UKEB
UK Endorsement Board

Dr Andreas Barckow
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XX July 2023

Dear Dr Barckow

Exposure Draft ED/2023/2 Amendments to the Classification and Measurement of Financial Instruments – Proposed amendments to IFRS 9 and IFRS 7

1. The UK Endorsement Board (UKEB) is responsible for endorsement and adoption of IFRS Accounting Standards for use in the UK and therefore is the UK's National Standard Setter for IFRS Accounting Standards. The UKEB also leads the UK's engagement with the IFRS 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.

2. There are currently approximately 1,500 entities with equity listed on the London Stock Exchange that prepare their financial statements in accordance with IFRS.[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]

3. We welcome the opportunity to provide comment on the International Accounting Standards Board (IASB) Exposure Draft (ED) *Amendments to the Classification and Measurement of Financial Instruments: Proposed amendments to IFRS 9 and IFRS 7* (the Amendments). In developing this letter, we have consulted with stakeholders in the UK, including users of accounts, preparers of accounts, and accounting firms and institutes.

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1 UKEB calculation based on LSEG and Eikon data, May 2023. This calculation includes companies listed on the Main market as well as on the Alternative Investment Market (AIM).

2 UKEB estimate based on FAME, Companies Watch and other proprietary data.

4. We welcome the IASB's responsiveness to the concerns raised by stakeholders, including those in our response[3], on the request for information on the *Post-implementation Review of IFRS 9 – Classification and Measurement.* The UKEB highlighted the following concerns:

   a) The potential unintended consequences for the derecognition of financial liabilities arising from the IFRS Interpretations Committee tentative agenda decision *Cash Received via Electronic Transfer as Settlement for a Financial Asset*.

   b) The importance of making it easier for financial instruments with ESG-linked features to achieve amortised cost accounting in circumstances where they are, in substance, basic lending transactions.

   c) The need for further guidance on the application of the effective interest method, particularly in relation to the application of IFRS 9 paragraphs B5.4.5 and B5.4.6.

   d) The need for increased clarity in distinguishing between non-recourse finance and contractually linked instruments when applying the cash flow characteristics test.

5. We note and welcome that the ED addresses most of these matters, with the remaining item addressed in the IASB pipeline project *Amortised Cost Measurement*. Our main observations and recommendations are set out in the paragraphs that follow. Responses to the IASB's specific questions about the ED are included in the Appendix to this letter.

Derecognition of Financial Liabilities

6. We welcome the IASB's proposal to create an option when derecognising financial liabilities settled with cash using an electronic payment system. This acknowledges that such payment methods have different characteristics to other forms of payment, including greater speed and certainty of settlement. Without this option, the clarification that settlement date accounting is required may be disruptive and costly for those using other derecognition approaches. However, we are concerned that the proposals, in their current form, may only have limited success in addressing stakeholder concerns. It is important that any option granted is sufficiently cost-effective to enable its application.

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[3] Comment letter to the IASB on the Post-implementation Review of IFRS 9 – Classification and Measurement, 28 January 2022 https://assets-eu-01.kc-usercontent.com/99102f2b-dbd8-0186-f681-303b06237bb2/41e29e45-0a23-4452-b010-99a65adb8650/Final%20Comment%20Letter%20-%20Post%20Implementation%20Review%20of%20IFRS%209%20-%20Classification%20and%20Measurement.pdf

7. We consider that the successful implementation of the proposals depends on whether the criteria for use of the option can be applied to common electronic payment systems, without imposing disproportionate operational cost on entities. Our initial analysis has identified doubts as to whether the application of the new requirements to some of the major UK payment systems, such as BACS, could achieve the proposed accounting without incurring disproportionate disruption and costs.

8. A strict interpretation of the criteria for applying the option would indicate that derecognition of the liability would be required to take place sometime between the date of instruction to the electronic payment system and settlement date. The exact timing of this derecognition would vary by payment system and banking provider. This is further explained in paragraphs A3-A4 and A8-A9 of Appendix A. The system and operational costs to identify and account for the different timings of these events would be likely to be disproportionate to the benefit gained, leading to limited take up.

