Consultation on IASB Exposure Draft, Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)

Seq.	Request for Comments	HKAB Comments
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?	The industry agrees with the approach to allow an entity to choose whether to derecognise a financial liability that is settled using an electronic payment system when specified criteria are met. However, some banks do not agree on the proposed amendments to achieve the objective. Paragraph B3.1.2A is confusing – it is understood that the intention of the amendments is to allow an earlier derecognition for the liability than settlement date in certain circumstances, but the paragraph refers into the trade date/settlement date accounting paragraph. Whereas, BC25 already acknowledges that settlement of liability should not be confused with the regular way. The statement seems inconsistent with the requirements in paragraph 3.1.1 which require recognition of a financial asset or liability when, and only when, the entity becomes party to the contract and derecognition requirements for assets in paragraph 3.2.3 and derecognition of liabilities in paragraph 3.3.1. The regular way exception is exception to these requirements, but for the sale and purchase of financial instruments under regular way arrangement. It appears that the only asset that could be assessed for trade date accounting in this case is cash. In order to avoid impact to other requirements of the standard, the exception/amendment could be brought in without B3.1.2A and excluding the start of B3.3.8. The amendment could start as "An entity is permitted to deem, by election, a financial liability……." However, the amendment also needs to address derecognition of cash before settlement date, or the recognition of a liability in case of overdraft. B3.3.8 currently only addresses deeming the liability to be satisfied. However, it does not seem to address the corresponding entry. Similar to exception to derecognition rules for trade date accounting, could cover both sides affected. If the criteria includes "a standard administrative period and the time between completing the instruction and the settlement is short", suggest these be included in the requirements themselves in B3.3.8. It is not clear whether the last statement in B3.3.9 "settlement risk would not be insignificant if the completion of the payment instruction is subject to the entity's

Seq.	Request for Comments	HKAB Comments
		ability to deliver cash on the settlement date" should be read in relation to criteria (b) or (c) of the requirements. It is also not clear how entities will assess this in case of uncommitted overdraft situation where they are relying on a bank allowing drawdown on an uncommitted overdraft facility to settle the payment. Uncommitted overdraft is a very common type of arrangement in some markets, so it would be helpful to address. Possibly in the BCs for completeness of discussion. As a practical matter, we are not sure that all bank statements for cash reconciliation show monies 'available for use' after earmarking monies identified for payment settlements submitted as a separate amount from the actual balance. However, it is expected that this is an existing matter for those with the current practice to derecognise on submitting the payment instruction in any case.
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.	Some banks agree with the amendments which provide clear clarification on how to assess loans with ESG features involving contingent event impacting the contractual cashflows. The clarification together with the examples on B4.1.13 and B4.1.14 will definitely be useful for financial institutions to classify financial assets with ESG-linked features. It is suggested to further amend the analysis of B4.1.13 Instrument EA by referring to new guidance in B4.1.8A and B.4.1.10A, in order to clarify in the case of bail-in feature being contractual terms, how the contingent loss absorption of instrument E would still fail SPPI (e.g. the change in contractual cashflow is inconsistent with a basic lending arrangement), as there are IFRS stakeholders may consider the loss could align with the worsening of credit risk of issuer, so questioning why contractual bail-in feature should fail SPPI. Some banks, however, while they welcome the initiative to address the ESG considerations, do not think the amendments as proposed address the matter well, and also create other concerns for assessments of SPPI which go beyond clarifications. In summary: • it is not clear whether to meet SPPI relying on the example, it only requires the change to be related to contingent event specific to debtor or also need to meet the newly inserted criteria of being aligned with the direction and magnitude of the change in the basis for the lending. The reason the query has been raised with IASB is that currently there is challenge establishing the ESG measures direction in relation to credit risk or profit correlation, but the example is silent on this.

Seq.	Request for Comments	HKAB Comments
	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?	• The inclusion of the example without addressing key requirement of the relationship to basic lending risks and costs raises the question over what other debtor specific contingent events could qualify and how much change is still consistent with SPPI. • The inclusion of the contingent event being specific to the debtor implies other contingent events specific to the lender would fail. For example, early termination rights in event of change in tax rules, Increased Cost charges in case of application in jurisdiction. • The inclusion of the narrow definition of what is specific to a lender causes also raised the question on how to now consider contingent events related to the collateral pledged for the loan, as many loans contain various protective measures and triggers of repayment related to the collateral. We assume that it is standard industry interpretation to date that occurrence of contingent event related to collateral would affect credit risk, and therefore changes to the timing and amount of cash flows could be consistent with SPPI under B4.1.10 because of that relationship (acknowledging direction requirement as well). The new criteria also raises the question on whether the terms related to collateral could be considered the debtor achieving a contractually specified target. Standard asset financing transactions include repayment in case of such as total loss of a plane, an insurance event on collateral, the quality of the collateral dropping, etc. • The inclusion of the requirement to consider the magnitude of the change in the basic lending risk or cost will be challenging to prove in practice, and confusing read with the new statement "The assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives". Particularly, the following issues are raised: *Issue 1: There is a need to clarify the principle as to why a change in cash flows due to an ESG factor is consistent with a basic lending arrangement* B4.1.13's proposed example "Instrument EA" states the green loan is SPPI because the contingent event is "specific to the debtor" and the cash flows "are in all circumstances solely payments of principle and interest on the principal amount

