STAFF PAPER

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IASB® meeting

Project	**Post-implementation Review of IFRS 9—Classification and Measurement**
Paper topic	Contractual cash flow characteristics—prioritising PIR findings

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Purpose of this meeting

1. In April 2022, the IASB discussed feedback on the requirements for assessing a financial asset's contractual cash flow characteristics (ie the 'solely payments of principal and interest' (SPPI) requirements). The IASB discussed preliminary views that it may need to clarify particular aspects of the requirements in response to the feedback.

2. At this meeting, the IASB will be asked to decide whether and when to take further action to make those clarifications, applying its set criteria for addressing findings from post-implementation reviews (PIRs).

3. This paper provides:

   (a) a reminder of the IASB discussion in April 2022;

   (b) a reminder of the IASB's two-step approach to addressing PIR findings;

   (c) staff assessment of whether and when to take action in response to PIR feedback on particular aspects of SPPI requirements; and

   (d) staff recommendation and question for IASB.

A reminder of the IASB discussion in April 2022

4. At its April 2022 meeting, the IASB discussed feedback and staff analysis on the IFRS 9 requirements for assessing a financial asset's contractual cash flow characteristics. Most respondents to the PIR Request for Information (RFI) agreed that generally these IFRS 9 requirements work as intended, indicating that there is not a need for fundamental changes to the requirements.

5. However, feedback indicated that the IASB could help entities with consistent application by clarifying particular aspects of the SPPI requirements. This was indicated in particular by the many questions raised by respondents about how to apply the SPPI requirements to financial assets with ESG-linked features, and about the scope of the requirements for contractually-linked instruments (CLIs).

A reminder of the IASB's two-step approach to addressing PIR findings

6. At its January 2022 meeting, the IASB discussed a two-step approach to deciding whether and when to take further action in response to findings identified in PIRs:

   (a) step 1—assess whether the findings from the PIR evidence that:

      (i) an objective of the new requirements is not being met;

      (ii) there is a significant deficiency in how information arising from application of the new requirement is meeting the needs of users of financial statements (for example, a significant lack of comparability resulting from diversity in application); or

      (iii) the costs (including financial and other costs, both initially and ongoing) of consistently applying some or all of the new requirements, consistently auditing and enforcing their application and using the information provided by them are significantly greater than expected.

   (b) step 2—if the findings evidence any of those characteristics described in step 1 the timing of any action would depend on the prioritisation of the finding as high, medium or low, based on the extent to which evidence indicates:

      (i) the matter has substantial consequences.

      (ii) the finding is pervasive.

(iii) the finding can be addressed by the IASB or the IFRS Interpretations Committee.

(iv) the benefits of any action are expected to outweigh the costs. To determine this, the IASB considers the extent of disruption and operational costs from change and the importance of the matter to investors.

7. Findings are addressed in accordance with their categorisation as follows:

(a) ***high priority findings***. Such findings are addressed as soon as possible. This category is expected to be used only rarely.

(b) ***medium priority findings***. Such findings are added to the IASB's research pipeline or the IFRS Interpretations Committee's pipeline.

(c) ***low priority findings***. Such findings are considered in the next agenda consultation and explored if identified as a priority.

(d) ***no action findings***. Such findings are not explored unless stakeholders identify the findings as a priority in their feedback on a future agenda consultation and the IASB decides, in its deliberations on the feedback, to take action.

Staff assessment of whether and when to take action in response to PIR feedback on particular aspects of the SPPI requirements

8. The majority of feedback on the SPPI requirements related to two topics:

(a) **ESG-linked features—**how to assess whether a financial asset has SPPI cash flows when the instrument has ESG-linked features.

(b) **contractually linked instruments (CLIs)**—the scope of transactions to which the CLI requirements apply and how to apply those requirements. This topic includes questions on the interaction between the requirements for CLIs and for financial assets with non-recourse features.

9. In the following tables we apply the IASB's two-step approach to help the IASB determine whether and when to take action on those topics.

Step 1—do the PIR findings evidence that further action should be taken?

10. The following table sets out each of the factors the IASB considers in assessing whether to take action in response to findings raised in a PIR, and the staff assessment of whether each of those factors is present in feedback on the IFRS 9 SPPI requirements:

Does PIR feedback indicate:	**Staff assessment**	
	ESG-linked features	**CLIs and non-recourse features**
(a) the objective of the SPPI assessment is not being met?	**No.** The objective of the SPPI assessment is to determine whether a financial asset has basic loan features and could be measured at amortised cost. Most respondents shared the view that generally the SPPI requirement works as intended and achieves the IASB's objective of providing users of financial statements with useful information about the amounts, timing and uncertainty of future cash flows. Furthermore, most respondents said that the assessment can be applied consistently for the majority of financial instruments, notwithstanding the application challenges discussed in (b) below.	
(b) there is a significant deficiency in how information arising from	**Yes.** Respondents expressed concern about diversity in practice in assessing the contractual cash	**Yes.** Some respondents raised concerns about the usefulness of differing classification outcomes

