

International Accounting Standards Board  
Columbus Building  
7 Westferry Circus  
Canary Wharf  
London  
E14 4HD

19 July 2023

Dear Sir

**Exposure Draft ED/2023/2: Amendments to the Classification and Measurement of Financial Instruments**

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network<sup>1</sup>, this letter summarises views of member firms that provided comments on the ED.

We support the efforts of the IASB to improve the requirements of IFRS 9 *Financial Instruments* applicable to the derecognition of financial liabilities settled through electronic transfers, classification of financial assets and disclosure requirements of IFRS 7 *Financial Instruments: Disclosures*.

However, we have concerns about some aspects of the proposals, including the following:

- Criteria proposed in paragraph B3.3.8 of IFRS 9 to apply the exception from settlement date accounting for financial liabilities settled through an electronic payment system, which we believe set a very high hurdle, which may not be achieved in practice;
- Proposed requirements in paragraph B4.1.10A of IFRS 9 for the occurrence (non-occurrence) of a contingent event to be specific to the debtor, which we believe may be inconsistent with the requirements related to basic lending risk in some scenarios; and
- Proposed requirements in paragraph B4.1.20A of IFRS 9 intended to provide an exception to the requirements related to contractually linked instruments for bilateral secured lending arrangements, which we believe may have unintended consequences in some cases.

Our responses to the questions in the ED, along with the reasons for our concerns, are set out in the attached Appendix.

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We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)7875 311782 or by email at [abuchanan@bdoifra.com](mailto:abuchanan@bdoifra.com).

Yours faithfully

Andrew Buchanan

*Global Head of IFRS and Corporate Reporting*

## Appendix

### *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?*

We agree with the IASB's proposal to provide an exception from settlement date accounting for financial liabilities settled through an electronic payment system.

However, we have concerns and suggestions related to certain aspects of the proposals, as set out below:

1. We believe that the criteria proposed in paragraph B3.3.8 of the draft amendments to apply the exception are highly restrictive in nature and, consequently, not many entities would be able to apply the exception, due to the failure to meet the criteria, especially criterion (a). We believe this may result in the exception not providing meaningful practical relief, as intended.

Criterion (a) requires that the entity has no ability to withdraw, stop or cancel the payment instruction. The threshold provided in criterion (a) [*ability*] is higher than the threshold in criterion (b) [*practical ability*] and difficult to meet. For example, even if a transfer system allows withdrawal or cancellation of a payment instruction only on payment of significant charges and the probability of the entity paying the charges is remote, an entity using this transfer system would not be able to apply the exception. Several widely used payment systems with settlement period of a few days permit entities to cancel payment instruction after initiation on day 1 or 2. Entities using these transfer systems would not be able to apply the exception. Therefore, it appears that the intended relief may not be achieved due to the very high hurdle set by the proposed criteria.

Furthermore, we believe that the assessment of the criteria may involve extensive legal analysis potentially in multiple jurisdictions and the cost involved may exceed the benefit expected.

Therefore, we suggest that the IASB reconsider the criteria, especially criterion (a).

2. The proposed exception to settlement date accounting is only for financial liabilities settled with cash using an electronic payment system that meet the specified criteria. There is no exception proposed for financial assets. Therefore, we believe that if an entity were to apply the proposed exception, the accounting treatment for the corresponding change in cash balance is not clear. It would appear that the corresponding cash balance would also need to be derecognised; otherwise, the entity will be required to recognise another liability. The nature and classification of this liability is not clear and such recognition of a liability may defeat the purpose of applying the exception. We suggest that the IASB clarify this accounting treatment.
3. To limit diversity in practice, we also suggest that the IASB consider including additional implementation guidance that may address common practice issues such as:

- Assessment of the criterion (b) in paragraph B3.3.8 (no practical ability to access the cash to be used for settlement) in case of overdraft facilities; and
- Credit cards: Clarification of whether credit cards are included in electronic payment systems.

The IASB may also consider providing a definition of ‘electronic payment systems’ to help entities assess the applicability of the exception.

*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?*

We generally agree with the clarification proposed in paragraph B4.1.8A on the assessment of interest. However, we believe that further guidance should be provided on the assessment of whether a risk represents a basic lending risk.

