Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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14 July 2023

Dr Andreas Barckow
International Accounting Standards Board
Columbus Building
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Canary Wharf
London E14 4HD
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Dear Andreas,

IASB Exposure Draft
Amendments to the Classification and Measurement of Financial Assets
(Proposed amendments to IFRS 9 and IFRS 7)

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing, ethics and sustainability disclosures for professional accountants in Hong Kong. We are grateful for the opportunity to provide our comments on this Exposure Draft (ED).

The HKICPA appreciates the IASB's endeavours to address the stakeholders' concerns raised in the post-implementation review of IFRS 9 *Financial Instruments* concerning the classification and measurement of financial assets with ESG-linked features and the tentative agenda decision regarding the accounting for the settlement of a financial asset or a financial liability using an electronic payment system.

We have carefully reviewed the ED and performed outreach with local stakeholders. We provide detailed comments in the Appendix and summarise our primary concerns and recommendations below.

<u>Classification of financial assets – contractual terms that are consistent with a basic lending arrangement</u>

We have significant concerns over the proposed amendments to the solely payments of principal and interest (SPPI) requirements. We consider that the proposed amendments do not establish clear principles for assessing whether the financial instruments with ESG-linked or similar features meet the SPPI requirements. The two new concepts introduced by the ED for the SPPI assessment, namely 'aligned with the direction and magnitude' in B4.1.8A and 'contingent event specific to the debtor' in B4.1.10A, have not been clearly defined or explained. Moreover, questions have been raised as to how these two concepts interact with each other and with the existing requirements in IFRS 9.

Another key concern is that the proposals were drafted with ESG-linked features in mind but they are not ring-fenced to ESG features only. If the proposals were applied to other non-ESG related contractual terms, they could change the current classification of those financial instruments and result in unintended consequences.

In addition, we question the objectives and usefulness of the related proposed disclosures regarding the changes in contractual cash flows of financial instruments. These proposed disclosures focus solely on contingent events specific to debtors, while

other events that could also change the contractual cash flows of the financial instruments are not considered. The lack of clarity on the meaning of ‘contingent event specific to debtors’ may also lead to inconsistent practices. Preparers from the banking industry have expressed concerns that the proposed disclosures would be onerous and costly to implement and questioned whether the benefits of providing the disclosures would outweigh the costs of preparing them.

Given these concerns, we strongly recommend the IASB take immediate action to evaluate the implications of the proposals on the current classification of financial assets, regardless of whether they have ESG-linked features, and consider whether this is the intention of the proposals. If the IASB were to proceed with the proposals, we recommend that the IASB provide more clarity on the conceptual rationale for and the application of the two new concepts, namely ‘aligned with the direction and magnitude’ and ‘contingent event specific to the debtor’. In this context, we believe that providing examples to demonstrate the application of these concepts on accounting for financial assets with common ESG-linked features, as well as non ESG-linked financial assets, would be helpful in mitigating potential diversity in application.

Non-recourse features and contractually linked instruments (CLI)

Our respondents expressed concerns regarding the narrow description of ‘non-recourse’ features proposed in B4.1.16A. They noted that it could be read to apply only to cases where there is a contractual recourse to cash flows of the specified assets during the life of the financial asset and in the case of default. However, in current practice, non-recourse consideration could also apply when a creditor’s claim is limited to specific assets or other cash flows, either contractually or in substance, and whether over the life of the instrument or in the case of default.

They also considered that it is inappropriate to include ‘non-recourse’ as a feature of CLI in B4.1.20 which would essentially treat CLI as a subset of financial assets with non-recourse features. This is because these two types of instruments are subject to different assessment criteria that cannot be reconciled by treating one type of instrument’s being a subset of the other without the IASB providing clear guidance as to which assessment criteria should be used.

In light of the above, we recommend that the IASB clarify the description of ‘non-recourse’ feature in B4.1.16A, and the key differences between ‘non-recourse’ and CLI by providing examples that incorporate typical features of non-recourse and CLI used in current practice. We have suggested some improvements that could help to clarify the proposals in the Appendix to this letter.