Does PIR feedback indicate:	Staff assessment	
	ESG-linked features	**CLIs and non-recourse features**
application of the SPPI assessment is meeting the needs of users of financial statements?	flows of financial assets with ESG-linked features. Most respondents expressed the view that for most financial assets with ESG-linked features, amortised cost measurement would provide the most useful information. However, some respondents interpret IFRS 9 as potentially requiring such financial assets to be measured at fair value.	for economically similar transactions depending on whether they are in the scope of the CLI requirements. Those respondents asked the IASB to clarify the scope of requirements applicable to CLIs and those applicable to financial assets with non-recourse features.
(c) the costs of consistently applying some or all of SPPI assessment, consistently auditing and enforcing their application and using the information provided by them are significantly greater than expected?	**Yes.** Feedback indicates that insufficient application guidance has resulted in significant application, audit and enforcement challenges in assessing whether financial assets with ESG-linked features have SPPI cash flows.	**Yes.** Feedback indicates that uncertainty around the scope of instruments to which the requirements in paragraphs B4.1.20–B4.1.26 of IFRS 9 apply has resulted in additional efforts to assess the cashflow characteristics of a wide range of financial assets with non-recourse features.

11. In the staff view, most of the characteristics described in step 1 are present in the findings. Therefore, the staff recommend that the IASB considers taking further actions for the findings identified.

Step 2—is the finding high, medium or low priority?

12. The following table sets out each of the factors the IASB considers in assessing the priority for taking an action in response to findings raised in a PIR, and the staff assessment of the priority that should be assigned to possible action in response to findings relating to the SPPI requirements:

Does PIR feedback indicate:	**Staff assessment**	
	ESG-linked features	**CLIs and non-recourse features**
(a) the matter has substantial consequences?	**Yes.** Respondents indicated that uncertainty about how to apply SPPI requirements to financial assets with ESG-linked features could result in diversity in practice, whereby instruments with similar contractual cash flows are classified and measured differently. This divergence would not provide useful information to users of financial	**Yes.** The SPPI requirements for CLIs are more specific than those for other financial assets, including financial assets with non-recourse features. Uncertainty about the scope of the CLI requirements has created confusion around which requirements (general SPPI requirements or the requirements specific to CLIs) apply when

Does PIR feedback indicate:	Staff assessment	
	ESG-linked features	**CLIs and non-recourse features**
	statements. Furthermore, many respondents expressed the view that measurement at fair value through profit or loss would not provide useful information because most of the fair value and changes therein would reflect changes in interest rate and credit risk rather than the risk associated with ESG-linked features.	assessing a financial asset's contractual cash flow characteristics. The lack of clarity of the scope could result in diversity in the measurement, which would reduce comparability and usefulness of information for users of the financial statements.
(b) the finding is pervasive?	**Yes.** The market for financial instruments with ESG-linked features is expected to grow rapidly globally. In addition, diverse views are developing regarding how to apply the SPPI requirements to financial assets with ESG-linked features or other features that give rise to similar variability in contractual cash flows.	**No.** CLIs are not the most significant part of entities' financial assets. However, if the CLI requirements are applied to a wider range of financial instruments (ie financial assets with non-recourse features), the resulting effect could be pervasive.

Does PIR feedback indicate:	Staff assessment	
	ESG-linked features	**CLIs and non-recourse features**
(c) the finding could be addressed by the IASB or the IFRS Interpretations Committee?	**Yes.** We think the findings could be addressed by the IASB. The staff view is that the SPPI requirements should apply to financial assets with ESG-linked features consistently with how it applies to other financial assets. However, IFRS 9 could be clarified to assist entities in assessing whether a financial asset with ESG-linked features has SPPI cash flows. We think that standard-setting would be more beneficial than referring the matter to the IFRS Interpretation Committee, because the assessment of features that could give rise to variability in contractual cash flows is a broader matter, which should not be analysed in isolation for a specific example of a financial assets with ESG-linked features.	**Yes.** We think the findings could be addressed by the IASB. PIR feedback raises many application questions on CLIs and non-recourse features. The need to clarify the scope of CLIs and the description of non-recourse features can be achieved by standard-setting, rather than interpretation or educational material. We think that standard-setting would be more beneficial than referring the matter to the IFRS Interpretation Committee, because a clarification of the scope of the CLI requirements would enable preparers to apply the requirements consistently in a range of potential scenarios.

