EFRAG
Financial reporting

Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

11 April 2024

Dear Mr Barckow,

Re: Exposure Draft *Financial Instruments with Characteristics of Equity*

On behalf of EFRAG, I am writing to comment on the IASB's Exposure Draft *Financial Instruments with Characteristics of Equity* (IASB/ED/2023/5), issued by the IASB in November 2023 ('the ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on the endorsement of definitive IFRS Standards in the European Union and European Economic Area.

In general, EFRAG appreciates the IASB's efforts and approach to addressing issues that arise in practice related to IAS 32 *Financial Instruments: Presentation* by clarifying some of the underlying principles in IAS 32 and adding application guidance to facilitate the consistent application of the principles. The IASB's approach is aligned with EFRAG's position in response to the 2018 Discussion Paper *Financial Instruments with Characteristics of Equity (2018 DP)* whereby EFRAG suggested that the IASB focus on targeted improvements to existing requirements in IAS 32 and related standards. Therefore, EFRAG is pleased that the IASB's ED is in line with EFRAG's suggestion in its comment letter.

EFRAG agrees with and welcomes many of the IASB's clarifications of the IAS 32 issues that arise in practice, particularly on the fixed-for-fixed condition, shareholder's discretion, presentation and transition requirements.

Nonetheless, EFRAG suggests that the IASB should pursue several improvements on the following requirements. In this regard, EFRAG:

- suggests that the IASB should discuss further measurement issues of financial liabilities with contingent settlement provisions under the scope of IAS 32, including the issue of whether the liability should be measured at a full amount of the conditional obligation or at a probability weighted amount, and the accounting treatment of the difference between the full obligation amount (that can be higher than the consideration received due to, for example, the fact that the obligation measurement ignores any probability or the existence of a cap) and the consideration received when the entity issued the instrument (which could lead to a negative equity component in order to comply with the requirements of IAS 32 that the sum of all components of the instruments must equal the fair value of the whole instrument or a loss on initial recognition) (Question 4 of the ED);
- suggests that the IASB should allow reclassification if the terms and conditions become, or stop being, effective with the passage of time as this would reflect the economic substance of the contractual terms for the remaining life of the instruments instead of an entity providing disclosures (Question 6 of the ED); and,
- while agreeing with the disclosure proposals, suggests that the IASB should ensure that proposed disclosure requirements are clear and can be implemented by entities and also that there is an adequate balance between the benefits for users of financial statements and the costs to preparers, particularly on disclosures of terms and conditions related to priority on liquidation (Question 7 of the ED).

Furthermore, EFRAG disagrees with the topics on the effects of relevant laws and regulations (Question 1 of the ED) and written put options on non-controlling interest (which is reflected in Question 3 of the ED) and considers that there is a need for a more comprehensive discussion and outreach activities with constituents. This is because these topics are complex and difficult to be addressed within the remits of the current narrow-scope-amendment project. EFRAG suggests that the IASB should:

- reconsider its proposals on the effects of relevant laws and regulations, as the IASB's clarifications that are proposed in the ED are likely to raise application challenges and uncertainty, lead to a significant change in existing practice, and introduce the risk of unintended consequences and new diversity in practice, particularly for instruments for which some or all key parameters are regulated by law or regulation;
- reconsider the initial accounting within equity for written put options on non-controlling interest, as EFRAG disagrees with the IASB's proposal to continue recognising non-controlling interest on initial recognition and considers that the debit entry should be

against non-controlling interests (similar to the alternative view of Mr Uhl in paragraph AV5 of the Basis for Conclusions);

- discuss more comprehensively measurement issues of written put options on non-controlling interest where there are different views in practice on how to determine the present value of the redemption amount and on whether probability weighted amounts should be used; and
- further consider subsequent measurement of the redemption amount as many stakeholders disagreed with presenting subsequent changes to the carrying amount of the financial liability in profit or loss while some stakeholders agreed with the IASB's proposals.

Therefore, EFRAG suggests that the IASB should separate the topics on the effects of relevant laws and regulations and written put options on non-controlling interest from the remaining topics in the ED and deal with them in a separate project. This is because EFRAG considers that the implementation of the other IASB proposals should not be delayed due to these two topics as they will provide clarifying information on classification requirements and useful information for both disclosure and presentation requirements. Nevertheless, even if suggesting a separate project for the two topics (the effects of relevant laws and regulations; and written put options on non-controlling interest), EFRAG highlights the urgency to find a solution for these two topics swiftly.

Moreover, before any of the IASB's proposals are finalised, EFRAG suggests field-testing these proposals and having outreaches with its constituents, for example, as with the approach taken for IFRS 18 *Presentation and Disclosure in Financial Statements*.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments in further detail, please do not hesitate to contact Sapna Heeralall or me.

Yours sincerely,

Wolf Klinz
EFRAG FRB Chairman

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Question 1 – Classification: The effects of relevant laws or regulations

Question 1 – The effects of relevant laws or regulations (paragraphs 15A and AG24A–AG24B of IAS 32)

The IASB proposes to clarify that:

(a) only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations are considered in classifying a financial instrument or its component parts (paragraph 15A); and

(b) a contractual right or obligation that is not solely created by laws or regulations but that is in addition to a right or obligation created by relevant laws or regulations shall be considered in its entirety in classifying the financial instrument or its component parts (paragraph AG24B).

Paragraphs BC12–BC30 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 with any of the proposals, please explain what you suggest instead and why.

EFRAG's response

1 EFRAG appreciates the IASB's efforts to clarify how relevant laws or regulations affect the classification of financial instruments under the scope of IAS 32 with the objective of addressing the issues that arise in practice with specific instruments (e.g., bail-in instruments).

2 However, EFRAG disagrees and has significant concerns with the IASB's proposals as a way forward to address the identified challenges that arise in practice, as they seem to raise more questions (particularly on financial instruments for which key parameters are regulated by law or regulations) than give answers for the practice questions stakeholders currently raise, which mostly relate to a limited number of types of financial instruments.

3 EFRAG considers that the IASB's clarifications are likely to raise application challenges and uncertainty, lead to a significant change in existing practice, and introduce the risk of unintended consequences and new diversity in practice. In particular, EFRAG considers that:

(a) it may be complex to assess whether the terms explicitly stated in the contract are actually in addition to what is established by law (i.e., an entity would have to consider all the elements of the law to assess whether the rights and obligations are

in addition to those), particularly for international groups with subsidiaries in many different jurisdictions with different legal requirements;

(b) instruments with economically similar obligations would have a different accounting classification depending on the legal environment of the entity and on whether the relevant features of the instrument are based on contractual terms that are in addition to the applicable laws and regulations;

(c) it seems conceptually incorrect to require contractual rights or obligations created solely by laws or regulations to be ignored when determining the classification of a financial instrument, particularly when considering that the conceptual framework and generally accepted accounting practice typically consider all relevant facts and circumstances when analysing accounting transactions and the economic substance of the contract;

(d) there is uncertainty on how the IASB's clarifications would apply to a number of instruments and whether it would result in more relevant information, particularly on those for which some or all key parameters are regulated by law or regulation, including regulated savings accounts, some cooperative banks' products and bail-in instruments (please see more details below); the IASB's clarifications lead to conflicting requirements within IFRS Accounting Standards (e.g., *IFRS 15 Revenue from Contracts with Customers* requires applicable laws to be considered when evaluating whether an entity has an enforceable right to payment) and the Conceptual Framework;

(e) implementing the principles set out by the IASB could prove complex from an operational point of view and generate significant costs related to performing a legal analysis in addition to the contractual terms and conditions;

(f) the IASB's proposals raise the risk of having unintended consequences, for example:

 (i) for a mandatorily convertible bond convertible into a fixed number of shares upon a contingent non-viability event (classified as equity), whether an entity should consider the enforceability of such a contract if, for example, the resolution authorities have the power to mandate conversion into a variable number of shares (thus classified as a compound instrument with an equity component that has a value of zero in accordance with the IASB's clarifications); and

(ii) the potential impact to the classification of financial instruments under *IFRS 9 Financial Instruments* from the holder perspective (i.e., financial asset), particularly when considering the requirements in IFRS 9 on classification asymmetry[1] between the holder (classification under IFRS 9 that is focused on the contractual terms and the business model) and the issuer of the financial instruments (classification under IAS 32 that would be focused on the contractual terms and the effects of law, including those under paragraphs 16A to 16D), which can impact the presentation of changes in fair value through OCI (i.e., the option to present the changes in fair value in OCI refers only to equity instruments defined as such by IAS 32; it does not apply to instruments defined as financial liabilities but classified as equity by the issuer, such as puttable instruments classified as equity by the issuer).This issue should be clarified in the application guidance.

