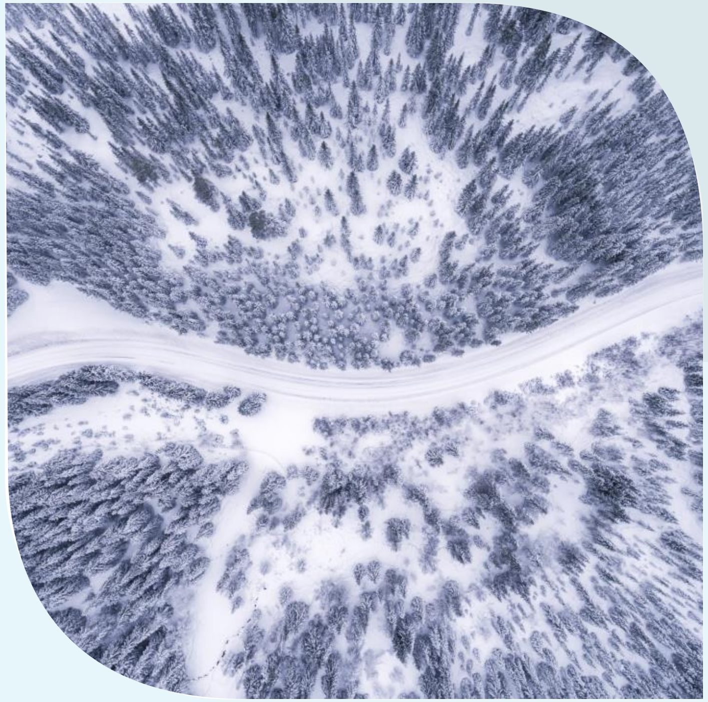
Comparison of the IASB's feedback summary with EFRAG's comment letter

FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY (FICE)

04-02 EFRAG FR TEG - CFSS meeting 02 July 2024



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IASB's feedback summary vs EFRAG's final comment letter: High-level comparison by topic

General assessment by topic

Topic	IASB feedback	EFRAG comment letter
Effects of relevant laws or regulations		
Fixed-for-fixed condition		
Obligations to purchase own equity instruments		
Contingent settlement provisions		
Shareholder discretion		
Reclassification of financial liabilities and equity instruments		
Disclosures		
Presentation of amounts attributable to ordinary shareholders		
Transition		
Disclosure requirements for subsidiaries without public accountability		

General assessment by topic – Key to the table in slide 4

- The colours in the column ‘IASB feedback’ are taken from the assessment in the IASB’s feedback summary (Agenda paper 04-03)

- The colours in the column ‘EFRAG comment letter’ reflect the assessment in the EFRAG’s final comment letter:
  - Red – the topic should be separated from FICE and dealt with in a separate project
  - Yellow – significant improvements needed, may be addressed as a part of FICE project without causing an excessive delay to FICE
  - Green – EFRAG in general agrees with the IASB’s proposals

- The keys issues on the ‘red’ and ‘yellow’ topics are further detailed in the Appendix

EFRAG Secretariat comments (expanded in Agenda paper 04-01)

Prioritisation of topics for re-deliberations reflect the conclusions in EFRAG's Comment Letter

- To prioritise re-deliberations for proposals where significant improvements are necessary
  - contingent settlement provisions
  - reclassification of financial liabilities and equity instruments
  - disclosures
- To also prioritise re-deliberations for proposals which EFRAG agreed with
  - the fixed-for-fixed condition
  - shareholder's discretion
  - presentation
  - transition requirements
- Subsequently to look at the following in a separate project
  - the effects of relevant laws and regulations
  - written put options on non-controlling interest

QUESTIONS FOR EFRAG FR TEG - CFSS

1. Does the EFRAG FR TEG – CFSS members agree with the EFRAG Secretariat's comments (in slide 6) regarding prioritisation of topics for re-deliberations? Please explain.

2. What specific topics (if any) does the EFRAG FR TEG-CFSS consider that the IASB should prioritise in its re-deliberations?

3. Does EFRAG FR TEG – CFSS have any other comments on the IASB's feedback summary (Agenda paper 04-03)?

Appendix: IASB's feedback summary vs EFRAG final comment letter: Key messages for main topics

IASB'S PROPOSALS ON EFFECTS OF RELEVANT LAWS AND REGULATIONS (1)

IASB's feedback summary	Conclusion – EFRAG's comment letter
• Distinction between obligations created by laws/regulations and contracts is never 'black and white'(codification depends on civil vs common law framework); • Some support for an 'all-inclusive approach' with/without exceptions; • Concerns raised included: • Proposals could result in significant disruption to practice—interpretation is based on paragraph 15 of IAS 32 'substance of the contractual arrangement' or paragraph 5 of IFRIC 2 Members' Shares in Co-operative Entities and Similar Instruments 'terms and conditions include relevant local laws, regulations'	EFRAG suggested 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

IASB'S PROPOSALS ON EFFECTS OF RELEVANT LAWS AND REGULATIONS (2)

IASB's feedback summary	Conclusion – EFRAG's comment letter

• Concerns raised included (cont.):
  • Diversity across jurisdictions and potentially within the same consolidated group for economically similar instruments could impair comparability and result in structuring opportunities;
  • Unintended consequences on classification (eg regulated savings accounts/deposits and puttable instruments/co-operative shares where the obligation arises from the law);
  • Lack of understandability on the drafting (eg 'in addition to') and need for judgement/extensive analysis could lead to new uncertainties and diversity in practice;
  • Whether laws or regulations include prudential guidelines or regulatory frameworks.
• Requests for illustrative examples and additional guidance as well as additional disclosures;
• Some suggested keeping the status quo until a fundamental review of IAS 32	

