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Exposure Draft

IFRS[®] Accounting Standard

Amendments to the Classification and Measurement of Financial Instruments

Proposed amendments to IFRS 9 and IFRS 7

Comments to be received by 19 July 2023

Exposure Draft

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Exposure Draft IASB/ED/2023/2 is published by the International Accounting Standards Board (IASB) for comment only. Comments need to be received by **19 July 2023** and should be submitted by email to commentletters@ifrs.org or online at <https://www.ifrs.org/projects/open-for-comment/>.

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AMENDMENTS TO THE CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

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Introduction

Why is the IASB publishing this Exposure Draft?

- IN1 The International Accounting Standards Board (IASB) carried out a post-implementation review (PIR) of the classification and measurement requirements in IFRS 9 *Financial Instruments* and related requirements in IFRS 7 *Financial Instruments: Disclosures*, in accordance with the IASB's due process, as described in the IFRS Foundation *Due Process Handbook*.
- IN2 After analysing the evidence gathered in the PIR, the IASB concluded that, in general, the requirements can be applied consistently and that in doing so an entity provides useful information to users of its financial statements. However, the IASB also concluded that, in relation to some matters, the requirements should be clarified to improve their understandability.
- IN3 The matters the IASB identified as requiring action as soon as possible were:
- (a) accounting for the settlement of a financial asset or a financial liability using an electronic payment system. This matter originated from a request to the IFRS Interpretations Committee (Committee). Respondents commenting on the Committee's tentative agenda decision were concerned about the potential outcomes of finalising the agenda decision, especially in the context of the settlement of financial liabilities.
 - (b) applying the requirements for assessing contractual cash flow characteristics to financial assets with features linked to environmental, social and governance (ESG) concerns. PIR participants said that, because the global market for these financial assets is growing rapidly, clarification is required to avoid diversity in practice becoming established.
- IN4 The IASB also identified other matters in the PIR requiring standard-setting. Although these matters when considered individually were not of a high enough priority to justify immediate action, the IASB decided that it would be more efficient to issue a single exposure draft covering proposed amendments to the classification and measurement requirements in IFRS 9 (see paragraph IN5) and disclosure requirements in IFRS 7 (see paragraph IN6). In deciding to issue a single exposure draft, the IASB considered stakeholders' capacity to provide high-quality feedback on the proposals and to implement any resulting changes to IFRS 9 and IFRS 7.

Proposals in this Exposure Draft

- IN5 To address the matters arising from the PIR, this Exposure Draft proposes amendments to IFRS 9. In order of their proposed placement in the Standard, these amendments concern:

AMENDMENTS TO THE CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

- (a) derecognition of a financial liability settled through electronic transfer –to clarify that an entity is required to apply settlement date accounting when derecognising a financial asset or a financial liability; and to permit an entity to deem a financial liability that is settled using an electronic payment system to be discharged before the settlement date if specified criteria are met.
- (b) classification of financial assets –to clarify the application guidance for assessing the contractual cash flow characteristics of financial assets, including:
 - (i) financial assets with contractual terms that could change the timing or amount of contractual cash flows, for example, those with ESG-linked features;
 - (ii) financial assets with non-recourse features; and
 - (iii) financial assets that are contractually linked instruments.

IN6 This Exposure Draft also proposes to make amendments or additions to the disclosure requirements in IFRS 7 for:

- (a) investments in equity instruments designated at fair value through other comprehensive income; and
- (b) financial instruments with contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event.

Next step

IN7 The IASB will consider any comments it receives on the Exposure Draft before 19 July 2023. It will then decide whether to proceed with the proposed amendments.

Invitation to comment

Introduction

The IASB invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

- (a) respond to the questions as stated;
- (b) indicate the specific paragraph(s) to which they relate;
- (c) contain a clear rationale;
- (d) identify any wording in a particular proposal that is not clear or would be difficult to translate; and
- (e) identify any alternative the IASB should consider, if applicable.

The IASB requests that comments should be confined to the matters addressed in this Exposure Draft.

However, respondents need not answer all the questions in this invitation to comment.

Questions for respondents

Question 1—Derecognition of a financial liability settled through electronic transfer
--

<p>Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity.</p>

<p>Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB’s rationale for this proposal.</p>

<p>Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?</p>
--

Question 2—Classification of financial assets—contractual terms that are consistent with a basic lending arrangement

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:

- (a) interest for the purposes of applying paragraph B4.1.7A; and
- (b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Question 3—Classification of financial assets—financial assets with non-recourse features

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term ‘non-recourse’.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Question 4—Classification of financial assets—contractually linked instruments

The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21–B4.1.26 of IFRS 9.

The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9.

Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Question 5—Disclosures—investments in equity instruments designated at fair value through other comprehensive income

For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to:

- (a) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period; and
- (b) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period.

Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Question 6—Disclosures—contractual terms that could change the timing or amount of contractual cash flows

Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB’s rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

Question 7—Transition

Paragraphs 7.2.47–7.2.49 of the draft amendments to IFRS 9 would require an entity to apply the amendments retrospectively, but not to restate comparative information. The amendments also propose that an entity be required to disclose information about financial assets that changed measurement category as a result of applying these amendments.

Paragraphs BC105–BC107 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Deadline

The IASB will consider all comments received in writing by 19 July 2023.

How to comment

Please submit your comments electronically:

Online <https://www.ifrs.org/projects/open-for-comment/>

By email commentletters@ifrs.org

Your comments will be on the public record and posted on our website unless you request confidentiality, and we grant your request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data.

[Draft] Amendments to IFRS 9 *Financial Instruments*

Paragraphs 7.1.11 and 7.2.47–7.2.49 and the heading before paragraph 7.2.47 are added. For ease of reading these paragraphs have not been underlined.

7.1 Effective date

...

- 7.1.11 *Amendments to the Classification and Measurement of Financial Instruments*, which amended IFRS 9 and IFRS 7, issued in March 2023, added paragraphs 7.2.47–7.2.49, B3.1.2A, B3.3.8–B3.3.10, B4.1.8A, B4.1.10A, B4.1.16A, B4.1.17A and B4.1.20A and amended paragraphs B4.1.13, B4.1.14, B4.1.16, B4.1.17, B4.1.20, B4.1.21 and B4.1.23. An entity shall apply these amendments for annual reporting periods beginning on or after [date to be determined]. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact and apply all the amendments at the same time.

7.2 Transition

...

Transition for *Amendments to the Classification and Measurement of Financial Instruments*

- 7.2.47 An entity shall apply *Amendments to the Classification and Measurement of Financial Instruments* retrospectively, in accordance with IAS 8, except as specified in paragraphs 7.2.48–7.2.49.
- 7.2.48 An entity is not required to restate prior periods to reflect the application of these amendments. An entity may restate prior periods if, and only if, it is possible to do so without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application of these amendments. This difference is recognised in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.
- 7.2.49 In the reporting period that includes the date of initial application of these amendments, an entity shall disclose for each class of financial assets that changed measurement category as a result of applying the amendments:
- (a) the previous measurement category and carrying amount determined immediately before the entity applied these amendments; and
 - (b) the new measurement category and carrying amount determined immediately after the entity applied these amendments.

Appendix B Application Guidance

Paragraphs B3.1.2A, B3.3.8–B3.3.10, B4.1.8A, B4.1.10A, B4.1.16A, B4.1.17A and B4.1.20A and the heading before paragraph B3.1.2A are added. Paragraphs B4.1.13, B4.1.14, B4.1.16, B4.1.17, B4.1.20, B4.1.21 and B4.1.23 are amended. Paragraphs B4.1.7A, B4.1.10, B4.1.15 and B4.1.22 are not amended but are included for ease of reference. New text is underlined and deleted text is struck through.

Recognition and derecognition (Chapter 3)

Initial recognition (Section 3.1)

...

Date of initial recognition or derecognition

B3.1.2A When recognising or derecognising a financial asset or financial liability, an entity shall apply settlement date accounting (see paragraph B3.1.6) unless paragraph B3.1.3 applies or an entity elects to apply paragraph B3.3.8.

...

Derecognition of financial liabilities (Section 3.3)

...

