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Amendments to the Classification and Measurement of Financial Instruments
Project update

Objective

1 To provide the EFRAG FRB members with an update on the forthcoming Exposure Draft for the IASB *Amendments to the Classification and Measurement of Financial Instruments* project as well as the reaction from EFRAG FR TEG and EFRAG Working Groups.

Background of the IASB project

2 In May 2022, in the context of the post-implementation review (PIR) of IFRS 9 *Financial instruments – Classification and Measurement*, respondents raised many questions about how to apply the 'solely payments of principal and interest' (SPPI) requirements to financial assets with ESG-linked features, and about the scope of the requirements for contractually-linked instruments (CLIs). Therefore, the IASB decided to start a standard-setting project to clarify particular aspects of the IFRS 9 requirements for assessing a financial asset's contractual cash flow characteristics and to provide further guidance relating to financial assets with non-recourse features and CLIs (AP3).

3 In June 2022, the IASB discussed the objective, scope and indicative timetable for the project (AP16). The objective is to make clarifying amendments to the application guidance in paragraphs B4.1.7 to B4.1.26 of IFRS 9 to enable the consistent application of the SPPI requirements and to consider whether additional disclosure requirements are needed.

4 In July 2022, the IASB had initial discussions on the IASB staff's preliminary analysis on the concepts of basic lending arrangement and nature of a contingent event (AP16A). In addition, the IASB had initial discussions on the IASB staff analysis of financial assets with non-recourse features and contractually CLIs (AP16B).

5 In September 2022, the IASB tentatively decided in line with the IASB staff's recommendations to clarify the contractual cash flow characteristics requirements in IFRS 9 (AP16A), the application of the SPPI requirements in IFRS 9 to financial assets with non-recourse features and the requirements in IFRS 9 for contractually linked instruments – CLIs (AP16B).

6 In its October 2022 meeting, the IASB agreed with the IASB staff's recommendations for proposed disclosure requirements and relating to the transition and effective date (AP16).

7 In addition, the IASB considered feedback on the requirements in IFRS 9 relating to equity instruments for which an entity has elected to present fair value changes in other comprehensive income (OCI) (AP3A). It decided to make no changes to those

requirements. However, the IASB tentatively decided to amend paragraph 11A of IFRS 7 *Financial Instruments: Disclosures* to require disclosure of:

(a) the aggregated fair value of equity investments for which the OCI presentation option is applied at the end of the reporting period; and

(b) changes in fair value recognised in OCI during the period.

8 Furthermore, the IASB considered possible standard-setting options to respond to concerns raised about the potential outcomes of applying the derecognition requirements in IFRS 9 to the settlement of a financial asset or a financial liability via electronic cash transfers (the IFRS IC TAD *Cash Received via Electronic Transfer as Settlement for a Financial Asset (IFRS 9)*, published in September 2021). The IASB tentatively decided to develop an accounting policy choice to allow an entity to derecognise a financial liability before it delivers cash on the settlement date when specified criteria are met (AP16B).

Timeline and content of the Amendments

9 Therefore, the IASB has expanded the original scope of the *Contractual Cash Flow Characteristics of Financial Assets (Amendments to IFRS 9)* project and changed its name to *Amendments to the Classification and Measurement of Financial Instruments*. The related Exposure Draft is now expected for early Q2 2023, with a comment period of 120 days (AP16C), and will include the amendments related to the following three different topics:

(a) the requirements for assessing a financial asset's contractual cash flow characteristics;

(b) the accounting policy choice for derecognition of financial liabilities; and

(c) the disclosure for equity instruments measured at FVOCI.

Close of the PIR

10 Finally, in November 2022, the IASB discussed a summary of its response to feedback from the PIR of the classification and measurement requirements in IFRS 9 (AP3B) and decided that adequate work had been completed to conclude the PIR and for the IASB staff to prepare the report and feedback statement (expected to be published in December 2022).

Possible other project on modifications and EIR

11 To be thorough, based on its analysis and prioritisation assessment (AP3C), at its July 2022 meeting, the IASB decided to add a standard-setting project to its research pipeline to clarify the requirements in IFRS 9 for modifications of financial assets and liabilities and applying the effective interest method. Any forthcoming standard-setting project will also consider the findings of the PIR of IFRS 9 – Impairment (the publication of the Request for Information is now expected in Q3 of 2023).