9. Instead, we recommend that the accounting should aim to provide a simple and practical method of managing and recording transactions that have only a short duration. Electronic payments have a short settlement period and a cancellation window which is even shorter. Further, we are informed by preparers and accounting firms that the cancellation feature is seldom used. The date of instruction is easily identifiable, and, as it does not vary by settlement system or banking provider, would allow for consistent application by all entities. This suggests that for many electronic payment systems the most appropriate alternative to settlement date accounting is one that allows derecognition of the liability at the point the instruction for payment is made. We think such an approach will be readily understood by users and will avoid disruption and improve consistency amongst preparers.

10. The proposals in the ED would create the need to record short term accounting entries (receivables or cash-in-transit) for the brief period between the payment instruction and the point at which cancellation is no longer possible. This is operationally complex and would provide little benefit to users of accounts. Our proposed solution avoids the need to decide whether cash moving through the settlement system represents cash-in-transit or a receivable, eliminating another potential source of diversity in practice.

Classification of Financial Assets

11. We welcome the IASB's work in this area, which we previously identified as one in which the requirements of IFRS 9[4] could be improved. We believed that in the absence of clear guidance inconsistent accounting practices would develop. Our stakeholders previously told us and still assert that many financial instruments which, but for the ESG-linked feature, would be considered basic lending should be measured at amortised cost.

12. We believe the proposals, in their current form, are only partially successful in addressing these concerns. In drafting these proposals we acknowledge that the IASB has attempted to make only limited changes to IFRS 9, and note such a prudent approach is helpful in mitigating any unintended consequences of changing the standard more widely. However, this has led to proposals that are unclear. This could lead to considerable diversity in practice.

13. In considering these proposals we have deliberated whether it would be beneficial for the IASB to take additional time to create a clearer set of principles, re-opening the text of IFRS 9 as necessary to do so. Such an approach may result in a more robust framework, better able to address future events and innovations. In the absence of such an approach the IASB may need to revisit these proposals at a future date, once the market is more established. On balance we concluded the urgency of resolving the accounting treatment for financial instruments with ESG-linked features required a pragmatic solution. Accordingly we have focussed on identifying the critical changes necessary to allow the current proposals to work in practice. Our detailed observations and recommendations are included in paragraph A14 of Appendix A. In the main we recommend that:

    a) Further detailed guidance should be provided that explains how the ESG-linked feature represents basic lending risk or cost. It is not currently clear how ESG-linked features comply with the concepts of basic lending risks and costs explained in paragraphs B4.1.7A and B4.1.8A. Additional guidance should also be provided for assessing the changes to cashflows described at B4.1.10A, particularly the requirement that the contingent event must be "specific to the debtor" to be consistent with basic lending. Alternatively, additional and more detailed examples should be provided. These examples should clearly analyse the key features of the instrument and how they meet (or fail to meet) the criteria set out in the amended classification requirements. This would more fully demonstrate how the

4 Comment letter to the IASB on the Post-implementation Review of IFRS 9 – Classification and Measurement, 28 January 2022 https://assets-eu-01.kc-usercontent.com/99102f2b-dbd8-0186-f681-303b06237bb2/41e29e45-0a23-4452-b010-99a65adb8650/Final%20Comment%20Letter%20-%20Post%20Implementation%20Review%20of%20IFRS%209%20-%20Classification%20and%20Measurement.pdf

various criteria are applied to the fact pattern to arrive at the proposed classification. Without this we anticipate significant diversity in practice when entities attempt to apply the proposals.

b) The requirements in the ED regarding the direction and magnitude of cashflow changes at paragraph B4.1.8A, and the information and example currently contained in BC52 and BC70, should be incorporated into paragraph B4.1.10A. This will provide greater context and clarity of the intent behind the "direction and magnitude" test and its application. Suggested wording to achieve this is provided in paragraph A14 of Appendix A.

c) Greater clarity should be provided around the circumstances in which amortised cost accounting is appropriate. The ED requires contingent events to be specific to the debtor to achieve amortised cost accounting in paragraph B4.1.10A and BC67. BC67 explains that in a basic lending arrangement the creditor is "compensated only for basic lending risks and the cost associated with extending credit to the debtor. Therefore, a change in cashflows due to a contingent event that is specific to the creditor or another party would be inconsistent with a basic lending arrangement". We are not yet convinced this holds true in all cases, and could result in some basic lending instruments being reclassified to fair value accounting. To acknowledge this, and to allow entities to better apply judgement based on individual fact patterns, we have provided recommended wording in paragraph A14 of Appendix A.

d) In accordance with emerging market practice, entities should be permitted to classify as basic lending loans with ESG-linked targets set at consolidated level or referencing other group companies where the incentive to change ESG-related behaviour is most relevant. A strict interpretation of the criterion at B4.1.10A that the contingent event be "specific to the debtor" implies that only ESG-linked targets set at the level of the borrowing entity would be successful in meeting the criteria for contractual cashflows that are solely payments of principal and interest. Our recommendation would continue to provide users with information they find decision useful for basic lending transactions, such as interest income and the expected credit loss requirements of IFRS 9. However, we agree with the IASB that reference to ESG targets external to the group (for example to an industry index) is beyond the scope of basic lending and should not meet the test at B4.1.10A as "specific to the debtor".

