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International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
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Dear Board Members,

RESPONSE TO EXPOSURE DRAFT – Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7) ("ED")

For this ED, ISCA sought views from its members through a two-month public consultation and from the ISCA Financial Reporting Committee which comprises experienced technical professionals from audit firms, preparers of financial statements and other stakeholders.

We welcome and support the IASB's efforts in addressing the concerns that stakeholders raised during the Post-Implementation Review (PIR) of the classification and measurement requirements in IFRS 9 and related requirements in IFRS 7, as well as from the request made to the IFRS Interpretations Committee.

We generally support the proposals put forth for the various topics set out in the ED except for the proposals in relation to the derecognition of financial liabilities through electronic transfer, which in our view, are excessive.

We consider electronic payment to be a mode of payment which is not dissimilar to traditional settlement methods such as cheques, and that the typical bank reconciliation procedures performed at the end of the reporting period should suffice in addressing the concern of whether a financial liability is settled. Hence, there is no need for the paying entity to expend significant efforts and resources to verify that the criteria for the derecognition of the financial liability is met. In this respect, we would like to urge the IASB to reconsider the proposals in this area. Please refer to our response to Q1 for more details.

Our detailed comments to specific questions in the ED are set out below.

ED 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?

The IASB has proposed:

(i) clarifying that the concept of 'settlement date' should be used in recognising and derecognising financial assets and financial liabilities; and
(ii) developing new requirements to permit an entity to deem a financial liability is settled using an electronic payment system to be discharged before the settlement date if specified criteria is met.

For (i), the IASB has proposed in paragraph B3.1.2A that 'settlement date' accounting is also applicable to recognition of financial assets or financial liabilities. This proposed change may have much wider implications such as to the timing of recognition of derivative contracts – for the example in paragraph B3.1.2(c), the forward contract is off balance sheet and the transaction is recorded on settlement of the

forward; for the example in paragraph B3.1.2(d), the option is off balance sheet and company only accounts when the option is exercised and settled. We suggest for the IASB to clarify how the derivative contracts in these examples should be accounted for based on the revised paragraph B3.1.2A.

For (ii), our view is that they are excessive.

In our view, electronic payment is not dissimilar to traditional payment settlement methods such as cheques. For cheque payments, the paying entity will typically derecognise the payable as well as cash at bank when the cheque is sent out to the recipient. As the actual settlement usually takes place several days later, the paying entity will track the timing difference via bank reconciliation procedures at the end of the reporting period. The settlement of such pending cheques is also verified by checking subsequent bank statements. The paying entity does not need to expend efforts and resources to deem a financial liability is settled.

For electronic payments, we understand that the paying entity will derecognise the financial liability when it has instructed the bank to transfer the cash to the recipient bank (say 31 December 2022). This is because the 'value date' of that cash payment will be on the same date (that is, 31 December 2022) even if for administrative reasons, the cash is only received in the recipient bank several days later. The paying entity will similarly track the timing difference via bank reconciliation procedures and verify the settlement of such pending payments to subsequent bank statements. There is no need for the paying entity to expend significant efforts and resources to verify that the criteria for the derecognition of the financial liability is met (see below).

Impracticality and excessive work for low-risk area

For the reporting entities, it will be impractical to individually assess that the settlement risk associated with the banks' electronic payment system is insignificant. It will be particularly challenging to assess if payments are made to overseas recipients and correspondent banks may be used by the entity's bank to assist in the settlement process. The entity may not even be privy to such arrangements by its bank.

For the auditors, they will be expected to perform additional verification work to ensure that an entity has met the derecognition criteria. However, since payment instructions are typically executed only when the entity has sufficient funds for the payment to be made and the settlement can be easily verified to subsequent bank statements (see above), this is typically considered a low-risk area. The additional efforts required do not commensurate with the risk level in this area.

In view of the above, we urge the IASB to reconsider the proposals in this area.

ED 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?

