EFRAG FR Board meeting
14 July 2022
Paper 03-01
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IFRS 9 *Post-implementation Review – Classification and Measurement*
Issues Paper

Objective

1 The objective of this meeting is to:

(a) Update the EFRAG FR Board on the IASB Staff preliminary views and IASB discussions in June 2022 meeting on equity instruments and other comprehensive income (OCI).

(b) Update the EFRAG FR Board on the IASB Project plan for amendments to IFRS 9 *Contractual Cash Flow Characteristics of Financial Instruments*.

2 The previous update was provided to EFRAG FR Board on 1 June 2022 (Paper 07-01).

Background of the IASB project

3 On October 2021, the IASB decided to begin the PIR of the IFRS 9 classification and measurement requirements. The Request for Information on IFRS 9 was published on 30 September 2021 with comments to be provided by 14 January 2022.

4 In its March 2022 meeting, the IASB discussed a summary of the feedback received on its consultation and a plan for how to deliberate feedback. The IASB members did not make any decisions but provided their views on the feedback received.

5 The IASB members welcomed the feedback that in general the classification and measurement principles of IFRS 9 worked well in practice and result in measurement of financial instrument that provides useful information to users of financial statements about amount, timing, and uncertainty of an entity's future cash flows.

6 In the meeting of April 2022, the IASB analysed feedback on the requirements for assessing a financial asset's contractual cash flow characteristics. The IASB discussed the two main topics raised in the feedback – contractually linked instruments and financial assets with ESG-linked features.

7 In the meeting of May 2022, the IASB tentatively decided to start a fast-track standard setting project to clarify particular aspects of the requirements for assessing a financial asset's contractual cash flow characteristics.

8 In June 2022 meeting, the IASB discussed the project plan for Amendments to IFRS 9 Contractual Cash Flow Characteristics of Financial Assets (Agenda Paper 16). In addition, the IASB board had an initial discussion on feedback received on equity

instruments and OCI and received the IASB Staff preliminary views (reported on the Agenda Paper 3A). The IASB was not asked for any decisions.

Equity instruments and other comprehensive income

IASB Staff preliminary views

9 In the initial discussion on feedback received on equity instruments and other comprehensive income the IASB Staff presents preliminary views on the following topics:

(a) **Consistent application of the OCI election**: the IASB staff considers that there is a **need to clarify the scope** of the equity instruments to which the OCI presentation election can be applied;

(b) **Request to broaden the scope of the OCI presentation election**: based on PIR feedback, the IASB Staff is of the view that those who believe the OCI presentation election should be available for a wider scope of instruments tend to strongly favour recycling of amounts presented in OCI. For this reason, the requests for OCI recycling should not be categorised as requests to amend the current OCI presentation election in IFRS 9, but **as request for a new classification category for equity instruments** that they think would better reflect a long-term business model or strategy;

(c) **Request to amend IFRS 9 to add a new classification category**: the IASB Staff is of the view that this would add complexity and would only be justified **if there is evidence that there is a significant deficiency in the information** that investors are being provided. The IASB Staff indicate that they **do not think that this is the case** since recycling would not result in users of financial statements receiving more or better information about “realised” gains and losses. Rather, recycling would change how that information is presented to users of financial statements; and

(d) **Request to open the OCI presentation election to “equity-like” instruments**: the IASB Staff is of the view that it **would not be appropriate to extend the OCI presentation option to “equity-like” instruments** that do not meet the definition of an equity instrument in IAS 32. They observe that the rights and obligations of an entity as an investor in a fund that trades equities and other instruments is different to those of an entity’s that directly purchases the shares of a company.

IASB discussion

10 During its June 2022 meeting, the IASB board had an initial discussion on feedback received on equity instruments and OCI and received the IASB Staff preliminary views. The IASB was not asked for any decisions.

11 **IASB members were overall supportive to the IASB Staff preliminary views and welcomed the feedback that in general the option to present FV changes on investments in equity instruments in OCI works as the IASB intended**.

12 Several IASB members noted that reintroduce the recycling of gains and losses to profit or loss would create something similar to the available-for-sale category in IAS 39 and would create the requirement to assess the equity instrument for impairment, which had created application problems. If recycling will be permitted or required, a robust impairment model would be needed, which would add complexity and be difficult to develop.

