Financial Instruments with Characteristics of Equity (Proposed amendments to IAS 32, IFRS 7 and IAS 1)

# Feedback to respondents – EFRAG Final Comment Letter

## June 2024

This Feedback Statement has been compiled by the EFRAG Secretariat to summarise the main comments received by EFRAG on its draft comment letter and explain how those comments were considered by EFRAG during its technical discussions leading to the publication of its final comment letter. The content of this Feedback Statement does not constitute any form of advice or opinion and does not represent the official views of EFRAG or any individual member of the EFRAG FRB or EFRAG FR TEG.

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# Introduction

## Objective of this feedback statement

EFRAG published its Final Comment Letter on the IASB's ED/2023/5 *Financial Instruments with Characteristics of Equity (Proposed amendments to IAS 32, IFRS 7 and IAS 1)* ('the ED') on 12 April 2024. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG's final comment letter.

## Background to the ED

IAS 32 *Financial Instruments: Presentation* sets out requirements for classifying and presenting financial instruments as financial liabilities or equity instruments in the financial statements of the entity that issues those instruments.

Overall, the IASB received feedback from stakeholders and other research that indicated that IAS 32 works well for most financial instruments. Therefore, the IASB decided that it was unnecessary to change the Standard fundamentally.

However, financial innovation, market forces and changes to financial sector regulations have resulted in a growing number of complex financial instruments with both financial liability and equity characteristics. This situation poses challenges for entities applying IAS 32 and has resulted in diversity in practice regarding classification.

The IASB published a Discussion Paper *Financial Instruments with Characteristics of Equity* in June 2018 to respond to the challenges in applying IAS 32. After considering feedback on the Discussion Paper, the IASB decided not to pursue the proposed classification approach. Instead, the IASB decided to focus on clarifying the classification requirements in IAS 32, including their underlying principles, to address known practice issues that arise in applying IAS 32.

In developing the proposals in the 2023 Exposure Draft, the IASB's intention was that classification outcomes be changed only if there is enough evidence that such a change would provide more useful information to users of financial statements.

The Exposure Draft also sets out proposals to improve the presentation and disclosure of information about financial liabilities and equity instruments. The IASB has developed these proposals in response to calls from users of financial statements for better information about the characteristics of financial liabilities and equity instruments that are not captured by classification alone and about the amounts attributable to ordinary shareholders of an entity. Further details are available on the [IASB's website].

## EFRAG's draft comment letter

EFRAG published a [draft comment letter] on the IASB's proposals on 15 January 2024. In the draft comment letter, EFRAG welcomed 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 consistent application of the principles.

EFRAG suggested that the IASB should:

- avoid classification changes that do not raise concerns in practice in order to avoid unintended consequences;
- consider whether a liability should be recognised for a Mandatory Tender Offer;
- discuss more comprehensively measurement issues of financial liabilities under the scope of IAS 32, such as those that arise from obligations to redeem own equity instruments and financial instruments with contingent settlement provision;
- reconsider the initial accounting within equity for written put options on non-controlling interest (NCI written put), 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;
- consider that many stakeholders disagree with presenting subsequent changes to the carrying amount of the financial liability in profit or loss;
- explore the alternative model to treat contracts which meet the definition of a derivative as a stand-alone derivative at fair value through profit or loss; and
- allow reclassification of 'passage-of-time changes'.

EFRAG also welcomed the proposed improvements to disclosures in IFRS 7 but expresses some concerns and suggestions in the following areas:

- disclosures on an entity's contractual nature and priority on liquidation, especially on separation between subordinated and unsubordinated claims; and
- suggestion to provide disclosures on the effects of law on the classification as financial liabilities or equity instruments.

In addition, EFRAG supported the IASB's proposals to separately present the amounts attributable to ordinary shareholders from other owners of the parent in the primary financial statements.

## Comments received from respondents

EFRAG has received and considered 18 comment letters from respondents. These comment letters are available on EFRAG's [website]. The comment letters received came from preparers and preparer organisations, national standard setters, professional organisations, an academic, a user organisation and an auditor.

EFRAG also conducted an online survey to gather the views of European constituents on the IASB's Exposure Draft. EFRAG received 12 responses from banks, insurers, financial conglomerates, a corporate and a national standard setter.

In addition, EFRAG conducted outreach activities with the Accounting Standards Committee of Germany (ASCG) together with the Austrian Financial Reporting

Advisory Committee (AFRAC), Organismo Italiano di Contabilità (OIC), European Accounting Association (EAA) and in other meetings.

Please refer below to a summary of the respondents' comments. The summary reflects feedback from comment letters received, the online survey and outreach activities.

## EFRAG's final comment letter

EFRAG issued its final comment letter on 11 April 2024. EFRAG agreed with and welcomed 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 suggested that the IASB pursue several improvements on the following requirements. In this regard, EFRAG:

- suggested that the IASB discuss further measurement issues of financial liabilities with contingent settlement provisions under the scope of IAS 32;
- suggested that the IASB allow reclassification if the terms and conditions become, or stop being, effective with the passage of time; and
- while agreeing with the disclosure proposals, suggested that the IASB ensure that proposed disclosure requirements are clear and can be implemented by entities and ensure an adequate cost-benefit balance, particularly on disclosures of terms and conditions related to priority on liquidation.

