Post Implementation Review: IFRS 9 *Financial Instruments* – Classification & Measurement: Final Comment Letter

Executive Summary

Project Type	Influencing
Project Scope	Significant
Purpose of the paper	
This paper requests the Board's approval of the comment letter to the IASB and the related feedback statement.	
Summary of the Issue	
The IASB has commenced a PIR of IFRS 9 *Financial Instruments,* focused on the classification and measurement requirements. The PIR assesses whether the standard is meeting its objectives, can be applied consistently, provides useful information to users, and that implementation costs are as expected. Stakeholder outreach has indicated that the IFRS 9 classification and measurement requirements are generally working as intended. The exceptions are: the cashflow characteristics assessments for some financial instruments; and the practical application of the effective interest calculation described at IFRS 9 B5.4.5 and B5.4.6. In addition, at the December 2021 meeting the Board agreed with stakeholder feedback that issues raised by the recent IFRIC tentative agenda decision *Cash Received via Electronic Transfer as Settlement for a Financial Asset* may be best resolved via the IFRS 9 PIR process. The comment letter reflects this position.	
Decisions for the Board	
The Board is asked for its: a) approval to issue the comment letter to IASB and publish on the UKEB website; b) approval to publish the feedback statement on the UKEB website; and c) approval of the Due Process Compliance Statement.	
Recommendation	
We recommend the Board approve the final comment letter and feedback statement for publication, and approve the Due Process Compliance Statement.	
Appendices	
Appendix 1 Draft final comment letter Appendix 2 Draft feedback statement Appendix 3 Due Process Compliance Statement	

Background

1. In July 2014 the IASB issued IFRS 9 *Financial Instruments*. The Standard was effective for annual periods commencing on or after 1 January 2018. Insurers may defer the effective date until 1 January 2023 to align with implementation of IFRS 17 *Insurance Contracts*, providing certain conditions are met.

2. IFRS 9 replaced IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 introduced changes to the IAS 39 accounting requirements in three main areas: classification and measurement, impairment (introduction of Expected Credit Losses) and hedge accounting.

3. In accordance with its due process, the IASB is required to conduct a post implementation review (PIR) of each new IFRS standard and major amendment. The purpose of the PIR is to assess whether the standard or amendment is meeting its objectives, can be applied consistently, that information is useful to users of financial statements, and that implementation costs are as expected.

4. The IASB's possible actions following the PIR are to:

   a) Produce educational materials;

   b) Conduct follow-up research work for possible standard setting; or

   c) Take no action.

5. The IASB has commenced its review of IFRS 9 by considering the standard's classification and measurement requirements, together with the related disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*. Separate RFIs addressing IFRS 9's impairment and hedge accounting requirements are expected in 2022.

UKEB draft comment letter – key themes

6. The UKEB's draft comment letter was open for public consultation from 15 December 2021– 10 January 2022. In anticipation of this short comment period, stakeholder feedback was also obtained via roundtable events and stakeholder meetings with stakeholders prior to the publication of the draft comment letter. The draft comment letter (DCL) noted that:

   a) IFRS 9 classification and measurement requirements are for the most part working as intended.

   b) there are two significant exceptions to this – financial instruments with ESG[1] features and contractually linked instruments. Stakeholders believe that the issue related to financial instruments with ESG features is urgent given the nature of the

[1] These are sustainability-linked features including the Environmental, Social or Governance practices of the entity.

instruments and their expected rate of growth. They believe this issue should be removed from the PIR process and addressed in a more urgent manner by IASB.

c) stakeholders also noted a lack of clarity in the application guidance on the use of the effective interest method. Specifically, the circumstances where paragraphs B5.4.5 and B5.4.6 should be applied. The UKEB DCL included a recommendation that IASB provided further guidance on key terms and additional examples.

d) UKEB considered the recent IFRS Interpretations Committee (IFRIC) tentative agenda decision (TAD) *Cash Received via Electronic Transfer as Settlement for a Financial Asset,* and recommended this matter should be addressed as part of the PIR of IFRS 9*.* This is an important issue for UK stakeholders given the widespread implications of the TAD. the UKEB DCL recommended IASB take an approach similar to that already taken for "regular way transactions" (IFRS 9 3.1.2), that is permitting a policy choice to determine the extinguishment of a financial payable (as per IFRS 9 3.3.1) or receivable (as per IFRS 9 3.2.3(a)) at either the commencement or conclusion of a market standard settlement mechanism. We believe that such a treatment could avoid many of the concerns that have been identified with the TAD.

7. Stakeholder feedback highlighted a small number of other IFRS 9 classification and measurement areas that may benefit from improvement. However, they were considered to be less important and not needing the IASB's attention as (i) they might distract from the critical issues raised above and (ii) the likelihood that the action necessary to resolve the issue would be disproportionate to the significance of the issue. During the agenda consultation IASB made clear it had limited resources to accommodate further work, and this approach is consistent with ensuring that this limited resource is focused on the most critical issues. Accordingly, these additional items were not included in the comment letter and we do not believe this is necessary. However should the board wish to reference these matters in the comment letter example wording is provided below. This would be inserted into paragraph A1 of the comment letter.

Potential revised wording (modifications in bold).

