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IASB ED/2023/2 *Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)* Cover Note

Objective

1 The objective of the session is to obtain EFRAG User Panel views on the IASB proposals in the IASB's Exposure Draft *ED/2023/2 Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)* (the "ED") and in particular on disclosure requirements.

2 The last update was provided to the EFRAG UP on 6 December 2022 where the IASB tentative decisions were discussed.

Background of the IASB project

3 The IASB carried out a post-implementation review of the classification and measurement requirements in IFRS 9 *Financial Instruments* and related requirements in IFRS 7 *Financial Instruments: Disclosures*, in accordance with the IASB's due process. The work completed by the IASB and the conclusions it reached are summarised in the Project Report and Feedback Statement—Post-implementation Review of IFRS 9 Financial Instruments—Classification and Measurement, published in December 2022.

4 In analysing the feedback, the IASB decided to make narrow-scope amendments to IFRS 9 and IFRS 7 to address some of the findings from the post-implementation review.

Proposals in the IASB ED

5 The IASB ED was published on 21 March 2023 with the comments requested by 19 July 2023.

6 The ED proposes amendments to the following requirements:

(a) Question 1 of the ED - derecognition of a financial liability settled through electronic transfer - to clarify that an entity is required to apply settlement date accounting when derecognising a financial asset or a financial liability; and to permit an entity to deem a financial liability that is settled using an electronic payment system to be discharged before the settlement date if specified criteria are met.

(b) classification of financial assets - to clarify the application guidance for assessing the contractual cash flow characteristics of financial assets, including:

(i) Question 2 of the ED - financial assets with contractual terms that could change the timing or amount of contractual cash flows, for example, those with ESG-linked features;

(ii) Question 3 of the ED - financial assets with non-recourse features; and

(iii) Question 4 of the ED - financial assets that are contractually linked instruments.

7 The ED also proposes amendments or additions to the disclosure requirements in IFRS 7 for:

(a) Question 5 of the ED - investments in equity instruments designated at fair value through other comprehensive income; and

(b) Question 6 of the ED - financial instruments with contractual terms that could change the timing or amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event.

8 The IASB proposes 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 (Question 7 of the ED).

9 The IASB identified the first two questions as requiring action as soon as possible.

10 Summary of the IASB proposals could be consulted here.

Proposed disclosure requirements in more detail

Question 5

11 For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the ED proposes:

(a) 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) to disclose the amount of change in the fair value of such investments during the period, showing separately the amount of that change related to investments derecognised during the reporting period and the amount of that change related to investments held at the end of the reporting period.

Question 6

12 To help users of financial statements understand the effect of contractual terms that could change the timing or amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event that is specific to the debtor, the ED proposes to disclose:

(a) a qualitative description of the nature of the contingent event;

(b) quantitative information about the range of changes to contractual cash flows that could result from those contractual terms; and

(c) the gross carrying amount of financial assets and the amortised cost of financial liabilities subject to those contractual terms.

13 An entity shall disclose the above information separately for each class of financial assets measured at amortised cost or fair value through other comprehensive income and for each class of financial liabilities measured at amortised cost. The entity shall consider how much detail to disclose, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate any quantitative information disclosed.

EFRAG draft response

14 EFRAG published the draft comment letter (DCL) on 5 May 2023 with a comment period till 30 June 2023.

15 In its DCL, EFRAG in general agrees with the proposed amendments and highlights that amendments to SPPI requirements for financial assets with ESG-linked or similar features should be prioritised.

Question 1 - Derecognition of a financial liability settled through electronic transfer

16 EFRAG considers that narrow-scope standard-setting approach, although will not solve all of the concerns, would provide a timely and workable solution and reduce costs for the entities concerned.

17 EFRAG, however, suggests to amend the paragraph B3.1.6 of the ED to include how the settlement date accounting applies to financial liabilities and to add a disclosure requirement on the policy used by the entity to recognise and derecognise cash.