B3.3.8 Notwithstanding the requirement in paragraph B3.1.2A to apply settlement date accounting, an entity is permitted to deem a financial liability (or a part of a financial liability)—that will be settled with cash using an electronic payment system—to be discharged before the settlement date if, and only if, the entity has initiated the payment instruction and:

- (a) the entity has no ability to withdraw, stop or cancel the payment instruction;
- (b) the entity has no practical ability to access the cash to be used for settlement as a result of the payment instruction; and
- (c) the settlement risk associated with the electronic payment system is insignificant.

B3.3.9 For the purposes of applying paragraph B3.3.8(c), settlement risk is insignificant if the characteristics of the electronic payment system are such that completion of the payment instruction follows a standard administrative process and the time between initiating a payment instruction and the cash being delivered is short. However, settlement risk would not be insignificant if the completion of the payment instruction is subject to the entity's ability to deliver cash on the settlement date.

B3.3.10 An entity that elects to apply paragraph B3.3.8 to the settlement of a financial liability using an electronic payment system shall apply the requirements in that paragraph to all settlements made through the same electronic payment system.

Classification (Chapter 4)

Classification of financial assets (Section 4.1)

...

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

...

B4.1.7A Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money (see paragraphs B4.1.9A–B4.1.9E) and credit risk are typically the most significant elements of interest. However, in such an arrangement, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, administrative costs) associated with holding the financial asset for a particular period of time. In addition, interest can include a profit margin that is consistent with a basic lending arrangement. In extreme economic circumstances, interest can be negative if, for example, the holder of a financial asset either explicitly or implicitly pays for the deposit of its money for a particular period of time (and that fee exceeds the consideration that the holder receives for the time value of money, credit risk and other basic lending risks and costs). However, contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. An originated or a purchased financial asset can be a basic lending arrangement irrespective of whether it is a loan in its legal form.

...

B4.1.8A In assessing whether the contractual cash flows of a financial asset are consistent with a basic lending arrangement, an entity may have to consider the different elements of interest separately. The assessment of interest focuses on *what* an entity is being compensated for, rather than *how much* compensation an entity receives. Contractual 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 (for example, a share of the debtor's revenue or profit), even if such contractual terms are common in the market in which the entity operates. Furthermore, 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.

...

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

B4.1.10 If a financial asset contains a contractual term that could change the timing or amount of contractual cash flows (for example, if the asset can be prepaid before maturity or its term can be extended), the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are solely payments of principal and interest on the principal amount outstanding. To make this determination, the entity must assess the contractual cash flows that could arise both before, and after, the change in contractual cash flows. The entity may also need to assess the nature of any contingent event (ie the trigger) that would change the timing or amount of the contractual cash flows. While the nature of the contingent event in itself is not a determinative factor in assessing whether the contractual cash flows are solely payments of principal and interest, it may be an indicator. For example, compare a financial instrument with an interest rate that is reset to a higher rate if the debtor misses a particular number of payments to a financial instrument with an interest rate that is reset to a higher rate if a specified equity index reaches a particular level. It is more likely in the former case that the contractual cash flows over the life of the instrument will be solely payments of principal and interest on the principal amount outstanding because of the relationship between missed payments and an increase in credit risk. (See also paragraph B4.1.18.)

B4.1.10A In applying paragraph B4.1.10, an entity shall assess whether contractually specified changes in cash flows following the occurrence (or non-occurrence) of any contingent event would give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding. This assessment shall be done irrespective of the probability of the contingent event occurring (except for non-genuine contractual terms as described in paragraph B4.1.18). For 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. The occurrence of a contingent event is specific to the debtor if it depends on the debtor achieving a contractually specified target, even if the same target is included in other contracts for other debtors. However, the resulting contractual cash flows must represent neither an investment in the debtor nor an exposure to the performance of specified assets (see also paragraphs B4.1.15–B4.1.16).

...

B4.1.13 The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
<p>...</p> <p><u>Instrument EA</u></p> <p><u>Instrument EA is a loan with an interest rate that is periodically adjusted by a specified number of basis points if the debtor achieves a contractually specified reduction in greenhouse gas emissions during the preceding reporting period.</u></p>	<p>...</p> <p><u>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding.</u></p> <p><u>The occurrence of the contingent event (achieving a contractually specified reduction in greenhouse gas emissions) is specific to the debtor. The contractual cash flows arising from the occurrence (or non-occurrence) of the contingent event are in all circumstances solely payments of principal and interest on the principal amount outstanding.</u></p> <p><u>The contractual cash flows represent neither an investment in the debtor nor an exposure to the performance of specified assets.</u></p>

- B4.1.14 The following examples illustrate contractual cash flows that are not solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
<p>...</p> <p><u>Instrument I</u></p> <p><u>Instrument I is a loan with an interest rate that is periodically adjusted when a market-determined carbon price index reaches a contractually defined threshold.</u></p>	<p>...</p> <p><u>The contractual cash flows are not solely payments of principal and interest on the principal amount outstanding.</u></p> <p><u>The contractual cash flows change in response 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.</u></p>

- B4.1.15 In some cases a financial asset may have contractual cash flows that are described as principal and interest but those cash flows do not represent the payment of principal and interest on the principal amount outstanding as described in paragraphs 4.1.2(b), 4.1.2A(b) and 4.1.3 of this Standard.
- B4.1.16 This may be the case if the financial asset represents an investment in particular assets or cash flows and hence the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. For example, if the contractual terms stipulate that the financial

asset's cash flows increase as more automobiles use a particular toll road, those contractual cash flows are inconsistent with a basic lending arrangement. As a result, the instrument would not satisfy the condition in paragraphs 4.1.2(b) and 4.1.2A(b). ~~This could be the case when a creditor's claim is limited to specified assets of the debtor or the cash flows from specified assets (for example, a 'non-recourse' financial asset).~~

B4.1.16A This may also be the case if a financial asset has 'non-recourse' features. A financial asset has non-recourse features if an entity's contractual right to receive cash flows is limited to the cash flows generated by specified assets both over the life of the financial asset and in the case of default. In other words, throughout the life of the financial asset, the entity is primarily exposed to the specified assets' performance risk rather than the debtor's credit risk.

B4.1.17 However, the fact that a financial asset ~~is~~ has non-recourse features does not in itself necessarily preclude the financial asset from meeting the condition in paragraphs 4.1.2(b) and 4.1.2A(b). In such situations, the creditor is required to assess ('look through to') the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.

B4.1.17A When assessing whether the contractual cash flows of a financial asset with non-recourse features are payments of principal and interest on the principal amount outstanding, in accordance with paragraph B4.1.17, an entity may also need to consider factors such as the legal and capital structure of the debtor, including, but not limited to, the extent to which:

- (a) the cash flows generated by the underlying assets are expected to exceed the contractual cash flows on the financial asset being classified; and
- (b) any shortfall in cash flows generated by the underlying assets is expected to be absorbed by subordinated debt or equity instruments issued by the debtor.

...

Contractually linked instruments

B4.1.20 In some types of transactions, an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments ~~that create concentrations of credit risk~~ (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. The prioritisation of payments to the holders of these tranches is established through a waterfall payment structure. That payment structure creates concentrations of credit

risk and results in a disproportionate allocation of losses between the holders of different tranches. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches, which means the tranches have non-recourse features (see paragraph B4.1.16A).

B4.1.20A Some transactions may contain multiple debt instruments without having all of the characteristics described in paragraph B4.1.20. For example, an entity (the creditor) may enter into a secured lending arrangement whereby the debtor (the sponsoring entity) establishes a structured entity which issues senior and junior debt instruments. The debtor may hold the junior debt instrument to provide credit protection to the entity holding the senior debt instrument. Such transactions do not contain multiple contractually linked instruments because the structured entity is created to facilitate the lending transaction from a single creditor. The contractual cash flows of the senior debt instrument in such transactions shall be assessed by applying the requirements in paragraphs B4.1.7–B4.1.19.

B4.1.21 In ~~such~~ transactions that contain multiple contractually linked instruments, as described in paragraph B4.1.20, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:

(a) ...

B4.1.22 An entity must look through until it can identify the underlying pool of instruments that are creating (instead of passing through) the cash flows. This is the underlying pool of financial instruments.