14. Once finalised, these ED proposals may lead to a greater number of instruments qualifying for amortised cost accounting. This would further emphasise the need to provide greater clarity on the application of the effective interest rate calculation for such instruments (particularly the requirements described at paragraphs B5.4.5 and B5.4.6 of IFRS 9). We note that this forms part of the IASB's pipeline

project *Amortised Cost Measurement* and encourage the IASB to commence that pipeline project as soon as possible.

15. Further detail on these topics can be found in Appendix A to this letter.

16. 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 A: Questions on ED *Amendments to the Classification and Measurement of Financial Instruments*

Question 1—Derecognition of a financial liability settled through electronic transfer
Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity. Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal. Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

Overview

A1. We welcome the IASB's proposal to create an option when derecognising financial liabilities settled with cash using an electronic payment system. This acknowledges that such payment methods have different characteristics to other forms of payment, including greater speed and certainty of settlement. Without this option, the clarification that settlement date accounting is required may be disruptive and costly for those using other derecognition approaches. However, we are concerned that the proposals, in their current form, may only have limited success in addressing stakeholder concerns. It is important that any option granted is sufficiently cost-effective to enable its application.

A2. We consider that the successful implementation of the proposals depends on whether the criteria for use of the option reflect common electronic payment systems, without imposing disproportionate operational cost on entities. Our initial analysis has identified doubts as to whether these new requirements would allow some major UK payment systems, such as BACS, to achieve the proposed accounting without incurring disproportionate disruption and costs.

Ability to stop, withdraw or cancel

A3. Paragraph B3.3.8(a) specifies that "the entity has no ability to withdraw, stop or cancel the payment instruction". For many UK payment systems, the point at which there is no ability to cancel a payment (Time Cancellation "TC") is subsequent to the issuance of the payment instruction (Time of Instruction "TI"). We are aware of a number of operational complexities in this context, including:

a) TC varies by type of electronic payment system.

b) For each electronic payment system TC may vary by instructing bank.

c) TC could also be subject to individual circumstances related to factors such as what time of day both TI and TC occurred.

d) Entities are likely to use multiple electronic payment systems depending on their business needs, and may have more than one banking relationship.

A4. An example of this would be the BACS system, one of the highest volume electronic payment processing systems in the UK. Once a payment instruction is issued, BACS has an approximate three-day processing cycle but entities have an approximate one-day window for cancellation, the exact timing of which varies depending on which bank is used. This complexity may be costly to implement in operational and accounting systems. Initial stakeholder feedback suggests that delaying the derecognition of financial liabilities, until the electronic payment can not be cancelled, does not provide users with significantly better information for decision making.

A5. We recommend that the accounting should aim to provide a simple and practical method of managing and recording transactions that have only a short duration. Electronic payments have a short settlement period and a cancellation window which is even shorter. Further, we are informed by preparers and accounting firms, the cancellation feature is seldom used. Cancellations are also subject to financial penalty. This suggests that for many electronic payments the most appropriate criterion is one that allows derecognition of the liability settled by electronic payment system at the point the instruction for the payment is made. We think such an approach will be readily understood by users, and will avoid disruption and improve consistency amongst preparers.

A6. The proposals in the ED would create the need to record short term accounting entries (receivables or cash-in-transit) for the brief period between the payment instruction and the point at which cancellation is no longer possible. This is operationally complex and would provide little benefit to users of accounts. Our proposed solution avoids the need to decide whether cash moving through the settlement system represents cash-in-transit or a receivable, eliminating another potential source of diversity in practice.

