IASB® meeting

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Project	**Amendments to the Classification and Measurement of Financial Instruments**
Topic	**Feedback analysis—Assessment of contractual cash flows**

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Purpose of this paper

1. This paper addresses feedback received on Question 2 of the Exposure Draft *Amendments to the Classification and Measurement of Financial Instruments* (ED) about contractual terms that are consistent with a basic lending arrangement. The paper does not ask the IASB for any decisions.

2. This paper is structured as follows:

   (a) question for the IASB;

   (b) background and proposals in the ED (paragraphs 3–5);

   (c) feedback analysis (paragraphs 6–23); and

   (d) staff analysis (paragraphs 24–55).

Question for the IASB
Do you have any comments or questions on the staff analysis presented in paragraphs 24–55?

Background and proposals in the ED

3. The IASB carried out a post-implementation review (PIR) of the classification and measurement requirements in IFRS 9 *Financial Instruments* and related disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*. One of the findings was concerns about growing diversity in practice in assessing whether the contractual cash flows of financial assets with ESG-linked features represent solely payments of principal and interest on the principal amount outstanding (SPPI).

4. As discussed in paragraphs BC39–B44 of the Basis for Conclusions on the ED, the IASB concluded that it would not be appropriate to change the general requirements for assessing the contractual cash flows of financial assets or to create an exception to these requirements for financial assets with ESG-linked features. The IASB instead decided to respond to the PIR feedback by proposing clarifications to the application guidance for the SPPI assessment. Specifically, the IASB proposed including additional application guidance on:

    (a) the elements of interest that are consistent with a basic lending arrangement in paragraph B4.1.8A of the ED; and

    (b) contractual terms that change the timing or amount of contractual cash flows in paragraph B4.11.10A of the ED:

5. The ED also included proposed examples to illustrate the application of the SPPI requirements to financial assets with ESG-linked features. An analysis of feedback on the examples will be provided in a separate paper at a future meeting.

Feedback analysis

Overall approach

6. Almost all respondents agreed with, and were appreciative of, the IASB's intention to clarify the requirements for assessing whether the contractual cash flows of financial

assets are SPPI, specifically in the case of financial assets with ESG-linked features. Many respondents reiterated their views shared as part of the PIR that amortised cost or fair value through other comprehensive income is a more appropriate measurement basis for financial assets with ESG-linked features than fair value through profit or loss.

7. Many respondents, including most preparers, said that the proposed clarifications would assist entities in determining the classification of financial assets with common ESG-linked features. Many of these respondents nevertheless identified particular aspects of the proposed clarifications that would benefit from further refinements. In contrast, a few other respondents suggested the IASB make more targeted amendments specifically for ESG-linked features rather than trying to establish a general principle. In their view, such an approach would be a more effective response to the issues raised during the PIR and has a lower risk of unintended consequences.

8. In addition to concerns about specific proposals, some respondents asked the IASB to clarify the interaction between the proposed clarifications and the existing requirements. Specifically, some respondents said that it is not clear why contingent events that are specific to the debtor (as stated in paragraph B4.1.10A of the ED), are consistent with the concept of basic lending risks and costs as discussed in paragraphs B4.1.7A and B4.1.8A of the ED.

9. A few respondents recommended clarifying that:

   (a) the core principle for assessing contractual cash flows is articulated in paragraph B4.1.7 of IFRS 9;

   (b) paragraphs B4.1.7A–B4.1.10A of IFRS 9 (as amended by the ED) should be considered sequentially; and

   (c) no paragraph should be considered in isolation.

10. A few respondents were concerned that if paragraph B4.1.10A of the ED was applied in isolation, it could result in some financial assets being considered to have SPPI cash flows even though the instruments are not currently considered to be consistent

with a basic lending arrangement, for example a loan with an interest rate that is linked to the debtor's sale targets.

