

Invitation to Comment

Call for comments on the UKEB Draft Comment Letter - Exposure Draft *Amendments to the Classification and Measurement of Financial Instruments: Proposed amendments to IFRS 9 and IFRS 7*

Deadline for completion of this Invitation to Comment:

Midday, Monday 26 June 2023

Please submit to:

UKEndorsementBoard@endorsement-board.uk

Introduction

The objective of this Invitation to Comment is to obtain input from stakeholders on the UKEB's Draft Comment Letter on the Exposure Draft (ED) *Amendments to the Classification and Measurement of Financial Instruments: Proposed amendments to IFRS 9 and IFRS 7* (the Amendments), published by the International Accounting Standards Board (IASB) on 21 March 2023. The IASB's comment period ends on 19 July 2023.

UK endorsement and adoption process

The UK Endorsement Board (UKEB) is responsible for endorsement and adoption of IFRS for use in the UK and therefore is the UK's National Standard Setter for IFRS. The UKEB also leads the UK's engagement with the IFRS Foundation (Foundation) on the development of new standards, amendments and interpretations. This letter is intended to contribute to the IASB's due process. The views expressed by the UKEB in this letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended International Accounting Standards undertaken by the UKEB.

Who should respond to this Invitation to Comment?

Stakeholders with an interest in the quality of accounts prepared in accordance with international accounting standards.

How to respond to this Invitation to Comment

Please download this document, answer any questions on which you would like to provide views, and return it together with the 'Your Details' form to UKEndorsementBoard@endorsement-board.uk by midday on Monday 26 June 2023.

Brief responses providing views on individual questions are welcome, as well as comprehensive responses to all questions.

Privacy and other policies

The data collected through responses to this document will be stored and processed by the UKEB. By submitting this document, you consent to the UKEB processing your data for the purposes of influencing the development of and adopting IFRS for use in the UK. For further information, please see our Privacy Statements and Notices and other Policies (e.g. Consultation Responses Policy and Data Protection Policy)¹.

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¹ These policies can be accessed from the footer in the UKEB website here: <https://www.endorsement-board.uk>

Questions

Electronic cash transfers

The ED requires that settlement date accounting shall apply when recognising or derecognising a financial asset or financial liability unless an entity applies paragraph B3.1.3 (regular way transactions) or uses the new proposed option for financial liabilities settled by electronic cash transfers at B3.3.8.

Question One

1. Do you believe the criteria at B3.3.8 to B3.3.10 could be successfully applied to the common UK electronic payment systems?

Yes	<input type="checkbox"/>		No	<input checked="" type="checkbox"/>
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If not, please explain why. What changes to the proposals you would recommend such that they could be applied to common electronic payment systems?

We have the following concerns and suggestions:

- 1) Each electronic payment system used by an entity would need to be assessed under the criteria proposed in paragraph B3.3.8 (a) to (c), which we expect will be time consuming and costly. If the IASB proceeds with the proposal as drafted this would need to be factored into transition and the effective date;
- 2) The meaning of “electronic payment system” is open to interpretation and it is not clear which type of systems were intended to be captured. If the IASB retained the scope of the practical expedient, then we suggest the IASB clarifies this;
- 3) The condition in paragraph B3.3.8(a) is overly restrictive – for example to prevent an ability to cancel a fraudulent transaction, would preclude the use of the practical expedient. We believe the condition should be relaxed;
- 4) It is not clear whether there is an intended difference between “no ability” in paragraph B3.3.8(a) and “no practical ability” in paragraph B3.3.8(b). We suggest the same words are used if the same meaning is intended;
- 5) There is an overlap between the condition in the last sentence of paragraph B3.3.9 and B3.3.8(b). In our view the last sentence in paragraph B3.3.9 should be deleted;
- 6) The new requirements should use existing terminology or explain the intended meaning of new terminology, for example:
 - a. Paragraph B3.3.8(c) refers to “settlement risk”, but this term is not explained or defined. For example, it is not clear whether settlement risk

should include the exposure to credit risk relating to the intermediate payment service provider or not.

