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

19 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.

---

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 welcome the fact 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 historic 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.

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

---

[3] Comment letter to the IASB on the Post-implementation Review of IFRS 9 – Classification and Measurement, 28 January 2022 , link to document here.

payment systems, without imposing disproportionate operational cost on entities. Our analysis has identified significant 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. No stakeholders consulted in our outreach for this project expressed interest in using this option as currently drafted.

8. The criteria for applying the option 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 A4 – A5 and A9 - A10 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. As many entities use more than one payment system this option will also increase inconsistency in derecognition practices. Some payment systems will qualify for the option and some will not (or will not have been subject to an assessment process against the criteria), leading to multiple derecognition practices both within a single entity and between different entities.

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 of such payments is rare. 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.

Classification of financial assets

10. 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 that would be considered basic lending, but for the ESG-linked feature, should be measured at amortised cost.

---

[4] Comment letter to the IASB on the Post-implementation Review of IFRS 9 – Classification and Measurement, 28 January 2022, link to document here.

11. We believe the ED proposals, in their current form, are only partially successful in addressing these concerns. We acknowledge that in drafting these proposals the IASB has attempted to make only limited changes to IFRS 9, mainly to avoid any unintended consequences. However, our outreach has indicated that this has led to a lack of clarity in the proposals that, in turn, could lead to considerable diversity in practice and, contrary to the IASB's intention, unintended consequences.

12. When considering these proposals, we deliberated whether it would be beneficial for the IASB to take additional time to create a clearer set of principles that would provide a more robust framework better able to address future events and innovations. In the absence of this, we consider there is a high risk the IASB will need to revisit these proposals at a future date. However we acknowledge that undertaking such a review at this time is inconsistent with the need to urgently resolve the issue of the classification and measurement of financial instruments with ESG-linked features.

13. To address this urgency, which was emphasised to us by UK stakeholders, we identify below the critical changes necessary to allow the current proposals to work in practice. Our detailed observations and recommendations are included in paragraph A14 - A24 of Appendix A. The UKEB recognises that instruments with ESG-linked features may include both instruments accounted for at amortised cost and instruments accounted for at fair value, depending on the related contractual terms and fact patterns. The discussion in this letter and in Appendix A focusses on instruments which are in substance basic lending, and for which amortised cost accounting would be an appropriate outcome.

    a) 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, and the further considerations explained at B4.1.10 and B4.1.10A. Further detailed guidance is necessary to explain how the ESG-linked feature represents basic lending risks or costs. If these principles cannot be readily understood, they will be difficult to apply to financial instruments with ESG-linked features and other future contracts with contingent events, leading to greater diversity in practice. Unless further guidance is provided there is a risk that the IASB will not meet its objective stated at IN5b of the ED to "clarify the application guidance for assessing the contractual cash flow characteristics of financial assets including... those with ESG-linked features".

    b) The new requirement regarding the "magnitude and direction" of cash flows appears contradictory and challenging to implement. Further consideration should be given to how the statement at B4.1.8A that the assessment should focus on "what an entity is being compensated for, rather than how much compensation an entity receives" sits alongside the requirement in the same paragraph to assess the "magnitude of the

change”. At face value this appears contradictory. In practice identifying an appropriate cash flow magnitude for any given change in risk/cost may prove challenging. The purpose of ESG-features is to encourage and reward behavioural change. Accordingly, such relationships may be complex and subjective. In this relatively young market, the link between the cash flow and the change in risk/cost may be unclear or difficult to quantify. Banks may also use their profit margin (an accepted element of basic lending) to adjust pricing for considerations such as their own market share and ESG targets. All these factors may make it difficult to demonstrate a predictable magnitude of change for a given change in risk/cost. This is further discussed, and suggested wording to clarify the proposals is provided, in paragraphs A16 - A19 of Appendix A.

c) The current examples at B4.1.13 and B4.1.14 are simplistic and therefore not helpful in resolving the issues of interpretation of the basic lending and direction and magnitude requirements described above. We suggest that further clarity in the text of the standard should be accompanied by more comprehensive examples to provide clarification to stakeholders and ensure consistent application. 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 at B4.1.7A – B4.1.10A. This would demonstrate how the 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.