Furthermore, EFRAG disagreed with the topics on the effects of relevant laws and regulations and written put options on non-controlling interest and considered that there was a need for a more comprehensive discussion and outreach activities with constituents. EFRAG suggested that the IASB should:

- reconsider its proposals on the effects of relevant laws and regulations;
- reconsider the initial accounting within equity for written put options on non-controlling interest;
- discuss more comprehensively measurement issues of written put options on non-controlling interest; and
- further consider subsequent measurement of the redemption amount.

Therefore, EFRAG suggested 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 considered that the implementation of the other IASB proposals should not be delayed due to these two topics. Nevertheless, EFRAG highlighted the urgency to find a solution for these two topics swiftly.

Moreover, before any of the IASB's proposals are finalised, EFRAG suggested testing these proposals and having outreaches with its constituents.

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## General comments

*Proposals in the ED*

The ED proposed requirements for a number of topics described below.

*EFRAG's tentative position*

In general, EFRAG welcomed the IASB's efforts and approach to addressing issues that arise in practice related to IAS 32.

EFRAG highlighted the importance of assessing, through fieldwork and outreach events, the likely effects of the changes proposed by the IASB, particularly the importance of applying the proposed changes to individual transactions or contracts as if the proposed Standard was already in effect.

*Respondents' comments*

Respondents provided significant concerns, for example, relating to the effects of relevant laws and regulations and written put options on non-controlling interest.

**EFRAG's response to respondents' comments**

*EFRAG's final position*

EFRAG, taking into consideration all the feedback from the respondents relating to the ten Exposure Draft questions, suggested 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 considered 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 one the one hand and written put options on non-controlling interest on the other), EFRAG highlighted the urgency to find a solution for these two topics swiftly.

Moreover, before any of the IASB's proposals are finalised, EFRAG suggested 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 tentative views expressed in the draft comment letter and respondents' comments**

## Q1 – The effects of laws or regulations

*Proposals in the ED*

In the ED, the IASB proposed to clarify that, in classifying a financial instrument as a financial liability or an equity instrument, a company (i) considers only contractual rights and obligations that are enforceable by laws or regulations and that are in addition to those created by applicable laws or regulations and (ii) disregards any rights or obligations created by applicable laws or regulations that would arise regardless of whether the right or obligation is included in the contractual arrangement. It also clarified that, in certain circumstances, a company might recognise and measure the rights and obligations that it disregarded when classifying a financial instrument as a financial liability or an equity instrument applying other accounting standards.

*EFRAG's tentative position*

In its DCL, EFRAG welcomed the IASB's discussions on the interaction between the terms and conditions of a contract and applicable law to avoid a blanket rejection of the effects of the law from classification, and it noted that the IASB´s proposals had the benefit of addressing the issues that arise in practice without fundamentally changing the principles in IAS 32.

However, EFRAG highlighted in its letter some practical challenges that arise from applying the IASB's proposals. For example, it was difficult to assess what was in addition to what is in the law, particularly for international groups. EFRAG also highlighted the importance of testing the IASB's approach (to better understand potential classification changes and any unintended consequences).

*Respondents' comments*

Many respondents appreciated the IASB's efforts to address the questions that arise in practice. However, most respondents, particularly preparers and regulators, expressed significant concerns on the IASB's proposals. Some of these respondents explicitly disagreed with the IASB's proposals.

In general, these respondents indicated that the IASB's proposals were not sufficiently clear, raised application challenges and uncertainty on the outcome, and indicated that they could lead to a significant change in current practice, adding that they introduced a risk of unintended

**EFRAG's response to respondents' comments**

*EFRAG's final position*

After considering the feedback from its constituents, EFRAG decided to change its initial position on the effects of relevant law and regulation to disagree with the IASB's proposals and highlight the 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 also decided to highlight the concerns received from its stakeholders that the IASB's clarifications as proposed in the ED are likely to raise application challenges and uncertainty, leading to a significant change in existing practice and introducing 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.

Finally, EFRAG suggested that the IASB should separate the topic on the effects of relevant laws and regulations from the remaining topics in the ED and deal with it in a separate project. This is because EFRAG considers that the implementation of the other IASB proposals should not be delayed due to this topic 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 effects of relevant laws and regulations, EFRAG highlighted the urgency to find a solution for this topic swiftly.

