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International Accounting Standards Board
IFRS Foundation
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18 July 2023

Dear Board members,

Invitation to comment – IFRS Standards Exposure Draft IASB/ED/2023/2 Amendments to the Classification and Measurement of Financial Instruments.

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the International Accounting Standards Board's (IASB or the Board) Exposure Draft ED/2023/2 Amendments to the Classification and Measurement of Financial Instruments. Proposed amendments to IFRS 9 and IFRS 7 (the ED).

We support the Board's efforts to develop guidance as a result of the feedback received as part of the IFRS 9 Post Implementation Review (PIR). We appreciate the urgency with which the IASB has developed proposed solutions to the issues identified during the PIR.

We would like to highlight the following observations for the Board to consider:

- We appreciate the IASB's decision to cover the recognition and derecognition of financial assets and liabilities in an Exposure Draft (ED) rather than to have confirmed the decision of the IFRS Interpretations Committee (IFRS IC) in September 2022. The significance of this matter is more appropriately dealt with as an amendment to IFRS than a decision by the IFRS IC.
- We believe that the recognition and derecognition amendments which highlight settlement date accounting as the default treatment for the recognition and derecognition of financial assets and financial liabilities, could be better integrated into the existing IFRS 9 requirements and would benefit from further explanation.
- We recommend that for the recognition and derecognition amendments, entities should be able to apply them from a different date to the other amendments proposed in the ED. This is because entities may need a significant length of time to implement the recognition and derecognition amendments, whereas they may be able to implement the other amendments earlier.
- We support the proposal to introduce an optional exception to settlement date accounting for financial liabilities settled via certain electronic payment systems, as a practical response to comments received on the IFRIC draft decision.
- We support the approach taken by the IASB to tackle the urgent challenges posed by the increasing importance of including ESG linked features in financial assets. We consider that the proposed changes to how the characteristics of contractual cash flows are assessed for their consistency with a basic lending arrangement will meet the main concerns in accounting for these features. We make some suggestions for how the proposals could be improved.

- We suggest that the proposed disclosures in relation to contractual terms that could change the timing or amount of contractual cash flows, should focus only on instruments with features of contractual cash flows that relate to a contingent event and not those that provide compensation for basic lending risks or costs.

- We support the other proposed amendments with respect to non-recourse features, contractually linked instruments and the disclosures for equity instruments designated at fair value through other comprehensive income. We have some suggestions for how these proposals could be improved.

Our responses to the specific questions in the ED are provided in the Appendix.

Should you wish to discuss the contents of this letter with us, please contact Michiel van der Lof at the above address or on +31 88 407 1030

Yours faithfully

Ernst + Young Global Limited

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Appendix – responses to specific questions

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?

Amendments to clarify the use of settlement date accounting in B3.1.2A

1. The proposed amendment in B3.1.2A has the potential to be a significant change for entities that currently follow the practice of adjusting their cash balances at the reporting period end for payments in-transit. For these entities, the time required to implement the change may be significant, particularly if their practice is long-established and they use multiple payment systems across different jurisdictions. In light of this, we recommend that entities are able to apply the derecognition amendments at a different time from the other changes proposed in the ED. This would allow entities more time where needed to transition to settlement date accounting, whilst being able to apply earlier the other amendments proposed in the ED. We discuss this point further in our response to question 7 below.

2. We understand that the inclusion of paragraph B3.1.2A is intended to resolve the questions on the derecognition of financial assets that were first brought to IFRS IC in September 2021. We recommend that as the IASB considers the responses received to the ED, it completes its discussions on the tentative agenda decision by IFRS IC and includes its conclusion in the Basis for Conclusions (BC) of the final amendments. This will make clear that the questions brought to IFRS IC have been resolved.

3. We note that proposed paragraph B3.1.2A cross references existing paragraph B3.1.6, which describes settlement date for financial assets in the context of regular way purchases and sales. There is no equivalent guidance in IFRS 9 for the settlement date of financial liabilities. We suggest that further explanation is added for financial liabilities and financial assets which describes how settlement date accounting is applied. In particular, we recommend that a new definition is added to Appendix A, Defined terms, for settlement date, based on the existing description in B3.1.6 (which could then be removed). The definition could be as follows:

   Settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to: (a) the recognition of an asset on the day it is received by the entity; and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity.

