

Summary of the Financial Instruments Working Group meeting held on 24 April 2023 from 2pm to 5pm

Meeting agenda

Item no.	Item
	<i>Welcome</i>
1	Technical discussion: IASB's Exposure Draft <i>Amendments to the Classification and Measurement of Financial Instruments</i> .
2	Horizon scanning
3	Governance matters
4	Any other business

Attendees

Present	
Name	Designation
Peter Drummond	Chair, Financial Instruments Working Group (FIWG)
Alan Chapman	FIWG member (by dial-in)
Brendan van der Hoek	FIWG member
Conrad Dixon	FIWG member
Fabio Fabiani	FIWG member
Helen Shaw	FIWG member
Kumar Dasgupta	FIWG member
Mark Randall	FIWG member (by dial-in)
Mark Spencer	FIWG member (by dial-in)

Present	
Name	Designation
Richard Crooks	FIWG member
Robbert Labuschagne	FIWG member
Sarah Bacon	FIWG member (by dial-in)
Silvie Koppes	FIWG member (by dial-in)
Ian Mitchell	Observer

In attendance	
Name	Designation
Pauline Wallace	Chair, UK Endorsement Board (UKEB)
Sandra Thompson	Board member, UK Endorsement Board (by dial-in)
Seema Jamil-O'Neill	Technical Director, UK Endorsement Board (by dial-in)

Apologies: Tim Dee (Observer)

Relevant UK Endorsement Board (UKEB) Secretariat team members were also present.

Welcome

1. The Chair of the Financial Instruments Working Group (FIWG) welcomed members, the observer and those in attendance to the meeting.

Technical discussion

Introduction

2. The FIWG Chair introduced the meeting topic, the Exposure Draft (ED) *Amendments to the Classification and Measurement of Financial Instruments*, issued by the IASB in response to feedback received as part of its Post-Implementation Review of IFRS 9.
3. The discussion would inform the UKEB's draft comment letter, which the Board intended to consider at its May meeting.

Derecognition of financial liabilities settled through electronic transfer

4. The UKEB Secretariat described the clarification within the ED that settlement date accounting is applied to the recognition and derecognition of financial assets and liabilities. The ED proposes that the only exceptions to this rule would be use of the regular way exemption and the proposed new accounting policy choice on derecognition of financial liabilities within paragraph B3.3.8. The Secretariat invited views on these requirements.
5. FIWG members agreed that, when derecognising assets, the counterparty initiates the payment and so, at least within current electronic payment systems, the reporting entity does not know that a payment has been initiated. The members therefore agreed the scope of the proposed new policy choice should not extend to assets.
6. FIWG members welcomed the objective of the amendments on the derecognition of financial liabilities. This was understood as an attempt at preserving current practice, which some associated with good financial control environments. However, FIWG members considered that the criteria as drafted might only partially achieve that objective.
7. Some FIWG members considered a definition of 'electronic payment system' would be helpful. Other members disagreed, considering that examples of electronic payment systems would suffice. They would also welcome clarity on whether credit and debit card payments were in scope. They expressed concerns about the implications of the proposals for cheques.

B3.3.8: derecognition of financial liabilities: accounting policy choice

8. The UKEB Secretariat invited views on paragraph B3.3.8, which provides an accounting policy choice not to apply settlement date accounting for payments settled with cash using an electronic system where:

"(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."
9. The ED proposes derecognition on the date payment is no longer revocable as an alternative to settlement date accounting. Members noted that this proposal does not reflect current practice and that this date could fall between initiation and settlement date. Preparers would have to develop new analysis of the date that payments were no longer revocable, which could vary by system. Take-up would likely therefore be limited.

10. In the discussion, the following suggestions were made:
- a) FIWG members preferred “practical ability” to “ability” for B3.3.8(a).
 - b) Some FIWG members suggested that B3.3.8(a) and (b) could be combined, for example using the following phrasing: “*the entity does not have the practical ability to cancel payment*”. However, another member suggested that these points were distinct, as the IASB’s intention for B3.3.8(b) was to focus on the loss of the control of the cash.
 - c) Some members suggested that paragraph B3.3.8 should be based on a holistic assessment of the transaction including the entity’s “*intent*” which may include an assessment of an entity’s past practice that electronic payments were settled as intended. Members referred to the own use exemption, hedge accounting and regular way accounting as precedents in IFRS 9 for such an approach. The short nature of the electronic payment transactions (typically 3 days between initiation and settlement date), and the ease of confirmation of successful settlement (e.g. via bank statement review or bank confirmation) would mitigate the risk of potential cut-off abuse.