IASB'S PROPOSALS ON OBLIGATIONS TO PURCHASE OWN EQUITY INSTRUMENTS (1)

IASB's feedback summary	Conclusion – EFRAG's comment letter

• Most feedback was provided in the context of NCI puts and although the type of NCI put (eg fair value vs fixed price) was not always specified, comments indicated that concerns mostly related to NCI puts exercisable at fair value or a proxy for fair value).
• General concerns about:
  • A 'one size fits all' approach due to diversity in practice;
  • Debiting 'parent equity' on initial recognition because of double counting on the balance sheet and the impact on banks' regulatory capital ratios;
  • Remeasurement of the liability through profit or loss due to counterintuitive effects, double counting in the income statement, or the view that this is a transaction between owners;
  • Counterintuitive impact in profit or loss for distributions to NCI because the liability is affected.
	EFRAG suggested that the IASB should:
	• Reconsider the initial accounting within equity for written put options on non-controlling interest, as EFRAG disagreed with the IASB's proposal to continue recognising non-controlling interest on initial recognition and considered 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);

IASB'S PROPOSALS ON OBLIGATIONS TO PURCHASE OWN EQUITY INSTRUMENTS (2)

IASB's feedback summary	Conclusion – EFRAG's comment letter
• Mixed views on measurement—some support fair value/amortised cost approach in IFRS 9 Financial Instruments, others support simplified 'new measurement approach' but want clarifications; • General support for accounting on expiry of written put; • Requests for illustrative examples and additional guidance (eg on assessing rights and returns, accounting on exercise of written put); • Some support for the net approach (derivative accounting); • A few suggested a separate project on NCI puts.	EFRAG suggested that the IASB should (cont.): • 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.

IASB'S PROPOSALS ON CONTINGENT SETTLEMENT PROVISIONS

EFRAG

IASB's feedback summary	Conclusion – EFRAG's comment letter
• General support for: • Clarification that some financial instruments with contingent settlement provisions are compound instruments; • Aligning the initial and subsequent measurement approaches; • Clarification of 'not genuine' with some wording changes. • Some misunderstanding about the scope of the proposals (either existing liabilities with contingent settlement provisions or only liability components of compound instruments). • Large disagreement about measurement deviating from IFRS 9 ie ignoring probability and estimated timing of contingency. • Concerns about: • Impact on hedge accounting if discretionary interest payments are recognised in equity instead of profit or loss; • Defining 'liquidation' or that the proposed definition may be too narrow. • Requests for additional guidance and examples (eg discount rate, if initial amount > fair value or multiple settlement amounts). • A few suggested considering measurement issues as part of a separate standard-setting project to amend IFRS 9/amortised cost research pipeline project	EFRAG suggested 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.

IASB'S PROPOSALS ON RECLASSIFICATIONS

EFRAG

IASB's feedback summary	Conclusion – EFRAG's comment letter

• General support for:
  • Requiring reclassification when the substance of the contractual arrangement changes because of a change in circumstances;
  • The timing of reclassification.
• Large disagreement with the proposal to prohibit reclassification from financial liability to equity when the substance of the contractual arrangement changes due to passage-of-time changes.
• Some requested clarifications on:
  • Whether changes in laws or regulations or changes in the factors relating to shareholder discretion can be considered as changes in circumstances requiring reclassification;
  • The impact of reclassification to holders of financial instruments and the interaction with other IFRS 9 requirements related to modification and derecognition.
• Requests for more illustrative examples and additional guidance (eg on the meaning and scope of 'external to the contractual arrangement').
	EFRAG suggested 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

IASB'S PROPOSALS ON DISCLOSURES (1)

IASB's feedback summary	Conclusion – EFRAG's comment letter

• General support for additional information not captured by a binary classification and expanding the objectives of IFRS 7;
• General concerns about application challenges and operational burden for preparers;
• Nature and priority of claims on liquidation:
    • Some misunderstanding that proposals require the order of priority on liquidation resulting in concerns about complexity in groups with subsidiaries in multiple jurisdictions and with complex capital structures (the information is relevant at a separate entity level);
    • Some viewed the proposed disclosure requirements as:
        • contradicting a going concern view or irrelevant for regulated banks where resolution aims to prevent liquidation;
        • incomplete (exclude non-financial liabilities);
        • challenging when considering varying jurisdictional laws and regulations where legal priority differs from contractual priority.
	While agreeing with the disclosure proposals, EFRAG suggested 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.

IASB'S PROPOSALS ON DISCLOSURES (2)

EFRAG

IASB's feedback summary	Conclusion – EFRAG's comment letter

• Terms and conditions:
  • Some support for additional disclosures to provide transparency and help understand complex instruments;
  • Some concerns about operational burden to prepare the information on an instrument-by-instrument basis.
• Potential dilution of ordinary shares:
  • Some confusion with IAS 33 Earnings per Share and how to reconcile to diluted EPS;
  • Some agreed this information would be useful but suggested including the proposals in IAS 33 to limit them to listed companies.
• Other disclosures:
  • Some support for the disclosure proposals on compound instruments, NCI puts and passage-of-time changes (if the IASB proceeds with the proposed reclassification prohibition).
• Some suggestions to reduce disclosure overload (eg narrow the scope or cross-refer to regulatory reports).
• Requests for additional guidance and illustrative examples about granularity and aggregation.	

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