ICAEW
REPRESENTATION 67/23

IASB – AMENDMENTS TO THE CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

Issued 7 July 2023

ICAEW welcomes the opportunity to comment on the IASB/ED/2023/2 *Amendments to the Classification and Measurement of Financial Assets* published in March 2023, a copy of which is available from this link.

For questions on this response please contact ICAEW Corporate Reporting Faculty: FRF@icaew.com quoting ICAEW REP 67/23.

We welcome the Board's work relating to instruments with ESG-linked features and continue to urge them to make this a priority. We do, however, have some concerns about the proposals as drafted.

We do **not** support the proposals relating to electronic transfers as we are not convinced that the benefits that they will bring will outweigh the potentially significant costs of implementing them.

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KEY POINTS

WE DO NOT SUPPORT THE PROPOSALS RELATING TO ELECTRONIC TRANSFERS

1. We do **not** support the proposals relating to electronic transfers as we are not convinced that the benefits that they will bring will outweigh the potentially significant costs of implementing them.
2. Many entities make electronic payments using a variety of systems across a range of jurisdictions. Determining whether or not payments made under each of these systems meet the criteria that would enable the entity to discharge a financial liability before its settlement date is therefore likely to be a complex and time-consuming process. To reach a definitive conclusion, entities may have to obtain a legal opinion for multiple different electronic payment systems used around the world. Doing so would not only be impractical and disproportionately costly but could also result in inconsistent treatment internationally due to differences across the various legal environments and different interpretations of which electronic payment systems are within the scope of the proposals. As a result, we do not believe that many entities will avail themselves of this new accounting policy choice.
3. We suggest that the Board instead introduce an accounting policy choice whereby entities can choose to derecognise the financial liability either when the instruction is made via the electronic payments system or at the settlement date. If, under this approach, entities were to elect to derecognise financial liabilities at the date when the instruction is made, it may be appropriate to require them to subsequently adjust the amounts derecognised for any payments that are then cancelled before they are processed. However, experience suggests that very few payments are cancelled after they are initiated so, in practice, we would not expect any such adjustments to be significant other than in exceptional circumstances.
4. See our response to question one below for more details.

FINANCIAL ASSETS WITH ESG-LINKED FEATURES

5. In our response to the Board's post implementation review of IFRS 9's classification and measurement requirements, we pointed out that financial assets with ESG-linked features are becoming increasingly common and urged the Board to consider addressing them as a matter of urgency. We therefore welcome the Board's work in this area and continue to urge the Board to make this a priority.
6. The proposals and related illustrative examples are helpful as they suggest that many instruments with ESG-linked features currently in issue will continue to be treated as basic lending arrangements and measured at either amortised cost or fair value through other comprehensive income (FVTOCI).
7. We are, however, concerned that the Board has chosen to propose clarifications to the SPPI requirements more broadly rather than specifically addressing financial assets with ESG-linked features. This approach has resulted in proposals that we believe are unclear, potentially contradictory and may require significant judgement in execution. In addition, modifying the existing requirements in this way may create uncertainty about what qualifies as a basic lending arrangement. This may have unintended consequences and could result in some instruments that have previously passed the SPPI test and been measured at either amortised cost or FVTOCI now failing that test and having to be measured at fair value through profit or loss (FVTPL).
8. We believe that our concerns could be addressed if the Board were to provide further clarification on certain points and enhance the illustrative examples provided. See our response to question two below for more details.

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9. We are also concerned that the Board, in having chosen to introduce general requirements that apply whenever there are contractual terms that could change the timing or amount of contractual cash flows rather than introducing requirements specific to instruments with ESG-linked features, is proposing disclosures that are very broad in nature. We believe that this could result in entities disclosing a significant amount of 'boilerplate' information that is potentially irrelevant and which could obscure more useful information. We therefore recommend that the Board either introduces a disclosure objective to make it clear what the disclosures are aiming to achieve or revise the disclosure requirements so that they more narrowly define the population within scope or make it clear that they are only intended to apply to instruments with ESG-linked features. See our response to question six below for more details.