We also believe that further clarification is required on the determination of the ‘magnitude’ of the change in basic lending risks or costs. In the absence of additional guidance, the proposed amendment could lead to diversity in practice with respect to determination of the magnitude of the change. We note that the proposed amendment requires the assessment of interest to focus on what an entity is being compensated for, rather than how much compensation an entity receives. However, for the assessment of a basic lending arrangement in the case of a change in contractual cash flows, the proposed amendment requires an assessment of the magnitude of the change. Therefore, we suggest that the requirement related to the assessment of the ‘magnitude’ of the change be refined to remove this inconsistency. In paragraph B4.1.10A, we agree with the proposed amendment that the ‘solely payments of principal and interest’ (SPPI) assessment shall be done irrespective of the probability of the contingent event occurring. However, we believe that the requirement for the occurrence (non-occurrence) of the contingent event to be specific to the debtor may be inconsistent with the principles of basic lending risk in some situations. Consider the following scenarios:

- The lending agreement provides for a reduction in the interest by a certain number of basis points if the borrower achieves a specified level of diversity in its employee base. The contingent event, i.e. achieving the specified level of diversity, is specific to the borrower. However, diversity in its employee base is typically not considered to be related to a basic lending risk.
- The lending agreement provides for an increase in interest rate by a certain number of basis points if the annual inflation reaches a specified threshold. In this case, the contingent event, i.e. the level of inflation, is not specific to the debtor, but may be consistent with a basic lending risk.

Therefore, in our view, the proposed requirements in B4.1.10A should be further refined to prevent any inconsistency with the requirements related to assessment of basic lending risk and possible structuring opportunities.

In the proposed paragraph B4.1.10A, it is not clear whether the reference to ‘debtor’ is restricted to the legal debtor. In a group of entities, bonds are often issued by a dedicated financing company within the group, with contractual terms (e.g. ESG targets) related to one or more operating entities within the group. If the term ‘debtor’ is restricted to the legal debtor, changes in contractual cash flows on account of such terms would not be considered to be consistent with a basic lending arrangement. Therefore, we suggest that the IASB clarify the scope of the term ‘debtor’.

*Question 3: Classification of financial assets—financial assets with non-recourse features*

*The draft amendments to paragraph B4.1.16 of IFRS 9 and the proposed addition of paragraph B4.1.16A enhance the description of the term ‘non-recourse’. Paragraph B4.1.17A of the draft amendments to IFRS 9 provides examples of the factors that an entity may need to consider when assessing the contractual cash flow characteristics of financial assets with non-recourse features. Paragraphs BC73-BC79 of the Basis for Conclusions explain the IASB’s rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree, please explain what aspect of the proposals you disagree with. What would you suggest instead and why?*

We generally agree with the proposed amendments.

We agree with the proposed clarification in paragraph B4.1.16A on a financial asset having non-recourse features if an entity’s contractual right to receive cash flows is limited to the cash flows generated by the specified assets both over the life of the financial asset and in the case of default. We believe that the proposed amendment helps to clarify the distinction between financial assets with non-recourse features and collateralised debt.

We believe that the proposed paragraph B4.1.17A would help entities make the assessment required in paragraph B4.1.17 for 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?*

We agree with the proposed amendments to paragraph B4.1.20. We believe that the proposed wordings on ‘waterfall payment structure’ and ‘disproportionate allocation of losses between the holders of different tranches’ provide greater clarity on the types of transactions covered within the scope of contractually linked instruments guidance.

We have a number of concerns regarding the proposed paragraph B4.1.20A, which we have set out below.

Proposed paragraph B4.1.20A:

The proposed paragraph B4.1.20A is intended to provide an exception to the requirements related to contractually linked instruments (CLI) for bilateral secured lending arrangements. As stated in paragraph BC87 of the Basis for Conclusions *‘in a secured lending transaction, the contract is generally negotiated between the creditor and the customer in the form of a sponsoring entity; therefore, such a transaction does not contain multiple contractually linked instruments’*. However, we have concerns regarding the proposed wording in paragraph B4.1.20A as set out below:

- Subsequent sale of the junior tranche by the debtor (sponsoring entity):

If the debtor initially holds the junior tranche, the arrangement would not be considered to contain contractually linked instruments as per the proposed paragraph B4.1.20A. As the classification of financial assets is not reassessed after initial recognition unless there is a change in business model, if the debtor were to subsequently sell the tranche, the transaction would not be covered by the CLI requirements. We believe that as explained in paragraph BC86 of the Basis for Conclusions, the IASB’s intention is for the proposed exception to apply to bilateral secured lending arrangements in which money is lent to a customer subject to specified assets being provided as security. However, the proposed requirement as drafted may result in transactions being outside the scope of the CLI requirements if the sponsor initially holds the junior tranche and sells it subsequently.