Seq.	Request for Comments	HKAB Comments
		outstanding." We think the reason for assertion that the cash flows arising from the contingent event are SPPI is not sufficiently explained. In particular, is unclear why the resulting contractual cash flows are considered SPPI. The proposed IFRS 9.B4.1.8A states "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…" IFRS 9.B4.1.10 continues to state, as it does now, that "the entity must determine whether the contractual cash flows that could arise over the life of the instrument due to that contractual term are [SPPI]." The example "Instrument EA" states the cash flows are changed by a debtor achieving a specified reduction in GHG emissions. It is not clear that, the cash flows are changed in respect of interest rate risk, credit risk, liquidity risk or any other form of what IFRS 9.B4.1.7A describes as a "basic lending arrangement." Therefore, regardless of whether the change was "specific to the debtor" by being related to achieving a target, the debtor has received a change in pricing due to a factor that may be inconsistent with basic lending risks as currently defined by IFRS 9.B5.1.7A. The proposed paragraph B4.1.8A may not be able to resolve this issue, given that as drafted it appears to: • bring into the body of IFRS the notion already included in BC4.182(b); • reword the principle already in B4.1.7A on SPPI cash flows being consistent with a basic lending arrangement with a clarification that market commonality is not determinative; • introduce the relationship of directionality between cash flows and related basic lending risks, which through B4.1.10 and industry interpretation should already being considered. (4) adds a new requirement to consider the magnitude of the change in basic lending risks or costs but does not provide any guidance on this new requirement. ED BC43 provides some illustration that "For a financial asset whose ESG-linked features represent a cost of lending, rather than an exposure to factors unrelated to a basic lending arrangement, the most relevant information [comes from amortised cost measurement]." However, this does not explain how ESG-linked features represent a "cost of lending" related to a basic lending arrangement. As such, the

Seq.	Request for Comments	HKAB Comments
		proposals appear to remain silent on why such changes in cash flows due to ESG factors are consistent with SPPI when many preparers have asked whether it can be met and on what basis given there is not currently supporting for a link to credit risk. At present, "Instrument EA" appears to be more an exception to the requirements, which does not clearly tie into the principles proposed in Appendix B, and would result in entities becoming overly reliant on the example of "Instrument EA", rather than the proposed principles. This contradicts the IASB's intention per ED BC42 that such an exception would not be appropriate. It would be helpful to expand on this statement with explanation of why the resulting cash flows are SPPI, and also to consider reflecting this rationale in the form of a principle within Appendix B (e.g. by changing how a basic lending arrangement is defined in IFRS 9.B4.1.7A). *Issue 2: including a requirement that all contingent events (for the purposes of B4.1.10) must be specific to the debtor is a fundamental change in the assessment.* Paragraph B4.1.10A states "For a change in contractual cash flows to be consistent with a basic lending arrangement, the occurrence (or non-occurrence) of the contingent event must be specific to the debtor. The occurrence of a contingent event is specific to the debtor if it depends on the debtor achieving a contractually specified target, even if the same target is included in other contracts for other debtors." It hence introduces the concept of "contingent events specific to the debtor" as being one criterion of consistency with a basic lending arrangement. The proposals appear to define "specific to the debtor" only as "the debtor achieving a contractually specified target". Furthermore the proposed language, which includes the term "must", implies that all contingent events must be specific to the debtor. A potential issue arises here if a contract contains a term that changes the timing or amount of cash flows but is not linked to a contractually specified target, which nevertheless results in a change in cash flows that are representative of a basic lending arrangement. For example, project finance facilities often have clauses the provide an adjustment to the cashflows in order to cover certain regulatory costs that may be imposed on the entity in respect of that lending "Increased Costs". The ability to on-charge the costs protects the bank's profit margin in the case of the charge applying. Likewise, many loan agreements provide that there is additional payment required as tax gross up to preserve the lender's net receipt, or the lender may be able to early terminate