(a) Need to consider different elements of interest and to focus on 'what' the entity is compensated for and not 'how much' compensation it receives

The proposed paragraph B4.1.8A states that even if a particular contractual term is common in the market, cash flows are inconsistent with a basic lending arrangement if they "include compensation…that are not typically considered to be basic lending risks". We would like to urge the IASB to clarify what would be considered basic lending risk if the contractual term that is common in the market is not typically considered to be basic lending risk.

In addition, there appears to be a contradiction between the requirement of not focusing on 'how much' compensation the entity receives and the requirement in the last sentence of the proposed paragraph B4.1.8A to assess the "magnitude" of the changes in basic lending risks.

(b) Occurrence (or non-occurrence) of contingent event must be assessed irrespective of probability of occurrence and that the event must be specific to the debtor

The proposed paragraph B4.1.10A requires that the probability of a contingent event is not considered when assessing the changes in contractual cash flows on occurrence of a contingent event and the IASB goes on to clarify that non-genuine contractual terms (as described in existing paragraph B4.1.18) should not be considered. We would like to suggest for the IASB to also clarify if the 'de-minimis' rule from the same paragraph is applicable here.

The guidance in the proposed paragraph B4.1.10A states that contingent events that can change the timing or amount of cash flows can meet the SPPI test if they are 'specific to the debtor'. We would like to suggest the IASB to provide further clarification of "debtor". For example:

(i) a loan with such contingent event features has been granted to the parent entity and is based on the attainment of ESG targets for the whole group. Will this be interpreted as the contingent event is "not specific" to the debtor if the ESG target is set for the whole group rather than just for the borrowing entity itself?

(ii) a loan with ESG targets for reduction of scope 3 GHG emissions. Such targets are indirect emissions that occur in the value chain of the entity (but not directly emitted by the entity). Will this be interpreted as "specific" to the debtor because these are targets of the debtor or "not specific" to the debtor as they are not direct emissions by the debtor but by parties in the debtor's value chain? Since scope 3 emissions are typically very significant, it would be helpful for the IASB to clarify this for avoidance of doubt.

(c) Proposed illustrative examples

We welcome the inclusion of the proposed illustrative examples to aid entities in applying the principles. However, we note that for the illustrative example in the proposed paragraph B4.1.13, the fact pattern indicates that "…interest rate that is periodically adjusted by a specified number of basis points if the debtor achieves…". For the avoidance of doubt, we would suggest for the IASB to clarify whether the 'specified number' means that the adjustment has to be fixed, or if the instrument still passes the SPPI test if only the methodology for determining the quantum of the adjustment is specified in the loan documentation.

However, the current analysiss does not clearly explain how the conclusions were reached (e.g. Instrument EA under B4.1.13 - it is not clear how the contractual cash flows arising from the occurrence or non-occurrence of the contingent event are in all circumstances SPPI). It is also unclear why the contractual cash flows represent neither investment in the debtor nor an exposure to the performance of specified assets. If the rationale is that the change in cash flows is due to a fixed increase in basis points and not based on changes in the GHG emissions, we would recommend clarifying this in the example's analysis.

ED 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 note that paragraph B4.1.16 includes the example that "if the contractual terms stipulate that the financial asset's cash flows increase as <u>more automobiles</u> use a particular toll road, those contractual cash flows are inconsistent with a basic lending arrangement…" We would like to suggest the IASB clarify if this assessment will change if the increase in the financial asset's cash flows is based on a 'fixed increase' (or 'stepped fixed increases, for instance, by blocks) as compared to if the increase is just based on the increase in automobiles.

We agree with the proposed paragraph B4.1.17A as it helps with the application of the SPPI requirements for non- recourse assets, especially for instances where loans are made to SPVs to purchase a single asset. However, more clarity is required for the requirement in the proposed paragraph B4.1.17A(b). We are of the view that it is unclear as to the rationale for including this, which requires an assessment as to whether any shortfall in cash flows generated by the underlying asset is expected to be absorbed by subordinated debt or equity instruments issued by the debtor. While subordinated debt and equity holders may cushion the losses initially, this does not result in the generation of additional cash flows for the entity. We would like to suggest the IASB to include in the Basis for Conclusions the rationale and thought process for including the proposed paragraph B4.1.17A(b).