Derecognition of a financial liability settled through electronic transfer

The terms ‘settlement date’ and ‘settlement date accounting’ are currently used in IFRS 9 with reference to ‘regular way purchase or sale of financial assets’ only. However, the way B3.1.2A is currently drafted in the ED seems to extend the ‘settlement date accounting’ to other transactions that are not regular way purchases or sales. If the IASB intends to apply settlement date accounting to other transactions, we recommend the IASB provide guidance and examples to demonstrate how to apply it to transactions other than regular way purchases or sales. Otherwise, the IASB should revisit the wording in B3.1.2A (and as a consequence B3.3.8 since that paragraph also refers to settlement date accounting) to avoid confusion when applying the proposed amendments. We provide an example of possible changes to wording in our detailed response to Question 1 in the Appendix.

To ensure consistent application of the proposal for the derecognition of financial liabilities settled through electronic transfer, we suggest that the IASB provide clarifications on the application of the three criteria in B3.3.8. We also suggest that the IASB clarify whether the criteria are applicable when the cash used for settlement will come from an overdraft or similar facility with a negative balance.

If you have any questions regarding the matters raised in this letter, please contact Carrie Lau (carrie@hkicpa.org.hk) or Kennis Lee (kennislee@hkicpa.org.hk), Associate Directors of the Standard Setting Department.

Sincerely,

Cecilia Kwei
Director of Standard Setting

Work undertaken by the HKICPA in forming its views:

The HKICPA:

(a) issued an Invitation to Comment on the ED on 23 March 2023 to its members and other stakeholders;

(b) sought input from its Financial Instruments Advisory Panel, Insurance Advisory Panel and Small and Medium-sized Practitioners Committee and its Technical Issues Working Group, which mainly comprise technical and industry experts from large as well as small and medium accounting firms; and

(c) developed its views through its Financial Reporting Standards Committee, having reflected on its respondents' views. The Committee comprises preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms.

Detailed comments on the IASB ED

Question 1: Derecognition of a financial liability through electronic transfer

1. We generally support providing an exception to the general derecognition requirements for financial liabilities that are settled through electronic transfers. However, we have the following comments and suggestions.

A. Recognition and derecognition of a financial asset or financial liability using settlement date accounting [B3.1.2A]

2. Our respondents noted that the proposal in B3.1.2A would change the current practice of derecognising a financial liability that is settled by cheque because entities would be required to derecognise the financial liability on the date when the cheque is cleared by the bank, instead of when the cheque is issued to the creditor. Some respondents questioned whether such a change would faithfully represent the substance of the current economic phenomenon as financial liabilities are generally considered as being settled once debtors have issued the cheques to their creditors. This is considering the fact that in our jurisdiction it is not often that cheques would be dishonoured or cancelled by the drawer after the cheques have been issued.

3. We acknowledge the market concerns about the need to change the timing for derecognising financial liabilities settled by cheques. However, we understand from BC22 of the ED that the intention of the proposal is to clarify that an entity is required to apply settlement date accounting when recognising or derecognising financial assets and financial liabilities (except for regular way exception) so as to improve consistent application of the requirement. On this basis, we believe that the proposal would help resolve the diversity in practice. To increase the market receptiveness to the proposed amendments and raise public awareness of their impact, we recommend the IASB provide relevant educational material on the impact of the proposals on cheque payments. We also suggest the IASB consider providing sufficient time for the market to implement the change when it determines the effective date of the amendments.

4. A few respondents highlighted that the terms 'settlement date' and 'settlement date accounting' are currently used in IFRS 9 with a reference to a 'regular purchase or sale of a financial asset' only. IFRS 9 provides special accounting (trade date or settlement date accounting) for regular way purchases or sales because of the nature of such transactions as explained in BA.4. Accordingly, the concept of settlement date accounting is irrelevant to other types of transactions under the

extant IFRS 9 including derecognition of financial liabilities and those involving derivatives.

