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Our Ref: 2023/O/C1/IASB/PM/473

RE: Exposure Draft | Amendments to the Classification and Measurement of Financial Instruments – Proposed Amendments to IFRS 9 and IFRS 7

Dear International Accounting Standards Board ("IASB" or "the Board") Members,

The International Organization of Securities Commissions ("IOSCO") Committee on Issuer Accounting, Audit and Disclosure ("Committee 1") thanks you for the opportunity to provide our comments on the Exposure Draft | Amendments to the Classification and Measurement of Financial Instruments – Proposed Amendments to IFRS 9 and IFRS 7.

IOSCO is committed to promoting the integrity of the international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Committee 1 ("members" or "we") seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect the general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General observations

Overall members are generally supportive of the intent of the proposed amendments outlined in the exposure draft which aim to add clarity and guidance on the application of the IFRS 9 classification and

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measurement principles. However, to help ensure consistent application and to minimize unintended consequences, greater specificity, clarity, and guidance is needed in several specific areas.

In addition, members acknowledge that principle-based accounting standards are integral to the IFRS Accounting Standards. However in some situations, like when dealing with financial instruments, prescriptive requirements may be needed; those should be provided in a fashion that supports the principles-based nature of the standards.

Furthermore, members are aware of the Board's research pipeline project on Amortised Cost Measurement, which looks to address the accounting for modifications of financial assets and liabilities, the application of the effective interest method to floating rate financial instruments, and the interaction of these two areas. We encourage the Board to ask investors what information about cash flows, and changes to cash flows, is important and decision useful.

Responses to the Board's Questions

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

Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity.

Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

<u>Response:</u>

Members generally agree with the Board's proposal. However, many members raised specific concerns and questions with the proposal as drafted.

Several members noted that the proposal lacks clarity in identifying the date an entity would derecognize the liability before the settlement date. While B3.3.8 states, "…an entity is permitted to deem a financial liability (or part of a financial liability)—that will be settled with cash using an electronic payment system—to be discharged before the settlement date…", it is unclear at what date between the payment

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instruction and settlement an entity would derecognize the liability. This lack of precision could lead to diversity in practice and reduce comparability. To reduce the potential for diversity in practice, the Board should require that the point in which an entity enters the payment instructions and when all the criteria in B3.3.8 are met, is the point at which an entity would derecognize the financial liability. However, if the Board decides to allow entities to select the point at which to derecognize the financial liability, then the decision should be clearly described in the standard. In addition, the Board should explain the link between the derecognition of the financial liability and the derecognition of the related asset. It is unclear whether an entity would derecognize the cash or reclassify cash to restricted cash or a similar account.

Members noted that it is unclear if the Board's intention is for entities to apply the election to all payment systems that meet the requirements in B3.3.8 or if there is optionality in the application of the election leading to the potential for inconsistent application of the election. For example, one could read the requirements to mean that if an entity uses two payment systems that both meet the requirements outlined in B3.3.8, an entity has the option to apply the election to one system and not to the other. We believe the Board should clearly require entities who use the election to apply the election to all electronic payment systems that meet the criteria.

Members suggest that the Board include in the Basis for Conclusions that entities would be required to disclose the use of the election in the notes to the financial statements in accordance with IAS1.117(b) when material and to apply the election consistently from period to period.

The proposal does not provide a description of what settlement date accounting is for a financial liability; the proposed paragraph B3.1.2A refers to settlement date accounting within B3.1.6 of IFRS 9. However, that paragraph describes settlement date accounting for a financial asset not a financial liability. The Board should consider including settlement date in Appendix A and expanding the definition of settlement date accounting in paragraph 9.3.3. In addition, the Board should consider clarifying the interaction between proposed paragraph B3.1.2A of IFRS 9 and the existing paragraph B3.1.2(c) which states that "a forward contract that is within the scope of this Standard (see paragraph 2.1) is recognised as an asset or a liability on the commitment date, instead of on the date on which ***settlement*** takes place" (emphasis added).

Additional clarifications can be made to the proposed amendments by removing "practical" from paragraph B3.3.8(b), "the entity has no ~~practical~~ ability to access the cash to be used for settlement as a result of the payment instruction…," or by clarifying in the basis what the Board means by "practical." In addition, clarifying the definition of "short" in the context of paragraph B3.3.9 would provide helpful guidance to assist in the application of the election. For example, by including some form of gauge (e.g.,

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less than three business days) to indicate the general envisioned time frame or to use the wording from the definition of "regular way purchase or sale" in Appendix A, "…within the time frame established generally by regulation or convention in the marketplace concerned." Otherwise, some may take diverse views on "short" (e.g., analogized to IAS 7.7 (three months or less) for which members would not be supportive of such a view).

