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RO n°7

Exposure Draft ED 2023-01—*Amendments to the Classification and Measurement of Financial Instruments—Proposed amendments to IFRS 9 and IFRS 7*

Dear Andreas,

I am writing to you on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned exposure draft (ED) published in March 2023.

We welcome the IASB's (Board) efforts to respond to the feedback received on the PIR of IFRS 9 *Financial Instruments—Classification and Measurement* and generally support the direction of the proposed amendments to IFRS 9.

Clarifications to the general SPPI principles in IFRS 9 and related proposed disclosures (Questions 2 and 6 of the ED)

We support the proposed amendments to the classification requirements in IFRS 9 aiming to clarify whether the contractual terms of a financial asset are consistent with a basic lending arrangement. In our view, those amendments are essential to secure the classification of sustainability-linked loans (or financial assets with ESG-features), in particular the conclusion that a number of those instruments are for the payment of principal and interest on the amount outstanding (SPPI). In this respect, we welcome the Board's observation in paragraph BC43 of the ED whereby amortised cost accounting could provide useful information about some of those instruments. Notwithstanding our support to the overall direction of the Board's proposals in this respect, we identified possible improvements to the drafting and content of the proposed requirements (see paragraphs 20–29 of Appendix A to this letter) as well as additional matters that should warrant further consideration from the Board, in particular (i) the case of increased cost clauses and (ii) applying paragraph B4.1.10A of the ED in the context of separate financial statements (see paragraphs 30–36).

In contrast, as explained in paragraphs 57–76, we disagree with the proposed disclosures for contractual terms that could change the timing or amount of contractual cash flows of financial assets and financial

liabilities. In our view, those disclosures may capture a very broad population of instruments, notably those issued or held by financial institutions. As drafted, the proposed disclosures may entail significant costs for limited informational benefits. Additionally, we think the Board has not gathered compelling evidence that users need information for *all* contractual terms that could change the timing or amount of contractual cash flows. Accordingly, we recommend the Board not proceed with the proposed disclosures. Should the Board decide to require disclosures, we think those disclosures should be limited to qualitative information as the one proposed in paragraph 20B(a) of IFRS 7 *Financial Instruments: Disclosures*.

In our view, the amendments to the general SPPI principles have much higher level of priority than, and are unrelated to, those related to the amendments relating to other matters addressed in the ED. Accordingly, we recommend the Board consider finalising those amendments (together with any related disclosures) expeditiously and publishing them as a separate set of narrow-scope set of amendments. The Board would subsequently consider the other proposed requirements and publish them in another set of narrow-scope amendments. This would ensure the Board provides a timely solution to an urgent matter. Should the Board decide to finalise all its proposals in a single package of amendments, we recommend the Board permit early application of those amendments.

Clarifications that would help assess the contractual cash flow characteristics of financial assets with non-recourse features and investments in contractually linked instruments (CLIs) (Questions 3 and 4 of the ED)

As explained in paragraphs 37–43, we support the proposed application guidance in paragraph B4.1.17A of the ED for assessing whether the contractual cash flows of a financial asset with non-recourse features are SPPI. In contrast, we do not support the proposed revised definition for financial assets with recourse features in paragraph B4.1.16A of the ED. In our view, the reason for narrowing that definition to circumstances in which an entity has a contractual right to receive cash flows that is limited to the cash flows generated by specified assets *both* over the life of the financial asset *and* in case of default is unclear. Absent any clear understanding of whether any such right existing *over the life of the financial asset*, we think the Board's proposed definition could significantly change the existing practice which, for a number of stakeholders, has so far been limited to assessing whether that right exists in case of default. Paragraph 43 includes our recommendation in this respect.

Paragraphs 44–52 outline our support to the thrust of the proposed clarifications to investments in CLIs, noting though these clarifications do not respond to the concerns expressed during the PIR on IFRS 9 about the cost of preparation and practicability of the look-through assessment required in paragraph B4.1.22 of IFRS 9. In particular, we welcome the Board's decision to permit the underlying pool of CLIs to include financial instruments that are not within the scope of the classification requirements of IFRS 9 (for example, lease receivables). However, as drafted, the Board's decision may not translate into real changes in practice and thus, may be of limited interest—paragraph 52 includes our recommendations to make the Board's proposals more effective in this respect.

Proposed amendments to the recognition and derecognition of financial assets and financial liabilities (Question 1 of the ED)

We welcome the Board's decision to put on hold the publication of the IFRS-IC (Committee) Agenda Decision *Cash Received via Electronic Transfer as Settlement for a Financial Asset* and instead, to undertake standard-setting. We think that introducing paragraph B3.1.2A in IFRS 9—which confirms the existing recognition and derecognition principles in IFRS 9—together with specifying clearly-defined transition requirements will provide a framework for an orderly transition to the new requirements. However, the Board has not responded to a number of practical concerns that stakeholders had raised about the Committee's technical analysis. In particular, the Board has not responded to the change in accounting policies that may affect payments made or received by cheques, debit or credit cards—

paragraphs 5–7 describe this matter further and question whether the requirements in IFRS 9 and IAS 7 *Statement of Cash Flows* altogether result in the most useful information.

We welcome and support the policy election set out in in paragraphs B3.3.8–B3.3.10 of the ED applying to a financial liability that will be settled with cash using an electronic payment system. Paragraphs 10–11 include our proposed improvements to this policy election.

Appendix A of this letter provides our detailed comments on the other matters addressed in the ED (Questions 5 and 7 in particular).

Should you need any further clarification, please do not hesitate to contact me.

Yours sincerely,

Robert Ophèle

Appendix A

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?