Seq.	Request for Comments	HKAB Comments
		the loan in case of tax changes affecting its returns. Currently, such clauses can be considered consistent with SPPI because they work to preserve a profit margin (part of basic lending arrangement). However, the clauses are not designed such that a client must meet a "contractually specified target". Hence, there is a risk the current drafting would affect such assessments. A similar issue arises with collateralised lending where there are clauses that can accelerate the repayment of the loan depending on the quality of the collateral underlying the loan. While normally one could consider such collateral issues as related to credit risk of the facility, it is not clear that all such mentioned above still being "specific to the debtor", this would be an issue where "specific to the debtor" is defined only as "the debtor achieving a contractually specified target". It would seem inconsistent with the current requirements of IFRS 9.B.4.1.10 to conclude that such a term results in the loan being non-SPPI. The proposed drafting appears to struggle with such a situation. This may be an issue that could be resolved by drafting how "specific to the debtor" is defined or whether to consider the impact for the creditor as well. Additionally, it is unclear how to apply the direction/magnitude guidance to an ESG linked loan and the interaction with paragraph B4.1.10A regarding contingent event being specific to the debtor – does this mean that even if the contingent event is specific to the debtor, banks would still need to consider whether the change in the interest rate as a result of the customer meeting the ESG target aligns with the direction of change in lending risk or costs? Typically, the interest rate is reduced if the customer meets the ESG target, so does that mean the banks would need to support that there is a corresponding reduction in lending risk or cost? If an entity views such interest rate reduction as an increased cost of holding the asset, then this is not in the same direction and would result in the instrument failing SPPI. In addition, a customer meeting an ESG target may not necessarily mean there is a reduction in credit or other lending risks. A drafting point - 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.' We would suggest IASB to consider whether this should be included paragraph B4.1.10A given it is referring to variability of the cash flows.

Seq.	Request for Comments	HKAB Comments
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?	While some banks generally agree that the amendments provide clearer description of the term ‘non-recourse’, some banks have the following comments: • Not agree to the proposed changes to how non-recourse is described in paragraph B4.1.16A. The new description appears narrow compared to B4.1.16. Currently, the non-recourse considerations could apply where a creditor’s claim is limited to specific assets or cash flows, whether contractually or in substance, and whether over the life of the instrument or on a default. B4.1.16A appears to narrow the definition, as it includes a proposal to limit the assessment to cases where there is contractual recourse to the cash flows of the assets during the life and on default (by use of the word “contractual” and “and”). This leaves it unclear as to what considerations we would otherwise apply in case of either situation (substance or only in event of default for example), whereas the NR considerations can be valid in all cases. • Many facilities currently identified as non-recourse arrangements have payment obligations expressed as “LIBOR + x bps”, and there are rarely terms that stipulate that the lender can only receive cash flows generated directly from the asset through the life of the loan. In particular, the lender may receive cash flows from the borrower’s other operations or the sponsor could put in more equity over the life of the loan, or raise further monies through sub-loans. However, on a default event, there would only be recourse to an asset (e.g. a property) including for any outstanding amounts including unpaid interest. Therefore, non-recourse considerations are relevant for these types of loans. It would be helpful to clarify that it is in substance non-recourse over the life of the financial assets if recourse only in event of default by implication, if this is what is understood to be over the life. It is assumed this is meant to be the case as in B4.1.17A, under which it states that entity may also need to consider factors such as the legal and capital structure of the debtor when applying B4.1.17 which may not necessarily reflect in the contractual terms. • Overall, the proposals do not improve the definition or identification of non-recourse instruments, nor the factors to consider. IASB is suggested to retain the existing language and add some examples of what may be included. For example, non-recourse scenarios in default events with loans to operating entities, and in-substance SPEs where legally it is not non-recourse.

Seq.	Request for Comments	HKAB Comments
		• Factors for determining whether something non-recourse can be SPPI could also include: (a) how the terms of the instrument itself are defined (similar to that of CLI as this would address the road toll case), (b) whether the business objective is to participate in the performance of the underlying; (c) the loan-to-value ratio and expected cash flows needed to repay the loan; (d) whether a third party has contributed equity or subordinated interests that will absorb expected losses; (e) whether there are any features such as margin calls or early termination rights in the terms to protect the LTV or recovery to limit exposure to asset performance risk. • It is also expected that if all the underlying items qualify for SPPI, even if the arrangement is non-recourse, it can qualify for SPPI as well. i.e. for CDO that is not CLI. However, this is not specifically addressed, and the last sentence in B4.1.10A " However, the resulting contractual cash flows must represent neither an investment in the debtor nor an exposure to the performance of specific asset (see paragraphs B4.1.15 – B4.1.16) raises concern on that now. • If non-recourse is being used to describe a category of instruments for testing under the non-recourse tests in B4.1.17A and also as a characteristic of CLIs, it is suggested to be made clear in the requirements that in cases which are both non-recourse and CLI, then the CLI criteria should be applied only, as otherwise the outcome of assessing under both B4.1.17A and B4.1.21 may not make sense. • It is also noted that B4.1.16A states the rights are limited to the cash flows of the asset, and goes on to state that the entity is 'primarily exposed' to the specified asset – but the tests in B4.1.7A are to try and demonstrate that the lender should not be exposed to the assets performance – and hence SPPI. It is suggested to take out primarily exposed sentence as it is not adding to the identification of non-recourse items or the assessment.
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	While some banks are supportive of the move to enhance the description of contractually linked instruments, some banks have the following comments on this section: • For the new insertion, disproportionate allocation of losses, it might be more appropriate to say disproportionate allocation of cash flows of the underlying assets (or shortfalls thereof)….