- b. Paragraph B3.3.8 refers to “will be settled with cash”, whilst paragraph B3.3.1 refers to “discharges the liability (or part of it) by paying the creditor, normally with cash”, if the same meaning is intended then using the same words would be preferred.
- c. “settlement date”, the term is used in the context of paragraph B3.1.6 as the date an asset is received by the entity or the date an asset is delivered by the entity. The IASB should clarify how settlement date should be understood in the context of paragraph B3.3.8.

Question Two

- 2a. What benefits would these proposals provide you?
- 2b. What costs would be associated with these proposals? Please share any qualitative or quantitative information on the cost of implementing the proposals you may be aware of.
- 2c. What estimated lead time (transition period) would you require to implement these proposals?

Please include any comments you may have in response to questions 2a, 2b and 2c in the box below.

We appreciate the IASB’s efforts to provide greater certainty regarding the application of the derecognition criteria following the publication of the IFRS Interpretation Committee’s tentative agenda decision *Cash Received via Electronic Transfer as Settlement of a Financial Asset (IFRS 9)*. This tentative agenda decision has created uncertainty in the UK over the practical application of the derecognition requirements of IFRS 9. Unfortunately, we do not believe that the proposals achieve the necessary certainty.

We further note that the issue was first raised through the IFRS Interpretation Committee process but was then identified as part of the PIR. Users of financial statements do not appear to be concerned about existing and possibly diverse reporting practice in this area. In our view the costs involved to achieve exact alignment with the IFRS Interpretation Committees tentative agenda decision are disproportionately higher than the benefits of consistency in this area. The time lag between the initiation of payments and the cash is received or paid out, is generally short. Any unusual delay will be identified through the bank reconciliation process.

We therefore support a pragmatic solution by the IASB which in our view would entail a practical expedient that covers financial assets and goes beyond electronic payment transfers. Unless greater certainty is provided by the IASB, it will fall on preparers and their auditors to form a view on whether existing practices are

compatible with IFRS 9 and the IFRS Interpretation Committee tentative agenda decision, potentially risking diversity in practice.

Question Three

3. In paragraph 9 of its draft comment letter, the UKEB proposes an alternative to settlement date accounting for items settled with cash using an electronic payment system. We recommend an option be given to derecognise the financial liability at the time instruction to make the payment is given. Do you agree with this alternative approach?

Yes	<input checked="" type="checkbox"/>	No	<input type="checkbox"/>
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Please explain why or why not

We believe the UKEB's alternative proposal is a more pragmatic solution to address the uncertainty about the practical application of the derecognition requirements in IFRS 9. However, in our view the practical expedient should not be limited to electronic payment systems and should also cover financial assets, ie the receipt of cash.

That said, any practical expedient should be conditional, including that the time between payment instruction and legal release from the obligation to pay the creditor will be short; that the settlement risk is insignificant; and that the entity has the ability to pay the cash.

Equivalent conditions could potentially be developed in respect of financial assets. However, we would definitely welcome the need to clarify, following the September 2012 IFRS-IC TAD , on whether the interim balances (such as cash-in-transit) would meet the cash or cash equivalent criteria.

Question Four

4. Do you have any other comments you would like to make on the proposed amendments related to the derecognition of liabilities settled with cash using an electronic payment system? If so, please include them in the box below.

We are concerned about the impact of new paragraph B3.1.2A which requires settlement date accounting in relation to the recognition and derecognition of financial assets and liabilities. We disagree with paragraph BC10 in the ED that states IFRS 9 already requires the application of settlement date accounting, except for regular way purchase and sale of financial assets and this amendment is a clarification (paragraph BC22(a)).

IFRS 9 contains requirements in relation to the recognition and derecognition of financial assets and it is not clear how the settlement date requirements of

paragraph B.3.1.6 are intended to fit with other IFRS 9 recognition and derecognition requirements. For example, paragraph B3.1.2(a) requires that unconditional payables and receivables are recognised when the entity becomes party to the contract and as a consequence has a legal right to receive or a legal obligation to pay cash. Settlement date accounting as defined in paragraph B3.1.6 refers to (a) a recognition of an asset on the day it is received by the entity and (b) the derecognition of an asset and the recognition of a gain or loss on disposal on the day that an asset is delivered by the entity. These requirements refer to different issues and how they are expected to be applied together is not clear. In our view paragraph B3.1.2A is better removed.