The requirements for assessing a financial asset's contractual cash flow characteristics

General requirements

12 In our comment letter on PIR IFRS 9 Classification and Measurement, published on 28 January 2022, EFRAG expressed urgency to address issues arising from financial instruments with ESG features due to the expected pervasiveness of such issues for European constituents.

13 The IASB deemed it unnecessary to create an exception to the SPPI requirements for ESG-linked features and therefore decided to initiate a standard-setting project

to add more explanation and application guidance of the overall objective of the SPPI requirements.

14 Therefore, in September 2022, the IASB tentatively decided to amend IFRS 9 to clarify that:

(a) for contractual cash flows of a financial asset to be ‘solely payments of principal and interest on the principal amount outstanding’, a basic lending arrangement does not cause variability in cash flows arising from risks or factors that are unrelated to the borrower, even if such terms and conditions are common in the specific market in which the entity operates; and

(b) a financial asset that includes contractual terms that change the timing and amount of the contractual cash flows would be consistent with ‘a basic lending arrangement’, if:

(i) the contractual cash flows that could arise from any contingent events are solely payments of principal and interest in all circumstances (that is, the probability of a contingent event occurring is not considered);

(ii) the contingent event is specific to the borrower;

(iii) the timing and amount of any variability in contractual cash flows are determinable and specified in the contract; and

(iv) the contractual cash flows arising from the contingent event do not represent an investment in the borrower or exposure to the performance of any underlying assets.

15 Furthermore, in October 2022, the IASB tentatively decided to add a requirement to IFRS 7 for entities to disclose for each class of financial assets and financial liabilities not measured at fair value:

(a) a qualitative description of contractual terms that could change the timing or amount of contractual cash flows, including the nature of any contingent events;

(b) quantitative information about the range of changes to contractual cash flows that could result from these contractual terms; and

(c) the gross carrying amount of financial assets and amortised cost of financial liabilities subject to these contractual terms.

16 The IASB also tentatively decided to propose that an entity should apply the clarifying amendments to IFRS 9 retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except that the entity would not be required to restate comparative information.

Financial assets with non-recourse features and contractually linked instruments

17 In September 2022 the IASB tentatively decided to amend IFRS 9 in order to clarify that a financial asset with non-recourse features:

(a) exposes the lender to the performance risk of underlying assets throughout the life of the instrument, both in making contractual payments as well as in default; and

(b) restricts the lender’s contractual right to receive contractual payments over the life of the instrument to the cash flows generated by the underlying assets.

18 The IASB also tentatively decided to include examples of relevant factors that an entity could consider when assessing the contractual cash flow characteristics of a financial asset with non-recourse features, such as:

(a) the legal or capital structure of the borrower;

(b) the extent to which the expected cash flows from the underlying assets exceed the contractual cash flows of the financial asset; or

(c) whether there are other sources of finance (that is, loans) that are subordinated to the loan from the lender.

19 The IASB tentatively decided to clarify that the unique characteristics of a structure of contractually linked instruments are:

(a) the use of multiple contractually linked instruments;

(b) the presence of non-recourse features;

(c) the prioritisation of payments through a waterfall payment structure; and

(d) concentrations of credit risk that disproportionately reduce contractual rights in the event of cash flow shortfalls.

20 The IASB also tentatively decided to clarify that the reference to 'instruments' in paragraph B4.1.23 of IFRS 9 includes financial instruments that are not entirely in the scope of IFRS 9, such as lease receivables.

21 Finally, in November 2022, the IASB considered a sweep issue on the scope of transactions to which the requirements in IFRS 9 for contractually linked instruments apply. The IASB tentatively decided to clarify that when an entity determines whether a transaction contains contractually linked instruments as described in IFRS 9, any financial instruments held by the transferor of the underlying assets in the transaction are excluded.

