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Amendments to the Classification and Measurement of Financial Instruments - Feedback analysis – Disclosures – contractual cash flows and reduced disclosures for SwPA

Objective

1 The objective of this paper is to:

(a) provide the EFRAG FR TEG with a summary of the feedback analysis on disclosures of contractual terms that change the timing or amount of contractual cash flows performed by the IASB Staff and the IASB Staff proposals to address the respondents' concerns.

(b) ask EFRAG FR TEG views on which new and amended disclosure requirements from the forthcoming *Amendments to the Classification and Measurement of Financial Instruments* should apply to subsidiaries without public accountability ('SwPA').

Disclosures on contractual cash flows

Summary of the IASB Staff recommendations

2 The IASB Staff recommends **finalising the proposed disclosure requirements** in paragraphs 20B and 20C of the ED, subject to:

(a) referring to contractual terms that could change the amount of contractual cash flows **based on a contingent event that is not directly related to a change in basic lending risks or costs** (for example, the time value of money or credit risk) **and including an example** of a contractual term to which this disclosure requirement would apply; and

(b) **not requiring an explicit disclosure of the range of possible adjustments** but **giving this as an example** of the quantitative information about the adjustments to contractual cash flows that an entity should disclose.

Background and proposals in the ED

3 The IASB proposed in paragraph 20B of the ED to require entities to disclose the following for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event that is specific to the debtor:

(a) A qualitative description of the nature of the contingent event;

(b) Quantitative information about the range of changes to contractual cash flows; and

(c) Cash flows that could result from those contractual terms.

4 The IASB proposed in paragraph 20C of the ED that an entity shall disclose the information required by paragraph 20B of the ED separately for each class of financial assets measured

at amortised cost or fair value through other comprehensive income and for each class of financial liabilities measured at amortised cost.

Detailed feedback analysis

Usefulness and scope of proposed disclosure requirements

5 Many respondents, including most standard setters as well as members of the Capital Markets Advisory Committee (CMAC), said that the proposed disclosures would provide useful information to users of financial statements.

6 However, many other respondents, specifically banks and banking organisations, voiced **strong objections against the proposed scope of the requirements**. In their view such a broad scope will place a significant cost on preparers which will outweigh any perceived benefits to investors. Many of these respondents made **suggestions for limiting the scope of the proposed disclosure requirements**, including:

(a) Excluding financial liabilities (since there appears to be an overlap with existing requirements in paragraph B10A of IFRS 7);

(b) Excluding financial assets measured at fair value through other comprehensive income (OCI) (since information about the fair value of these instruments is available);

(c) Excluding changes in cash flows due to changes in credit risk (since the credit risk disclosures in IFRS 7 already explain how credit risk is managed);

(d) Excluding changes due to 'increased cost clauses';

(e) Limiting the scope to ESG-linked features; or

(f) Limiting the scope to financial assets to which paragraph B4.1.10A of the ED is applied for contingent events that are not directly linked to basic lending risks or costs.

7 A few respondents noted that additional disclosures requirement are unnecessary given existing disclosure requirements in IFRS 7.

Quantitative disclosures

8 Comments on the proposed quantitative disclosure requirements proposed in subparagraph 20B(b) of the ED include suggestions:

(a) To remove the requirement to disclose quantitative information since it would be costly for preparers to track and provide limited benefit to users, especially on an aggregated basis;

(b) To reconsider the requirement to disclose the range of possible adjustments to contractual cash flows because the ends of the range could relate to low probability events that would not provide useful information to users of the financial statements; and

(c) To include application guidance or illustrative examples.

IASB Staff analysis

Usefulness and scope of proposed disclosure requirements

<u>Need for additional disclosure requirements</u>

9 The IASB Staff notes the call of some PIR participants and CMAC members for additional disclosure requirements, notably those concerning instruments with ESG-related features.

The IASB Staff observes as well that paragraph 7 of IFRS 7 already contains a general disclosure requirement which, as evident from the feedback received, might not be sufficient to result in entities with financial assets or financial liabilities with ESG-linked or similar features to disclose information about changes to contractual cash flows because of such features.

10 The IASB Staff acknowledges the concerns concerning the scope of the proposed disclosure requirements as well as the cost vs benefit considerations.