14. The ED requires contingent events to be “specific to the debtor” if amortised cost accounting is to be achieved (paragraph B4.1.10A and BC67). 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”. However, the current drafting appears problematic for both ESG-linked instruments and other types of contingent events.

a) 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. Given emerging market practice, we consider that it may be necessary to permit classification as basic lending for 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.

b) One unintended consequence of the “specific to the debtor” criterion could be for other contingent events that are today considered compatible with basic lending. For example, certain protective cost clauses or tax clauses are common in contracts considered to represent basic lending, but these

clauses may relate to contingent events specific to other parties (for example, to the creditor in the context of changing laws, taxes or regulation). Such clauses relate to the cost associated with extending credit to the debtor, which is one of the permitted features of basic lending. However, such clauses would not meet the "specific to the debtor test" nor the associated explanation at BC67 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 cash flows due to a contingent event that is specific to the creditor or another party would be inconsistent with a basic lending arrangement". If this criterion is not corrected this could result in significant numbers of basic lending transactions currently classified as at amortised cost being re-classified as at fair value through profit or loss.

Suggested wording to address the issues described at paragraphs 14a and 14b is provided at paragraph A24 of Appendix A. Further ideas to address the issue described at paragraph 14a have been included at paragraph A22 of Appendix A.

15. The pipeline project *Amortised Cost Measurement* will be critical to ensure that instruments with ESG-linked features (or other contingencies), which are now more likely to qualify for amortised cost accounting, can be measured consistently and on an appropriate basis

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

17. 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 historic 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 analysis has identified significant doubts as to whether these new requirements would allow the option to be used for some major UK payment systems, such as BACS, without entities incurring disproportionate disruption and costs. No stakeholders consulted during our outreach expressed interest in using the option as currently drafted should it become available.

A3. Further, as every payment system in every jurisdiction would need to be assessed before the proposed option could be used, it is likely that entities would find

themselves using the option for some payment systems (which passed the criteria in paragraph B3.3.8) but not others (systems which did not pass the criteria, or where the entity chose not to invest in performing the assessment). This will lead to greater inconsistency in the derecognition of financial liabilities between entities, and even within the same entity or group.

Ability to stop, withdraw or cancel

A4. Paragraph B3.3.8(a) specifies that “the entity has no ability to withdraw, stop or cancel the payment instruction”. This seems very restrictive. For example, we question whether the fact that a system permits the cancellation of a fraudulent transaction should affect the accounting classification of all other transactions on that system. It is also operationally complex. 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.

A5. 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 is likely to make the proposed option costly to implement in operational and accounting systems. Where an option is to be provided as a practical expedient, this extra cost appears disproportionate to any benefit gained.

A6. In our view 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 it is rare for such payments to be cancelled. Cancellations are subject to financial penalty, and considerable practical barriers including the resource impact of cancelling and reperforming batch payment runs, and relationship management issues with other suppliers expecting payment in the cancelled batch. This suggests that for many electronic payments the most appropriate option is one that allows

derecognition of the liability settled by electronic payment system at the time the instruction for the payment is made. 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. We think such an approach will be readily understood by users and will avoid disruption and improve consistency amongst preparers.

A7. However, should the IASB proceed with the existing proposals, we recommend that the criteria regarding cancellation at paragraph B3.3.8a be removed or, failing that, modified to read "no practical ability to withdraw, stop or cancel…".

A8. 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 above 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

A9. In the absence of a definition of "electronic payment system" there appears to be confusion amongst UK stakeholders as to what is the intended scope 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 A9a. or A9c. above).

A10. Based on our high level 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 A9d, to be within the scope of these proposals. Our stakeholder outreach has indicated differing opinions as to

whether certain types of 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?

A11. The UKEB recognises that instruments with ESG-linked features may include both instruments accounted for at amortised cost and instruments accounted for at fair value, depending on the related contractual terms and fact patterns. The discussion in this document focusses on instruments which are in substance basic lending, and for which amortised cost accounting would be an appropriate outcome.

Overview

A12. 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,

[5] Comment letter to the IASB on the Post-implementation Review of IFRS 9 – Classification and Measurement, 28 January 2022, link to document here.

but for the ESG-linked feature, would be considered basic lending should be measured at amortised cost. UK stakeholders emphasised to us the urgency of resolving the classification and measurement requirements for financial instruments with ESG-linked features.