4 EFRAG notes that these are prevailing issues that not only significantly affect financial institutions but also a wide range of other industries and companies (e.g., the accounting for ordinary shares that require the payment of dividends which is higher than the minimum dividend required by law).

Instruments for which some or all key parameters are regulated by law or regulation

5 EFRAG also expresses significant concerns on how the IASB's proposals would apply to instruments for which some or all key parameters are regulated by law or regulation, such as regulated savings accounts and some cooperative banks' products for which there are currently classification questions. More specifically, EFRAG considers that there is uncertainty on:

(a) how the IASB's clarifications would apply to **loans or banking savings deposits** for which some or all key parameters are regulated by law or regulation. The main terms of such financial instruments (e.g., duration) are predefined by law and may only be incorporated by reference into the contractual terms. Therefore, only few contractual aspects would be considered additional to rights or obligations created by laws (e.g., interest). The IASB's proposals raise questions on the classification of these products and could lead to unintended consequences (e.g., may result in some

[1] where the holder of an investment assesses whether the instrument meets the definition of equity from the perspective of the issuer.

financial institutions reclassifying some or all of their financial instruments from liability to equity);

(b) how the IASB's clarifications would apply to financial instruments under the scope of **IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*** (even if the IASB's mentions in its basis for conclusions that the IASB's proposals would be aligned with IFRIC 2). For example, for cooperative shares for which the 'member's right to reimbursement' and the 'unconditional right to refuse redemption of the entity' have both their origins in the law (which would not be considered for classification purposes), the IASB's proposals raise the question on whether such instruments could continue to be classified as equity;

(c) how the IASB's proposals would apply to **'bail-in' instruments**. For example, EFRAG notes that there are questions on the definition of laws or regulations (e.g. whether it includes guidance from regulators) and that the description of the 'bail-in' provisions in paragraph BC13(a) of the ED using Additional Tier 1 (AT1) instruments as an example does not seem to be correct. The loss-absorption feature mentioned in this paragraph which, upon the occurrence of a trigger event, requires either write down or conversion into ordinary shares of the issuer should not be viewed as resulting from legislation. This is a key qualifying condition which the contractual terms must include for such instruments to qualify as a specific part of Tier 1 banking capital (i.e. the legislation provides a framework how contractual terms should be drafted so the instrument is granted a specific regulatory treatment); and

(d) some of the proposals on relevant laws or regulations, such as those in paragraph 15A, which appear to be confusing for certain existing instruments that can be discretional by contract but mandatorily redeemable by regulation, as the IASB's proposals seem to discard both contractual terms that cannot be enforceable by law and laws or regulations that would otherwise apply regardless of whether they are included in contractual terms or not, thus creating uncertainty as to the appropriate classification of those instruments (e.g., certain Tier 1 capital with contractual discretionary features).

6 Thus, EFRAG is concerned that with its proposals the IASB may be solving some of the existing diversity in practice but, at the same time, may be creating a new diversity in practice.

Moving forward

7 As mentioned above, EFRAG retains its position expressed on the IASB's 2018 Discussion Paper that the IASB should focus on targeted improvements to current requirements in IAS 32.

8 However, on the topic of 'effects of relevant law or regulation' EFRAG considers that there is a need for a more comprehensive discussion and outreach activities as currently the IASB's proposals are not satisfactory, and this topic is pervasive, broad, complex and difficult to be addressed within the remits of the current narrow scope amendment, particularly when considering that currently there is a lack of consensus on how to move forward. As explained in the cover letter, we consider that the issue of the 'effects of relevant laws and regulations' should be decoupled from the rest of the project but needs to be dealt with swiftly.

9 Therefore, EFRAG considers that the IASB should continue to discuss this topic in a more comprehensive way, including testing its proposals against a wide range of financial instruments, particularly those heavily regulated; discuss further the meaning of 'in addition to'; discuss how its guiding principles would interact with different instruments that are highly regulated; define what laws or regulations are; and consider the interaction of its proposals with instruments classified under IFRS 9.

10 In addition, EFRAG considers that, conceptually, the combination of both contractual and legal regulations (enforceable framework) is necessary to understand the contract and its economic relevance. The most conceptual approach would be an all-inclusive approach, where an entity would have to consider contractual rights and obligations as well as obligations established by laws and regulations for classification purposes.

11 Therefore, EFRAG suggests that the IASB does not exclude this approach from its future discussions but that, in so doing, the IASB should consider the challenges mentioned below:

(a) the overall effects of laws could be costly and represent a significant change to current requirements, which would be beyond the scope of the current project on Financial Instruments with Characteristics of Equity, particularly when considering that IFRS 9 is a contractually-based Standard only;

(b) an all-inclusive classification approach could lead to significant classification changes, such as changes on the classification of ordinary shares with statutory minimum dividends, which would become liabilities (at least in part);

(c) it is challenging to develop an all-inclusive approach without encompassing items that are defined by statute, such as income tax and levies;

(d) law and regulation can be changed unilaterally by an authority (without agreement from the counterparties in the contract) and thus, in an all-inclusive approach, this could lead to continuous classification changes when there are frequent changes in the law.

12 In addition, EFRAG considers that the IASB should better connect the discussion on the effects of law and regulation with its proposals on disclosures, where preparers explain the interaction between the contractual terms and applicable law. Such disclosures are important for investors to understand the substance of the contractual arrangement of a financial instrument (e.g., disclosures together with the terms and conditions of financial instruments as discussed in our response to Question 7 below).

13 Finally, EFRAG highlights the importance of any future proposal remaining in line with the principles of IFRIC 2. The integration of this specific reference to IFRIC 2 in a revised IAS 32 could reaffirm the consistency and coherence of the accounting standards, ensuring a clear and unambiguous framework for the classification of cooperative shares as equity instruments.

14 After discussing this topic more comprehensively, the IASB should, through additional outreach, better understand whether improved guiding principles can lead to classification outcomes that are understandable and provide relevant information to users of financial statements without significant unintended consequences, and it should assess whether the benefits of future proposals would outweigh the costs of introducing a new approach. If not, the IASB may have to reconsider whether additional guidance is needed in this area.

Mandatory Tender Offers

15 EFRAG notes that when applying the IASB's proposals to MTOs, an entity is likely to conclude that the legal requirement to make an offer to non-controlling shareholders is not part of the contractual terms and therefore the MTO is not recognised. Such an approach does not seem to address the concerns raised by stakeholders about not recognising an obligation (i.e., liability) at the date in which the acquirer acquires a specified level of shareholding. In addition, the IASB's proposed clarifications that only contractual rights and obligations that are in addition to those created by relevant laws or regulations are to be considered do not seem to help in solving the issue of when to recognise a liability (e.g., when there is a legal obligation for the entity to make an offer, when an entity launches an offer as a result of the law or when an entity makes a contractual offer, given

that even a contractual offer may not be considered to lead to a financial liability on the basis that it is not in addition to what is otherwise required by law).