11 The IASB Staff believes that the nature of the contingent event could be qualitatively material even if it does not determine the way a financial instrument is measured. In such cases, disclosures are required to provide transparency about these contractual features.

12 Although discussions have focused on financial instruments with ESG-linked features, the IASB Staff are of the view that the principle applies equally to other contractual features which could change contractual cash flows for reasons other than a change in basic lending risks or costs, for example, loans provided to banks by central banks with an interest rate that is adjusted based on the achievement of certain lending targets.

<u>Excluding financial liabilities from the scope of the requirements</u>

13 The IASB Staff acknowledges potential overlaps between the proposed disclosure requirements and the existing requirements of paragraphs B8A and B10A of IFRS 7. However, the IASB Staff is of the view that the proposed disclosure requirements should also apply to financial liabilities measured at amortised cost, as proposed in the ED. The IASB Staff believes that the risk of duplicate disclosures is low, based on the current reporting practices.

<u>Excluding the financial assets measured at FVOCI</u>

14 Given that the financial assets measured at FVOCI are accounted for in the same way as financial assets measured at amortised cost for the purposes of the statement of profit or loss, the IASB Staff prefers to provide users of the financial statements with information about contractual terms that could impact the amounts recognised in profit or loss. Therefore, the IASB Staff recommends retaining the financial assets measured at FVOCI in the scope of the proposed disclosure requirements.

<u>Limiting the scope to ESG features</u>

15 The IASB Staff is of the view that whilst an ESG-linked feature is a good example of a contractual terms that should be disclosed to users of financial statements, the need for disclosures is not limited to such cases. Also, there is no conceptual basis for limiting these disclosure requirements to contractual terms that cash flows based on an ESG-linked target as opposed to other contingent events that are not directly related to basic lending risks or costs.

<u>Other ways of refining the scope of the proposed requirements</u>

16 Following the feedback from respondents, the IASB Staff believes that **the contractual terms to which these disclosures are intended to apply could be described more directly by referring to contractual terms that change the amount of contractual cash flows based on a contingent event that does not directly relate to a change in basic lending risks or cost**, such as the time value of money or credit risk.

17 In the view of the IASB Staff, scoping the disclosure requirement in this manner would be consistent with the IASB's tentative decision on clarifying the requirements for assessing the contractual cash flows of financial assets (Question 2 of the ED) and would provide useful information to the users of financial instruments while limiting the cost to preparers. Although this assessment does not apply to financial liabilities, the IASB Staff believes that

this refinement in scope of the disclosure requirements is nonetheless also appropriate for financial liabilities. Information about factors other than basic lending risks or costs that could change contractual cash flows would provide users of financial statements with the most useful information for both financial assets and financial liabilities.

18 The IASB Staff does not recommend defining 'basic lending risks and costs' for the purposes of the disclosure requirements, but believes it would be helpful to include an example of a contractual term to which the disclosure requirements would apply, such as a change in interest rates based on the achievement of a greenhouse gas emission target.

Quantitative information requirements

19 The IASB Staff acknowledges concerns about the usefulness of quantitative disclosures, especially on an aggregated basis if the entity has many instruments with similar characteristics. However, the IASB Staff believes that the judgements involved in presenting information in a useful manner is similar to what is required to comply with other disclosure requirements in IFRS 7 and therefore **does not recommend removing the required to disclose quantitative information**.

20 The IASB Staff notes concerns that providing a range of possible adjustments would not always provide useful information if the end points of the range are not representative of the most common types of adjustments. The IASB Staff still considers disclosure of a range of possible adjustments to contractual cash flows useful for the users but acknowledges that there may be other quantitative information, such as the mean or modal value of the size of adjustments which could also provide useful information. Therefore, the IASB Staff **recommends refining the requirement to require quantitative information about the adjustment to contractual cash flows and giving the range of possible adjustments as an example**.

21 The IASB Staff does not think it is necessary to include illustrative examples of the disclosures required since the requirements are straightforward, and the precise format of the disclosures would depend on the nature of the entity's portfolio and the entity's judgement about the best way of presenting the information.

The EFRAG Secretariat assessment

22 The EFRAG Secretariat welcomes the IASB efforts to address concerns expressed by the stakeholders about the scope and cost-benefits of the proposed disclosure requirements. Reference to "contingent event not directly related to a change in basic lending risks or cost" instead of ''a contingent event that is specific to the debtor'' reduces the scope of the disclosure requirements.

