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Subsequent changes to the effective interest rate

Issues Paper

Objective

- 1 The objective of this session is to discuss with EFRAG FR TEG the IASB analysis of the feedback received from the outreach activities on subsequent changes to the effective interest rate (EIR) and the [IASB staff paper AP11B](#) to the September 2025 IASB meeting.

Background

- 2 As advised by the consultative groups, in March – May 2025 the IASB staff conducted several outreach events with groups of stakeholders from various industries and regions. In total the IASB held 10 outreach events with 90 individual entities, over 60 per cent of which were preparers. For more information, please refer to the [Appendix A of the IASB AP 11A](#).
- 3 The questions were divided in three main topics, Topic 2 being subsequent changes to the EIR, in particular: determining whether changes in expected cash flows are accounted for by adjusting the effective interest rate (i.e. applying paragraph B5.4.5 of IFRS 9) or through a cumulative catch-up adjustment (i.e. applying paragraph B5.4.6 of IFRS 9). How do they interpret the phrase a ‘floating-rate’ financial asset or liability or the phrase ‘movements in market rates’ for purposes of applying paragraph B5.4.5 of IFRS 9?
- 4 The main purpose of the outreach events was to gather information about the root causes of potential diversity in application of the amortised cost measurement requirements.
- 5 The following terms in this agenda paper broadly indicate the portion of outreach participants that reported a particular view:
 - (a) almost all - all except a very small minority;
 - (b) most - large majority, with more than a few exceptions;
 - (c) many - small majority or large minority;
 - (d) some - small minority, but more than a few; and
 - (e) a few - a very small minority.

Feedback summary

- 6 Outreach feedback did not identify a common principle or rationale in applying paragraphs B5.4.5 or B5.4.6.
- 7 Two main views were reported by participants:

- (a) **Narrow view** – a few participants only apply paragraph B5.4.5 to account for movements in benchmark component of an interest rate. Changes arising from **borrower-specific factors are not viewed as reflective of movements in market rates of interest**. For example, the changes in interest rates due to credit ratchets where the rate is reset to reflect changes in the *fixed credit spread* of the borrower are not considered reflective of movements in market rates of interest. Consequently, these changes are accounted for through a cumulative catch-up adjustment applying paragraph B5.4.6 of IFRS 9, not by adjusting the EIR applying paragraph B5.4.5.
 - (b) **Broad view** – many other participants consider that **‘market rates of interest’** can relate to one or more of the different components that comprise the contractual interest rate and **arise from both market-wide changes and changes from borrower-specific factors**.
- 8 Some of these participants reasoned that while only a component of the interest rate may be reset to market (such as the benchmark component), paragraph B5.4.5 does not only apply to this floating component. Rather, in their view, the overall contractual interest rate of such an instrument is considered a ‘market floating-rate’ and any change in that overall rate is accounted for by adjusting the EIR applying paragraph B5.4.5 of IFRS 9.
- 9 For example, in contrast to the ‘narrow view’, these participants deemed the changes in interest rates due to credit ratchets as reflective of movements in market rates of interest and thus accounted for such changes by adjusting the EIR applying paragraph B5.4.5. However, they acknowledged that an adjustment to the contractual interest rate predetermined when entering into a contract cannot reflect the future market rate of interest. It can only reflect an expectation of what a market rate of interest might be at the time the contingent event occurs.
- 10 Some of these participants explained that the key assessment they make is whether a movement in any component of the contractual interest rate is designed to effectively reset the overall interest rate to its prevailing market rate (i.e. to its fair value). These participants **did not distinguish between the general movements in the market rates of interest (such as benchmark interest) that are not borrower-specific, and the changes in the market rate for a particular financial instrument that reflect borrower-specific factors** (such as changes in its credit risk).
- 11 Some outreach participants took a ‘broad view’ even on the type of instruments in scope of paragraph B5.4.5 of IFRS 9, applying it to some fixed-rate instruments. For example, they view a fixed-rate loan that the borrower may prepay at any time at par, or with only negligible compensation, as similar to a ‘floating-rate’ loan. The prepayment feature enables the borrower to renegotiate the interest rate at any time to align with the prevailing market rate which, in their view, makes it a floating-rate loan.

The IASB staff analysis

- 12 For subsequent changes to the EIR, **the root causes of diversity in application were identified as IFRS 9 having no explicit requirements or application guidance, leading entities to develop their own accounting policies**.
- 13 In the IASB staff view the diversity in application of requirements in paragraph B5.4.5 and B5.4.6 arises from varied interpretations of what changes in interest rates are reflective of a ‘movement in market rates of interest’. These interpretations arise because, among other reasons, IFRS 9:
- (a) describes the mechanisms of accounting for subsequent changes in interest rates in paragraphs B5.4.5 and B5.4.6 without articulating what are they designed to achieve.