B4.1.23 The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. For the purpose of this assessment, the underlying pool can include financial instruments that are not within the scope of the classification requirements (see Section 4.1 of this Standard), for example, lease receivables that have contractual cash flows that are equivalent to payments of principal and interest on the principal amount outstanding.

...

[Draft] Amendments to IFRS 7 *Financial Instruments: Disclosures*

Paragraphs 20B, 20C and 44JJ are added. Paragraph 11A is amended. New text is underlined and deleted text is struck through.

Significance of financial instruments for financial position and performance

...

Statement of financial position

...

Investments in equity instruments designated at fair value through other comprehensive income

11A If an entity 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, it shall disclose:

- (a) ...
- (b) ...
- (c) the fair value of ~~each~~ such investments at the end of the reporting period.
- (d) ...
- (e) ...
- (f) the amount of change in the fair value of such investments during the period, showing separately the amount of that change related to investments derecognised during the reporting period and the amount of that change related to investments held at the end of the reporting period.

...

Statement of comprehensive income

Items of income, expense, gains or losses

...

20B To help users of financial statements understand the effect of contractual terms that could change the timing or amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event that is specific to the debtor, an entity shall disclose:

- (a) a qualitative description of the nature of the contingent event;
- (b) quantitative information about the range of changes to contractual cash flows that could result from those contractual terms; and

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

20C An entity shall disclose the information required by paragraph 20B 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. The entity shall consider how much detail to disclose, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate any quantitative information disclosed.

...

Effective date and transition

...

44J Amendments to the Classification and Measurement of Financial Instruments, issued in March 2023, added paragraphs 20B and 20C and amended paragraph 11A. An entity shall apply these amendments when it applies the amendments to IFRS 9. An entity need not provide the disclosures required by these amendments for any period presented beginning before the date of initial application of the amendments.

**Approval by the International Accounting Standards Board of
Exposure Draft *Amendments to the Classification and
Measurement of Financial Instruments* published in March 2023**

The Exposure Draft *Amendments to the Classification and Measurement of Financial Instruments* was approved for publication by 11 of the 12 members of the International Accounting Standards Board (IASB) as at February 2023. Ms Buchanan abstained in view of her recent appointment to the IASB.

Andreas Barckow	Chair
Linda Mezon-Hutter	Vice-Chair
Nick Anderson	
Patrina Buchanan	
Tadeu Cendon	
Zach Gast	
Jianqiao Lu	
Bruce Mackenzie	
Bertrand Perrin	
Rika Suzuki	
Ann Tarca	
Robert Uhl	

Basis for Conclusions on Exposure Draft Amendments to the Classification and Measurement of Financial Instruments

This Basis for Conclusions accompanies, but is not part of, the Exposure Draft Amendments to the Classification and Measurement of Financial Instruments. It summarises the considerations of the International Accounting Standards Board (IASB) when developing the Exposure Draft. Individual IASB members gave greater weight to some factors than to others.

Introduction

- BC1 The IASB carried out a post-implementation review (PIR) of the classification and measurement requirements in IFRS 9 *Financial Instruments* and related requirements in IFRS 7 *Financial Instruments: Disclosures*, in accordance with the IASB's due process, as described in the IFRS Foundation *Due Process Handbook*. The work completed by the IASB and the conclusions it reached are summarised in the *Project Report and Feedback Statement – Post-implementation Review of IFRS 9 Financial Instruments – Classification and Measurement*, published in December 2022.
- BC2 The PIR resulted in the identification of two matters that the IASB decided should be addressed as soon as possible:
- (a) electronic cash transfers as settlement of a financial asset or a financial liability – proposing amendments to the application guidance on recognition and derecognition (see paragraphs BC5–BC38); and
 - (b) the assessment of the contractual cash flow characteristics of financial assets with features linked to environmental, social and governance (ESG) concerns – proposing amendments to the application guidance on the classification of financial assets (see paragraphs BC39–BC72).
- BC3 The IASB also identified other matters that, although of a lower priority, also require standard-setting. The IASB decided that it would be most efficient for stakeholders if the IASB included the proposed amendments to IFRS 9 and IFRS 7 in a single exposure draft. The first of these matters involves clarifying the application of the contractual cash flow characteristics assessment to financial assets with non-recourse features and to contractually linked instruments. The proposed requirements for these instruments are part of the general requirements on contractual cash flow characteristics, and therefore need to be considered along with any necessary clarifications to them (see paragraphs BC73–BC93).
- BC4 This Exposure Draft also proposes amendments or additions to the disclosure requirements in IFRS 7 for:
- (a) investments in equity instruments designated at fair value through other comprehensive income (see paragraphs BC94–BC97); and
 - (b) financial instruments with contractual terms that could change the timing or amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event (see paragraphs BC98–BC104).

Derecognition of a financial liability settled through electronic transfer

Background

- BC5 In September 2021 the IFRS Interpretations Committee (Committee) received a request about the application of IFRS 9 in relation to the recognition of cash received by an entity via electronic transfer as settlement of a financial asset (a trade receivable).
- BC6 The Committee concluded that an entity, in applying paragraphs 3.2.3(a) and 3.1.1 of IFRS 9, is required:
- (a) to derecognise a trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire; and
 - (b) to recognise the cash (or other financial asset) received as settlement of that trade receivable on the same date.
- BC7 Respondents to the Committee's tentative agenda decision did not disagree with its technical analysis and conclusions. However, many respondents were concerned about the potential outcomes of finalising the agenda decision.
- BC8 At its June 2022 meeting, the Committee considered this feedback and confirmed the technical analysis and conclusions in its tentative agenda decision. However, the Committee decided to refer to the IASB respondents' concerns, which included:
- (a) a disruption to long-standing practices;
 - (b) the costs of applying the agenda decision; and
 - (c) possible adverse consequences in relation to other fact patterns, in particular, the derecognition of trade payables.
- BC9 A few PIR participants also commented on the Committee's discussion of this topic and reconfirmed the aforementioned concerns. Consequently, the IASB decided to consider this matter as part of its PIR.
- BC10 Except for a regular way purchase or sale of financial assets, IFRS 9 requires an entity to apply settlement date accounting when recognising or derecognising financial assets or financial liabilities. Those recognition and derecognition requirements—which result in an entity faithfully representing in its financial statements its contractual rights and obligations at the reporting date—provide useful information to users of financial statements. The IASB observed that the PIR did not provide evidence of fundamental questions about the clarity and suitability of the derecognition requirements in IFRS 9. The IASB further noted that potential for disruption to long-standing practices arising from an agenda decision published by the Committee is not, in itself, a reason to undertake standard-setting.

- BC11 However, despite the fact that the PIR had concluded that the recognition and derecognition requirements in IFRS 9 generally work well, the IASB acknowledged the diversity in practice that stakeholders identified, especially in the context of the settlement of financial liabilities. The IASB therefore decided:
- (a) to clarify that an entity is required to use settlement date accounting when recognising or derecognising financial assets and financial liabilities (unless paragraph B3.1.3 of IFRS 9 applies); and
 - (b) to develop new requirements to permit an entity to derecognise, before the settlement date, a financial liability that will be settled with cash using an electronic payment system.

Approaches considered

- BC12 The IASB considered two possible narrow-scope standard-setting approaches:
- (a) clarifying aspects of the derecognition requirements in IFRS 9 (see paragraphs BC13–BC21); or
 - (b) developing requirements to permit derecognition of a financial liability before the settlement date when specified criteria are met (see paragraphs BC22–BC24).

Clarification of aspects of the derecognition requirements

- BC13 The first approach, had it been followed, would have necessitated an amendment to IFRS 9 to clarify *when* the contractual rights to the cash flows from a financial asset expire (paragraph 3.2.3(a) of IFRS 9) or when a financial liability is extinguished (paragraph 3.3.1 of IFRS 9).
- BC14 Respondents to the Committee’s tentative agenda decision said that determining exactly when a liability is extinguished, or the rights to the cash flows from a financial asset expire, could be time-consuming, costly and involve extensive (legal) analysis of each payment platform and the related individual contractual terms. This is because the relevant regulations and requirements to determine the point of extinguishment vary between jurisdictions and could potentially lead to economically similar financial assets and financial liabilities being derecognised at different times.
- BC15 The IASB noted that the recognition and derecognition requirements in IFRS 9 generally result in symmetrical outcomes—in other words, if one entity has a financial asset, another entity will have a corresponding financial liability (or an equity instrument)—while the detailed assessments for derecognition differ (see paragraphs BC16–BC17).
- BC16 For example, paragraph B3.3.1 of IFRS 9 states that a financial liability is extinguished when either an entity is legally released from primary responsibility for the financial liability, or when the entity’s contractual obligation is discharged through payment (upon delivery of cash or another financial asset by the entity on the settlement date).

