ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

13 July 2023

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(By online submission)

Dear Andreas

RESPONSE TO EXPOSURE DRAFT ON AMENDMENTS TO THE CLASSIFICATION AND MEASUREMENT OF FINANCIAL INSTRUMENTS

The Singapore Accounting Standards Committee (ASC), under the Accounting and Corporate Regulatory Authority (ACRA), performs the function of making or formulation of accounting standards in Singapore, a function previously carried out by the Singapore Accounting Standards Council. We welcome the opportunity to comment on the Exposure Draft on *Amendments to the Classification and Measurement of Financial Instruments* (the ED) issued by the International Accounting Standards Board (the IASB) in March 2023.

We appreciate the IASB's efforts to provide a quick response to the matters arising from the Post-implementation review (PIR) of the classification and measurement requirements in IFRS 9 *Financial Instruments* and related requirements in IFRS 7 *Financial Instruments: Disclosures* and a request to the IFRS Interpretations Committee. Overall, we support the ED as it seeks to clarify certain requirements in IFRS 9 intended to assist entities in the assessment of contractual cash flow characteristics of financial assets, particularly for those contractual terms with features linked to environmental, social and governance (ESG), and accounting for the settlement of a financial liability using an electronic payment system. The disclosure requirements proposed in the ED also have the potential to improve the information an entity provides to its users of the financial statements (users) that is not currently explicitly required in IFRS 7.

Our comments on the ED are as follows:

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?

Subject to our comments below, we are generally supportive of the proposed accounting alternative to derecognise financial liabilities before the settlement date based on a narrow-scope fact pattern that the financial liabilities will be settled with cash using an electronic payment system.

<u>Settlement date accounting</u>

We appreciate the IASB's efforts to clarify the general principle that an entity should apply settlement date accounting when recognising or derecognising a financial asset or financial liability in the proposed paragraph B3.1.2A. To further enhance the application guidance of settlement date accounting, we suggest that the IASB expands paragraph B3.1.6 of IFRS 9 to include how 'settlement date accounting' applies to a financial liability as that paragraph currently only illustrates how it applies to a financial asset.

<u>Proposed criteria to derecognise financial liabilities before settlement date</u>

The IASB used the term "no ability" in proposed paragraph B3.3.8(a) and "no practical ability" in proposed paragraph B3.3.8(b). We suggest that the IASB clarifies the reason for the use of different terms, or to use a consistent term, for example, remove "practical" in the latter paragraph.

We also note that the IASB introduced the term "settlement risk" in proposed paragraph B3.3.8(c), which is defined in paragraph BC33 of the ED to refer to 'the risk that a transaction will not be settled (or completed) and therefore that the debtor will not deliver cash to the creditor on the settlement date'. We suggest that the IASB includes this definition in Appendix A of IFRS 9.

The proposed paragraph B3.3.9 explains that for settlement risk associated with the electronic payment system to be insignificant, the completion of the payment instruction follows a standard administrative process [1] and that the time between initiating a payment instruction and the cash being delivered should be “short” [2]. The last sentence in paragraph B3.3.9 further states that 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. We think that the IASB could clarify that the settlement risk associated with the electronic payment system is only assessed from the entity’s perspective and that the settlement risk is insignificant as long as it is subject to [1] and [2].

On [2], the term “short” is subjective as the standard administrative processing time varies across payment systems and jurisdictions. Accordingly, we think that it would be useful to include in the main text of the proposed amendments that “short” should be read in the context of the standard administrative processing time for the specific payment systems in question.

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?

We agree with the IASB’s approach of proposing clarifying amendments to IFRS 9 to further assist entities in determining whether financial assets – including those with ESG-linked or similar features – have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

It is important for these clarifying amendments to be future proof given that loans with ESG features are growing rapidly with ESG features evolving to take various forms beyond the examples included in the draft amendments to paragraphs B4.1.13 and B4.1.14. Accordingly, we appreciate the IASB's efforts to introduce principles-based clarifying amendments.

With regards to the amendments to clarify how to assess what constitute interest in the context of a basic lending arrangement, we agree with the proposed inclusion of the principle in paragraph BC4.182(b) of the BC on IFRS 9, that focuses on *what* the entity is being compensated for rather than *how much* the entity receives in paragraph B4.1.8A.

However, we have the following comments for the IASB's consideration:

<u>Clarification on 'basic lending risks or costs' and 'direction and magnitude' test</u>

We note that paragraph BC51 of the ED states that the term 'basic lending arrangement' is used in IFRS 9 to refer to the *nature of a lending arrangement* and that the IASB has proposed amendments in the ED to clarify certain classification principles. However, it remains challenging to determine whether lending arrangements with ESG-linked features are consistent with basic lending arrangements.