4. For financial liabilities, BC16 in the ED refers to paragraph B3.3.1 and states that a financial liability is extinguished when either an entity is legally released from primary responsibility for the financial liability, or when the entity's contractual obligation is discharged through payment (upon delivery of cash or another financial asset by the entity on settlement date. This wording is more specific than is currently in B3.3.1 and helpfully clarifies the principle that derecognition occurs on settlement date. We, therefore, suggest B3.3.1(a) is amended to the following:

(a) *discharges the liability (or part of it) normally upon delivery of cash, other financial assets, goods or services by the entity on settlement date.*

5. We suggest that IAS 39 IG D1.1. *Recognition: cash collateral*, provides helpful guidance for when cash should be recognised and derecognised. It highlights that this is when the economic benefits of the cash transferred can be realised by the receiving entity, which corresponds to the time when the paying entity should derecognise the cash. We suggest that this could be helpfully included in section 3.1 Initial recognition, potentially as an additional paragraph B3.1.2B.

Derecognition of a financial liability settled through electronic transfer

6. We agree with the proposal to allow an accounting policy choice for financial liabilities settled using an electronic payment system and recognise the potential benefit. We consider that it is helpful in addressing some of the concerns with respect to the impact of moving to a full settlement date approach for the derecognition of financial assets and financial liabilities. We note that this concern was identified in feedback to the IFRS IC discussion when they first discussed the question in September 2021.
7. For the purpose of the double entry when the accounting policy election is taken and the financial liability is derecognised, the amendments would benefit from stating what the credit entry should be. Whilst B.3.3.8(b) could be understood to support the cash being derecognised because the cash is no longer available for the entity to use, this is not explicit and different interpretations are possible. We, therefore, suggest it would be helpful to clarify that the credit entry is to cash when the conditions under the election have been met to derecognise the financial liability.
8. We believe that the wording in paragraph B3.3.8(a) should be amended from when the entity has 'no ability to withdraw stop or cancel the payment' to be when the entity has 'no *practical* ability to withdraw, stop or cancel the payment'. We understand that the exception is only allowable when the entity is irrevocably committed to the payment. We are concerned that, as proposed, a full legal analysis would be required to identify at precisely what stage there is absolutely no ability for the paying entity to cancel the transaction.
9. There is some uncertainty over the precise meaning of terms introduced by the amendments, for which a definition or further explanation would help avoid confusion and support consistent application. They include 'electronic payment system' and 'short' for the time between payment instruction and the cash being delivered. We note that it may be difficult to define a time period that is 'short', but it may be useful to clarify if the Board is referring to days rather than weeks (like the trade date accounting election). For defining electronic payment systems, a key consideration could be that once initiated, the settlement process operates automatically and does not require any further human intervention by the payor.
10. The last sentence of paragraph B3.3.9 appears unclear because the existence of such a settlement risk would seem to contradict B3.3.8 (a) and (b). BC34 focuses on the completion time only. We suggest it may be helpful to further explain the concept with an example or, alternatively, to remove the sentence.

    No equivalent accounting policy election is proposed for financial assets. We understand that this is because when the IFRIC reached the agenda decision in September 2022 there was no challenge to the technical basis for the decision for financial assets, only practical concerns over the widespread existing practice and impact for financial liabilities settled with electronic payment systems. The exception is to deal with this practical issue only, with no equivalent exception for financial assets. We suggest that an explanation is added to the BC for why an equivalent accounting policy election for financial assets has not been provided, to address the question that will otherwise arise.

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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?

1. We agree with the proposals and consider that they are an appropriate addition to the guidance in IFRS 9 for how to assess whether assets have contractual cash flows that are solely payments of principal and interest (SPPI). However, we suggest some clarifications to what is proposed would be beneficial, which we describe below.