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| consequences and that they could lead to new diversity in practice. Some of these respondents explicitly disagreed with the IASB's proposals.<br><br>In particular, many respondents expressed 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, including regulated saving accounts and cooperative banks instruments, which currently do not raise significant classification issues.<br><br>On mandatory tender offers, some respondents, including regulators and users, considered that the IASB should address this issue due to unclarities regarding the treatment of MTOs (mentioned in EFRAG's draft comment letter).<br><br>On how to move forward, many encouraged the IASB to reconsider its proposals and considered that the best way forward would be an 'all-inclusive' approach. As an all-inclusive approach may disrupt some current practices, two respondents considered that the IASB may provide limited exceptions.<br><br>Still, many respondents called for the IASB to further consider (revise) its proposals, perform more field-testing and provide more clarifications and examples to illustrate the application of the IASB's proposals. This was suggested with the objective of helping the assessment of whether a contractual right or obligation is required by laws or regulations, ensuring comparability across companies, ensuring effectiveness and coherence of the requirements and avoiding unintended consequences on the classification of financial instruments. | |

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q2 – Fixed-for-fixed condition for derivatives

*Proposals in the ED*

In the ED, the IASB proposed to clarify in IAS 32 that, for the fixed-for-fixed condition to be met, the amount of consideration exchanged for each of a company's own equity instruments is required to be in the company's functional currency and to be either fixed or variable solely because of a preservation or passage-of-time adjustment. The IASB also provided guidance on preservation and passage-of-time adjustments, share-for-share exchanges and contracts that allow a choice of settlement between two or more classes of own equity instruments.

*EFRAG's tentative position*

In general, EFRAG supported the IASB's proposals for fixed-fixed condition as the they would improve consistency and were aligned with current practice.

However, EFRAG noted that there were cases where a variable interest rate could represent the time value of money that is relevant to a derivative (and thus the fixed-for-fixed condition should be met).

EFRAG also identified two cases where the IASB's proposals on fixed-for-fixed would represent a change to current practice (e.g., call options that can be exercised for pre-determined amounts at pre-determined dates or where the strike price varies with an interest rate benchmark or an inflation index).

*Respondents' comments*

Many respondents generally agreed with the IASB's proposals and considered that these clarifications would reduce the existing diversity in practice.

On the passage of time and preservation adjustments, some respondents, while supportive, expressed some concerns and called for additional guidance, particularly on the use of a variable interest rate. There were also concerns on the IASB's proposals related to which functional currency should be the reference point.

**EFRAG's response to respondents' comments**

After considering the feedback received, EFRAG decided to make limited changes to EFRAG's initial position.

More specifically, EFRAG decided to improve its initial position by leveraging on the comments received, for example, on requesting more illustrative examples and implementation guidance on passage-of-time adjustments, on preservation adjustments and on which functional currency should be the reference point.

On the latter, EFRAG highlighted that the IASB should provide guidance on derivative contracts on equity instruments of another entity within the same group 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).

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q3 – Obligation to purchase a company's own equity instruments

*Proposals in the ED*

IAS 32 requires that, if a contract includes an obligation for a company to purchase its own equity instruments, a financial liability is recognised for the present value of the redemption amount and removes that amount from equity. Examples include a written put option that gives the holder the right to require the company to purchase its own shares from non-controlling interest holders.

The IASB proposes to clarify that:

- a company that does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates continues to recognise those instruments as equity instruments and removes from a component of equity other than non-controlling interests or issued share capital an amount equal to the initial amount of the financial liability;
- when measuring the financial liability (initial and subsequent measurement), a company disregards the probability and estimated timing of the counterparty's exercise of its redemption right and discounts the redemption amount to its present value assuming that the redemption will occur at the earliest possible redemption date;
- a company recognises gains or losses on remeasurement of the financial liability in profit or loss; and
- a company also applies the requirements relating to obligations to purchase its own equity instruments to contracts that will be settled by delivering a variable number of another class of the company's own equity instruments.

*EFRAG's tentative position*

**EFRAG's response to respondents' comments**

*EFRAG's final position*

After considering the feedback from its constituents, EFRAG decided to maintain its initial position concerning accounting treatment at initial recognition, i.e., to disagree with the IASB's conclusion and proposal to continue recognising non-controlling interest on initial recognition and to propose instead that the debit entry should be presented as part of non-controlling interests. The argumentation of this position was further elaborated on the basis of the feedback received from the constituents.

EFRAG decided to change its initial position concerning the net presentation and not to recommend exploring the net presentation model. This change of the initial position is due to the feedback received from the constituents who noted that such a change would be too fundamental, given the scope of the current project.

EFRAG decided to maintain its initial position concerning gain and losses on subsequent measurement of the financial liability, i.e., to note the disagreement of many stakeholders with the IASB's clarifications that the effects of such remeasurement should be recognised in profit or loss, while also acknowledging benefits of these clarifications. The feedback received from the constituents is generally in line with this initial position, with many constituents preferring instead that the effects of remeasurement of the financial liability be presented within equity. EFRAG considered that the issue should be analysed in a more comprehensive manner, including exploring an accounting treatment of reflecting the effects of remeasurement of the financial liability in other comprehensive income (by analogy with own credit risk requirements under IFRS 9), as an alternative to the two approaches discussed above.

## EFRAG's tentative views expressed in the draft comment letter and respondents' comments

*Initial recognition* – EFRAG noted that current practice was mixed due to lack of guidance in IAS 32. Some considered logical to derecognise the NCI, while others considered such derecognition inappropriate.

EFRAG disagreed with the IASB's conclusion and proposal to continue recognising non-controlling interest on initial recognition and considered that the debit entry should be presented as part of non-controlling interests, because:

- it is counter-intuitive 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);
- recognising the liability amount against the parent's ownership interests would double-count the non-controlling interests subject to the contract; and
- reducing the carrying amount of non-controlling interests by the forward or written put option would better reflect the economic substance of the transaction.