Does PIR feedback indicate:	Staff assessment	
	ESG-linked features	**CLIs and non-recourse features**
(d) the benefits of any action would be expected to outweigh the costs?	**Yes.** The staff view is that any action would focus on clarifying the requirements and providing additional application guidance. Such clarifications should not be specific only to ESG-linked features, but principle-based and generally applicable. The staff think this clarification is unlikely to disrupt current practice and would not necessitate entities to re-perform the SPPI assessment for contracts that have already been assessed as having SPPI cash flows.	**Yes.** We think potential actions would be to clarify the scope of the CLI requirements along with the description of non-recourse features without disrupting practice relating to the other general SPPI requirements. Such clarification would reduce the confusion between CLIs and financial assets with non-recourse features and ultimately help consistent application of the requirements.

Conclusion

13. Based on the analysis in this paper, the staff recommend the IASB categorise findings related to clarifying the SPPI requirements for features such as ESG-linked features as high priority. Clarification is needed urgently before diverse practice becomes embedded.

14. Consistent with the IASB discussion in April 2022, the staff continue to think that it is unnecessary to create an exception from the SPPI requirements for ESG-linked features to ensure useful information about the amount, timing and uncertainty of contractual cash flows are provided to users of the financial statements. Nor do we think there is a need for fundamental changes to the principles of the SPPI requirements in IFRS 9. We think adding more explanation of the overall objective of the SPPI requirements and providing additional application guidance through standard-setting will address the issue effectively and efficiently.

15. Based on the analysis in this paper, the staff view is that if it were considered in isolation, the findings related to CLIs and financial assets with non-recourse features could be categorised as medium priority. However, if the IASB decides to start a standard-setting project to clarify the general SPPI requirements as discussed in paragraphs 13−14 of this paper, we think this is a good opportunity for the IASB to also clarify the CLI requirements. Both findings relate to the SPPI requirements in IFRS 9, and therefore from both the IASB and external stakeholders' perspective, proposing the clarifications at the same time would:

    (a) maximise the benefits of going through the standard-setting process with relatively small incremental effort; and

    (b) minimise the risk of any unintended consequences or impacts that could result from making one amendment in advance of another amendment in the same area of the requirements.

Other considerations

16. With regards to financial assets with ESG-linked features, respondents also asked how to account for revisions in estimated contractual cash flows if those financial assets are measured at amortised cost (ie whether to apply a prospective method in paragraph B5.4.5 or a retrospective method applying paragraph B5.4.6 of IFRS 9). As discussed in March 2022, RFI feedback confirmed that this question exists in various circumstances, not only for financial assets with ESG-linked features.

17. The IASB plans to discuss the feedback on that issue more broadly at a future meeting. In our view, the outcome of that discussion should not preclude the IASB from deciding at this meeting whether to add a standard-setting project to clarify aspects of the SPPI requirements. If, at a future meeting, the IASB decides to take any actions in response to those questions, there will be an opportunity then to decide whether that action should be taken in parallel with clarifying aspects of the SPPI requirements. However, the staff view is those questions are not relevant to whether a financial asset is measurement at amortised cost (ie classification), but are only relevant once a financial instrument is measured at amortised cost (ie measurement).

Staff recommendation and question for the IASB

18. Based on the analysis in this paper, the staff recommend the IASB starts a standard-setting project to clarify particular aspects of the requirements for assessing a financial asset's contractual cash flow characteristics (paragraphs B4.1.7−B4.1.26 of IFRS 9).

19. The purpose of the project would be to make drafting changes and additions, and possibly add examples, to support entities to consistently assess the contractual cash flow characteristics of all financial assets. Areas that the PIR has indicated would benefit from clarification are:

    (a) assessing contractual terms that change the timing or amount of contractual cash flows (paragraphs B4.1.10−18 of IFRS 9), in particular:

        (i) clarifying whether and when the nature of a contingent event (ie the trigger for a change in contractual cash flows) is or is not relevant to determining whether the cash flows are SPPI applying paragraph B4.1.10 of IFRS 9 (for example, considering an interest-rate incentive that is triggered by the borrower meeting pre-defined ESG targets);

(ii) assessing whether a financial asset might represent an investment in a particular asset applying paragraphs B4.1.16–B4.1.17 of IFRS 9 even if the contractual cash flows are described as payments of principal and interest (for example, considering financial assets with non-recourse features); and

(b) assessing whether an instrument is in the scope of the requirements for CLIs (paragraphs B4.1.20–B4.1.26 of IFRS 9).

20. If the IASB agrees to add a standard-setting project to its agenda, at a future meeting the staff will present a project plan setting out in further detail the proposed objective and scope, and an indicative timeline for the project.

Question for IASB
Do you agree with the staff recommendation to start a standard-setting project to clarify particular aspects of the IFRS 9 requirements for assessing a financial asset's contractual cash flow characteristics?