2. We suggest the articulation between B4.1.8A and B4.1.10A is improved to make clear how these paragraphs should be applied. We consider that they are meant to be complimentary rather than representing separate assessments. In particular, B4.1.8A provides general guidance on basic lending features for which the entity is compensated, whilst B4.1.10A applies to contingent cash flows, which are not basic lending features. For example, B4.1.7A identifies other basic lending risks and costs that would be consistent with SPPI, including administrative costs. Normal adverse costs clauses are consistent with a basic loan arrangement and the elements of interest that provide compensation for basic lending risks or costs as described in B4.1.8A, so do not cause the loan to fail SPPI. Another example is floating interest rates, which a very large number of instruments reference. BC 67 states that "… a change in contractual cash flows due to a contingent event that is specific to the creditor or another party, would be inconsistent with a basic lending arrangement". This could be seen to apply to floating interest rates, but they are obviously a basic lending feature as they compensate the lender for the time value of money, so are assessed under B4.1.8A. Paragraph B4.1.10A deals with other contingent features such as those which relate to ESG-linked targets that do not compensate the lender for basic lending costs or risks.

3. Where a legal entity has a loan containing a trigger that relates to the performance by the group as a whole against ESG targets, under the proposals in the ED, the loan would not be SPPI for the lender. This is because B4.1.10A requires that the contingent event must be specific to the debtor, which would not be the case where the target references other group entities instead of, or in addition to, the actual entity within the group that has entered into the loan. This approach may not result in the reporting of useful information where a loan is made to an entity comprising a group of legal entities, because ESG related targets are often

set and monitored on a group-wide basis. We suggest that where the borrower is an entity controlled within a group, any group-wide targets that the loan references should be considered specific to the debtor. We recognise that it would not be appropriate to introduce an amendment which allows targets that apply to the group to automatically pass SPPI. We, therefore, suggest that the relief applies only to the contractual terms that change the amount or timing of cash flows dealt with by B4.1.10A and not to the elements of interest covered by paragraph B4.1.8A.

4. We consider that the sentence in B3.1.8A that refers to 'direction and magnitude of the change' is potentially problematic. It introduces a new quantitative assessment which did not previously exist and it is unclear exactly what the phrase means and how it would be applied in practice. It is not clear whether the assessment of direction and magnitude should be done qualitatively, quantitatively or with some combination of the two. There also appears to be a contradiction between a requirement to not focus on 'how much' compensation in the beginning of the paragraph B4.1.8A and the requirement to assess the 'magnitude' of changes in basic lending risks and costs at the end of the same paragraph. In addition, it is not clear how this new concept interacts with the existing requirements in B4.1.9, which describe how leverage can cause instruments to fail SPPI. We, therefore, suggest that the concept should be explained further or be deleted.

5. The examples provided in paragraphs B4.1.13 and B4.1.14 would be more useful if they covered the areas of judgement introduced by the ED. They currently only explore characteristics which fall within the requirements of B4.10.A. It would be helpful if they could distinguish between adjustments relating to basic lending risks and costs covered by B4.1.8A, versus those which are more specific and fall within the requirements of B4.1.10A. One or more additional examples could also help explain the 'direction and magnitude' concept if it is retained.

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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?

1. We agree with the proposals but suggest some further minor clarifications that would be helpful, as discussed below.

2. It appears that B4.1.16A would now exclude from the non-recourse guidance, a Purchase of Credit Impaired (POCI) loan which does not have contractual non-recourse features but is 'de facto' non-recourse because the collateral is now the only source of the expected recovery. It would be helpful if it can be clarified in the BC whether this is the IASB's intended outcome. We note that B4.1.16A has the effect of emphasising that the arrangement should be contractually explicit that it is designed with non-recourse features in order to be considered non-recourse. We are of the view that de facto recourse may still be interpreted as being possible, but the ED is not clear on this point. For example, we suggest that for POCI assets the analysis should consider whether there is only a contractual right to the assets, rather than whether or not it is considered likely that there will be payment from the collateral.

3. In B4.1.16A, it is unclear if the reference to 'the life' of the asset refers to the contractual life or if this could be the life from the acquisition date (which possibly is not the origination date). It would be useful to clarify this point. We consider that the IASB originally intended for the reference to be to the contractual life when the loan was entered into, so this should be clarified in the final amendments.

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?

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1. We agree with the proposals but suggest some further minor clarifications that would be helpful, as discussed below.