23 However, the EFRAG Secretariat notes that the IASB did not exclude credit-impaired financial assets for which the disclosure requirements could be irrelevant or misleading, as suggested in EFRAG final comment letter.

24 Furthermore, the EFRAG Secretariat notes that without clearer definition of what is or is not "**directly** related to a change in basic lending risks or cost" unclarity about the scope remains.

25 The EFRAG Secretariat also welcomes the recommendation to refer to a range of possible adjustments as an example of quantitative disclosure rather than a strict requirement as it was previously required by paragraph 20B(b) of the ED. In our view, it gives more freedom to preparers to disclose the quantitative information in the most relevant way, especially in a situation where the ends of the range illustrate cases which are not representative for the range in general.

26 However, the EFRAG Secretariat highlights the importance to see the final wording of the Amendments to ensure that a range becomes an example of a disclosure and not a requirement.

27 Furthermore, the EFRAG Secretariat still has concerns about overall operability and relevance of the proposed disclosure requirements, even with the limited scope.

28 Further, the EFRAG Secretariat remains of the opinion expressed in its final comment letter that it would be appropriate to remove financial assets measured for at FVOCI from the scope of the proposed quantitative disclosure requirements. While noting the arguments of the IASB Staff to the contrary, we consider that the required information is, indeed, already captured in the fair value disclosures required by IFRS 13.

EFRAG discussions

29 EFRAG IAWG and EFRAG FIWG discussed this topic at their meetings on 26 and 27 February 2024, respectively.

30 EFRAG IAWG and EFRAG FIWG members welcomed the scope limitation as proposed by the IASB staff. However, they indicated that, in the context of the new approach to the assessment of the contractual cash flows of financial instruments with contingent features (i.e., assessing whether the contractual cash flows of a financial instrument with a contingent feature are significantly different from those of a similar instrument without such a contingent feature), the proposed disclosure requirements may be excessive, as they would imply disclosing information which was assessed as not significant by applying the comparison mentioned above.

31 Also, some EFRAG FIWG members noted that the disclosure requirements still remain burdensome to apply and advocated that the retrospective application is not required.

Questions for EFRAG FR TEG

32 Does EFRAG FR TEG have any comments on the IASB Staff's proposed amended disclosure requirements on contractual cash flows?

33 With regards to the proposed refinements, what is your opinion about the cost-benefit balance of the resulting information?

Reduced disclosure requirements for SwPA

General approach for maintenance of Subsidiaries without Public Accountability Standard ('Subsidiaries Standard')

34 The IASB's agreed approach to maintenance of the Subsidiaries Standard requires that potential changes to the Standard are reviewed at two levels:

(a) *in detail* against the principles for reducing disclosures set out in paragraph BC34 of the Basis for Conclusions on the 2021 ED *Subsidiaries without Public Accountability: Disclosures*, relating to:

(i) information about short term cash flows and obligations, commitments and contingencies whether or not they are recognised as liabilities;

(ii) information about liquidity and solvency;

(iii) information on measurement uncertainties;

(iv) information about accounting policy choices; and

(v) disaggregation of amounts presented in the financial statements.

(b) *at a high level,* considering whether newly added or amended disclosure requirements would be proportional and would be in keeping with the goal of allowing reduced disclosures while meeting the needs of users of the financial statements of eligible subsidiaries.

35 The IASB's proposals will be included in the Catch-Up Exposure Draft ('the catch-up ED') that will be published after the issue of the new Standard *Subsidiaries without Public Accountability: Disclosures* ('the Subsidiaries Standard') later in 2024.

Equity instruments and other comprehensive income

36 When developing the Subsidiaries Standard, the IASB decided to include the requirement in paragraph 8(h)(ii)[1] of IFRS 7 *Financial Instruments: Disclosures* to separately disclose the carrying amount of investments in equity instruments designated as measured at FVOCI at initial recognition, but not to include the detailed disclosures required by paragraphs 11A and 11B of IFRS 7.

