

## PUBLIC STATEMENT

### ESMA promotes transparency regarding the accounting for the third series of the ECB's Targeted Longer-Term Refinancing Operations (TLTRO III)

ESMA is issuing this Public Statement with regard to the disclosures of significant accounting policies and significant judgements related to the third series of the ECB's Targeted Longer-Term Refinancing Operations (TLTRO III)<sup>1</sup> in the financial statements of banks prepared in accordance with IFRS Standards.

The third TLTRO programme consists of ten refinancing operations, each with a maturity of three years, starting in September 2019 with a quarterly frequency. During 2020, some of the transaction parameters were modified to support the continued access of businesses and households to bank credit in the face of disruptions and temporary funding shortages associated with the COVID-19 pandemic. According to the modified terms, borrowing rates in these operations can be as low as 50 basis points below the average interest rate on the deposit facility<sup>2</sup> over the period from 24 June 2020 to 23 June 2022, and as low as the average interest rate on the deposit facility during the rest of the life of the respective TLTRO III transaction.

The borrowing rate to be applied is linked to the lending patterns of the participating banks. The reduced interest rate is subject to the achievement of predefined lending performance thresholds. Interest will be settled in arrears on the maturity of each TLTRO III operation or on early repayment.

ESMA observes that in practice there is diversity regarding the accounting treatment of the TLTRO III refinancing transactions by banks. More specifically, the observed diversity relates to the assessment of banks as to:

- whether the transactions involve loans at a below-market interest rate and, if so, whether the advantage of the below-market rate of interest needs to be accounted for according to the requirements of IFRS 9, *Financial Instruments*, or IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*;<sup>3</sup>
- whether the changes in estimates of payments due to revised assessment of meeting the eligibility criteria (i.e. achievement of predefined lending performance thresholds)

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<sup>1</sup> For details on the terms of the TLTRO III operations see information published on the ECB's website: <https://www.ecb.europa.eu/mopo/implement/omo/tltro/html/index.en.html> and [https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr201210\\_1~e8e95af01c.en.html](https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr201210_1~e8e95af01c.en.html).

<sup>2</sup> Subject to the cap of -100 bps.

<sup>3</sup> In scope of IAS 20 are loans at a below-market rate of interest obtained from a government, as defined in IAS 20.

are accounted for in accordance with paragraph B5.4.6 of IFRS 9, requiring recalculation of the amortised cost of the financial liability; and

- how to calculate the applicable effective interest rate.

Given the overall volume of the TLTRO III operations, ESMA believes that this matter may have a material effect on the financial statements of banks and may be widespread across the EU.

Therefore, ESMA emphasises the importance of providing an adequate level of transparency regarding the accounting treatment of these transactions in the financial statements of banks. In particular, ESMA recommends that the affected banks provide entity-specific disclosures of the significant accounting policies and of the significant judgements and assumptions related to the TLTRO III transactions as required by paragraphs 117 and 122 of IAS 1, *Presentation of Financial Statements*, addressing in particular:

- the basis for the assessment of whether the transactions qualify as loans at a below-market rate of interest;
- the methodology applied to the calculation of the effective interest rate(s); and
- any changes in estimates of payments due to revised assessment of meeting the eligibility criteria.

In addition, in the case where the bank concludes that the interest rate is a below-market rate of interest and the benefit of the below-market rate of interest is accounted for according to the requirements of IAS 20, ESMA recommends that the following matters be disclosed:

- the basis for concluding that the TLTRO III transactions qualify as a loan from a government the benefit of which is treated as a government grant;
- the nature of the costs which the grant is intended to compensate for and the periods, if any, in which the bank recognises as expenses those costs as well as the basis for such recognition.

Furthermore, in order to comply with paragraph 31 of IFRS 7, *Financial Instruments Disclosures*, which requires the disclosure of information about risks arising from financial instruments, ESMA recommends providing transparency on banks' assessment of the possible achievement of conditions or covenants attached to the TLTRO III loans (e.g. achievement of lending performance thresholds).

Finally, ESMA highlights that according to paragraph 7 of IFRS 7, banks shall disclose information that enables users of the financial statements to evaluate the significance of financial instruments for the financial position and performance of banks. ESMA believes that disclosing the carrying amount of TLTRO III liabilities at the end of the reporting period and the related interest expense is consistent with that objective.

It should be noted that, in the immediate future, ESMA intends to submit questions related to this matter to the IFRS Interpretations Committee for consideration.