

## IFRS 9 Post-implementation Review - ESG Cover Note

### Objective

- 1 The objective of this meeting is twofold:
  - (a) To inform EFRAG FR TEG members on the IASB decisions of April 2022 and the IASB staff proposals in the May 2022 papers (oral update) in relation to financial instruments with ESG features; and
  - (b) To obtain the views of EFRAG FR TEG members on potential solutions for accounting for the financial instruments with ESG features.
- 2 To obtain the views of EFRAG FR TEG members on the tentative decisions and orientation of the staff on contractually linked instruments.

### Background of the IASB project

- 3 In October 2020, the IASB decided to begin the PIR of the IFRS 9 classification and measurement requirements. The Request for Information on IFRS 9 was published on 30 of September 2021 with comments to be provided by 14 January 2022.
- 4 In its March 2022 meeting the IASB discussed a summary of the feedback received on its consultation and a plan for the next phase of the project. The IASB members did not make any decisions, but provided their views on the feedback received.
- 5 The IASB members welcomed the feedback that in general the classification and measurement principles of IFRS 9 worked well in practice and result in measurement of financial instruments that provides useful information to users of financial statements about the amount, timing and uncertainty of an entity's future cash flows.
- 6 The IASB members preferred to approach holistically this issue, not to look at the ESG instruments in isolation and not to create exceptions just because respondents do not like the outcome. They highlighted the importance of avoiding a disruption of application of IFRS 9 requirements to other financial products.
- 7 The IASB Staff planned to approach the issue in 2 phases:
  - (a) to decide whether IFRS 9 provides enough guidance for such instruments; and
  - (b) to evaluate whether the resulting outcome makes sense.
- 8 This discussion continued at the [IASB April meeting](#) where it analysed feedback on the requirements for assessing a financial asset's contractual cash flow characteristics. The IASB discussed the two main topics raised in the feedback—contractually linked instruments and financial assets with ESG-linked features. The IASB was not asked to make any decisions.

### Approach to 6 application questions

- 9 The IASB also considered six application questions raised in the feedback:
  - (a) **Question A**—whether a financial asset has non-recourse features (i.e., features that limit an entity's claim to specified assets of the debtor), and under

what circumstances an entity is required to assess the cash flows from the specified assets;

- (b) **Question B**—whether an entity needs to consider cash flows arising from bail-in legislation when the relevant legal requirements are reproduced or referred to in a contract;
  - (c) **Question C**—whether interest rates that are contractually adjusted for inflation introduce leverage;
  - (d) **Question D**—whether interest rates that include a government-imposed leverage factor are regulated interest rates as described in IFRS 9;
  - (e) **Question E**—whether a prepayment feature includes reasonable compensation for early termination of a contract; and
  - (f) **Question F**—whether particular types of interest rates include a modified time value of money element.
- 10 The IASB decided to:
- (a) consider **Question A** with its analysis of contractually linked instruments;
  - (b) consider **Question B** after its *Financial Instruments with Characteristics of Equity* project has developed further;
  - (c) perform outreach with members of ASAF and the IFRS IC to gather further information about **Question C** and **Question D**; and
  - (d) take no further action on **Question E** and **Question F**.

#### Questions for EFRAG FR TEG members

- 11 Do EFRAG FR TEG members agree with the IASB not taking actions on E and F above?
- 12 Do EFRAG FR TEG members have observations and recommendations to make on questions A and B above?
- 13 What is the input on C and D above that EFRAG FR TEG members would like the EFRAG Secretariat to convey to ASAF?
- 14 Do EFRAG FR TEG members have suggestions to the EFRAG Secretariat on additional outreach to be performed on C to D above?

#### Contractually linked instruments

- 15 IASB Staff paper AP3 C (available at [this link](#)) provides preliminary staff views on applying the contractual cash flow characteristics assessment in IFRS 9 Financial Instruments to contractually linked instruments. Please refer in particular to the session dealing with possible standard setting: if the IASB decides to undertake standard-setting in this area, the staff think the IASB could consider whether and how the scope of the requirements and application guidance for non-recourse financial assets and CLIs can be clarified. Such clarification will help ensure that the relevant requirements are applied consistently and that the resulting classification outcomes will faithfully represent the underlying economics and substance of the financial instruments.

#### Question for EFRAG FR TEG members

- 16 Do EFRAG FR TEG members agree with the directions indicated by the IASB Staff in the paper AP3C?

### **Background of the EFRAG discussions**

- 17 In its [final comment letter](#) on PIR IFRS 9 *Classification and Measurement*, published on 28 January 2022, EFRAG expressed its commitment and willingness to provide further work with the aim of helping the IASB in finding a solution for accounting for the financial instruments with ESG features.
- 18 In March 2022 the EFRAG Secretariat presented a paper summarising the possible approaches that IASB could follow to address the ESG issue, on the basis of the views of the constituents that replied to the IASB letter and discussed them with EFRAG FIWG and EFRAG IAWG in March and April respectively.
- 19 Neither EFRAG FIWG nor EFRAG IAWG members expressed a preference for a particular approach proposed by the EFRAG Secretariat, some preferring a link to credit risk approach, others – a link to profit margin approach or to consider ESG as a component of a basic lending arrangement.
- 20 Members noted that it would be very difficult to choose one approach at this stage. They noted that the evolution of the financial products as well as development of the floating rates should be considered.
- 21 In the light of recent IASB discussions and EFRAG working groups members' views, EFRAG now proposes to look at the separation of financial and non-financial components of a contract in order to find a possible solution and would like to hear the views of members.

### **View of one EFRAG FIWG member**

- 22 One EFRAG FIWG member provided a potential way forward to deal with financial instruments which is replicated hereafter:
- 23 ESG features incorporated in financial instruments would be considered SPPI compliant when:
  - (a) Improvement of an ESG linked target (KPI, rating) results in a cash flow reduction and vice versa; and
  - (b) The interest cash flow change over the instrument life is up to +/-20bps on a p.a. basis (or a mathematical equivalent when the interest adjustment is one sided, e.g., 40bps p.a. interest step up if the ESG target is not reached).

### **Next steps**

- 24 The IASB will continue its discussion and decide whether to take action in response to the feedback on these two topics in its May meeting.
- 25 The IASB project plan is summarised in the table below:

Topics for discussion in PIR Phase 2	Expected timing
1. Contractual cash flow characteristics (including financial assets with sustainability-linked features and contractually linked instruments)	April–May 2022
2. Business model assessment	Q2/Q3 2022
3. Equity instruments and OCI	Q2/Q3 2022
4. Modifications to contractual cash flows	Q2/Q3 2022
5. Amortised cost and the effective interest method	At same meeting as topic 4 (interaction between topic 4 and topic 5)
6. Other matters	Q3 2022

26 The EFRAG Secretariat will continue to monitor the IASB discussions.

**Questions for EFRAG FR TEG**

27 Does EFRAG FR TEG have any comments on the proposed approaches to separate financial from a non-financial components of a contract described in the paper 06-04?

**Agenda Papers**

28 In addition to this cover note, agenda papers for this session are:

- (a) Agenda paper 08-02 – Financial instruments with ESG features – way forward - to stimulate the discussion on the possible new application guidance that the IASB could develop;
- (b) Agenda paper 08-03 – Financial instruments with ESG features – possible alternative approach - (for background reading only);
- (c) Agenda paper 08-04 – Financial instruments with ESG features – proposals for clarifications to paragraphs B5.1.1 and B4.1.7A of IFRS 9 - Issues Paper