IASB evaluating whether the existing requirements of IFRS 9 can be applied in such a robust way that the faithful representation of such instruments can be ensured.

While being fully supportive of the European Green Deal and the related initiatives at EU level, we acknowledge however that defining what "ESG-related" means might be a very difficult task for the global standard setter to approach. We would not be supportive of providing huge number of detailed rules to the principles-based standard or to create a specific advantageous treatment of such instruments which would put in question the SPPI concept for debt instruments as such. Nevertheless, we are fully convinced that a thorough **timely analysis** of the existing standard requirements in this regard and potential constructive alternative approaches provided by interested stakeholders will enable the IASB to find a proper way of approaching the politically sensitive issue in a responsive and still principles-based way.

Finally, also in the context of this consultation we would like to highlight that any amendments to the standard should be combined with as a thorough analysis whether the potentially revised and amended guidance remains cost-effective for preparers and whether the benefits exceed related costs.

Our detailed responses to all the specific questions raised in the ED are provided in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,

German Insurance Association (GDV)

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Appendix

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.

Re a)

Yes, overall, we believe that the classification and measurement requirements in IFRS 9 enable reporting entities to align measurement of financial assets with the cash flow characteristics of the assets and how the entities manage them. Specifically, the business model assessment is essential in this regard.

Re b)

Yes, it is our assessment that, in general, the classification and measurement requirements in IFRS 9 lead to faithful representation and that they allow reporting entities to provide useful information to investors and other users of financial statements.

The main change for the German insurers introduced by IFRS 9 is the inability to account for financial instruments at FVOCI *with* recycling when they do not pass the SPPI test, although they obviously meet the business model condition (i.e., they are not held for trading purpose). In addition, we kindly refer to our detailed response to Question 4 where we explain why we believe that the accounting treatment of equity instruments in the scope of the FVOCI option and the accounting treatment of the private equity structures under IFRS 9 needs further and thorough reconsideration by the IASB.

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).

Re a)

Yes, from our perspective the business model approach is working as the Board intended and it supports reporting entities in providing useful information in their financial statements to investors and other users. We specifically support that the business model assessment does <u>not</u> depend on management's intentions for an individual financial instrument. It is indeed important that the business model assessment continues to be determined at a level of aggregation that reflects how the reporting entity manages portfolios of financial assets to achieve a business objective.

Hence, from our perspective no changes are necessary in this regard. It is inherent to the principles-based standard that assessing the busines model of financial assets requires a reporting entity to apply judgment. And this judgment allows an entity to consider all relevant evidence to make the necessary assessment.

Re b)

We consider the business model approach appropriate und the German insurers can apply the business model assessment consistently. We are not aware of any diversity in practice in this regard. We also believe that the application guidance already provided by the IASB is sufficient to make properly the distinction between the different business models as defined in the Standard.

Furthermore, we are fully supportive of existing conditions established for reclassification of financial assets after initial recognition and back the related initial Board's expectation that they would be met only on a rather rare occurrence of a significant event leading to a change in the business model for managing them. Hence, the currently existing conditions for subsequent reclassification are appropriate, they properly ensure the necessary level of consistency in accounting over time. And that aspect is specifically essential when considering the relevance of undistorted trend information for investors and other users of financial statements.

Re c)

We have been informed that the German insurers haven't experienced unexpected effects from the business model assessment so far. In this regard the standard is cost-effective from the perspective of reporting entities and provides useful information to investors and other users of financial statements.

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).

In general, we believe that (a) the **cash flow characteristics assessment** is working as intended by the IASB and that (b) it can be applied **consistently** in practice. It is an understandable and operational approach how the **simple debt instruments** can be identified whether they are eligible for the amortised cost accounting or for the FVOCI accounting, depending on the underlying business model under which the financial instruments are managed. And it is our understanding that the SPPI test is conducted in isolation, being not depended on the outcome of the business model assessment.