1. The ED neither comments on nor includes any question on the proposed clarifying requirement in paragraph B3.1.2A. Paragraphs 2–7 below include our comments in this respect. In paragraphs 8–11, we specifically comment on the proposed policy election set out in in paragraphs B3.3.8–B3.3.10 of the ED.

Clarifying that settlement date accounting is the principle underpinning the initial recognition or derecognition of financial assets and liabilities (paragraph B3.1.2A of the ED)

2. The IFRS-IC (Committee) received a submission seeking clarifications about the recognition of cash received via an electronic transfer system as settlement for a financial asset. As the feedback on the Committee's tentative agenda decision (TAD) indicated, it had not be entirely clear for a number of stakeholders how to apply to recognition and derecognition requirements in IFRS 9 to a number of common fact patterns (such as the settlement of trade receivables and trade payables). The TAD, together with the Agenda Decision (AD) that the Committee finalised in June 2022, provided additional insights that will (i) change many stakeholders' understanding of the requirements in IFRS 9 and thus, (ii) disrupt many entities' long-standing accounting practices.

3. In the light of the AD's far-reaching implications, we welcome the Board's decision to put on hold the publication of that AD and instead, to undertake standard-setting. We think that introducing paragraph B3.1.2A in IFRS 9, together with specifying clearly-defined transition requirements, will provide a framework for an orderly transition to the new requirements. In particular, this will give stakeholders clarity as to when to apply the new requirements––rather than relying on the 'sufficient time' concept as defined in paragraph 8.6 of the *Due Process Handbook* and applying to accounting changes resulting from ADs.

4. That being said, we note that paragraph B3.1.2A of the ED clarifies––ie does not substantially change––the existing requirements in IFRS 9 and thus, clarifies the accounting of transactions beyond the one described in the AD. With the exception of the policy election set out in paragraphs B3.3.8–B3.3.10 of the ED (see below), the Board did not, as a matter of fact, respond to a number of practical concerns that stakeholders had raised about the implications of the TAD (and AD) on a number of transactions (see in particular Agenda Paper 12A for the June 2022 Committee's meeting and paragraph BC8 of the ED).

5. The Board did not in particular respond to the concerns[1] about the changes in accounting policies (and the related implementation costs) that will affect payments made or received by

[1] In paragraph BC23 of the ED, the Board acknowledged the proposed amendments would not resolve all of the concerns that stakeholders had raised.

cheques, debit cards or credit cards[2]. In this respect, we have not identified in the Basis for Conclusions on the ED any cogent argument for (i) not undertaking broader standard-setting or (ii) providing any policy election applicable to financial assets along the lines of the proposed election for some financial liabilities—ie permitting in specific circumstances the extinguishment of some financial assets (such as some trade receivables) before their settlement date. Consequently, we recommend the IASB provide greater clarity as to why it decided to proceed with such a narrow-scope standard-setting[3].

6. The Board neither responded to the counter-intuitive outcome to which the existing requirements in IFRS Accounting Standards may lead. We note that if finalised as proposed, the amendments may significantly change the accounting policies of a number of entities in relation to credit cards payments. In some industries such as the retail industry, credit cards[4] payments account for a significant part of customers' payments. Determining the timing at which an entity recognises the cash inflows resulting from credit cards payments is critical in those industries as a number of payments occur at, or close to, the entity's reporting date. When a credit-card settled transaction occurs, many selling entities recognise, from the inception of the transaction, a financial asset towards the credit card acquiring entity rather than a trade receivable towards the customer—this is because the credit card acquiring entity facilitates the payment and owes the money collected to the entity. The settlement of the transaction requires a day, or a couple of days, for most credit cards but may require up to a week for some credit cards. A number of those entities have so far considered this financial asset as being cash or cash equivalent and have often referred to it as 'cash-in-transit'. Applying the proposed amendments and having in mind the discussions that took place at the Committee's meeting in June 2022[5], those entities may need to revisit their accounting policy and exclude 'cash-in-transit' from their cash and cash equivalents balances in their statement of financial position and in their statement of cash flows.

7. Beyond the effects of such an accounting change on entities' cash position, there are valid questions as to whether this will result in the most useful information for users of financial statements. This is because 'cash-in-transit' financial assets have a shorter maturity—a couple of or several days—than a number of investments that currently meet the definition of 'cash equivalents' in IAS 7—the maturity of which could be up to three months. They are also subject to smaller risk of changes in value than many cash equivalents. This provides further evidence that the Board should at some point revisit the definition of cash and cash equivalents in IAS 7—at latest when it starts working on its research project on *Statement of Cash Flows and Related Matters*.

The policy election in relation to the derecognition of liabilities settled with cash using an electronic payment system

8. We welcome and support the thrust of the policy election set out in in paragraphs B3.3.8–B3.3.10 of the ED. We think it will (i) provide practical relief to an entity that is unable to know when

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[2] Payments received by cheques, debit cards and credit cards are subject to settlement date accounting and are not eligible to the policy election set out in this ED.

[3] We acknowledge that paragraphs BC12–BC24 include a discussion about the two approaches that the Board considered. That being said, we think this discussion is not comprehensive.

[4] The comments in this paragraph equally apply to debit cards.

[5] The Agenda Decision does not discuss whether the 'cash-in-transit' financial asset meets the definition of cash equivalent in IAS 7 *Statement of Cash Flows*. Paragraphs 23–27 of Agenda Paper 3 for the June 2022 Committee's meeting explain that the Committee decided not to opine about this specific point. However, those paragraphs imply that 'cash-in-transit' does not meet the definition of cash equivalent. We note that 'cash-on-transit' was understood as any financial asset that an entity would recognise if it were to derecognise a trade receivable before it receives cash—the pending payment arising from the credit card transactions described in this letter would meet the definition of 'cash-in-transit'.

exactly a financial liability that is settled using an electronic payment system is extinguished applying the requirements in paragraph B3.1.2A of the ED—ie when cash is effectively delivered to the counterparty as settlement for the entity's payable—and thus (ii) will permit current accounting practices to be continued in specified circumstances.

