Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Berlin, 19 July 2023

Dear Andreas,

ED/2023/2 – *Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)*

On behalf of the Accounting Standards Committee of Germany, I am writing to comment on the ED/2023/2 *Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)*, issued by the IASB on 21 March 2023 (herein referred to as 'ED'). We appreciate the opportunity to comment on the proposals.

We support the IASB's efforts to amend and clarify existing IFRS 9 requirements. Further, we overall agree with the issues that the ED touches on, since they are deemed to be relevant, urgent, and lacking some clarity, thus they deserve redeliberation.

As the ED comprises several proposed amendments which affect different areas of IFRS 9 requirements, and which have different background and urgency, our assessment and resulting detailed comments are rather distinct and diverging.

While we support some of the proposals, we are not convinced about or even not supportive of others. In addition, we support the intention and the idea of most of the clarifications but consider some of the proposals in detail to be not purposeful and thus not helpful or even inappropriate.

Given the different urgency and relevance of the proposed amendments, we suggest to considering a way of "unbundling" its finalisation and initial application. This would allow for some amendments to be finalised sooner, and to be applicable rather early, while other amendments be finalised later, accompanied by a later application date.

Bearing in mind that other urgent matters of applying IFRS 9, like the application of the own use exemption to Power Purchase Agreements (PPAs) and subsequent issues of the accounting for virtual PPAs, recently have emerged, we suggest that any potential standard-setting activity in this regard should be added to this process.

For more details on our findings on the specific proposals in the ED, we refer to our responses to the questions which are laid out in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Sven Morich

Vice President

<u>Appendix – Answers to the questions in the ED</u>

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? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

We agree that there is a need for clarification as regards derecognition of a financial liability settled through electronic transfer as deliberated. However, we consider the proposed option for derecognising a financial liability settled through electronic transfer not being useful, for the following reasons:

- First, providing an exception from the general derecognition principle for a very specific and narrow fact pattern appears conceptually inappropriate.
- Second, we deem the proposed criteria that accompany this option not being sufficiently clear, and we expect serious and recurring discussions about whether those criteria are met given any individual fact pattern. Further, we are not even convinced that the criteria proposed really cover all usual fact patterns, which would be essential for the option to be broadly relevant and helpful.
- Third, we are not convinced that an option is an advantageous solution, as it may impede comparability.

This said, our findings so far suggest that the option as proposed (in particular because of its specific criteria) would neither be broadly relevant, nor would preparers broadly make use of it.

Nevertheless, as we acknowledge that a solution is desired, we feel the IASB should at least reconsider the criteria proposed aiming at being more broadly compatible.

Q2 – Classification—contractual terms 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 para. B4.1.7A; and (b) contractual terms that change the timing or amount of contractual cash flows for the purposes of applying para. 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.

First, we like to note that these proposed amendments appear to be the most urgent, the most challenging, and the most complex proposal throughout the ED.

Therefore, we like to express our full support for addressing this important and multi-faceted issue. We particularly support that the IASB choose a principles-based way to add to, and clarify, existing guidance on the classification and how to apply the Solely Payments of Principal and Interest (SPPI) criterion instead of developing specific, or fact-pattern related, requirements or exceptions. This said, we support the idea of addressing "financial instruments with contractual terms that change the timing or amount of contractual cash flows" comprehensively – and thereby including (but not focussing only on) instruments with ESG features, which are deemed the most relevant use case.

While expressing this general support, we like to point to one restriction as regards the overall focus: We regret that the IASB does not consider the issue from the borrower's/debtor's perspective. While the accounting for those instruments on the asset side is an acknowledged area of concern, and explicitly addressed by the ED, we are aware that the same issue also provides challenges for the accounting for those instruments as liabilities – which appear to be the even more relevant area of concern for many (non-financial) industries.

This said, we consider the IASB's intention and idea of clarifying how to apply the SPPI criterion being generally useful. However, we are not convinced that the specific proposals in this regard, as laid out in the ED, are understandable and helpful. In brief: We struggle to identify a comprehensive, coherent, and convincing set of guidance; therefore, we deem these proposals not being fully appropriate.