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

18 EFRAG considers that clarifying amendments proposed in the ED would provide a good basis for evaluating whether contractual cash flows of financial assets with ESG-linked or similar features meet SPPI requirements.

19 EFRAG supports the generic approach chosen by the IASB not to provide a specific exception from the requirements on contractual cash flow characteristics in IFRS 9 for financial assets with ESG-linked features.

20 Nevertheless, to avoid unintended consequences, EFRAG suggests to carefully consider the impact of the proposed requirements about the “magnitude” and “contingent event specific to the debtor” on the existing financial instruments currently meeting SPPI requirements.

21 EFRAG suggests the IASB to provide a definition and examples of “contingent event”, and to clarify that de-minimis rule remains applicable when performing SPPI assessment. EFRAG also suggests providing additional examples better illustrating the concepts used in the ED and examples of more complex financial instruments to address the potential application questions.

Question 3 - Classification of financial assets — financial assets with non-recourse features

22 EFRAG supports the IASB decision to clarify that a financial asset has non-recourse features if an entity’s contractual right to receive cash flows is limited to the cash flows generated by specified assets both over the life of the financial asset and in the case of default as well as the IASB’s decision to provide examples.

23 However, EFRAG notes that the IASB is introducing a new concept and the definition of financial assets with non-recourse features provided in the ED is more restrictive than the general meaning assigned to “non-recourse” by current practice.

Question 4 - Classification of financial assets — contractually linked instruments

24 EFRAG welcomes the proposed clarifications and notes that the proposed amendments help to clarify the scope of transactions to which the CLI requirement apply and the distinction between CLI transactions and financial assets with non-recourse features.

Question 5 - Disclosures - investments in equity instruments designated at FVOCI

25 EFRAG agreed with the proposed disclosures although recognising that it is not an ideal solution and reminding its response to PIR about the need to review the non-recycling treatment of equity instruments designated at FVOCI.

26 EFRAG considered that the proposed disclosure requirements will help provide users with transparent and more comprehensive information about the performance of the relevant equity instruments since acquisition.

Question 6 - Disclosures – contractual terms that could change the timing or amount of contractual cash flows

27 EFRAG welcomes the proposed disclosure requirements but considers that they would not provide relevant information for credit-impaired financial assets and for financial assets measured at fair value through other comprehensive income.

28 EFRAG considers that information regarding a description of the nature of the contingent event will provide useful information because it would indicate the possibility of changes to the contractual cash flows of the financial instruments.

29 The requirement to provide quantitative disclosure about the range of such changes would further help users to assess the potential changes to the amounts and uncertainty of future cash flows.

30 In EFRAG's view, quantitative disclosure of the gross carrying amount of financial assets and the amortised cost of financial liabilities would also be useful for users as it would help to understand the prevalence of these financial instruments and the entity's exposure to contingent events.

31 EFRAG notes, however, that the proposed disclosure requirements may have significant operational challenges, and therefore, implementation costs.

32 In addition, EFRAG suggests that the IASB considers the requirements on quantitative disclosures in the context of forthcoming IASB project on Amortised Cost and Effective Interest Rate with a more holistic approach.

33 Taken the above into consideration, on balance EFRAG agrees with the proposed disclosure requirements.

Next steps

34 The following steps to reach EFRAG's final position are planned by the EFRAG Secretariat :

30 June 2023	Deadline to respond to EFRAG's DCL
30 June – 7 July 2023	Analysis of the comment letters received
11 July 2023	**EFRAG FR TEG:** to recommend the EFRAG's final comment letter (FCL) to EFRAG FRB
17 July 2023	**EFRAG FRB:** to approve the FCL

Questions to EFRAG FR TEG and UP

35 Do members have any comments on the EFRAG draft response to the IASB ED and in particular in respect of proposed disclosure requirements?

36 Do members consider that the proposed disclosures would provide useful information to users of financial statements?

Agenda Papers

37 In addition to this cover note, agenda paper 07-02 – *EFRAG's draft comment letter* – has been provided for the session.

The ED can be found here and the Snapshot of the ED can be found here.