- (b) uses the phrase ‘market rates of interest’ differently in different parts of the Standard. For instance, paragraph B5.1.1 of IFRS 9 refers to the ‘prevailing market rate(s) of interest’ used to determine the fair value of a financial instrument at initial recognition, while paragraph B5.4.5 refers to ‘movements in the market rates of interest’ without any further explanation of what this means or, whether or not this is similar to the concept of fair value.
- 14 Accordingly, in the IASB staff view, the IASB should consider clarifying the amortised measurement principles to support greater consistency in application.
- 15 From the 2025 outreach and staff analysis, the IASB staff identified **three alternatives** to clarify requirements in paragraph B5.4.5 of IFRS 9:

Alternative A

- 16 Under alternative A, **paragraph B5.4.5 of IFRS 9 would apply solely to movements in contractual interest rates that are linked to general market-based variables, such as the benchmark interest component or inflation rate.** Under this alternative, paragraph B5.4.5 of IFRS 9 would not apply to movements linked to borrower-specific factors, such as the credit spread.
- 17 The alternative aims to keep most elements of financial asset or liability calculations fixed, reflecting the conditions on initial recognition of a financial instrument. EIR would only be updated to reflect movements in the market rates of interest resulting from market wide changes. These market changes would be readily observable and reflective of general market conditions not individual borrower circumstances.
- 18 The main advantages of Alternative A are as follows:
- (a) More aligned with amortised cost being a cost-based measure, because only specific components of a contractual interest rate would be repriced to market.
 - (b) Based purely on observable inputs, reducing subjectivity. Under this alternative EIR would only be updated for changes in general market conditions, which are observable, market-based inputs. That is, this approach would not require updating the EIR using unobservable or borrower specific inputs.
 - (c) Consistent with previous IASB views on the application of paragraph B5.4.5 of IFRS 9.
- 19 The main disadvantages of Alternative A are as follows:
- (a) It could result in recognition of catch-up adjustments for all movements in contractual interest rates of financial instruments, other than those linked to the general market-based variables.
 - (b) More movements in contractual interest rates being accounted for using the catch-up adjustment mechanism would also lead to increased operational costs for preparers, including system changes.
- 20 In the IASB staff view, in terms of potential effects, Alternative A could result in significant consequences (i.e. major changes to current practices and potentially significant operational costs). Furthermore, it is not clear whether the information resulting from this approach would always be useful to investors.
- 21 The IASB staff concluded that Alternative A might be a reasonable approach to clarifying the application of paragraph B5.4.5 as it is most consistent with the basis of amortised cost measurement, uses only market observable inputs, and aligns with previous IASB discussions. However, given its potential effects, the IASB staff considers that, without any adjustments, the application costs may exceed the benefits of the resulting information.

Alternative B

- 22 Under Alternative B, **paragraph B5.4.5 of IFRS 9 would apply to movements in contractual interest rates that are linked to any changes in market variables (both general market and borrower-specific rates)**. This means, the contractual interest rate as a whole might be reset or repriced to its prevailing market rate of interest.
- 23 Alternative B would therefore mean an entity applies paragraph B5.4.5 of IFRS 9 to account for market resets or repricing of all components of an interest rate, i.e. both the general market-based elements (such as interest benchmark component) as well as the borrower specific elements (such as the credit spread).
- 24 This alternative aims to reset the EIR to its prevailing market rate of interest. In this context, the term ‘market rate of interest’ in paragraph B5.4.5 of IFRS 9 would be linked to the concept of fair value defined in IFRS 13 and as described in paragraph B5.1.1 of IFRS 9 as the rate of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating.
- 25 The main advantages of Alternative B are as follows:
- (a) It uses fair value, a familiar concept, to measure interest cash flows.
 - (b) Consistent with how ‘market rates of interest’ is used in some parts of IFRS 9.
 - (c) Compared to Alternative A, this results in fewer significant adjustments to financial assets or liabilities and smaller gains or losses in profit or loss, since more changes in contractual interest rates are accounted for under paragraph B5.4.5.
- 26 The main disadvantages of Alternative B are that:
- (a) It might lead to counterintuitive outcomes and ambiguous information for investors.
 - (b) it lacks conceptual basis because resetting the EIR to its prevailing market rate of interest is inconsistent with amortised cost, which is intended to be a cost-based measure.
 - (c) It requires measuring interest cash flows at fair value for instruments which are otherwise measured at amortised cost and this would often require using non-observable inputs.
 - (d) It might significantly increase operational costs for preparers to determine the prevailing market rate of interest for large portfolios of financial assets and financial liabilities.
- 27 In terms of potential effects, in the IASB staff’s view, Alternative B might lead to less significant changes in practice compared to Alternative A. Some entities already assess if a change in the contractual interest rate effectively resets the entire interest rate of a financial instrument to its prevailing market rate of interest. Alternative B may align with these practices.
- 28 The IASB staff concluded that Alternative B offers some advantages over Alternative A, such as clarifying paragraph B5.4.5 of IFRS 9 by linking it to the concept of fair value in IFRS 13, which might reduce the potential for different interpretations and achieve a more consistent application. However, measuring interest cash flows at fair value for financial instruments classified at amortised cost could be conceptually flawed and not result in useful information for investors.