B3.3.9: assessing whether settlement risk is insignificant for the purposes of B3.3.8(c)

11. The UKEB Secretariat invited views on paragraph 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.”*
12. Members questioned the inclusion of B3.3.8(b) and (c) as separate tests: once the cash is set aside, there is no more settlement risk. Together with B3.3.9, these criteria appeared intrinsically linked. FIWG members suggested that the final sentence of B3.3.9 should be deleted.
13. The Chair noted that further research on payment systems and the application of the proposed conditions was needed, and further input may be requested from the group.
14. FIWG members agreed that examples that related to specific electronic payment systems would be helpful to clarify terms within this paragraph which currently appear ambiguous, for example, “*short*” and “*standard administrative process*”.

Classification of financial assets

B4.1.8A: elements of interest in a basic lending arrangement

15. The UKEB Secretariat invited views on the ED's proposed clarifications on the elements of interest in a basic lending arrangement, which in part are designed to address loans with Environmental, Social and Governance (ESG)-linked features.

Scope of the Amendments

16. FIWG members agreed that the objective of this part of the Amendments – to permit ESG-linked loans to be held at amortised cost where appropriate – was timely, welcome and pragmatic, but that the explanation of the conceptual underpinning was not strong and the Amendments could have wider unintended consequences.
17. One member suggested adding explicit guidance clarifying the treatment of ESG-linked features. A paragraph written to address specific jurisdictions where a government or a regulatory authority sets interest rates was noted as a precedent within IFRS 9.¹ However, other members challenged whether ESG-linked features would need to be defined if this approach were taken.
18. Some FIWG members observed that the concept of "*basic lending risks or costs*" (B.4.1.8A) could include instruments with ESG features but in future also instruments featuring other (non-ESG) targets. They were concerned that the current examples do not explain why the basic lending criteria are met. FIWG members agreed the Amendments should provide clear examples, together with the principles underpinning the boundary, so preparers can apply the principles aided by examples. A third example, illustrating a middle-ground fact pattern, would also be helpful in understanding how each criterion is applied.

B4.1.8A: assessment of whether the contractual cash flows of a financial asset are consistent with a basic lending arrangement

19. FIWG members discussed whether ESG-linked features constituted basic lending risks or costs.
 - a) One member noted that ESG-linked features could be part of the cost or the profit margin, or could be characterised as a profit margin adjustment.
 - b) Another member asked whether it was implicit in the example that a preparer should assess the loan both with and without the ESG-linked feature in order to conclude on whether it met the basic lending criteria. If so, preparers could use their judgement to do so.

¹ IFRS 9 B4.1.9E.

20. It was observed that B4.1.8A, which focuses on “*what an entity is being compensated for*” rather than “*how much compensation an entity receives*”, appeared to contradict other guidance on assessing whether cash flows are solely payments on principal and interest on the principal amount outstanding (SPPI), where the amounts involved do matter, for example, on de minimis amounts and leverage.²
21. In order to address the practical difficulties of applying the “*direction and magnitude*” test, one member suggested modifying the wording to allow practical, qualitative assessment, similar to the existing requirements on time value of money³.

B4.1.10A / BC67: assessing 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 outstanding

22. The UKEB Secretariat invited views on the requirement for the occurrence (or non-occurrence) of the contingent event to be “*specific to the debtor*” (B4.1.10A) to be consistent with a basic lending arrangement, and how this requirement would apply to loans with ESG-linked features.
23. Members were concerned as to whether an ESG-linked feature based on a consolidated group’s performance could be seen as “*specific to the debtor*” when assessing a loan provided to a subsidiary entity in a consolidated group. There were mixed views: while some FIWG members considered that a loan agreement with ESG targets at a group level could still be “*specific to the debtor*” (perhaps by reference to the definition of a reporting entity in IFRS 10 *Consolidated Financial Statements*), others disagreed with this view.
24. FIWG members suggested that including “*consolidated greenhouse gas emissions*” in the example at paragraph B4.1.13 would indicate this treatment was acceptable.
25. FIWG members were particularly concerned that there could be unintended consequences if changes in contractual cash flows due to contingent events that were “*specific to the creditor or another party*” (BC67) were regarded as inconsistent with a basic lending arrangement. Under the ED proposals, certain loans with clauses in which increased costs can be passed onto a borrower could fail the SPPI criteria. However, FIWG members understood such clauses to be common in the UK. Members were requested to share examples of such clauses with UKEB staff.

² De minimis amounts: B4.1.18; leverage: B4.1.9.

³ IFRS 9 B4.1.9A and B.

26. Possible solutions put forward included:
- a) One member proposed that, as increased cost clauses are generally employed to maintain the creditor's profit margin, an extra sub-clause "*to maintain a creditor's profit margin*" could be included alongside "*specific to a debtor*". Another member suggested that if this suggestion were to be implemented, BC67 would need to be deleted.
 - b) Another member noted that many increased cost clauses are anchored in changes to tax regulations, which are market-wide. That member asked if B4.1.10A could be interpreted as not applying to increased cost clauses.
27. FIWG members suggested that the requirements related to "direction and magnitude", within B4.1.8A, should be included within the "contractual terms which change the timing or amount of contractual cashflows" section of IFRS 9 (B4.1.10 and subsequent paragraphs). This would clarify that the 'direction and magnitude' test associated with changes in contractual cash flows is relevant to the consideration of the effect of contingent events, rather than the consideration of whether a feature constituted a basic lending risk or cost.