References to settlement should instead be explained or defined in the context of cash payments or receipts. This would also avoid questions around the application of settlement date accounting for financial liabilities, as the settlement date accounting requirements in paragraph B3.1.6 only apply to assets.

Classification of Financial Assets

Question Five

5. Do you believe the proposed requirements for contractual cashflows at B4.1.8A and B4.1.10A are sufficiently clear to be implemented without excessive diversity in practice?

Yes	<input type="checkbox"/>	No	<input checked="" type="checkbox"/>
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If not, what changes to the wording would you recommend to improve clarity?

We support the amendments in that they provide some clarification and enhanced certainty regarding the accounting for financial instruments with ESG linked features. Nevertheless, in our view the amendments do not resolve all issues and may result in new application problems.

Paragraph B4.1.8A helpfully clarifies that compensation for basic lending risk can include different elements, ie it is not just compensation for time value of money, liquidity risk, administrative costs and a profit element.

In our view ESG linked financial instruments compensate a lender for reputational risks or could be a market driven, ie lenders have to offer these products in order to remain competitive. The amendments do not explain why compensation or indeed negative compensation for such risks or objectives, would or would not fall under basic lending risks.

Paragraph B4.1.8A further states that features that compensate for risk and market factors that are not typically considered to be basic lending risks are excluded from basic lending risks, even if such contractual terms are common in the market. This requirement is difficult to interpret, as it seems contradictory. In the context of ESG

features it is likely that such products will become common in the market, but the amendments are still not clear on whether and if so when such features would typically be considered basic lending risks

Paragraph B4.1.8A also introduces the concept of alignment of the change in cash flows with direction and magnitude of a change in basic lending risk. In relation to ESG features it is difficult to interpret whether they would meet that condition or not.

We believe it may be impossible for the IASB to develop a set of conditions or criteria that can be consistently applied to decide on whether certain loan features are basic or not. Therefore we suggest that the IASB enhances its examples to illustrate and explain how the concept of basic lending risk would be applied in the context of ESG features. The clarifications in relation to the elements of basic lending risk and the exclusion of profit or revenue share related features contained in paragraph B4.1.8A should also be retained.

Paragraph B4.1.10A requires that the contingent feature must be specific to the debtor. We concur that there is a need to restrict when contingent features can be considered basic, however in our view, aligned with the definition of a derivative, the IASB should explore whether the contingency could be specific to a party to the contract instead.

ESG related features may not be specific to the contracted borrower, but for example to a group of entities to which the contracted borrower belongs. Nevertheless, defining what qualifies as “specific to a debtor”, could have unintended consequences.

We note that for the purpose of the definition of a derivative “party” is not defined either and this has not been identified as an application problem. Instead of explicitly defining “borrower” or “party”, we suggest that the IASB includes an example to explain the concept.

Additionally, consideration could also be given to “increased costs” clauses, and on the wording retained by the amendment (against the use of “magnitude” for example) We also note that in the UKEB letter, the clarification suggested deals only with “direction” and not with “magnitude”.

Question Six

6. Do you agree, that for the purpose of assessing contractually specified changes in cashflows including a contingent event for an ESG-linked financial instrument (B4.1.10A), the use of consolidated, parent or other group company ESG targets should be permitted?

Yes	<input checked="" type="checkbox"/>	No	<input type="checkbox"/>
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Please explain why or why not.

Generally we believe in the context of ESG this could provide relevant information, however, we are not convinced that a general widening of the scope to groups or other group entities, is the best solution. See our response to Question 5 above.

Question Seven

7. Are you aware of any common financial instruments that are accounted for at amortised cost today under existing IFRS 9 requirements, which would move to fair value accounting under these proposals?

Yes	<input type="checkbox"/>	No	<input checked="" type="checkbox"/>
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If so, please explain which products and why.

Click or tap here to enter text.

Question Eight

- 8a) What benefits would the proposals regarding the classification of financial assets provide you?
- 8b) What costs would be associated with the proposals regarding the classification of financial assets? Please share any qualitative or quantitative information of the cost of implementing the proposals you may be aware of.
- 8c) What estimated lead time (transition period) would you require to implement the proposals regarding the classification of financial assets?