EFRAG also acknowledged that there were stakeholders who considered that an entity should account for the contract that met the definition of a derivative as a stand-alone as well as in the separate financial statements. Therefore, EFRAG considered that there was merit in exploring an alternative model, including the possibility of recognising changes in the fair value of the derivative within equity.

*Initial and subsequent measurement of obligations to purchase an entity's own equity instruments* – EFRAG highlighted 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 as well as whether the probability and estimate of the timing of the contingent event occurring should be considered.

EFRAG regretted that the IASB had not addressed the issues related to measurement of liabilities under IAS 32 in a more comprehensive way in the ED and suggested that the IASB address more comprehensively the questions that arose 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 noted that many stakeholders disagreed with the IASB's clarifications. This is because it would be in conflict with the requirements to account in equity for transactions with owners in their capacity as owners and

## EFRAG's response to respondents' comments

Finally, EFRAG suggested that the IASB should separate the topic on written put options on non-controlling interest from the remaining topics in the ED and deal with it in a separate project. This is because EFRAG considers that the implementation of the other IASB proposals should not be delayed due to this topic 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 written put options on non-controlling interest, EFRAG highlighted the urgency to find a solution for this topic swiftly.

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| would be counterintuitive to have measurement changes being presented in profit or loss, as performance decreased when the value of the shares subject to the put option increased, and vice versa (particularly if NCI and other owners of the parent retained ownership rights).<br><br>Nonetheless, EFRAG acknowledged that some consider that the IASB's clarifications had the benefit of addressing current diversity in practice, improving comparability and being consistent with current requirements in IAS 32, IFRS 9 and IAS 1.<br><br>*Respondents' comments*<br><br>*Initial recognition of the obligation to redeem an entity's own equity instruments* – Most of the respondents to the comment letter and a significant majority of the respondents to the survey did not support the IASB's proposal on the gross presentation whereby an entity initially recognises a financial liability for the redemption amount with the debit side going against the parent's equity. Instead, these respondents prefer that the debit side at initial recognition go against the NCI share of equity.<br><br>The key arguments provided by the respondents were the concerns on double accounting (i.e., NCI in equity and purchase obligation as financial liability); the view that the IASB's proposals do not properly reflect the economic substance of the transaction in question and result in counterintuitive effects; on 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; and on punitive impact on banks' prudential own funds.<br><br>At the outreach events, the majority of the participants disagreed with the IASB's proposals on initial recognition and considered that the debit should go to NCI (the arguments were similar to those presented above). At the German/Austrian event, around half of the participants agreed with the IASB's proposals on initial recognition while a large minority agreed with debiting NCI equity.<br><br>*Net presentation* – Many respondents to the comment letter and a majority of the respondents to the survey expressed various degrees of sympathy for the 'net presentation'. However, a majority of these respondents expressed that such a change would be too fundamental, given the scope of the IASB's project. | |

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| At the outreach events, in general there was support for gross presentation rather than net presentation.<br><br>*Subsequent measurement of the financial liability* – Respondents to the comment letter expressed mixed views as to whether the subsequent remeasurement of the financial liability should be reflected via profit or loss or via equity. Whilst most of those respondents who expressed a preference supported reflecting the effects of remeasurement in equity, some supported the IASB's proposal that it be treated via profit or loss. On the other hand, a significant majority of respondents to the survey did not support the IASB's proposals, preferring instead that the effects of remeasurement of the financial liability be presented within equity. Equally, at the outreach events there was more support for changes in the financial liability going to equity rather than to profit or loss.<br><br>The respondents to the comment letter and the survey and the participants of the outreach events who opposed the IASB's proposals referred to the following key arguments: (a) these instruments should be viewed as transactions with owners in their capacity as owners; (b) it is counterintuitive to have measurement changes being presented in profit or loss, as performance decreases when the value of the shares subject to the put option increases, and vice versa; (c) double effect on profit or loss; and (d) accounting complications if the put option expires without exercise. | |

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q4 – Contingent settlement provisions

*Proposals in the ED*

In the ED, the IASB proposed to clarify in IAS 32 that (i) financial instruments with contingent settlement provisions could be compound instruments; (ii) when measuring the financial liability (initial and subsequent measurement), a company disregards the probability and estimated timing of the contingent event occurring and discounts the settlement amount to its present value assuming that the settlement will occur at the earliest possible date; and (iii) a company recognises payments that are at its own discretion in equity, even if the equity component has an initial carrying amount of zero. In addition, the IASB decided to provide guidance on the meaning of 'not genuine' and 'liquidation'.

*EFRAG's tentative position*

On classification, EFRAG welcomed the IASB's clarification that some financial instruments with contingent settlement provisions, such as bail-in instruments, are compound financial instruments with a liability and equity components, even if the equity component is zero.

However, we called for the IASB to discuss measurement issues more comprehensively (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.

*Respondents' comments*

In general, respondents that replied to this question agreed with the IASB's proposals on contingent settlement provisions, although many disagreed with the IASB's proposal on initial and subsequent measurement of the liability (i.e., the IASB's proposal to disregard probability).