Concept of a basic lending arrangement

11. Most respondents generally supported the clarifications to the elements of interest that are consistent with a basic lending arrangement proposed in paragraph B4.1.8A of the ED. However, some respondents said that paragraph B4.1.8A of the ED mostly contains guidance on what is inconsistent with a basic lending arrangement and does not contain sufficient guidance to identify the types of features that would be consistent with a basic lending arrangement. In particular, these respondents said that the proposed clarifications still do not make it clear why certain ESG-linked features could be considered to represent compensation for basic lending risks or costs.

12. Furthermore, many respondents raised concerns about the statement in the last sentence in that paragraph that 'a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs.' These concerns included:

    (a) apparent inconsistencies with other statements in IFRS 9 on whether or not a quantitative assessment of compensation is required (see paragraphs 14–17 of this paper);

    (b) uncertainty about how to apply this requirement in the case of common ESG-linked features where the change in contractual cash flows cannot be linked directly to a change of basic lending risks or costs; and

    (c) the view that this statement should not be part of the clarification of the concept of a basic lending arrangement, but should be incorporated into the guidance on contractual terms that change the timing or amount of contractual cash flows.

13. Other suggestions for refining the clarification of what constitutes a 'basic lending arrangement' included:

(a) adding ‘cost of capital’ and ‘ESG-linked features’ to the list of elements of interest in a basic lending arrangement that is included in par B4.1.7A of IFRS 9;

(b) clarifying whether compensation to cover the cost of hedging would be consistent with a basic lending arrangement;

(c) clarifying in paragraph B4.1.8A of the ED that compensation for ‘basic lending risks and costs’ may include a profit margin, to be consistent with paragraph B4.1.7A of IFRS 9;

(d) including content from the Basis for Conclusions on the ED in the main body of the Standard, specifically the statement in paragraph BC47 of the Basis for Conclusions on the ED that the elements of interest specified in paragraph B4.1.7A of IFRS 9 do not constitute an exhaustive list of the elements that are consistent with a basic lending arrangement;

(e) including an explicit statement that a proportional adjustment to the pricing of the profit margin element is consistent with a basic lending arrangement;

(f) including a rebuttable assumption that ESG risk is a basic lending risk;

(g) clarifying that incentives given to the debtor (such as ESG-linked features) that do not compensate the lender for specific basic lending risks or costs could nonetheless be consistent with a basic lending arrangement; and

(h) clarifying how an entity can determine whether something is ‘typically’ considered a basic lending risk when paragraph B4.1.8A of the ED states that a contractual term may be inconsistent with a basic lending arrangement ‘even if such contractual terms are common in the market in which the entity operates’.

Considering the size of changes in contractual cash flows

14. Many respondents observed that there is an apparent contradiction between the following two statements in paragraph B4.1.8A of the ED:

(a) the assessment of interest focuses on *what* an entity is being compensated for, rather than *how much* compensation an entity receives; and

(b) a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs.

15. While most respondents agreed with the statement in paragraph (a) of this paper, some did not support its inclusion. These respondents noted that some requirements in IFRS 9 require an entity to consider how much compensation it receives for a particular element of interest. For example, paragraphs B4.1.9B-B4.1.9D of IFRS 9 requires the entity to perform a benchmark test if the time value of money element of interest is modified and paragraph B4.1.18 of IFRS 9 states that a contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a de minis effect on the contractual cash flows of the financial asset. One respondent suggested amending the statement to: 'the assessment of interest focuses <u>more</u> on *what* an entity is being compensated for, rather than *how much* compensation an entity receives'.

16. Although most respondents did not disagree with the statement in paragraph (b) of this paper with regards to the change in cash flows needing to be directionally consistent with a change in basic lending risks or costs, many expressed concerns with the use of the term 'magnitude', including that:

(a) the meaning of the term is unclear, because it is not defined and is not used elsewhere in IFRS 9;

(b) it is unclear how the term relates to the concept of leverage in paragraph B4.1.9 of IFRS 9; and

(c) such a requirement could result in diversity in practice developing around whether a 'punitive' increase in interest rates in response to an event such as missed payments, is aligned with the magnitude of a change in credit risk.