16 EFRAG considers that this is a significant issue that should be addressed by the IASB as part of the overall topic of the 'effects of relevant laws and regulations', as there is a perception of inconsistency between the accounting for MTOs and the accounting for written put options on non-controlling interests (NCI puts).

Question 2 – Classification: Settlement in an entity's own equity instruments (including the fixed-for-fixed condition in IAS 32)

Question 2 – Settlement in an entity's own equity instruments (paragraphs 16, 22, 22B–22D, AG27A and AG29B of IAS 32)

The IASB proposes to clarify when the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 is met by specifying that the amount of consideration to be exchanged for each of an entity's own equity instruments is required to be denominated in the entity's functional currency, and either:

(a) fixed (will not vary under any circumstances); or

(b) variable solely because of:

(i) preservation adjustments that require the entity to preserve the relative economic interests of future shareholders to an equal or lesser extent than those of current shareholders; and/or

(ii) passage-of-time adjustments that are predetermined, vary with the passage of time only, and have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of the entity's own equity instruments (paragraphs 22B–22C).

The IASB also proposes to clarify that if a derivative gives one party a choice of settlement between two or more classes of an entity's own equity instruments, the entity considers whether the fixed-for-fixed condition is met for each class of its own equity instruments that may be delivered on settlement. Such a derivative is an equity instrument only if all the settlement alternatives meet the fixed-for-fixed condition (paragraph AG27A(b)).

The IASB further proposes to clarify that a contract that will or may be settled by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments is an equity instrument (paragraph 22D).

Paragraphs BC31–BC61 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 with any of the proposals, please explain what you suggest instead and why.

EFRAG's response

17 EFRAG welcomes the IASB's efforts to clarify the principles in IAS 32 on the fixed-for-fixed condition for derivatives on own equity, as currently this is one of the main sources of accounting challenges to solve. As there is limited guidance in IAS 32 on the fixed-for-fixed condition, various questions have arisen on how requirements in IAS 32 should be interpreted and applied in practice (e.g., adjustment clauses that alter the conversion ratio to prevent dilution). This lack of clarity has also led to diversity in practice.

18 In general, EFRAG supports the IASB's proposed foundation principle and adjustment principles as the clarifications proposed by the IASB would improve consistency and are fairly aligned with current practice.

Foundation principle

19 EFRAG supports the IASB's proposed foundation principle that is based on the certainty of the amount of cash exchanged per unit of equity instrument. The IASB's proposed foundation principle would require that the issuer knows the exact exchange or conversion ratio at the inception of the derivative ('fixed exchange ratio'). This principle seems to stem from the current wording for the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 and is aligned with current practice. The principle can be expressed as fixed functional currency units per share or a fixed number of shares for each functional currency unit.

20 EFRAG also welcomes the IASB's clarification that the fixed-for-fixed condition is met if a derivative provides one party to the contract with a choice of settlement between two or more classes of the entity's own equity instruments and if all of the settlement alternatives result in a fixed exchange ratio as described in paragraph BC35.

21 As currently IAS 32 does not address a fact pattern that involves a share-for-share exchange where both legs of the exchange are a fixed number of own shares, EFRAG supports the IASB's proposal to introduce new guidance and classify as equity a contract that can be settled by exchanging a fixed number of non-derivative own equity instruments with a fixed number of another type of non-derivative own equity instruments.

Adjustment principle

22 EFRAG also supports the IASB's proposed adjustment principle that will encompass preservation adjustments and passage of time adjustments.

23 Nonetheless, EFRAG considers that it is important that the IASB provides guidance to help preparers to assess whether an adjustment is a preservation adjustment or a passage of time adjustment depending on what it is intended to compensate the bondholder for (e.g., including a flowchart in the final amendments summarising the proposals and helping preparers in reaching a conclusion). This is because such a distinction might not always be clear.

Adjustment principle – preservation adjustments

24 On preservation adjustments, EFRAG generally agrees with the IASB's proposals, which aim to allow equity classification as long as the adjustments preserve the relative economic interests of the future shareholders to an equal or a lesser extent compared to the existing underlying equity instrument holders (from the issuers' perspective), for example, change of control provisions.

However, to help implementation, EFRAG recommends that the IASB provides additional examples (particularly on those that meet the preservation adjustment principles as both the Basis for Conclusions and Illustrative Examples seem to be more focused on instruments that do not meet the preservation adjustment principle) and guidance on preservation adjustments as well as more details on the assessment of the nature of the adjustments, including the application of paragraph AG27A(b) of the ED in the context of consolidated financial statements with instruments issued by different legal entities.

Adjustment principle – passage of time adjustments

25 EFRAG welcomes the IASB's proposal to allow passage of time adjustments in order classify a derivative as equity. We also welcome the fact that the adjustment should in principle have the effect of fixing the cash amount per share in terms of present value (i.e., that the value varies only with the passage of time).

26 In general, EFRAG also agrees that the adjustment has to be pre-determinable at inception (i.e., be a pre-determinable amount or a pre-determined formula as long as the inputs to the formula only vary with time; that is, time is the only input).

27 Similar to preservation adjustments, EFRAG would also welcome additional examples and guidance on passage of time adjustments, including explanations on how the principles would apply to convertible instruments with a variable interest rate.

28 EFRAG notes that for options where the strike price varies with an interest rate benchmark or an inflation index, the IASB concluded in paragraph IE86 of the Illustrative Examples that the adjustment to the strike price is neither a preservation adjustment nor a passage-of-time adjustment as specified in paragraph 22C. However, in cases where the benchmark interest rate represents the time value of money that is relevant to the derivative and where the inflation index is not leveraged and relates to inflation in the issuer's own economic environment, it could be argued that the adjustment is based on a pre-determined formula where the inputs to the formula only vary with time (i.e., time is the only input) and thus meet the fixed-for-fixed condition.

29 Finally, EFRAG highlights that in finance the passage of time is considered to be reflected by a fixed or variable interest rate. In addition, under IFRS 9 this type of benchmark or inflation index does not call into question the 'SPPI test' and is a representation of the time value of money.

Functional currency

30 EFRAG welcomes that to meet the fixed-for-fixed condition the amount of consideration to be exchanged is required to be denominated in the entity's functional currency.

31 EFRAG also welcomes that the IASB will not reconsider the requirements that were added to IAS 32 in 2009 for 'foreign currency rights issues' and will retain the foreign currency rights issue exception, as it is considered useful. Such an exception would be retained even if the IASB clarifies that, for the fixed-for-fixed condition to be met, the amount of consideration to be received or paid for each of an entity's own equity instruments is expressed in units of the entity's functional currency.

32 EFRAG considers that the issue of which functional currency should be the reference point in determining whether a derivative is denominated in a foreign currency is very important. Entities often issue financial instruments that are denominated in a currency other than their functional currency and, as mentioned in paragraph BC44 of the Basis for Conclusions, issue instruments of another entity in the group with a different functional currency.

33 The IASB proposes that, in situations in which one entity in a consolidated group issues a derivative over the equity instruments of another entity in the group with a different functional currency, the appropriate reference point would be the functional currency of the entity within the consolidated group whose equity instruments are to be delivered or received on settlement.

34 EFRAG considers that the IASB should provide more guidance and illustrative examples on which currency should be the appropriate reference point, including derivative contracts on equity instruments of another entity within the same group (e.g., classification in a group when a parent with a Norwegian Krone functional currency issues a derivative on equity instruments of the subsidiary with strike price in Norwegian Krone and the subsidiary's functional currency is in euro), to better explain how these principles would apply in practice considering different perspectives (subsidiary, parent and group) and the different concepts of presentation and functional currency (e.g., a parent entity that issues a derivative on its own equity in its functional currency and the group uses another currency as its presentation currency).

