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Comments on the Exposure Draft（ED/2023/2）
Amendments to the Classification and Measurement of Financial Instruments
(Proposed amendments to IFRS 9 and IFRS 7)

1. The Accounting Standards Board of Japan ("the ASBJ" or "we") welcome the opportunity to provide our comments on the International Accounting Standards Board ("the IASB")'s Exposure Draft (ED/2023/2) *Amendments to the Classification and Measurement of Financial Instruments* (Proposed amendments to IFRS 9 and IFRS 7) ("the ED"), issued in March 2023.

2. In the paragraphs below, we set out our overall comment on the post-implementation review ("the PIR") of the classification and measurement requirements in IFRS 9 and related IFRS 7 disclosures and our main comments on each of the questions in the ED.

Overall comment on the PIR

3. The IASB carried out the PIR and concluded that, in general, the requirements in IFRS 9 and IFRS 7 can be applied consistently and that in doing so an entity provides useful information to users of its financial statement. At the same time, the IASB concluded that, in relation to some matters, the requirements should be clarified to improve their understandability. The IASB decided to propose a narrow set of amendments to address those matters identified as requiring action as soon as possible and other matters that the IASB decided that it would be more efficient to include in a single exposure draft.

4. In this respect, we are not convinced with the conclusion that the classification and measurement requirements in IFRS 9 can generally be applied consistently and

provide useful information to users of financial statements. In particular, with regard to the accounting for equity instruments subject to the FVOCI option, we are disappointed that the IASB noted that it had received no evidence as part of the PIR to support the argument that the reclassification of the amounts recognised and accumulated in other comprehensive income (OCI) to profit or loss ('recycling') would always result in users of financial statements receiving more or better information about realised gains than they do from existing requirements.

We continue to believe that a mechanism to recycle unrealised gains or losses on the disposal of equity instruments subject to the FVOCI option is necessary from the perspective of emphasising net income as an indicator of the entity's performance.

5. On the other hand, we appreciate the IASB's efforts to address issues in a timely manner with respect to the proposed narrow scope amendments to improve understandability.

6. In particular, we have been commenting to the IASB that the new types of financial instruments with ESG-linked features that were not envisaged at the time the IFRS 9 was developed are increasing in number and has attracted growing interest to stakeholders and, therefore, the accounting for such financial instruments should be clarified. Also, we have been taking the view that it would be inappropriate to measure all financial assets with ESG-linked features at fair value and that it may be appropriate to measure such financial assets at amortised cost. Accordingly, we support the IASB's efforts in the ED to explore the possibility of classifying financial assets with ESG-linked features as financial assets measured at amortised cost.

7. However, as noted in our comments on each question below, we are of the view that some of the proposed requirements are not sufficiently clear or are inconsistent with existing requirements. Accordingly, we are of the view that the IASB should revisit these requirements or provide further clarification. In doing so, we hope that the revised standard will be more consistent with stakeholders' needs.

Main comments on each of the questions in the ED

(Derecognition of a financial liability settled through electronic transfer)

8. We agree with the proposal to permit an entity to deem a financial liability that will be settled with cash using an electronic payment system to be discharged before the settlement date, as a practical expedient to address the needs of the stakeholders to clarify the accounting treatment.

9. In conjunction with providing the derecognition provision for financial liabilities settled through an electronic payment system, the ED proposes adding paragraph B3.1.2A to require an entity to apply settlement date accounting, regardless of the nature of the financial asset or financial liability and the nature of the transaction, when recognising or derecognising the financial asset or financial liability, except for a regular way purchase or sale of financial assets or when paragraph B3.3.8 is applied. In this regard, we are concerned that this provision would result in inconsistencies with existing requirements in IFRS 9 (e.g. initial recognition of derivatives).

10. Therefore, we are of the view that the revised IFRS 9 should identify and clearly describe situations where settlement date accounting should be applied, taking into account the relationship with the existing requirements in IFRS 9.