17. Suggestions for addressing the concerns with the word 'magnitude' include:

(a) removing the requirement to consider the size of the change in contractual cash flows altogether and relying on the existing application guidance on the impact of leverage;

(b) rewording the requirement using terms such as 'order of magnitude', 'level of magnitude', 'consistent with the economic rationale', 'commensurate to the risks' or 'proportionate'; and

(c) including additional application guidance on when a consideration of the size of a change in contractual cash flows is required and what such a consideration would entail.

Contractual terms that change the timing or amount of contractual cash flows

Scope and application of paragraph B4.1.10A of the ED

18. Many respondents were concerned that the proposed clarifications in paragraph B4.1.10A of the ED could result in contractual terms that are currently widely considered to be consistent with a basic lending arrangement to no longer represent SPPI cash flows. Many of these respondents disagree with the statement in paragraph BC67 of the Basis for Conclusions on the ED that 'a change in contractual cash flows due to a contingent event that is specific to the creditor or another party would be inconsistent with a basic lending arrangement'. In their view, this could be interpreted to include so-called 'increased cost clauses' in which the lender reserves the right to adjust the interest rate due to changes in tax laws or regulations which increase the cost of lending.

19. Some respondents also said that it is not clear whether paragraph B4.1.10A of the ED is intended to apply to all contractual terms that change the timing or amount of contractual cash flows, or only those terms that are contingent on events that are not directly linked to basic lending risks or costs. A few respondents also observed that

the requirements in paragraph B4.1.10A of IFRS 9 appear more restrictive than those in paragraph B4.1.10 of IFRS 9.

20. Some respondents asked the IASB to better define the scope of paragraph B4.1.10A of IFRS 9 by defining the term ‘contingent event’. A few respondents suggested including in the main Standard the statement in paragraph BC69 of the Basis for Conclusions on the ED that the ‘contingent events’ referred to in paragraph B4.1.10 of IFRS 9 excludes those associated with the time value of money or prepayment features.

Contingent events specific to debtor

21. With regards to the proposals in paragraph B4.1.10A of the ED that ‘the occurrence (or non-occurrence) of the contingent event must be specific to the debtor’, many respondents observed that this would preclude any instruments where the ESG-linked targets are set at a consolidated level or for a group entity other than the legal debtor. These respondents said that it is quite common for banks to identify ESG-linked targets for a consolidated group when making a loan to the main operating entity in a group. These respondents noted that the contractual cash flows on the financial asset are identical to those where the targets are defined for the legal debtor only and asked the IASB to clarify that these instruments are still consistent with a basic lending arrangement. Respondents also asked the IASB to consider whether the following targets would be considered ‘specific to the debtor’:

    (a) scope III emissions;

    (b) emissions of a sector of which the lender is a part;

    (c) where the target is relative to a benchmark, for example the debtor is in the top X% of sustainability leaders for a particular industry or group; and

    (d) certain levels or ratios of expenses or revenues (for example, from ‘green business activities’) where changes in expenses or revenues depend on both the specific activities of the borrower and changes in market prices.

Investment in the debtor and performance of specified assets

22. Some respondents expressed concerns with the statement in paragraph B4.1.10A of the ED that the resulting cash flows must represent neither an investment in the debtor nor an exposure to the performance of specified assets, including that:

    (a) the wording in this paragraph differs from paragraph B4.1.16 of IFRS 9 which refers to 'an investment in particular assets or cash flows';

    (b) it is not clear what is meant by the term 'an investment in the debtor' in this context (one respondent suggested referring to 'an equity-like investment in the debtor');

    (c) there is a potential for structuring opportunities if the target is only indirectly linked to cash flows generated by the debtor, such as a reference to the market share of the debtor or the number of store openings; and

    (d) the requirement to achieve a particular ESG-target could be based on the 'performance of specified assets' and the IASB should therefore clarify whether it intended to refer to financial performance only.