Nevertheless, we have been informed by our members about the following practical experience about some relevant cases in which the SPPI test is rather challenging to apply:

- For fund structures it is sometimes complicated to comply with the cash flow criteria, even if the business model is to collect solely payments of principal and interest, as the fund investment is only indirect and not always sufficient information are provided to fulfill the SPPI test. In such cases investors might consider rather direct investments in debt instruments if the SPPI test cannot be met for the fund investment.
- "Sukuk investments" (i.e., investments in Islamic bonds) are complicated when applying the SPPI test, as they do not lead to interest payments in legal perspective. But they often have the intention to provide similar cash flows to investors as simple debt instruments do. In particular, the ongoing payments might be expected to occur on specified dates and the date of final repayment used to be determinable for investors as well. It would be very helpful for reporting entities if an explicit clarification could be provided that in such specific and similar circumstances the SPPI test can be met when applying the substance over form principle to such investments.

Finally, we are fully aware of the numerous requests towards the IASB to approach urgently the accounting of **green bonds** and other **ESG-related debt instruments** at the standard setting level. We acknowledge these recent requests and recall that indeed this specific context had not been evaluated at the time the standard was developed. Hence, we would fully support the IASB evaluating whether the existing requirements of IFRS 9 can be applied in such a robust way that the faithful representation of such instruments is possible. Conducting such an **evaluation in a timely manner would demonstrate the IASB's responsiveness to this emerging topic** and would help to verify whether there is indeed a need for any standard setting activity or whether a kind of additional educational material might would be sufficient to clarify the issue of standard's application in such circumstances in a comprehensive manner.

From our perspective, while being fully supportive of the European Green Deal and the related important initiatives at EU level, we also acknowledge that defining what “ESG-related” means might be a very difficult task for the global standard setter to approach. And we would not be supportive of providing a huge number of detailed rules to the principles-based standard or to create a specific advantageous treatment of such instruments which would put in question the core SPPI concept for debt instruments as such.

Nevertheless, we are fully convinced that a **thorough timely conducted analysis of the existing standard requirements** in this regard and potential constructive alternative approaches provided by interested stakeholders in this consultation will enable the IASB to find a proper way of approaching and addressing the politically sensitive issue in a responsive and principles-based way. We believe that the agenda paper 3B for the July 2021 Board meeting (link) provides already a suitable starting point to advance such an analysis further.

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).

From the perspective of the German insurers, the option to present fair value changes on investments in equity instruments in other comprehensive income (**FVOCI option**) is **fully supported but it requires a targeted amendment** to achieve a proper accounting treatment of such investments which are not held for trading. Our rationale is as follows:

- We like to highlight our strong agreement with the view that the default requirement to account for all equity instruments at fair value through profit or loss (FVPL) is not appropriate to reflect the business model of investors being capable of holding their investments for long-term.

- Therefore, we **fully support the FVOCI option** in IFRS 9 for investments in equity instruments not held for trading.
- **However**, the existing requirements in IFRS 9 do not allow for an adequate depiction of the financial performance of long-term oriented investors like insurers in their profit or loss statement, specifically when such investments in equity instruments accounted for at FVOCI are derecognised and the related gains or losses are realised.
- While the dividend payments are recognised in profit or loss on ongoing basis, the cumulative gains or losses are prohibited from being recognised in profit or loss when the related investments are derecognised at their disposal. This way a **significant part of financial performance** of insurers' investments in equity instruments is not reported in the profit or loss statement, though recognising gains and losses on equity investments accounted for at FVOCI would give investors and other users of financial statements direct access to information about the **economically motivated** disinvestments decisions made by a reporting entity and would thus put investors in a better position to assess the stewardship of the management.
- Hence, it is our firm view that the current treatment of realised gains or losses creates a significant **deficiency** of IFRS 9. And, as a matter of principle, the disclosure requirements in IFRS 7.11A-11B cannot remove the need to address this key accounting issue with IFRS 9.
- This deficiency in IFRS 9 causes also an **accounting disadvantage** for all investments in **equity instruments** eligible for the FVOCI option. And the removal of the recycling ban would restate **symmetry** with the accounting treatment of **debt instruments** when accounted for at FVOCI.
- Indeed, and in line with the **Conceptual Framework** income and expenses included in OCI in one period should be reclassified into profit or loss in a future period when doing so results in the profit or loss statement providing more relevant information or providing a more faithful representation of the entity's financial performance for that future period.
- As explained above, it is our view that including all fair value changes in profit or loss via FVPL treatment would create a market noise in it, and it would overshadow the real underlying economic performance. Hence, the full fair value accounting does not lead to providing relevant information about the stable and long-term oriented business model of insurers to investors and other users of financial statements.
- At the same time, **omitting realised capital gains or losses** on investments in equity instruments **is not leading to a more faithful representation** of the entity's financial performance in the profit or loss statement in the period of the disposal/derecognition.