These reservations are explained in more detail as follows:

- We acknowledge that the respective proposals mainly comprise new para. B4.1.8A, new para. B4.10A and additional examples in B4.1.13 and B4.1.14. Our main caveat affects B4.1.8A and B4.10A and its interaction. From our perception, both paras. are collocated (as two sets of requirements for assessing cashflows), but we do not understand whether and how they interrelate. Further, we are not convinced that the additional examples in B4.1.13 and B4.1.14 clearly derive from the new paras. B4.1.8A and B4.10A; instead, they appear rather contradictory.
- Considering para. B4.1.8A in detail, it seems that a "basic lending arrangement" (BLA) is the "object lesson" for a financial asset complying with the SPPI criterion, which shall be clarified. If so, the four aspects of B4.1.8A partially appear abstract and not under-standable. The third aspect ("Cashflows are inconsistent with BLA if they include … risks or market factors that are not typically … basic lending risks or costs …") appears circular. Further, it does not provide any clarity as to whether, or to what extent, ESG elements may comply with typical BLA risks or costs and, thus, satisfy with the SPPI criterion. It is, and would remain, particularly unclear whether, or to what extent, ESG elements are not a "share in the debtor's revenue or profit" – ie. whether ESG elements provide "performance-

related changes" which are admitted, while generally "performance-related changes" would not be permitted. This assessment is, and would remain, difficult, with B4.1.8A not helping further. As regards the fourth aspect ("… change in cashflows is inconsistent … if not aligned with the direction and magnitude …"), assessing and verifying whether cashflow changes from ESG elements correlate with, and are proportionate to, changes from other BLA risks or costs is difficult, if not impracticable. Again, B4.1.8A (even along with BC52) would not help further in this regard.

- Considering para. B4.1.10A in detail, the second aspect ("… occurrence of an event … "specific to the debtor") is a very broad criterion and does not add any clarity as to whether an ESG feature does comply, or does not, with this requirement. In addition, this requirement seems to contradict B4.1.8A, stating that cashflows for being consistent with a BLA must not compensate for a factor representing a "share of the debtor's revenue or profit".
- Considering the examples added to paras. B4.1.13 and B4.1.14, we understand the intention of each underlining that the SPPI criterion is met, or not met, respectively. In addition, we would support both examples as typical and its respective assessments as regards the SPPI criterion as appropriate. However, we fail to understand how the SPPI assessment of these two examples derives from the requirements in B4.1.8A and B4.10A. In particular, we do not acknowledge why Instrument EA (B4.1.13) is deemed for complying with the SPPI condition, since – to our understanding – its cashflow clearly depend on an entity's (non-financial) performance. This said, we deem Instrument EA meeting the SPPI criterion does not derive from, or is even contradictory to, B4.1.8A.

Summing this up, we acknowledge the need for, and fully support the intention of, clarifying how to apply the SPPI criterion to instruments with contractual terms that change the timing or amount of contractual cash flows. However, we take the view that – unfortunately – neither the conceptual interaction nor the wording of B4.1.8A and B4.1.10A appear comprehensible and practicable. Therefore, there is a risk that the proposed new requirements would not only be unhelpful but may even distort current accounting practices (ie. current interpretation and application of existing requirements) in this regard. As a consequence, instruments currently assessed to fulfill the SPPI criterion might potentially be dismissed from this assessment.

Overall, we feel that these proposed amendments would not enhance clarity. However, we would be happy were the IASB to reconsider and potentially refine its current proposals in this respect.

Q3 – Classification—financial assets with non-recourse features

The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term 'non-recourse'.

Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features.

Paragraphs BC73–BC79 of the Basis for Conclusions explain the IASB's rationale for these proposals.

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

We generally support the respective proposals.

We like to note that the instruments affected mainly occur in the banking sector; they are less prevalent for the insurance sector and other (non-financial) industries. This given, we acknowledge that the proposed amendments are relevant and helpful for the banking sector.

Furthermore, as regards our jurisdiction, the proposals are expected to have very limited effect, since the banking sector is already applying the IFRS 9 requirements in the same way as now proposed by the IASB's clarifications. The reason is existing local technical guidance, which suggest a similar clarification for applying the IFRS 9 requirements.

Q4 – 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 para. B4.1.23 clarify that the reference to instruments in the underlying pool can include fin. instruments that are not within the scope of the classification requirements of IFRS 9.

Paragraphs BC80–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

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

We generally support the respective proposals.

