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International Accounting Standards Board
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Comments on the Exposure Draft *Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)*

To the IASB Board Members:

The Japanese Institute of Certified Public Accountants (JICPA) appreciates the continued efforts of the International Accounting Standards Board (IASB) to develop high quality accounting standards and welcomes the opportunity to comment on the Exposure Draft *Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7).*

JICPA agrees with the IASB's decision to issue the ED with an intention to amend IFRS 9 *Financial Instruments* (IFRS 9) and IFRS 7 *Financial Instruments: Disclosures* (IFRS 7) in response to matters identified through the post implementation review (PIR) of the classification and measurement requirements in IFRS 9 and related requirements in IFRS 7 as well as deliberations made at the IFRS Interpretations Committee (Committee).

In particular, we fully support the IASB's conclusion that the contractual cash flow characteristics of financial assets with ESG-linked features would not be precluded from amortised cost measurement just because of the existence of ESG-linked features. On the

other hand, given that the proposed amendments to IFRS 9 in the ED are also applicable to financial assets that do not have ESG-linked features, we are highly concerned the ED could trigger a ripple effect, causing inconsistencies between the ED and the current IFRS 9 requirements as well as practical interpretations. We do not agree with any amendments that might affect specific important matters not identified through the PIR. We are also concerned about the cost-benefit perspective of the proposed amendments to IFRS 7 regarding disclosure requirements mainly because the scope seems to be too broad by including financial liabilities, and specific information to be disclosed is not explicitly stated in the ED.

In addition to financial assets with ESG-linked features, financial assets with non-recourse features and contractually linked instruments are also matters identified through the PIR, which are subject to clarification in the ED. However, we do not think the IASB's proposals in the ED are sufficient enough to address practical issues. Specifically, we still do not think the distinction is clearly made between contractually linked instruments and other financial assets with non-recourse features. Also, the underlying pool of assets for contractually linked instrument is still based on an assumption that it consists of financial assets. In other words, when the underlying pool of assets of a financial asset are composed of non-financial assets, it is determined that the cash flow characteristics would be precluded from the amortised cost measurement, even when there is a remote chance of default risks for the underlying assets. We recommend the IASB reconsider this matter because such conclusion does not align with the assessment of cash flow characteristics for financial assets with non-recourse features in general.

Lastly, we agree with the IASB to create an exception to account for the derecognition of a financial liability settled through the use of an electronic payment system as a practical expedient. However, we are concerned that the proposals in the ED might not be able to sufficiently address practical challenges identified by the Committee. JICPA listed up specific areas to be reconsidered by the Board in our comment.

We understand that conducting PIRs and Committee deliberations are essential as a process to ensure that IFRS standards that have been developed and published are appropriately applied in practice as originally planned. We highly expect the ED will be able to effectively address the practical issues identified in the PIR.

Please see our comments to each Question in the following pages.

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?

Comment:

We agree with the IASB to create an exception to account for the derecognition of a financial liability settled through the use of an electronic payment system in order to address practical challenges identified by the Committee. However, we are concerned about the following, which we believe should be reconsidered by the Board.

- **Reference to the settlement date accounting:** Description in paragraph B3.1.2A of the ED should be revisited as it does not appear to be consistent with the accounting treatment required under the current IFRS 9.
- **Criteria** to be met for **the exceptional accounting**: Criteria described in paragraph B3.3.8 of the ED should be carefully reconsidered for their usefulness.
- **Items** subject to **the exceptional accounting**: The Board should also create exceptional accounting for financial assets.

<u>Reference to the settlement date accounting</u>

Description in paragraph B3.1.2A of the ED should be revisited as it does not appear to be consistent with the accounting treatment required under the current IFRS 9.

Paragraph B3.1.2A stipulates that 'when recognising or derecognising a financial asset or financial liability, an entity shall apply settlement date accounting.' According to paragraph BC11(a) of the ED, it seems such requirement was added based on the IASB's decision 'to clarify that an entity is required to use settlement date accounting when recognising or derecognising financial assets and financial liabilities.'