These respondents are concerned that B3.1.2A seems to extend the 'settlement date accounting' to other types of transactions that are not even sales or purchases or which are not 'regular way'. If that is the case, these respondents questioned how the settlement date accounting should be applied to such transactions, e.g. transactions with interest rate swaps and other net settled derivatives where there is no subsequent settlement by transferring some financial assets for those instruments. Currently, without B3.1.2A, those derivatives are recognised under 3.1.1 which is not an application of 'settlement date accounting'.

5. Some respondents noted from the Basis for Conclusions of the ED that the IASB did not indicate any intention to change the existing recognition and derecognition principles of financial assets and financial liabilities in IFRS 9. These respondents suggested the IASB consider taking out the entire paragraph of or redrafting B3.1.2A to avoid any confusion or potential impact to other IFRS 9 requirements if the primary purpose of the amendments is to provide an exception (i.e. B3.3.8) for entities to derecognise their financial liabilities before the settlement date for payment transactions settled through electronic transfers.

6. We understand that one of the aims of adding B3.1.2A is to resolve the diversity in practice regarding settlement of financial liabilities using electronic payment systems as explained in the ED. By means of issuing the amendments, the IASB can duly consider an appropriate effective date for entities to change their current practice. From this point of view, we do not object to this proposal.

7. However, in light of the respondents' concerns in paragraphs 4 and 5 above, we recommend the IASB consider the following suggestions to avoid any confusion or unintended misinterpretation of the requirements:

   (a) If the IASB intends to apply the 'settlement date accounting' to transactions other than regular way purchases or sales, we suggest the IASB provide guidance and practical examples to demonstrate how to apply settlement date accounting to transactions other than regular way purchases or sales such as net settled derivatives. Furthermore, we noted that the current drafting in B3.1.2A shows that settlement date accounting applies to both financial assets and financial liabilities but 'settlement date accounting' as described in paragraph B3.1.6 only refers to financial assets. Therefore, we consider that B3.1.6 should be expanded accordingly to cover financial liabilities.

   (b) If the IASB does not intend to change the application of the recognition and derecognition requirements in IFRS 9, we recommend the IASB revisit the wording in B3.1.2A to ensure that they are aligned with the general principles of recognition and derecognition of financial assets and financial liabilities as set out in 3.1.1, 3.2.3 and 3.3.1 of IFRS 9. A possible redrafting of B3.1.2A would be as follows:

   'When recognising or derecognising a financial asset or financial liability, an entity shall apply the general relevant requirements in this Standard (specifically paragraph 3.1.1 in the case of recognition of financial assets and financial liabilities, section 3.2 in the case of derecognition of financial assets and section 3.3 in the case of derecognition of financial liabilities) ~~an entity shall apply settlement date accounting (see paragraph B3.1.6)~~ unless paragraph B3.1.3 applies or an entity elects to apply paragraph B3.3.8.'

A consequential redrafting of B3.3.8 would be as follows:

'*Notwithstanding the requirement in paragraph B3.1.2A ~~to apply settlement date accounting~~, an entity is permitted (…)'*

We would also suggest that the IASB review any references in the Basis for Conclusions of the ED for similar issues regarding the application of settlement date accounting to financial liabilities.

B. *Derecognising a financial liability settled through electronic transfer before the settlement date [B3.3.8-B3.3.10]*

8. Our respondents raised the following comments regarding the proposal for the derecognition of financial liabilities before the settlement date:

   (a) It is unclear whether B3.3.8(a) is considered to be met when an entity is subject to a penalty if it withdraws, stops or cancels a payment instruction and whether this depends on the size of the penalty.

   (b) It is unclear what 'practical ability' in B3.3.8(b) means and how to assess it, e.g. whether it can be based on an entity's intention and past practice; and how it is different from 'ability' as referred to in B3.3.8(a).

   (c) Some respondents suggested deleting the last sentence in B3.3.9 *'settlement risk would not be insignificant if the completion of the payment instruction is subject to the entity's ability to deliver cash on the settlement date'*, as they considered that this sentence confuses criteria (a) and (b) of B3.3.8 (i.e. the ability of the entity to stop the payment instruction or deliver cash) with criterion (c) (i.e. settlement risk).