On subsequent measurement, there were different views on whether the liability should remain measured at the full amount of the conditional obligation subsequently or whether the probability and estimate of the timing of the contingent event occurring should be considered. Many saw the benefits of the IASB's approach on subsequent measurement, where an entity is

**EFRAG's response to respondents' comments**

*EFRAG's final position*

After considering the feedback received, EFRAG decided to highlight that there are mixed views among its stakeholders on the relevance of the IASB's proposals and retained its suggestion 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)

EFRAG also continued to welcome the IASB's clarifications of the terms 'liquidation' and 'non-genuine' but called for the IASB to further clarify some additional points (e.g., the IASB should clearly explain the meaning of the process for permanently ceasing operations and how it interacts with resolution and administration processes and also with insolvency)

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| 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 initial measurement requirements by not introducing significant changes to current requirements and not adding complexity to the measurement calculation, as it would involve significant judgement, continuous reassessment and additional costs to preparers.<br><br>However, there are also many 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 and it is the basis for the amortised cost accounting.<br><br>The respondents that referred to payments at the issuer's discretion agreed with the IASB's proposal that payments at the issuer's discretion be recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero. However, some respondents provided a number of suggestions (e.g., transition relief).<br><br>On the meaning of 'liquidation' and 'non-genuine', respondents called for the IASB to outline further (e.g., in the Basis for Conclusions) the situations that present practical application difficulties and how its proposals would apply. | |

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q5 – Shareholder discretion

*Proposals in the ED*

In applying paragraph 19 of IAS 32 to classify a financial instrument as a financial liability or an equity instrument, an entity considers whether it has an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation. In some cases, the settlement is at the discretion of the entity's shareholders.

The IASB proposes to clarify in IAS 32 that an entity is required to use its judgement to assess whether shareholder decisions are treated as entity decisions that result in the entity having an unconditional right to avoid delivering cash or another financial asset. The IASB proposes some non-exhaustive factors that an entity is required to consider when making that judgement.

*EFRAG's tentative position*

EFRAG, at that stage, was unsure of the outcome of the four factors in paragraph AG28A of IAS 32 in the ED and would conduct testing to gather evidence on the impact of the factors.

*Respondents' comments*

A significant majority of respondents agreed or welcomed the proposed requirements on how to treat shareholders' decisions. Also, there seemed to be support for the factors from the outreach feedback. The respondents considered that the proposals would provide useful and helpful guidance and would allow entity-specific judgments.

The majority of respondents from comment letters received requested for illustrating examples or further guidance/specific principles on the application of the factors to help minimise the risk of diversity in application and to improve comparability.

Many respondents from the survey feedback considered that the IASB should mandate a particular accounting treatment because they indicated that interactions could be quite varied and therefore real cases should be further investigated in order to develop a more complete guidance.

**EFRAG's response to respondents' comments**

*EFRAG's final position*

Based on the positive feedback from the respondents, EFRAG supported the IASB's proposals as this would 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.

Also, respondents requested for illustrative examples or further guidance/principles. Therefore EFRAG, in its comment letter, suggested 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.

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q6 – Reclassification of financial liabilities and equity instruments

*Proposals in the ED*

The IASB is proposing to prohibit reclassification unless paragraph 16E of IAS 32 applies or the substance of the contractual arrangement changes because of a change in circumstances that are external to the contractual arrangement, e.g., a change in an entity's functional currency or a change in an entity's group structure.

For cases where reclassification is allowed, as described above, the entity should apply the reclassification prospectively from the date in which the change in circumstances occurs.

*EFRAG's tentative position*

EFRAG expressed concerns on the prohibition to reclassify when contractual terms become, or stop being, effective with the passage-of-time ('passage-of-time changes') and instead required disclosures on terms and conditions that became, or stop being, effective with the passage of time. If this disclosure was useful for users of financial statements, EFRAG questioned why it is not relevant that the instrument be reclassified if the change from passage of time was such that the reason why it was classified, for example, as a financial liability, was no longer applicable.

For the above reason, and also because reclassification for 'passage-of-time changes' would reflect the substance of the contractual terms for the remaining life of the instruments, EFRAG suggested allowing reclassification if there are changes to the effective terms and conditions of the financial instruments.

*Respondents' comments*

Respondents in general were supportive of reclassification when a change of the substance of the contractual arrangement is due to a change in external circumstances.

The majority of respondents to the comment letter and survey feedback did not support the prohibition of reclassification for contractual terms that become, or stop being, effective with the passage-of-time. They considered that the resulting information would be potentially

**EFRAG's response to respondents' comments**

*EFRAG's final position*

Considering feedback from the respondents, EFRAG agreed 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.