Alternative C

- 29 Under Alternative C, **paragraph B5.4.5 of IFRS 9 would apply to any changes in a contractual interest rate that result from contractually specified variables, regardless of the movements in market rates of interest**. This alternative would therefore update the

EIR even for changes that adjust the contractual interest rate independently of market rates prevailing at the time the contingent event occurs.

- 30 The aim of this alternative would be to update the EIR to ensure it is consistent with the contractual interest payments or receipts, as and when they happen. To some extent, this alternative would result in an approach that is similar to cash accounting.
- 31 **The main advantage of Alternative C is being operationally simple and aligned with contractual amounts.** This may mean potentially less system changes required, because interest income or expense would be recognised in financial statements based purely on contractual information. There would be no calculation of the effective return on a financial instrument, no estimation involved. Similarly, there would no assessment against the movements in the prevailing market rates of interest.
- 32 The main disadvantages of Alternative C are that it is:
- (a) Inconsistent with the basis of amortised cost which is calculated using the effective interest method.
 - (b) Entirely inconsistent with the explicit reference in paragraph B5.4.5 of IFRS 9 to the movements in market rates of interest as those that alter the EIR.
- 33 In the IASB staff's view, in terms of potential effect, Alternative C is likely to require the least change in practice when compared to Alternative A and Alternative B, as it would effectively mean that any change in the contractual interest rate is accounted for applying paragraph B5.4.5 of IFRS 9. This would more closely align to current practices.
- 34 The IASB staff concludes that Alternative C is operationally simple, aligns with contractual payments or receipts, and in some cases would result in accounting outcomes consistent to current practice. However, in their view, this alternative is similar to cash accounting and, as such, it is incompatible with accrual basis of accounting.

The IASB staff's preliminary views and questions to the IASB

- 35 The IASB staff noted that to advance further, they ask for views from the IASB. The IASB was not asked to make any decisions.
- 36 The IASB staff indicated that they plan to discuss this topic with the IASB's consultative groups in Q4 2025. The IASB might then be asked to make decisions on this topic in Q1 2026.
- 37 The questions to the IASB included:
- (a) Are there any variations to alternatives A–C that could more effectively balance costs and benefits?
 - (b) Are there any other alternatives which the IASB would like the IASB staff to explore? Similarly, are there any of the alternatives that should be excluded from further consideration?
 - (c) Are there any points that the IASB staff should research further or highlight for consultation with the IASB's consultative groups?

The September 2025 IASB meeting

- 38 Some members noted that the presented alternatives illustrate a range between a "conceptual answer" and a "market answer" which are very different. Whilst Alternative A may be the conceptually purest answer, it is rather difficult to implement and costly.
- 39 Alternative B didn't receive support from members (it was referred to as a "fair value surrogate", while the amortised cost should not be labelled in this manner).

- 40 Many members were in favour of further exploring Alternative C as this approach may be a good cost-benefit compromise. On the one hand, it will not significantly disrupt the existing practice, on the other hand, it may be worth investigating whether the “conceptual price to pay” is not excessive.
- 41 Several members suggested that there may be a form of compromise between Alternative A and Alternative C. To further elaborate what exactly this compromise may be, understanding users’ needs is crucial.
- 42 Another key point discussed is considering effects of each approach on the balance sheet and the income statement, including potential volatility. Importantly, holistic assessment may be rather different from the assessment on the individual level. However, the cost-benefit assessment should focus on global rather than individual level.