ED 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 note that the proposed paragraph B4.1.20A includes the example of the entity (the creditor) entering into a secured lending arrangement whereby the sponsoring entity (the debtor) establishes a structured entity which issues senior and junior debt instruments; and the debtor holds the junior debt instrument. In this example, the assessment is that the transactions do not contain multiple contractually linked instruments because the structured entity is created to facilitate the lending transaction. However, we understand that there are structures in practice where the junior and/or mezzanine debts are initially held by the sponsoring entity but subsequently sold to third-party investors. As such, we would like to suggest the IASB to consider clarifying if the assessment will change for such structures if the plan for such transactions is to securitise the different tranches but the entity may require time to divest the tranches.

Additionally, it would be helpful if the IASB could clarify the following:

(i) whether the assessment in this example is based on the assumption that the sponsoring entity consolidates the structured entity (and hence, the consolidated group is the debtor); and

(ii) whether the assessment will be different in the separate financial statements of the sponsoring entity if it holds an investment in the junior debt of the structured entity.

We note that the proposed revised paragraph B4.1.23 includes the example of 'lease receivables that have contractual cash flows that are equivalent to payments of principal and interest on the principal amount outstanding'. We are concerned that this example may result in entities interpreting that any tranche linked to an underlying pool that include lease receivables will 'automatically' have cash flows similar to payments of principal and interest on the principal amount outstanding. Hence, we like to suggest the IASB clarify that there are situations where lease receivables may not be equivalent to payments of principal and interest on the principal amount outstanding and include examples of such situations in the standard. Some examples could include finance lease receivables that are subject to residual value risk, and leases with variable lease payments that may be linked to an index. It would also be helpful if the IASB could clarify whether typical lease features such as deposit components or reinstatement clauses that may result in contingent cash flows could result in lease receivables not being equivalent to payments of principal and interest on the principal amount outstanding.

ED 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?

The proposed revised paragraph 11A(c) requires the disclosure of an aggregate fair value of equity instruments at the end of the reporting period. We note that a similar requirement already exists in paragraph 8(h) where entities are required to disclose the aggregate fair value of equity instruments at FVOCI. Hence, we would like to suggest the IASB to consider removing the proposed revised paragraph 11A(c) in its entirety.

For the proposed paragraph 11A(f), we would like to highlight that most entities already disclose this information in the SOCE as the transfer from fair value reserve to retained earnings upon disposal is shown.

ED 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 are of the view that more clarity is required to explain whether the scope of this disclosure includes prepayment and/or extension options. Based on a strict reading of the wording, it appears that prepayment and extension options are included, as the contingent event is whether or not the borrower/lender exercises

the option. Such clauses are common in loan agreements, and disclosure of such clauses may not be meaningful.

The proposed paragraph 20B requires “quantitative information about the range of changes to contractual cash flows that could result from those contractual terms”. More guidance in terms of what quantitative information need to be disclosed will be useful to aid comparability.

For instance, are entities expected to compute the difference in interest income with and without the contingent event and disclose the difference? If yes, what time period should the disclosure extend to? For instance, a loan with such features can have a tenor of 5 years, with a yearly review to determine if the specified targets are met. Is the disclosure based on meeting the target for all 5 years vs not meeting the target for all 5 years, or only for a 1 year horizon?

We understand the IASB’s view to not design requirements specific to financial instruments with ESG-linked features as “contingent events” can be very wide and cover multiple scenarios. The requirement to disclose the type of contingent event, along with the range of change to contractual cash flows can result in undue cost and effort. Also, enhancements to existing systems may be required as such data might not be readily available in systems. We urge the IASB to reconsider the benefits and costs of the new proposed requirement or to limit the scope of disclosure to contingent events that meet a certain level of probability.

Should you require any further clarification, please feel free to contact Ms Felicia Tay at felicia.tay@isca.org.sg or Ms Jezz Chew at jezz.chew@isca.org.sg.

Yours faithfully,

Mr Wai Geat, KANG
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