23. A few respondents asked the IASB to clarify whether the following would be consistent with a basic lending arrangement:

    (a) cross-sell clauses, where the interest rate on the loan is contractually agreed to increase by a specific amount of basis points if the borrower does not enter into other specific transactions or business arrangements with the bank in the future;

    (b) an instrument that adjusts its interest rate upwards or downwards by a fixed number of basis points when a particular level of profits is reached;

    (c) changes to cash flows based on the level of borrowing relative to a measure such as earnings before interest, tax, depreciation and amortisation (EBITDA) as an indicator of changes in credit risk; and

    (d) changes to cash flows based on loan to value ratio, which depends on the value of the underlying collateral.

Staff analysis

Overall approach

24. The staff note that almost all respondents agreed with the IASB's approach as articulated in paragraphs BC39–BC44 of the Basis for Conclusions on the ED to address the issue raised in the PIR by clarifying the application guidance in IFRS 9 for assessing contractual cash flows, rather than creating a specific exception for financial assets with ESG-linked features.

25. The staff acknowledge respondents' concerns that the proposals to clarify the existing general application guidance could unintentionally disrupt existing practice. However, the staff are of the view that these concerns can effectively be addressed by refining the proposed clarifications to the requirements in IFRS 9.

26. The staff further acknowledge concerns raised around the interaction between the proposed clarifications and the existing requirements. The IASB's intention was to clarify the application guidance rather than fundamentally alter the assessment of contractual cash flows. The proposed clarifications do not change the basic principles behind the assessment of contractual cash flows of financial assets:

    (a) paragraphs 4.1.2 and 4.1.2A of IFRS 9 require a financial asset to be measured at amortised cost or fair value through other comprehensive income (subject to the business model assessment) if the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI. Paragraph 4.1.3 of IFRS 9 describes what is meant by 'principal' and 'interest' in this context. The IASB did not propose any changes to these requirements.

    (b) paragraphs B4.1.7–B4.1.26 of IFRS 9 sets out application guidance and examples to assist entities in applying this basic principle. The IASB proposed clarifications to this application guidance as well as additional examples.

27. In the staff's view, the overall feedback on the proposals supports this approach. The staff believe that the relevant application guidance for the SPPI assessment should

be considered holistically; no specific paragraph or requirement takes precedence or can be applied in isolation and neither does the order in which paragraphs are located in the Standard affect whether cash flows are SPPI or not.

28. Nevertheless, the staff acknowledge that the proposed clarifications to the application guidance could be further refined to more effectively respond to the issues raised during the PIR while limiting the risk of unintended consequences.

Concept of a basic lending arrangement

29. As mentioned in paragraph BC47(a) of the Basis for Conclusions on the ED, the IASB reconfirmed that the elements of interest specified in paragraph B4.1.7A of IFRS 9 do not constitute an exhaustive list of the elements that are consistent with a basic lending arrangement.

30. As discussed in paragraph 14 of Agenda Paper 16A for the September 2022 IASB meeting, in cases where it is difficult to determine whether contractual cash flows are consistent with a basic lending arrangement, it might also be helpful to consider whether any contractual cash flows are inconsistent with a basic lending arrangement. The proposals in paragraph B4.1.8A of the ED were therefore intended to further clarify the statement in paragraph B4.1.7A of IFRS 9 that 'contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement […] do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding'.

31. Feedback on the ED indicated support for the statement in paragraph B4.1.8A of the ED that '[c]ontractual cash flows are inconsistent with a basic lending arrangement if they include compensation for risks or market factors that are not typically considered to be basic lending risks or costs'. The staff believe that this is an important factor to consider for all financial assets. In the proposed example of Instrument I in paragraph B4.1.14 of the ED, the creditor is compensated for exposure to a market factor (the carbon price index), which is not a basic lending risk or cost and is therefore inconsistent with a basic lending arrangement. This instrument can be viewed as a

combination of a basic lending arrangement and a separate financial instrument of which the value changes based on a market factor unrelated to the basic lending arrangement. Therefore, such a combined instrument does not have contractual cash flows that are SPPI.

