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20.03.2024

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Response to EFRAG's draft comment letter on the IASB's Exposure Draft IASB/ED/2023/5
Financial Instruments with Characteristics of Equity

Dear Wolf,

We appreciate the opportunity to comment on EFRAG's draft comment letter on the IASB's Exposure Draft *IASB/ED/2023/5 Financial Instruments with Characteristics of Equity – Proposed amendments to IAS 32, IFRS 7 and IAS 1* (herein referred to as 'ED').

In general, we support the ED's aim to improve the information a company provides in its financial statements about its financial liabilities and equity instruments within the scope of IAS 32 *Financial Instruments: Presentation* and to resolve application issues companies have when applying the classification requirements in IAS 32. In this context, we also agree with the view that that IAS 32 works well for most financial instruments and that fundamental changes to its classification requirements are unnecessary. As such, we support the IASB's approach to develop proposals focused on clarifying the requirements, including the underlying principles, for classifying a financial instrument as a financial liability or an equity instrument and thereby resolving known application issues.

In our view, EFRAG's draft comment letter addresses similar issues and concerns that we will raise in our own comment letter to the IASB. In particular, this relates to Question 1 – *The effects of relevant laws or regulations* and Question 3 - *Obligation to purchase an entity's own equity instruments*.

With regards to Question 1, we would like to emphasize the risk that the proposed amendments could lead to unintended consequences. Our main concern in this context is that economically similar instruments may have a different classification as either equity or financial liability depending

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whether their relevant terms (e.g. minimum dividends or termination rights) are solely created by laws or regulations or are contractual terms in addition to the prevalent laws and regulations.

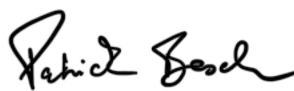
In connection with Question 3, we support EFRAG's suggestion to present the debit entry for the liability for redemption obligations to purchase an entity's own equity instruments as part of non-controlling interests, similar to the alternative view of Mr. Uhl in paragraph AV5 of the Basis for Conclusions. In addition, we will provide further supportive arguments in our own comment letter to the IASB to present the remeasurement changes of the liability in equity instead of profit or loss. In our opinion, the reasoning within the Bases for Conclusion for the approach to measure the changes of the liability in profit or loss is inconsistent. Therefore, we believe that this approach is not superior to the view that changes in the measurement of the put option are reflective of a transaction between owners in their capacity as owners, which is accounted for in equity in accordance with IFRS 10.

The appendix to this letter sets out our views on these two questions in further detail.

Notwithstanding the above, we would like to point out that we do not concur with EFRAG's conclusions related to the additional disclosure requirements (Question 7). We do not expect that these additional disclosures will add significant benefit to the users in terms of decision usefulness, despite the substantial operational burden for the preparers to provide them. In addition, we see the risk that the ever increasing amount of specific disclosure requirements with every Standard amendment will eventually have the negative consequence of obscuring more relevant disclosures of an entity. The same underlying considerations apply in our view with regards to the proposed amendments for the presentation of amounts attributable to ordinary shareholders (Question 8). Hence, we would ask the IASB to reconsider their proposals and refrain from these additional disclosure and presentation requirements.

We hope that our feedback is helpful for you. Please feel free to contact Job Schöningh (job.schoeningh@allianz.com) or us to discuss any matters raised in this letter.

Yours sincerely,



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Appendix: IASB ED/2023/5 – Selected Consultation Questions

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

We fully understand the intention of the IASB to address practice issues about whether and how laws or regulations (such as statutory or regulatory requirements) applicable to a financial instrument affect the classification of the instrument. However, the proposed clarifications to consider only those contractual rights and obligations in the classification of a financial instrument that are enforceable by law and are *in addition to those created by relevant laws or regulations* may lead to unintended consequences.

In particular, the situation could arise that economically similar instruments could have to be classified differently, depending on whether their relevant terms are solely created by laws or regulations or are contractual terms in addition to the prevalent laws and regulations. For example, if the relevant laws or regulations require a minimum divided, this would not be considered in the classification as equity or a financial liability, whereas if the same requirement would be included in a contract without a corresponding legal requirement, it would have to be considered. A similar case would be the right of the holder to put the instrument to the issuer.