2. The IASB should clarify that the reference to 'de minimis' in B4.1.25 can be applied at the level of the entire pool of underlying assets and not only at the level of each individual underlying asset. This would explicitly permit a wider application of the de minimis requirements which we think would be helpful, and it would improve the wording in this regard.

3. There was helpful discussion in the Staff Papers for the IASB meetings in September and November 2022, which covered the background to the proposed amendments for CLI requirements and how they should be applied.[1] We recommend that more of the detail from those papers is included in the amendments to provide additional clarity, either in the final amendments or the basis for conclusions.

4. The proposal in B4.1.20A identifies when a structure is created to facilitate a lending transaction from a single creditor. We observe that a consideration in applying the proposed approach relates to understanding the design and purpose of the structure. Given the importance of this assessment, we suggest that additional clarification is provided to highlight the judgement required in this instance.

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?

1. We agree with the proposals, but suggest some minor clarification that would be helpful, as discussed below.

2. It is noted that there is a difference between the implementation example in the IFRS 9 Implementation Guidance (IG) 11A and IG 11B and the amended IFRS 7 disclosure requirement. Paragraph 11A(f) does not require disclosure of the cumulative amount that was deferred in OCI for relevant equity instruments derecognised during the period, that would

[1] Papers from the September 2022 meeting included the General requirements LINK and detailed discussion on financial assets with non-recourse features and contractually linked instruments LINK.
At the November 2022 meeting, there was a paper on contractually linked instruments, sweep issue LINK

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otherwise have been recognised in the income statement if that were permitted, whereas the example does provide this. We note that the approach taken in the IG provides additional relevant information which is potentially helpful for users of the accounts. However, we recognise that it is not a requirement for entities to track the cumulative amount deferred in OCI for each equity investment and it could be overly burdensome to make this mandatory. We, therefore, suggest that the difference between 11A(f) and the IG is retained and it is acknowledged in the BC that the IASB intends to encourage entities to voluntarily provide disclosure of cumulative OCI when it provides additional relevant information.

3. It is noted that the removal of 'each' from 11A(c) is a welcome change to avoid an unnecessarily excessive reporting burden for entities that have many individual equity instruments designated at fair value through other comprehensive income.

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?

1. We agree that some additional disclosure with respect to financial instruments with contingent cash flows would be beneficial. However, we have some concerns with the disclosures as proposed and believe that there is an opportunity to better focus them on the most relevant information, which we discuss below.

2. The proposed disclosures seem likely to result in extensive information, which could be difficult to present in a meaningful way. Paragraph 20C requires entities to consider how much detail to disclose, the appropriate level of aggregation or disaggregation, and whether users of financial statements need additional explanations to evaluate any quantitative information disclosed. We are concerned that without further guidance, this has the potential to result in a wide variety of different approaches being followed by entities which would adversely affect comparability. We suggest that some examples are provided to help entities understand the baseline level of disclosure.

3. We suggest that the scope of the disclosures could be tailored to more closely align to the characteristics of instruments. The disclosures should focus on the factors that relate to B4.1.10 and B4.1.10A and not features that relate to basic lending risks and costs covered by B4.1.8A. To provide further clarity, it may be helpful to explain in the BC that standard credit ratchet clauses and normal adverse costs clauses are expected to fall under B4.1.8A, and so would not be in the scope of the disclosure. This suggestion is consistent with our response to question two above to improve the articulation between B4.1.8A and B4.1.10.

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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?

1. We do not agree with the transition proposals. We suggest that they are revised so that entities are able to apply the amendments arising from the ED that relate to initial recognition and derecognition at a different time to the other changes. This will be especially helpful for entities that require a significant length of time to implement the initial recognition and derecognition amendments. The IASB may wish to set the date of initial application sufficiently far ahead to allow time for those entities that wish to restate prior periods to gather the data necessary to prepare comparative information. Entities affected by changes to reported cash flows, which affect covenants and balance sheet ratios, will be better able to disclose the development of balance sheet trends over time.

2. Separating the transition requirements as suggested above would also enable entities to apply earlier the amendments for the characteristics of contractual cash flows and other changes. Entities may need less time to implement these changes and it may be beneficial for them to be applied sooner to facilitate improved reporting and disclosure, especially for ESG-linked financial instruments.