Other considerations

A7. It is not clear why the "no practical ability to access the cash" criterion at B3.3.8(b) and the "settlement risk" criterion at B3.3.8(c) are included as separate tests. In the UK, we are not aware of any examples where an entity could pass one test but fail the other. Once access to cash has been removed, there is no further settlement risk (in the absence of bank/settlement system collapse). Similarly, if there is no settlement risk then an entity can have no ability to withdraw or move the cash. The requirement at B3.3.9 repeats this point. In the interests of a concise, streamlined standard it may be beneficial to delete the final sentence at B3.3.9, as below.

> **Exposure Draft text (with UKEB markup)**
>
> B3.3.8 Notwithstanding the requirement in paragraph B3.1.2A to apply settlement date accounting, an entity is permitted to deem a financial liability (or a part of a financial liability)—that will be settled with cash using an electronic payment system—to be discharged before the settlement date if, and only if, the entity has initiated the payment instruction and:
>
> 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.
>
> 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.~~

A8. In the absence of a definition of "electronic payment system" there appears to be confusion amongst UK stakeholders as to what is the intended universe of electronic payment systems. Discussions with stakeholders considered four main types of payment systems:

a) Those that move money from a bank account shortly after a payment instruction (for example in the UK these include BACS, Faster Payments, CHAPS and SWIFT).

b) Those that move money from a bank account on a regular basis established in advance (in the UK these include Direct Debit and Standing Orders).

c) Card based payments, including debit cards and credit cards.

d) Other digital payment methods including Apple Pay, Google Pay and Paypal (where the underlying payment mechanism may be linked to items A8a. or A8c. above).

A9. Based on our initial analysis it seems possible some systems will never meet the criteria for use of the option as currently drafted, effectively falling permanently outside its scope. It is possible the IASB did not intend some payment systems, such as those described at A8d, to be within the scope of these proposals. Our stakeholder outreach to date has indicated differing opinions as to whether certain systems were intended to be considered, and whether such payment systems can ever pass the necessary criteria. If it was IASB's intention to exclude certain common payment systems, clarification of that would be helpful in ensuring consistent practice.

Question 2—Classification of financial assets—contractual terms that are consistent with a basic lending arrangement

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:

a) interest for the purposes of applying paragraph B4.1.7A; and

b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Overview

A10. We welcome the IASB's work in this area, which we previously identified as one in which the requirements of IFRS 9[5] could be improved. We believed that in the absence of clear guidance inconsistent accounting practices would develop. Our stakeholders previously told us and still assert that financial instruments which, but for the ESG-linked feature, would be considered basic lending should be measured at amortised cost.

A11. We believe the proposals, in their current form, are only partially successful in addressing these concerns. In drafting these proposals we acknowledge that the IASB has attempted to make only limited changes to IFRS 9, and note such a prudent approach is helpful in mitigating any unintended consequences of changing the standard more widely. However, this led to proposals that are unclear. This could lead to considerable diversity in practice.

A12. In accordance with emerging market practice, entities should be permitted to classify as basic lending loans with ESG-linked targets set at consolidated level or referencing other group companies where the incentive to change ESG-related behaviour is most relevant. A strict interpretation of the criterion at B4.1.10A that the contingent event be "specific to the debtor" implies that only ESG-linked targets set at the level of the borrowing entity would be successful in meeting the criteria for contractual cashflows that are solely payments of principal and interest. Our recommendation would continue to provide users with information they find decision useful for basic lending transactions, such as interest income and the expected credit loss requirements of IFRS 9. However, we agree with the IASB that reference to ESG targets external to the group (for example to an industry index) is beyond the scope of basic lending and should not meet the test at B4.1.10A as "specific to the debtor".

A13. Once finalised, these ED proposals may lead to a greater number of instruments qualifying for amortised cost accounting. This would further emphasise the need to provide greater clarity on the application of the effective interest rate calculation for such instruments (particularly the requirements described at paragraphs B5.4.5 and B5.4.6 of IFRS 9). We note that this forms part of the IASB's pipeline project *Amortised Cost Measurement* and encourage the IASB to commence that pipeline project as soon as possible.