9. Even though not specifically mentioned in the Basis for Conclusions on the ED, we understand that the Board designed the proposed policy election considering whether an entity has lost control of cash when initiating an electronic payment. We support this approach which may result in useful information.

10. This being said, we suggest below a few simplifications to the criteria set out in paragraph B3.3.8 that an entity shall meet to deem a financial liability—that will be settle with cash using an electronic payment—to be discharged before the settlement date:

    a. the criterion specified in paragraph B3.3.8(a) of the ED may, as drafted, be too restrictive. An entity will seldom be in a position in which it has no ability to withdraw, stop or cancel a payment instructions *in all circumstances*. For example, an entity may usually have this contractual ability (known as 'recall') when the payment instructions have been initiated further to fraud, a technical error (such as erroneous bank coordinates of the beneficiaries) or duplicate sending—ie in circumstances that we view as exceptional. If the Board were to proceed with this criterion, we recommend the drafting be at least adjusted to cater for those exceptional circumstances.

    b. an entity may recall payments in exceptional circumstances other than those specifically described above. This leads to question whether the criteria set out in paragraphs B3.3.8(a) and (b) of the ED may not together inadvertently and unduly restrict the scope of circumstances in which an entity could apply the policy election. The Board could instead develop a single criterion—in addition to the criterion set out in paragraph B3.3.8(c)—referring to the entity's *intention* not to withdraw, stop or cancel the payment. An entity's past experience in relation to recalls or cancellations of payments could provide evidence that any such intention exists.

11. As a final note, we observe that the proposed amendments do not clearly specify when exactly an entity that decided to apply the policy election set out in paragraph B3.3.8 of the ED—ie the entity deems the liability discharged before the settlement date—would derecognise the financial liability. Without any further clarification, there would still be doubts as to whether a difference in timing between derecognising cash used for payment and derecognising the related financial liability exists—in other words as to whether a 'cash-in-transit' financial liability exists. We think it was the Board's intention to align the timing of the derecognition of both the financial liability and cash. Accordingly, we recommend the Board clarify this point in the final amendments.

The June 2022 Agenda Decision

12. We understand that the Board did not make any formal decision at its September 2022 meeting as to whether it objected to the publication of the Committee's AD[6]. It instead decided to explore narrow-scope standard-setting.

13. We note that the clarifications introduced by paragraph B3.1.2A of the ED align with the Committee's conclusion set out in the AD. However, the ED does not carry forward all the explanatory materials in the AD that the Committee developed in response to the submission—

[6] Paragraph 8.7 of the Due Process Handbook

in particular the Committee's observation that, if an entity's contractual rights to the cash flows from the trade receivable expire before the transfer settlement date, the entity would recognise any financial asset received as settlement for the trade receivable (for example, a right to receive cash from the customer's bank) on that same date.

14. In our view, it could be helpful, once the Board finalises the amendments, to ask the Committee to update its AD in the light of the revised requirements in IFRS 9 and then publish—subject to the usual due process steps—an updated AD. If the Board were to decide otherwise, it would be then helpful for the Board clarify the status and implications of the June 2022 AD.

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?

Overall assessment of the Board's proposals and level of priority

15. In our letter on the PIR of IFRS 9—*Classification & Measurement*, we drew the Board's attention on the accounting of sustainability-linked loans[7] (SLLs or assets with ESG-linked features in this document), in particular on whether those instruments are solely for the payment of principal and interest on the amount outstanding (SPPI or basic lending arrangements). We then recommended the Board undertake standard-setting to clarify how the principles in IFRS 9 apply to those instruments. We also held the view that amortised cost was the right measurement basis for most of those instruments.

16. In this context, we welcome:

    a. the Board's proposed clarifying amendments which will assist entities in determining whether those instruments are SPPI.

    b. the Board's observations in paragraph BC43 of the ED whereby amortised cost accounting could provide useful information about some financial assets with ESG-linked features.

    c. the approach underpinning the proposed amendments—ie clarifying the existing

[7] The interest rate of these loans is adjusted periodically to reflect changes in the borrower's performance relative to specified ESG targets. The primary objective of such loans is to incentivise the borrower to take actions that may not have a direct effect on its financial KPIs but that do have an effect on non-financial KPI that are of public interest (in relation to environment, social and governance matters).

principles in IFRS 9 without creating an exception for some instruments. We think the Board's proposals will also help entities better assess whether financial assets other than those with ESG-linked features are SPPI.

17. Notwithstanding our support to the overall direction of those amendments, we identified possible improvements to the drafting and content of the proposed requirements (see paragraphs 20–29) as well as additional matters that the Board should consider further (see paragraphs 30–36).

18. As explained in our letter on the PIR of IFRS 9, SLLs is a fast-growing category of instruments that is set to play an instrumental role in the transition to a sustainable economy in the European Union. There is an urgent need for having clarifications as to how the classifications requirements in IFRS 9 apply to those instruments. Accordingly, we encourage the Board to finalise expeditiously the proposed requirements in paragraph B4.1.8A and B4.1.10A of the ED (subject to our proposed changes).