Financial assets with non-recourse features (NRF) and Contractually Linked Instruments (CLIs)

B4.1.16A: 'non-recourse' features

28. The Secretariat asked for views on the description of non-recourse features in paragraph B4.1.16A. Points expressed by FIWG members included the following:
- a) Some members considered that the paragraph could be read literally and narrowly, which would likely exclude many arrangements other than those with waterfall features from the NRF guidance. It would be useful to understand whether this paragraph was intended so narrowly.
 - b) Another member preferred the struck-through wording example [B4.1.16], in which the use of "*or*" not "*and*" was important. However, it was also noted that the more precise wording of B4.1.16A, compared to the sentence struck through in B4.1.16, does provide clarity by distinguishing collateralised loans (where in a default the claim on the collateral is non-recourse) from cases where the entity is fully exposed to an asset's performance risk, as explained in BC75.

B4.1.20: description of a tranche

29. One FIWG member observed that an arrangement in which an entity does not put cash in upfront but is potentially called on to do so later, for example, when providing a loan commitment, may be considered a tranche if it could bear losses in a similar way to a junior tranche. However, the ED does not address this scenario.

B4.1.20A: multiple debt instruments without all of the characteristics described at B4.1.20

30. FIWG members welcomed the Amendments in paragraph B4.1.20A, but were concerned about the potential for abuse, as it was felt that subsequent sales of tranches could change the nature of the structure post-inception. Discussion on how this could be prevented included consideration as to whether the classification would need to be reassessed if tranches were sold.

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

31. FIWG members observed that the residual value of leases often causes them to fail the SPPI requirements. Although the IASB September board paper⁴ explained this clearly, it would be helpful to clarify this issue within the ED.

Disclosures and transition

32. The UKEB Secretariat invited views on the disclosures and transition arrangements proposed in the ED.

11A: disclosures on investments in equity instruments designated at fair value through other comprehensive income (FVOCI)

33. This was not considered a topic of great concern for the UK. However, one member noted that the proposed disclosure at 11A(f) appeared overly prescriptive.

20B and 20C: disclosures on 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

34. Members agreed the disclosure requirements appeared extremely broad and concerns were expressed that this may invite boilerplate disclosure. One member observed that disclosure could be brief but targeted; nonetheless, preparing that disclosure would be onerous and its decision-usefulness remained unclear. Members noted that some parts of the disclosure requirements overlapped with existing disclosure requirements in this or other standards.
35. A member suggested that one solution could be to scope out credit-related contingencies as the usefulness of the information was not apparent given the expected credit loss requirements of IFRS 9.

⁴ [Contractual Cash Flow Characteristics of Financial Assets \(Amendments to IFRS 9\), Agenda Paper 16B, September 2022](#), paragraph 53.

Overall: disclosure

36. FIWG members agreed that it would be best to link the disclosures to the classification and measurement requirements, such as B4.1.10A, ensuring they were proportionate. They further agreed that a disclosure objective should be added to facilitate consistent, targeted application of the requirements.

Overall: transition

37. FIWG members suggested that there should be an option to adopt different parts of the Amendments at different dates: the sections on financial assets with ESG-linked features were needed urgently, whereas the requirements on electronic payment systems could require significant system changes to implement and would therefore require longer lead times.
38. FIWG members noted that in the past different parts of IFRS 9 had been permitted to be adopted at different paces (e.g. the own credit exemption) so there was precedent for such an approach.

Horizon scanning

39. The Secretariat asked for horizon scanning items, observing that views on the matter in the IFRIC pipeline⁵ on the own use exemption (including whether such transactions were prevalent in the UK) would be welcome.
40. Several members commented on the IFRIC pipeline matter, noting that they did not think these issues were prevalent in the UK. One member observed that the second scenario in the IFRIC project paper may be more straightforward as there was a body of past practice to draw upon when assessing unexpected net settlement. The Chair of the UKEB observed that, as these issues did not appear prevalent in the UK, there was no significant pressure for the UKEB to address the IFRIC pipeline matter. Members agreed.
41. One member also highlighted FASB guidance on cryptoassets and an IFRIC paper on guarantees over derivatives.

Governance matters

42. The UKEB Technical Director gave a brief presentation on governance matters relevant to the working group's activities.

AOB

43. The meeting discussed possible topics for the June meeting.

⁵ [IFRIC pipeline request; Application of the Own Use exemption in the light of current market and geopolitical questions.](#)

End of meeting