32. The staff acknowledges that in some cases (such as the proposed example of Instrument EA in paragraph B4.1.13 of the ED) it can be more difficult to distinguish between contractual terms that include compensation for market factors or risks that are not typically considered basic lending risks or costs and contractual terms that adjust the compensation received for basic lending risks or costs over the life of the instrument.

33. There is no requirement in IFRS 9 for the compensation for basic lending risks and costs to be fixed, or calculated on the same basis, throughout the life of the financial asset. The example of Instrument C in paragraph B4.1.13 of IFRS 9 explains that an instrument with a capped variable interest rate can be viewed as a combination of a fixed-rate and a floating-rate instrument and that the combined instrument can have cash flows that are SPPI if each of the component instruments have cash flows that are SPPI. In the same way, Instrument EA can be viewed as a combination of a basic lending arrangement with an interest rate that applies if the greenhouse gas emission targets are met and a basic lending arrangement with a higher interest rate if the greenhouse gas emission targets are not met.

34. However, there is still a need to consider whether the variability in cash flows introduced by such a contractual term is consistent with a basic lending arrangement, which is why the IASB proposed clarifying amendments to paragraph B4.1.10 of IFRS 9 (see paragraphs 43-55 of this paper).

35. The staff acknowledge concerns raised by respondents about the statement in paragraph B4.1.8A of the ED that 'a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs.' In the staff's view, this statement is

consistent with the examples in paragraph B4.1.10 of IFRS 9, although it could be seen as being more categorical.

36. The staff agree with respondents that it is not helpful to include such an unconditional statement as part of the clarified description of what constitutes a basic lending arrangement and that the principles articulated in this statement should be considered together with the requirements relating to contractual terms that change the timing or amount of contractual cash flows (see paragraphs 43-55 of this paper).

37. Paragraphs 38-42 of this paper considers the specific concerns raised about assessing the 'magnitude' of changes in contractual cash flows in the context of the broader question of when an entity is required to consider the size of changes in contractual cash flows.

Considering the size of changes in contractual cash flows

38. The staff acknowledge respondents' concerns that the proposals as drafted do not provide sufficient clarity on when, and to what extent, a consideration of the size of changes in contractual cash flows is needed. The staff further agree that it is not helpful to imply that the 'magnitude' of changes in contractual cash flows needs to be considered without being more specific about what such a consideration would require.

39. In the staff's view, the application guidance in paragraphs B4.1.9A-B4.1.26 of IFRS 9 is consistent with the principle proposed in paragraph B4.1.8A of the ED (based on paragraph BC4.182(b) of the Basis for Conclusions on IFRS 9) that '[t]he assessment of interest focuses on *what* an entity is being compensated for, rather than *how much* compensation an entity receives.' However, in practice, there may not be a perfect one-to-one relationship between the risks for which a lender is seeking compensation and the spread calculated for each element of interest. There are different approaches to pricing the different elements of interest in a basic lending arrangement and the IASB did not intend to prescribe a particular approach, call into question an entity's

approach to pricing or require a quantitative analysis of the interest rate to determine if contractual cash flows represent SPPI.

40. In some cases, IFRS 9 requires a consideration of the quantitative impact of particular contractual features which might not be consistent with changes in basic lending risks and costs, in assessing whether the resulting contractual cash flows over the life of the financial asset are nevertheless consistent with a basic lending arrangement, for example:

    (a) for regulated interest rates where the objective of the time value of money element is not to provide consideration only for the passage of time, paragraph B4.1.9E of IFRS 9 requires an entity to consider whether the consideration is broadly consistent with the passage of time; and

    (b) for financial assets prepayable before maturity and acquired or originated at a premium or a discount, paragraph B4.1.12 of IFRS 9, requires, among other factors, that the fair value of the prepayment feature is insignificant at initial recognition.