JICPA understands, though, that the term 'settlement date accounting' in IFRS 9 is used only when referring to 'regular way purchase or sale of financial assets' (see paragraphs 3.1.2 and B3.1.3–3.1.6 of IFRS 9) and 'settlement date accounting used as

regular way purchase or sale of financial assets' is already considered to be an exceptional accounting treatment in IFRS 9. Moreover, there is no settlement date accounting for financial liabilities explicitly stated in IFRS 9. That being said, we do not think it is appropriate to state in the ED that 'when recognising or derecognising a financial asset or financial liability, an entity shall apply settlement date accounting,' without defining how to apply 'settlement date accounting' for general transactions.

In addition, requirements already exist in the current IFRS 9 for the recognition and derecognition accounting. Although paragraph BC10 of the ED states that 'IFRS 9 requires an entity to apply settlement date accounting when recognising or derecognising financial assets or financial liabilities,' there is no reference to settlement date accounting in the requirements for recognition and derecognition in the current IFRS 9, except for a regular way purchase or sale of financial assets. If we only have to think about the settlement transaction described in the ED, we do agree that requirements for the recognition and derecognition under IFRS 9 would be met on upon settlement date; however, generally speaking, settlement date would not always be the point of time when requirements for the recognition and derecognition in IFRS 9 are met. Derivative transactions are good examples. Accordingly, if the new rule as proposed in paragraph B3.1.2A of the ED were to be introduced, it could generate double standards within IFRS 9 between the new rule and the current requirements for the recognition and derecognition, causing inconsistent application of IFRS 9.

Criteria to be met for the exceptional accounting

Criteria described in paragraph B3.3.8 of the ED should be carefully reconsidered for their usefulness.

Paragraph B3.3.8 of the ED provides three criteria for the purpose of newly introducing an exception to permit an entity to derecognise a financial liability settled using an electronic payment system before the settlement date.

However, given that the exceptional accounting proposed in the ED is supposed to be a practical expedient to address certain concerns arising when applying the current derecognition requirements in IFRS 9 for the settlement of a financial liability through electronic transfers, flexibility should be allowed to some extent for application purposes as long as the exception does not encourage overuse or promote misuse through broad application and does not harm usefulness of financial information. Therefore, the IASB should carefully consider whether or not the three strict criteria proposed in the ED would be useful enough from the cost-benefit perspective, especially given that practical expedient has been prepared for the original purpose of introducing the proposal.

In particular, paragraph B3.3.8(a) requires 'the entity has no ability to withdraw, stop or cancel the payment instruction.' We disagree with including the statement as a requirement, which is explained in detail below, as it could inhibit the ED's original goal to purposely introduce an expedient method to address practical challenges.

(Reason 1) Could limit the scope of applying exception more than necessary
The requirement focuses on the entity's 'ability' to withdraw, stop or cancel the payment instruction. However, it is highly unlikely that the party initiating the payment instruction has no ability to 'withdraw, stop or cancel' the instruction, although there could be cases where the party is asked to pay certain penalties for pulling back payments. Our concern might be useless depending on how far the ED is requiring the 'has no ability' judgement to be strictly applied to entities. But we generally believe the requirement is unnecessarily narrowing payment methods to which the exception could be applied, diminishing the purpose of introducing the practical expedient.

(Reason 2) Accounting treatment could become more complicated
Some electronic payment systems allow the cancelation of payment instructions or other instructions if made within certain time-frame after the initial instruction. The ED does not explicitly explain how the proposed exception could be applied for those type of electronic transfers. Accounting treatment could become more complicated under the proposed exceptional accounting if an entity is required to continuously assess whether or not the criteria are met even after payment instructions are made and if financial liabilities can be derecognised only when the entity has zero ability to withdraw, stop or cancel the payment instruction, which is supposed to be the point of time when the criterion is met. It might also be the case that users of an electronic payment system cannot even determine when exactly they become unable to withdraw, stop or cancel payment instructions. As settlement systems generally do not provide information on 'the date when payment instructions can no longer be canceled,' system updates might also be required under the proposed exceptional accounting.

We do understand that the purpose of the proposed criteria in paragraph B3.3.8 is to limit the applicability of exceptional accounting in order to mitigate the risk of misusing the exception. However, we expect such risk is minimal when the period is extremely short from the payment instruction date to the settlement completion date. Further, if the

settlement is not completed appropriately for some reason, it will be notified immediately. In such cases, we believe the original accounting treatment, based on an assumption that settlement is completed, can be adjusted on a timely basis.