19. We note those proposed requirements have a much higher level of priority than, and are unrelated to, those related to the other matters addressed in the ED. Accordingly, the Board could consider finalising the proposed requirements in paragraph B4.1.8A and B4.1.10A and then publishing them as a separate set of narrow-scope set of amendments. The Board could subsequently consider the other proposed requirements and publish them in another set of narrow-scope amendments.

Improvements to the content and drafting of the proposed amendments

- **Including some observations in the Basis for Conclusions on the ED in the final amendments**

20. In paragraph BC47 of the ED, the Board explains that in analysing the PIR feedback, it reconfirmed several of its views about a 'basic lending arrangements'. We note that paragraph B4.1.8A of the ED reflects the views described in paragraphs BC47(b) and (d). Nonetheless, the Board's views in paragraphs BC47(a) and (c) of ED have not been reflected in paragraph B4.1.8A; nor have they led to clarifications to the existing requirements in IFRS 9. In particular, we note that the Board decided not to amend paragraph B4.1.7A that we consider as including pivotal principles when assessing whether a financial asset is SPPI.

21. In our view, it would be helpful to amend paragraph B4.1.7A of IFRS 9 to explicitly mention, as relevantly mentioned in paragraph BC47(a) of the ED, that the elements of interest this paragraph specifies do not constitute an exhaustive list of the elements that are consistent with a basic lending arrangement[8].

22. If the Board were to decide not to proceed with our recommendation in paragraph 21 above, we then recommend the Board include in the final amendments some observations in paragraph BC55 of the ED—in particular the observation whereby *'the variability in cash flows need not relate to one of the elements of interest explicitly mentioned in paragraph B4.1.7A of IFRS 9'*.

23. We further think that paragraph BC55 of the ED also sheds light on the interaction between paragraphs B4.1.7A, B4.1.8A on the one hand and B4.1.10A on the other hand. By observing that *'variability cannot be assumed to be consistent with a basic lending arrangement simply because it arises from one of the elements of interest mentioned in paragraph B4.1.7A'*, the Board may have meant that variability that arises from one of the elements of interest mentioned in

[8] Whether to read this list as an open or closed list explains the existing uncertainties as to whether SLLs are SPPI.

paragraph B4.1.7A is a necessary but not sufficient condition for that variability to be consistent with a basic lending arrangement—any such variability shall also meet the criteria set out in paragraph B4.1.10A. Because the interaction between paragraphs B4.1.8A and B4.1.10A is not entirely clear to all stakeholders, we recommend this be clarified in the final amendments, for example by retaining the Board's observation currently in paragraph BC55 in the final amendments.

- **Improvements to the examples in paragraphs B4.1.13–B4.1.14 of the ED**

24. We support including examples illustrating the requirements in paragraph B4.1.10A.

25. That being said, we note the two new examples:

    a. only illustrate some (and not all) of the criteria set out in paragraph B4.1.10A; and

    b. do not shed light on a critical point ie why instrument EA has contractual cash-flows that are consistent with a basic lending arrangement as required in particular in paragraphs B4.1.7A and B4.1.8A. Is this, for example, because ESG-adjustments that solely serve as an incentive for the borrower to meet the specified ESG could be consistent with a basic lending arrangement?

26. Because the examples are to be part of the final amendments, it would be helpful to develop further the technical analysis supporting those examples—in particular the point described in paragraph 25.b above.

27. Additionally, we note that Instrument EA described in paragraph B4.1.13 of the ED illustrates circumstances in which the debtor achieves a contractually specified environmental target. We think helpful to amend this example, or develop a new one, to illustrate a fact pattern that, in our view, is increasingly common and consists in the debtor achieving a mixture of targets—ie social (S) and/or governance (G) targets in addition to environmental targets (E). Absent the clarifications we recommend in paragraphs 20–23 above, there might indeed be some questions as to whether 'S' and 'G' indexation clauses are consistent with a basic lending arrangement. As implied in paragraphs IN3, BC41 and BC43 of the ED, we understand it was not the Board intention to prohibit amortised cost accounting to instruments including 'S' and 'G' clauses—provided though that those clauses are consistent with the requirements in paragraphs B4.1.7A, B4.1.8A and B4.1.10A in particular. Including an example mixing various targets—that all comply with the requirements in paragraph B4.1.10A—would make the Board's intentions clearer.

- **Improvements to the drafting of the proposed amendments**

28. We have the following observations on the drafting of paragraph B4.1.8A:

    a. it specifies 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 (for example, a share of the debtor's revenue or profit)...*". This drafting does not fully mirror the elements of interest that are consistent with a basic lending arrangement as specified in paragraph B4.1.7A of IFRS 9, in particular the profit margin element. It does not either reflect the wording of the Board's observation in paragraph BC4.182(b) of IFRS 9 ('*...The IASB also noted that the assessment of interest focuses on what the entity is being compensated for (ie whether the entity is receiving consideration for basic lending risks, costs <u>and a profit margin</u> or is being compensated for something else...*') (emphasis added). In our view, the omission of that element in the

drafting of the final amendments could raise some questions about the Board's intentions (if any) and thus, recommend the profit margin element be mentioned in the final amendments.

b. its wording may create conflicting requirements. It first says '*...the assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives*' (emphasis added) and concludes that '*...a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs*' (emphasis added). Additionally, as drafted, this paragraph might prompt entities to perform quantitative analysis regarding the magnitude of the change in basic lending risks or costs—this would also conflict with the Board's view in paragraph BC74(c) of the ED. We think the Board's intention would be better reflected by referring to the notion of 'disproportion' (rather than 'magnitude').

c. The use of double negations in the last sentence of the paragraph unnecessarily obfuscates its reading.