   (d) The proposed requirements are unclear regarding whether and how the exception to derecognising a financial liability applying B3.3.8 would apply in cases where the cash, which is used to settle the financial liability in the electronic transfer system, comes from an overdraft or other similar facility with a negative balance. It is noted that paragraph B3.3.8 refers to 'settled with cash' and (b) of that paragraph refers to 'access the cash'. This raises a question as to whether 'cash' is defined as in IAS 7.6 as 'cash on hand and demand deposits' and so only refers to positive cash balances, or the broader definition in IAS 7.8 which acknowledges that 'bank overdrafts which are repayable on demand form an integral part of an entity's cash management' and '[i]n these circumstances, bank overdrafts are included as a component of cash and cash equivalents' and so can include negative balances. It would be useful for the IASB to clarify this aspect and whether the fact that the overdraft facility is committed or uncommitted would make a difference to the ability to use the election in B3.3.8.

9. We generally agree with our respondents' comments in paragraph 8 and therefore recommend the IASB provide clarifications with guidance and examples to address those comments so as to avoid the potential diversity in application in those areas.

10. Furthermore, given the significance of settlement risk as one of the criteria for applying the exception under B3.3.8, we recommend the IASB consider defining 'settlement risk' in Appendix A of IFRS 9 instead of explaining the term in BC33.

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

11. We appreciate the endeavours of the IASB to address the issue concerning the classification and measurement of financial assets with ESG-linked features, which are increasingly prevalent in the market. However, we are concerned that the proposed amendments to the SPPI requirements do not achieve the objective of establishing clear principles for assessing whether financial instruments with ESG features meet the SPPI requirements. In addition, the proposals were drafted with ESG-linked features in mind but they are not ring-fenced to ESG features only. If the proposals were applied to other non-ESG related contractual terms, they could change the current classification of those financial instruments and result in unintended consequences.

12. Overall, we consider that the proposed amendments in B.4.1.8A and B4.1.10A introduce new criteria for assessing whether the contractual cash flows are consistent with a basic lending arrangement and they are not merely a clarification of the existing SPPI requirements. As such, we are concerned about the use of the word 'clarification' in the Basis for Conclusions of the ED which also implies that certain past classification treatments would be errors.

A. *Element of interest in a basic lending arrangement [B4.1.8A]*

13. Most respondents were concerned about the proposal requiring entities to assess both the direction and magnitude of the change in basic lending risks or costs when determining whether the contractual cash flows are consistent with a basic lending arrangement because it would be difficult to model the change and assess the reasonableness of such a change against movements in the market. There is insufficient evidence in the market to demonstrate how ESG factors correlate with credit risk and other basic lending risks.

14. Some respondents noted that there appears to be an inconsistency within B4.1.8A. In assessing the elements of interest, although the IASB clarified that an entity should not focus on 'how much' compensation it receives, the proposal requires an entity to consider the 'magnitude' of the change in basic lending risks or costs when determining whether the contractual cash flows are consistent with a basic lending arrangement in the same paragraph.

15. We acknowledge the challenges in assessing both the direction and magnitude of the change in basic lending risks or costs in the absence of adequate market information. Accordingly, we recommend that the IASB clarify the core principle and supplement the principle with guidance and examples on how to apply it to instruments with different ESG characteristics.

16. In addition, we recommend that the IASB:

    (a) clarify how the concept of 'magnitude' as introduced in B4.1.8A interact with the existing 'leverage' concept stipulated in B4.1.9 in assessing a basic lending arrangement; and

    (b) move the last sentence in B4.1.8A '*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*.' to B4.1.10A as it relates to a change in contractual cash flows and it would be more appropriate to include it in B4.1.10A instead of B4.1.8A.