SETTLEMENT DATE ACCOUNTING – PROPOSED PARAGRAPH B3.1.2A

10. Because the amendments specifically propose to require settlement date accounting throughout IFRS 9, except for regular way purchases of financial assets and absent any further accounting policy choice for liabilities settled using an electronic payment system, there could be a number of potential unintended consequences for financial liability accounting.
11. We suggest that the Board re-examine this issue further before making this change as the effect of the amendment could be significant for those entities that follow long-established practices. Specifically, the following areas would benefit from further clarification:
    - For the initial recognition of financial instruments such as derivatives, the reference to settlement date will often not be relevant as there will be no delivery of cash or another financial asset at inception. Paragraph B3.1.2(c) of IFRS 9 notes that 'A forward contract… is recognised… on the commitment date, instead of on the date on which settlement takes place'. Also, for the derecognition of financial liabilities, paragraph B3.3.1(a) of IFRS 9 describes this as normally being when the creditor has been paid 'with cash, other financial assets, or goods or services' so while this arguably has the appearance of being equivalent to settlement date, paragraph B3.3.1(b) of IFRS 9 goes on to describes that derecognition occurs when the entity is 'legally released from primary responsibility for the liability…', which emphasises the contractual status, similar to the initial recognition of derivatives. These points should be noted along with an explanation that the concept of 'settlement date' is only relevant where cash or another financial asset is delivered.
    - Trade date accounting is an exception to the general settlement date principle as described in paragraph B3.1.3 of IFRS 9 and is applicable only to the recognition of financial assets that are purchased and sold under regular way transactions. It does not apply to financial liabilities. It is therefore confusing that the definition of settlement date accounting used in paragraph B3.1.6 of IFRS 9 and referred to in proposed paragraph B3.1.2A applies only to financial assets. We believe that the wider relevance of this description including where it does (and does not) apply should be more clearly explained and articulated.
12. The suggestions above, and those that may be raised by other respondents, may be more extensive than the Board had considered when proposing paragraph B3.1.2A. However, given the fundamental nature of this change, we think it would be more appropriate for the Board to separate this work from the other proposals in the exposure draft to allow respondents to fully understand and provide further input to the proposals as well as to limit any potential unintended consequences arising.

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ANSWERS TO SPECIFIC QUESTIONS

Question 1 – Derecognition of a financial liability settled through electronic transfer

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.

Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal.

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?

14. We do **not** support the proposals relating to electronic transfers as we are not convinced that the benefits that they will bring will outweigh the potentially significant costs of implementing them, particularly as the risk of significant misstatement of financial statements is low given that the time between the payment instruction and settlement is short.

The proposals are impractical

15. Many entities make electronic payments using a variety of systems across a range of jurisdictions. Determining whether or not payments made under each of these systems meet the criteria that would enable the entity to discharge a financial liability before its settlement date is therefore likely to be a complex and time-consuming process. To reach a definitive conclusion, entities may have to obtain a legal opinion for multiple different electronic payment systems used around the world. Doing so would not only be impractical and disproportionately costly but could also result in inconsistent treatment internationally due to differences across the various legal environments and different interpretations of which electronic payment systems are within the scope of the proposals. As a result, we do not believe that many entities will avail themselves of this new accounting policy choice.
16. Discussions with our constituents suggest that, in many cases, it will be difficult for an entity to demonstrate that the criteria set out in paragraph B3.3.8 have been met. For example, some electronic payment systems allow an entity to withdraw, stop or cancel a payment instruction within a certain time period after the instruction has been made. It might also be difficult in connection with some payment systems for an entity to demonstrate that it has no practical ability to access the cash to be used for the settlement after the payment instruction has been made. This means that, in many cases, current practice would have to change as the derecognition date would have to shift from the initiation date to the date when the criteria were met.
17. We believe that clarification is needed as to what the Board means when it refers to the entity initiating the payment. For example, paragraph B3.3.8 uses the wording 'if, and only if, the entity has initiated the payment instruction'. In cases where a customer has requested a payment, and the customer's financial instruction actions the instruction on the customer's behalf, it isn't clear if the 'entity' that has 'initiated' the payment would also extend to the financial institution that is being instructed by the customer and, therefore, whether the accounting policy choice would be available for financial institutions acting in this capacity.
18. Consequently, the proposed option to permit derecognition earlier than settlement date may be difficult for entities to apply in practice as we believe the proposals set a high bar that we think is impractical and which we believe many entities will struggle to clear. We therefore suggest that these criteria are removed and that derecognition earlier than settlement date should be allowed as an accounting policy choice whereby entities can choose to derecognise the financial liability either when the instruction is made via the electronic payments system or at the settlement date.