29. Further to our comments in paragraph 28 above, we recommend the drafting of paragraph B4.1.8A be revised as follows:

> *In assessing whether the contractual cash flows of a financial asset are consistent with a basic lending arrangement, an entity may have to consider the different elements of interest separately. The assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives. 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 (for example, a share of the debtor's revenue or profit) or profit margin, even if such contractual terms are common in the market in which the entity operates. Furthermore, a change in contractual cash flows is ~~in~~consistent with a basic lending arrangement if it is ~~not~~ aligned with the direction ~~and magnitude~~ and appears proportionate to the change in basic lending risks, ~~or~~ costs or profit margin.*

Matters that the Board should further consider

- **The case of entities assessing the classification of a financial assets in their separate financial statements**

30. We generally agree with the criteria set out in paragraph B4.1.10A that contractual terms that change the timing or amount of cash flows must meet for the related instrument to be SPPI.

31. This being said, we think a common fact pattern should warrant the Board's attention. In our jurisdiction, a number of ESG-indexation clauses are based on a *group of entities* achieving contractually specified ESG targets. For example, a subsidiary may issue a loan whose interest rate is adjusted on the basis of whether the *group* in which the subsidiary is consolidated meets specified ESG targets. As drafted, such an indexation clause may not meet the SPPI criterion when the subsidiary assesses the loan's classification for the purpose of preparing its separate financial statements. A similar matter may arise if the group's consolidating entity were to issue the loan and prepare its separate financial statements.

32. Accordingly, we recommend the criterion whereby the occurrence of the contingent event shall be specific to the debtor be extended to include events that are specific to any entity (i) controlling the debtor or (ii) being controlled by the debtor.

- **The need to consider the case of increased cost clauses**

33. The contractual terms of some financial assets may permit the lender to pass some costs it incurs onto the borrower contingent upon the occurrence of some specified events. The lender usually charges those costs to the borrower by increasing the interest rate on the instrument. Those terms are known as increased cost clauses. For example, the lender may be permitted to pass onto the borrower increases in its costs of funding owing to changes in market conditions (such as changes in regulation or law or market disruption) or for other reasons that are specific to the lender (such as costs related to increase in the lender's credit risk or losses incurred on some business activities). Some increased cost clauses are widespread (such as those in relation to changes in regulation or law).

34. Entities currently apply the existing requirements in paragraphs B4.1.7A and B4.1.10 of IFRS 9 to assess whether the contractual cash flows that arise from such clauses are SPPI. This assessment, which much depends on the facts and circumstances, aims to identify whether the lender passes onto the borrower costs that are consistent with a basic lending arrangement.

35. Applying the proposed requirements in paragraph B4.1.10A of the ED, there is a risk that a number of instruments including such clauses might no longer meet the SPPI criterion. Applying first the requirements in paragraphs B4.1.7A of IFRS 9, an entity may conclude (on the basis of facts and circumstances and assuming that no other clause would change the instrument's timing or amount of contractual cash flows) that a given increased cost clause passes onto the borrower costs that are consistent with a basic lending arrangement and that the instrument could meet the SPPI criterion. However, subsequently applying paragraph B4.1.10A, an entity may conclude that the contingent event triggering the clause is not specific to the debtor--accordingly, the instrument might not ultimately meet the SPPI criterion.

36. We are unsure of whether the Board considered the existence of such clauses when developing the requirements in paragraph B4.1.10A of the ED. Therefore, we recommend the Board consider further the extent to which the existence of such clauses could meet the SPPI criterion. By doing so, the Board would also clarify the interaction between paragraphs B4.1.10A, B4.1.7A and B4.1.8A which, as explained in paragraph 23 above, is not entirely clear. In our view, there should be a rebuttable presumption that clauses passing onto the borrower the lender's costs of funding owing to changes in market conditions are consistent with a basic lending arrangement.

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?

Overall assessment of the Board's proposals

37. We welcome the Board's efforts to respond to the feedback on the PIR of IFRS 9 and to clarify the extent to which a financial asset has non-recourse features. The Board aims to provide such clarification by (i) providing an explicit definition of 'non-recourse' features in paragraph B4.1.16A of the ED and (ii) developing factors in paragraph B4.1.17A of the ED helping an entity assess whether a financial asset has such features.

38. We agree with the proposed factors in paragraph B4.1.7A of the ED. Those factors much align with the factors stakeholders have so far considered in their analyses. We think those factors, together with the associated observations in the Basis for Conclusions on the ED, should be carried forward in the final amendments and their related Basis for Conclusions.

39. In contrast, we have reservations about the proposed revised definition of 'non-recourse' features.

40. Paragraph B4.1.16A of the ED states that a financial asset has non-recourse features if an entity's contractual right to receive cash flows is limited to the cash flows generated by specified assets '...*both over the life of the financial asset* and in the case of default...' (emphasis added). It is unclear why the Board decided that financial assets for which any such right exists in the case of default would not have 'non-recourse' features.

41. An entity is able to assess the existence of any such right in case of default—in this circumstance, the specified assets may be liquidated and the entity has an ultimate contractual claim limited to the proceeds arising from the liquidation. This is solely how many stakeholders have so far assessed whether a financial asset has-recourse features.

42. The meaning of an entity's right to receive contractual payments being restricted to the cash flows generated by the specified assets *over the life of the instrument* is, in our view, unclear. Absent any clear understanding of the intended meaning, the definition of non-recourse features risks being read as being more restrictive than the existing definition in paragraph B.4.1.16 of IFRS 9. This, in turn, could lead to reconsider the analysis for some common financial assets (such as residential mortgages in specific jurisdictions). Additionally, it is unclear how an entity would walk through the requirements in IFRS 9 to determine the classification of a financial asset for which the right only exists in case of default.