B. *Contractual terms that change the timing or amount of contractual cash flows [B4.1.10A]*

17. Our respondents expressed concerns about the proposed requirement that 'contingent event must be specific to the debtor' in order for a change in contractual cash flow to be consistent with a basic lending arrangement for the following reasons:

    (a) Even though the consideration of contingent events is an extant requirement of IFRS 9, the term 'contingent event' is not defined and it could be very broad. In practice, many financial instruments with contractual terms that introduce variability to contractual cash flows are currently considered as compatible with SPPI, regardless of whether they are considered contingent events under B4.1.10. For example, an instrument with fall-back clauses triggered by the disappearance of the relevant benchmark rate is considered compatible with SPPI. If these events are considered to be contingent events, that instrument would fail to meet the SPPI requirements under B4.1.10A as they are not specific to debtors.

    (b) It is unclear as to why the contingent event has to be specific to debtors but not lenders, given that the elements of interest are meant to compensate the lenders for undertaking lending risks and costs and thus interest can also include a profit margin for lenders as stipulated in B4.1.7A. In practice, many loan contracts include clauses that are specific to lenders to protect their interests, e.g. a lender's contractual right to adjust the amount to be received due to new tax provisions or compensation for additional costs. Therefore, the proposal could change the current practice, as these loans would fail to satisfy the SPPI requirements under the proposals.

    (c) Some respondents commented that the meaning of 'specific to the debtor' lacks clarity, particularly in terms of whether it is only restricted to 'the debtor achieving a contractually specified target' as indicated in B4.1.10A. They also questioned whether a contingent event relating to a debtor's asset would be considered as 'specific to the debtor' under the proposal. For example, it is not clear whether a provision in a collateralised lending arrangement that could accelerate repayment of the loan if the quality of the collateral deteriorates (e.g. a significant drop in the fair value of the property that is subject to a mortgage loan) would be considered a contingent event that is 'specific to the debtor', or a contingent event that is specific to 'an asset of the debtor' (being the property) as opposed to the debtor as a whole. Another example that highlights this issue is when a debtor is required to repay the margin loan earlier if the value of securities held in this debtor's margin account falls below a specified threshold and the debtor is unable to add more funds to raise the equity in his account to the required level. It is not clear whether such a contingent event relating to the debtor's asset (being the shares) would be considered as 'specific to the debtor'.

    (d) B4.1.10A states that to meet the SPPI requirements, an instrument's cash flows resulting from the occurrence of a contingent event must not represent an investment in the debtor. The ED only provides an example on what could be an 'investment in the debtor' in BC 70 but does not provide a clear definition or explanation of the concept. A few respondents considered that the term 'investment in the debtor' is broad and can be interpreted in different ways, leading to inconsistent practices. For instance, it is unclear whether an

instrument that adjusts its interest rate upwards or downwards by a fixed number of basis points when a certain level of profits or revenue is reached would be considered 'a share of the debtor's revenue or profit' under BC 70. One school of thought is that the adjustment to the interest rate constitutes a share of the debtor's revenue or profit because it affects the share of profit for ordinary shareholders. Others contend that it is not a share of the debtor's revenue or profit because the participation in higher profits is limited by the fixed adjustments to the interest rates. The fact that BC 69 of the ED states that 'contractual cash flows that change based on the level of a debtor's revenue or profits in a specific period would not generally be considered to be consistent with a basic lending arrangement' is likely to add further confusion to this issue.

18. In light of the above concerns, we consider that more clarity on what constitutes 'contingent events' is necessary to ensure consistent application and avoid any unintended consequences. In particular, if the IASB intends to exclude contingent events associated with the time value of money or prepayment features (BC 69 of the ED), we consider that the proposed requirements should explicitly state this. Furthermore, the IASB should provide a clear rationale on why a contingent event must be specific to the debtor in order to be consistent with a basic lending arrangement and provide more guidance on what 'specific to the debtor' and 'investment in the debtor' intend to encompass under the proposal. Given that the proposed requirement of 'contingent event specific to the debtor' could affect the classification of certain financial instruments currently meeting the SPPI requirements, we strongly recommend the IASB evaluate the implications of the proposal on the current classification of financial instruments, regardless of whether they have ESG-linked features, and consider whether this is the intention of the proposal.