41. Some respondents reiterated the argument raised by PIR participants that certain ESG-linked factors are consistent with a basic lending arrangement because the adjustments to contractual cash flows are small relative to the overall cash flows of the financial asset (although the adjustments may be greater than de minimis according to paragraph B4.1.18 of IFRS 9). These respondents argued that measuring these instruments at fair value through profit or loss would not provide useful information to users of financial statements as the fair value movements on these instruments would be dominated by changes in interest rates and credit risk, rather than changes in the relevant ESG factors.

42. In the staff's view, in cases where it is not clear whether a contractual term that may change the timing or amount of contractual cash flows is consistent with a basic lending arrangement, a helpful consideration might be whether the fair value of a such contractual feature is insignificant (see paragraphs 47-52 of this paper).

Contractual terms that change the timing or amount of contractual cash flows

Scope and application of paragraph B4.1.10A of the ED

43. In the staff's view, it was not the IASB's intention to disrupt market practice that has developed in applying paragraph B4.1.10 of IFRS 9 and the other requirements in IFRS 9 to assess whether common contractual terms such as credit ratchet clauses or increased costs clauses are consistent with a basic lending arrangement. Instead, the IASB intended to provide additional guidance where an assessment made in accordance with the principles articulated in paragraph B4.1.10 of IFRS 9 is inconclusive.

44. Furthermore, the staff are of the view that the core principle articulated in paragraph B4.1.10 of IFRS 9 is that the cash flows before and after a change in contractual cash flows should represent SPPI. For example, if the repayments on a loan are linked to the price of a commodity, the contractual cash flows change directly in response to a risk or market factor that is not typically considered to be basic a lending risk or cost and therefore do not represent SPPI.

45. Paragraph B4.1.10 of IFRS 9 further states that an entity 'may need to assess the nature of any contingent event' but that the 'nature of the contingent event in itself is not a determinative factor'. In one of the examples included in this paragraph, the contractual cash flows before and after the contingent event of a specified equity index reaching a particular level appear to represent SPPI. Nevertheless, the paragraph suggests that such an instrument is less likely to have cash flows that are SPPI over the life of the instrument than an instrument with an interest rate that is set to a higher rate if the debtor misses a particular number of payments.

46. In the absence of further clarification, paragraph B4.1.10 of IFRS 9 could be interpreted to indicate that an instrument with an interest rate that is adjusted based on the greenhouse gas emissions of the debtor would also be less likely to have cash flows that are SPPI than an instrument with an interest rate that is linked to changes in

the credit risk of the borrower. However, the paragraph does not suggest that an instrument with such terms could in no circumstances be consistent with a basic lending arrangement. The IASB attempted to give more definitive guidance by proposing that the occurrence of a contingent event should be 'specific to the debtor' to be consistent with a basic lending arrangement. Given the shortcomings of this proposal summarised in paragraph 47, the staff believe it is worth considering a different approach to clarifying the principles in paragraph B4.1.10 of IFRS 9.

Contingent events specific to the debtor

47. The staff acknowledge the concerns raised by respondents regarding the statement that '[f]or a change in contractual cash flows to be consistent with a basic lending arrangement, the occurrence (or non-occurrence) of the contingent event must be specific to the debtor.' Although in many cases this consideration can be a useful indicator of whether a change in contractual cash flows is consistent with a basic lending arrangement, it does not by itself provide sufficient guidance in the following circumstances:

   (a) factors that impact basic lending risks and costs but are not specific to the borrower (such as the profit margin or administrative costs included in the interest rate);

   (b) factors that are specific to the borrower, but unrelated to basic lending risks and costs (such as profit-sharing arrangements or targets linked to the debtor's revenue); and

   (c) factors such as ESG-targets included in instruments that would otherwise appear to be consistent with a basic lending arrangement but are set at a level other than the legal debtor (such as group-wide ESG-targets or targets for Scope III emissions).