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5 Comment letter to the IASB on the Post-implementation Review of IFRS 9 – Classification and Measurement, 28 January 2022 https://assets-eu-01.kc-usercontent.com/99102f2b-dbd8-0186-f681-303b06237bb2/41e29e45-0a23-4452-b010-99a65adb8650/Final%20Comment%20Letter%20-%20Post%20Implementation%20Review%20of%20IFRS%209%20-%20Classification%20and%20Measurement.pdf

Specific feedback

A14. We note below the minimum changes we believe are required to clarify key areas, reduce diversity in application and minimise unintended consequences:

a) There are a number of ways the IASB could make clear that consolidated, parent or other group company ESG targets as discussed at paragraph A12 are acceptable to meet the criteria at ED paragraph B4.1.10A. The most straightforward would be to define "specific to the debtor", or to use modified wording, such as that presented at paragraph A14c below. Alternatively, a lighter touch approach could be to include the concept in one of the examples included in the standard to demonstrate this intent. In the example at paragraph B4.1.13 the description of Instrument EA could be modified to say "if the debtor achieves a contractually specified reduction in the group's consolidated greenhouse gas emissions".

b) Further detailed guidance should be provided that explains how the ESG-linked feature represents basic lending risk or cost. It is not currently clear how ESG-linked features comply with the concepts of basic lending risks and costs explained in paragraphs B4.1.7A and B4.1.8A. Additional guidance should also be provided for assessing the changes to cashflows described at B4.1.10A, particularly the requirement that the contingent event must be "specific to the debtor" to be consistent with basic lending. If such an approach is impractical then further consideration should be given to the examples included in the standard. The examples of analysis shown in ED paragraphs B4.1.13 and B4.1.14 are simplistic, and the analysis column arrives directly at the conclusion without any analysis demonstrating how each of the relevant criteria described at paragraph B4.1.7.A – B4.1.10A is met. We recommend the analysis column be revised to show an assessment of each fact pattern against the proposed criteria. It would also be helpful to include some examples where the answer is less obvious to better illustrate the application of the criteria. We would be happy to assist IASB staff in identifying or testing suitable examples.

c) Greater clarity should be provided around the circumstances in which amortised cost accounting is appropriate. The ED requires contingent events to be specific to the debtor to achieve amortised cost accounting in paragraph B4.1.10A and BC67. BC67 explains that in a basic lending arrangement the creditor is "compensated only for basic lending risks and the cost associated with extending credit to the debtor. Therefore, a change in cashflows due to a contingent event that is specific to the creditor or another party would be inconsistent with a basic lending arrangement". We are not yet convinced this holds true in all cases. For example, certain protective clauses are common in contracts considered to represent basic lending, but these clauses may relate to contingent events specific to other parties (for example the government potentially changing laws or regulation). However, such clauses relate to the cost associated with extending credit to the debtor, which is one of the permitted criteria of basic lending. To acknowledge this, and to allow entities to better apply judgement based on individual fact patterns, we recommend the wording of these paragraphs be modified as below. We believe this modified wording would also be helpful in addressing the issue raised at paragraph A14a above.

Exposure Draft text (with UKEB markup)
B4.1.10A In applying paragraph B4.1.10 an entity shall assess 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 on the principal amount outstanding. This assessment shall be done irrespective of the probability of the contingent event occurring (except for non-genuine contractual terms as described in paragraph B4.1.18). A contingent event which is specific to the debtor is consistent with a basic lending arrangement. ~~For a change in contractual cashflows to be consistent with a basic lending arrangement, the occurrence (or non-occurrence) of the contingent event must be specific to the debtor.~~ The occurrence of a contingent event is specific to the debtor if it depends on the debtor achieving a contractually specified target, even if the same target is included in other contracts for other debtors. However the resulting contractual cashflows must represent neither an investment in the debtor nor an exposure to the performance of specified assets. BC67 The IASB acknowledged that requiring a contingent event to be "specific to the debtor" has similarities to the definition of a derivative in IFRS 9, which refers to a "non-financial variable" that "is not specific to a party to the contract". However, in a basic lending arrangement, the creditor is compensated only for basic lending risks and the cost associated with extending credit to the debtor. Therefore, a change in cashflows due to a contingent event that is specific to the creditor or another party would usually be inconsistent with a basic lending arrangement.

d) The requirement at B4.1.8A on "direction and magnitude of the change" has caused some confusion amongst stakeholders, in terms of understanding both the nature of the requirement and its application. It states that "a change in contractual cashflows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs". To provide clarity and reduce the risk of diversity in practice, we recommend moving the requirement to paragraph B4.1.10A, where other changes to contractual cashflows are discussed, and incorporating some of the text from BC52 and BC70 as shown below.