8 Subject to the issues associated with the cash flow characteristics assessment and effective interest method noted below, we have found that the IFRS 9 classification and measurement requirements generally work as intended and are an improvement to the previous rule-based requirements in IAS 39 *Financial Instruments: Recognition and Measurement*. Our response to the IASB's Request for Information (RFI) therefore focuses primarily on *Question 3: Contractual Cash flow Characteristics* and *Question 7: Amortised Cost and the Effective Interest Method*, where improvement, and potentially standard setting activity, are required. Individual responses to RFI questions for areas that, materially, work as intended are not provided. ***Stakeholders requested UKEB focus its response on the most serious of the topics raised so as not to distract from these critical messages. Examples of other areas for potential improvement raised by stakeholders included the application of the business model test, ability to recycle gains from equity instruments in OCI, the treatment of modifications to contractual cashflows,*** **the boundary between IFRS 16 *Leases* and IFRS 9 *Financial Instruments*, *and accounting for financial guarantees. However many stakeholders noted these were not priority topics to raise or noted the action necessary to resolve the issue would be disproportionate to the significance of the issue. We have not included these topics in this letter and do not recommend IASB undertake further work in these areas.*** We also

provide comment on the IFRS Interpretations Committee (IFRIC) tentative agenda decision (TAD) *Cash Received via Electronic Transfer as Settlement for a Financial Asset* at Question 9: Other Matters.

Question for the Board
a) Given stakeholder direction not to distract from the critical issues, do Board members agree that it is not necessary to include in our comment letter the issues identified by stakeholders as being lower priority, and that the modification to paragraph A1 above is not required?

Subsequent UK stakeholder feedback

9. Subsequent to the December Board meeting, additional stakeholder outreach included a survey on IFRS 9 and an interview with a banking analyst. Including these activities, in total 31 stakeholders, representing 23 organisations, provided feedback via the different formats made available. No responses were received to the draft comment letter. This was not unexpected as many organisations expected to respond on this topic had participated in the earlier outreach events which helped identify the issues included in the draft comment letter.

10. Two preparers, representing the banking and insurance sectors, responded to the IFRS 9 survey. Their feedback was consistent with previous stakeholders comment.

11. The treatment of financial instruments with ESG features was the most significant area of concern, with concerns raised that fair value treatment of such instruments may reduce decision useful information, and that such an outcome could make green investment less attractive to investors.

12. The responses noted that for ESG instruments the economic substance and risks inherent in these products continued to relate to credit and interest rate, making amortised cost the more appropriate methodology. A view expressed in the July 2021 IASB staff paper[2] was also questioned. This had stated that it was not sufficient when assessing classification to note that an ESG interest rate adjustment is part of the lending profit margin, as "any contractual term that could give rise to variability in the contractual cashflows needs to be assessed to determine whether they are SPPI". This was considered too strict and could result in fair value accounting treatment, and the likely loss of decision useful information, in too many cases. It noted further guidance was required and in doing so IASB should be mindful of creating a consistent model which would minimize structuring opportunities.

13. The banking analyst we consulted felt strongly that lending products should use amortised cost accounting as this provided the most decision useful information and any move away from this would reduce the usefulness of that information. They considered that amortised cost provided transparent and relevant information, and facilitated reliable comparison both within and between organisations, for example on

[2] IFRS Staff Paper, Feedback on Financial Assets with Sustainability Linked Features, Agenda Paper 3B, July 2021, paragraph 26.

fundamental areas such as lending growth and provision coverage. By contrast, the valuations of lending products at fair value were considered to be opaque, and difficult to disaggregate to obtain decision useful information.

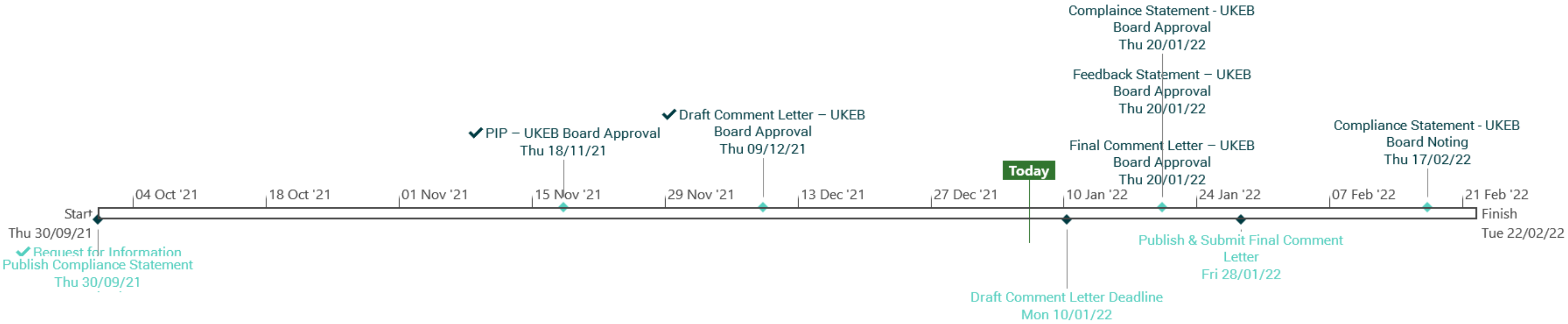
14. This feedback is consistent with that previously received and included in the draft comment letter. Paragraph A6 has been expanded to include this additional feedback from the banking analyst, and a new paragraph added at A7c to reflect feedback from the survey responses, and the potential unintended consequences of moving away from principles based accounting requirements.