48. In the staff's view, a useful comparison for an instrument with an interest rate that is adjusted based on the greenhouse gas emissions of the debtor, is to the example of the 'Livret A' saving accounts in France discussed in paragraph BC4.179 of the Basis for

Conclusions on IFRS 9. The interest rates on these saving accounts are determined by the central bank for public policy reasons to incentivise entities to use these particular saving accounts. The IASB concluded that although the objective of the time value of money element is not to provide consideration for only the passage of time, a regulated interest rate shall be considered a proxy for the time value of money if that regulated interest rate provides compensation that is broadly consistent with the passage of time and does not provide exposure to risks or volatility in the contractual cash flows that are inconstant with a basic lending arrangement (see paragraph B4.1.9E of IFRS 9).

49. The difference between regulated interest rates and ESG-features commonly included in loans is that the latter tends to be at the discretion of the creditor. However, for the purpose of classifying a financial asset in accordance with IFRS 9, the intention behind including a contractual term in a financial asset is less important than whether the contractual term changes the timing or amount of contractual cash flows in such a way that amortised cost measurement would no longer provide useful information to users of the financial statements. It may therefore be useful to consider whether, despite such a contractual term, the contractual cash flows are still consistent with a basic lending arrangement.

50. The staff believe that the requirements in paragraph B4.1.10 of IFRS 9 can be supplemented by clarifying that if a financial asset, that would otherwise have cash flows that are SPPI, contains a contractual feature that would change the timing or amount of contractual cash flows based on the occurrence of a contingent event and the nature of this contingent event does not clearly indicate that the contractual cash flows over the life of the financial asset are SPPI, the instrument could nevertheless have SPPI cash flows if:

(a) the contractually specified changes in cash flows following the occurrence (or non-occurrence) of any contingent event would give rise to cash flows that are SPPI when considered in isolation; and

(b) the fair value of this contractual feature at initial recognition is insignificant.

51. In the staff's view, considering the fair value of the contractual feature could be a good indicator of whether an entity is being compensated for something other than basic lending risks and costs. In other words, if the fair value of the contractual feature at initial recognition is not insignificant, it means that an entity is being compensated for something that is not broadly consistent with a basic lending arrangement and that measurement at fair value would provide more useful information to users of the financial statements. The staff therefore suggest that a consideration of the significance of the fair value of the contractual feature may be more useful than focusing on whether the contingent event is specific to the debtor.

52. Nevertheless, the entity will still need to make a holistic assessment of whether the contractual cash flows on the financial asset represent SPPI by taking into account the other requirements in IFRS 9, including that the resulting cash flows should not represent an investment in particular assets or cash flows.

Investment in the debtor and performance of specified assets

53. The staff acknowledge the concerns raised by respondents about the meaning of the terms 'investment in the debtor' an 'performance of specified assets' used in paragraph B4.1.10A of the ED.

54. As discussed in paragraphs BC70-BC72 of the Basis for Conclusions on the ED, the IASB intended to clarify that even if a factor is specific to the debtor, it would not be consistent with a basic lending arrangement if it represents an investment in the entity (for example profit sharing arrangements or other features that are akin to an equity investment) or in particular assets or cash flows (for example when the entity is exposed to performance risk of particular assets such as the example of the number of cars using a toll road in paragraph B4.1.16 of IFRS 9).

55. Considering the intention of the IASB and the concerns raised by respondents on the terminology used in the proposals, the staff are of the view that aligning the wording of the refined clarification with that which is used in paragraph B4.1.16 of IFRS 9 — that is that the resulting cash flows should not represent 'an investment in particular

assets or cash flows' —would resolve most of the concerns. Furthermore, since the IASB proposed in paragraph B4.1.8A of the ED that a share of revenue or profits of the debtor is an example of a risk not typically considered a basic lending risk or cost, the staff do not believe that further application guidance is needed in this context.