A13. We believe the proposals, in their current form, are only partially successful in addressing these concerns. We acknowledge that in drafting these proposals the IASB has attempted to make only limited changes to IFRS 9. However, this has led to proposals that are unclear and likely to lead to diversity in practice. To achieve the IASB's stated objective (paragraph IN5b of the ED) to "clarify the application guidance for assessing the contractual cash flow characteristics of financial assets including...those with ESG-linked features" further guidance will be required. The key issues that should be resolved to meet this objective are:

a) Further detailed guidance should be provided that explains how the ESG-linked feature represents basic lending risks or cost.

b) More complex and comprehensive examples should be provided. The current examples at B4.1.13 and B4.1.14 are simplistic and therefore not helpful in resolving the issues of clarity noted above.

c) Further consideration should be given to how the statement at B4.1.8A that the assessment should focus on "what an entity is being compensated for, rather than how much compensation an entity receives" sits alongside the requirement in the same paragraph to assess the "magnitude of the change".

d) Further consideration should be given to the requirement that contingent events must be "specific to the debtor" if amortised cost accounting is to be achieved (paragraph B4.1.10A and BC67). 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". However, the current drafting appears problematic for both ESG-linked instruments and other types of contingent events.

These issues are explained further in paragraphs A14 - A24 below.

Detailed feedback

Clarity of requirements

A14. Further detailed guidance should be provided that explains how the ESG-linked feature represents basic lending risks or cost. The approach taken in paragraph B4.1.8A ,which describes characteristics which may be inconsistent with basic

lending, is helpful as highlighting such "red flags" can provide a practical basis for application and interpretation. However, it remains unclear how ESG-linked features comply with the concepts of basic lending risks and costs explained in paragraphs B4.1.7A, and B4.1.8A., and the further considerations explained at B4.1.10 and B4.1.10A. If these principles cannot be readily understood, they will be difficult to apply to ESG-linked features and other future contracts with contingent events, leading to greater diversity in practice. Unless further guidance is provided there is risk that the IASB will not meet its objective, stated at IN5b of the ED, to "clarify the application guidance for assessing the contractual cash flow characteristics of financial assets including...those with ESG-linked features".

The use of examples

A15. The examples of analysis currently 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 paragraphs B4.1.7.A – B4.1.10A is met. We recommend:

a) The analysis column be revised to show an assessment of each fact pattern against the proposed criteria, to determine if the fact pattern is consistent with the criteria for basic lending and whether there are any "red flags" present that would raise doubt about such a conclusion.

b) More complex examples are included. This would better illustrate the application of the criteria.

c) An increased number of examples is used to assist understanding. As the guidance in this area is not clear the use of more examples than are used elsewhere in IFRS 9 may assist in demonstrating the IASB's intent. We would be happy to assist the IASB staff in identifying or testing suitable examples.

Direction and magnitude

A16. Further consideration should be given to how the statement at B4.1.8A that the assessment should focus on "what an entity is being compensated for, rather than how much compensation an entity receives" sits alongside the requirement in the same paragraph to assess the "magnitude of the change". At face value this appears contradictory and has caused some confusion amongst stakeholders, in terms of understanding both the nature of the requirement and its application.

A17. In practice, identifying an appropriate cash flow magnitude for any given change in risk/cost may prove challenging as such relationships can be complex and subjective. The use of softer language such as "directionally consistent" rather

than "direction and magnitude" may reduce such difficulties without losing the overall intent explained in paragraph BC52. In considering this test we reflected on the underlying purpose of ESG-linked features – to encourage and reward behavioural change. This suggests there may not always be a simple linear relationship between a change in risk/cost and the change in cashflows. Lenders may elect to flex their own profit margin (an acceptable element of basic lending as described at B4.1.7A) rather than price the expected cash flows proportionately to the change in ESG-linked risk/cost. This may be part of a complex pricing decision that considers the bank's own market position and its own ESG targets. As profit margin is an accepted element of basic lending, this would not in itself preclude the instrument from being considered basic lending. However, the phrase "aligned with the … magnitude"(B4.1.8A) appears to suggest a proportionate change in cashflow to risk, which would not necessarily be the case. The idea of directional "consistency" does not exclude consideration of the quantum of the change where relevant, but provides more flexibility to consider individual fact patterns better reflecting how the instrument is priced.