Questions for the Board
a) Do Board members have any suggested amendments to the comment letter included at Appendix 1, or to the feedback statement at Appendix 2?
b) Subject to any suggested amendments, does the Board approve the comment letter for issuance to the IASB?
c) Subject to any suggested amendments, does the Board approve the feedback statement for publication on the UKEB website?
d) Do Board members have any suggested amendments to the draft compliance statement included at Appendix 3?
e) Subject to any suggested amendments, does the Board approve the compliance statement for publication on the UKEB website?

Next Steps

15. The next project milestones are as follows:

Date	Milestone	Complete
30 September 2021	IASB Publish RFI	✓
15 November 2021	Publish stakeholder survey.	✓
18 November 2021 **Board Meeting**	Approve PIP	✓
09 December 2021 **Board Meeting**	Approve Draft Comment Letter	✓
15 December 2021	Publish Draft Comment Letter. Deadline for responses 10 January 2022.	✓
20 January 2022 **Board Meeting**	Approve Final Comment Letter Approve Feedback Statement Approve Compliance Statement	
28 January 2022	Submit Comment Letter to IASB Publish Feedback Statement on website.	
17 February 2022 **Board Meeting**	Final Compliance Statement to board for noting.	
18 February 2022	Publish Compliance Statement on website.	


Complaince Statement - UKEB
Board Approval
Thu 20/01/22
Feedback Statement – UKEB
Board Approval
Thu 20/01/22
Draft Comment Letter – UKEB
Board Approval
Thu 09/12/21
PIP – UKEB Board Approval
Thu 18/11/21
Compliance Statement - UKEB
Board Noting
Thu 17/02/22
Final Comment Letter – UKEB
Board Approval
Thu 20/01/22
Today
04 Oct '21
18 Oct '21
01 Nov '21
15 Nov '21
29 Nov '21
13 Dec '21
27 Dec '21
10 Jan '22
24 Jan '22
07 Feb '22
21 Feb '22
Start
Thu 30/09/21
Finish
Tue 22/02/22
Request for Information
Publish Compliance Statement
Thu 30/09/21
Publish & Submit Final Comment
Letter
Fri 28/01/22
Draft Comment Letter Deadline
Mon 10/01/22

Dr Andreas Barckow
Chairman
International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London
E14 4HD

28 January 2022

Dear Dr Barckow

Invitation to Comment: Request for Information – Post-implementation Review: IFRS 9 *Financial Instruments* Classification and Measurement

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 Foundation'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.

There are currently approximately 1,500 entities with equity listed on London Stock Exchange that prepare their financial statements in accordance with IFRS Standards[1]. In addition, UK law allows unlisted companies the option to use IFRS and approximately 14,000 such companies currently take up this option[2].

We welcome the opportunity to provide comment on the IASB's Request for Information – Post-implementation Review: IFRS 9 *Financial Instruments* Classification and Measurement (RFI). To develop our response our work has included in-house research, a stakeholder survey, and feedback received during stakeholder roundtables and interviews. Based upon this work we note the following:

1. Our stakeholder outreach has highlighted that the IFRS 9 classification and measurement requirements generally work as intended and represent an improvement to the previous rule-based requirements in IAS 39 *Financial Instruments: Recognition and Measurement*. Our response to the RFI will therefore focus on the three significant areas where we consider that improvement, and potentially standard setting activity, is required. Two areas of concern relate to the application of the contractual cash flow characteristics assessment for financial assets, while the third relates to the effective interest rate methodology.

[1] UKEB calculation based on LSEG and Eikon data. This calculation includes companies listed on the Main market as well as the Alternative Investment Market (AIM).
[2] UKEB estimation based on FAME, Companies Watch and other proprietary data.

Financial instruments with sustainability-linked features

2. The IFRS 9 classification and measurement requirements are designed to deal with all types of financial instruments. In recent years, instruments for which interest rates vary on the occurrence of one or more pre-determined events have become increasingly prevalent. Of these, financial instruments with ESG[3] features ("FIEF") are the most common and are expected to grow significantly in future. FIEF come in a variety of forms, including sophisticated instruments which clearly qualify for fair value treatment under IFRS 9. Our concern lies with financial instruments that, but for the ESG feature, would be considered basic lending and qualify for amortised cost accounting.

3. There is a general concern that IFRS 9 currently does not adequately cater for such instruments. In the absence of clear guidance, there is a risk that inconsistent accounting practices will develop for such instruments. Furthermore, UK stakeholders have expressed concern that FIEF that are in substance basic lending may be required to be accounted for at fair value based on the current drafting of IFRS 9. In this respect, it is worth noting that the purpose of ESG features in such instruments is generally to change behaviour and not to lead to a change in the value of the loan. Where the product in substance represents basic lending, IFRS 9 is based on the premise that amortised cost provides users with more decision useful information: (i) the effective interest rate (EIR) interest flows are reported as interest income, often monitored as a key metric for such instruments; and (ii) the expected credit loss requirements of IFRS 9 are considered to provide comprehensive and transparent information on the performance of the product. Measuring such basic lending instruments at fair value would lose that decision useful information.

4. In Appendix 1 paragraph A7, we make a number of suggestions to clarify the IFRS 9 requirements in this regard. These include adding relevant examples to IFRS 9 and providing further guidance as to what can be considered covered by credit risk, profit margin, and "other basic lending risks". Guidance included previously for the treatment of items related to liquidity risk and administrative costs provides precedent for such an approach.

5. We believe resolution of this issue is needed as a matter of urgency. This product set is expected to experience significant and sustained growth in the near future. We concur with stakeholders that attempting to resolve this issue via the Post Implementation Review (PIR) process is unlikely to lead to a timely outcome. We urge the IASB to address it via a more urgent mechanism than the PIR process.