(Classification of financial assets—contractual terms that are consistent with a basic lending arrangement)

Approach to address the issue

11. The IASB is attempting to address the concerns and requests of stakeholders expressed in the PIR in a timely manner by generally addressing the various elements of interest that are consistent with a basic lending arrangement. However, we are of the view that the proposal in the ED does not adequately explain when financial instruments with ESG-linked features meet the "solely payments of principal and interest" criteria (hereinafter referred to as "the SPPI criteria").

12. Proposed paragraph B4.1.8A of IFRS 9 in 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'. Also, proposed paragraph B4.1.10A of IFRS 9 states 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'. In our view, the relationship between these statements is unclear. This is because we are of the view that the fact that the occurrence (or non-occurrence) of the contingent event is specific to the debtor does not necessarily incur lending risks or costs to the lender.

13. We strongly believe that clarity on what constitutes interest is necessary for this amendment to be properly applied in practice. For this reason, we are of the view that the IASB should further clarify the relationship between the requirement that the

occurrence (or non-occurrence) of a contingent event must be specific to the debtor and the elements of interest that meets the SPPI criteria.

Probability of the contingent event occurring

14. With respect to the probability of the contingent event occurring, proposed paragraph B4.1.10A of IFRS 9 in the ED states that the assessment of the contractual cash flow characteristics shall be done irrespective of the probability of the contingent event occurring, except for non-genuine contractual terms, as required by the existing requirements in IFRS 9. However, we think that for some financial assets with ESG-linked features, there may be cases where the conditions are rarely met (or not met), similar to debt covenants. We are of the view that excluding non-genuine conditions is not sufficient because we think that it is not necessary to assess the contractual cash flow characteristics where the conditions are rarely met (or met).

(Disclosures—contractual terms that could change the timing or amount of contractual cash flows)

Scope of application

15. Proposed paragraph 20B of IFRS7 in the ED proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event. We are concerned that the scope of contractual terms subject to this disclosure requirement would be extensive.

16. We suggest that this disclosure requirement be limited to ESG-linked features that are of particular interest to stakeholders, given that ESG-linked features were the starting point for the discussion regarding this disclosure requirement.

Disclosures of quantitative information

17. Regarding the quantitative information about the range of changes to contractual cash flows that could result from the contractual terms set out in proposed paragraph 20B(b) of IFRS 7 in the ED, we question whether this information is useful in situations where the probability of contingent events occurring is uncertain.

18. As an alternative, instead of requiring the disclosure of the quantitative information, we suggest that an entity be required to explain quantitative aspects in the context of a qualitative description of the contingent nature set out in proposed paragraph

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20B(a) of IFRS 7 in the ED, based on the judgement from the perspective of achieving the disclosure objectives.

19. For our comments on the specific questions in the ED, please see the Appendix of this letter.

20. We hope our comments are helpful for the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

Yasunobu Kawanishi
Chair
Accounting Standards Board of Japan

Appendix

Comments on Specific Questions in the ED

Our comments on the specific questions sought in the ED are as follows.

Question 1— Derecognition of a financial liability settled through electronic transfer
Paragraph B3.3.8 of the draft amendments to IFRS 9 proposes that, when specified criteria are met, an entity would be permitted to derecognise a financial liability that is settled using an electronic payment system although cash has yet to be delivered by the entity. Paragraphs BC5–BC38 of the Basis for Conclusions explain the IASB's rationale for this proposal. Do you agree with this proposal? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?

(Paragraph B3.3.8 of IFRS 9)

1. We agree with the proposal to permit an entity to deem a financial liability that will be settled with cash using an electronic payment system to be discharged before the settlement date, as a practical expedient to address the needs of the stakeholders to clarify the accounting treatment.

   Conceptually, a financial liability cannot be discharged before the settlement date even when the three criteria in proposed paragraph B3.3.8 of IFRS 9 are met, because an obligation related to the financial liability still exists and meets the definition of a liability. Nevertheless, we are of the view that it is acceptable to have the proposed accounting treatment as a practical expedient.