Based on above, instead of describing specific application criteria for the exceptional accounting, we recommend allowing an entity to apply the exception 'when the cash settlement is made through an electronic transfer and it is almost certain that the settlement will be executed when the entity has initiated the payment instruction.' We think the criteria currently proposed in paragraph B3.3.8 should be provided as examples, instead of requirements, to illustrate how the exception can be applied under certain circumstances. At the same time, we also think it is essential to enhance disclosures to mitigate the risk of misusing the exception, given that interpretations and accounting treatments could be different among entities. Disclosure information could include detailed descriptions as to how entities are specifically applying the exception.

Items subject to the exceptional accounting

We believe the exceptional accounting should also be provided for financial assets.

We understand the purpose of the proposed exception in the ED is to respond to requests from preparers, insisting that entities should be permitted to account for settlements as if they were completed at the time when payment instructions are made. To serve the purpose, a financial liability should be derecognised when a payment instruction is initiated, and at the same time, outflow of economic resource upon settlement should be accounted for when the payment instruction is made. However, the ED's proposal for exceptional accounting is limited to the financial liability side only. In other words, entities might be still not allowed to deem cash and deposits to be discharged as if cash settlements were completed at the time of payment instruction. Accordingly, the financial liability shall be reclassified to other liabilities or other temporary accounts upon derecognition, which will only cause confusion for accounting purposes, ending up being far from achieving the original goal to respond to practical challenges identified through the Committee's deliberations.

Or if it is the IASB's intention to recognise that the offsetting requirements in IAS 32 *Financial Instruments: Presentation* (see paragraph 42 of IAS 32 and after) are met, such intention should also be explicitly described in the ED, stating that entities are allowed to account for cash settlements as if they were completed at the time when payment instructions are made on the face of the statement of financial position for financial reporting purposes without introducing the exceptional accounting for the derecognition of financial assets.

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?

Comment:

We agree with the proposals except for the following:

- Consistency between paragraph B4.1.8A of the ED and paragraph B4.1.18 of the current IFRS 9 should be clarified.
- Including 'specific to debtor' requirement for the assessment of contingent event could give rise to an unintended consequence, denying the current IFRS 9 accounting treatment.
- Illustrative example in paragraph B4.1.13 of the ED should align with the proposed considerations to be made in paragraph B4.1.8A.

<u>Consistency between paragraph B4.1.8A of the ED and the current IFRS 9</u>

Consistency between paragraph B4.1.8A of the ED and paragraph B4.1.18 of the current IFRS 9 should be clarified.

According to paragraph B4.1.18 of the current IFRS 9, 'a contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a de minimis effect on the contractual cash flows of the financial asset.' In addition to

considering whether or not the contractual cash flow characteristic is genuine from the perspective of likeliness of occurrence, this statement indicates that monetary impact should also be included as a consideration factor.

On the other hand, paragraph B4.1.8A of the ED states that 'the assessment of interest focuses on what an entity is being compensated for, rather than how much compensation an entity receives.' We are afraid this provision could be interpreted as if monetary impact need not be included as a consideration factor. We understand the IASB's point in the ED is to emphasise that the assessment of interest rates should first focus on the qualitative perspective as to whether they represent consideration for basic lending risks or costs. We also understand that, according to paragraph BC48, the ED's wording aligns with the principle explained in paragraph BC4.182(b) of the current IFRS 9, indicating the ED is not introducing any new concepts. That being said, if we take paragraph B4.1.8A of the ED at face value, it seems to contradict paragraph B4.1.18 of the current IFRS 9, which may cause confusion among users. Accordingly, we highly recommend clarification be made between the ED and the current IFRS 9.

Including 'specific to debtor' requirement for the assessment of contingent events

Paragraph B4.1.10A of the ED may be inconsistent with the current IFRS 9 requirement and accounting practice under the current standard. We are afraid the ED could trigger a ripple effect, which is certainly not the original intention of the IASB.