Exposure Draft text (with UKEB markup)
B4.1.10A In applying paragraph B4.1.10, an entity shall assess 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 on the principal amount outstanding. This assessment shall be done irrespective of the probability of the contingent event occurring (except for non-genuine contractual terms as described in paragraph B4.1.18). For a change in contractual cash flows to be consistent with a basic lending arrangement, the occurrence (or non-occurrence) of the contingent event must be specific to the debtor <u>and its impact on contractual cash flows aligned with the direction and magnitude of the change in basic lending risks or costs</u>. The occurrence of a contingent event is specific to the debtor if it depends on the debtor achieving a contractually specified target, even if the same target is included in other contracts for other debtors. However, the resulting contractual cash flows must represent neither an investment in the debtor <u>(for example, contractual terms that entitle the creditor to a share of the debtor's revenue or profits)</u> nor an exposure to the performance of specified assets (see also paragraphs B4.1.15–B4.1.16). <u>A change in contractual cash flows is aligned with the direction and magnitude of the change in basic lending risks or costs when, for example, an increase in the credit risk of a borrower is reflected in an increase, and not a decrease, in the interest rate of the financial asset</u>.

e) The criteria at B4.1.10A that "the resulting contractual cashflows must represent neither an investment in the debtor nor an exposure to the performance of specified assets" would benefit from further clarification. Presumably this requirement is intended to refer to the financial performance of the specified assets, not the assets' ESG performance (e.g. a specified reduction in greenhouse emissions from that asset) which could represent the assets' ESG-linked target. We recommend amending the requirement to "the resulting contractual cashflows must represent neither an investment in the debtor nor an exposure to the financial performance of the specified assets".

Question 3—Classification of financial assets—financial assets with non-recourse features
The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term 'non-recourse'. Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features. Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Financial assets with non-recourse features

A15. The UKEB generally supports the proposals outlined in this section. However, stakeholders have told us that ED paragraph B4.1.16A describing non-recourse features could be read very narrowly, and would be likely to exclude most items other than waterfall arrangements from the non-recourse guidance. This is not how this section of IFRS 9 has been interpreted to date. The previous text at B4.1.16 referred to a creditor's claim being limited to specified assets of the debtor OR the cashflows from specified assets, whereas the proposed replacement text at B4.1.16A requires the contractual right to receive cashflows over the life of the asset AND in the case of default. So now both default (the asset) and life of the asset (cashflow) tests must be considered, whereas previously meeting either of these criteria was sufficient to qualify as a non-recourse feature. If this was not the IASB's intention then further explanation to clarify this matter would be helpful.

Question 4—Classification of financial assets—contractually linked instruments
The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21–B4.1.26 of IFRS 9. The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9. Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Contractually linked instruments

A16. We welcome the IASB's efforts to clarify the distinction between non-recourse finance and contractually linked instruments. The proposals now make it clear that contractually linked instruments are considered a subset of non-recourse finance for IFRS reporting purposes. However, this clarification gives rise to potential further confusion that both the non-recourse and contractually linked instrument contractual cashflow tests may apply to contractually linked instruments, as one is a subset of the other. This could lead to diversity in practice, and we therefore recommend a further clarification that contractually linked instruments only need to be assessed using the criteria at ED paragraphs B4.1.20 – B4.1.26. This is implied at B4.1.20A but should be more explicitly stated.

A17. We welcome the fact that the text now makes clear that items which are in substance bilateral secured lending arrangements are not within the scope of the contractually linked instrument requirements.

A18. With reference to the underlying pool of assets ED paragraph B4.1.23 refers to lease receivables. The current text could be interpreted as implying that lease receivables would always meet the proposed cashflow characteristics test, which we do not believe was the IASB's intention. We note that the IASB has already considered this issue in the IASB staff paper presented to the September IASB meeting[6]. That paper noted that leases may have cashflows characteristics similar to solely payments of principal and interest, but may have other features such as exposure to residual value risk or to residual value guarantees that would fail to meet the characteristics of the contractual cashflows test. We recommend that this guidance is included in this section of the proposals, and provide suggested wording below.