However, also taking into account the feedback from the respondents, EFRAG disagreed with and expressed concerns on the prohibition to reclassify 'passage-of-time changes'.

| EFRAG's tentative views expressed in the draft comment letter and respondents' comments | EFRAG's response to respondents' comments |
| --- | --- |
| misleading for the readers of the financial statements, i.e., may no longer faithfully represent the substance of the financial instrument. In addition, respondents did not consider that it would be very costly to assess at each reporting date whether an instrument would be reclassified if there were passage-of-time changes.<br><br>There were mixed views from the outreach feedback whereby at one outreach event there was agreement with the proposals or no objection to them, while in another there were concerns about non-reclassification/non-derecognition of non-derivative financial liabilities on expiration of contingent settlement provisions. | |

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q7 – Disclosures

*Proposals in the ED*

The IASB is proposing to:

- expand the objective and scope of IFRS 7 to include equity instruments that are within the scope of IAS 32 to understand how an entity is financed and what its current and potential ownership structures are;
- require in IFRS 7 that a company disclose the nature and priority of claims against the company on liquidation arising from its financial liabilities and equity instruments;
- require in IFRS 7 that a company disclose the terms and conditions of financial instruments and how they affect the nature, amount, timing and uncertainty of the instrument's cash flows;
- require in IFRS 7 that a company disclose the potential dilution to the company's ownership structure resulting from financial instruments issued at the reporting date;
- require in IFRS 7 that a company disclose information to enable investors to understand the effect of how an obligation for a company to purchase its own equity instruments may impact the company's future cash flows; and
- require in IFRS 7 that a company disclose information relating to financial liabilities that include contractual obligations to pay amounts based on the company's performance or changes in its net assets, reclassifications of financial instruments as financial liabilities or equity instruments and judgements the company has made in classifying financial instruments.

*EFRAG's tentative position*

EFRAG welcomed the improvements to the disclosures on issued instruments and considers that it is important to ensure that they are clear and can easily be implemented by entities. It was also important to ensure that there is an adequate balance between the benefits to users

**EFRAG's response to respondents' comments**

*EFRAG's final position*

Taking into consideration feedback from users of financial statements and also considering the concerns raised by respondents, EFRAG overall supported the proposed disclosure requirements.

Nonetheless, EFRAG highlighted the significant operational concerns from respondents relating to the nature of and priority on liquidation and that the disclosures on liquidation should make clear that they do not provide a full picture of what would happen on liquidation.

EFRAG also suggested that the IASB should ensure that proposed disclosure requirements are clear and can be implemented by entities and that there is an adequate balance between the benefits for users of financial statements and the costs to preparers.

EFRAG also considered the operational concerns from respondents relating to disclosures related to terms and conditions of financial instruments with both financial liability and equity characteristics. However, EFRAG considered that these disclosures would help users in understanding the reasons for the classification of these types of instruments and the nature and characteristics of the instruments. Therefore, EFRAG supported these proposed disclosure requirements.

| **EFRAG's tentative views expressed in the draft comment letter and respondents' comments** | **EFRAG's response to respondents' comments** |
|---|---|

of financial statements and the costs for preparers. Therefore, field-testing would be essential in this context.

In this regard, EFRAG had the following concerns and suggestions:

- on disclosures on an entity's contractual nature and priority on liquidation, especially for distinguishing between subordinated and unsubordinated claims, entities may face challenges determining whether priority stems from the contract or from related law/regulation. In addition, EFRAG considered that it may be useful to provide information based on subgroups if they are located in different jurisdictions and information on how the structure of the group affects the priority on liquidation; and,
- on disclosures related to terms and conditions of financial instruments with both financial liability and equity characteristics, EFRAG considered that it would be useful to provide disclosures on the effects of law on the classification as financial liabilities or equity instruments.

*Respondents' comments*

*Comment letter feedback*

The majority of respondents acknowledged that the users of financial statements would like to understand the complex instruments and that (some) of the disclosure requirements would be useful for users.

A significant majority of respondents had concerns on the disclosure requirements, with many of them indicating that the package of disclosures did not strike the right balance between the benefits of disclosures to the users and the cost for preparers. However, many respondents supported the disclosure requirements or indicated that they could be prepared at a reasonable cost and effort.

The main concerns on the proposed disclosure requirements stemmed from:

- disclosures on liquidation:

| **EFRAG's tentative views expressed in the draft comment letter and respondents' comments** | **EFRAG's response to respondents' comments** |
|---|---|
| <ul><li>many respondents indicated that IFRS Standards are based on a going concern principle and not liquidation or resolution. Therefore, disclosures on liquidation would be contrary to the information based on a going concern view;</li><li>many respondents questioned the operationality without undue cost and effort of disclosures relating to the nature and priority of claims against the entity on liquidation. They also questioned whether these disclosures could be presented in a way that is useful to users; and</li></ul>• disclosures on the terms and conditions of financial instruments with both financial liability and equity characteristics, whereby many respondents considered these disclosures to be specifically burdensome to comply with and were unsure as to how the users of the financial statements were going to absorb and use all the mostly narrative information of different levels of granularity between entities.<br><br>*Survey feedback*<br><br>*Understandability of the disclosures* – Most of the respondents considered the proposed disclosures to be generally understandable.<br><br>*Significant operational issues expected* – The majority of respondents expected significant operational issues when providing the disclosure requirements mainly because they considered that there was an imbalance from a cost versus benefits and decision-usefulness versus disclosure overload perspective. On the contrary, many respondents did not expect significant operational issues, indicating that the information can be prepared at a reasonable cost and effort.<br><br>*Disclosures – Terms and conditions of financial instruments –* Most of the respondents agreed with the guidance provided on debt-like characteristics and equity-like characteristics in paragraphs B5B–B5G of IFRS 7 in the ED.<br><br>*Outreach feedback*<br><br>At the OIC outreach event, users and preparers expressed different views. Users supported the proposals, in particular disclosures on terms and conditions of financial instruments. The preparers instead highlighted a number of risks (overload and obscuring), operational challenges and implementation costs. | |