According to BC56 of the ED, it is the IASB's intention to identify and clarify in paragraph B4.1.10A the principles for assessing contractual cash flows of a financial asset when they change by the occurrence (or non-occurrence) of any contingent event. Further, when financial assets whose contractual interest rate changes as a result of an entity achieving a contractually specified ESG target are determined that they do not have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, the IASB insists that such conclusion is inappropriate because it may prevent financial statements from providing useful information to users. JICPA fully supports the IASB in this respect.

However, according to paragraph B4.1.10A of the ED, the IASB proposes that '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.' This indicates that the proposed requirement covers not only financial assets with ESG-linked features but all other financial assets whose contractual cash flows change due to the occurrence (or non-occurrence) of contingent events. As a result of trying to avoid creating an exception for financial assets with ESG-linked features in relation to the

requirements for contractual cash flow characteristics in IFRS 9, we are highly concerned that the IASB might unexpectedly be triggering a ripple effect.

For example, we think the proposal in paragraph B4.1.10A of the ED contradicts with the narrative in paragraph B4.1.13 of the current IFRS 9, which illustrates 'Instrument C,' indicating a bond with an interest rate cap can have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding under certain circumstances. When the bond's interest rate reaches its cap rate due to rising market interest rates, we can argue the bond represents a financial instrument whose contractual cash flows change in response to the occurrence of a contingent event that is NOT specific to debtor.

Moreover, practically speaking, if there is a financial asset whose interest rate changes upon occurrence of an event that affects the determination of basic contractual terms (e.g. an event that could cause a change in interest rates or credit risks), we have always had an opportunity to argue that the financial asset can fall under the category of a financial instrument with contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, as long as the change in interest rates is within a reasonable range and leverage or other elements are not involved. That being said, the proposal in paragraph B4.1.10A of the ED may override the current interpretation.

We certainly believe it was not the IASB's original intention to require an amendment to the current IFRS 9 and practical interpretations while pursuing the goal to identify and clarify the principles for contractual cash flows that change in response to contingent event. If our understanding is correct, we recommend solving the above-mentioned contradiction by clearly stipulating that a contingent event that would give rise to a change in contractual cash flows does not have to meet the 'specific to debtor' requirement when the event is related to interest elements as described in paragraph B4.1.7A of the ED. If, on the contrary, it is the IASB's intention to change the current IFRS 9 requirement, JICPA would disagree with such proposed amendment to IFRS 9 because it only will damage the relevance of financial information.

Additionally, if the Board is seeking to make it as a requirement that a contingent event has to be specific to debtor in assessing whether the change in contractual cash flows is consistent with the basic lending arrangement, then clarification would be required to assess whether or not the event is specific to debtor. However, the assessment could be divided depending on the nature of debtor's event, such as changes in the debtor's share price and the future outlook of the industry. Moreover, we believe the definition of 'debtor' should be clarified, whether it is only referring to the legally bound

debtor who receives the loan or it is including its group companies, including the parent. The IASB should address these issues accordingly to avoid inconsistency in practice.

Illustrative example in paragraph B4.1.13 of the ED

Illustrative example in paragraph B4.1.13 of the ED is meant to represent detailed guidance on how to make an assessment based on the requirement per paragraph B4.1.8A. Thus, we recommend the description in paragraph B4.1.13 align with the consideration points identified in paragraph B4.1.8A.

In particular, paragraph B4.1.8A states as an example that in assessing whether the contractual cash flows of a financial asset are consistent with the basic lending arrangement, an entity should consider 'whether or not they include compensation for risks or market factors that are not typically considered to be basic lending risks or costs' as well as 'whether or not a change in contractual cash flows is consistent with the direction and magnitude of the change in basic lending risks or costs.' Accordingly, when illustrating Instrument EA in paragraph B4.1.13, concluding that the contractual cash flows are solely payments of principal and interest on the principal amount outstanding, we suggest further description should be added to the paragraph in order to align with the example provided in paragraph B4.1.8A and to explain the relationship between the change in interest rates due to the achievement of contractually specified reduction in greenhouse gas emission and the change in lending risks or costs.

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?