Exposure Draft text (with UKEB markup)
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. For the purpose of this assessment, the underlying pool can include financial instruments that are not within the scope of the classification requirements (see Section 4.1 of this Standard) for example, lease receivables that have contractual cash flows that are equivalent to payments of principal and interest on the principal amount outstanding. <u>However, an entity must assess the effects of any other features of the financial instrument for compliance with the contractual cashflow requirements. For example some lease receivables may be subject to residual value risk or guarantees. Such features would typically not be considered consistent with a basic lending arrangement.</u>

6 AP16B Financial assets with non-recourse features and contractually linked instruments, paragraph 51-54, September 2022 https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/iasb/ap16b-ccfc-financial-assets-with-non-recourse-features-and-clis.pdf

Question 5—Disclosures—investments in equity instruments designated at fair value through other comprehensive income
For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to: a) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period; and b) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period. Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Disclosure – Investments in equity instruments designated at fair value through other comprehensive income

A19. We understand the IASB has proposed these changes in relation to feedback in the previous consultation requesting the recycling to profit or loss of fair value changes previously recognised in other comprehensive income once an investment is disposed of. We do not believe this is an issue of widespread concern in the UK.

A20. The IASB's response, to provide additional disclosure on changes in the fair value of equity instruments, including for those investments derecognised in the reporting period, provides users of financial statements with additional relevant information on this topic. We agree with these proposals.

Question 6—Disclosures—contractual terms that could change the timing or amount of contractual cash flows
Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C). Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal. Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

Disclosure – Contractual terms that could change the timing or amount of contractual cashflows.

Disclosure objectives

A21. The proposals in paragraphs 20B and 20C of the ED add requirements to disclose the nature of contingent events specific to the debtor, quantitative information about the range of changes that could result from those contractual terms and the carrying amount of instruments subject to such terms. However, they do not specify the objective of the proposed new disclosure, nor how users of financial statements are likely to use this information. In our comment letter[7] to the IASB on *Targeted standards-level Review of Disclosure* project we recommended the use of such objectives, as stakeholders find them useful when applying judgement to what should be disclosed and the best way to do so. We understand the use of such general and specific objectives, explaining investors' information needs, are in future to be used by the IASB[8] when developing disclosure requirements. We recommend such a disclosure objective is included in these proposals.

7 Final comment letter, IASB Exposure Draft ED/2021/3, 17 December 2021 https://assets-eu-01.kc-usercontent.com/99102f2b-dbd8-0186-f681-303b06237bb2/86412a90-0d00-40a0-9415-8325c030e272/Final%20Comment%20Letter%20-%20Disclosure%20Requirements%20in%20IFRS%20Standards%E2%80%94A%20Pilot%20Approach.pdf

8 Project Summary and Feedback Statement, Disclosure Initiative – Targeted Standards-level Review of Disclosures, March 2023 https://www.ifrs.org/content/dam/ifrs/project/disclosure-initative/disclosure-initiative-principles-of-disclosure/project-summary/projectsummary-fbs-di-tsrd-march2023.pdf

UK Endorsement Board

Scope of disclosure

A22. Our stakeholders have highlighted concerns that the broad nature of the proposals at paragraphs 20B and 20C may mean that entities are required to disclose potentially irrelevant information that obscures more useful information about variations in contractual cashflows. Additionally, preparers are concerned that the quantitative information on the range of changes to contractual cashflows by class of financial asset may create a very wide range, that proves time consuming to prepare but is not useful for investor decision-making.

A23. We also note that such broad requirements increase the risk of boilerplate disclosures, and in this instance also risks duplication of, or inconsistency with, disclosure requirements that already exist elsewhere within IFRS. For example, IFRS 7 B10A already requires similar disclosures for liabilities to assist users in assessing liquidity risk, and the proposed amendments in exposure draft *Non-current Liabilities with Covenants* address disclosure related to covenants in IAS 1 *Presentation of Financial Statements*.

A24. We recommend that the IASB reconsiders the scope of these disclosures to improve their usefulness for users of financial statements. Duplication of existing requirements should be removed from scope, including those related to credit event contingencies, as disclosures related to breach of covenants and factors relevant to credit impaired loans are already adequately addressed in the expected credit loss requirements of this standard.

Question 7—Transition
Paragraphs 7.2.47–7.2.49 of the draft amendments to IFRS 9 would require an entity to apply the amendments retrospectively, but not to restate comparative information. The amendments also propose that an entity be required to disclose information about financial assets that changed measurement category as a result of applying these amendments. Paragraphs BC105–BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Transition

A25. We support the proposed transition requirements, including the requirement not to restate comparatives.

A26. UK stakeholders continue to stress the urgency of resolving the classification and measurement requirements for financial instruments with ESG-linked features. Accordingly, we recommend that early adoption be permitted for the amendments relevant to this, including paragraphs B4.1.7A – B4.1.16.