EFRAG's previous discussions and views

22 The IASB's deliberations have been discussed at the following EFRAG meetings:

<table>
<tr><th></th><th>FIWG / IAWG</th><th>FR TEG</th><th>FRB</th></tr>
<tr><td>Objective, scope, and indicative timetable</td><td>21 June 2022
23 June 2022</td><td>29 June 2022</td><td>14 July 2022</td></tr>
<tr><td>IASB staff's preliminary analysis and IASB's tentative decisions</td><td>27 September 2022
4 October 2022</td><td>6 October 2022</td><td rowspan="3">21 December 2022</td></tr>
<tr><td>Disclosure, transition, and effective date</td><td>25 October 2022
3 November 2022
UP 6 December 2022</td><td>9 November 2022</td></tr>
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24 November 2022</td><td>1 December 2022</td></tr>
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23 On the basis of the above EFRAG discussions, the IASB decisions are considered positive and there was general agreement with the principle expressed by the IASB.

24 EFRAG FR TEG members raised the following points:

(a) it is essential to have the final wording of the proposed clarifications relating to the SPPI requirements in order to assess potential impact on financial instruments with ESG-linked features and the current practices on other debt instruments;

(b) the scope of the proposed disclosure requirements could be substantially broad and the potential application costs should be careful assessed, considering the large number of contracts with contingent events that change timing and amount of payments;

(c) it is important to have the final drafting of the proposed amendments for the scope of application of IFRS 9 CLI requirements in order to ensure that all types of structures lead to the same accounting treatment considering that the borrower / sponsor's investment in the special purpose entity (SPE) could have heterogeneous legal forms (e.g., deferred consideration, residual interest, excess spread, first loss tranches, etc.);

(d) the clarifications to the SPPI requirements are more urgent and straightforward and can be dealt with relatively quickly. There was a strong preference to separate the proposed amendments to the SPPI requirements from the rest of the amendments included in the forthcoming Exposure Draft to ensure.

The accounting policy choice for derecognition of financial liabilities

25 The IFRS Interpretations Committee (IFRS IC) received a request about the recognition of cash received via an electronic transfer system as settlement for a financial asset (the TAD). The request asked whether the entity could derecognise the trade receivable and recognise cash on the date the cash transfer is initiated (its reporting date), rather than on the date the cash transfer is settled (after its reporting date).

26 In the fact pattern described in the request, the IFRS IC concluded that, applying paragraphs 3.2.31 and 3.1.12 of IFRS 9, the entity:

(a) derecognises the trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire; and

(b) recognises the cash (or another financial asset) received as settlement for that trade receivable on the same date.

27 The IFRS IC concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine when to derecognise a trade receivable and recognise cash received via an electronic transfer system as settlement for that receivable. Consequently, the IFRS IC tentatively decided not to add a standard-setting project to the work plan.

28 In June 2022, after considering the feedback on the TAD, the IFRS IC confirmed the analysis and conclusion in the TAD and voted to finalise the agenda decision. Nonetheless, the IFRS IC members decided to report to the IASB respondents' comments on the potential outcomes of finalising the agenda decision. Namely:

(a) disruption to long-standing practices;

(b) unintended consequences for other fact patterns; and

(c) the costs and complexity of applying the agenda decision.

29 The IASB considered the draft agenda decision and the concerns raised at its September 2022 meeting and tentatively decided to explore narrow-scope standard-setting as part of its PIR of IFRS 9–Classification and Measurement.

30 Therefore, in October 2022, the IASB tentatively decided to develop an accounting policy choice to allow an entity to derecognise a financial liability before it delivers cash on the settlement date when specified criteria are met.

31 An entity has an accounting policy choice to derecognise a financial liability before the settlement date when:

(a) the entity does not have the ability to withdraw, stop or cancel an electronic payment instruction;

(b) the entity has lost the practical ability to access the cash as a result of the electronic payment instruction; and

(c) the settlement risk associated with the electronic payment instruction is insignificant.

32 Settlement risk is considered insignificant if the payment system used has these characteristics:

(a) the period between the payment initiation date and the settlement date is relatively short and is standardised for the particular payment system concerned; and

(b) completion of the payment instruction follows a standard administrative process so that the debtor has reasonable assurance that the transfer will be completed and the cash will be delivered to the creditor.