Seq.	Request for Comments	HKAB Comments
	of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21–B4.1.26 of IFRS 9. The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9. Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?	• The additional clarifications on "contractually linked" do not add more to the ability to distinguish between those instruments that should be assessed under the non-recourse considerations (B4.1.17A) and those to consider under the CLI considerations (B4.1.21). And in particular, the example provided in B4.1.20A does not add to the principles for distinguishing the types on instruments and does not clarify how to consider the senior tranche of note issued if it has prioritisation of cash flows is initially issued out to the market by the issuer consolidated group. • The example does not address in the fact pattern whether the senior and junior debt instruments are entitled to cash flows from the same assets, or whether they have disproportionate allocation of cash flows which are two features used to identify contractually linked instruments. The rationale for concluding that it is not contractually linked, as only one tranche is issued out to single creditor, in our view is not a distinguishing feature between non-recourse and CLI instruments. It also raises further concern on how to use the example or principle in case three tranches with cashflow entitlements from the same assets and disproportionate allocation of cashflows are established at inception, but only one is initially issued outside the Issuer Group and the mezzanine tranche is sold/issued out to the market at a later date. It is expected that in such case that the first issuance would still be considered a CLI. • The following may help to distinguish CLI from other non-recourse instruments: o There are terms and waterfall embedded to allocate the cash flows of the assets. o Cash flows to each tranche is impacted by allocations to the other tranches. o The terms of the instruments provide that payment is conditional on and directly linked to the performance of the underlying. o The only source of cashflows for all payment is from the specified assets. o The 'contractually linked' instruments (group of instruments) are all known at inception and in contemplation of each other (regardless of whether all tranches issued to parties other than sponsor/originator).

Seq.	Request for Comments	HKAB Comments
		○ Any other tranche cannot be inserted into the arrangement to change or re-allocate the rights to the cashflows of the assets underlying without modification of existing tranches ○ Subordination of all the linked instruments compared to each other is in-built into the terms of the instruments at issuance, and may address other claims. ○ Claims are limited in EOD on those assets.
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?	Some banks do not disagree with the additional disclosure requirements on FVOCI equity instruments as they can provide users of financial statements with more comprehensive information. However, it was suggested that the amendments on paragraph 11A(c) may not be favorable for certain users on analysis purposes such as investments by nature, geographical location etc., if the disclosure requirement on fair value of equity instrument is to be on aggregate basis.
6.	*Disclosures—contractual terms that could change the timing or amount of contractual cash flows*	We caution against drafting the proposed IFRS 7.20B in a way that implies the need for excessive granularity. Large financial institutions may have myriad sustainable finance products with various ESG-linked terms. As such, qualitative and

Seq.	Request for Comments	HKAB Comments
	Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C). Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal. Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?	quantitative disclosures related to those features at a granular level could quickly become onerous. For example, the requirement of 20B(b) to disclose quantitative information about the range of changes to contractual cash flows could be very wide and not result in useful information. In our opinion, it is more relevant to disclose how an entity has applied the guidance in B4.1.10-10A, rather than the nature of the contingent event. We think how the entity has applied the guidance in B4.1.10-10A should already be captured by the requirement in IAS 1.117 to disclose material accounting policy information. We also question the need for this disclosure initiative. In particular, we note that, the contingent events that change the amount or timing of cashflows should already be taken into account in the maturity analysis assessment (considering the amortised cost requires consideration of expected future cashflows and expected life) – so users of the financial statements can in theory already see the entity's assessment of contingent events in its maturity analysis. Further, in order to qualify as SPPI, there should already have been consideration that the contingent event does not result in cashflows that are inconsistent with basic lending arrangement. i.e. the cashflows before and after the contingent event should still be SPPI. In addition, the new requirement may bring practical challenges to preparers when quantifying the potential impact of changes in contractual cashflows. We consider that the operational complexity in compiling the information will outweigh the benefit to users of the aggregated information.
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.	We agree on the transitional arrangement. However, we are doubtful about the rationale for the requirement to disclose financial assets that change measurement category given the amendments are supposed to be clarifying amendments according to the BC. The proposed disclosure implies that the IASB expects material changes on transition which is indicative more of a substantive, rather than clarifying, amendment.

Seq.	Request for Comments	HKAB Comments
	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?	