

March 2023

Exposure Draft—Snapshot

IFRS[®] Accounting Standards

Amendments to the Classification and Measurement of Financial Instruments

Proposed amendments to
IFRS 9 and IFRS 7

The IASB's objectives

To respond to feedback on the post-implementation review of the classification and measurement requirements in IFRS 9 *Financial Instruments* by improving:

- the understandability of some of these requirements; and
- the usefulness of related information disclosed by an entity applying the requirements in IFRS 7 *Financial Instruments: Disclosures*.

Proposals

The IASB proposes amendments to requirements relating to:

- derecognition of financial liabilities settled through electronic transfer;
- assessment of contractual cash flow characteristics in classifying financial assets; and
- disclosure of information about some financial instruments.

Next step

The IASB will consider the comments it receives on the Exposure Draft and will decide whether to proceed with the proposed amendments.

Comment deadline

19 July 2023

Introduction

The International Accounting Standards Board (IASB) carried out a post-implementation review (PIR) of the classification and measurement requirements in IFRS 9.

After analysing the evidence gathered in the PIR, the IASB concluded that, in general, entities are able to apply the requirements consistently, and in doing so provide useful information to users of financial statements. However, the IASB also concluded that the requirements on some matters should be clarified to improve their understandability.

The Exposure Draft *Amendments to the Classification and Measurement of Financial Instruments* proposes amendments to the requirements for:

- settling financial liabilities using an electronic payment system; and
- assessing contractual cash flow characteristics of financial assets, including those with environmental, social and governance (ESG)-linked features.

The Exposure Draft also proposes amendments or additions to the disclosure requirements for:

- investments in equity instruments designated at fair value through other comprehensive income; and
- 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.

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1 Derecognition of financial liabilities

A—Derecognition of financial liabilities settled through electronic transfers

What is the issue?

In September 2021, the IFRS Interpretations Committee (Committee) received a question about the recognition of cash received via an electronic transfer system as settlement of a financial asset. The Committee concluded that, applying IFRS 9, an entity:

- derecognises a trade receivable on the date when its contractual rights to the cash flows from the trade receivable expire; and
- recognises the cash (or other financial asset) received as settlement of that trade receivable on the same date.

Although stakeholders raised no technical objections to the Committee's conclusions, many expressed concerns about the potential outcomes of finalising an agenda decision with these conclusions, especially in the context of settlement of financial liabilities such as payables. Stakeholders expressed concerns about:

- potential disruption to long-standing practices;
- costs of applying such an agenda decision; and
- possible consequences for other fact patterns, in particular the derecognition of trade payables.

Despite concluding in the PIR that the recognition and derecognition requirements in IFRS 9 generally work well, the IASB acknowledged stakeholders' concerns about the settlement of financial liabilities. The IASB therefore decided to propose amendments to the requirements in IFRS 9.

What is the IASB proposing?

The IASB proposes to:

- clarify that an entity uses settlement date accounting when recognising or derecognising financial assets and financial liabilities; and
- develop new requirements 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.

Applying the proposals, an entity would be permitted to derecognise a financial liability if and only if the entity has initiated the payment instruction and:

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

The IASB concluded that the proposals would:

- provide a timely and effective response to stakeholders' concerns;
- be operable and mitigate the risk of unintended consequences; and
- lead to consistent application of the derecognition requirements.

2 Classification of financial assets

Background

What is the issue?

Financial assets with ESG-linked features

When developing IFRS 9, the IASB concluded that amortised cost provides useful information 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 (SPPI).

PIR participants said that:

- it is challenging to apply the SPPI requirement to financial assets with ESG-linked features; and
- amortised cost could provide useful information about these financial assets to users of financial statements.

Other types of financial assets

PIR participants also raised questions about how to assess the contractual cash flow characteristics of:

- *financial assets with non-recourse features*—for example, how to distinguish between these financial assets and other financial assets secured by collateral; and
- *investments in contractually linked instruments*—for example, when to apply the requirements for contractually linked instruments and which instruments are eligible to be included in the underlying pool.

What is the IASB proposing?