13 Some IASB member considered that the feedback provided by stakeholders highlighted that the scope for the OCI presentation election that the IASB had in mind when the Standard was published is not applied consistently. Particular

considerations should be discussed in relation to the insurance companies and the connection with the IFRS 17 requirements.

14 One IASB member noted that a possible way forward could be to clarify in the Standard the scope of the OCI presentation election by referring to the indications described on the Basis of Conclusions of IFRS 9.

15 Another IASB member considered valuable to expand the perimeters of the OCI presentation election to include a narrow scope of puttable instruments and funds that invest in equity instruments. He noted that, from the holder perspective, these types of instruments have equity risks, and it seems to be reasonable to consider them in the scope of the OCI presentation election.

16 Some IASB members asked IASB Staff to conduct further analyses on information users' needs and how to improve consistently the impairment test.

17 One IASB member was in favour of further discussion on the potential inconsistency in IFRS 9 between the requirements in paragraph B5.1.2.A[1] (i.e., day 1 gain or loss) and the requirements in paragraph 5.7.1(b)[2] for the presentation of fair value changes. He was also noted that in practice there are several issues regarding the estimation of the fair value of unquoted instruments, therefore the reintroduction of the IAS 39 exemption to fair value measurement could be reconsidered.

EFRAG FIWG and EFRAG IAWG discussions

18 The EFRAG FIWG and EFRAG IAWG discussed the topic in the meetings on 21 June and 23 June 2022 respectively. Members generally were not supportive of the IASB Staff preliminary views.

19 The following comments were provided:

(a) It was noted that the preliminary views described in the IASB Staff Agenda Paper are not in line with the EFRAG suggestions reported in its Final Comment Letter. Moreover, the mandatory recycling was considered necessary as an amendment for the whole FVOCI category and there was no question of creating an additional category.

(b) Some members noted that in their respective jurisdiction the IASB Staff proposals will have significant impacts on banks and financial and mixed conglomerates.

(c) One member questioned if abolishing the OCI presentation election was considered by the IASB to reduce complexity, as only around 0.25% of financial instruments were allocated to the FVOCI option.

(d) Another member indicated that it is crucial to keep the current principle-based approach: many insurers have decided to apply the OCI presentation election because it is a more meaningful treatment than FVPL. FVPL is not relevant

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[1] IFRS 9 B5.1.2.A states: "*The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also IFRS 13). If an entity determines that the fair value at initial recognition differs from the transaction price as mentioned in paragraph 5.1.1A, the entity shall account for that instrument at that date as follows:*

a) at the measurement required by paragraph 5.1.1 if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets. An entity shall recognise the difference between the fair value at initial recognition and the transaction price as a gain or loss.

b) *in all other cases, at the measurement required by paragraph 5.1.1, adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the entity shall recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the asset or liability*".

[2] IFRS 9 5.7.1(b) states: "*A gain or loss on a financial asset or financial liability that is measured at fair value shall be recognised in profit or loss unless: …*

b) *it is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive income in accordance with paragraph 5.7.5…*".

for many preparers to provide a fair view of the performance of the entity in the context of their business model.

(e) Special rules might be incorporated in IFRS 17 for insurers.

EFRAG FR TEG discussions

20 EFRAG FR TEG discussed the topic in the meeting on 29 June 2022. Members generally were not supportive of the IASB Staff preliminary views.

21 The following comments were provided:

(a) It was noted that preliminary views described in the IASB Staff Agenda Paper were not in line with the EFRAG suggestions to review the recycling of gains and losses on equity instruments measured at FVOCI nor with the clear expectation of reintroducing recycling reported by the stakeholders of the European financial sector. Members questioned the IASB Staff conclusion that this request required a new classification category.

(b) Some members did not share IASB concern about the impairment model. In its advice to the European Commission and its Final Comment Letter, EFRAG provided an illustration of how the impairment model could be improved if recycling was to be reintroduced, clarifying that example the terms “prolonged” and “significant decline”. Other suggestions to improve the impairment test were provided during the PIR process. Members noted that in the absence of further research, it is not possible to conclude that the application problems connected to the available-for-sale category in IAS 39 cannot be overcome with an improved impairment model.

(c) The time elapsed since the application of the Standard was considered not sufficient to support the conclusion of the IASB Staff that there was no new evidence that OCI presentation election does not work as intended. In addition, there is a lack of evidence from the insurance sector that will apply IFRS 9 only starting from the 2023.