Question 3 – Classification: Obligation to purchase an entity's own equity instruments (e.g., written put options on non-controlling interest)

Question 3 – Obligations to purchase an entity's own equity instruments (paragraphs 23 and AG27B–AG27D of IAS 32)

The IASB proposes to clarify that:

(a) the requirements in IAS 32 for contracts containing an obligation for an entity to purchase its own equity instruments also apply to contracts that will be settled by delivering a variable number of another class of the entity's own equity instruments (paragraph 23).

(b) on initial recognition of the obligation to redeem an entity's own equity instruments, if the entity does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates, those equity instruments would continue to be recognised. The initial amount of the financial liability would, therefore, be removed from a component of equity other than non-controlling interests or issued share capital (paragraph AG27B).

(c) an entity is required to use the same approach for initial and subsequent measurement of the financial liability—measure the liability at the present value of the redemption amount and ignore the probability and estimated timing of the counterparty exercising that redemption right (paragraph 23).

(d) any gains or losses on remeasurement of the financial liability are recognised in profit or loss (paragraph 23).

(e) if a contract containing an obligation for an entity to purchase its own equity instruments expires without delivery:

(i) the carrying amount of the financial liability would be removed from financial liabilities and included in the same component of equity as that from which it was removed on initial recognition of the financial liability.

(ii) any gains or losses previously recognised from remeasuring the financial liability would not be reversed in profit or loss. However, the entity may transfer the cumulative amount of those gains or losses from retained earnings to another component of equity (paragraph AG27C).

(f) written put options and forward purchase contracts on an entity's own equity instruments that are gross physically settled – consideration is exchanged for own equity instruments – are required to be presented on a gross basis (paragraph AG27D).

Paragraphs BC62–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 with any of the proposals, please explain what you suggest instead and why.

EFRAG's response

35 EFRAG appreciates the IASB's discussion on the accounting for contracts that contain an obligation for an entity to purchase its own equity instruments, particularly on derivatives such as written put options on non-controlling interest (NCI puts), where there is diversity in practice that needs to be addressed by the IASB.

36 Currently, this is a topic where there are different views on how to account for such derivatives and where companies use different accounting policies when accounting for the obligation to purchase an entity's own equity instruments (e.g., written put options on non-controlling interest), mostly on the initial accounting within equity and the presentation of the subsequent measurement of the redemption amount (changes in the redemption amount presented either in profit or loss or equity). Therefore, any clarifications are likely to change current practice.

37 EFRAG notes that some stakeholders strongly believe that the accounting issues on NCI puts are too complex and broad to be addressed as part of the scope of the current project, which is only intended to introduce narrow-scope amendments. Therefore, as explained in the cover letter, we consider that the issue on NCI puts should be decoupled from the rest of the project but needs to be dealt with swiftly.

Classification for NCI puts

Recognising obligation to repurchase own equity at present value of redemption amount

38 EFRAG appreciates the IASB's efforts to clarify the requirements on the gross presentation of the liability for redemption obligations to purchase an entity's own equity instruments (e.g., written put options and forward purchase contracts), even when an entity uses a variable number of (the parent's) own equity instruments to settle a contract (i.e., to recognise a gross liability for the pay leg of the written put). Such clarifications have the benefit of ensuring consistency on the accounting for obligations to purchase an entity's own equity instruments (that are not net settled nor issued as part of a business combination), whilst largely maintaining the gross presentation requirements in paragraph 23 of IAS 32.

39 On the initial accounting within equity, EFRAG notes that current practice is mixed due to lack of guidance in IAS 32. Some consider it logical to derecognise the NCI, while others consider such derecognition inappropriate. As explained in paragraph BC80 of the Basis for Conclusions, the IASB concluded that if an entity does not yet have access to the rights and returns associated with the ownership of the equity instruments to which the obligation relates, then the related NCI should continue to be recognised.

40 EFRAG disagrees with the IASB's conclusion and proposal to continue recognising non-controlling interest on initial recognition and considers that the debit entry should be presented as part of non-controlling interests (similar to the alternative view of Mr Uhl in paragraph AV5 of the Basis for Conclusions). EFRAG considers that the IASB's proposal on initial accounting to not remove non-controlling interest would not provide relevant information to users of financial statements, as:

(a) it is counterintuitive to have a redemption amount recognised as a liability (reflecting a claim from NCI) and at the same time have the related NCI recognised within equity (the contra to the liability would be a general reduction);

(b) recognising the liability amount against the parent's ownership interests would double-count the non-controlling interests subject to the contract;

(c) reducing the carrying amount of non-controlling interests by the forward or written put option would better reflect the economic substance of the transaction; and

(d) some consider that the proposals contradict the existing principles and guidance in paragraphs BC11, BC68 and AG29 of IAS 32, which stipulate that the own shares (or subsidiary's non-controlling shares) cease to be equity instruments when the entity

assumes the obligation to purchase them. These stakeholders suggest that the IASB should reconcile its proposals with these paragraphs of IAS 32.

41 EFRAG also acknowledges that there are stakeholders who see merits of an approach where an entity would account for the contract that meets the definition of a derivative as a stand-alone derivative (similar to the alternative view of Mr Uhl in paragraph AV3 of the Basis for Conclusions) as well as in the separate financial statements. However, most of these stakeholders equally acknowledge that the changes this approach implies are fundamental and go beyond the scope of the current project.

Initial and subsequent measurement of obligations to purchase an entity's own equity instruments

42 EFRAG highlights that, due to lack of guidance in IAS 32, in practice there are different views on how to determine the present value of the redemption amount. For example, as mentioned in paragraph BC81 of the Basis for Conclusions, questions arise in practice on how the financial liability is measured if the amount payable on redemption is variable (such as an instrument puttable at fair value or based on a formula) or subject to a cap. There are also different views on whether the probability and estimate of the timing of the contingent event occurring should be considered.

43 EFRAG regrets that the IASB has not addressed the issues related to measurement of liabilities under IAS 32 in a more comprehensive way in the ED (where the present value of the redemption amount seems to be a third measurement approach for financial liabilities), including the use of caps.[2] Therefore, EFRAG suggests that the IASB addresses more comprehensively the questions that arise in practice related to the measurement of liabilities under IAS 32.

Gains and losses on remeasurement of the financial liability

On the presentation of the subsequent measurement of the redemption amount, EFRAG notes that **many** stakeholders, including its user community, disagree with the IASB's clarifications, in particular on what concerns written put options over non-controlling interest. The main alternative proposed by these stakeholders is that changes in the financial liability should be recognised in equity. This is because it would be counterintuitive to have measurement changes being presented in profit or loss, as performance decreases when the value of the shares subject

[2] Even if discussed by the IASB in September 2022 on *Obligations to redeem own equity instruments* but seemingly not reflected in the ED.

to the put option increases, and vice versa (particularly if NCI and other owners of the parent retain ownership rights).

44 Also, EFRAG acknowledges that **some** consider that the IASB's clarifications are consistent with current requirements in IAS 32 and IFRS 9 whereby, generally, gains and losses on remeasurement of financial liabilities are recognised in profit or loss.

45 In addition, EFRAG also notes that a **minority** of stakeholders consider that the IASB should explore the accounting for subsequent changes in the NCI put liability in other comprehensive income ('OCI') instead of profit or loss in order to solve the mismatch created by accounting for dividends paid to NCIs as equity while reflecting the resulting change in the NCI put in profit or loss. The treatment in OCI could be applied by analogy with own credit risk requirements under IFRS 9 whereby changes in fair value related to changes in own credit risk are presented separately in OCI.