2. However, we are of the view that the accounting treatment for financial assets used for settlement when an entity applies paragraph B3.3.8 of IFRS 9 should also be clarified. Because paragraph B3.3.8 of IFRS 9 only addresses the derecognition of financial liabilities and the ED does not provide guidance as to whether financial assets used for settlement should simultaneously be derecognised, it is likely that settlement date accounting would be applied to financial assets and such financial assets would not be derecognised before the settlement date. We do not think that is the intention of the IASB and, therefore, we propose that the accounting for financial assets used for settlement should be clarified.

(Paragraph B3.1.2A of IFRS 9)

3. In conjunction with providing the derecognition provision for financial liabilities settled through an electronic payment system, the ED proposes adding paragraph B3.1.2A to require an entity to apply settlement date accounting, regardless of the nature of the financial asset or financial liability and the nature of the transaction, when recognising or derecognising the financial asset or financial liability, except for a regular way purchase or sale of financial assets or when paragraph B3.3.8 is applied. In this regard, we are concerned that this provision would result in inconsistencies with existing requirements in IFRS 9.

4. For example, paragraph 3.1.1 of IFRS 9 requires that a financial asset or financial liability to be recognised when, and only when, the entity becomes a party to the contractual provisions of the financial instrument. Following this requirement, derivative contracts are recognised at the commitment date (refer to (c) and (d) of paragraph B3.1.2 of IFRS 9). The proposal in the ED is inconsistent with this requirement.

5. Therefore, we are of the view that the revised IFRS 9 should identify and clearly describe situations where settlement date accounting should be applied, taking into account the relationship with the existing requirements in IFRS 9.

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?

(Approach to address the issue)

6. We appreciate the IASB's efforts in the ED to explore the possibility of classifying financial assets with ESG-linked features as financial assets measured at amortised cost. We have been commenting to the IASB that the new types of financial instruments with ESG-linked features that were not envisaged at the time the IFRS 9 was developed are increasing in number and has attracted growing interest to stakeholders and, therefore, the accounting for such financial instruments should be clarified. Also, we have been taking the view that it would be inappropriate to measure all financial assets with ESG-linked features at fair value and that it may be appropriate to measure such financial assets at amortised cost.

7. The IASB is attempting to address the concerns and requests of stakeholders expressed in the PIR in a timely manner by generally addressing the various elements of interest that are consistent with a basic lending arrangement. However, we are of the view that the proposal in the ED does not adequately explain when financial instruments with ESG-linked features meet the "solely payments of principal and interest" criteria (hereinafter referred to as "the SPPI criteria").

8. Proposed paragraph B4.1.8A of IFRS 9 in 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'. Also, proposed paragraph B4.1.10A of IFRS 9 states 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'. In our view, the relationship between these statements is unclear. This is because we are of the view that the fact that the occurrence (or non-occurrence) of the contingent event is specific to the debtor does not necessarily incur lending risks or costs to the lender.

9. For example, we think that it is not necessarily clear what lending risks or costs would be incurred if the loan included features linked to greenhouse gas (GHG) emissions. From a long-term perspective, it is possible that it would become difficult for the entity to continue its business and a credit risk issue would arise if such entity was

unable to comply with regulations relating to GHG emissions. However, the contingent event conditions we have observed in contracts so far are often more appropriately described as incentives for the debtor entity's business to move in a better direction in line with social needs, rather than as a condition that creates lending risks and costs to the lender.

10. In this regard, proposed paragraph B4.1.13 in the ED provides, as “Instrument EA”, an example of a loan with an interest rate that is periodically adjusted by a specified number of basis points if the debtor achieves a contractually specified reduction in GHG emissions during the preceding reporting period. However, this example does not explain what lending risks or costs the lender incurs. Accordingly, the example may be interpreted to mean that any contractual term that changes the cash flows would not conflict with the SPPI criteria if the occurrence (or non-occurrence) of the contingent event is specific to the debtor and the resulting change in the cash flows is reflected as a change in the interest rate. However, we are of the view that such an interpretation is inappropriate because it reverses the necessary and sufficient conditions for meeting the SPPI criteria.