19. In addition, the application of the SPPI requirements is closely linked to the amortised cost measurement in IFRS 9. In our previous submission to the IASB[1], we highlighted several application issues with amortised cost measurement. In particular, diversity in practice exists in applying the effective interest method to floating rate instruments due to the lack of clarity on the scope and definition of what constitutes a floating rate instrument under B5.4.5 of IFRS 9. Given the growing prevalence of ESG-linked instruments that will be subject to amortised cost measurement once the proposed amendments are finalised, we strongly recommend that the IABS commence the pipeline project *Amortised Cost Measurement* as soon as practicable.

C. New examples of applying the proposed requirements [B4.1.13-14]

20. Many respondents considered that the two new examples in B4.1.13-14 are not sufficiently clear in demonstrating how instruments with ESG-linked features are assessed for SPPI requirements under the proposal and how paragraphs B4.1.8A and B4.1.10A interact.

21. For example, B4.1.13 illustrates that the instrument is SPPI compatible purely because the contingent event is specific to the debtor (B4.1.10A), without considering the direction and magnitude of the change in basic lending risks or costs (B4.1.8A). There is a risk that this example will be cited as providing a definitive answer in its own right without the need to look at any other requirements in the SPPI assessment.

[1] See paragraph 19 of the HKICPA's submission to the IASB on PIR of IFRS 9 – Classification and Measurement on 13 January 2022.

22. Given the above, we consider that further guidance and examples are needed to explain the application of B4.1.8A and B4.1.10A, in particular, the concepts of 'aligned with the direction and magnitude' and 'contingent event specific to the debtor', and how they interact.

Question 3: Classification of financial assets – Financial assets with non-recourse features

23. We generally welcome the IASB's proposals to address the market's need for clear guidance on 'non-recourse' financial assets.

24. However, some respondents from the banking industry expressed concerns that the description of 'non-recourse' in B4.1.16A appears to be too narrow. B4.1.16A seems to limit the assessment only to those cases where there is <u>contractual</u> recourse to cash flows of the <u>specified assets</u> during the life of the financial asset <u>and</u> in the event of default. However, in current practice, the non-recourse guidance has been applied to cases where a creditor's claim is limited to specified assets or other cash flows, either contractually or in substance, regardless of when the limit to specified assets applies, i.e. during the life of the instrument only, in the event of default only or both.

    These respondents have also highlighted that many banking facilities currently considered as non-recourse arrangements seldom have terms that stipulate that the lender can only receive cash flows generated directly from a specified asset throughout the life of the loan. Instead, in a typical special purpose entity (SPE) structure, the lender may receive cash flows from the SPE's other operations or the sponsor could put in more equity over the life of the loan or raise further loans from which repayments could be made to the original lender. In the event of default, the lender would contractually have recourse only to a specified asset. It is unclear whether the above arrangement could be considered as an 'in substance' non-recourse loan in terms of B4.1.16A.

25. The above comments suggest that there are some entities which may probably be applying a wider definition of 'non-recourse' than the IASB proposal. To support consistent application of the requirements, we recommend the IASB clarify the description of 'non-recourse' in B4.1.16A and explain how it should be applied to the bank facilities indicated above.

26. In addition, we have the following comments and recommendations to improve the clarity of the assessment in B4.1.17A.

    (a) The IASB should clarify how the two factors set out in B4.1.17A should be applied, in particular, whether a qualitative and/or a quantitative assessment would be needed under the proposal.

    (b) In addition to the two factors in B4.1.17A, there are a number of other factors used by current practice for assessing whether the contractual cash flows of a financial asset with non-recourse features are SPPI (e.g. consideration of Loan-to-Value (LTV) ratios). We recommend the IASB explore those factors and incorporate them into B4.1.17A where appropriate so that the market has more guidance and reference on how to perform the 'look-through' assessment to evaluate whether the non-recourse features are SPPI.