Accounting for the expiry of a written put option

46 EFRAG notes that many of the questions that arise on the accounting for the expiry of a written put option are related to their initial recognition and measurement and are thus directly related to the concerns raised above.

Question 4 – Classification: Contingent settlement provisions

Question 4 – Contingent settlement provisions (paragraphs 11, 25, 25A, 31, 32A, AG28 and AG37 of IAS 32)

The IASB proposes to clarify that:

(a) some financial instruments with contingent settlement provisions are compound financial instruments with liability and equity components (paragraphs 25 and 32A);

(b) the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision would not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event (paragraph 25A);

(c) payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero (paragraphs 32A and AG37);

(d) the term 'liquidation' refers to the process that begins after an entity has permanently ceased its operations (paragraph 11); and

(e) the assessment of whether a contractual term is 'not genuine' in accordance with paragraph 25(a) of IAS 32 requires judgement based on the specific facts and circumstances and is not based solely on the probability or likelihood of the contingent event occurring (paragraph AG28).

Paragraphs BC94–BC115 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 with any of the proposals, please explain what you suggest instead and why.

EFRAG's response

47 EFRAG appreciates the IASB's proposals to clarify initial recognition and measurement of financial instruments with contingent settlement provisions. Such clarifications seem to be fairly aligned with current practice and current requirements in IAS 32.

Classification of financial instruments with contingent settlement provisions

48 EFRAG welcomes the IASB's clarification that some financial instruments with contingent settlement provisions, such as those that are mandatorily convertible into a variable number of shares upon a contingent 'non-viability' event, are compound financial instruments with a liability and equity components (i.e., an entity applies both sets of requirements in paragraph 25 and paragraphs 28-30 of IAS 32).

Measurement of financial instruments with contingent settlement provisions

49 EFRAG acknowledges that the IASB's clarification that financial liabilities arising from a financial instrument with a contingent settlement provision and the liability component of a compound financial instrument with contingent settlement provisions should be measured at the present value of the settlement, where the settlement amount is discounted based on the assumption that settlement will occur at the earliest possible settlement date specified in the contract, is in line with paragraph 23 of IAS 32 and in line with some of the current practices on the classification of Additional Tier 1 instruments (in line with the view that the contingent non-viability event could occur immediately because it is beyond the control of the issuer, and there is no contractual minimum time period that must elapse before the contingent non-viability event could occur. For example, an entity could suddenly breach a required Tier 1 Capital ratio as a result of a significant one-off event).

50 However, EFRAG is concerned that:

(a) there could be a contingent settlement feature or a liability component, which can include the existence of caps, that has a higher value than the entire consideration that was received by the entity when it issued the instrument (for example, when the instrument is contingent on an event that is unlikely to happen). EFRAG is not clear on how this interacts with the current proposals on classification (including compound instruments) and requests clarity on the accounting treatment of the difference between the full obligation amount (that can be higher than the consideration received) and the consideration received when the entity issued the instrument (which could lead to a negative equity component or a loss on initial recognition); and

(b) **there are different views on whether the liability should be measured at the full amount of the conditional obligation or whether the probability and estimate of the timing of the contingent event occurring should be considered**. Some see the benefits of the IASB's approach on measurement where an entity is required to measure the liability at the present value of the redemption amount and ignore the probability and estimated timing of the counterparty exercising that redemption right. Such an approach has the benefit of being consistent with paragraph 23 of IAS 32 requirements and thus avoids both introducing significant changes to current requirements and adding complexity to the measurement calculation, as it would involve significant judgement, continuous reassessment and additional costs to preparers. However, there are also stakeholders who consider that it is preferable to measure the liability that arises from hybrids at a probability-weighted amount as the market prices of the financial instruments consider probabilities in line with IFRS 9 measurement requirements.

51 EFRAG considers that the IASB's proposals have the benefit of addressing the diversity in practice; however, we acknowledge that there are mixed views among our stakeholders on the relevance of the IASB's proposals (as described above). Thus, EFRAG suggests that the IASB discuss measurement issues of financial liabilities under the scope of IAS 32 (i.e., do not exclude from the scope of the project issues relating to the measurement of financial liabilities, as mentioned in paragraph BC82 of the Basis for Conclusions) – such as those that arise from obligations to redeem own equity instruments and financial instruments with contingent settlement provisions – where there are different views in practice on how to determine the 'full amount' or 'present value of the redemption amount' (e.g., for instruments with a cap and floor) and on whether probability weighted amounts should be used.

52 Nonetheless, if proceeding with its proposals, EFRAG notes that the IASB's proposals are putting pressure on the definition of 'present value of the redemption amount' and that EFRAG would welcome more guidance in this area, including more guidance on the scope of the IASB's proposals in paragraph 25A, on the calculation of the present value of the redemption amount (e.g., discount rates) and on the interaction of the IASB's proposals with existing initial and subsequent requirements of IFRS 9 and IFRS 13.

Accounting for discretionary payments

53 EFRAG welcome the IASB's clarification that payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero.

54 However, EFRAG considers that the IASB's proposals have to be properly linked to the IASB's proposals on disclosures and presentation requirements to ensure that users understand why related payments of interest are recognised as dividends (i.e., within equity).

55 In addition, EFRAG highlights that if the payments at the discretion of the issuer are recognised as equity, then an entity cannot hedge the interest payments made in a foreign currency. This could be a problem for entities that issue these instruments in a currency that is different from its functional currency.

Other clarifications

56 In general, EFRAG welcomes the IASB's clarifications of the terms 'liquidation' and 'non-genuine'. Nonetheless:

(a) on the meaning of 'liquidation', considering that different jurisdictions have different requirements for the liquidation process (different stages and may take significant time until completing close of business), the IASB should clearly explain the meaning of the process for permanently ceasing operations (e.g., how it interacts with resolution and administration processes and also how it interacts with insolvency) as this may impact classification of instruments; and,

(b) on the meaning of 'non-genuine', it might be useful to link this clarification to the concepts of 'not being legally enforceable' and 'not substantive' and see how 'non-genuine' is used in other IFRS Standards.

Question 5 – Classification: Shareholder discretion

Question 5

> The IASB proposes:
>
> (a) to clarify that whether an entity has an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle a financial instrument in such a way that it would be a financial liability) depends on the facts and circumstances in which shareholder discretion arises. Judgement is required to assess whether shareholder decisions are treated as entity decisions (paragraph AG28A).
>
> (b) to describe the factors an entity is required to consider in making that assessment, namely whether:
>
> (i) a shareholder decision would be routine in nature—made in the ordinary course of the entity's business activities;
>
> (ii) a shareholder decision relates to an action that would be proposed or a transaction that would be initiated by the entity's management;
>
> (iii) different classes of shareholders would benefit differently from a shareholder decision; and
>
> (iv) the exercise of a shareholder decision-making right would enable a shareholder to require the entity to redeem (or pay a return on) its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) (paragraph AG28A(a)–(d)).
>
> (c) to provide guidance on applying those factors (paragraph AG28B).
>
> Paragraphs BC116–BC125 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 with any of the proposals, please explain what you suggest instead and why.

EFRAG's response

57 EFRAG, in its comment letter to the 2018 DP, suggested that the IASB should consider developing further guidance on what is in the control of the entity, which can be complex in practice. EFRAG also suggested considering making an assessment based on whether shareholders are making decisions as 'part of the entity' (as members of the entity's corporate governance structure) or whether they are distinct from the entity itself when making these decisions (as holders of a particular instrument).

