Grupo Latinoamericano de Emisores de Normas de Información Financiera

Group of Latin American Accounting Standard Setters

January 24, 2022

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

RE: Request for Information (RFI) on PIR of IFRS 9

Dear members of the Board:

The "Group of Latin American Accounting Standard Setters"[1] – GLASS welcomes the opportunity to comment on the Request for Information on the Post-implementation Review of IFRS 9, on Classification and Measurement (the RFI).

This response includes the comments obtained by the members of the different countries that comprise GLASS, pursuant to the following due process.

Due process

The discussions regarding the RFI were held within a specified Technical Working Group (TWG) created in November 2021. All country members had the opportunity to designate at least one member to participate in this TWG. Each standard setter represented in the TWG carried out different tasks in their respective countries (for example, outreach, surveys, internal working groups). All results were documented and served as the platform for the TWG discussion process.

The TWG discussed the different points of view received through virtual conferences. In those conferences, the TWG developed a final document based on the technical points of view received. Finally, the TWG document was submitted to the GLASS Board, who discussed and approved it.

Overall comments

GLASS has concluded that in general there were no significant problems in applying the requirements of IFRS 9 regarding classification and measurement. Some particular problems were observed, which are commented in the attachment where the specific questions in the RFI are answered.

[1] The overall objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions with respect to all Exposure Drafts issued by the IASB, Requests for Information and Discussion Papers, and to generate proposals originated from the regional initiatives. Therefore, GLASS aims to have a unified regional opinion before the IASB. GLASS is constituted by: Argentina (Chairman), Bolivia, Brazil (Vice Chairman), Chile (Board), Colombia (Board), Costa Rica (Board), Dominican Republic, Ecuador, Guatemala, Honduras, Mexico (Board), Panama, Paraguay, Peru (Board), Uruguay (Board) and Venezuela (Board).

Specific Comments

Attached please find our specific responses to the questions presented in the RFI.

Contact

If you have any questions about our comments, please contact glenif@glenif.org.

Sincerely yours,

Jorge José Gil
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

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.

The consensus reached by GLASS is that:

a) The classification and measurement requirements of IFRS 9 allow entities to align the measurement of their financial assets with their cash flow characteristics and in accordance with the business model used by management. Even though no significant changes were observed for many entities (especially those that have assets recognized at amortized cost), the changes have allowed a better description of the nature of the financial assets in accordance with the contractual cash flow characteristics and the strategy under which they are managed. There has been a major challenge in banks to define their different business models, mainly due to sporadic sales of instruments measured at amortized cost. In some cases, there are sporadic sales not only due to credit risk issues, but also due to market opportunities to realize capital gains in the short term due to the volatility in the price of certain instruments.

b) Also, the requirements of IFRS 9 reasonably provide useful information to the users of the financial statements on the amount, timing and uncertainty of future cash flows.

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.

(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).

GLASS observed that:

a) In general, the business model assessment is working as the Board intended. There was a request to include some clarification on financial instruments that qualify as solely payments of principal and interest (SPPI) and which are due in a very short term. Since due to their short term there is no market for them, these are usually measured at amortized cost. Also, not all entities (especially those that are not listed or in the financial sector) have robust government and documentation of their business models to generate cash flows from their assets and classify them in the corresponding category. It was considered that a simplified approach would be required for SMEs.

b) Comments were received indicating that there is no definition of "very infrequent" and "significant to the entity's operations" to determine if there was a change in the business model. As a result, what other IFRS prescribe is applied by analogy, which can lead to a wide range of interpretations and diversity in practice. The IFRS focuses more on credit risk than on market risk when it refers to sporadic sales. When opportunities arise to realize capital gains in the short term due to market volatility, some entities have found it difficult to distinguish sales due to volatility from those related to credit risk.

c) We received a comment indicating that the Board should consider some flexibility in the reclassification requirements for financial assets in markets that show significant volatility and where the expected scenarios have more unfavorable or necessary cases, since abrupt changes in economic conditions may lead to a change in the business model. Also, financial institutions may develop new products, which even if they appear similar to previously developed products, may be better classified in another category. In addition, entities may modify their products, policies and business model due to

events that affect their cash flows and may collect instruments that were previously held to collect principal and interest. Therefore, it would be convenient to have a clearer explanation in the standard regarding how these changes affect the business model and the classification of financial assets.

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).

GLASS observed the following issues:

a) There are issues regarding inflation, which is common in the countries of our region. In many cases principal and interest are inflation adjusted to yield a "real" interest rate, and it has been questioned whether that results in leveraging that would cause loss of the characteristic of SPPI for the financial instrument such that it no longer be measured at amortized cost but rather at fair value. Additional guidance on this issue supporting the use of amortized cost would be useful.