Amortised cost and the effective interest method

6. Stakeholder feedback indicates that the application guidance in IFRS 9 in relation to amortised cost and use of the effective interest method is not sufficiently clear. In particular, stakeholders raise the application of B5.4.5 and B5.4.6 and whether a revision of estimates should be reflected as a change in the effective interest rate or recognised as a 'catch-up adjustment'. We have therefore included recommendations on this issue in Appendix 1 paragraphs A12-A13. If, as expected, FIEF become more

[3] These are sustainability-linked features including the Environmental, Social or Governance practices of the entity.

prevalent and the potential change in cash flows due to the ESG feature becomes greater, then this issue will become more significant. We consider this issue should be addressed alongside those described above relating to FIEF and with the same urgency.

Contractually linked instruments and non-recourse finance

7. Currently there is limited guidance on the contractual cash flow characteristics assessment in IFRS 9 in relation to the boundary between contractually linked instruments (CLI) and non-recourse finance (NRF) transactions. The boundary is not clear and, with the existing guidance, distinguishing between the two is challenging. As CLI requires the underlying portfolio to meet the cash flow characteristics test to achieve amortised cost accounting and NRF does not, outcomes can be very different. Outcomes can also be counterintuitive: instruments with relatively little asset risk may be treated as CLI and measured at fair value while other instruments with significantly more asset risk may be treated as NRF and measured at amortised cost.

8. In Appendix 1 A10-A11 we make a number of suggestions to provide greater clarity and reduce current diversity of practice in this area. These include providing background information to clarify IASB's intent with regard to the CLI requirements, providing definitions of key terms, clarifying that lending provided by a single lender is not within scope of CLI, and considering a proposal whereby the most senior tranche of lending is treated as NRF, leaving only tranches which provide credit protection to the structure to be subject to the CLI requirements.

In addition to the above, we have considered the recent IFRS Interpretations Committee (IFRIC) tentative agenda decision (TAD) *Cash Received via Electronic Transfer as Settlement for a Financial Asset*. This is an important issue for UK stakeholders and, given the widespread implications of the TAD, we agree with the stakeholder feedback provided to IFRIC that this matter should be addressed as part of the PIR of IFRS 9. Our thoughts and recommendation on this issue are discussed in paragraphs A14-A18 of Appendix 1.

If you have any questions about this response, please contact the project team at UKEndorsementBoard@endorsement-board.uk

Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

Appendix 1: Questions on Request for Information: *Post Implementation Review IFRS 9, Classification and Measurement*.

A1 Subject to the issues associated with the cash flow characteristics assessment and effective interest method noted below, we have found that the IFRS 9 classification and measurement requirements generally work as intended and are an improvement to the previous rule-based requirements in IAS 39 *Financial Instruments: Recognition and Measurement*. Our response to the IASB's Request For Information (RFI) therefore focuses primarily on *Question 3: Contractual Cash flow Characteristics* and *Question 7: Amortised Cost and the Effective Interest Method*, where improvement, and potentially standard setting activity, are required. Individual responses to RFI questions for areas that, materially, work as intended are not provided. We also provide comment on the IFRS Interpretations Committee (IFRIC) tentative agenda decision (TAD) *Cash Received via Electronic Transfer as Settlement for a Financial Asset* at Question 9: Other Matters.

Question 3: Contractual cash flow characteristics
a) Is the cash flow characteristics assessment working as the Board intended? Why or why not? Please explain whether requiring entities to classify and measure a financial asset considering the asset's cash flow characteristics achieves the Board's objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows. If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain: *(i)* why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI). *(ii)* which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk). (See Section 7 for more questions about applying the effective interest method.)
b) Can the cash flow characteristics assessment be applied consistently? Why or why not? Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features). If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.
c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects? Please explain the costs and benefits of the contractual cash flow assessment, considering any financial reporting effects or operational effects for preparers of financial statements, users of financial statements, auditors or regulators. In responding to (a)–(c), please include information about financial instruments with sustainability-linked features (see Spotlight 3.1) and contractually linked instruments (see Spotlight 3.2).

Contractual cash flow characteristics of financial assets

A2 To develop our response our work has included in-house research, a stakeholder survey and feedback received during stakeholder roundtables and interviews. This has identified two significant areas where the cash flow characteristics test is not working as intended, leading to inconsistent application and counterintuitive results, and a third area of concern relating to the effective interest rate methodology. We believe improvement, and potentially standard setting activity, is required in these areas. These issues are described below.

Financial instruments with sustainability-linked features

A3 The IFRS 9 classification and measurement requirements are principles-based and therefore intended to deal with all types of financial instruments, including new financial instruments as they emerge.

A4 Subsequent to IFRS 9 being issued, financial instruments for which interest rates vary on the occurrence of one or more pre-determined events have become more prevalent. Of these, financial instruments with ESG[4] features ("FIEF") are the most common and are expected to grow significantly in future. FIEF come in variety of forms, including sophisticated instruments which clearly qualify for fair value treatment under IFRS 9. The scope of this response and the discussion below relates to financial instruments that, but for the ESG[5] feature, would be considered basic lending and qualify for amortised cost accounting

A5 We understand that the IFRS 9 requirements do not provide adequate guidance to enable accounting for FIEF that is consistent with the substance of the transactions. Current practice varies, with some considering the ESG feature as part of credit risk, and others considering it a part of the profit margin. Many consider such features to meet the de-minimis criteria of IFRS 9 B4.1.18 but acknowledge this may not be a sustainable argument should these features become more prominent as this asset class continues to evolve and grow.