58 Nevertheless, EFRAG highlights the difficulty and subjectivity of developing guidance on how to determine whether the shareholders are acting in their individual capacity or as

part of the entity's operating and corporate governance processes. Any proposed factors should help preparers in reaching a conclusion on whether the shareholder's decision should be treated as a decision of the entity or of the shareholder, and the outcome should be clear.

59 Despite the subjectivity, EFRAG is supportive of the IASB's proposals because this will provide helpful guidance in making the assessment of whether shareholder decisions are treated as entity decisions. In addition, the assessment would depend on specific facts and circumstances; therefore, the guidance would allow entity-specific judgement while avoiding a more prescriptive approach. This view is supported by the feedback received from stakeholders, including results of the survey that EFRAG has conducted.

60 Nevertheless, EFRAG suggests that the IASB explain better the principles underpinning the proposals on shareholder discretion and consider additional examples that illustrate various scenarios where shareholders' decisions are considered part of the entity's decision or not.

61 In addition, EFRAG considers that paragraph 122 IAS 1, whereby an entity should disclose its significant accounting policies that have the most significant effect on the amounts recognised in the financial statements, would help provide transparency to users on the judgements made in making the assessment of whether a shareholder decision is treated as a decision of the entity.

Question 6 – Classification: Reclassification of financial liabilities and equity instruments

Question 6

The IASB proposes:

(a) to add a general requirement that prohibits the reclassification of a financial instrument after initial recognition, unless paragraph 16E of IAS 32 applies or the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement (paragraphs 32B–32C).

(b) to specify that if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement, an entity would:

> (i) reclassify the instrument prospectively from the date when that change in circumstances occurred.

(ii) measure a financial liability reclassified from equity at the fair value of that financial liability at the date of reclassification. Any difference between the carrying amount of the equity instrument and the fair value of the financial liability at the date of reclassification would be recognised in equity.

(iii) measure an equity instrument reclassified from a financial liability at the carrying amount of the financial liability at the date of reclassification. No gain or loss would be recognised on reclassification (paragraph 32D).

(c) provide examples of changes in circumstances external to the contractual arrangement requiring reclassification (paragraph AG35A).

Paragraphs BC126–BC164 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 with any of the proposals, please explain what you suggest instead and why.

Would the proposal to reclassify the instrument prospectively from the date when a change in circumstances occurred give rise to any practical difficulties? If so, please describe those practical difficulties and the circumstances in which they would arise.

EFRAG's response

62 EFRAG appreciates the IASB's efforts to address the issue of lack of guidance on reclassification in IAS 32.

63 EFRAG agrees with the IASB's proposals to reclassify if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement.

64 However, EFRAG disagrees with the IASB's proposals and expresses concerns on the prohibition to reclassify 'passage-of-time changes' and instead requiring disclosures on terms and conditions that become, or stop being, effective with the passage of time. If this disclosure is useful for users of financial statements, EFRAG questions why it is not relevant that the instrument be reclassified if the change from passage of time is such that the reason why it was classified, for example, as a financial liability, is no longer applicable. Furthermore, reclassification for 'passage-of-time changes' would reflect the economic substance of the contractual terms for the remaining life of the instruments.

65 As per paragraph BC139 of the Basis for Conclusions supporting the Exposure Draft, the IASB considered that an entity would be required to assess at each reporting period

whether there has been a change in substance that affects classification for all changes in the substance of the contractual arrangement. The IASB concluded that requiring reclassification for all changes in the substance of the contractual arrangement would require a fundamental change to the current approach in IAS 32 and is therefore beyond the scope of the project. Feedback from stakeholders, including our user community, indicates that the assessment at each reporting period of 'passage-of-time changes' is not an issue. In any case, entities still have to keep track of the information as it is required as part of the new disclosure requirements (paragraph 30F of the proposed IFRS 7 in the Exposure Draft). Based on these reasons, EFRAG suggests that entities should reclassify also for terms and conditions that become, or stop being, effective with the passage of time.

66 EFRAG acknowledges that there is some guidance in paragraph 32C related to what 'external to the contractual arrangement' means. However, we are unclear as to whether this also means as per law and regulation.

67 In addition, if there are substantial modifications made to a financial liability, there is guidance in IFRS 9 on how to deal with these modifications. However, if there are substantial modifications made to an equity instrument or a compound instrument, it is unclear to EFRAG what requirements to apply. EFRAG considers that guidance or clarification on this would be helpful.

Question 7 – Disclosures

Question 7 – Disclosures

The IASB proposes:

(a) to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its ownership structure is, including potential dilution to the ownership structure from financial instruments issued at the reporting date (paragraph 1).

(b) to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7.

(c) to move paragraphs 80A and 136A from IAS 1 to IFRS 7. These paragraphs set out requirements for disclosures relating to financial instruments classified as equity in accordance with paragraphs 16A–16B and/or paragraphs 16C–16D of IAS 32 (paragraphs 12E and 30I). The IASB also proposes to expand paragraph 80A to cover reclassifications if there are changes in the substance of the contractual arrangement from a change in circumstances external to the contractual arrangement.

(d) to amend paragraph 20(a)(i) of IFRS 7 to require an entity to disclose gains or losses on financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in its net assets, separately from gains or losses on other financial liabilities in each reporting period.

(e) to include disclosure requirements for compound financial instruments in IFRS 7 (paragraph 17A).

The IASB proposes to require an entity to disclose information about:

(a) the nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments (paragraphs 30A–30B);

(b) the terms and conditions of financial instruments with both financial liability and equity characteristics (paragraphs 30C–30E and B5B–B5H);

(c) terms and conditions that become, or stop being, effective with the passage of time (paragraph 30F);

(d) the potential dilution of ordinary shares (paragraphs 30G–30H and B5I–B5L); and

(e) instruments that include obligations to purchase the entity's own equity instruments (paragraph 30J).

Paragraphs BC170–BC245 of the Basis for Conclusions explain the IASB's rationale for these proposals.

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

EFRAG's response

Overall comments on the disclosure requirements

68 EFRAG agrees with the proposed disclosure requirements as this information will provide useful information to users of financial statements in order for them to understand how the entity is financed, its ownership structure and the potential dilution to its ownership structure from financial instruments that are issued at the reporting date. The feedback from users of financial statements indicated that the disclosure requirements provide more transparent and useful information.

69 However, some stakeholders have indicated that they expect significant operational challenges specifically with providing disclosures on liquidation (i.e., disclosures on the nature and priority of claims against the entity on liquidation and terms and conditions related to priority on liquidation). Some others consider that the disclosures on liquidation

do not provide a full picture of what would happen on liquidation as the disclosures are limited to only instruments under the scope of IAS 32.

70 EFRAG considers that it is important to ensure that the proposed disclosure requirements are clear and can be implemented by entities. Also, it is important to ensure that there is an adequate balance between the benefits for users of financial statements and the costs to preparers.

71 Furthermore, EFRAG considers that the disclosure requirements would be subject, as always, to the overarching materiality principle in IAS 1 *Presentation of Financial Statements*. This includes identifying which financial instruments disclosures would be warranted and considering the granularity of the information provided. EFRAG suggests that the IASB develop some guidance on an appropriate level of aggregation in order to provide relief on these operational challenges.

Response to the first part of questions (a) to (e)

72 There are currently no specific disclosure requirements in IFRS 7 with regard to an entity's issued equity instruments or equity components of compound instruments, and some related disclosures are currently included in IAS 1. Therefore, EFRAG supports the expansion of the objective of IFRS 7 and the inclusion of disclosures relating to these instruments in one place, i.e., in IFRS 7.

73 With the expansion of the objective, EFRAG agrees to the changes proposed for paragraph 3(a) of IFRS 7 and to moving paragraphs 80A and 136A from IAS 1 to IFRS 7, as these relate to equity instruments.