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19. If, under the approach suggested above, entities were to elect to derecognise financial liabilities at the date when the instruction is made, it may be appropriate to require them to subsequently adjust the amounts derecognised for any payments that are then cancelled before they are processed. However, experience suggests that very few payments are cancelled after they are initiated so, in practice, we would not expect any such adjustments to be significant other than in exceptional circumstances.

A more wide-ranging solution is needed

20. We do not believe that it is appropriate to address this one issue in isolation. The original question submitted to the IFRS Interpretations Committee that ultimately resulted in these proposals focussed on the recognition of cash received via an electronic transfer system as settlement of a financial asset, yet this issue is not addressed in the exposure draft. In addition, other similar payment transactions where the payee is affected by the rationale behind the proposals – such as cheque payments, credit card receipts that can be cancelled before they are settled and intragroup cash transfers at or across a reporting period end – have not been considered. We therefore believe that a more wide-ranging solution that consistently addresses the appropriate treatment of both cash inflows and outflows is needed.

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?

21. In our response to the Board's post implementation review of IFRS 9's classification and measurement requirements, we pointed out that financial assets with ESG-linked features are becoming increasingly common and urged the Board to consider addressing them as a matter of urgency. We therefore welcome the Board's work in this area and continue to urge the Board to make this a priority.

22. The proposals and related illustrative examples are helpful as they suggest that many instruments with ESG-linked features currently in issue will continue to be treated as basic lending arrangements and measured at either amortised cost or FVTOCI.

Significant diversity in practice and unintended consequences

23. We are, however, concerned that the Board has chosen to propose clarifications to the SPPI requirements more broadly rather than specifically addressing financial assets with ESG-linked features. This approach has resulted in proposals that we believe are unclear, potentially contradictory and may require significant judgement in execution.

24. For example, we are unclear about exactly how references in paragraph B4.1.10A to contingent cash flows that change in response to events that are 'not specific to the debtor'

should be read as this term is not defined. See paragraphs 31 and 32 below for specific examples of where this lack of clarity could cause problems in practice.

25. Similarly, we have concerns about references in paragraph B4.1.8A to cash flows changing in a way that is not aligned with the 'direction and magnitude' of changes in lending risks and costs, which is also undefined. In particular, it would be helpful to provide more clarity about what is meant by the 'magnitude' of the changes in lending risks or costs. One alternative would be to refer to changes that are 'consistent with the economic rationale' or 'commensurate to the risks' of the lending arrangement. Another solution would be to delete the references to 'direction and magnitude' altogether and instead clarify how the existing guidance on leverage applies to changes in contractual cash flows that are specific to the debtor. A third solution would be to make it clear that 'direction and magnitude' is a qualitative and not a quantitative assessment.
26. These issues could lead to significant diversity in practice, as different entities may interpret the criteria in different ways, with some concluding that financial assets with ESG-linked features fail the SPPI test and must therefore be measured at FVTPL while others with similar instruments conclude the opposite and continue to measure such instruments at amortised cost or FVTOCI.
27. In addition, modifying the existing requirements in this way may create uncertainty about what qualifies as a basic lending arrangement. This may have unintended consequences and could result in some instruments that have previously passed the SPPI test and been measured at either amortised cost or FVTOCI now failing that test and having to be measured at FVTPL.