Comment:

We agree with the draft amendments to paragraph B4.1.16 and the proposed addition of paragraph B4.1.16A. On the other hand, we suggest the IASB should reconsider paragraph B4.1.17A of the ED to effectively address specific concerns identified in the PIR.

When assessing the contractual cash flow characteristics of financial assets with non-recourse features, we first have to determine whether the financial assets are contractually linked instruments or not. This is because when financial assets are determined to be contractually linked instruments, a form of financial assets with non-recourse features, the requirements in assessing the contractual cash flow characteristics of such financial assets are going to be different from those for other financial assets with non-recourse features.

That said, we do not think paragraph B4.1.17A of the ED provides useful guidance for the above-mentioned required assessments particularly when referring to the waterfall payment structure and the legal and capital structure of the debtor.

(Reason 1) Waterfall payment structure

As an example of factors to consider when assessing the contractual cash flows of a financial asset with non-recourse features, paragraph B4.1.17A(b) states that 'any shortfall in cash flows generated by the underlying assets is expected to be absorbed by subordinated debt or equity instruments issued by the debtor.' However, this description is referring to a waterfall payment structure per paragraph B4.1.20, representing the characteristic of contractually linked instruments. Including this description as part of the general guidance on financial assets with non-recourse features could cause confusion, making it more difficult to tell the difference from contractually linked instruments.

(Reason 2) Legal and capital structure of the debtor

According to paragraph B4.1.17A, when assessing the contractual cash flows of a financial asset with non-recourse features, an entity may also need to consider factors such as the legal and capital structure of the debtor. In this case, according to paragraph B4.1.20, contractually linked instruments represent instruments that prioritise payments to the holders of financial assets using multiple tranches, which can be mainly differentiated from general financial assets with non-recourse features by looking into the credit side of composition. Thus, we understand that the ED is requiring an appropriate distinction to be made between general financial assets with

non-recourse features and contractually linked instrument by referring to legal and capital structure of the debtor. Meanwhile, there is no detailed guidance in paragraph B4.1.17A about how and what should be specifically considered for the legal and capital structure of the debtor.

In this regard, we understand that the following application issue was identified in the PIR, illustrating two financial schemes with similar economic outcomes but with different conclusions as to whether they represent contractually linked instruments or not.

Case A)
A special purpose entity raised two loans, CU80 of loan and CU20 of subordinated loan. Equity is zero (or at nominal value). In this case, generally speaking, the guidance for contractually linked instruments would be applied to the loans.

Case B)
A special purpose entity raised CU80 of loan and equity finance of CU20. Also assume equity is not at nominal value. In this case, generally speaking, the guidance for financial assets with non-recourse features would be applied to the loan.

Although the above-mentioned two cases create almost the same economic outcomes, the assessment as to whether financial assets are considered to be contractually linked instruments or not, which leads to the assessment of the contractual cash flow characteristic, could result in different conclusions. We are concerned that it will not only raise doubt about the usefulness of financial reporting, but also create an opportunity for structuring. We believe these issues emerge as a result of the current IFRS 9, which does not explicitly define what tranches and waterfall payment structures are. Although one of the purposes of publishing the ED was to clarify characteristics that differentiate contractually linked instruments with other transactions, we are afraid this matter is not addressed in other paragraphs of the ED.

Paragraph B4.1.17A states that ‘an entity may also need to consider factors such as the legal and capital structure of the debtor.’ The definition of tranches and waterfall payment structures should be explicitly stated in IFRS 9 before requiring necessary considerations to be made. Otherwise, the above-mentioned issues identified in the PIR would remain unsolved. Accordingly, we are concerned that paragraph B4.1.17A would not be able to serve as a useful guidance for assessing the contractual cash flow characteristics of

financial assets with non-recourse features.

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?

Comment:
We agree with the draft amendments to paragraphs B4.1.20–B4.1.21 of IFRS 9. However, we do not agree with the proposed addition of paragraph B4.1.20A due to the reason explained below. Moreover, regarding the draft amendments to paragraph B4.1.23, we recommend the definition of lease receivables be made and also the position of the underlying pool be reviewed to address specific concerns identified in the PIR.