The proposed amendments would also have an impact on the classification of investments held as either equity or debt financial instrument. In this case, the holder would be required to assess the contractual terms of each instrument held, understand the relevant legal and regulatory requirements that the issuer is exposed to and determine whether the contractual terms go beyond the legal and regulatory requirements. Especially for large institutional investors with hundreds or thousands of investments, this could lead to substantial operational burden and undue costs and efforts.

In our view, these unintended consequences could lead to an assessment that is more driven by the form than the legal substance.

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

We generally follow the ED's proposals for the accounting of obligations to purchase an entity's own equity instruments.

However, we do not agree with the new requirement of IAS 32.23 to recognize gains and losses on remeasurement of the financial liability in profit or loss (Question 3(d)).

In particular, we do not share the view expressed in BC87 that an entity's obligation to purchase its own equity instruments from non-controlling shareholder is not considered a transaction between owners in their capacity as owners.

As mentioned in BC78(a), non-controlling interests represent existing ownership interests. As a consequence, non-controlling interests are presented within the consolidated equity of the entity as a separate component. This is also expressed in IFRS 10.BCZ159, which states: *"the Board noted that minority (non-controlling) interests represent the residual interest in the net assets of those subsidiaries held by some of the shareholders of the subsidiaries within the group, and therefore met the Framework's definition of equity."*

From this we conclude that entering into a put-option with the non-controlling shareholders represents a contract between owners of the entity in their capacity of owners. This is also demonstrated by the fact that the debit entry for the liability for the present value of the redemption amount is made in shareholder's equity at initial recognition (IAS 32.23). In our view, the subsequent measurement changes should be booked in the same line item within equity, because they are directly related to the transaction between the parent's shareholders and the non-controlling interests.

In this context, we would also like to point out that IAS 32.23 requires that the carrying amount of the financial liability is removed from financial liabilities and included in equity if the contract expires without delivery. Hence, in this case, there is no impact in profit or loss either. In contrast to this accounting treatment, the derecognition requirements for financial liabilities set forth in IFRS 9.3.3.3 foresee that the extinguishment is reflected in profit or loss. In BC93 the IASB explains the inclusion of the amounts removed from the liability in equity with the fact that *"The expiry of the written put option does not change the fact that the original transaction occurred—the put option was issued, giving rise to the financial liability."*

In our view, it is not consistent to refer to the original transaction in the case of expiry, while not doing so for the subsequent measurement of the liability before its expiry. With regards to subsequent measurement, BC87(c) refers to the IFRS 9 requirements to recognize gains or losses on remeasurement of the liability. At the same time, BC85 explains that the IASB deleted the reference to IFRS 9 in paragraph 23 of IAS 32 to avoid potential confusion about how an entity measures a financial liability for an obligation to purchase its own equity instruments after initial recognition. Instead of applying IFRS 9, the IASB considered that many questions about subsequent measurement could be resolved if an entity applied the same approach for subsequent measurement as that applied for initial measurement (BC83). In other words, the IASB acknowledges that the subsequent measurement shall follow the same principles as the initial measurement and not the respective rules of IFRS 9.

Based on these considerations, we conclude that it would only be consequential if the results of the proposed measurement approach for the put options are reflected in the financial statements for subsequent measurement in the same way as for initial measurement or upon expiry of the option. Hence, in our view the measurement changes should be recognized within shareholder's equity because they arise from a transaction with owners in their capacity as owners.

As an additional remark, we would further propose to the IASB to consider the Alternative View from Mr. Uhl described in the Bases for Conclusions AV5 and AV6 with regards to the presentation of the debit entry for the recognition of the obligation to purchase a subsidiary's equity instruments. We agree with the conclusion in AV6 that that the proposed accounting treatment to recognize both a liability and the full amount of non-controlling interest is not representationally faithful because it overstates claims on the entity's net assets held by parties other than the entity's controlling owners while understating the controlling interests' claim on the entity's net assets.

Therefore, we support the proposal in AV5 to present the debit entry as a separate component after non-controlling interests and within a subtotal for net non-controlling interests. In our view, if the amount of the liability exceeds the corresponding non-controlling interests, only the excessive amount should be debited against shareholder's equity.