37 Although the feedback from PIR of classification and measurement requirements of IFRS 9 highlighted that the irrevocable election in paragraph 5.7.5 of IFRS 9 was used more broadly than the IASB had originally intended, in particular by insurance entities, the IASB Staff is of view that additional **disclosure requirements proposed in paragraphs 11A and 11B of IFRS 7** are not necessary to understand the effect of these instruments on the solvency and liquidity of the eligible subsidiary and, therefore, **does not recommend adding these disclosure requirements to the catch-up ED**.

38 As a reminder, in its November meeting the IASB tentatively decided to:

(a) amend the introductory sentence in paragraph 11A of IFRS 7 to require an entity to apply the disclosure requirement in that paragraph per class of equity investment; and

(b) include in paragraph 11B of IFRS 7 (which requires disclosures on derecognition) a disclosure requirement similar to that in paragraph 11A(e) of IFRS 7[2].

Contractual terms that could change the amount of contractual cash flows

39 Assuming the IASB agrees with the IASB Staff's recommendation described in the first part of this Agenda Paper, the IASB Staff recommends including in the catch-up ED the forthcoming disclosure requirements relating to contractual terms that could change the contractual cash flows of financial assets and financial liabilities not measured at fair value through profit or loss.

40 This is because information about contractual terms that could change the amount of contractual cash flows of financial assets and financial liabilities could provide information about short term cash flows and obligations, as well as solvency and liquidity, to users of a subsidiary's financial statements.

41 The IASB Staff notes that although the eligible subsidiaries are unlikely to hold financial assets with such contractual terms, they may hold financial liabilities.

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[1] Paragraph 8(h)(ii) of IFRS 7 requires investments in equity instruments designated as such upon initial recognition in accordance with paragraph 5.7.5 of IFRS 9 to be disclosed separately, either in the statement of financial position or in the notes.

[2] Paragraph 11A(e) of IFRS 7 requires an entity that has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.7.5 of IFRS 9, to disclose: any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.

42 If such a financial liability constitutes a significant portion of an entity's financing, changes to the cash flows of the instrument are likely to impact the entity's liquidity and, therefore, are useful to users. In the IASB Staff view this information should be readily available as it is included in the contract. Therefore, the IASB Staff considers these disclosure requirements as proportional and **recommends including them in the catch-up ED**.

EFRAG Secretariat assessment

43 The EFRAG Secretariat highlights that the IASB is requesting comments on consequential amendments to a future Subsidiaries Standard that had not been yet issued or endorsed in the EU. Therefore, the endorsement of the Amendments resulting from this ED related to the reduced disclosures, is conditional on the outcome of the EU endorsement process of the future IFRS Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures].

44 The EFRAG Secretariat further notes that **financial institutions, including insurance companies, are out of the scope of the forthcoming Subsidiaries Standard**. This means that their subsidiaries applying IFRS Accounting Standards would **have to provide a full package of new disclosure requirements** required by this ED **without any reduction**.

45 The EFRAG Secretariat notes that the user profile of the subsidiaries without public accountability is different from the one of publicly traded entities and agrees with the IASB that users of eligible subsidiaries' financial statements are first interested in the information about short-term cash flows, obligations, commitments and contingencies and about liquidity and solvency.

46 Taking into account the above considerations, the EFRAG Secretariat agrees with the IASB proposal not to include additional proposed disclosure requirements in paragraphs 11A and 11B of IFRS 7 in the catch-up ED. The EFRAG Secretariat considers that these disclosure requirements are mainly relevant for the insurance entities which are outside of the scope of the Subsidiaries Standard and which will have to provide full disclosures.

47 On the proposed disclosure of contractual terms that could change the amount of contractual cash flows, the EFRAG Secretariat shares the IASB conclusion that eligible subsidiaries outside the banking and insurance sector would hardly have financial assets in scope of the proposals but may have limited number of financial liabilities. At this stage the EFRAG Secretariat is of view that provision of such information should be feasible to preparers and useful for users of financial statements.

Questions to EFRAG FR TEG

48 Does EFRAG FR TEG agree with the IASB Staff recommendation to not include in the catch-up ED the forthcoming amendments to disclosure requirements relating to equity instruments and other comprehensive income?

49 Does EFRAG FR TEG agree with the IASB Staff recommendation to include in the catch-up ED the forthcoming disclosure requirements relating to contractual terms that could change the contractual cash flows of financial assets and financial liabilities not measured at fair value through profit or loss?