- In our assessment the **time of disposal is a valid basis** for identifying the period in which reclassification would have to occur. And the **amount to be reclassified can be easily and properly determined** with reference to the underlying investment being disposed. In addition, we observe that IFRS 7 requires already disclosures about the investments for which the FVOCI option is exercised and about the reasons for disposing of the investments if any, including the related cumulative gain or loss in such a case.
- Finally, based on our detailed rationale provided above, we respectfully don't support that the standard setting should be based on the need to prevent a perceived possibility to create opportunities for earnings management (RFI document, page 18). Any disposal of significant investments in equity instruments is always a significant **economically** motivated **disinvestment decision** of the management, on many occasions driven by the capital (reallocation) needs of the reporting entity when facing changes in external environment and/or triggered by asset-liability-management considerations as typically the case for the insurance industry.
- That's why we continue to have the strong view that the current **recycling ban** on equities accounted for at FVOCI **should be abolished**. The mandatory reclassification of realised gains or losses from the OCI to profit or loss statement at the time of disposal would be a comprehensible approach, straightforward to operationalise and easily to understand for investors and other users of financial statements.
- Recycling of realised gains or losses for investments in debt and equity instruments would increase consistency in accounting outcomes on financial instruments side, but also lead to a better alignment with the requirements of IFRS 17 Insurance Contracts.
- If the recycling issue is not addressed by the IASB, the FVOCI option would remain less attractive for insurers and IFRS 9 would continue to create a significant disadvantage for insurers' investments in equity instruments not held for trading.

Summing up, for all these reasons above we urge the IASB to approach and revisit the ban of **recycling for investments in equity instruments** accounted for at FVOCI expeditiously as recommended by EFRAG in its advice to the European Commission of 30 January 2020 (link). The realised **gains and losses** accumulated in the OCI on such investments should be transferred to profit or loss statement at the time of their realisation/disposal.

As a matter of fact, the German insurers are keen to apply the irrevocable FVOCI option for equity instruments with recycling to the extent possible. Its adoption would allow to consistently align the accounting treatment for all equities not held for trading with the underlying distinct business model of insurers and with the existing accounting models for (re)insurance

contracts in IFRS 17 Insurance Contracts. The standard provides an OCI option as well and we continue to be strongly supportive of its existence. The currently existing FVOCI option for equity instruments without recycling in IFRS 9 is less attractive to insurers and is going to be used to the extent reasonable in the entity-specific circumstances, as it is the only accounting alternative currently available in IFRS 9 instead of the FVPL approach, but its use will certainly create a need for additional measures for external and internal reporting and steering purposes to address the implications of the ban of recycling on performance reported in the profit or loss statement.[1]

An impairment model for equities accounted for at FVOCI – A proposal

In the paragraphs above we have provided the detailed rationale why the German insurers continue to strongly believe that the recycling should be introduced to amend the FVOCI option for equity instruments and why this amendment is absolutely essential to properly portray the performance of insurers, when investing in equity instruments not held for trading.

Nevertheless, we also fully acknowledge the need to complement the introduction of the recycling with an impairment model for equities. Hence, below we provide a **ready-to-use proposal for a robust impairment model** which would be capable of being applied consistently and without discretion. It would not be complex to understand and would provide comparable results for investors and other users of financial statements.