EFRAG FIWG on 13 October 2025

- 43 One member noted that the contractual rate should be the starting point of any alternative and indicated that the assumption that market data for any component is easily available may be misleading.
- 44 One member noted that certain instruments (e.g., mortgage loans with multiple resets through the life of the loan) should qualify for the floating rate treatment but they will not, under Alternative A as currently formulated. If Alternative A is considered further, such instruments, which are rather common in certain jurisdictions, should be allowed to be treated as floating rate instruments. However, the same member appreciated the pragmatic approach of the IASB, i.e., understanding that following Alternative A would cause huge changes in practice. The same member noted that Alternative C would be a pragmatic approach but would lack conceptual merits.
- 45 Members discussed Alternative B and noted that a significant issue would be the credit component as under Alternative B, it would be marked to market, like other market variables. This was a point of concern for several members.
- 46 One member noted the importance of consistency between how the EIR is determined and projected at initial recognition and how it is adjusted subsequently (i.e., which components are considered to be fixed as from inception and which are to be floating and are reset further on in line with the market – e.g., market-observed credit spread vs predetermined in credit ratchets). From this perspective, Alternative B with its reference to fair value may be misleading. Also, for an instrument where all components are floating, putting it to a fixed EIR with catch-up adjustments would contradict the nature of the instrument.
- 47 An IASB staff member noted that, in the case of a change in contractual interest rate because of changes in the credit spread component, under Alternative B, an assessment would need to be made as to whether the change is aligned to movements in market rates of interest (in which case the requirement of B5.4.5 would be applied). Otherwise, paragraph B5.4.6 of IFRS 9 would apply.
- 48 One member described an alternative approach (“Alternative D”) which could address the issue of the credit component in a more conceptual manner. Under this approach, the credit component of the EIR would be updated similar to the accounting seen for some contractual credit ratchet instruments. This approach would better reflect the credit premium as intended at the inception of the instrument, contrary to the Alternative B which would imply that the market valuation of the credit component is brought into the revaluation of the amortised cost. This member mentioned, as possible advantages of this approach, its simplicity and some existing practice.
- 49 One member noted that one of the key criteria for the assessment of the alternatives would be usefulness for users. From this perspective and having in mind an instrument intended

to be held to maturity, it would be preferable to avoid excessive volatility in P&L (i.e., too many catch-up adjustments).

- 50 One member noted that having examples would be useful, especially ones which could illustrate the link between the credit component in the amortised cost measurement and the ECL.

EFRAG FIWG on 9 September 2025

- 51 Members supported the IASB staff intention to clarify the objective of paragraph B5.4.5 and B5.4.6, in their view having a clear definition what these paragraphs aim to capture would be helpful.
- 52 One member highlighted that potential clarifications to these paragraphs should not be too prescriptive. He noted that in UK the most corporate loans have ratchet features and entities usually apply paragraph B5.4.5 for the interest rate changes which is in line with a “broad view”. In this member view, applying the narrow view would result in important changes in practice for corporates and would not benefit users.
- 53 Several members expressed their preference for the “broad view” approach, including into “market rates of interest” both market-wide changes and changes from borrower-specific factors. They noted the importance of accurately reflecting impact of the interest rate changes on margins.
- 54 Two EFRAG FIWG members noted that their banks also apply floating rate treatment to fixed rate retail loans with very cheap prepayment options. They noted that in this situation the customers are in a position to easily ask for prepayment if market rates decrease and that these prepayment options are enforced by a legislation. They considered it to be a purely commercial negotiation where a “catch-down” adjustment or modification loss booking will not make sense.
- 55 A member suggested that it would be useful to consider a corporate treasury point of view where cost of debt will be impacted by catch-up adjustments under paragraph B5.4.6.

The EFRAG Secretariat assessment

- 56 The EFRAG Secretariat reiterates that amortised cost should remain simple measurement method¹ and any potential clarifications should be carefully assessed against cost-benefit balance and whether and to what extent it affects the established practice.
- 57 The EFRAG Secretariat acknowledges the merits of some of the proposed alternatives but as of now, does not see any of them as an ideal solution. E.g., whilst alternative C may be seen as a good practical solution with a minimal disruption to the existing practice, its conceptual departure from the notion of amortised cost in IFRS 9 seems too significant. Probably, the best way would be, indeed, to seek a compromise between Alternative A and Alternative C. From this point of view, the role of further activities of the IASB staff, including the discussions in the consultative groups is key.
- 58 The EFRAG Secretariat notes that the three Alternatives will not necessarily result in three different outcomes for the same financial instrument.
- 59 The EFRAG Secretariat notes that movements in contractual cash flows that are linked to borrower-specific market variables (e.g., contractual flows referenced to a credit risk market variable) may be rather rare in practice compared to credit ratchets with predetermined credit risk premiums.

¹ If and when applied to more complex financial instruments a conceptual pure solution cannot be achieved without making the amortised cost a complex measurement method.

Questions to EFRAG FR TEG

- 60 What are your views on the IASB staff feedback analysis of the outreach feedback received and the issues related to subsequent changes in the EIR discussed in this agenda paper?
- 61 In particular, what are your views on 3 alternatives described by the IASB staff and their advantages and disadvantages?