   IFRS 9 includes an example of an instrument to be measured at amortized cost, which can be prepaid by the debtor, with a reasonable compensation for the prepayment. However, there is no explanation of what is considered to be "reasonable compensation". Guidance is suggested.

b) There is a problem for the holder of a financial instrument in two currencies when evaluating the cash flows, since the instrument may establish that interest is determined in a foreign currency at an interest rate applicable to that currency, or on the local currency at the interest rate applicable to local currency, whichever is higher.

   Regarding financial instruments payable with an interest rate linked to sustainability indicators, there could be variability in the interest rate and each entity must consider whether there is an embedded derivative that must be recognized separately or whether it is closely related so that the whole instrument must be measured at fair value. Guidance is required.

c) No cases were observed regarding unexpected effects arising from the cash flow characteristics assessment.

Question 4—Equity instruments and other comprehensive income

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

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

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

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

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

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

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

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

The responses received by GLASS indicated that:

a) The option to present fair value changes for investments in equity instruments in OCI as the Board intended is used very little in the countries in the region.

b) Due to the above, it was not possible to determine for what type of equity instruments are entities electing to present fair value changes in OCI.

c) In the majority of the cases, the effects of measuring investments in equity instruments are recognized in profit and loss. It is questioned whether the effects recognized in OCI should be recycled, and in some countries the regulator has not issued guidance.

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.

The responses received by GLASS indicated that:

a) It is not common for liabilities to be measured at fair value and that the effect of own credit risk be presented in OCI. One country indicated that the local regulator does not allow liabilities to be measured at fair value. Another country indicated that greater coherence would be attained by allowing all liabilities to be recognized at fair value and not only those designated since their initial recognition.

b) It was indicated that in the majority of the cases when liabilities are measured at fair value all of the effects are recognized in profit and loss.

Question 6—Modifications to contractual cash flows

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

Please explain what changes you consider to be modifications of a financial asset for the purpose of applying paragraph 5.4.3 of IFRS 9 and as a modification of a financial liability for the purpose of applying paragraph 3.3.2 of IFRS 9. Does the application of those paragraphs, and the disclosure requirements related to modifications, result in useful information for users of financial statements?

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

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

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

GLASS received the following comments:

a) One country indicates that, to attain better consistency and comparability, it would be beneficial to include in the standard more guidelines (both qualitative and quantitative)

to be able to identify the situations in which the entity would be facing a substantive modification of the cash flows of a financial asset, which would require derecognition. At the present time, the rule of a variation of 10% or more than in future cash flows of financial liabilities is applied by analogy to the financial assets. More guidance would be required thereon.

The responses of another country indicate that it is a question of judgment to determine when the financial asset or financial liability is extinguished for accounting purposes and a new one arises, requiring that all of the costs incurred when issuing the financial instrument be applied to profit and loss; this generates diversity in practice.

b) One country indicates that several banks have elected to consider that the restructurings of all small loans are extinguishments, and an analysis of future cash flows using the original interest rate is made only for major loans. For many loans the interest rate has been renegotiated due to the general reduction of interest rates in the market and, in such case, the original rate is considered to continue to exist. When implementing programs to support customers due to the pandemic, the effect of the interest on payments that were deferred was computed and reflected in profit and loss. Another country indicates that illustrative examples would be helpful.

Question 7—Amortized cost and the effective interest method

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

Please explain what changes you consider to be modifications of a financial asset for the purpose of applying paragraph 5.4.3 of IFRS 9 and as a modification of a financial liability for the purpose of applying paragraph 3.3.2 of IFRS 9. Does the application of those paragraphs, and the disclosure requirements related to modifications, result in useful information for users of financial statements?

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

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

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

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

The responses received by GLASS indicate that:

a) The application of the requirements in the standard results in useful information for the users of the financial statements about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest rate method. Nevertheless, entities have had to develop systems and procedures to compute the effective interest rate and its application. This required significant effort and the involvement of people of diverse backgrounds, including in some cases external consultants.

b) In general, the effective interest method could be consistently applied.

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?

The responses received by GLASS indicated that:

a) No problems were observed in the transition to IFRS 9. In some countries transition is still pending the implementation locally by banks, and no problems have been observed. Those banks that have already implemented IFRS 9 for reporting to a foreign parent bank did not face significant problems.

b) There were difficulties due to a lack of technical knowledge of employees, which required training, and existing systems had to be modified or new software acquired, generating additional costs for the entities. There were also difficulties due to a lack of observable information to apply the hierarchies of fair value.

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?

The responses received by GLASS did not indicate any additional problems. In one country that became hyperinflationary, problems were reported in applying IFRS 9 as well as other IFRS, due to the recognition of the effects of inflation.