- Acknowledging the criticism regarding the impairment model for equity instruments under IAS 39 we would like to recommend an impairment model which is neither complex to apply nor to understand. Hence, we suggest including **rebuttable quantitative impairment triggers** in an impairment model for FVOCI equites in IFRS 9.
- The impairment would be assumed and recognised in profit or loss for an equity investment at the reporting date if either its current fair value is more than **20 %** below the acquisition cost or its current far value has remained below the acquisition cost for **more than the last 9 consecutive months**.

[1] The GDV provides in its digital Statistical Yearbook 2021 (> link) the currently available data also about the composition of the investment portfolio of the German insurance industry. According to Tables 15 and 16, the equity investments of the primary insurers add up for 2020 to € 194.1 bn (€ 76.5 bn in shares + € 117.6 bn in participating interests, including investments in affiliated companies). It represents 12.9 % of the total investments of the primary insurers. For the reinsurance companies the total equity investments add up to € 138.8 bn (€ 2.4 bn + € 136,4 bn). It represents 53.3 % of the total investment portfolio of reinsurance companies for 2019 (Table 93). Please note that the statistics provided in the Yearbook cover the German insurance industry as a whole, irrespective of the accounting regime applied (IFRS or the German GAAP).

- Such a simple rule-based impairment model with the **objective criteria** would lead directly to a common understanding what 'significant' or 'prolonged' decline in fair value of an equity instrument means and being a disciplined one it would safeguard a consistent practice that such falls in the fair value are generally reflected in the profit or loss statement.
- In addition, it could be clarified by the IASB that the suggested impairment triggers could be rebutted in rare circumstances only.
- That's why we believe that such an approach would also contribute to increased **comparability** of financial statements, providing relevant information about recognised impairments in equity investments, currently not presented in the profit or loss statement under IFRS 9.
- From **operational** perspective there would be little change to the current practice under IAS 39 because the suggested rule would reflect how the reporting entities used to operationalise the *significant-or-prolong*-principle when applying the IAS 39's impairment model.
- However, we also believe that this recommended rule-based impairment model for equities in IFRS 9 should be accompanied by **reversals** to be recognised in the profit or loss statement if the fair value recovers subsequently, to the extent the impairment loss was previously recognised in profit or loss. The principle "*once impaired, always impaired*" does not reflect the economic reality properly and it would create again a problematic asymmetric treatment of decreases and increases in the fair value of equity instruments.

Summing up, the suggested simple rule-based impairment model is intended to address the Board's and other stakeholders' concerns regarding complexity, non-consistent application and missing comparability as raised in the past regarding the impairment approach for equities in the available-for-sale category in IAS 39.

Private equity issue – a proposal for an alignment of IFRS 9 and IAS 32

In the paragraphs above we have provided our detailed rationale why we continue to argue in favour of the introduction of mandatory recycling for direct investments in equity instruments.

Nevertheless, an additional important aspect of the discussion should be the topic of a similar treatment of economically similar positions. The German insurers engage increasingly in **private equity investments**, for example in infrastructure projects, via the legal form of a limited partnership. While for the purpose of IAS 32 the presentation at the issuer's side as equity can be achieved via the 'puttable instruments exemption', for the purpose of IFRS 9 those investments are considered to be debt instruments and have to be accounted for at the FVPL since these investments would

not meet the SPPI test. And, as they are considered to be debt instruments, they are also not eligible for the FVOCI option for equity instruments not held for trading.

As it is generally known this outcome has been explicitly clarified by the IFRS Interpretation Committee in its Agenda Decision of 12 September 2017 (> link). While this Committee's interpretation is in line with the current standards' requirements, this result is a highly **problematic** one as it is suitable to create inappropriate volatility in profit and loss of investors affected. In particular, the accounting outcome for such investments is not consistent with the long-term nature of these important engagements.