Members also believe that payment systems that also provide currency exchange services have increased settlement risk as in some circumstances this may increase the time between payment initiation and settlement and expose an entity to additional risks such as exchange rate risks. We recommend the Board update BC33 to clearly state 'Settlement risk' generally refers to the risk that a transaction will not be settled (or completed) in a fixed or known amount of functional currency, and therefore that the debtor will not deliver cash to the creditor on the settlement date.

Furthermore, it is unclear why the Board included reference to an "entity's ability to deliver cash on the settlement date" in B3.3.9. Paragraph B3.3.9 refers to B.3.3.8(c) when assessing settlement risk; the entity's inability to pay is addressed in B3.3.8(a) and as such, it is unclear why the board is including inability to pay within its assessment of settlement risk. We ask the Board to clarify what they meant and explain how an entity would consider the entity's ability to deliver cash on the settlement date in the assessment of settlement risk separately from the entity's ability to withdraw, stop, or cancel payment instructions.

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

Paragraphs B4.1.8A and B4.1.10A of the draft amendments to IFRS 9 propose how an entity would be required to assess:

a) interest for the purposes of applying paragraph B4.1.7A; and
b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying paragraph B4.1.10.

The draft amendments to paragraphs B4.1.13 and B4.1.14 of IFRS 9 propose additional examples of financial assets that have, or do not have, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs BC39–BC72 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Response:

Overall, members support the IASB's efforts to provide additional guidance about how to assess whether contractual cash flows are consistent with a basic lending agreement without focusing solely on ESG features. We agree with the proposed clarification in B4.1.8A indicating that contractual cash flows are inconsistent with a basic lending arrangement if they include compensation for risks or market factors that are not typically considered to be basic lending risks or costs and that changes should be aligned with the direction and magnitude of the change in basic lending risks or costs. In addition, we are in favor of the clarification in B4.1.10A indicating that the assessment of the contractual cash flows should be done irrespective of the probability of the contingent event causing the change. However, members believe that the proposal lacks clarity that could lead to misapplication.

Basic lending risks and costs

Specifically, we do not believe that the principles described in Paragraph B4.1.8A provide enough precision to determine whether compensation is for risks other than basic lending risks or costs. We believe the IASB should better explain the reasons why it concluded that the ESG feature described in B4.1.13 is consistent with a basic lending arrangement and why the ESG feature described in B4.1.14 is inconsistent with a basic lending arrangement. For example, the illustrative example in B4.1.13 could be improved by indicating that this conclusion is because the occurrence of the contingent event is specific to the debtor because it depends on the debtor achieving the contractually specified target (i.e., reduction in greenhouse gas emissions during the preceding reporting period). The example should further explain how the change in interest rate reflects compensation for basic lending risks and costs.

In addition, we think that the statement in B4.1.8A indicating that the assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives, is not clear. It seems contradictory to say that an entity is being compensated for a certain risk if such compensation would be inadequate. On the other hand, in case of excessive compensation, it seems that the entity is being compensated for something else in addition to the risk exposure. Therefore, to assess whether an entity is being compensated for a certain risk, we do not think that an entity can ignore the amount of the compensation. This paragraph also appears to be in conflict with existing principles and guidance in IFRS 9, for example, when there is a tenor mismatch or any other feature resulting in a

modified amount received as compensation for the time value of money. One can refer to the quantitative and qualitative analysis, the benchmark exercise, de minimis effect, etc. to be undertaken in order to conclude whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding (SPPI) (IFRS 9.B4.1.9B). We suggest the Board provide additional clarity and guidance in the standard around this point in order to support consistent application and limit unintended consequences.

Paragraph B4.1.10A of the exposure draft seems to suggest that any contractually specified change in cash flows following the occurrence (or non-occurrence) of any contingent event will result in SPPI so long as (i) the occurrence (or non-occurrence) of the contingent event is specific to the debtor, and (ii) the resulting contractual cash flows represent neither an investment in the debtor nor an exposure to the performance of specified assets. The guidance does not clearly explain how the contractual cash flows represent compensation for basic lending risks and costs.

We support that the ED clarifies that a change in contractual cash flows that represent an investment in the debtor is not consistent with a basic lending arrangement. B4.1.8A states that contractual terms that entitle the creditor to a share of the debtor's revenue or profit would include compensation for risks or market factors that are not typically considered to be basic lending risks. This is already embedded in B4.1.16 when it states that if the contractual terms stipulate that the financial asset's cash flows increase as more automobiles use a particular toll road, those contractual cash flows are inconsistent with a basic lending arrangement. However, in order to avoid structuring opportunities, we suggest the Board clarify that there is no need to have a direct link between the cash flows expected to be received by the creditor and the debtor's revenues or profits. The investment in the debtor could be reflected with an indirect link of the cash flows with, for instance, an increase in the market share of the debtor or in the number of new store openings.