11. In our jurisdiction, we have observed financial instruments with ESG-linked features that are specific to the debtor but instead of changing interest rates when certain conditions are not met, requiring the debtor to make contributions to specified third parties when certain conditions are not met. When the features are specific to the debtor and the cash flows change due to the occurrence (or non-occurrence) of the contingent event, we do not think it is convincing to conclude that the cash flows would meet the element of interest when they are reflected in interest rates but not otherwise.

12. In addition, some may be argue that, if the change in cash flows due to the occurrence (or non-occurrence) of a contingent event specific to the debtor is within the profit margin, the cash flows would meet the element of interest. However, we disagree with this argument because such a view may result in contractual cash flows that are clearly not interest meeting the SPPI criteria. In this regard, the ED proposes to provide paragraph B4.1.8A of IFRS 9 which states that "a change in contractual cash flows is inconsistent with a basic lending arrangement if it is not aligned with the direction and magnitude of the change in basic lending risks or costs". However, we are of the view that this condition by itself would not preclude cash flows that are clearly not interest from meeting the SPPI criteria.

13. We strongly believe that clarity on what constitutes interest is necessary for this amendment to be properly applied in practice. For this reason, we are of the view that the IASB should further clarify the relationship between the requirement that the occurrence (or non-occurrence) of a contingent event must be specific to the debtor and the elements of interest that meets the SPPI criteria.

14. If the relationship between the two cannot be successfully explained, it may imply that the approach in the ED of generally addressing various elements of interest consistent with the underlying financing arrangements is not working. In such case, an exception provision targeted to ESG-linked elements may be a more appropriate way to address the issue and such approach should be reconsidered.

(Requirement that the occurrence (or non-occurrence) of a contingent event is specific to the debtor)

15. The ED states that the occurrence (or non-occurrence) of the contingent event must be specific to the debtor in order for a change in contractual cash flows to be consistent with a basic lending arrangement to address an instrument with ESG-linked features. However, we are concerned that introducing such a requirement may have unintended consequences. For example, we think that a financial instrument with an interest rate cap or floor condition has been considered to meet the SPPI criteria but such financial instrument may not be considered to meet the SPPI criteria because it does not meet the requirement.

(Approach to reflect changes in cash flows arising from ESG-linked features in amortised cost)

16. In our view, it is necessary to clarify how and when changes in cash flows arising from ESG-linked features should be reflected in amortised cost (for example, when the event becomes probable or when the conditions are met (or not met), or whether expected values are considered) when financial assets with ESG-linked features are classified as financial assets measured at amortised cost.

(Probability of the contingent event occurring)

17. With respect to the probability of the contingent event occurring, proposed paragraph B4.1.10A of IFRS 9 in the ED states that the assessment of the contractual cash flow characteristics shall be done irrespective of the probability of the contingent event occurring, except for non-genuine contractual terms, as required by the existing requirements in IFRS 9. However, we think that for some financial assets with

ESG-linked features, there may be cases where the conditions are rarely met (or not met), similar to debt covenants. We are of the view that excluding non-genuine conditions is not sufficient because we think that it is not necessary to assess the contractual cash flow characteristics where the conditions are rarely met (or met).

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?

18. We agree with the proposals in the ED. This is because the proposals in the ED clarify the difference between financial assets with non-recourse features and other collateralised financial assets and provide considerations for whether investments in and/or loans to special purpose entities with specified assets meet the SPPI criteria in IFRS 9. We are of the view that the proposals in the ED would contribute to consistent application in practice.

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?

19. We agree with the proposals in the ED. This is because we have been commenting that the accounting treatment of lease receivables in the underlying pool of financial instruments should be clarified and other proposed clarifications are considered to be consistent with the understanding in current practice.

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?

(Accounting for equity instruments subject to the FVOCI option)

20. As part of the PIR, the IASB discussed the feedback received and gathered evidence

(including academic evidence) on the accounting for equity instruments subject to an irrevocable election to present subsequent changes in fair value in other comprehensive income (the FVOCI option) and eventually decided not to make any changes to the requirements of IFRS 9 for such equity instruments because they are generally working as the IASB intended. In this regard, we are disappointed with the IASB's decision because we think that the mechanism to recycle unrealised gains or losses on the disposal of equity instruments subject to the FVOCI option is necessary from the perspective of emphasising net income as an indicator of the entity's performance.