Financial assets with ESG-linked features

The IASB considered the feedback and decided that the assessment of contractual cash flow characteristics in IFRS 9 is relevant to financial assets with ESG-linked features just as it is to other financial assets. The IASB decided against creating an exception for assets with ESG-linked features, but responded to the PIR feedback by proposing clarifications to the general SPPI principles in IFRS 9 together with additional examples of applying these principles. Specifically, the IASB proposes to clarify the requirements on:

A	Elements of interest in a basic lending arrangement
B	Contractual terms that change the timing or amount of contractual cash flows

Other types of financial assets

In response to the PIR feedback, the IASB also proposes to clarify the requirements on:

C	Financial assets with non-recourse features
D	Investments in contractually linked instruments

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Classification of financial assets *continued ...*

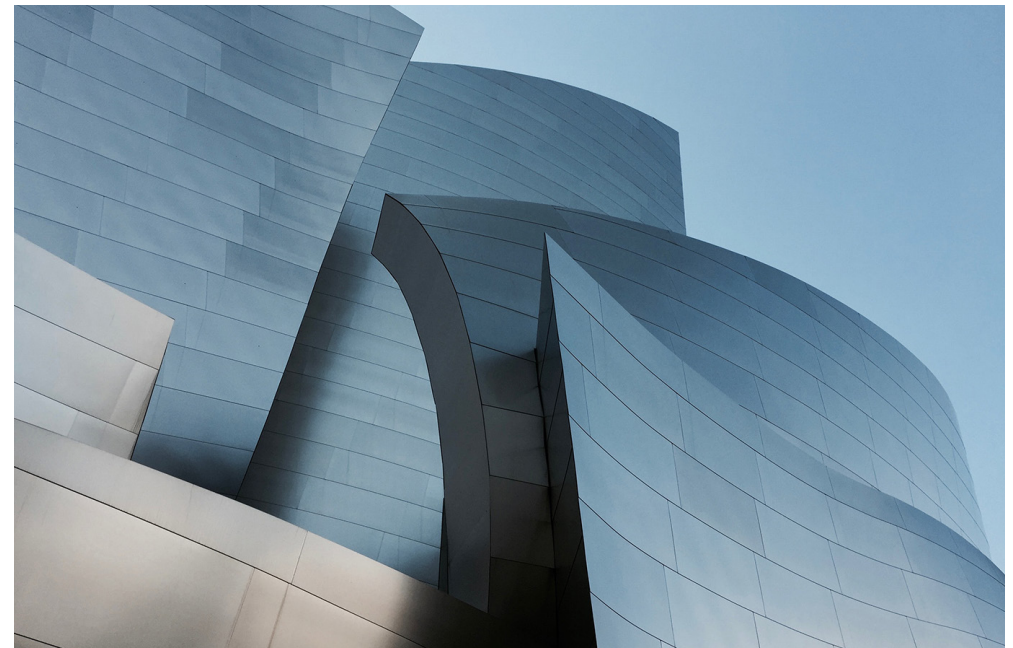
A—Elements of interest in a basic lending arrangement

What is the IASB proposing?

IFRS 9 states that contractual cash flows that are SPPI are consistent with a basic lending arrangement. In such arrangements, typical elements of interest include compensation for the time value of money, credit risk, other basic lending risks (such as liquidity risk), and costs associated with holding the financial asset—as well as a profit margin.

To help an entity assess whether the interest it receives in an arrangement is consistent with a basic lending arrangement, the IASB proposes to clarify that:

- the assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives; and
- contractual cash flows are inconsistent with a basic lending arrangement if:
 - the cash flows include compensation for risks or market factors not typically considered basic lending risks or costs, even if such terms are common in the market; and
 - the cash flows change in a way that is not aligned with the direction and magnitude of changes in lending risks or costs.



2 Classification of financial assets *continued ...*

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

What is the IASB proposing?

IFRS 9 requires an entity to determine whether the cash flows that could arise over the life of a financial asset meet the SPPI requirement.