43. Accordingly, we recommend the Board either (i) clarify how an entity would determine the classification of a financial asset for which its contractual right to receive cash flows is limited to

the cash flows generated by specified assets exists only in case of default or (ii) retain the existing definition for non-recourse features in paragraph B.4.1.16 of IFRS 9.

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 (CLIs) 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?

Overall assessment of the Board's proposals

44. Here again, we welcome the Board's efforts to respond to the feedback on the PIR of IFRS 9 and to bring clarification (i) on the scope of transactions to which the CLI requirements apply and (ii) how to apply those requirements. That being said, we note that the proposed amendments do not substantially respond to stakeholders' comments (such as those expressed in our January 2022 comment letter), in particular on the cost of preparation and practicability of the look-through assessment required in paragraph B4.1.22 of IFRS 9. We wish the Board had considered developing simplifications to the look-through assessment (in particular for the most senior tranches of CLIs[9]).

45. With regard to the Board's proposals, we support the clarifications of the description of transactions that are in the scope of paragraphs B4.1.21–B4.1.26 of IFRS 9 subject to some refinements and clarifications (see paragraphs 46–47 of this letter). In contrast, we have mixed views on the proposed amendments to paragraph B4.1.23 of IFRS 9 (see paragraphs 48–52 of this letter).

Clarifications of the description of transactions including CLIs

46. We agree with the amendments to paragraphs B4.1.20, B4.1.20A and B4.1.21 of ED. The related clarifications align with our stakeholders' current understanding of the transactions to which the CLI requirements apply. Accordingly, we do not expect significant changes in the classification of CLIs.

47. However, we recommend the Board:

    a. amend the wording of paragraph B4.1.20A to reflect the circumstances in which the secured lending is financed by a pool of the creditors. In our view, the conclusion of the fact pattern discussed in this paragraph would be unchanged if the lending transaction were to involve several creditors and those creditors were to share the same features.

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[9] The Board has not responded in particular to the requests for simplifying the CLI approach for senior instruments that are not affected by the variability of underlying assets. The look-through approach is particularly difficult to apply and operationally burdensome and seems disproportionate when the tranche held is not exposed to the variability of underlying assets.

Replacing 'a single creditor' by 'class of creditors' may particularly help solve this point; and

b. clarify the consequences of specifying that the tranches in CLIs have non-recourse features.

Underlying pool of financial instruments that is SPPI

48. We support the thrust of the proposed amendment to paragraph B4.1.23 of IFRS 9—ie clarifying that it was not the Board's intention to limit the scope of eligible financial instruments in the underlying pool of instruments to those instruments that are entirely in the scope of IFRS 9. We understand the Board's proposal chiefly aims to clarify that *some* lease receivables may be such eligible instruments.

49. That being said, we think that neither the proposed amendments to paragraph B4.1.23 nor the Board's observations in the Basis for Conclusions sufficiently clarify what those eligible lease receivables are—ie how to assess '*leases receivables that have contractual cash flows that are equivalent to SPPI*' (emphasis added). Absent any further details, the ED might imply that any tranche linked to an underlying pool of assets that include lease receivables could automatically have cash flows that are similar to SPPI. Alternatively, some differing views could emerge as to identifying eligible lease receivables, thereby leading to diversity in classification practices. In our view, the Board should provide clarifications in this respect in any final amendments.

50. Reading agenda paper 16B for the September 2022 Board meeting, we understand the Board's intention was not to imply that all lease receivables are eligible items for the purpose of applying paragraph B4.1.23. In particular, we understand that finance leases receivables that are subject to residual value risk would typically not be consistent with a basic lending arrangement and thus, would not be 'equivalent to SPPI'. Neither would be variable lease payments that may be linked to an index.

51. We note that the circumstances in which a lease receivable is subject to residual value risk are common, in particular for operating leases. Additionally, reading the above-mentioned agenda paper, we understand that the IASB staff holds the view that '*many finance lease receivables are subject to residual value risk which is typically not consistent with a basic lending arrangement*'. We question the staff's conclusion in relation to finance leases—because a finance lease transfers substantially all the risks and rewards incidental to ownership of an underlying asset, we think the lessor would transfer residual value risk to the lessee in many finance leases and thus, would primarily be exposed to credit risk. That being said, if the staff's view were to be true, the Board's proposals would be understood to apply to only a small population of lease receivables, thereby questioning here the genuine benefits of standard-setting.

52. Consequently, we recommend the Board:

    a. clarify in any final amendments the meaning of '*leases receivables that have contractual cash flows that are equivalent to SPPI*';

    b. provide application guidance to help entities assess the effects of features such as residual value guarantees on the nature of the lease receivable's contractual cash flows; and

    c. consider, to maximise the benefits of standard-setting and as an exception, specifying that a tranche of CLIs is deemed to meet the criterion in paragraph B4.1.21(b) of IFRS 9 if the underlying pool includes lease receivables for which the residual value risk has only a

de *minimis effect* on the contractual cash flows of the tranche––in other words, the residual value risk may not have only a *de minimis* effect on the contractual cash flows of the individual lease receivables but, in contrast, has such de minimis effect on the contractual cash flows of the tranche.

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?

53. In our comment letter on the PIR of IFRS 9 *Classification & Measurement*, we recommended the Board reconsider the accounting for investments in equity instruments for which an entity has elected to present subsequent changes in fair value in other comprehensive income (OCI) rather than profit or loss. In particular, we held the views––and still hold them––that the subsequent changes in fair value should be reclassified in profit or loss when the entity disposes of the instrument and that the presentation election should also be opened to 'equity-type instruments'. EFRAG in its comment letter on that PIR expressed similar views.