Question 4: Classification of financial assets – Contractually linked instruments

27. Our respondents have provided the following comments to improve the clarity of the proposed amendments in B4.1.20:

    (a) Many respondents considered that the last sentence in B4.1.20 (i.e. *'... which means the tranches have non-recourse features (see paragraph B4.1.16A'*).) inappropriately links the assessment criteria for non-recourse features with those for CLI. They considered that:
    - the drafting of B4.1.20 seems to imply that the presence or absence of non-recourse features depends on whether there is a waterfall payment structure, which is inconsistent with the extant guidance on financial assets with non-recourse features. BC 89 of the ED states that non-recourse feature means that the holders have recourse only to the cash flows from the underlying pool of financial instruments, which is unrelated to the seniority and payment ranking of different tranches; and

    - it is inappropriate to include 'non-recourse' as a feature of CLI which would essentially treat CLI as a subset of financial assets with non-recourse features. This is because these two types of instruments are subject to different assessment criteria that cannot be reconciled by treating one type of instrument's being a subset of the other without the IASB providing clear guidance as to which assessment criteria should be used.

    Instead of including 'non-recourse' as a feature of CLI that might lead to confusion as to what requirements in IFRS 9 (i.e. non-recourse or CLI) should be applied, we consider that it would be useful to clarify the key differences between 'non-recourse' and CLI by providing examples that incorporate typical features of non-recourse and CLI used in current practice. See also discussions in paragraph 28 below relating to our comment on the example in B4.1.20A.

    (b) We also suggest the IASB consider changing *'disproportionate allocation of **losses**'* to *'disproportionate allocation of **cash flows**'* in B4.1.20 as the contractual terms of CLI in the market normally set out the holders' right to cash flows instead of losses.

28. A few respondents have the following comments on the example in B4.1.20A:

    (a) The fact pattern is over-simplified as the example does not consider the characteristics of CLI, such as the prioritisation of payments, whether the senior and junior debt instruments are entitled to cash flows from the same specified assets, and whether there is any linkage between the junior and senior debt instruments, before arriving at the conclusion that the transaction does not contain CLI. This may create the confusion that transactions with only senior and junior debt instruments would automatically be assessed as having 'non-recourse' features and not containing CLI.

    (b) It is unclear how the example could be applied to situations where, at inception of the lending arrangement, there are multiple tranches with cash flow entitlements from the same specified assets and a disproportionate allocation of cash flows, but only one tranche is issued to the market and the mezzanine tranche is issued at a later date.

(c) Questions also arise as to whether the classification needs to be re-assessed if the debtor subsequently disposes of the junior tranche of an instrument that has been assessed as CLI at inception.

To clarify the key differences between 'non-recourse features' and CLI, we recommend the IASB consider adding an example with a similar fact pattern as B4.1.20A but in that example there is linkage between the junior and senior tranches and prioritisation of payments, which then requires the entity to apply the CLI requirements. Building on those examples, the IASB can further elaborate whether the classification should be re-assessed when there is a change in circumstances (e.g. the scenarios as mentioned in (a), (b) and (c) of this paragraph) by applying the relevant existing guidance in IFRS 9 where appropriate.

Question 5: Disclosures – Investments in equity instruments designated at fair value through other comprehensive income (FVTOCI)

29. We generally agree with the proposal to expand the disclosure requirements that mandate entities to disclose changes in the fair value of equity instruments, including those instruments that have been derecognised in the reporting period. This aligns with the IASB's objective of providing more transparent and comprehensive information about the performance of equity instruments designated at FVTOCI.

30. Nevertheless, some respondents from the banking industry believe that disclosing the fair value of equity instruments on an aggregated basis instead of an individual basis, as proposed in 11A(c), may obscure relevant information and reduce the understandability of individual equity instruments to users of the financial statements.