Some financial assets contain contractual terms that could change the timing or amount of contractual cash flows following the occurrence (or non-occurrence) of a contingent event.

To help entities assess whether such financial assets meet the SPPI requirement, the IASB proposes to clarify that:

- an entity shall assess whether the contractually specified change would meet the SPPI requirement irrespective of the probability of the contingent event occurring;
- a change in contractual cash flows is consistent with a basic lending arrangement if the occurrence (or non-occurrence) of the contingent event is specific to the debtor; and
- the resulting contractual cash flows should represent neither an investment in the debtor nor an exposure to the performance of specified assets.

Illustrative examples

Instrument	Analysis
<p>Debt with interest linked to a debtor’s greenhouse gas emissions</p> <p>The instrument 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.</p>	<p>The SPPI requirement is met</p> <p>The occurrence of the contingent event is specific to the debtor. The resulting contractual cash flows are SPPI in all circumstances.</p>
<p>Debt with interest linked to carbon price index</p> <p>The instrument is a loan with an interest rate that is periodically adjusted when a market-determined carbon price index reaches a contractually defined threshold.</p>	<p>The SPPI requirement is not met</p> <p>The contractual cash flows change in response to a market factor (the carbon price index), which is not a basic lending risk or cost.</p>

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Classification of financial assets *continued ...*

C—Financial assets with non-recourse features

What is the IASB proposing?

Scope

IFRS 9 states that a financial asset has non-recourse features if the entity's claim is limited to specified assets of the debtor or the cash flows from specified assets.

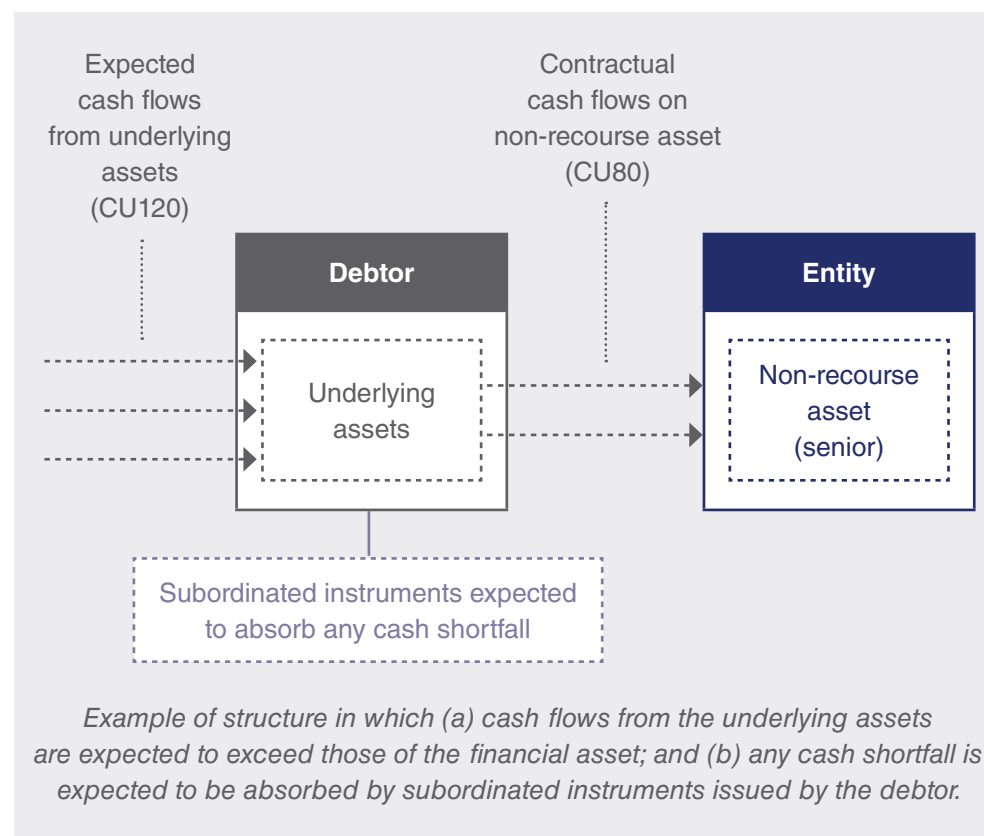
The IASB proposes to clarify that, for a financial asset to have such features, the entity's contractual right to receive cash flows must be limited to the cash flows from the specified assets both over the life of the financial asset and in the case of default. The entity is therefore primarily exposed to the specified assets' performance risk rather than the debtor's credit risk over the life of the instrument.