- BC17 In relation to financial assets, the IASB noted that paragraph 3.2.3(a) of IFRS 9 states that a financial asset is derecognised either when the contractual rights to the cash flows expire (upon delivery of cash or another financial asset to the entity on the settlement date) or the financial asset is transferred, and the transfer qualifies for derecognition by applying paragraphs 3.2.4–3.2.6 of IFRS 9.
- BC18 The IASB considered that, although the derecognition outcomes are symmetrical, the timing of recognition and derecognition for the same transaction may not be. This is because an entity does not base its accounting on what a counterparty has done but, instead, assesses its contractual rights or obligations to receive or pay cash on the basis of the information it has at the reporting date (for example, when applying settlement date accounting).
- BC19 To clarify when rights expire or liabilities are extinguished, the IASB would need to look holistically at the derecognition requirements in IFRS 9 for both financial assets and financial liabilities. The IASB concluded that such an approach would require a fundamental reconsideration of those requirements, and, as a consequence, also consideration of the recognition requirements for financial assets and financial liabilities.
- BC20 The IASB also noted that it would not be possible to limit such an approach to particular types of such assets or liabilities. The approach would, therefore, give rise to a significant risk of unintended consequences. Careful consideration of that risk would require analysis of all potential scenarios and transactions, and consequently a significant investment of time and resources, of the IASB and of its stakeholders.
- BC21 The IASB concluded that fundamentally reconsidering the recognition and derecognition requirements in IFRS 9 would be inconsistent with:
- (a) the feedback received during the PIR that the recognition and derecognition requirements generally work well; and
 - (b) its framework for assessing when to take action on matters identified during a PIR.

Therefore, the IASB decided not to follow such an approach.

Requirements to permit derecognition before the settlement date when specified criteria are met

- BC22 Although the request and the Committee’s tentative agenda decision focused on the application of the derecognition requirements to trade receivables, most of the concerns stakeholders raised related to trade payables. The IASB therefore decided to explore whether it could, through narrow-scope standard-setting:
- (a) clarify that an entity is required to apply settlement date accounting (unless paragraph B3.1.3 of IFRS 9 applies) when recognising and derecognising financial assets and financial liabilities; and
 - (b) permit the derecognition of a financial liability before the settlement date if specified criteria were met.

- BC23 The IASB acknowledged that such a narrow-scope amendment to IFRS 9 would not resolve all of the concerns that stakeholders had raised, nor would it reduce the costs of applying the derecognition requirements in IFRS 9 to all financial liabilities—because the criteria would be met only in specified circumstances. However, the IASB was of the view that such a narrow-scope amendment would:
- (a) provide a timely and effective response to many of the concerns raised by stakeholders;
 - (b) mitigate the risk of unintended consequences by retaining the current derecognition requirements without fundamental change;
 - (c) lead to consistency in applying the derecognition requirements by clarifying the use of settlement date accounting and ensure that the usefulness of the information provided to users of financial statements was not compromised;
 - (d) limit the circumstances in which financial liabilities could be derecognised before the settlement date through the use of specified criteria; and
 - (e) be operable if the scope of the amendment were sufficiently narrow.
- BC24 Consequently, the IASB decided to explore further the feasibility of such a narrow-scope amendment.

Proposed requirements for financial liabilities

Criteria for derecognising a financial liability before the settlement date

- BC25 The settlement of a financial asset or a financial liability is not a regular way purchase or sale of a financial asset, as defined in Appendix A to IFRS 9. However, the requirements for regular way transactions in paragraphs 3.1.2 and B3.1.3–B3.1.6 of IFRS 9 already provide an alternative to the general requirements to recognise or derecognise a financial asset before the settlement date if specified criteria were met. The IASB therefore considered those requirements as a useful starting point to develop criteria for the derecognition of financial liabilities before the settlement date.
- BC26 The IASB also considered the requirements in paragraph AG38F of IAS 32 *Financial Instruments: Presentation* for a gross settlement system that would meet the net settlement criterion in paragraph 42(b) of that Standard. As for a regular way purchase or sale in IFRS 9, for a gross settlement system to meet the criteria for net settlement, one of the key principles is that the risk of settlement not occurring must be insignificant.
- BC27 The IASB proposes in paragraph B3.3.8 of the draft amendments that an entity be permitted to deem a financial liability (or a part of it)—that will be settled with cash using an electronic payment system—to be discharged before the settlement date if, and only if, the entity has initiated the payment instruction and:

- (a) the entity has no ability to withdraw, stop or cancel the payment instruction (see paragraphs BC28–BC29);
- (b) the entity has no practical ability to access the cash to be used for settlement as a result of the payment instruction (see paragraphs BC30–BC32); and
- (c) the settlement risk associated with the electronic payment system is insignificant (see paragraphs BC33–BC34).

No ability to withdraw, stop or cancel the payment instruction

BC28 The IASB considered that an entity typically initiates cash payments to settle its financial liabilities by issuing payment instructions to its bank(s) through a wide range of payment systems or platforms. Although in issuing the payment instruction an entity might be committed to settling a liability, the entity might still be able to withdraw, stop or cancel a payment instruction depending on the nature of the payment system—for example, when cash has not yet been transferred or delivered to a creditor. In other words, if an entity has the ability to withdraw, stop or cancel a payment instruction, the entity could still prevent the payment from completing and, in those circumstances, it could not be said that the entity has discharged the liability, as currently required by paragraph B3.3.1(a) of IFRS 9.

BC29 The IASB therefore proposes that, for an entity to deem a financial liability to be discharged before the settlement date, the entity must have no ability to withdraw, stop or cancel the relevant payment instruction.

No practical ability to access the cash used for settlement

BC30 The IASB is also proposing that, to derecognise a financial liability before the settlement date, an entity must have no practical ability to access the cash used for settlement.

BC31 In developing this criterion, the IASB considered situations in which an entity has no practical ability to access cash even though the cash might not have been transferred from the entity’s bank account. In such a situation, the entity might be reasonably certain that the cash will be delivered to the creditor in accordance with the standard processing time for the cash payment system used (delivery would usually be within a short time frame). For example, although the cash might still be part of the entity’s cash balance with the bank, the ‘available’ balance might be reduced by the amount of the payment instruction. At this time, the entity might no longer be able to access the cash or direct its use for a purpose other than settling the payment obligation.

BC32 In the IASB’s view, it would be inappropriate for an entity to deem a financial liability to be discharged if the entity could still access or direct the use of the cash to be used to settle the liability. If an entity has the practical ability to access the cash for a purpose other than settling the financial liability, it could neither be considered that the entity has delivered cash (as required for settlement date accounting by paragraph B3.1.6 of IFRS 9) nor that the entity

has discharged the liability by paying with cash (as required by paragraph B3.3.1(a) of IFRS 9).

Settlement risk associated with the electronic payment system is insignificant

BC33 'Settlement risk' generally refers to the risk that a transaction will not be settled (or completed) and therefore that the debtor will not deliver cash to the creditor on the settlement date. For the purposes of the requirements in paragraphs B3.1.6 and B3.3.1 of IFRS 9, when a financial liability has been discharged by paying cash to a creditor, the creditor is no longer exposed to any settlement risk associated with the transaction.

BC34 The IASB is of the view that for an entity to deem a financial liability to be discharged before the settlement date, the risk of settlement not occurring must be insignificant. In the draft amendments, the IASB proposes that settlement risk is insignificant when the characteristics of an electronic payment system are such that completion of the payment instruction follows a standard administrative process, and that the time between initiating a payment instruction and the cash being delivered is short. The longer the completion time for a specific payment system, the higher the risk that the payment may not be completed due to default of the debtor.