Specific to the debtor

In addition, we believe that identification of contingent events "specific to the debtor" in paragraph B4.1.10A lacks precision, and in turn could lead to diversity in application. We believe it is necessary for the Board to clarify the concept of "specific to the debtor" included in B4.1.10A, especially if the occurrence (or non-occurrence) of the event is partially dependent on the debtor. For instance, Scope 3 greenhouse gas emissions include emissions of third-party entities and there might be doubts on whether Scope 3 emissions are specific to the debtor. Another example where there could be doubt is a contingency event that refers to greenhouse gas emissions of a specific sector and the debtor is part of this sector. Those contingency events would be partially dependent on the debtor.

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

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term 'non-recourse'.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Response:

Members generally agree with the IASB's proposal to enhance the description of the term "non-recourse" and to provide examples of factors that an entity considers in assessing the contractual cash flow characteristics of financial assets with non-recourse features. These members believe the amendments will reduce diversity in the application of the standard.

To further support consistent application of B4.1.17A, we recommend the deletion of the word "may" and replacing it with "shall." For example, "…*an entity ~~may~~ shall also ~~need to~~ consider factors such as the legal and capital structure of the debtor, including, but not limited to, the extent to which*…"

Given the feedback received during the post-implementation review regarding the application challenges for non-recourse loans, we suggest the Board consider adding additional illustrative examples to the standard to assist in the assessment of financial assets with non-recourse features. For example, it may not be clear how to assess whether a creditor is exposed to "performance risk" or "basic lending risks" as described in BC76 when a loan is made to a single project or single asset entity. To address this concern, we suggest the IASB add illustrative examples describing situations in which the contractual cash flows

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were not SPPI and illustrative examples of loans with non-recourse features or entirely subordinated loans with contractual cash flows that were SPPI.

In addition, BC77 provides additional scenarios of situations when financial assets do not have non-recourse features because the creditor has the right to require a debtor to pledge additional assets if the specified assets do not generate sufficient cash flows or when their values decrease below a specified threshold. The Board should consider whether to include this example in the body of the standard.

Question 4—Classification of financial assets—contractually linked instruments

The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21– B4.1.26 of IFRS 9.

The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9. Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Response:

Most members support the proposed amendments to paragraphs B4.1.20-B4.1.21 and B4.1.20A as they provide clarity to the application guidance. While the Board has explained a "waterfall structure" in the basis for conclusions, the Board should consider adding the term to Appendix A defined items.

A few members, however, do not agree with the Board's decision not to revisit the accounting treatment for non-recourse loans and contractually linked instruments. These members believe the Board should develop a single test for non-recourse and contractually linked instruments as, in their view, the economic substance of these instruments is similar, and these members do not believe there should be a different outcome.

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Question 5—Disclosures—investments in equity instruments designated at fair value through other comprehensive income

For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposes amendments to:

a) paragraph 11A(c) of IFRS 7 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) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period.

Paragraphs BC94–BC97 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Response:

Members do not agree with the proposed amendments to paragraph 11A(c) of IFRS 7 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. Members believe the current disclosure requirements in paragraph 11A(c) of IFRS 7 should be retained. Disclosing the aggregate fair value of equity instruments rather than the fair value of each instrument is less transparent and it is unclear why it would provide more decision useful information to the users of the financial statements.

However, we support the proposed amendments to paragraph 11A(f) of IFRS 7 to require entities to disclose changes in fair value presented in other comprehensive income during the period.

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

Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

Response:

We support the disclosure requirements in paragraphs 20B and 20C of the [draft] amendments to IFRS 7. The proposed disclosures will improve transparency by enabling investors and other users of the financial statements to understand the nature of the contractual terms that could change the timing and/or amount of the contractual cash flows and to understand the extent of an entity's exposure to such contingent events. However, members noted that paragraph 7.20B(b) is unclear if the Board expects entities to provide quantitative information about the range of changes to contractual cash flows for all possible changes or only for the changes in contractual cash flows resulting from reasonably possible contingent events. While members are supportive of the proposed disclosures, some members believe the Board should consider including implementation guidance to assist in the preparation of the disclosures in order to enhance comparability.

Question 7—Transition

Paragraphs 7.2.47–7.2.49 of the draft amendments to IFRS 9 would require an entity 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.

Paragraphs BC105–BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals.

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Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

Response:

Members agree with the Board's proposal to require entities to apply the amendments retrospectively but not to restate comparative information, which is consistent with the transition requirements on initial adoption of IFRS 9 *Financial Instruments*.

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We appreciate your thoughtful consideration of the views provided in this letter.

If you have any questions or need additional information, please do not hesitate to contact Jonathan Wiggins, Chair of the Accounting Subcommittee of Committee 1 at +1 202-551-3694 or me. In case of any written communication, please mark a copy to me.

Yours sincerely,

Paul Munter

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