We believe proposals to specifically address ESG related features in financial assets should be finalised and made available for application with urgency.
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Question Nine

9. Do you have any other comments you would like to make on the proposed amendments to the Classification of Financial Assets? If so, please include them in the box below.

Proposed paragraph B4.1.16A introduces a description for “non-recourse” features. In our view this description is narrower than it should be and also departs from how “non-recourse” is typically interpreted without this amendment. Non-recourse financial assets are those with no or limited recourse to specific assets in the case of default only, rather than over the life and in case of default.

The factor identified in paragraph B4.1.17A(a) would not seem relevant in the context assessing the debtors’ legal and capital structure, although we don’t dispute that it is a relevant factor in relation to non-recourse features. In addition it would be helpful if the IASB could clarify whether the factors to consider are required conditions or simply indicators.

The IASB is proposing to clarify in paragraph B4.1.20 that tranches have non-recourse features. We do not disagree. Nevertheless, it would be helpful for the IASB to clarify that a financial asset that is considered basic applying the conditions applicable to contractually linked instruments, will also be deemed basic in relation to the non-recourse requirements, because the contractually linked requirements are more restrictive than those for non-recourse financial assets.

The clarification in paragraph B4.1.20A that transactions do not contain multiple contractually linked instruments when the lending transaction is from a single creditor should be extended to include groups of creditors with the same ranking, to cover typical structures.

Paragraph B4.1.23 helpfully clarifies that the pool of underlying assets can include assets outside the scope of the classification requirements of IFRS 9. It would be helpful for the IASB to clarify the intention behind “equivalent to payments of principal and interest”. For example if lease receivables are the underlying assets there could be exposure to the residual value of the leased assets, a feature that would not normally be deemed compatible with the classification as solely payments of principal and interest.

Disclosure

Question 10

10. Do you agree with the IASB proposals for amendments to the disclosure of investment in equity instruments designated at fair value through other comprehensive income?

Yes	<input checked="" type="checkbox"/>	No	<input type="checkbox"/>
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Please include any comments you may have in response to question 10:

Paragraph 11B (c) requires the disclosure of the cumulative gain or loss recognised in other comprehensive income for equity instruments measured at fair value through other comprehensive income. In our view this is the most relevant information for users. Although we do not oppose the new disclosure requirement, the benefit that users could derive from it, seems small.

We note that consideration could be given to the need for derecognised assets during the period to disclose the information of the accumulated OCI since recognition of the asset and not only the variation in OCI of the period

Question 11

11. Do you agree with the UKEB's draft conclusion that the proposed disclosure requirements for contractual terms that could change the timing or amount of contractual cashflows are too broad?

Yes	<input checked="" type="checkbox"/>	No	<input type="checkbox"/>
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If necessary, how would you recommend modifying these proposals?

We do not support the extension of the disclosure requirement to financial liabilities, as the new proposed requirements in relation to contingent events specific to a debtor are related to the classification of financial assets, not financial liabilities.

We concur that for a lender the proposed disclosures in relation to financial assets could be extensive. In our view disclosure of the carrying amount of financial assets subject to contingent events, separately identifying those that are measured at amortised costs and those that are measured at fair value should suffice.

Transition

Question 12

12. Do you agree with the UKEB's draft recommendation that amendments relevant to the classification of ESG-linked financial instruments be made available for early adoption?

Yes	<input checked="" type="checkbox"/>	No	<input type="checkbox"/>
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Please include any comments you may have in response to question 12:

None

Question 13

13. Do you agree with the IASB's transition proposals, including the proposal not to restate comparative information?

Yes	<input checked="" type="checkbox"/>	No	<input type="checkbox"/>
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Please include any comments you may have in response to question 13:

None

All

Question 14

- 14a. Have you identified any other benefits from the proposals in this ED?
- 14b. Are there any other comments you would like to make on costs arising from the proposals in this ED?
- 14c. Are there any other comments you would like to make on the estimated lead time (transition period) required to implement the proposals in this ED?

If so, please include them in the box below.

Click or tap here to enter text.

Question 15

15. Are there any other comments you would like to make on the proposals in this ED? If so, please include them in the box below.

None

Thank you for completing this Invitation to Comment

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by midday on Monday 26 June 2023 to:
UKEndorsementBoard@endorsement-board.uk