- We believe that these unfortune situation can be overcome with a narrow-scope amendment to IFRS 9. It would be sufficient to explicitly clarify that those puttable instruments - as currently already defined in IAS 32 for the purpose of the presentation as equity in issuers' accounts - are in the scope of the FVOCI option for equites not held for trading in IFRS 9.
- Such an explicit referencing link in IFRS 9 to IAS 32 would ensure a consistent alignment between the accounting treatment on the investors' side with the issuer's accounting treatment.
- Such an alignment would also ensure that direct equity investments and debt investments and the investments via the private equity structures - based for example on the legal form of limited partnerships - are not treated differently for accounting purposes in investors' accounts, after the recycling is required also for direct equity investments as recommend above.
- We believe that the private equity investments can be subject to the same impairment approach as suggested above for direct equity investments. Hence, no different treatment needs to be developed.

Summing up, also the private equity investments require an appropriate accounting treatment under IFRS 9, in line with its long-term nature. Hence, such engagements should be eligible for the scope of the FVOCI option in IFRS 9, including the recycling at the point in time of their derecognition, and subject to the same impairment approach as outlined above for the direct equity investments.

Summary

The German insurers are not seeking to fundamentally reopen and revise the standard IFRS 9 and its core design regarding the classification and measurement principles. Nevertheless, we believe that the specific concerns of the insurance industry regarding the existing accounting disadvantage for FVOCI equity instruments should be approached by the IASB properly and without any further undue delay.

Not introducing recycling for the FVOCI equites and keeping the status quo would be absolutely not an adequate approach to respond to the concerns identified already in the EFRAG's final endorsement advice on IFRS 9 of 15 September 2015 (> link) and reinforced in the EFRAG's technical advice to the European Commission recently again on 30 January 2020 (> link).

We are fully convinced that allowing for recycling for the eligible investments in **equity instruments** and in **private equity structures** would improve the sustainability of the financing sources for the economy at large via enhancing the scale of long-term equity financing which insurers and other long-term institutional investors are able to provide on a stable and sustainable basis. And an equal treatment of direct equity, private equity and debt investments would contribute to this objective even further. In addition, it would increase the **conceptual consistency** of accounting outcomes under IFRS 9 at large.

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.

We have been informed by our GDV members that there are cases, in which it might be difficult to present the own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income (OCI), as the components of the instrument are closely interwoven and cannot be isolated easily.

- This is especially true for contracts the fair value option is applied on, that contain one or more embedded derivatives to be separated that cannot be measured reliably. In this case, the whole instrument is designated at fair value through profit or loss to provide more useful and reliable information to investors and other users of financial statements.

- For such contracts, an isolated view on own credit risk without consideration of the interaction with the other components is difficult and may not result in the desired presentation. Moreover, as paragraph 2 of IFRS 13 defines the fair value as an exit price (including own credit risk), from our perspective, it would be more appropriate to recognise own credit risk in profit or loss as well.

We recommend the IASB to consider allowing an option in this regard which would address such circumstances.

Question 6 – Modification to contractual cash flows

(a) Are the requirements for modification to contractual cash flow 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 modification to contractual cash flow 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.

From our perspective the current requirements for modifications work very well and can be applied consistently to financial assets and financial liabilities. We would support the explicit introduction of the requirements for financial liabilities as well for financial assets.

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 flow** (see Spotlight 7).

We believe that the effective interest method is working as the IASB intended and that it can be applied consistently. Hence, it results in reporting entities providing useful and comparable information for investors and other users of financial statement.

Regarding the treatment of debt instruments with ESG-characteristics in this context we kindly refer to our response to Question 3.

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?

In general, we believe that the transition requirements in IFRS 9 are working as intend by the IASB at that time. However, they have been developed in isolation for financial instruments only and specifically without a full consideration of their inherent interaction with IFRS 17 Insurance Contracts when applying for the first time.