A6 UK stakeholders expressed overwhelming concern that, once ESG features are material, FIEF that in substance represent basic lending may be required to be accounted for at fair value based on current IFRS 9 requirements. In this respect it is important to note that the purpose of ESG features in such instruments is generally to change behaviour and it is not intended that they will lead to a change in the value of the loan. Where the product in substance represents basic lending, IFRS 9 is based on the premise that amortised cost provides users with more decision useful information. The EIR interest flows are reported as interest income, which in various forms is monitored as a key metric. The expected credit loss requirements of IFRS 9 are considered to provide comprehensive and transparent information on the performance of the product. Discussion with a banking analyst highlighted that the transparency of amortised cost accounting produces more relevant information, facilitates comparison within and between organisations, and allows critical information such as lending growth and provision coverage to be clearly identified. By contrast lending at fair value was considered opaque and difficult to disaggregate to obtain the desired information.

[4] These are sustainability-linked features including the Environmental, Social or Governance practices of the entity.
[5] Where the ESG feature is also considered "basic" such as pre-determined targets specific to the borrower, and not referencing indices or third parties who are not a specific to a party to the contract.

Accounting for basic lending instruments at fair value would lose decision useful information.

A7 The nature of basic lending products will evolve over time to meet the changing needs of society. A principle-based accounting standard should accommodate such changes in a way that provides decision useful information. To enable such products to pass the cash flow characteristics test, and hence achieve amortised cost accounting (to reflect the substance of the transaction), we recommend that IASB:

a) Provide additional examples illustrating the application of the cash flow characteristics assessment to FIEF products;

b) Provide further guidance as to permitted elements of credit risk and profit margin relevant to this debate. In doing so we recommend the IASB expands on Paragraph B4.1.7A of IFRS 9 which states that '*interest can also include consideration for other basic lending risks*' and '*interest can include a profit margin that is consistent with a basic lending arrangement*' to clarify the nature of "other basic lending risks" and how ESG features may fit within this. B4.1.7A already specifies liquidity risk and administrative costs as examples of activities which meet these definitions, and this creates precedent to include other helpful examples such as those relevant to FEIF assessments.

c) Be mindful when developing further guidance or interpretation that it does not cumulatively move the standard from a principles to a rules based approach or inadvertently creates bright lines e.g. creating examples to address individual issues ends up creating new redlines. This is considered particularly important when dealing with examples where there are likely to be further developments or ongoing changes, such as new product sets. In this respect, it is more helpful when guidance opens up or clarifies new possibilities rather than reduces possibilities. For example, one stakeholder expressed concern with the view expressed in the July 2021 IASB staff paper[6] that it was not sufficient when assessing classification to just note that an ESG interest rate adjustment is part of the lending profit margin (an acceptable element of SPPI at B4.1.7.A), as "*any contractual term that could give rise to variability in the contractual cashflows needs to be assessed to determine whether they are SPPI*". This was considered too narrow an interpretation, which by excluding consideration of broader factors or context was likely to lead an inappropriate number of loans then failing the SPPI test and moved to fair value accounting, in turn leading to less decision useful information.

A8 In addition, we believe resolution of this issue is needed as a matter of urgency. This product set is expected to experience significant and sustained growth in the near future. Attempting to resolve this issue via the PIR process is considered unlikely to lead to a timely outcome and may exacerbate the inconsistent accounting practices. We urge IASB to address it via a more urgent mechanism than the PIR process.

[6] IFRS Staff Paper, Feedback on Financial Assets with Sustainability Linked Features, Agenda Paper 3B, July 2021, paragraph 26.

Contractually linked instruments and non-recourse finance

A9 Currently there is limited guidance on the contractual cash flow characteristics assessment in IFRS 9 in relation to the boundary between contractually linked instruments (CLI) and non-recourse finance (NRF) transactions. The boundary is not clear and, with the existing guidance, distinguishing between the two is challenging. As CLI requires the underlying portfolio to meet the cash flow characteristics test to achieve amortised cost accounting and NRF does not, outcomes can be very different. Outcomes can also be counterintuitive: instruments with relatively little asset risk may be treated as CLI and measured at fair value while other instruments with significantly more asset risk may be treated as NRF and measured at amortised cost. We are told the volume of analysis is onerous and costly, and the asset classes impacted diverse and widespread. Examples provided by stakeholders have, with permission, been shared with IASB staff.

A10 We strongly recommend the IASB clarifies the objective for contractually linked instruments in IFRS 9, to help enhance stakeholder understanding of the transactions intended to be in scope as well as improving the framework for assessment.

A11 Further work would be required to determine the most effective way to improve clarity, but aspects to consider could include:

a) Providing definitions of key terms in B4.1.20 including “multiple” (we suggest this must be more than two), “tranche” and “issuer”, and clarify whether these must be contractual or can be implied (for example a legal vs implicit tranche, whether contractual linkage can be implied when lending to an entity with limited other assets).

b) Assessing the most senior tranche as non-recourse finance, leaving the CLI guidance to only apply to tranches which apply credit protection to the structure. This would provide clarity and reduce the number of instruments that need to be assessed under the more onerous/costly CLI guidance.

c) Clarifying that where lending is provided by a single lender (or multiple lenders acting pari-passu) this is not within the scope of CLI.

d) Clarifying what is meant by concentrations of credit risk, particularly in structures with only two parties – a borrower and a single lender (or multiple lenders acting pari-passu).