A18. Paragraph B4.1.8A 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". However, we note that at times there may be no clear link, or such a link may be difficult to demonstrate. For example, as noted above a bank may accept a lower margin if specified ESG-related targets are met by the borrower to gain business advantageous to the bank's market position and its own ESG objectives. In this case a bank may accept a lower profit margin despite the risk of lending not having identifiably decreased. In other cases, improved ESG performance may link to improved credit risk of the borrower, but this may be difficult to demonstrate and quantify for these relatively new instruments. We have suggested revised wording to accommodate this in paragraph A19 below.

Direction and magnitude – proposed text

A19. In addition, to provide clarity and reduce the risk of diversity in practice, we make the following recommendation and highlight other stakeholder feedback the IASB may wish to consider :

a) We recommend moving the "direction and magnitude" requirement to paragraph B4.1.10A, where other changes to contractual cashflows are discussed, incorporating some of the text from BC52 and BC70, and providing further clarification as shown below.

b) Alternatively, some stakeholders have suggested the "direction and magnitude" requirements cover the same ground as the leverage requirements at B4.1.9 of IFRS 9. If that was the IASB's intent then

referring to that section of the standard rather than introducing new language may be more effective.

c) 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. For instruments with ESG-linked targets the lender is likely to be exposed to the borrower's ESG performance, as this may vary the interest rate paid. To improve clarity 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".

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 and its impact on contractual cash flows expected to be ~~aligned with the direction and magnitude of~~ directionally consistent with the change in basic lending risks or costs. 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 (for example, contractual terms that entitle the creditor to a share of the debtor's revenue or profits) nor an exposure to the financial performance of specified assets (see also paragraphs B4.1.15–B4.1.16). A change in contractual cash flows is directionally consistent with 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.

Specific to the debtor

A20. The ED requires contingent events to be "specific to the debtor" if amortised cost accounting is to be achieved (paragraph B4.1.10A and BC67). 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". However, the current drafting appears problematic for both ESG-linked instruments and other types of contingent events. We would be happy to discuss with IASB staff relevant examples we identified during our work.

Specific to the debtor – ESG-linked features

A21. 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. In accordance with emerging market practice, we consider that 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.

A22. For ESG-linked contingent events there are a number of ways the IASB could make clear that consolidated, parent or other group company ESG targets are acceptable to meet the criteria at ED paragraph B4.1.10A. The most straightforward would be to define "specific to the debtor" (although we note this may give rise to unintended consequences). Alternatively, modified wording such as that presented at paragraph A25 below could be used. 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". Such guidance may be sufficient for a common understanding to be established, without introducing new definitions that may lead to unintended consequences elsewhere.

Specific to the debtor - other

A23. The "specific to the debtor" criterion could also be problematic for other contingent events that are today considered compatible with basic lending. For example, certain protective cost clauses or tax clauses are common in contracts considered to represent basic lending, but these clauses may relate to contingent events specific to other parties (for example, to the creditor in the context of changing laws, taxes or regulation). Such clauses relate to the cost associated with extending credit to the debtor, which is one of the permitted features of basic

lending. However, such clauses would not meet the “specific to the debtor test” nor the associated explanation at BC67 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”. If this criterion is not corrected this could result in significant numbers of basic lending transactions currently classified as at amortised cost being re-classified as at fair value through profit or loss.

Specific to the debtor – proposed text

A24. To acknowledge these issues, and to allow entities to better apply judgement based on individual fact patterns, we recommend the wording of these paragraphs be modified as indicated 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). 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.

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

A25. 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 cash flows 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 (cash flow) 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

A26. 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.

A27. 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.

A28. 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 cash flow 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 may fail to meet the characteristics of the contractual cash flows 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. However, an entity must assess the effects of any other features of the financial instrument for compliance with the contractual cash flow requirements. For example some lease receivables may be subject to residual value risk or guarantees. Such features may not be consistent with a basic lending arrangement.

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

A29. 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.

A30. 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

A31. 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 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.

Scope of disclosure

A32. 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

7 Final comment letter, IASB Exposure Draft ED/2021/3, 17 December 2021, link to document here.

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

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.

A33. 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*.

A34. 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

A35. We support the proposed transition requirements, including the requirement not to restate comparatives.

A36. 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. Alternatively, the ESG

requirements could be de-coupled from the rest of the proposals and an earlier implementation date applied.