Question 6: Disclosures – Contractual terms that could change the timing or amount of contractual cash flows

31. Our respondents expressed mixed views on the proposed disclosures regarding the contractual terms that could change the timing or amount of contractual cash flows. Respondents who agreed with the proposed disclosures considered that the proposal could help users of financial statements to ascertain the impact of a contingent event specific to the debtor on an entity's future cash flows. Other respondents (including preparers from the banking industry) have raised the following concerns:

    (a) Some respondents raised concerns regarding the objective and usefulness of the proposed disclosures as they concentrate solely on contingent events specific to debtors but not others that could also change the contractual cash flows of the financial instruments. They also considered that the lack of clarity on the meaning of 'contingent event specific to the debtor' (refer to our responses to Question 2 above) may lead to inconsistent practices.

    (b) The proposed qualitative and quantitative disclosures would be onerous and costly to implement, especially for entities such as financial institutions that have a large number of financial instruments containing diverse contingent terms that are specific to debtors as well as a myriad of sustainable finance products with various ESG-linked features. The disclosure of quantitative information regarding the range of changes to contractual cash flows resulting from these terms would also be challenging. Hence, the costs of implementing

the proposal may outweigh the benefits that users of financial statements would obtain.

(c) The proposal may overlap with the requirements in the following accounting standards that require entities to provide information about the expected timing and amount of contractual cash flows of financial instruments:
- Disclosure of maturity analysis of financial instruments under IFRS 7 *Financial Instruments: Disclosures*
- Disclosure of information about covenants and how they could affect the settlement of liabilities under paragraph 76ZA of Amendments to IAS 1 *Non-current Liabilities with Covenants*

(d) A respondent questioned the necessity of the proposed disclosures in 20B of the ED for financial liabilities measured at amortised cost, given the origin of the issue relates to the classification of financial assets, not financial liabilities. This respondent was concerned that excessive disclosures could overburden the financial statements which would not be useful for decision making.

(e) Given the concerns raised above, a respondent suggested that the IASB defer the consideration of the proposed disclosures in 20B of the ED to the *Amortised Cost Measurement* project.

32. In light of the above concerns, we recommend that the IASB reconsider the costs and benefits of the proposed disclosures. In particular, it is important to reconsider whether including financial liabilities into the scope of the proposal would bring significant benefits, given other standards have already set out similar disclosure requirements regarding the expected timing and amount of contractual cash flows. If the inclusion of financial liabilities is necessary, we suggest that the IASB clarify how the proposal would interact with other existing disclosures in IFRS 7 and IAS 1.

33. We also recommend that the IASB:

(a) clarify how the quantitative disclosure requirement should be determined if a sensitivity analysis or a quantification of the likely effect of the contingent events is not required (BC103 of the ED); and

(b) provide examples of contingent events that would be captured under the proposed disclosures to clarify which types of financial instruments would be subject to the disclosures.

Question 7: Transition

34. As explained above, some respondents considered that the proposals in the ED might change the classification and measurement of existing financial instruments. They were concerned that the proposed requirements would create significant practical challenges to preparers, especially financial institutions and entities with lending as their main business, as these entities would need to reassess the classification and measurement of all the instruments held. Also, some financial instruments which have been measured at amortised cost might need to be measured at FVTPL under the proposals. It would be challenging for entities to apply the proposals retrospectively.

35. In view of the above, we recommend the IASB first understand and assess the potential impact that would be brought by the proposed requirements to the market

and then further consider the practicability and the extent of retrospective application when developing the transition provisions.

36. In terms of voluntary early adoption of the amendments, we recommend that the IASB consider allowing an entity to early adopt the amendments on the classification of financial assets, without early adopting the amendments on the derecognition of financial liabilities for the following reasons:

    (a) The proposals on the classification of financial asset and the derecognition of financial liability are conceptually separate and they do not interact with each other; and

    (b) The above suggestion would help entities that wish to early adopt the amendments on classification of financial assets for their ESG-linked instruments but need more time to assess the practical implications of applying the exception to derecognise financial liabilities before settlement date under B3.3.8 and to address preparers' concern in changing the long standing diversity in practice as described in paragraph 3 above.

~ End ~