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q8 – Presentation of amounts attributable to ordinary shareholders

*Proposals in the ED*

The IASB proposes to amend IAS 1 to help uses of financial statements understand how a company distributes returns attributable to ordinary shareholders. The proposed presentation requirements comprise:

- presentation in the statement of financial position of issued share capital and reserves attributable to ordinary shareholders of the parent company separately from other owners of the parent company;
- allocation of profit or loss and other comprehensive income between ordinary shareholders of the parent company and other owners of the parent company in the statement of comprehensive income;
- reconciliation for each class of ordinary share capital and each class of other contributed equity in the statement of changes in equity; and
- separate presentation of dividends relating to ordinary shareholders and those relating to other owners of the company.

*EFRAG's tentative position*

EFRAG welcomed the IASB's efforts to improve the presentation of equity instruments and supported the IASB's proposal to separately present the amounts attributable to ordinary shareholders from other owners of the parent in the primary financial statements, given the fundamental needs of users of financial statements.

However, EFRAG had certain concerns about the IASB's proposals, in particular regarding:

- the use of the terms 'ordinary shareholders' and 'other owners of the parent'; and
- 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

**EFRAG's response to respondents' comments**

*EFRAG's final position*

After considering the feedback received, EFRAG decided to make limited changes to its initial position. More specifically, EFRAG considered that it is fundamental for the users of financial statements to have information about multiple equity providers and financial instruments disaggregated in the proposed way. Therefore, EFRAG continued to support the IASB's proposals.

In other aspects, EFRAG maintained its initial position of supporting the IASB's proposal and, taking into consideration the respondents' concerns, considered that more application guidance and illustrative examples would be useful to ease the implementation.

| **EFRAG's tentative views expressed in the draft comment letter and respondents' comments** | **EFRAG's response to respondents' comments** |
|---|---|

those attributable to other owners of the parent should be performed on the statement of financial position and the statement of financial performance.

EFRAG considered that additional application guidance and illustrative examples would be useful to ease implementation.

Furthermore, EFRAG welcomed the IASB's decision not to change the classification of perpetual instruments. However, EFRAG considered that it would be useful to require entities, where material, 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.

*Respondents' comments*

Respondents to the comment letter had mixed views about the IASB's proposals. Whilst many respondents supported, sometimes strongly, the proposals, many others did not consider the need for such presentation requirements.

A majority of the respondents to the comment letter had concerns about the clarity of the IASB's proposals and emphasised that additional application guidance and illustrative examples would be needed to be able to perform the split. Equally, half of the respondents to the survey expected significant difficulties in making an allocation between 'ordinary shareholders of the parent' and 'other owners of the parent' in the statement of financial position, the statement of comprehensive income (e.g., in allocating profit or loss, other comprehensive income or both, notably such elements of OCI as profits from hedging, revaluation result and FX adjustments) and the statement of changes in equity. In particular, some respondents to both the comment letter and the survey raised issues regarding the calculation of the attribution for AT1 instruments.

Some respondents to the comment letter had concerns about the use of the terms 'ordinary shareholders' and 'other owners of the parent' in the ED.

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q9 – Transition

*Proposals in the ED*

The IASB proposes to require a company to apply all 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 a company chooses or is required to present more than one comparative period in its financial statements.

*EFRAG's tentative position*

EFRAG agreed 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.
However, EFRAG considered that in practice the amendments 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.

EFRAG welcomed the IASB's efforts in this respect aimed at minimising the costs for preparers by providing several reliefs and simplifications of transition requirements, e.g., not requiring the restatement of information for more than one comparative period.

In addition to the transition reliefs already provided, EFRAG recommended the IASB to explore an optional transition relief to not apply the fully retrospective approach to instruments that did not exist at the time of initial application of the amendments, similar to the approach taken in other recent IFRS Accounting Standards.

Furthermore, EFRAG suggested 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.

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

**EFRAG's response to respondents' comments**

*EFRAG's final position*

EFRAG maintained its initial position of supporting the IASB's proposal while mentioning several concerns and recommending exploring an optional transition relief to not apply the fully retrospective approach to instruments that did not exist at the time of initial application of the amendments.