Scope of the proposed requirements

BC35 In developing its proposed requirements, the IASB considered their potential scope. In particular, the IASB considered whether the proposed requirements could be applied to a wider population of cash payments instead of just electronic payment systems, for example, all cash payments from demand deposits.

BC36 The IASB noted that, were the proposed requirements to be so widely applied, such an approach could give rise to a number of conceptual and practical challenges. First, the risk that cash could be seen as being treated differently from other financial assets for the purposes of the derecognition requirements in IFRS 9. This could lead to different accounting outcomes when an entity settles a transaction with cash rather than by delivering another financial asset, such as a security.

BC37 Second, were the proposed amendments to apply to all cash payments from demand deposits (for example, a current account), cash payments would be excluded from an entity's other sources of cash. With this in mind, the IASB noted that the practical challenges that led to the development of the proposed requirements did not arise from the nature of the account from which a payment is made, but rather from the nature of the payment method being used. The IASB also noted that any consideration of 'cash' or 'cash equivalents'—defined in IAS7 *Statement of Cash Flows*—is outside the scope of IFRS 9 and therefore not relevant to the proposed requirements.

- BC38 Consequently, the IASB decided to limit the scope of the proposed requirements to cash settlements using electronic payment systems that meet the specified criteria but without otherwise changing the application of the derecognition requirements in IFRS 9. The IASB also decided that an entity must apply the proposed requirements to all payments using the same payment system.

Classification of financial assets

Background

- BC39 When developing the classification requirements for financial assets in IFRS 9, the IASB decided that amortised cost provides useful information to users of financial statements about the amount, timing and uncertainty of a financial asset's future cash flows only if those cash flows are solely payments of principal and interest on the principal amount outstanding (see paragraph BC4.23 of the Basis for Conclusions on IFRS 9).
- BC40 Appendix B to IFRS 9 includes application guidance on assessing whether a financial asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding. PIR participants agreed that, in general, the application guidance works as intended by the IASB. However, participants noted challenges in applying the guidance to financial assets with ESG-linked or similar features.
- BC41 In the IASB's view, the contractual cash flow characteristics assessment in IFRS 9 is as relevant to financial assets with ESG-linked features as it is to other financial assets; and that the requirements in IFRS 9 (subject to clarifications) provide an appropriate basis to determine whether such financial assets meet the conditions to be measured at amortised cost or fair value through other comprehensive income.
- BC42 The IASB concluded that creating an exception from the requirements on contractual cash flow characteristics in IFRS 9 for financial assets with ESG-linked features would not be appropriate. In the IASB's view, this conclusion is consistent with the PIR feedback that indicated that there was no need for fundamental changes to the classification and measurement requirements in IFRS 9.
- BC43 The IASB agreed with PIR participants that amortised cost could provide useful information to users of financial statements about the amount, timing and uncertainty of future cash flows of some financial assets with ESG-linked features. For a financial asset whose ESG-linked features represent a cost of lending, rather than an exposure to factors unrelated to a basic lending arrangement, the most relevant information about such a financial asset is the contractual return to which the creditor is entitled and the cash flows that the creditor does not expect to receive. Amortised cost measurement captures both these elements through the effective interest method and the impairment requirements (see paragraph BC4.6 of the Basis for Conclusions on IFRS 9).

- BC44 The IASB therefore decided to respond to the PIR feedback by proposing clarifying amendments to IFRS 9. The amendments will further assist entities in determining whether financial assets—including those with ESG-linked or similar features—have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, as required by paragraphs 4.1.2 and 4.1.2A of IFRS 9. Specifically, the IASB is proposing amendments relating to:
- (a) the elements of interest that are consistent with a basic lending arrangement (see paragraphs BC46–BC52); and
 - (b) contractual terms that change the timing or amount of contractual cash flows (see paragraphs BC53–BC72).
- BC45 PIR participants also raised questions about assessing the contractual cash flow characteristics of other types of financial assets. In response to these questions, the IASB is proposing clarifying amendments relating to:
- (a) financial assets with non-recourse features (see paragraphs BC73–BC79); and
 - (b) contractually linked instruments (see paragraphs BC80–BC93).

Elements of interest in a basic lending arrangement

- BC46 Paragraph B4.1.7A of IFRS 9 states that contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. That paragraph also outlines some typical elements of interest that are consistent with a basic lending arrangement, namely, consideration for the time value of money; credit risk; other basic lending risks, such as liquidity risk; costs associated with holding the financial asset; and a profit margin.
- BC47 In analysing the PIR feedback, including uncertainty about the term ‘basic lending arrangement’, the IASB reconfirmed that:
- (a) 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;
 - (b) the specified elements do not provide a ‘safe haven’—even if something is labelled ‘credit risk’ or ‘profit margin’, further analysis may be required;
 - (c) an entity is not necessarily required to carry out a quantitative analysis of the different elements of interest to determine whether the contractual cash flows are consistent with a basic lending arrangement; and
 - (d) contractual terms are not necessarily consistent with a basic lending arrangement simply because they are common in the market in which the entity operates.

AMENDMENTS TO THE CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

- BC48 The IASB decided to respond to the PIR feedback by proposing amendments to clarify how to assess interest for the purposes of applying paragraph B4.1.7A. The IASB confirmed the principle explained in paragraph BC4.182(b) of the Basis for Conclusions on IFRS 9—that the assessment of interest focuses on *what* the entity is being compensated for rather than *how much* the entity receives for a particular element. The IASB decided to incorporate this principle into the application guidance in paragraph B4.1.8A of the draft amendments.
- BC49 The IASB also decided to clarify when contractual cash flows are consistent with a basic lending arrangement and when they are not, and to provide examples to illustrate how an entity should apply the clarified requirements.
- BC50 The IASB concluded that it would not be possible to prescribe an exhaustive list of the elements of interest that would be consistent with a basic lending arrangement. Paragraph B4.1.15 of IFRS 9 already states that, in some cases, cash flows that are contractually labelled as ‘interest’ may not be consistent with a basic lending arrangement. Similarly, although a contractual term might not explicitly refer to ‘interest’, it may nonetheless result in consideration that forms part of the lender’s compensation for the time value of money, credit risk and other basic lending risks and costs. The IASB therefore concluded that an entity may need to apply judgement, in particular when assessing contractual terms relating to new developments in lending markets.
- BC51 The IASB also noted that the term ‘basic lending arrangement’ is used in IFRS 9 to refer to the nature of a lending arrangement, rather than to an arrangement that is common or widespread in a particular market or jurisdiction. Although, as a general proposition, the market is relevant—for example, in a particular jurisdiction it might be common to reference interest rates to a particular benchmark rate—just because something is common practice in a particular jurisdiction, it does not necessarily result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. For example, paragraph B4.1.7A of IFRS 9 states that exposure to commodity or equity prices is inconsistent with a basic lending arrangement. This would be the case regardless of whether loans in a particular market commonly have contractual terms that are linked to such factors.
- BC52 In a basic lending arrangement, a lender lends a principal amount to a borrower for a specified term (which may be contractually shortened or extended) in exchange for the contractual right to receive payments of principal and interest representing compensation for risks and costs associated with holding the financial asset. There is, therefore, a relationship between the perceived risk the lender is taking on and the compensation it receives for that risk. The IASB therefore decided to clarify that, for contractual cash flows to be consistent with a basic lending arrangement, a change in contractual cash flows has to be directionally consistent with, as well as proportionate to, a change in lending risks or costs. For example, an increase in the credit risk of a borrower is reflected in an increase, and not a decrease, in the interest rate of the financial asset.