Amortised cost and the effective interest method

Question 7: Amortised cost and the effective interest method	
a)	**Is the effective interest method working as the Board intended? Why or why not?** Please explain whether applying the requirements results in useful information for users of financial statements about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest method.
b)	**Can the effective interest method be applied consistently? Why or why not?**

Please explain the types of changes in contractual cash flows for which entities apply paragraph B5.4.5 of IFRS 9 or paragraph B5.4.6 of IFRS 9 (the 'catch-up adjustment') and whether there is diversity in practice in determining when those paragraphs apply. Please also explain the line item in profit or loss in which the catch-up adjustments are presented and how significant these adjustments typically are. If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

A12 It is not always clear how uncertain cash flows should best be reflected in the EIR calculation, and specifically in which circumstances paragraphs B5.4.5 or B5.4.6 should be applied. This was illustrated in the recent IFRS Interpretations Committee (IFRIC) TLTRO[7] decision, which considered an instrument where the interest rate may vary on a pre-determined basis, on the occurrence of one or more pre-determined events. This is not an isolated example as such ratchet structures feature in other financial instruments, including many FIEF.

A13 We recommend the IASB provides further guidance on key terms such as "floating rate" and "market rate" to assist in understanding better the boundary between instruments to be accounted for under paragraph B5.4.5 and those to which B5.4.6 applies. Further examples, particularly those involving FIEF, would be helpful. In paragraph A8 we recommend removing the issue related to ESG instruments from the PIR and addressing it via a more urgent mechanism. We make the same recommendation in relation to this matter, as if (as expected) FIEF become more prevalent and the potential change in cash flows due to the ESG feature becomes greater, a clear understanding of the application of the EIR requirements to such instruments will be required.

Question 9: Other matters	
a)	Are there any further matters that you think the Board should examine as part of the post-implementation review of the classification and measurement requirements in IFRS 9? If yes, what are those matters and why should they be examined? Please explain why those matters should be considered in the context of the purpose of the post-implementation review, and the pervasiveness of any matter raised. Please provide examples and supporting evidence when relevant.

A14 In its September 2021 update IFRIC published a tentative agenda decision (TAD) *Cash Received via Electronic Transfer as Settlement for a Financial Asset.* The IFRIC was asked whether an entity can derecognise a trade receivable and recognise cash on the date the cash transfer is initiated (its reporting date), rather than on the date the cash transfer is settled (after its reporting date). The IFRIC concluded that: an entity derecognises the trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire; and recognises the cash (or another financial asset) received as settlement for that trade receivable on the same date.

A15 Though we agree this approach complies with a literal reading of the IFRS 9 requirements, it appears to run counter to well established practice. While the TAD addresses only the specific transaction submitted to the Committee, it would appear to have far reaching implications. It is probable that as a direct result of this TAD, entities will have to reconsider their approaches for a wide range of payment systems that were not considered by the IFRIC when it issued its TAD. These include: payment settlement, including cheque payments in lieu of trade payables/ trade receivables; credit card

[7] TLTRO III Transactions (IFRS 9 Financial Instruments and IAS 20 Accounting for Government Grants and Disclosure of Government Assistance), IFRIC, Tentative Agenda Decision, June 2021

receipts that can be cancelled before they are settled; payments made for a financial liability by electronic transfer; and intragroup cash transfers straddling a reporting period end. It would also appear that creditors paying accounts payable would also have to review the approach they take to accounting for those transactions.

A16 The TAD would potentially require significant analysis by preparers to determine the exact point at which cash is legally transferred. This would require detailed analysis of each transaction type as the timing of extinguishment may not be known without additional information and analysis (e.g. for international transfers legal extinguishment may arise sometime in the middle of the settlement cycle, rather than only at the end). As noted by one respondent to the TAD, both entities involved in a transaction would need to be able to answer questions such as "if the receiver's bank failed after the cash was received by the bank but before the receiver's bank account was credited with the funds, would the receiver have a claim on the payer, or would the payer's obligation be extinguished at this point and the receiver's claim be solely on its own bank?". Obtaining legal advice to establish when routine trade receivables (and trade payables) are extinguished for the different jurisdictions and settlement systems involved will be time consuming, costly and an unnecessary diversion from already established and understood norms in the market.

A17 Even if the legal rights can be established to the level required, new accounting will need to be established that addresses the potential mismatch between the timing of the settlement/payment of a receivable and the transfer of cash into/out of accounts. This may now happen earlier or later, which could be impacted by whether the counterparties are using the same paying /receiving bank or different institutions. Entities will be required to create a new class of financial asset/liability to "fill the gap" between, for example, a liability being extinguished and cash arriving to the bank account. This will require the creation of new subledgers and control systems.

A18 A significant number of respondents to the IFRIC noted similar concerns and recommended that instead of an IFRIC Agenda Decision being published, the matter should instead be considered as part of the IFRS 9 PIR. The UKEB agrees with this view. Specifically we recommend that the IASB consider (as part of the PIR) applying a similar approach to that already taken for "regular way transactions" (IFRS 9 3.1.2), that is permitting a policy choice to determine the extinguishment of a financial payable (as per IFRS 9 3.3.1) or receivable (as per IFRS 9 3.2.3(a)) at either the commencement or conclusion of a market standard settlement mechanism. We believe that such a treatment could avoid many of the concerns that have been identified with the TAD.