The "direction and magnitude test" are new terms proposed to be introduced in IFRS 9. Paragraph BC52 of the ED explains that the IASB is proposing to introduce these terms to clarify that, for contractual cash flows to be consistent with a basic lending arrangement, a change in contractual cash flows has to be directionally consistent with, as well as proportionate to, a change in lending risks or costs. For example, an increase in the credit risk of a borrower is reflected in an increase, and not a decrease, in the interest rate of the financial asset. The latter example provided by the IASB may be easy to understand in a situation when the instrument is 'basic' or 'plain vanilla' where the changes in contractual cash flows commensurate with time value of money or credit risk. However, applying the direction and magnitude test to loans with ESG-linked features may not be as straightforward given that the changes in contractual cash flows associated with ESG-linked features and basic lending risks, such as credit risk, may not be that direct or clear cut.

We are of the view that IASB should provide additional application guidance relating to the direction and magnitude test for lending arrangements with ESG-linked features as it is not always obvious what the ESG element(s) aims to compensate. For example, in some circumstances, ESG-linked features could be included in lending arrangements to protect (or compensate) the lender against the borrower's financial and reputational risks when a significant event with an adverse ESG impact occurs (ESG event). In such an ESG event, even though the borrower may meet all the ESG targets, the lender may choose not to apply the margin adjustment or introduce a penalty on the borrower. In such situations, it may be challenging to determine whether the changes in cash flows relating to the ESG-linked feature are consistent with basic lending risks or costs.

We think that the IASB should also clarify the interaction of the direction and magnitude test with the qualitative and/or quantitative assessment in existing IFRS 9 requirements. For example, should an entity consider the direction and magnitude test when it applies paragraphs B4.1.9B and B4.1.9C of IFRS 9 in performing a qualitative or quantitative assessment (e.g., benchmark cash flows test) of the modified time value of money, and whether this may result in unintended consequences of existing SPPI instruments failing the SPPI requirements.

<u>Contingent event that must be "specific to the debtor" may have unintended consequences</u>

We note that the contingent events included in lending arrangements may not always be specific to the debtor; hence, including such a condition in the proposed paragraph B4.1.10A could risk unintended consequences. We think that including such a condition in the proposed paragraph B4.1.10A would result in a new requirement in IFRS 9 rather than a clarification of the existing requirement in paragraph B4.1.10 of IFRS 9, which considers the nature of the contingent event, as an indicative factor, that could change the timing or amount of the contractual cash flows.

For lending arrangements with ESG-linked features, we understand that in practice, the contingent event (ESG target) may not always be specific to the debtor (borrower). For example, when the borrower is a funding entity responsible for borrowing funds on behalf of its Group, the ESG target could be set to be met by the entire Group. In other cases, the ESG target could be linked to Scope 3 emissions, where the ESG target would be met by the entities within the value chain of the borrower/Group. In such scenarios, following the literal interpretation of the proposed paragraph B4.1.10A, it is counterintuitive that lending arrangements with similar nature of contingent events but to be met by different contractually specified parties, would have different classification outcomes.

Therefore, we recommend that the IASB undertakes careful consideration and to avoid unintended consequences, carries out research on whether there are other changes in contractual cash flows arising from contingent events, whether or not specific to the debtor, that could potentially fail SPPI requirement upon the introduction of the proposed paragraph B4.1.10A.

We also suggest that the IASB considers clarifying the interactions between proposed paragraph B4.1.10A and B4.1.12 of IFRS 9, whether the contingent event that must be specific to the debtor would be applicable to those contingent events associated with the time value of money and prepayment features, consistent with paragraph BC69 of the ED.

<u>Additional examples</u>

We recommend that the IASB expands the analysis for the examples included in the draft amendments to paragraphs B4.1.13 and B4.1.14 to explain how the direction and magnitude test is applied. The current analysis only illustrates whether the contingent event (achieving a contractually specified reduction in greenhouse gas emissions) is specific to the debtor. We also recommend that the IASB includes more complex examples of lending arrangements with ESG-linked features to assist entities to apply judgement in relation to the proposed paragraphs added in B4.1.8A and B4.1.10A.

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?

We appreciate the IASB’s efforts to clarify the meaning of non-recourse features and to provide examples of the factors that an entity may need to consider when they perform the ‘look through to’ assessment required in paragraph B4.1.17 of IFRS 9.

Nonetheless, we have the following comments:

We think that the proposal in paragraph B4.1.16A of ‘*both* over the life of the financial asset *and* in the case of default’ appears to be more restrictive than the current practice. Moreover, we think that the IASB should clarify that an entity is required to consider the cash flows from recovery under default only in the case of financial assets with non-recourse or limited recourse features as cash flows from recovery under default are not typically considered in the assessment of contractual cash flow characteristics over the life of the instrument.

We agree with the example in paragraph BC76 of the ED for non-recourse features structured as a loan to a special purpose entity (SPE) with specified assets, that an entity would often ‘look through to’ the underlying assets to assess whether the SPE has sufficient equity for loss absorption capacity. However, we think that the wordings in the proposed paragraph B4.1.16A, as italicised, that requires cash flows must be limited to the *cash flows generated by specified assets*, may cause a different interpretation of the proposed paragraphs B4.1.17A and B4.1.17A(b), that the subordinated debt or equity instruments issued by the debtor may not be perceived as cash flows generated by the specified assets. Depending on the feedback received on this ED, we suggest that the IASB revisits the words in italics.