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

- BC53 IFRS 9 acknowledges that some financial assets contain contractual terms that could change the timing or amount of contractual cash flows during the life of those assets. For such a financial asset, paragraph B4.1.10 of IFRS 9 requires an entity to determine whether the cash flows that could arise over the life of the financial asset are solely payments of principal and interest on the principal amount outstanding.
- BC54 PIR participants asked the IASB for more guidance on applying the principles in B4.1.10 to contingent events that are not currently covered by the examples in that paragraph. Feedback suggested that entities might infer from one of the examples—namely, a change in contractual cash flows triggered by a change in the debtor’s credit risk—that, for cash flows to be solely payments of principal and interest on the principal amount outstanding, the nature of any contingent event must be associated with one of the elements of interest specified in paragraph B4.1.7A of IFRS 9.
- BC55 The IASB noted that IFRS 9 requires all variability in contractual cash flows over the life of an instrument to be assessed. In other words, variability cannot be assumed to be consistent with a basic lending arrangement simply because it arises from one of the elements of interest mentioned in paragraph B4.1.7A of IFRS 9. Furthermore, the variability in cash flows need not relate to one of the elements of interest explicitly mentioned in paragraph B4.1.7A. For example, IFRS 9 mentions liquidity risk as an example of ‘other basic lending risks’ because it is a common element of interest. However, IFRS 9 does not state that it is the only other basic lending risk or cost. In the IASB’s view, the key principle is whether the changes in the timing or amount of contractual cash flows are consistent with a basic lending arrangement.
- BC56 The IASB decided that it would be helpful to identify and clarify in paragraph B4.1.10A of the draft amendments the following interrelated principles for assessing the contractual cash flows over the life of a financial asset:
- (a) all possible changes in contractual cash flows are considered irrespective of the probability of a contingent event occurring (except for non-genuine contractual terms, as described in paragraph B4.1.18 of IFRS 9) (see paragraphs BC58–BC60);
 - (b) the timing and amount of any variability in contractual cash flows are specified in the contract (see paragraphs BC61–BC62);
 - (c) the occurrence of the contingent event is specific to the debtor (see paragraphs BC63–BC69); and
 - (d) the contractual cash flows arising from the contingent event represent neither an investment in the debtor nor an exposure to the performance of specified assets (see paragraphs BC70–BC72).

BC57 The IASB also decided to add examples to paragraphs B4.1.13 and B4.1.14 of IFRS 9 to illustrate these principles.

Consideration of possible changes in contractual cash flows, irrespective of probability

BC58 When developing IFRS 9, the IASB considered feedback suggesting that a contingent feature should not affect the classification of a financial asset if the likelihood of the contingent event occurring is remote. The IASB rejected this approach, concluding that even if the probability of a contingent event occurring is low, an entity must consider all contractual cash flows that could arise over the life of the instrument unless the contingent feature is not genuine (see paragraphs BC4.186 and BC4.189 of the Basis for Conclusions on IFRS 9).

BC59 This view was further reflected in the requirements in IFRS 9 that prohibit reclassifications based on a financial asset's contractual cash flows. An entity is required to classify a financial asset at initial recognition based on the contractual terms over the life of the instrument (see paragraph BC4.117 of the Basis for Conclusions on IFRS 9).

BC60 The IASB therefore noted that the contractual cash flow assessment is based on all contractual cash flows that could arise over the life of the financial instrument; it is not a probability-based assessment. In other words, an entity must consider the effect on contractual cash flows were any of the contingent events specified in the contract to occur, however unlikely.

Changes to cash flows specified in the contractual terms

BC61 The underlying principle for the classification of financial assets is that amortised cost provides useful information to users of financial statements about the amount, timing and uncertainty of future cash flows of financial assets if the contractual cash flows are either fixed both in timing and amount, or variable yet determinable.

BC62 The IASB therefore decided that, for changes in the amount or timing of contractual cash flows arising from a contingent event to give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding, those changes in cash flows must be contractually specified and, therefore, determinable. In other words, in addition to knowing what would give rise to a change in cash flows, the entity must also know what the adjustment to the cash flows would be in order for it to conclude that contractual cash flows—that could arise over the life of the instrument—are solely payments of principal and interest on the principal amount outstanding.

The occurrence of the contingent event is specific to the debtor

BC63 When considering the PIR feedback, the IASB noted that IFRS 9 already requires that consideration received on a financial asset measured at amortised cost or fair value through other comprehensive income must compensate the creditor only for basic lending risks and costs (that is, the risks and costs associated with extending credit to a debtor for a specified

period of time). The IASB also considered that changes to the timing or amount of contractual cash flows could arise from contractual terms associated with the time value of money (see paragraphs B4.1.9A–B4.1.9E of IFRS 9), prepayment features (see paragraphs B4.1.11–B4.1.12A of IFRS 9) or the occurrence (or non-occurrence) of a contractually specified contingent event, for example, changes in the contractual interest rate resulting from an entity achieving a contractually specified ESG target.

- BC64 The occurrence of a contingent event can be specific to the debtor even though the nature of the contingent event is not unique to the debtor. For example, a creditor could include in all of its contracts a term whereby the debtor’s interest rate is reduced if the debtor meets certain targets to reduce its own greenhouse gas emissions.
- BC65 Although, in that example, all debtors are subject to the same contingent event (achieving the same contractually defined reduction in greenhouse gas emissions), the occurrence (or non-occurrence) of the event is specific to each debtor. In contrast, some contracts might include contingent events that are not specific to a debtor or depend on factors that are unrelated to the debtor. For example, a change in the timing or the amount of a financial asset’s contractual cash flows that were based on a reduction in industry-wide greenhouse gas emissions would not be consistent with a basic lending arrangement.
- BC66 Some PIR participants suggested that the IASB should clarify that a change in the timing or amount of contractual cash flows is consistent with a basic lending arrangement if it arises from a ‘non-financial variable that is specific to a party to the contract’, as this concept is used in the definition of a derivative in IFRS 9.
- BC67 The IASB acknowledged that requiring a contingent event to be ‘specific to the debtor’ has similarities to the definition of a derivative in IFRS 9, which refers to a ‘non-financial variable’ that ‘is not specific to a party to the contract’. However, in a basic lending arrangement, the creditor is compensated only for basic lending risks and the cost associated with extending credit to the debtor. Therefore, 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.
- BC68 The IASB also decided that it would be inappropriate to distinguish between financial and non-financial variables when making this kind of assessment. Variability in contractual cash flows arising from variables that are inconsistent with a basic lending arrangement do not result in cash flows that are solely payments of principal and interest on the principal amount outstanding, irrespective of whether the variables are financial or non-financial.
- BC69 The IASB concluded that for the contractual cash flows to be consistent with a basic lending arrangement, the occurrence of a contingent event (other than those associated with the time value of money or prepayment features) must be specific to the debtor. The IASB further noted that not all contingent events that are specific to a debtor would be consistent with a basic lending

arrangement. For example, contractual cash flows that change based on the level of a debtor's revenue or profits in a specific period would not generally be considered to be consistent with a basic lending arrangement (see paragraphs BC70–BC72).

Cash flows represent neither an investment in the debtor nor an exposure to the performance of specified assets

- BC70 The IASB decided to clarify that changes in the timing or amount of contractual cash flows that represent an investment in the debtor (for example, contractual terms that entitle the creditor to a share of the debtor's revenue or profits), or an exposure to the performance of specified assets, are inconsistent with a basic lending arrangement, even if such terms are specific to the debtor.
- BC71 This clarification is consistent with the principles in paragraph B4.1.15 and B4.1.16 of IFRS 9 that, even if contractual cash flows are described as payments of principal and interest, such cash flows would not represent solely payments of principal and interest on the principal outstanding if the financial asset represents an investment in particular assets.
- BC72 The nature of a contingent event could be an indicator that a financial asset's contractual cash flows represent an investment in the debtor or exposure to the performance of specified assets (and is therefore inconsistent with a basic lending arrangement), although it is not in itself a determining factor.

Financial assets with non-recourse features

- BC73 Paragraph B4.1.6 of IFRS 9 describes financial assets for which a creditor's claim is limited to specified assets of the debtor, or to cash flows from specified assets as financial assets with 'non-recourse' features. When developing IFRS 9, the IASB concluded that the existence of non-recourse features does not in itself necessarily preclude a financial asset from having cash flows that are solely payments of principal and interest on the principal amount outstanding. In such cases, paragraph B4.1.17 of IFRS 9 requires an entity to assess ('look through to') the underlying assets to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding.
- BC74 PIR participants asked the IASB to clarify the meaning of non-recourse features; in particular, the difference between financial assets with non-recourse features and financial assets for which a creditor's claim is secured by the assets pledged as collateral. Participants also observed that, for the purposes of assessing both financial assets with non-recourse features (paragraph B4.1.17 of IFRS 9) and contractually linked instruments (paragraph B4.1.22 of IFRS 9), an entity is required to 'look through to' the particular underlying assets or underlying pool of financial instruments. They therefore asked for clarity as to the purpose of the 'look through' assessment in these situations.