We like to note that these instruments mainly occur in the financial services sector; they are less prevalent for other (non-financial) industries. Thus, we acknowledge that the proposed amendments are very relevant and useful for the financial services sector.

In addition, we are aware that – at least in our jurisdiction – current accounting practice in this regard equals the way as now proposed by the IASB's clarifications. This given, the proposals by the IASB are deemed not having broad effects.

Q5 – Disclosures—investments in equity instruments designated at FVtOCI

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?

When assessing these proposed disclosures, we reiterated the long-lasting debate about classifying equity instruments at FVtOCI. We like to state that there are still two main and positions: one is to support the current FVtOCI classification (including the non-recycling of fair value changes); the other is to not support the FVtOCI classification, and in particular the non-recycling.

Opponents of this classification take the view that additional disclosures about subsequent fair value changes do neither appropriately accompany nor "remedy" the FVtOCI classification, as this classification is deemed inappropriate. However, even those generally supporting the FVtOCI classification are not yet convinced that additional disclosures as proposed in the ED would be information-/decision-useful.

This said, we doubt whether there is a demand for such quantitative information about fair value changes as proposed by the IASB in para. 11A(f) and depicted in IG11B. In more detail, we are not convinced that there is a need for information about fair value changes of such investments *during the period*. If anything, cumulated fair value changes recognised in OCI for instruments being derecognised (ie. accumulated fair value changes being "realised") might possibly be of interest.

In addition, we like to state that the detailed information as per the table in IG11B do not necessarily and completely derive from the (proposed) requirements as laid out in IFRS 7.11A. Hence, IG11B seem to go beyond the requirements in IFRS 7.11A.

As regards the proposed amendment to IFRS 7.11A(c), we clearly acknowledge a relief and support this proposal.

Finally, we were made aware by preparers that providing quantitative data required to meet the proposed additional disclosure requirement might not, or not fully, be technically possible; this is particularly the case for the disaggregation as proposed in IFRS 7.11A(f).

Q6 – Disclosures—contractual terms that could change the timing or amount of contractual cash flows

Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C).

Paragraphs BC98–BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal.

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

We consider the proposals covering a very broad range of instruments and circumstances and, thus, being very challenging and potentially not useful.

We are aware, and like to point out, that providing these additional information would lead to essential technical efforts, as those information are neither currently present nor can be provided easily. We expect that the proposed detail and disaggregation of these information causing technical challenges and cost, particularly as the required level of disaggregation currently is not even sufficiently clear yet.

Moreover, changes in timing or amount of cashflows are not a new phenomenon, and we are not aware of any information needs that are unsatisfied so far. It should be acknowledged that any related disclosure requirements (as are now being proposed) so far do not exist, which appear consistent with our perception that there is no lack of useful information and disclosure.

Overall, were the proposed additional disclosure requirements to be finalised, we expect (actual) costs that would exceed (perceived) use or benefits by far. This given, we like to suggest that respective disclosure requirements be narrowed down to those particular instruments or fact patterns for which the need for additional information is evident.

Q7 – 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.

Paras. BC105–BC107 of the Basis for Conclusions explain the IASB's rationale for these proposals.

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

We are aware that some of the proposed amendments, eg. those on classification (and assessing the SPPI criterion), might be long-awaited since they are expected to be an urgent improvement for certain instruments. So far, it seems that the quickest possible finalisation and an early application would be desired.

However, we acknowledge that implementing the proposed amendments would be technically challenging. This is particularly the case for those amendments that go along with additional quantitative disclosure and for analysing financial liabilities that are electronically settled necessary to assess applying the proposed derecognition option. We were told that assessing which cash settlements via an electronic transfer system do meet the criteria for applying the derecognition option would be the most prominent case for a very time-consuming and challenging transition. This given, it could be appreciated if the initial application of the amendments were dated rather later than earlier. Furthermore, the ED so far does not provide specific transition requirements, e.g. for the presentation of corresponding changes in the cash flow statement.

Given these opposing views, a helpful compromise could be setting a late initial application date while allowing for early application. Though, a much better way for satisfying the different needs would be to “unbundle” the finalisation and initial application of these amendments, thereby allowing for some amendments to be finalised very soon while others be potentially refined and – as a consequence – be finalised later, accompanied by a later application date.