33 The IASB tentatively decided to limit the scope of this accounting policy choice to electronic payment systems.

EFRAG's previous discussions and views

34 The IASB's deliberations have been discussed at the following EFRAG meetings:

	FIWG / IAWG	FR TEG	FRB
IFRS IC TAD implications	6 September 2022	13 July 2022 (closed session)	14 July 2022 (closed session)
Possible standard-setting options	25 October 2022 3 November 2022	9 November 2022	21 December 2022
Accounting policy choice criteria	22 November 2022 24 November 2022	1 December 2022	

35 EFRAG FR TEG members generally welcomed the IASB proposed accounting policy choice and the refinements to the criteria suggested by the IASB, considered that criteria were helpful and agreed with asymmetry between payer and receiver.

36 Members questioned, however, the scope limitation to the electronic payments only, because if the reasoning is that the payment instruction cannot be cancelled, then it can be applicable to other payment systems (e.g., credit card payments or cheques).

The disclosure for equity instruments measured at FVOCI

37 In our comment letter on PIR IFRS 9 Classification and Measurement, EFRAG drew attention to the fact that the IASB should expeditiously review the non-recycling treatment of equity instruments within IFRS 9, testing whether the Conceptual Framework would justify the recycling of FVOCI gains and losses on such instruments when realised. EFRAG also drew attention to its advice to the EC in January 2020 on alternative accounting treatments to measurement at fair value through profit or loss for equity and equity-type instruments held in long-term investment business models.

38 In its June 2022 meeting, the IASB had an initial discussion on feedback received on equity instruments and FVOCI presentation election and received the IASB staff preliminary views (AP3A). The IASB staff considered that there was no evidence that the absence of recycling for equity instruments measured at FVOCI provides significant deficiencies in the information provided to investors.

39 In October 2022, based on the analysis of feedback against the PIR framework, the IASB decided to make no changes to the requirements in IFRS 9 relating to equity instruments for which an entity has elected to present fair value changes in OCI (AP3A).

40 However, to increase the usefulness and transparency of information provided about the overall performance of equity investments for which the OCI presentation election was made, the IASB staff recommended amending paragraph 11A of IFRS 7 to require disclosure of:

(a) the aggregated fair value of equity investments for which the OCI presentation option is applied at the end of the reporting period; and

(b) changes in fair value recognised in other comprehensive income during the period.

EFRAG's previous discussions and views

41 The IASB's deliberations have been discussed at the following EFRAG meetings:

	FIWG / IAWG	**FR TEG**	**FRB**
IASB staff's preliminary views	21 June 2022 23 June 2022	29 June 2022 13 July 2022 (closed session)	14 July 2022 (closed session)
Possible ways forward	6 September 2022 8 September 2022 4 October 2022	6 October 2022 (closed session)	18 October 2022 (closed session)
IASB's tentative decisions and additional disclosures	25 October 2022 3 November 2022	9 November 2022	21 December 2022

42 EFRAG FR TEG members expressed their disappointment about the IASB decision of not allowing the recycling of equity instruments measured at FVOCI but acknowledged the IASB arguments. The importance of monitoring this topic in the future and providing empirical evidence of the mismatch after the implementation of IFRS 9 and IFRS 17 by insurers was highlighted.

43 In addition, members supported the proposed additional disclosure and considered that it could be relatively easy and not costly for preparers.

Questions for EFRAG FRB

44 Does EFRAG FRB have comments on the summary above?

Next steps

45 The EFRAG Secretariat will continue to update the EFRAG FRB on the IASB's discussions and deliberations after discussions with EFRAG Working Groups and FR TEG.

46 The IASB's next step will be the issuance of the Exposure Draft which should be published for the beginning of the second quarter 2023, with a comment period of 120 days.

47 The EFRAG discussions highlighted the importance of a robust field test of the final wording of the amendments, in particular to provide concrete evidence for the cost-benefit analysis for the new disclosure requirements relating to the variability of cash

flows of financial instruments and to evaluate possible unintended consequences of the new SPPI requirements.

48 The amendments relating to financial instruments with non-recourse features and CLIs should also be careful analysed to ensure that all types of structures present in the European context lead to the same accounting treatment.

49 In addition, the EFRAG Secretariat will monitor the transition to IFRS 9 and IFRS 17 by the insurance companies with the aim to obtain new evidence supporting or not supporting the reintroduction of recycling for the equity instruments measured at FVOCI.

Questions for EFRAG FRB

50 Does EFRAG FRB have comments on the proposed next steps above?