74 Furthermore, EFRAG agrees with the proposed disclosure requirements for compound financial instruments at initial recognition. This is because these disclosures would provide users with clarity on which components were part of a compound instrument before separation.

The nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments and terms and conditions related to priority on liquidation

75 As per EFRAG's comment letter on the 2018 DP, users indicated that they need information on the priority of claims in the event of liquidation.

76 EFRAG considers that these disclosures would help users assess the nature of these claims against the entity and understand how the claims affect the entity's solvency and liquidity.

77 However, some stakeholders have significant operational concerns associated with providing disclosures on an entity's contractual nature and priority on liquidation as follows.

(a) There are areas of complexity, such as the legal structure of international groups, when determining the nature and priority of the claims. For example, whether or not an instrument is secured or subordinated will depend on regulatory requirements and local legislation. The legal framework may change depending on the jurisdiction where the instruments have been issued.

(b) For the disclosures to be useful to users, the information should be much more granular than what is being proposed. However, this would be very difficult to produce and to be presented in an understandable manner.

78 In addition, some stakeholders consider that the disclosures on liquidation should make clear that they do not provide a full picture of what would happen on liquidation, as the disclosures focus only on instruments under the scope of IAS 32 and the local legislation may stipulate other aspects that relate to priority on liquidation, e.g., taxes and employee benefits.

79 Furthermore, some user stakeholders indicated that priority on liquidation would be particularly useful if it showed the capital and funding structure of the group.

The terms and conditions of financial instruments with both financial liability and equity characteristics (excluding terms and conditions related to priority on liquidation)

80 EFRAG agrees with the disclosures on the terms and conditions of financial instruments with both financial liability and equity characteristics. These disclosures will help users in understanding the reasons for classification for these types of instruments and the nature and characteristics of the instruments.

81 EFRAG welcomes and agrees with the disclosures of 'debt-like' and 'equity-like' characteristics, which will provide useful information to users of financial statements. For example, for compound instruments with a zero-value equity component, these disclosures would help users to understand why payments are recognised as dividends.

82 EFRAG compares the debt-like characteristics with a typical debt instrument, which usually comprises principal and interest payments. The cash flows are usually either fixed amounts or determinable amounts based on a market rate of interest, which are payable on specified dates. The amount and timing of this instrument is similar to an equity instrument

with debt-like characteristics even if the entity can avoid or defer those payments before its liquidation.

83 In addition, EFRAG compares equity-like characteristics with equity instruments; for example, distributions to ordinary shareholders are subject to the entity's discretion, and payments may be variable.

84 Nonetheless, EFRAG notes that an entity should include both quantitative and qualitative information in its disclosure of debt-like and equity-like characteristics. Regarding a compound instrument, if an entity chooses the fair value option for the financial liability and there is a derivative against it, but the entity is not exposed to the derivative component in the instrument itself, we question whether quantitative disclosures on the derivative component would provide useful information and suggest not to provide quantitative disclosures for the derivative component.

85 Also, EFRAG notes that there are no additional disclosures proposed on legal requirements that could affect the timing and amount of future cash flows of issued financial instruments. EFRAG considers that, for example, if a financial instrument is classified as equity but the effects of law changes that financial instrument to be debt-like, e.g., being converted into a variable number of shares in specific circumstances, disclosures describing these changes by law would provide useful information to users of financial statements.

Terms and conditions that become, or stop being, effective with the passage of time

86 We refer to our response to Question 6 above, whereby EFRAG disagrees with the prohibition to reclassify 'passage-of-time changes' while requiring disclosures on terms and conditions that become, or stop being, effective with the passage of time.

The potential dilution of ordinary shares

87 EFRAG welcomes the refinements the IASB made to the disclosures, in particular having more disclosures on potential maximum dilution of ordinary shares, as this will provide useful information to users of financial statements. We have heard from users that it would also be useful for the IASB to develop proposals for the users to know the maximum value of what would be contributed to ordinary equity by the conversion to shares in order to calculate the enterprise value.

88 EFRAG highlights the importance of having additional information about dilution for both listed and non-listed entities and having a better definition of dilution compared to IAS 33, as in practice it is not always clear what dilution is.

Instruments that include obligations to purchase the entity's own equity instruments

89 EFRAG welcomes the IASB's proposals because users of financial statements will obtain information about the entity's exposure to and management of liquidity risk. We also refer to our response to Question 3 above where we have concerns regarding the written put options on non-controlling interest.

Question 8 – Presentation of amounts attributable to ordinary shareholders

Question 8 – Presentation of amounts attributable to ordinary shareholders (paragraphs 54, 81B and 107–108 of IAS 1)

The IASB proposes to amend IAS 1 to require an entity to provide additional information about amounts attributable to ordinary shareholders. The proposed amendments are that:

(a) the statement of financial position shows issued share capital and reserves attributable to ordinary shareholders of the parent separately from issued share capital and reserves attributable to other owners of the parent (paragraph 54);

(b) the statement of comprehensive income shows an allocation of profit or loss and other comprehensive income attributable to owners of the parent between ordinary shareholders and other owners of the parent (paragraph 81B);

(c) the components of equity reconciled in the statement of changes in equity include each class of ordinary share capital and each class of other contributed equity (paragraph 108); and

(d) dividend amounts relating to ordinary shareholders are presented separately from amounts relating to other owners of the entity (paragraph 107).

Paragraphs BC246–BC256 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 with any of the proposals, please explain what you suggest instead and why.

Would the proposed requirement to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent give rise to any practical difficulties in determining the required amounts? If so, please describe the possible difficulties and specify areas in which further guidance would be helpful.

EFRAG's response

90 EFRAG acknowledges the inherent limitations of any binary debt-equity split and therefore welcomes the IASB's efforts to improve the presentation of equity instruments.

91 EFRAG supports the IASB's proposal to present the amounts attributable to ordinary shareholders separately from other owners of the parent in the primary financial statements. It is fundamental for the users of financial statements to have information about multiple equity providers and financial instruments disaggregated in the proposed way, as this will help them better understand how the proceeds will be distributed on the sale of a business and evaluate the ordinary shareholders' value. This should be emphasised in the Basis for Conclusions.

92 Also, EFRAG suggests replacing the term 'other owners of the parent' with 'other equity providers' to reflect the fact that other equity providers may not necessarily be owners of the business.

93 In addition, EFRAG highlights that the new disaggregation requirements in the forthcoming IFRS 18 *General Presentation and Disclosure* are likely to improve disaggregation, including within equity.

94 However, EFRAG raises questions on the practical application of the IASB's proposals, for example, how the allocation to issued capital and reserves attributable to ordinary shareholders of the parent and those attributable to other owners of the parent should be performed on the statement of financial position and the statement of financial performance.

95 EFRAG notes that it will not always be an easy split, as there could be several subcategories within issued capital (with multiple classes of shares) and reserves, and there is diversity in practice on the presentation of items within equity (e.g., share premiums, retained earnings, dividend pushers and translation differences). Therefore, EFRAG considers that additional application guidance and illustrative examples would be useful to ease implementation (such as more detailed examples, including on how to allocate profit or loss to other owners of the parent and whether this allocation should be done in accordance with IAS 33). For example, it could be application guidance and illustrative examples for instruments that pay a fixed rate coupon, but the issuer has the right to defer payment until its liquidation whether or not profit or loss and comprehensive income should be attributed to other owners of equity only when dividends/coupons are declared or whether any unpaid amounts are required to be accumulated and attributed.

96 In EFRAG's view, the IASB's proposals would put pressure on the term 'ordinary shareholders', as there are cases in which it is difficult to assess whether a specific class of shareholder is considered as ordinary shareholders.