ESG-linked features

28. We are pleased that the Board has sought to address financial assets with ESG-linked features, albeit in an indirect manner, and that it is proposing changes to the existing guidance that should – in theory – make it easier for entities to conclude that such loans pass the SPPI test and can therefore be measured at either amortised cost or FVTOCI rather than at FVTPL.
29. However, as noted in paragraphs 23-27 above, we are concerned that the revisions to the SPPI requirements are not clear. In addition, there does not appear be to sufficient guidance to enable entities to apply these revised requirements in practice meaning that entities may struggle to determine whether or not a loan with ESG-linked features qualifies as a basic lending arrangement.
30. The examples provided in B4.1.13 and B4.1.14 are helpful as they provide examples of features that are and aren't considered consistent with a basic lending arrangement. However, it isn't clear how the conclusions reached in the first of these examples link to the requirements that precede it and, specifically, why the instrument would qualify as a basic lending arrangement. For example, it is not clear how the guidance on direction and magnitude has been considered when concluding that the instrument is a basic lending arrangement or why the nature of the contingency was considered to be SPPI (other than that it is specific to the debtor). The example given in paragraph BC52 involves an increase in credit risk of the borrower which is considered to be entirely consistent with a basic lending arrangement. We think some further guidance is required to clearly set out why ESG-linked features specific to the debtor are consistent with a basic lending arrangement. The lack of clarity means that entities may struggle to apply the requirements to different – and potentially more complex – fact patterns. For example, it is unclear what the outcome would be if the ESG target was specific to the debtor but relative to a market index. It would be helpful if the Board could futureproof its proposals by including additional, more detailed

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examples that clearly analyse the key features of the instrument and explain more clearly how they do or don't meet the proposed criteria.

31. In practice, many ESG-linked targets are set at a group level rather than at an entity level as this often provides the most meaningful information about the performance of the business as a whole. However, it is unclear whether instruments that reference such targets would qualify as basic lending arrangements as they will depend on the occurrence or non-occurrence of a contingent event that is specific to the group rather than the debtor itself. The Board should clarify its intentions and make it clear that any reference to group-wide ESG targets will not on their own prevent an instrument from passing the SPPI test.

Loans with increased cost clauses

32. The requirements of paragraph B4.1.10A require that for a change in contractual cash flows to be consistent with a basic lending arrangement, the occurrence or non-occurrence of a contingent event must be specific to the debtor. This would cause an issue for 'increased cost' clauses that ensure that the lender is protected from the impact of changes to the interpretation, administration or application of relevant laws or regulations. Such clauses are common in the UK. As such clauses are not specific to the debtor, the proposals would lead to large numbers of instruments that have previously been considered basic lending arrangements failing the SPPI test and having to be measured at FVTPL rather than at either amortised cost or FVTOCI. Paragraph BC67 is unequivocal in this respect that contingent events that are specific to the creditor are inconsistent with a basic lending arrangement.

33. We believe that such clauses are consistent with a basic lending arrangement as they relate to the creditor's 'cost associated with extending credit' as described at BC67. We therefore recommend that paragraph B4.1.10A and BC67 be amended to explicitly exclude such clauses.

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?

34. We are generally supportive of the proposals relating to financial assets with non-recourse features. We agree with the established principle that the existence of non-recourse features does not automatically stop a financial asset from passing the SPPI test.

35. The proposed additional text is welcomed as it should aid understanding and help entities to apply the SPPI test to such arrangements. However, we believe it would helpful if the Board could add some specific examples to illustrate how the new guidance in paragraph B4.1.17A should be applied in practice. While we understand that the guidance relates solely to contractual non-recourse features, it would be useful to explicitly state this for the avoidance of doubt.

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

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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?