'Look through' assessment

If a financial asset has non-recourse features, IFRS 9 requires an entity to assess ('look through to') the particular underlying assets or cash flows to determine whether the financial asset meets the SPPI requirement.

To assist entities in making this assessment, the IASB proposes to clarify that an entity may also need to consider factors such as the legal and capital structure of the debtor, including the extent to which:

- the cash flows from the underlying assets are expected to exceed the contractual cash flows on the financial asset being classified; and
- any cash shortfall from the underlying assets is expected to be absorbed by subordinated instruments issued by the debtor.



2 Classification of financial assets *continued ...*

D—Investments in contractually linked instruments

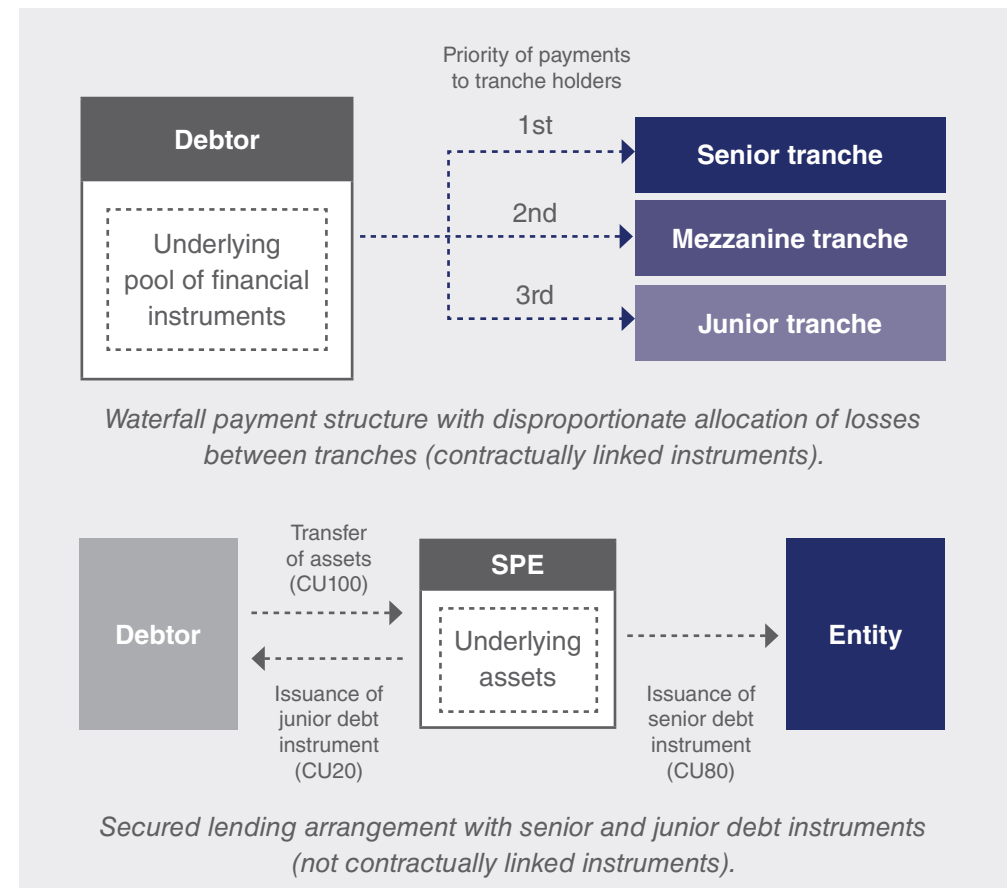
What is the IASB proposing?

