Financial assets with contingent features

During the post-implementation review of IFRS 9, stakeholders raised concerns about the classification of financial assets with contingent features - for example, interest adjustments linked to ESG targets. This article considers the recent amendments to IFRS 9 to address these concerns.

In May 2024, the International Accounting Standards Board (IASB) amended IFRS 9 *Financial Instruments* (**'IFRS 9'**). The amendments, among other things, address the classification and measurement of financial assets with contingent features in their contractual terms. This article briefly considers this aspect of the amendments.

Classification of financial assets

IFRS 9 contains principles for classifying financial instruments. They consider the business model for managing financial assets and the contractual cash flow characteristics of those assets. It requires that a financial asset should be measured at amortised cost if (a) its contractual cash flows consist solely of payments of principal and interest (SPPI) on the principal amount outstanding and (b) the entity's business model involves holding the instrument and collecting these cash flows. In light of this, it is critical to assess whether the cash flows of an instrument meet the SPPI requirement.

During the post-implementation review of IFRS 9, stakeholders expressed uncertainty about how to assess interest elements in financial assets that include contingent features, such as contingencies linked to ESG targets.

IFRS 9 guidance on contingent features

The amendment clarifies that the assessment of whether contractual cash flows are solely payments of principal and interest must focus on what the entity is being compensated for rather than the amount of compensation.

Compensation for basic lending risks and costs satisfies the SPPI criterion. However, terms that are not consistent with these risks and costs, such as index-linked or profit-share cash flows, do not represent SPPI cash flows.

The amended guidance acknowledges that contingent features may change the timing or amount of contractual cash flows. The amendment specifies that even when a contingent event is unrelated to basic lending risks—such as a feature linked to achieving a reduction in carbon emissions—an entity must assess whether the cash flows in all contractually possible scenarios, irrespective of their probability, would significantly differ from those of an identical instrument without the contingent feature. The cash flows subject to these contingent adjustments meet the SPPI requirement if they are not significantly different from those without it.

The new illustrative examples demonstrate that a loan with an interest rate adjustment contingent on a carbon emissions reduction could meet the SPPI criterion if these adjustments do not significantly alter the interest rate. Loans with interest indexed to a carbon price index fail the SPPI test because the cash flows are linked to variables unrelated to basic lending risks.

Implementation

The amendments to IFRS 9 become effective for annual reporting periods beginning on or after 1 January 2026. Given the nuanced changes introduced by these amendments, entities should carefully review the contractual terms of their loans and other financial instruments to consider whether they include contingent features and, if they do, consider the impact of these features on their classification.

+27 83 417 5904 pieter@pvdz.co.za www.pvdz.co.za