Paragraph B4.1.20A
If a debtor (the sponsoring entity) establishes a structured entity which issues senior and junior debt instruments, and a third party is holding the senior debt instrument while the sponsoring entity itself is holding the junior debt instrument, it is clarified under paragraph B4.1.20A of the ED that the senior debt instrument would be recognized as financial assets with non-recourse features, not contractually linked instruments.

The description seems to be too detailed by focusing on a specific scheme. As it does not provide guidance as to how the requirement should be applied to other similar schemes, the paragraph might cause confusion in practice. Therefore, we do not think paragraph B4.1.20A is appropriate to be added as an application guidance.

Particularly, this paragraph is indicating that even under an identical scheme, the

assessment as to whether financial assets are those with non-recourse features or contractually linked instruments can be different, depending on who the funding provider is. We cannot support such IASB's view because it will only generate inconsistencies in the accounting for financial instruments, which is further explained in the following illustrative examples:

According to paragraph B4.1.20A of the ED, when the party providing funding changes at the time of establishing a structured entity (T0) and after establishing the structured entity (T1), different guidance should be applied to financial assets held by Entity A at T0 and T1, respectively, even though the situation remains the same for Entity A.

(Case 1)

- When structured (T0): senior debt instrument (held by Entity A), junior debt instrument (held by Entity B), equity instrument (invested by the sponsoring entity)
- After structured (T1): the sponsoring entity acquires junior debt instrument from Entity B

It can be interpreted that financial assets held by Entity A should follow the guidance for contractually linked instruments at the point of T0, but then should apply the guidance for financial assets with non-recourse features from T1 and after.

(Case 2-1)

- When structured (T0): senior debt instrument (held by Entity A), junior debt instrument (held by the sponsoring entity)
- After structured (T1): the sponsoring entity sells junior debt instrument to Entity B

(Case 2-2)

- When structured (T0): senior debt instrument (held by Entity A), junior debt instrument (held by the sponsoring entity)
- After structured (T1): junior debt instrument is further split into senior/junior instruments, part of which is sold to Entity B

In both cases, it appears that financial assets held by Entity A should follow the guidance for financial assets with non-recourse features at the point of T0, but then should apply the guidance for contractually linked instruments from T1 and after.

When Entity A holds certain financial assets as illustrated above, IFRS 9 does not

necessarily provide a clear-cut explanation as to whether the entity should assess contractual cash flow characteristics using different guidance at T0 and T1, respectively. It is required under the current IFRS 9 that reclassification of financial assets should be made only when an entity changes its business model (see paragraph 4.4.1 of IFRS 9), and reclassification is not permitted when contractual cash flow characteristics of a financial asset vary over that asset's life based on its original contractual terms (see paragraph BC4.117 of IFRS 9). However, the illustrative examples above do not represent a change in contractual cash flow characteristics based on contractual terms.

If the IASB is requiring that contractual cash flow characteristics should be reviewed each period based on different guidance, this would be an accounting treatment never expected under IFRS 9, which should be carefully considered for its appropriateness.

If, on the other hand, the IASB does not think the annual review is necessary, we are concerned the proposed addition of paragraph B4.1.20A might create an opportunity for structuring. This is because entities can initiate a certain scheme temporarily at the time of acquiring financial assets, allowing them to assess contractual cash flow characteristics by following a requirement different than those that should have been originally applied.

<u>Paragraph B4.1.23</u>

(1) The term 'lease receivables'

The ED has clarified that contractually linked instruments can have contractual cash flows characteristics that are solely payments of principal and interest on the principal amount outstanding even when the underlying pool of instruments include lease receivables. However, there is no definition of 'lease receivables' in the ED or any reference to other related standards.

In the 'Scope' section of IFRS 9, there are terms 'finance lease receivables' and 'operating lease receivables,' instead of 'lease receivables' (see paragraph 2.1(b) of IFRS 9). Also, in the 'Impairment' section, reference is made to the terms 'finance lease receivables' and 'operating lease receivables,' commenting that 'lease receivables that result from transactions that are within the scope of IFRS 16' (see paragraph 5.5.15(b) of IFRS 9). Likewise, the term 'lease receivables' should also be defined in paragraph B4.1.23 in order to avoid misunderstandings in practice.