- BC75 Non-recourse features in IFRS 9 referred to the absence of liability on the part of a debtor beyond any underlying assets pledged as collateral. In contrast, in the case of a collateralised loan, a creditor's claim is secured by the collateral only in the case of default. Throughout the life of such a loan, the creditor has recourse to the debtor for repayment of the loan. The IASB therefore concluded that financial assets with non-recourse features are different from collateralised financial assets, because the creditor's claim is limited to the specified underlying assets throughout the life of the financial assets as well as in the case of default.
- BC76 The IASB considered situations in which a financial asset could have non-recourse features if it is structured as a loan to a special purpose entity with specified assets and the creditor has no recourse to the entity that has transferred the assets to the special purpose entity. For example, suppose that a special purpose entity has only one source of income, being cash flows generated by the transferred assets, from which to repay the loan. In addition, the special purpose entity may only have nominal equity—or very little loss-absorbing capacity beyond the transferred assets. In such a situation, the creditor would be exposed to the performance risk of the underlying assets—as opposed to basic lending risks, such as credit risk; consequently the loan might not have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.
- BC77 The IASB also considered a situation in which a creditor has the contractual right to require a debtor to pledge additional assets if specified assets do not generate sufficient cash flows or when their value decreases below a specified threshold. In such situations, the financial asset does not have non-recourse features because the creditor has recourse to the debtor to secure its contractual right to the cash flows from the financial asset.
- BC78 To assist entities in determining whether a financial asset has non-recourse features, the IASB decided to clarify that, for a financial asset to have such features, the creditor's contractual right to receive cash flows must be limited to the cash flows generated by specified assets, both over the life of the financial asset and in the case of default.
- BC79 The IASB also decided to include in paragraph B4.1.17A of the draft amendments guidance on how to make the assessment required in paragraph B4.1.17 of IFRS 9 for financial assets with non-recourse features.

Investments in contractually linked instruments

- BC80 When developing IFRS 9, the IASB considered transactions in which an issuer prioritises payments to the holders of financial assets using multiple contractually linked instruments (tranches) that create concentrations of credit risk. In such situations, the holders of some tranches receive a premium in return for providing credit protection to other tranches.
- BC81 In assessing the contractual cash flow characteristics of contractually linked instruments, the IASB noted that classification based solely on the contractual features of the instruments would fail to capture their economic characteristics when concentrations of credit risk arise through contractual

linkage (see paragraphs BC4.26–BC4.36 of the Basis for Conclusions on IFRS 9). Therefore, for these types of financial instruments, paragraph B4.1.22 of IFRS 9 requires an entity to ‘look through’ until the entity can identify the underlying pool of financial instruments that are creating the cash flows.

- BC82 PIR participants asked the IASB to clarify the scope of the requirements in paragraphs B4.1.20–B4.1.26 of IFRS 9, noting that there are diverse interpretations of some of the terms used in the Standard to describe the types of instruments to which those requirements are applied. PIR participants said that, for some types of financial assets, it is unclear whether an entity should apply the requirements for contractually linked instruments or the requirements for financial assets with non-recourse features. In their view, applying the requirements for contractually linked instruments instead of the requirements for financial assets with non-recourse features (or vice versa) can result in different accounting outcomes.
- BC83 Participants also asked whether financial instruments that are not entirely within the scope of IFRS 9 could meet the criteria for financial instruments in the underlying pool, as set out in paragraph B4.1.23 of IFRS 9.

Scope

- BC84 The IASB proposes to clarify the characteristics of contractually linked instruments that distinguish them from other transactions by amending paragraph B4.1.20 of IFRS 9 and adding paragraph B4.1.20A to the draft amendments.
- BC85 The IASB noted that the phrase ‘contractually linked’ refers to a transaction for which the relationship between, and the rights and obligations associated with, the different tranches—including the order in which cash flows are allocated—are specified in the contractual terms of the instruments. Although it is common for transactions involving such instruments to have three or more tranches, the IASB did not intend that paragraphs B4.1.20–B4.1.26 of IFRS 9 should be understood as applying only to transactions with three or more tranches.
- BC86 The IASB considered whether the requirements for contractually linked instruments apply to bilateral secured lending arrangements in which a creditor agrees to lend money to a customer subject to specified assets being transferred into a special purpose entity as security for the loan. In such an arrangement, the customer, as the sponsoring entity of the special purpose entity, would typically provide a portion of the funding the special purpose entity uses to acquire the specified assets. This could be in the form of either an equity investment or a debt instrument that is subordinated to the debt instrument held by the creditor.
- BC87 The IASB noted that the type of secured lending transaction described in paragraph BC86 is different in nature from a transaction in which multiple contractually linked instruments are issued to the holders of the tranches, as described in paragraph B4.1.20 of IFRS 9. In a secured lending transaction, the contract is generally negotiated between the creditor and the customer in the form of a sponsoring entity; therefore, such a transaction does not contain

multiple contractually linked instruments. In line with this reasoning, the IASB decided to clarify in paragraph B4.1.20A of the draft amendments that an entity is required to assess the contractual cash flows of the debt instrument held by the creditor in such transactions in accordance with the requirements in paragraphs B4.1.7–B4.1.19 of IFRS 9.

- BC88 Paragraph BC4.26 of the Basis for Conclusions on IFRS 9 refers to a ‘waterfall’ structure that prioritises payments to the holders of the different tranches. The IASB decided that it would be useful to include this wording from BC4.26 of the Basis for Conclusions on IFRS 9 in the description of contractually linked instruments in paragraph B4.1.20 of the draft amendments to explain how concentrations of credit risk are created.
- BC89 The IASB further decided to clarify that, in a transaction that uses multiple contractually linked instruments, the holders of the different tranches have recourse only to the cash flows from the underlying pool of financial instruments. Such transactions therefore have non-recourse features, as described in paragraph B4.1.16A of the draft amendments.
- BC90 However, in the IASB’s view, not all financial assets with non-recourse features are contractually linked instruments. An important factor that distinguishes contractually linked instruments from financial assets with non-recourse features is the disproportionate allocation of losses between the holders of the tranches. For example, if the holders of multiple debt instruments have recourse only to the issuer’s underlying assets, the instruments have non-recourse features and the holders share proportionately in the losses of those underlying assets. Thus, there are no concentrations of credit risk, as specified in paragraph B4.1.20 of IFRS 9 for multiple contractually linked instruments. The IASB therefore decided to clarify the description of contractually linked instruments to include in it the disproportionate allocation of losses between the holders of the different tranches.

Underlying pool of financial instruments

- BC91 Paragraph B4.1.21(b) of IFRS 9 states that a tranche has cash flow characteristics that are solely payments of principal and interest on the principal amount outstanding only if the underlying pool of financial instruments has the cash flow characteristics set out in paragraphs B4.1.23 and B4.1.24 of IFRS 9. PIR participants asked whether financial instruments that are not entirely within the scope of IFRS 9, such as lease receivables, could meet the criteria for the underlying pool of instruments in paragraph B4.1.23 of IFRS 9.
- BC92 The IASB noted that it was not its intention to limit the scope of eligible financial instruments in the underlying pool to those financial instruments that are entirely in the scope of IFRS 9. For example, lease receivables are not in the scope of IFRS 9 for classification purposes but could have cash flows that are equivalent to solely payments of principal and interest on the principal amount outstanding.

- BC93 Accordingly, the IASB proposes to clarify that financial instruments that are not within the scope of the classification requirements of IFRS 9, such as lease receivables, can be included in the underlying pool of financial instruments for the purpose of paragraph B4.1.23 of IFRS 9.