36. We are supportive of the proposals relating to contractually linked instruments. Adding specific references to concentrations of credit risk and secured lending arrangements structured through special purpose entities should make it easier for entities to understand the instruments to which these requirements are intended to apply.

Tranches

37. Further guidance on what is meant by a 'tranche' would be useful. It would also be helpful if the conclusion in respect of the example in B4.1.20A could be clarified ie, is the transaction not considered to be a contractually linked instrument because there is only one tranche held by a third party?

Lease agreements

38. We also note that paragraph B4.1.23 proposes that the instruments in the underlying pool can include financial instruments – such as lease receivables – that are not within the scope of IFRS 9. While we do not believe that this was the Board's intention, this paragraph could be read as implying that lease receivables will always meet the SPPI test when this may not always be the case.

39. Many lease agreements, particularly in the automotive sector, will include residual value guarantees. While such clauses would typically not be considered consistent with a basic lending arrangement, it is not clear whether this will be the case in all instances. For example, we are unsure whether such a clause would prevent a lease – and potentially the whole underlying pool of assets – from passing the SPPI test even if it was unlikely to be activated or if its effect was expected to be insignificant. More clarity is needed to avoid diversity in practice.

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?

40. In our view, IFRS 9's existing requirements relating to investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income are

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generally working well. We therefore agree with the IASB's decision to make no changes in relation to them.

41. We are, however, broadly supportive of the proposed additional disclosures as they will provide users of financial statements with additional useful information.

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?

42. We understand that these changes were proposed in response to the increased use of financial assets with ESG-linked features. We agree that more disclosure may help financial statement users to better understand how such clauses could change the timing and amount of an entity's future cash flows. We are, however, concerned that the Board has chosen to tackle this issue by introducing general requirements that apply whenever there are contractual terms that could change the timing or amount of contractual cash flows rather than introducing requirements specific to instruments with ESG-linked features.

43. This approach has resulted in the Board proposing disclosures that are very broad in nature and could result in entities having to apply a significant amount of judgement to determine which information needs to be disclosed. Affected entities could end up disclosing a significant amount of 'boilerplate' information that is potentially irrelevant and which could obscure more useful information. It would be helpful if the requirements made it clear that qualitative disclosures are only needed for loans with ESG-linked features.

44. We are also concerned that producing the proposed quantitative information about the range of changes to contractual cashflows that could result from contractual terms for each class of financial asset or financial liability would take significant time to produce but result in information that is of limited use to users of the financial statements. A better compromise might be to require disclosure of any contractual terms that have resulted in changes to estimates of future cash flows in the current reporting period that have significantly affected the instrument's carrying value.

45. We therefore believe that the scope of this disclosure needs to be made more proportionate. We recommend that the Board either introduces a disclosure objective to make it clear what the disclosures are aiming to achieve or revises the disclosure requirements so that they more narrowly define the population within scope or make it clear that they are only intended to apply to instruments with ESG-linked features. Either way, we believe that some clauses (such as the increased cost clauses we discussed in our response to question two above or standard clauses that increase the interest rate if the borrower's credit rating falls) ought to be specifically excluded. Either of these options would result in more proportionate disclosures that focus on areas of more interest to the users of the financial statements.

46. We also recommend that the Board includes some examples of applying these disclosure requirements in the amended implementation guidance as this will be helpful to entities.

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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?

47. We are generally supportive of the proposed transition requirements, including the requirement not to restate comparatives.

48. We suggest that the Board allows early adoption of the proposals relating to financial instruments with ESG-linked features, without the need to adopt the other amendments at the same time, as this matter is considered to be urgent by some of our constituents.

49. As noted in our response to question one above, we are concerned that implementing the proposals in relation to the derecognition of financial liabilities settled through electronic transfer would be both complex and time-consuming. As previously noted, our preference is for these proposals to be decoupled from the remainder of the exposure draft and included in a separate research project. If, however, the Board decides to proceed with these proposals, we believe that entities should be given more time to implement them.

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