(2) Necessity of limiting underlying assets to financial assets

We support the IASB's proposal to clarify the accounting for lease receivables in paragraph B4.1.23. On the other hand, we highly recommend the IASB to revisit the requirement in IFRS 9, stipulating that the underlying pool of contractually linked

instruments must contain one or more instruments that have contractual cash flows characteristics that are solely payments of principal and interest on the principal amount outstanding. This is because we do not believe the IASB can address specific matters identified in the PIR as long as underlying assets are limited to financial assets.

According to paragraph BC4.206 of IFRS 9, we understand it was the original intention of the IASB to establish a requirement for contractually linked instruments in IFRS 9 in order to clarify cases where it is inappropriate to account for financial assets differently depending on whether they are directly or indirectly held. And that is the very reason why the underlying pool of assets for contractually linked instruments are limited to the holding of financial assets.

According to paragraph B4.1.17 of IFRS 9, the fact that underlying assets are non-financial assets does not in itself affect the assessment of contractual cash flow characteristics of financial assets with non-recourse features. But when it comes to contractually linked instruments, when their underlying pool of assets are solely composed of non-financial assets, it is determined that the cash flows will not be considered as solely payments of principal and interest on the principal amount outstanding because, it does not meet the requirement in paragraph B4.1.21(b), stating that 'the underlying pool of financial instruments has the cash flow characteristics set out in paragraphs B4.1.23 and B4.1.24,' even when there is a remote chance of default risks for the underlying assets. The Basis for Conclusions of IFRS 9 does not provide a clear enough explanation for the reason behind the different accounting treatments.

For example, there are many SPC schemes in practice investing in real estate that form tranches of super senior debt (i.e. debt instruments with highest priority) with an aim to almost entirely separate any default risks in real estate, the underlying assets, through a waterfall payment structure. However, when the underlying assets are composed of non-financial assets with a structure of contractually linked instruments, it is concluded that the cash flows are not solely payments of principal and interest on the principal amount outstanding, even when the non-financial assets are substantially not exposed to default risks. Such conclusion does not align with the concept of the accounting for financial assets with non-recourse features, which we do not think is appropriate.

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?

Comment:

We agree with the proposal.

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?

Comment:

We agree with the proposed amendment to newly add paragraph 20C.

Meanwhile, we believe cost-benefit consideration should be carefully made for the proposal in paragraph 20B, as disclosures required in the paragraph do not appear to be

clear enough, which is explained in the following:

Scope of ‘contingent events specific to the debtor’

Paragraph BC102 of the ED states that ‘contingent events specific to the debtor’ are not limited to ESG-linked features. However, there is no further clear explanation about the scope of contingent events subject to disclosures, making it difficult to determine how far contractual terms need to be examined for disclosure purposes.

Disclosure of quantitative information about the range of changes

Under the disclosure requirement in paragraph 20B(b) of the proposed amendment to IFRS 7 for quantitative information about the range of changes, it is relatively easy to imagine how to disclose information on changes in the amount of cash flows for interest rate changes (see paragraph BC103 of the ED). However, it is not clear, for example, about the information required for changes in the timing of cash flows, such as for prepayment contractual terms.

Necessity of including financial liabilities in paragraph 20B for disclosure purposes

Disclosure requirements in paragraph 20B of the proposed amendment to IFRS 7 include financial liabilities not subject to clarifications in the proposed amendments to IFRS 9 of the ED. In other words, we understand financial instruments on which the proposed disclosure requirement should be focusing on are financial assets with ESG-linked features, and should not include financial liabilities. That said, paragraph 20B is not clear as to why financial liabilities are also required to be disclosed. Further, we do not see how the disclosure requirement proposed for financial liabilities in paragraph 20B of the ED relates to other disclosure requirements for financial liabilities, such as maturity analysis per paragraph 39 of IFRS 7. As no clear purpose is given for disclosing financial liabilities, it is hard to understand what kind of information disclosure is required in paragraph 20B. We highly recommend that this issue be made clear in order to provide relevant information through the enhancement of disclosures.

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?

Comment:
We agree with the proposal.

Yours faithfully,

Eriko Otokozawa
Executive Board Member − Business Accounting Standards and Practice/Corporate Disclosure
The Japanese Institute of Certified Public Accountants