- In investment banking scenario, senior tranches held by the investment bank for a short time (ramp-up phase) before sale to investors:

In securitisation transactions involving investment banks, the sponsoring entity sets up an asset backed security (ABS) structure with multiple tranches. After the structure is set up, the junior-most tranche is purchased by the sponsoring entity and all other tranches are purchased by the investment bank, with a clear intention to subsequently sell a number of the tranches to unrelated third parties. Applying the proposed amendment, it appears that the structure would not be covered by CLI requirements as all the senior tranches are held by the investment bank, with the sponsoring entity holding the junior-most tranche.

Therefore, we suggest that the IASB consider refining the requirements to clarify the following points:

- If there is a single senior tranche held by the creditor and the sponsoring entity, which holds the junior tranche, intends to sell it subsequently, do the CLI requirements apply to the arrangement at the initial recognition?
- If an investment bank, that holds multiple senior tranches, intends to sell a number of the tranches subsequent to the ramp-up phase of the ABS arrangement, do the CLI requirements apply from the initial recognition?
- If the CLI requirements do not apply from the initial recognition does that mean that the CLI requirements may never be applied, because the classification of financial assets is determined at their initial recognition and is not subsequently changed

unless there is a change in the business model? If the CLI requirements would be considered never to apply in such scenarios, it would result in a different accounting requirement than that in a case where one or more tranches were pre-sold, although the two arrangements are in-substance identical.

We agree with the proposed amendments to paragraph B4.1.23. We believe that the amendment would help clarify the scope of the transactions covered by the CLI requirements where the underlying pool includes financial instruments that are not within the scope of the classification requirements of IFRS 9.

*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?*

We agree with the proposed amendments. We believe that the disclosure of aggregate fair value of investments in equity instruments instead of disclosure of fair value of each instrument would be less onerous without significantly diluting the usefulness of the information presented.

We agree with paragraph BC97 of the Basis for Conclusions that the proposed disclosure requirement in paragraph 11A(f) of IFRS 7 would provide users of financial statements with useful and more comprehensive information about the performance of equity instruments measured at fair value through other comprehensive income.

*Question 6: Disclosures—contractual terms that could change the timing or amount of contractual cash flows*

*Paragraph 20B of the draft amendments to IFRS 7 proposes disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows on the occurrence (or non-occurrence) of a contingent event. The proposed requirements would apply to each class of financial asset measured at amortised cost or fair value through other comprehensive income and each class of financial liability measured at amortised cost (paragraph 20C). Paragraphs BC98-BC104 of the Basis for Conclusions explain the IASB's rationale for this proposal. Do you agree with this proposal? Why or why not? If you disagree, please explain what aspect of the proposal you disagree with. What would you suggest instead and why?*

Although we concur with the needs of users of financial statements, as stated in paragraph BC99 of the Basis for Conclusions, for the information on contractual terms that could change

the timing or the amount of contractual cash flows, we believe that the proposed requirements could be onerous for preparers of financial statements.

There may be multiple contractual terms related to different contingent events for each instrument that may result in changes to contractual cash flows. The proposed amendment would require preparation of quantitative information for all such contingent events. It may result in an extensive disclosure requirement, not all of which might provide useful information to the users for their understanding of the financial statements. Proposed paragraph 20C permits entities to decide the extent of detail to disclose and the appropriate level of aggregation or disaggregation. However, it does not permit entities to select the nature of contractual terms to disclose.

Therefore, we suggest that the proposed disclosure requirement be amended to permit entities to disclose the effect of those contractual terms that are significant to the users' understanding of the financial statements. For instance, an entity may determine that disclosure of the effects of covenant breaches on contractual cash flows is not significant to the users' understanding of the financial statements as management is reasonably certain of meeting the covenants.

#### *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?*

We generally agree with the proposed amendments.

Given that a number of entities are facing challenges in applying the existing requirements to the financial assets with ESG-linked features, we suggest that the IASB consider permitting entities to apply the amendments related to classification of financial assets prior to applying the other amendments. This would permit entities to obtain the benefits of certain amendments without having to undertake the effort to apply all other amendments, for example, applying the SPPI amendments prior to the electronic payments amendments.