In some transactions, an issuer may prioritise payments to the holders of financial assets using multiple contractually linked instruments that create concentrations of credit risk (tranches). In assessing whether investments in such instruments meet the SPPI requirement, IFRS 9 requires an entity to ‘look through’ until it can identify the underlying pool of financial instruments. The entity then assesses, among other things, whether this underlying pool contains one or more instruments that have SPPI cash flows.

To help identify the instruments to which these requirements are applied, the IASB proposes to clarify the characteristics of contractually linked instruments through specific reference to the concentrations of credit risk that result in the disproportionate allocation of losses between different tranches.

Some secured lending arrangements involve the creation of a structured entity (Special Purpose Entity—SPE) that issues multiple debt instruments (ie senior and junior) to facilitate a lending transaction with a single creditor (the entity). The IASB also proposes to clarify that such transactions do not contain contractually linked instruments.

In addition, the IASB proposes that the instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9 (for example, lease receivables). However, an entity is required to assess whether the financial instruments in the underlying pool have cash flows that are equivalent to SPPI cash flows.



3 Disclosures

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

What is the issue?

When an entity disposes of an equity investment that was designated using the other comprehensive income (OCI) presentation option, IFRS 9 prohibits the entity from reclassifying the amounts accumulated in OCI to profit or loss ('recycling').

PIR participants said this prohibition means the financial statements may not faithfully represent the performance of such investments upon disposal.

What is the IASB proposing?

The IASB noted that:

- neither IFRS 9 nor IFRS 7 distinguishes between 'realised' and 'unrealised' gains or losses; and
- there was no evidence as part of the PIR to indicate that 'recycling' would necessarily result in more or better information about realised gains or losses.

To provide users of financial statements with useful, transparent and more comprehensive information, the IASB proposed amendments to IFRS 7 to require entities to disclose additional information about the amounts accumulated in OCI.

Disclosure objectives

The proposed disclosure requirements are intended to help users of financial statements:

- to better evaluate the performance of equity investments designated using the OCI presentation option during the reporting period; and
- to differentiate between changes in fair value related to investments derecognised during the reporting period and changes in fair value related to investments held at the end of the reporting period.

Achieving the objectives

To achieve these objectives, an entity would be required to disclose:

- the change in the fair value of investments in equity instruments during the reporting period, showing separately the amount of that change related to investments derecognised during the reporting period and the amount related to investments held at the end of the reporting period; and
- the aggregate fair value of investments in equity instruments (rather than the fair value of each investment) at the end of the reporting period.

3 Disclosures

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

What is the issue?

In response to the PIR, users of financial statements said that they need to better understand the effect of contractual terms that could change the timing or amount of contractual cash flows. This information is important for their analysis and assessment of an entity's future cash flows.

An example of such information is the nature and effect of changes based on the occurrence or non-occurrence of a contingent event linked to ESG targets.

What is the IASB proposing?

The IASB agreed that the disclosure requirements in IFRS 7 could be improved to meet the needs of users of financial statements in this area and therefore proposed further disclosure requirements aimed at giving users more information about contingent events and their nature and possible effects on contractual cash flows. This information would be required irrespective of the likelihood of the contingent events.

Disclosure objectives

The proposed disclosure requirements are intended 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; and
- the extent of the entity's exposure to such contingent events.

Achieving the objectives

To achieve these two objectives, an entity would be required to disclose:

- a qualitative description of the nature of the contingent event;
- quantitative information about the range of changes to contractual cash flows that could result from the contractual terms; and
- the gross carrying amount of financial assets and the amortised cost of financial liabilities subject to those contractual terms.

An entity would disclose the information above 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.

Information for respondents

The deadline for comments on the Exposure Draft is 19 July 2023

Everyone is invited to respond to the questions in the Exposure Draft.

You can submit comments on our [Open for comment](#) page.

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Exposure Draft package

The Exposure Draft package includes:

- the IASB's detailed proposals, in the form of draft amendments to IFRS Accounting Standards
- the Basis for Conclusions on the Exposure Draft, which summarises how the IASB developed its proposals
- questions for respondents.

This document

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