Question 4—Classification of financial assets—contractually linked instruments
The draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9, and the proposed addition of paragraph B4.1.20A, clarify the description of transactions containing multiple contractually linked instruments that are in the scope of paragraphs B4.1.21– B4.1.26 of IFRS 9. The draft amendments to paragraph B4.1.23 clarify that the reference to instruments in the underlying pool can include financial instruments that are not within the scope of the classification requirements of IFRS 9. Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?

We are supportive of the clarification in paragraph B4.1.20 which specifies the characteristics of contractually linked instruments (CLI) and the implicit clarification in B4.1.20A that an instrument must have all the characteristics in B4.1.20 to fall within the scope of the CLI requirements in paragraphs B4.1.20 to B4.1.26 of IFRS 9 (CLI guidance). We consider that these proposals would help an entity to determine whether an instrument would fall within the scope of the CLI requirements.

We are also supportive of the clarification in paragraph B4.1.23 and the IASB's rationale in paragraph BC92 of the ED that financial instruments that are not within the scope of the classification requirements of IFRS 9 (e.g., lease receivables) can be included in the underlying pool of financial instruments when an entity applies paragraph B4.1.23.

However, we have the following comments:

We appreciate the IASB's effort in providing an example on secured lending arrangement in paragraph B4.1.20A with the intention to distinguish between multiple debt instruments that do not have all of the characteristics of CLI described in paragraph B4.1.20 from a CLI. We think that including the explanation in paragraph BC85 of the ED, that "the phrase 'contractually linked' refers to a transaction for which the relationship between, and the rights and obligations associated with, the different tranches – including the order in which cash flows are allocated – are specified in the contractual terms of the instruments", in the main text of the proposed amendments would help to strengthen the characteristics of CLI in B4.1.20 and differentiate between CLIs and financial assets with non-recourse or general subordination characteristics. Therefore, we suggest that the IASB includes this sentence in the main text of the proposed amendments.

Moreover, if the IASB finalises the amendments in the proposed paragraphs B4.1.16A to B4.1.17A on non-recourse (non-recourse guidance), we suggest that the IASB provides clarity in the last sentence of B4.1.20, that if particular tranches of a CLI have non-recourse features, whether an entity should apply the non-recourse guidance to those tranches rather than the CLI guidance.

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?

We are generally supportive of the disclosure proposals to disclose the aggregate fair value of equity instruments and changes in fair value presented in OCI during the period on the basis of the IASB's rationale.

Question 6—Disclosures—contractual terms that could change the timing or amount of contractual cash flows
Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C). Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale

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

We can appreciate the IASB's decision not to limit the disclosure requirement to only financial instruments with ESG-linked features and we are supportive of having disclosure requirements to satisfy the users' informational needs to understand the effect of contractual terms that could change the timing or amount of the contractual cash flows of these financial instruments.

However, we have the following concerns:

Clarification on the scope of the proposed disclosure

We think that the term "contingent event" is broad and that more clarity is required to explain the scope of the proposed disclosure in paragraph 20B, whether and how the proposed disclosure requirements would apply to a contingent event that must be specific to the debtor and other types of contingent events, that may or may not be specific to the debtor, such as those arising from prepayment options, extension options, or events that change the contractual cash flows through a change in control event, a change in tax laws, or lender's adjustment in interest rate.

We suggest that the IASB engages the users on what information they need and whether it relates to changes in contractual cash flows arising from lending arrangements with ESG-linked features. If it is the latter, the IASB could consider to introduce a specific disclosure objective for the proposed paragraph 20B to cater for lending arrangements with ESG-linked features.

Proposed disclosure is unclear

We think that the proposed disclosure is unclear given that in a typical lending arrangement, there may be more than one type of contingent event which makes it challenging for entities to determine what, and how to aggregate or disaggregate, information required by the proposed paragraph 20B that would strike a balance between providing useful information to the users over the costs of preparing such information.

It is also unclear how an entity could provide the quantitative information about the range of changes to contractual cash flows, and whether an entity is required to make assumptions and factor in all different permutations of a contingent event occurring (or not occurring) over the life of the instrument. Without more guidance on what is required of the proposed disclosure, it could undermine the comparability and usefulness of the information provided.

Given that lending arrangements with ESG-linked features are growing rapidly, we urge the IASB to prioritise and resolve the matters on classification and measurement of financial assets with changes in contractual cash flows arising from contingent events. For loans with ESG-linked features that meet the SPPI requirement and are classified as financial assets measured at amortised cost, the IASB should resolve the issues highlighted by stakeholders from the PIR on the application of effective interest method to reflect the changes in cash flows arising from contractual terms with conditionality or contingent features in its pipeline project on amortised cost measurement.

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?

We are generally supportive of the transition requirements on the basis of the IASB's rationale.

We hope that our comments will contribute to the IASB's deliberation on the ED. Should you require any further clarification, please contact our project manager Yu Shan Koo at Yu_Shan_Koo@acra.gov.sg.

Yours sincerely

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