Disclosures

Investments in equity instruments designated at fair value through other comprehensive income

- BC94 As part of the PIR, the IASB discussed the feedback and evidence (including academic evidence) that it had received on investments in equity instruments for which an entity has elected to present subsequent changes in fair value in other comprehensive income. The IASB concluded that the requirements in IFRS 9 for such investments were generally working as intended and decided not to make any changes to the Standard in relation to them.
- BC95 However, some PIR participants were of the view that the requirements in IFRS 9 do not faithfully represent the financial performance of equity investments when, after an investment is disposed of, fair value changes accumulated in other comprehensive income are not reclassified to profit or loss when they are realised.
- BC96 The IASB noted that neither IFRS 9 nor IFRS 7 *Financial Instruments: Disclosures* distinguishes between 'realised' and 'unrealised' gains or losses, and that it had received no evidence as part of the PIR to support the contention that reclassification of amounts recognised and accumulated in other comprehensive income to profit or loss ('recycling') would necessarily result in users of financial statements receiving more or better information about realised gains than they do from existing requirements.
- BC97 Having considered the feedback, the IASB is nonetheless proposing to expand the disclosure requirements in paragraph 11A of IFRS 7 to require the disclosure of changes in the fair value of investments in equity instruments during the reporting period. The IASB is also proposing to require an entity to disaggregate changes in fair value during the period between investments derecognised during the reporting period and the amount related to investments held at the end of the reporting period. In the IASB's view, this information, together with the presentation and disclosure of amounts recognised in other comprehensive income, as required by paragraph 20(a)(vii) of IFRS 7 (and paragraph 82A(a)(i) of IAS 1 *Presentation of Financial Statements*), would provide users of financial statements with useful and more comprehensive information about the performance of these equity instruments.

Contractual terms that could affect the timing or amount of contractual cash flows

- BC98 To understand the nature and extent of risks arising from an entity's financial instruments, IFRS 7 requires disclosures that enable users of financial statements to understand the amount, timing and uncertainty of future cash flows (see, for example, paragraphs 21A and 35A of IFRS 7).
- BC99 In response to the PIR, users of financial statements said that understanding the effect of contractual terms that could change the timing or amount of contractual cash flows is important to their analysis and assessment of an entity's future cash flows. In their view, understanding the nature of such contractual terms—for example, financial instruments with ESG-linked and similar features—would provide useful information to users of financial statements.
- BC100 Stakeholders also said that it would be important for users of financial statements to understand the potential magnitude of changes in future contractual cash flows.
- BC101 Paragraph 20(b) of IFRS 7 requires disclosure of total interest revenue for financial assets measured at amortised cost or fair value through other comprehensive income and total interest expense for financial liabilities not measured at fair value through profit or loss. However, IFRS 7 does not specifically require an entity to disclose the effect of contractual terms that could change the timing or amount of the contractual cash flows of these financial instruments.
- BC102 The IASB therefore decided to propose requiring an entity to provide a description of the nature of contingent events specific to the debtor but not to limit such a requirement to only financial instruments with ESG-linked features.
- BC103 In balancing the benefits for users of financial statements against the costs for preparers, the IASB is also proposing that an entity should be required to disclose quantitative information about the range of possible changes in contractual cash flows (for example, the range of adjustments to the contractual interest rates that could arise from contingent events linked to ESG targets). The IASB decided not to propose that an entity be required to provide a sensitivity analysis of possible changes in contractual cash flows or to require a quantification of the likely effect these contingent events could have on an entity's financial statements. Unlike market prices (which are generally observable), contractual terms that could change the timing or amount of contractual cash flows of financial assets or financial liabilities depend on contingent events specific to the debtor. It would therefore be onerous for an entity to provide a sensitivity analysis of the effects of contingent events on its financial statements.
- BC104 However, to assist users of financial statements to understand the extent of an entity's exposure to such contingent events, the IASB is proposing that an entity be required to disclose the gross carrying amount of its financial assets and the amortised cost of its financial liabilities that are subject to contractual

terms of that kind. The IASB is of the view that this information would be useful in understanding the prevalence of financial instruments with contractual terms that could change the timing or amount of contractual cash flows in relation to the entity's total financial assets and financial liabilities within each class. This would therefore enable a better understanding of the uncertainty of an entity's future cash flows.

Transition

- BC105 The IASB is proposing transition requirements for the proposed amendments to IFRS 9 that are similar to those that applied on initial application of IFRS 9.
- BC106 The proposal in paragraph 7.2.48 of the draft amendments not to require the restatement of comparatives is consistent with the IFRS 9 transition requirements on initial application of IFRS 9, as set out in paragraph 7.2.15 of IFRS 9.
- BC107 However, the IASB decided to propose that, to the extent that the initial application of the proposed amendments result in a change in the classification of financial assets, an entity be required to disclose information about the measurement of those financial assets immediately before and after the amendments are applied. This is to enable users of financial statements to understand the change in the classification of financial assets and its effect, therefore, on an entity's financial statements.

**[Draft] Amendments to Guidance on implementing IFRS 7
Financial Instruments: Disclosures**

[Draft] Heading before paragraph IG11A and paragraphs IG11A and IG11B providing guidance on meeting some of the disclosure requirements in paragraphs 11A and 11B of IFRS 7 *Financial Instruments: Disclosures* have been added. For ease of reading, this new text is not underlined.

...

Investments in equity instruments designated at fair value through other comprehensive income (paragraphs 11A and 11B)

IG11A The guidance below accompanies but is not part of IFRS 7 *Financial Instruments: Disclosures*. The guidance does not purport to demonstrate all of the possible ways of applying the disclosure requirements; but it does illustrate one possible way in which an entity could provide some of the disclosures required by paragraphs 11A and 11B of IFRS 7. An entity should apply its judgement in determining what disclosures would provide the most useful information, including the appropriate level of aggregation or disaggregation.

Background

Having met the requirements in paragraph 5.7.5 of IFRS 9 *Financial Instruments*, Entity A has elected to present subsequent changes in the fair value of its investments in equity instruments in other comprehensive income. In accordance with its accounting policies, Entity A transfers accumulated gains or losses from other comprehensive income to retained earnings only when an investment is derecognised. Entity A has a reporting year end of 31 December.

As at 1 January 20X1, Entity A's equity investments had an aggregate carrying amount of CU800,000, and the cumulative changes in fair value of these investments recognised in accumulated other comprehensive income as at that date were CU200,000. There were no disposals from this portfolio before 1 January 20X1.

On 31 July 20X1, Entity A acquired a non-controlling interest in Entity Y, a non-listed entity for CU155,000.

On 30 June 20X1, Entity A received CU1,000 of dividend income from Entity X. On 30 September 20X1, Entity A disposed of its investment in Entity X for CU200,000, resulting in a cumulative gain of CU50,000.

The remaining investments of Entity A had an aggregate fair value of CU820,000, as at 31 December 20X1. Entity A received total dividend income of CU5,000 from these remaining investments in 20X1.

The total change in fair value of Entity A's equity investments during the period was CU65,000, including CU20,000 relating to its investment in Entity X.

IG11B Entity A provides the following information in the notes to its financial statements for the year ending 31 December 20X1 (for simplicity, comparative information is not shown):

Information provided in the notes to Entity A's financial statements

The following table shows the Company's equity investments in non-listed entities. The Company holds these investments for strategic purposes on a medium- to long-term basis; the Company has neither a controlling interest in these entities (it holds less than a 5% equity investment in each entity) nor are the investments held for trading. Therefore, the Company has elected to present the subsequent changes in fair value of these investments in other comprehensive income. Accumulated gains or losses are transferred to retained earnings only when an investment is disposed of.

On 31 July 20X1, the Company acquired a non-controlling interest in Entity Y (less than a 5% equity investment), a non-listed entity; and on 30 September 20X1, the Company disposed of its investment in Entity X.

Equity instruments designated at fair value through other comprehensive income

	Carrying amount	Other comprehensive income
	(CU000) ^(a)	(CU000) ^(b)
1 January 20X1	800	200
Investments acquired	155	–
Fair value changes:		
Investments held as at year end	45	45
Investments disposed of	20	20
Investments disposed of	(200)	–
Transfers within equity following disposal	–	(50)
31 December 20X1	820	215

The Company transferred a cumulative gain of CU50,000, relating to the disposal of its investment in Entity X, from other comprehensive income to retained earnings during the year.

The Company received CU6,000 dividend income from its equity investments during the year, including CU1,000 that was received from Entity X.

(a) Entity A cross-referred from this column to the notes to its statement of financial position where the information required by paragraph 93 of IFRS 13 *Fair Value Measurement* is provided.

(b) Entity A cross-referred from this column to the statement of changes in other comprehensive income and the statement of changes in equity.



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