(d) One member noted that, from a preparer’s point of view, having the realised gains and losses in the statement of performance is quite different than having them in the notes of the financial statements. Furthermore, it does not provide faithful information when losses are reported in OCI and result in a reduction of equity without passing by the statement of profit and loss.

(e) It was noted that the statement of profit or loss and the OCI have different relevance to users. In addition, *Conceptual Framework for Financial Reporting* requires that the amounts recognised in the OCI should always be recycled. In addition, it is unclear why the recycling is acceptable for bonds but not for equity instruments.

(f) One member considered that the current scope for the OCI presentation election needs to be clarified. The terminology used by the Standard is unclear and the example from the RFI does not help to understand what “strategic” or “long-term” investment means. Another member suggested that if the recycling is reintroduced more guidance on both impairment and derecognition should be developed.

(g) Lastly, the opening of the IASB to extend the OCI presentation election also to equity-like instruments expressed during the last IASB meeting was welcomed.

Project plan for amendments to IFRS 9 *Contractual Cash Flow Characteristics of Financial Instruments*

Proposed project objective

22 With regards to what potential clarifications could be made in regard financial assets with ESG-linked features, the IASB staff believed the IASB could consider:

(a) adding application guidance with respect to the characteristics of a basic lending arrangement and its link to amortised cost measurement. In their view, such additional application guidance would not only assist entities with assessing the contractual cash flows of financial assets with ESG-linked features, but would also help more consistent application of the SPPI assessment in general;

(b) clarifying how to assess whether variability arising from contractual terms that change the timing or amount of contractual cash flows are consistent with SPPI; and

(c) considering how the disclosure objectives and principles in IFRS 7 would apply to financial assets with ESG-linked features, including information about an entity's exposure to risks arising from such features and how an entity manages such risks.

23 With regards to what potential clarifications could be made in regard contractually linked instruments, the IASB staff believed the IASB could consider clarifying:

(a) the key characteristics of a CLI to clarify for what types of contractual arrangements the requirements were intended (scope). The IASB staff considered that such clarification will help ensure that the relevant requirements are applied consistently and that the resulting classification outcomes will faithfully represent the underlying economics and substance of the financial instruments;

(b) the cash flow characteristics of instruments in the underlying pool for a CLI to meet the SPPI requirements. The IASB staff noted that even if the IASB amended IFRS 9 to scope out the most senior tranche from the CLI requirements, IFRS 9 would still require the holder to assess the effects of the cash flows of the underlying pool of instruments. Scoping out the most senior tranche from the CLI requirements would not necessarily alleviate the need to consider the effect of the cash flows of the underlying pool on the senior tranche.

24 The IASB Staff believed that it is unnecessary to create an exception from the SPPI requirements for financial assets with ESG-linked features. The IASB Staff believed adding more explanations of the overall objective of the SPPI requirements and providing additional application guidance through standard-setting will address the issue effectively and efficiently. The IASB Staff is of the view that many of the questions around the application of the CLI requirements are symptomatic of the lack of understanding of the scope of instruments to which the requirements apply. The IASB Staff think that most of these questions could be resolved by providing a clear description of CLIs and the requirements applicable to the underlying pool of instruments.

25 The proposed objective of this project would therefore be 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.

Proposed project scope

26 The IASB Staff's view is that objective for this project will be best achieved by clarifying the following aspects of the SPPI application guidance:

(a) the concept of a basic lending arrangement (paragraph B4.1.7A);

(b) whether and how the nature of a contingent event (i.e., the trigger for a change in the timing or amount of contractual cash flows) is relevant to determining whether the cash flows are SPPI (paragraphs B4.1.10 and B4.1.11);

(c) examples in paragraphs B4.1.13 and B4.1.14 of applying the SPPI requirements to specific fact patterns (including adding additional examples for financial assets with ESG-linked features);

(d) the meaning and characteristics of non-recourse features (including rearticulation of the need to assess the underlying assets or cash flows);

(e) the meaning and scope of instruments to which the CLI requirements are applied (paragraph B4.1.20); and

(f) the requirements for the underlying pool of instruments for a CLI to meet the SPPI requirements (paragraphs B4.1.23 and B4.1.25).

27 The IASB Staff also propose assessing whether additional disclosure requirements are needed regarding contractual terms that could affect the amount or timing of contractual cash flows.