54. Despite the efforts to provide a comprehensive and thorough analysis of the comments received[10], we note and regret that the Board ultimately decided not to respond to the request of a number of European stakeholders. We note however that the Board indicated it would continue to monitor and evaluate any new evidence—as it does for all requirements—that indicates that users of financial statements consider the OCI presentation election to result in information that is neither relevant nor a faithful representation of an entity's performance. We nonetheless recommend the Board also monitor any new piece of information that would emerge from the first-time application of IFRS 17 *Insurance Contracts*.

55. We do not see the proposed disclosures requirements as an effective response to the request of those such as ANC who explained that the existing accounting for investments in equity instruments is not adequate, in particular to reflect the performance for those instruments held in a long-term perspective. The Board is, as a matter of fact, still working with the assumption that choosing either fair value through profit or loss or the OCI presentation election, accompanied by the IFRS 7 disclosures, provides users with the information they need about the performance of equity investments––the proposed disclosures for investments in equity instruments simply built on that specific assumption. From this perspective, we see the proposed disclosures as being consistent with the Board's view.

56. We do not expect entities to face significant practical difficulties in preparing the proposed disclosures and thus, do we do not disagree in principle with the Board's proposals. That being said, we question the usefulness of the proposed disclosures in paragraph 11A(f) of IFRS 7 as drafted. We are unclear as to the benefits of solely showing separately the changes in fair value

[10] See in particular the analysis in Agenda Paper 3A for the October 2022 Board meeting.

for investments in equity instruments (i) derecognised during the period and (ii) those that the entity still holds at the reporting date. In our view, it would be more appropriate to require separate disclosures for the cumulative changes in the fair value of both types of investments—this would shed clarity on 'realised' and 'unrealised' gains or losses recognised in OCI.

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 (FVOCI) 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?

57. We agree with the nature of the proposed disclosures. In particular, we concur with the Board's decision to not require entities to provide a sensitivity analysis of the effects of contingent events on their financial statements for the reasons set out in paragraph BC103 of the ED.

58. However, we disagree with the proposed disclosures for some financial assets (see paragraphs 59–68) measured at amortised cost or FVOCI and for some liabilities subsequently measured at amortised cost (see paragraphs 69–74). Should the Board decide to proceed with some disclosures, we recommend the approach be revisited and entities be required to disclosure only qualitative information about contractual terms that could change the timing or amount of contractual cash flows—ie entities be required to provide the proposed disclosures in paragraph 20B(a) of IFRS 7. We also identified a matter that should be clarified if the Board were to retain the proposed scope for disclosures (see paragraphs 75–76).

The proposed disclosures for some financial assets subsequently measured at amortised cost or fair value

59. We think the extent of the proposed disclosures is unnecessarily too wide and thus, may result in information whose benefits are unlikely to justify the costs incurred to provide it (the cost constraint as defined in paragraphs 2.39–2.43 of the 2018 *Conceptual Framework for Financial Reporting*). We recommend the Board scale back the proposed disclosures.

- **The lack of robust evidence justifying the scope of instruments to which the proposed disclosures would apply**

60. The Board proposes disclosure requirements for financial assets that have contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event that is specific to the debtor. We note that (i) IFRS 9 already includes classification-only requirements about contractual terms that could change the timing or amount of contractual cash flows but without IFRS 7 *Financial Instruments: Disclosures* currently requiring any specific requirements for such terms and (ii) the proposed amendments to IFRS 9 would only develop further the existing principles for those contractual terms without fundamentally changing them.

61. We further observe that the feedback on the PIR has not outlined any request from users to receive information about *all* contractual terms that could change the timing or amount of contractual cash flows[11]. As acknowledged in Agenda Paper 16 for the October 2022 Board meeting, some users solely said disclosures would be critical in providing useful information about entities' exposures to ESG-linked risks arising from financial instruments––in other words, disclosures would be relevant when ESG-features could change the timing or amount of contractual cash flows.

62. Accordingly, we impugn the principle of introducing disclosures requirements applying to *all* instruments that have contractual terms that could change the timing or amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event. We are in particular unconvinced that sufficient evidence exists for developing such disclosures.

- **The potential benefits of the proposed disclosures may not exceed their associated costs**

63. We expect the proposed disclosures to mainly apply to financial assets held by financial institutions or insurance entities. Those disclosures would apply to contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of any contingent event specific to the debtor. The ED does not include any definition for a 'contingent event'. Referring to the common meaning of 'contingent', the disclosures could apply to a very wide range of financial assets that financial institutions originate, including instruments with repayment options, covenants or other contingent settlement terms (such as change of control clauses).

64. Making the inventory of those contractual terms would require screening the whole banking book. Once identified, there are questions as to how to prepare the related proposed disclosures––in particular the quantitative information in paragraph 20B(b). We acknowledge that paragraph 20D amending IFRS 7 would require entities to apply their judgement as to how to disclose the proposed information, in particular as to the appropriate level of aggregation or disaggregation. That being said applying judgement (i) when the population of contractual terms is potentially very large and (ii) without having a precise description of the detailed information needs of users of financial statements[12], would create some practical challenges. In our view, the proposed disclosures would result in significant implementation costs for entities.

65. Having in mind the difficulties to identify the appropriate level of aggregation, we also question whether the proposed disclosures would ultimately result in the most useful information. There are indeed risks that users receive information that is not tailored to their real needs.

66. We acknowledge that market risks to which financial institutions are exposed (in particular interest rate risk) has recently come under greater scrutiny. Some might argue that the proposed amendments could be an opportunity to respond to this scrutiny. We do not hold this view because:

    a. IFRS 7 already requires entities to disclose extensive information about market and liquidity risks. That information may already enable users to make well-informed decisions.