(Amendments to paragraph 11A(c) of IFRS 7)

21. We agree with the proposals in the ED. This is because we are of the view that disclosing the fair value of each equity instrument subject to the FVOCI option held at the end of the reporting period is burdensome for preparers of financial statements but such disclosure does not necessarily provide useful information to users of financial statements.

(Additional disclosure requirements in paragraph 11A(f) of IFRS 7)

22. We have concerns regarding whether the benefits outweigh the costs of the additional disclosures related to the changes in the fair value of the equity instruments subject to the FVOCI option during the reporting period and their disaggregation.

23. Existing standards require entities to disclose information regarding disposals and realised gains and losses on equity instruments subject to the FVOCI option, including the fair value at the date of derecognition and the cumulative gain or loss on the disposal of such equity instruments that were derecognised during the reporting period (refer to paragraph 11B of IFRS 7). We are of the view that this information is the most relevant information in situations where unrealised gains and losses on the disposal of the equity instruments subject to the FVOCI option are not recycled. We question how the additional disclosure requirements proposed in the ED would provide additional benefit when disclosures of such relevant information is already required.

24. In addition, preparers of financial statements in our jurisdiction state that it would be necessary to collect the information for the disclosures proposed in the ED by disaggregating data at each transaction level, and that it would be difficult to track the information for such disclosures, particularly when an entity additionally acquires

certain equity instruments subject to the FVOCI option and sells a portion of those equity instruments in the same reporting period. In light of the above, we are of the view that the additional costs expected to be incurred would outweigh the benefits obtained.

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?

(Scope of application)

25. Proposed paragraph 20B of IFRS7 in the ED proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows based on the occurrence (or non-occurrence) of a contingent event. We are concerned that the scope of contractual terms subject to this disclosure requirement would be extensive.

26. Our understanding is that the proposed additional disclosure requirements in paragraph 20B of IFRS 7 were derived from the discussion of ESG-linked features; but this requirement would not apply only to ESG-linked features. Therefore, we are of the view that contracts including contractual terms relating to the occurrence (or non-occurrence) of contingent events other than ESG-linked features can be quite extensive and would impose practical burden in terms of collecting information to comply with this disclosure requirement. Furthermore, we note that the extent of

the information to be disclosed is not clear, when there is a wide range of contractual terms.

27. In light of the above, we suggest that this disclosure requirement be limited to ESG-linked features that are of particular interest to stakeholders, given that ESG-linked features were the starting point for the discussion regarding this disclosure requirement.

(Disclosures of quantitative information)

28. Regarding the quantitative information about the range of changes to contractual cash flows that could result from the contractual terms set out in proposed paragraph 20B(b) of IFRS 7 in the ED, we question whether this information is useful in situations where the probability of contingent events occurring is uncertain. Furthermore, we are concerned that quantitative information about the range of changes in contractual cash flows by itself may be misleading to users of financial statements.

29. As an alternative, instead of requiring the disclosure of the quantitative information, we suggest that an entity be required to explain quantitative aspects in the context of a qualitative description of the contingent nature set out in proposed paragraph 20B(a) of IFRS 7 in the ED, based on the judgement from the perspective of achieving the disclosure objectives.

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?

30. We agree with the proposal to provide transition requirements that would not require the restatement of comparative information.

31. We are of the view that retrospective adjustments under IAS 8 may result in practical burden. For example, if an entity had accounted for financial assets with ESG-linked features as financial assets measured at fair value through profit or loss because the entity thought that its contractual cash flow characteristics did not meet the SPPI criteria, the amendments may result in the financial assets being reclassified as financial assets measured at amortised cost. In such a case, retrospective adjustments may require the recalculation of amortised cost and calculation of expected credit losses in prior reporting periods, which would involve practical burden such as the collection of additional data. Therefore, from the perspective of reducing the practical burden associated with retrospective application, we are of the view that it is appropriate to provide transition requirements that would not require the restatement of comparative information.