In this context the German insurers greatly appreciate the **responsiveness of the IASB** which in the meantime effectively addressed the critical transitional issues identified by the insurance industry in this regard. The narrow-scope amendment to IFRS 17, developed by the IASB in a pragmatic targeted way and on a timely basis, has been proposed on 28 July 2021 for the public consultation over the summer break. The fine-tuned amendments had been approved by the Board on 28 October 2021 and ultimately released on 9 December 2021. The amendments to IFRS 17, currently subject to the EU endorsement process, has created the very much needed one-time relief and the classification overlay approach properly addresses the 'comparatives issue' from the operational and conceptual perspective.

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 would like to provide the following comment on the concern about the treatment of financial guaranties from the perspective of insurance industry:

- In contrast to the issuer of financial guarantees, the holder of a financial guarantee is currently **not** allowed to account for financial guarantees received under IFRS 4/IFRS 17. Especially for insurance companies this different treatment of received and issued financial guarantees may result in an accounting mismatch, for example in the case of a reinsurance contract (e.g., retrocession, fronting or similar contracts).
- Therefore, we like to recommend that for companies accounting for financial guarantees issued under IFRS 4/IFRS 17 the alternative treatment under IFRS 4/IFRS 17 should also be allowed for financial guarantees received to prevent such an accounting mismatch.
- Our **recommendation** is that - similarly to the option already existent in IFRS 9 and IFRS 17 regarding the treatment of financial guarantees on issuers' side - a irrevocable choice should be established in an explicit way on the holders' side, irrespective whether the financial guarantee received constitutes a reinsurance contract or not. We acknowledge that a narrow-scope amendment solely to the scope of IFRS 9 and IFRS 17 might be necessary in this regard.

Our rationale in some more detail:

Generally, financial guarantee contracts at the **issuers' side** are in the scope of IFRS 9 (IFRS 9.B2.5). For financial guarantee contracts, that meet the definition of an insurance contract **the issuer can choose** between a treatment according to IFRS 9 or to IFRS 17 if the issuer has a past practice

of doing so and has explicitly asserted that such contracts are regarded as insurance contracts (IFRS 17.7(e), IFRS 9.B2.5(a)). Hence, the issuer can determine the accounting treatment for each contract individually. However, such a determination is irrevocable (IFRS 9.2.1(e), IFRS 17.7(e)).

In case of insurers the option to apply IFRS 17 is going to be exercised to the extent possible as it will allow to follow a **consistent accounting approach** aligned with (re)insurance contracts accounting issued.

Furthermore, the **definition of a financial guarantee is the same for both**, the holder, and the issuer.

- However, **financial guarantee contracts held are not in scope of IFRS 9** and should be accounted for according to IAS 37 (Amendments to International Reporting Standards, IAS 39 & IFRS 4, August 2005, IN6, IFRS 9.BC2.17).
- Different from a treatment according to IAS 37, there is a **scope exemption** for the accounting of financial guarantees received. Financial **guarantees received that constitute a reinsurance contract are accounted for according to IFRS 17** instead according to IAS 37 (IFRS 17.3, IFRS 17.BC66).
- However, **for contracts that are not insurance contracts**, the **holder of a financial guarantee** is currently not allowed to account for financial guarantees received under IFRS 4/IFRS 17, differently to the issuer of financial guarantees.
- In case of insurance companies this **unaligned different treatment** of received and issued financial guarantees would result in an **accounting mismatch** if IFRS 17 was not applied to financial guarantees held. And the occurring accounting mismatches (e.g., in case of retrocession, fronting or similar contracts) might be significant because of different measurement approaches being followed.

Therefore, we believe that specifically for financial guarantees issued being reinsurance contracts according to IFRS 4/IFRS 17, the treatment of financial guarantees received according to IFRS 4/IFRS 17 should also be permitted to prevent such an accounting mismatch.

Summing up, to achieve the important objective of an overall aligned and consistent accounting treatment for insurance industry and to overcome the threat of potentially significant accounting mismatches in the cases affected, we kindly recommend that financial guarantees received should be allowed to be accounted for applying IFRS 17 if the guarantee holder chooses to regard/classify such financial guarantees as reinsurance contracts held and applies accounting applicable to reinsurance contracts held in IFRS 17, specifically with the objective to avoid or reduce accounting mismatches.