UKEB FEEDBACK STATEMENT

IASB Post-implementation Review (PIR)
IFRS 9 *Financial Instruments*: Classification and Measurement

[DRAFT FOR BOARD REVIEW]

January 2022

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.

The comment letter to which this feedback statement relates forms part of those influencing activities and is intended to contribute to the Foundation’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.

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Purpose of this feedback statement

This feedback statement presents the views of UK stakeholders received during the UKEB's outreach activities on the IASB's Post-implementation Review (PIR) of IFRS 9 *Financial Instruments*: Classification and Measurement and explains how the UKEB's comment letter addressed those views.

The IASB's Post-implementation Review

The IASB has commenced its PIR of IFRS 9 *Financial Instruments,* focusing initially on the classification and measurement requirements.

The PIR assesses whether the standard is meeting its objectives, can be applied consistently, provides useful information to users, and that implementation costs are as expected. The IASB's possible actions following the PIR are to:

a. Produce educational materials;

b. Conduct follow-up research work for possible standard setting; or

c. Take no action.

IASB's Request for Information identified nine areas of the classification and measurement requirements on which IASB were seeking feedback. The UKEB response was responsive to UK stakeholder feedback and focused only on those areas where UK stakeholders expressed particular concerns.

UKEB

Outreach approach

The UKEB's outreach activities took place between October 2021 and January 2022.

The outreach approach was underpinned by the UKEB's guiding principles of thought leadership, transparency, independence and accountability.

The outreach activities with UK stakeholders revealed that the IFRS 9 classification and measurement requirements generally work as intended, except for a small number of concern. Stakeholders requested UKEB focus its response on the most serious of these topics (the "primary topics") so as not to distract from these critical messages.

All comments and views were considered in reaching the UKEB final views on the questions raised.

Outreach activities included:

- Hosting a series of roundtables events with stakeholder groups which included preparers, auditors/accounting firms.
- Meetings with users, accounting firms and regulators;
- An online survey; and
- Public consultation on the UKEB's draft comment letter;

In total 31 stakeholders representing 23 organisations, and one professional body/committee engaged in outreach activities as follows.

Stakeholder type	Stakeholders	Organisations represented
Preparers	15	12
Auditors & Accounting Firms	12	7
Regulators	3	3
Users	1	1
Professional bodies / committees*	1 professional body/ committee	

* The professional bodies/committees have multiple members, often representing a variety of stakeholder types.

UKEB

1. Primary topics of concern to UK stakeholders

Contractual cashflow characteristics of financial assets.

Initial stakeholder views	UKEB draft position	Further stakeholder views	UKEB final position
Concern was expressed that IFRS 9 does not adequately cater for financial instruments with ESG features* (FIEF). There is risk that basic lending products with such features may be required to be accounted for at fair value rather than amortised cost, resulting in decision useful information being be lost. UK stakeholders thought this should be treated as an urgent issue. Stakeholders also noted that the boundary between contractually linked instruments and non-recourse finance was unclear, and this was leading to diversity in practice.	Observes that the IFRS 9 classification and measurement requirements generally work as intended. Explains the concerns regarding the treatment of FEIF and makes a number of recommendations including increased guidance and examples. Recommends that IASB resolve this issue as a matter of urgency, outside the PIR process. Explains the concerns regarding contractually linked instruments and makes a number of recommendations to improve clarity and reduce the current diversity in practice.	Further stakeholder feedback was consistent with the initial feedback received.	Observes that the IFRS 9 classification and measurement requirements generally work as intended. Explains the concerns regarding the treatment of FEIF and makes a number of recommendations including increased guidance and examples. Recommends that IASB resolve this issue as a matter of urgency, outside the PIR process. Explains the concerns regarding contractually linked instruments and makes a number of recommendations to improve clarity and reduce the current diversity in practice.

* These are sustainability-linked features including the Environmental, Social or Governance practices of the entity.

UKEB

2. Primary topics of concern to UK stakeholders
Amortised cost and the effective interest method

Initial stakeholder views	UKEB draft position	Further stakeholder views	UKEB final position
Stakeholders noted that is was not always clear how uncertain cashflows should best be reflected in the EIR calculation, and specifically in which circumstances paragraphs B5.4.5 or B5.4.6 should be applied.	Explains the concerns regarding the use of paragraphs B5.4.5 or B5.4.6 and recommends IASB provide further guidance on a number of key terms along with further examples. Notes that as FIEF become more prevalent and the potential change in cash flows due to ESG features becomes greater, this issue will become more significant. Recommends this issue should be addressed alongside those relating to FIEF and with the same urgency.	Further stakeholder feedback was consistent with the initial feedback received.	Explains the concerns regarding the use of paragraphs B5.4.5 or B5.4.6 and recommends IASB provide further guidance on a number of key terms along with further examples. Notes that as FIEF become more prevalent and the potential change in cash flows due to ESG features becomes greater, this issue will become more significant. Recommends this issue should be addressed alongside those relating to FIEF and with the same urgency.

UKEB

3. Primary topics of concern to UK stakeholders:
Other matters

Initial stakeholder views	UKEB draft position	Further stakeholder views	UKEB final position
Stakeholders also highlighted the recent IFRS Interpretations Committee (IFRIC) tentative agenda decision (TAD) *Cash Received via Electronic Transfer as Settlement for a Financial Asset.* Given the practical concerns and wide ranging implications of the TAD some stakeholders would prefer this matter be considered as part of the IFRS 9 PIR.	Highlights the wide ranging practical difficulties which may result from the TAD, recommends it is instead considered as part of the IFRS 9 PIR, and recommends that a similar approach be taken to the issue as to that already used for "regular way transactions" at IFRS 9 3.2.3(a), which would likely avoid many of the concerns identified with the TAD.	No additional feedback was received on this topic.	Highlights the wide ranging practical difficulties which may result from the TAD, recommends it is instead considered as part of the IFRS 9 PIR, and recommends that a similar approach be taken to the issue as to that already used for "regular way transactions" at IFRS 9 3.2.3(a), which would likely avoid many of the concerns identified with the TAD.