97 Furthermore, EFRAG welcomes the IASB's decision not to change the classification of perpetual instruments (financial instruments that contain obligations that only arise on liquidation of the entity classified as equity), which would otherwise require a significant change to current requirements in IAS 32 and could cause a market disruption (e.g., may cause early redemption, make it less attractive for issuers and increase their cost of capital). However, EFRAG considers that it would be useful to require entities, where material, to issue perpetual instruments to present them as a separate line item within equity in the statement of financial position and in a separate column in the statement of changes in equity.

Question 9 – Transition

Question 9 – Transition (paragraphs 97U–97Z of IAS 32)

The IASB proposes to require an entity to apply the proposed amendments retrospectively with the restatement of comparative information (a fully retrospective approach). However, to minimise costs, the IASB proposes not to require the restatement of information for more than one comparative period, even if the entity chooses or is required to present more than one comparative period in its financial statements.

For an entity already applying IFRS Accounting Standards, the IASB proposes:

(a) to require the entity to treat the fair value at the transition date as the amortised cost of the financial liability at that date if it is impracticable (as defined in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors) for the entity to apply the effective interest method in IFRS 9 Financial Instruments retrospectively (paragraph 97X);

(b) not to require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision was no longer outstanding at the date of initial application (paragraph 97W);

(c) to require the entity to disclose, in the reporting period that includes the date of initial application of the amendments, the nature and amount of any changes in classification resulting from initial application of the amendments (paragraph 97Z);

(d) to provide transition relief from the quantitative disclosures in paragraph 28(f) of IAS 8[3] (paragraph 97Y); and

(e) no specific transition requirements in relation to IAS 34 Interim Financial Reporting for interim financial statements issued within the annual period in which the entity first applies the amendments.

For first-time adopters, the IASB proposes to provide no additional transition requirements.

Paragraphs BC262–BC270 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 with any of the proposals, please explain what you suggest instead and why.

Would the proposal to apply the proposed amendments retrospectively give rise to any other cases in which hindsight would be necessary? If so, please describe those cases and the circumstances in which the need for hindsight would arise.

EFRAG's response

98 EFRAG agrees that full retrospective application of the proposed amendments will enhance consistency and facilitate the analysis of the financial information by the users of financial statements.

99 Nevertheless, EFRAG considers that despite proposed amendments being clarifying amendments which do not fundamentally change the existing requirements, in practice they may require more changes to the classification of financial instruments than originally envisaged. As a result, the impact of the fully retrospective approach should be carefully assessed in terms of timing and cost-benefit analysis.

100 EFRAG welcomes the IASB's efforts in this respect aimed at minimising the costs for preparers by providing several reliefs and simplifications of transition requirements, such as:

[3] Paragraph 28(f) of IAS 8 states: 'When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose

> . . . (f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment: (i) for each financial statement line item affected; and (ii) if IAS 33 Earnings per Share applies to the entity, for basic and diluted earnings per share . . .

(a) not requiring the restatement of information for more than one comparative period;

(b) allowing to consider fair value at the transition date as the amortised cost of the financial liability if it is impracticable to apply the effective interest method in IFRS 9, respectively;

(c) not requiring separation of the liability and equity components if the liability component of a compound financial instrument was no longer outstanding at the date of initial application; and

(d) providing the exemption from quantitative disclosures in paragraph 28(f) of IAS 8.

101 In addition, EFRAG recommends that the IASB should explore an optional transition relief to not apply the fully retrospective approach to instruments that do not exist at the time of initial application of the amendments, similar to the approach taken in other recent IFRS Accounting Standards. For example, paragraph 7.2.1 of IFRS 9 provides similar transitional relief whereby entities shall not apply IFRS 9 requirements to items that have already been derecognised at the date of initial application. Due to the fact that in practice the IFRS 9 transition relief had some operational challenges, EFRAG suggests that this relief could be optional.

102 Furthermore, EFRAG suggests that entities applying hedge accounting should not apply the fully retrospective approach because this could give rise to accounting mismatches, which would not reflect the performance of the entity. For example, for hybrid instruments that had been accounted as financial liabilities and whose interest rate risk has been hedged, if interest is recognised in equity upon transition, retrospective application would give rise to open derivatives with fair value changes that would impact profit or loss, thereby causing accounting mismatches. This situation will not result in useful information provided to the users of financial statements.

103 Upon transition, if reclassification occurs because of a change in circumstances external to the contractual arrangement (please refer to Question 6 for more details), EFRAG suggests providing information for the prior comparative period based on reclassified terms and conditions of a financial instrument.

104 EFRAG also notes that a full retrospective approach could have an impact on prior year coefficients linked to debt/equity ratios due to the reclassifications between financial liabilities and equity.

105 Therefore, EFRAG considers that the entities should be given sufficient time to implement the requirements of the ED, especially taking into account a full retrospective transition approach.

Question 10 – Disclosure requirements for eligible subsidiaries

Question 10 – Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])

The IASB proposes amendments to the draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures], which will be issued before the proposals in the Exposure Draft are finalised.

[IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures.

The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures.

Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

EFRAG's response

106 EFRAG notes that the consideration of reduced disclosure requirements for eligible subsidiaries in the scope of the forthcoming draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures] will be a part of any future amendments to existing IFRS Accounting Standards or a new IFRS Accounting Standard where disclosure requirements are amended, added or deleted.

107 Therefore, EFRAG welcomes that the IASB is considering whether the reduction of the proposed disclosure requirements is warranted for eligible subsidiaries within the scope of the forthcoming draft Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*] by applying the principles described in the paragraph BC 34 of the Basis for Conclusions on the Exposure Draft *Subsidiaries without Public Accountability: Disclosures*.

108 However, EFRAG highlights that the IASB is requesting comments on consequential amendments to a future IFRS Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*] that had not yet been issued or endorsed in the EU. Therefore,

the endorsement of the Amendments resulting from this ED, or at least a part of them related to the reduced disclosures, is conditional on the outcome of the EU endorsement process of the future IFRS Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*].

109 EFRAG further notes that financial institutions, including insurance companies, are out of the scope of the forthcoming IFRS Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*]. This means that their subsidiaries applying IFRS Accounting Standards would have to provide a comprehensive package of new disclosure requirements on financial liabilities and equity required by this ED without any reduction.

110 EFRAG notes that the user profile of the subsidiaries without public accountability is different from the one of publicly traded entities and agrees with the IASB that users of eligible subsidiaries' financial statements are first interested in the information about short-term cash flows, obligations, commitments and contingencies and about liquidity and solvency.

111 EFRAG agrees that disclosures of terms and conditions of the financial instruments with debt- and equity-like features, together with the nature and priority of claims on liquidation, provide necessary information about the short-term liquidity and solvency of the entity. EFRAG highlights that the above proposed disclosures are not reduced by the IASB (paragraphs 30A–30F of IFRS 7).

112 EFRAG also agrees that separate disclosure of gains or losses recognised on financial liabilities with contractual obligations to pay amounts based on an entity's performance or changes in the entity's net assets (IFRS 7, paragraph 20(a)(i)), together with disclosures on financial instruments containing obligations to purchase own equity instruments (IFRS 7, paragraph 30J), cover user needs on disaggregation of information for such instruments. EFRAG highlights that these disclosures are not reduced by the IASB.

113 The ED does not require eligible subsidiaries to disclose information about reclassification, compound financial instruments, potential dilution of ordinary shares and puttable instruments. EFRAG considers that such information is less relevant to the users of financial statements of eligible subsidiaries and agrees with the IASB's proposal.

114 EFRAG generally agrees with the IASB's proposals, which seem to be a fair balance between costs and benefits related to disclosing relevant information.

115 EFRAG refers to its detailed comments and concerns expressed in the full set of the proposed disclosure requirements in Question 7 and notes that they remain valid for subsidiaries without public accountability.