After analysing the feedback of the respondents and considering their support of the proposals, no significant changes have been introduced as the key concerns of the respondents have already been reflected in EFRAG's initial position.

| EFRAG's tentative views expressed in the draft comment letter and respondents' comments | EFRAG's response to respondents' comments |
| --- | --- |
| *Respondents' comments*<br><br>Most of the respondents to the comment letter supported the IASB's proposals in general, but only four respondents expressed their support without having any significant issues, while the others mentioned one or more concerns, including:<br><br>• complications that could arise for entities applying hedge accounting;<br>• the need to carefully assess the fully retrospective approach in terms of timing and cost-benefit analysis;<br>• a proposal to provide a transition relief for instruments that have been derecognised before initial application of the amendments; and<br>• the issue of retrospective application and hindsight.<br><br>The majority of the respondents to the survey did not agree with the IASB's proposal regarding the restatement of information for one comparative period. Their arguments included concerns regarding the cost for the preparers and the usefulness for users, concerns about application of hedge accounting and, regarding NCIs, concerns about a significant difficulty to recalculating all historical acquisitions. | |

**EFRAG's tentative views expressed in the draft comment letter and respondents' comments**

## Q10 – Disclosure requirements for eligible subsidiaries

*Proposals in the ED*

The IASB is planning to issue the new IFRS Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*] before the amendments proposed in this Exposure Draft are finalised. This new IFRS Accounting Standard proposes reduced disclosure requirements for the eligible subsidiaries without public accountability.

The IASB has considered the proposed amendments to IFRS 7 and selected disclosure requirements appropriate for subsidiaries eligible for reduced disclosures.

*EFRAG's tentative position*

EFRAG highlighted that the IASB was 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, was conditional on the outcome of the EU endorsement process of the future IFRS Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*].

EFRAG further noted that financial institutions, including insurance companies, were out of the scope of the forthcoming IFRS Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*].

EFRAG generally agreed with the IASB's proposals, which seemed to strike a fair balance between costs and benefits related to disclosing relevant information. Nonetheless, EFRAG indicated that it would make a cost-benefit analysis of the reduced disclosures during the consultation period, particularly on disclosures on the nature and priority of claims on liquidation.

*Respondents' comments*

Many respondents from the survey feedback indicated that the reduced disclosures were not applicable to them as they are financial institutions.

**EFRAG's response to respondents' comments**

*EFRAG's final position*

EFRAG took into consideration the feedback from the respondents and maintained its initial position of generally agreeing with the IASB's proposals.

EFRAG also made reference to comments and concerns expressed in the full set of the proposed disclosure requirements in Question 7 of the ED and noted that they remained valid for subsidiaries without public accountability.

| EFRAG's tentative views expressed in the draft comment letter and respondents' comments | EFRAG's response to respondents' comments |
|---|---|
| Also a few respondents from the comment letters received indicated that the reduced disclosures were not applicable to them, which they regretted, as they are financial institutions, while a few generally welcomed the reduced disclosure requirements. | |

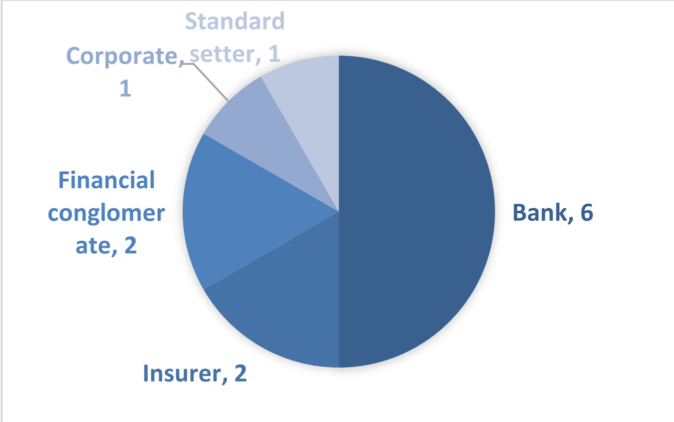
## Appendix 1: List of respondents from comment letters received

***Table 1: List of respondents from comment letters received***

| ***Name of respondent*** | ***Country*** | ***Type / Category*** |
|---|---|---|
| Accountancy Europe | Europe | Professional organisation |
| Accounting Standards Committee of Germany (ASCG) | Germany | National Standard Setter |
| Allianz | Germany | Preparer |
| Autorité des norms Comptables (ANC) | France | National Standard Setter |
| BusinessEurope | Europe | Preparer organisation |
| Credit Agricole | France | Preparer |
| Diogo Pesoa | Portugal | Academic researcher |
| Dutch Accounting Standards Board (DASB) | Netherlands | Germany |
| Erste group | Austria | Preparer |
| European Association of Co-operative Banks (EACB) | Europe | Preparer organisation |
| European Insurance CFO Forum | Europe | Preparer organisation |
| European Securities and Markets Authority (ESMA) | Europe | Regulator |
| Finance Finland | Finland | Preparer organisation |
| German Insurance Association (GDV) | Germany | Preparer organisation |
| Mazars | France | Auditor |
| Organismo Italiano di Contabilità (OIC) | Italy | National Standard Setter |
| The European Federation of Financial Analysts Societies (EFFAS) | Europe | User organisation |
| World Savings and Retail Banking Group (WSBI) and European Savings and Retail Banking Group (ESBG) | Europe | Preparer organisation |

## Appendix 2: Overview of respondents from the online survey

*Breakdown of respondents by type*




*Breakdown of respondents by geographical area*