28 At this stage, the IASB Staff do not expect the project to clarify or amend other areas of IFRS 9, including:

(a) the underlying principles of classifying financial assets (paragraphs 4.1.1 to 4.1.5);

(b) subsequent measurement of financial assets measured at amortised cost and applying the effective interest rate method (paragraphs 5.4.1 to 5.4.2 and B5.4.1 to B.5.4.7);

(c) the requirements for classifying financial liabilities (paragraphs 4.2.1 to 4.2.2);

(d) the requirements related to embedded derivatives (paragraphs 4.3.1 to 4.3.7); and

(e) any other aspects of the SPPI requirements, including considerations around the modified time value of money and probability of contingent events.

High-level project timing

29 The table below summarises the indicative timing and key areas for discussion that will require decisions from the IASB at future meetings:

Preliminary timeline	**Topics for discussion / Publication**
Q3 2022	Consideration of potential clarifications
Q4 2022	Consideration of potential clarifications (continued) Permission to ballot
Q1 2023	Publication of Exposure Draft

30 The proposed clarifications for non-recourse features and CLIs are not high priority matters, but there is an interaction with the general SPPI requirements. The IASB Staff do not believe it would be appropriate for the potential clarifications to the general SPPI requirements to be unduly delayed if there is an indication that the proposed clarifications for CLIs would require more extensive analysis. If this would appear to be the case, the IASB Staff will prioritise the work on the general SPPI

requirements to ensure the publication of the exposure draft is not delayed beyond Q1 2023.

IASB discussion

31 In June 2022 meeting, the IASB discussed the project plan for Amendments to IFRS 9 Contractual Cash Flow Characteristics of Financial Assets (Agenda Paper 16). The IASB was not asked for any decisions.

32 IASB members were overall supportive to the scope and direction of the project proposed by IASB Staff, and the indicative timeline.

EFRAG FIWG discussions

33 EFRAG FIWG discussed the topic in the meeting on 21 June 2022. Members generally supported the direction of the project. Nevertheless, members expressed concerns that political challenge of SPPI test is underestimated and that simple clarifications will not be sufficient to cater for the instruments with ESG features.

34 EFRAG FIWG also provided the following comments:

(a) The project plan looked realistic and more evidence was needed if the modification of the standard is sought. The clarifications to the standard can be applied earlier as there is no need to endorse them, whereas if the standard is modified it might take at least till 2025 before it could be applied, but a solution is already needed for the two coming years.

(b) The priority should be given for a solution for the ESG instruments whereas CLI and non-recourse issues can be dealt with later.

EFRAG FR TEG-CFSS and EFRAG FR TEG discussions

35 EFRAG FR TEG-CFSS and EFRAG FR TEG discussed the topic in the meetings on 28 June and 29 June 2022 respectively. Members generally supported the direction of the project.

36 The following comments were provided:

(a) Members were sceptical that simple clarifications will be sufficient and suggested that if the most of the ESG instruments will fail SPPI test, the IASB will need to reconsider its approach.

(b) It was also noted that financial instruments with ESG-linked features do not present a different credit risk than a senior bond with the same level of guarantees as the credit risk is referred to the counterparty. Compliance with ESG requirements and objectives in the future will affect the credit risk of the counterparty, therefore it will also affect the credit risk of financial instruments without ESG-linked features.

(c) Members noted that at this stage the information about potential clarifications is limited and suggested to wait for the detailed IASB proposals to make any decisions. Members suggested that the definition of "basic lending arrangement" should be more dynamic than static.

(d) The project plan looked realistic. If the standard needs modification it might take at least till 2024 (or even later) including EU endorsement before it could be (early) applied, but a solution might already be needed for the two coming years.

(e) Priority should be given to a solution for ESG-linked instruments whereas CLIs and non-recourse issues can be dealt with later. Members welcomed the IASB openness to remove from the fast-track project the potential clarification on CLIs if during the discussion there is an indication that these proposed clarifications would require more extensive analysis.

Next steps

37 The EFRAG Secretariat, EFRAG FIWG, EFRAG IAWG and EFRAG FR TEG to continue to follow closely the IASB project.

Questions for EFRAG FR Board members

38 Do EFRAG FR Board members have any comments on the IASB Staff preliminary views in respect of equity instruments and OCI?

39 Do EFRAG FR Board members have any comments on the project plan and direction for amendments to IFRS 9 *Contractual Cash Flow Characteristics of Financial Instruments?*