UKEB

Disclaimer

This feedback statement has been produced in order to set out the UKEB's response to stakeholder comments received on IASB's Post-implementation Review IFRS 9 *Financial Instruments*: Classification and Measurement and should not be relied upon for any other purpose.

The views expressed in this feedback statement are those of the UK Endorsement Board at the point of publication.

Any sentiment or opinion expressed within this feedback statement will not necessarily bind the conclusions, decisions, endorsement or adoption of any new or amended IFRS by the UKEB.

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Influencing process: PIR IFRS 9

Step	Required / Optional	Metrics or evidence	UKEB secretariat comments
IASB's due process document			
Request for Information. Post-implementation Review, IFRS 9 *Financial Instruments -* Classification and Measurement		**Published:** 30/09/2021 **Comment deadline**: 28/01/2022	Note: This PIR only addresses Classification and Measurement. IASB are expected to commence PIRs for the impairment and hedge accounting requirements of IFRS 9 in late 2022/ early 2023.

Project preparation			
Technical project added to UKEB technical work plan and discussed	Required	Project is included in the published technical UKEB Work Plan.	Yes
Project preparation and Project Initiation Plan (PIP)	Required	PIP created which includes: - Approach to influencing; - Proposed types of fieldwork; - Involvement of IASB staff; - Key milestones and timing; - Initial analysis based on desk based or other research.	Yes
	Required	Assessment of whether to set up an ad-hoc advisory group	Not assessed due to project timeframe.
	Required	UKEB Board public meeting held to approve PIP	Yes, approved 18/11/21 meeting
	Optional	UKEB Education or initial assessment	Yes, an information sheet on IFRS 9 Classification and Measurement requirements was included in the technical update at the 18/11/21 Board meeting.

	Communications		
Communications	Required	UKEB Board public meetings held to discuss technical project	Yes, **18/11/21** Approve PIP **09/12/21** Approve DCL and ITC questions; **20/01/22** Approve FCL, Approve FS, Approve CS.
	Required	Board meeting papers posted and publicly available on a timely basis.	Yes
	Required	Project website contains a project description and up to date information.	Yes

Outreach activities			
Fieldwork undertaken			
Public events, roundtables, workshops or interviews with specific groups of stakeholders	Optional	Numbers for stakeholder outreach and venues documented	Documented in Feedback Statement. All meetings were virtual.
Online survey	Optional	Number and results of surveys	One survey was undertaken which received two responses from preparers. Feedback provided was consistent with that of other preparers who had participated in previous roundtable events etc.

UKEB draft comment letter			
Draft comment letter	Required	Draft comment letter approved for publication at UKEB public meetings	Yes, approved at 09/12/2021 Board meeting
	Required	Draft comment letter, including deadline for responses, posted on UKEB Website for public consultation	Yes Published: 15/12/2021 Comment deadline: 10/01/2022 Due to timing of the consultation a stakeholder survey asking open ended questions on the questions in IASB's Request for Information was published on the UKEB website on 16 November and closed on 15 December 2021. This

			provided an opportunity for stakeholders to provide feedback if they found the DCL timing inconvenient.
	Required	News Alert published to announce publication	Yes
	Required	Public responses on draft comment letter posted on website	No responses received.

UKEB final comment letter			
Final comment letter	Required	Final comment letter approved for publication at UKEB public meeting.	To be approved at the 20/01/22 Board meeting
	Required	Publish final comment letter on UKEB website and submit to IASB	Letter to be published once approved at Board meeting 20/01/22.
	Required	News Alert published to announce publication	To take place following posting to website.

Finalisation			
Feedback statement	Required	Draft Feedback Statement for discussion and review at UKEB public meeting	Feedback Statement to be approved at Board meeting 20/01/22.
	Required	Feedback Statement posted on UKEB Website	To take place following Board approval of the Feedback Statement.
	Required	News Alert published to announce publication	To take place following posting to website.
Compliance Statement	Required	Due process Compliance Statement approved by UKEB in public meeting	To consider at 20/01/22 Board meeting.
	Required	Due Process Compliance Statement posted on UKEB Website	To take place following Board approval of Compliance statement.
	Required	News Alert published to announce publication	To take place following posting to website.

Conclusion
This RFI was published on 30 September 2021 and the PIP approved at the November Board meeting. The timing of the consultation was curtailed as it largely fell over the holiday season and year end preparation/reporting for many preparers. To mitigate the impact of this, stakeholder roundtables were held in November and the feedback from these informed the draft comment letter. Stakeholders were also provided other ways of contributing their views

on the consultation e.g. a stakeholder survey asking open ended questions on all the Request for Information topics, open from 16 November to 15 December 2021. The lack of formal responses to the draft comment letter has been mitigated by survey responses and the extensive stakeholder participation in other forms of outreach, which contributed to the drafting of the DCL. Overall this project due process complies with the UKEB Due Process that is in place at the time of writing.

Approval
Does the Board approve the Disclosure Pilot Due Process Compliance Statement for publication?