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[11] This also much aligns with the feedback of financial institutions operating in our jurisdiction which say they usually receive few questions in this respect.

[12] Paragraphs BC98–BC100 do not clearly describe how and for what purpose users will use the information in the disclosures. Absent any explanation in this respect, we think it would be difficult for an entity to identify material information that is required to be disclosed to satisfy the specific disclosure objective in paragraph 20B of the ED.

b. the Board is currently developing an accounting model that would enable users to understand the effect of an entity's dynamic risk management of repricing risk due to changes in interest rate and to evaluate the effectiveness of that risk management (DRM project). This project is expected to include disclosures requirements that may well respond to users' needs as to how an entity manages its global interest rate risk.

- **Requiring entities to provide the proposed information in paragraph 20B(a) of IFRS 7 only**

67. As explained above, limited evidence exists that users need information about all contractual terms that could change the timing or amount of contractual cash flows. In our view, the Board should undertake further research before proceeding with the proposed disclosures to (i) better identify users' needs and (ii) develop a robust disclosure objective. We are unsure this project is the appropriate vehicle for doing this. Accordingly, in our view, the best way forward would be not to proceed with any disclosures.

68. That being said, should the Board wish to proceed with some disclosures, we think essential to finalise disclosures that entities could provide at a reasonable cost. Consequently, we recommend the Board not require entities to disclose quantitative information as proposed in paragraphs 20B(b)–(c) of IFRS 7 and, instead, only require disclosures as proposed in paragraph 20B(a).

The proposed disclosures for some financial liabilities subsequently measured at amortised cost

69. We think a number of observations we made for financial assets would equally apply to the proposed disclosures for financial liabilities. For example, there is insufficient evidence that users would like to receive more information for any contractual term that could change the timing or amount of a financial liability's contractual cash flows.

70. That being said, we think that the cost constraint assessment may differ among entities.

71. In our view, the proposed disclosures are unlikely to justify the costs incurred to provide them for financial institutions or insurance entities. This is because the population of instruments that the proposed disclosures would target would be too wide in those circumstances.

72. In contrast, the cost constraint assessment may be positive for other entities. This is because we expect the proposed disclosures to apply to a limited number of financial liabilities held by those entities—primarily loan payables as defined in Appendix A to IFRS 7. In those circumstances, identifying the affected instruments and applying judgement as to how to aggregate or disaggregate information may be much easier than for financial institutions or insurance entities. Information could thus be provided at a reasonable cost.

73. The Board could logically consider proceeding with the proposed disclosures only for a specific population of entities. We would not, on balance, support any such approach. This is because it would be complex to operationalise given the existing requirements in IFRS Standards—for example, no IFRS Accounting Standard currently distinguishes entities with specified main business activities as those defined in the context of the Primary Financial Statements project—and would risk delaying the finalisation of those amendments.

74. Accordingly, we recommend the Board consider a way forward similar to the one described in paragraphs 67–68 above.

Additional point for the Board's consideration

75. Paragraph 20B sets out the objective of the proposed disclosures ie '*...to help users of financial statements understand the effect of contractual terms that could change the timing or amount of contractual cash flows...*' (emphasis added). It is unclear as to whether the related information shall be provided taking into consideration:

    a. the probability of the contingent event occurring (or not occurring), and

    b. whether the contingent event could account for a characteristic that could have a *de minimis* effect on the contractual cash flows or is not genuine as described in paragraph B4.1.18 of IFRS 9.

76. Should the Board proceed with its proposed approach for disclosures, we think important to clarify this point.

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. 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?

- **Transition requirements**

77. We support the proposed transition requirements as set out in paragraphs 7.2.47–7.2.49 of the ED.

78. We note that paragraph 7.2.48 does not require an entity to restate prior periods. An entity is permitted to restate those periods if, and only if, it is possible to do so without the use of hindsight. Despite not clearly stated, consistent with the principles underpinning the requirements in paragraph 7.2.15 of IFRS 9, we understand that if an entity elects to restate prior periods, the restated financial statements must reflect *all* of the requirements in any final amendments.

79. The proposed amendments address several matters that are not entirely interrelated—for example, the clarifications to the recognition and derecognition of financial assets and financial liabilities (in chapter 3 of IFRS 9) have no relation to the clarifications for assessing whether financial assets are SPPI (in chapter 4 of IFRS 9). If the final amendments were to be issued as a single package, we think the Board could consider encouraging entities to restate prior periods—and thus, to provide better information—by permitting that the restated financial statements reflect only some of the requirements in the final amendments (for example by permitting that the amendments to the requirements in chapter 4 of IFRS 9 be reflected in their entirety, but not the amendments to the requirements in chapter 3 of IFRS 9).

- **Recommendation in relation to the effective date**

80. The ED does not specify any effective date for the proposed amendments should they be finalised.

81. Paragraph 6.35 of the *Due* Process Handbook explains that the effective date of any amendments is set so that jurisdictions have sufficient time to incorporate the new requirements into their legal systems and (b) those applying IFRS Accounting Standards have sufficient time to prepare for the new requirements. In practice, the Board generally allows at least 12–18 months between the issuance of a new IFRS Accounting Standard or amendment and its effective date.

82. We think that requiring entities to apply the proposals in the ED 12 to 18 months after the issuance of the amendments would give sufficient time to stakeholders to prepare for the implementation of the new requirements.

83. As a final note, we agree that the Board should permit earlier application. Any such application would even be critical for the proposed amendments in paragraphs B4.1.8A and B4.1.10A of the ED given their high level of priority (see paragraphs 18–19 of this letter).