# Financial Instruments with Characteristics of Equity

# Extensive field-test on the IASB's Exposure Draft ED/2023/5

## Introduction and Objective

1 EFRAG, in close coordination with European National Standard Setters, will conduct field-testing of the IASB proposals included in the Exposure Draft ED/2023/5 *Financial Instruments with Characteristics of Equity* ('ED'), which was published in November 2023.

2 The purpose of the field-testing is to provide information on the effects of the application of the IASB proposals on classification, presentation, disclosures and transition on an entity's existing financial instruments, to identify potential implementation and application concerns, to determine whether there is a need for additional guidance, and to estimate the efforts required to implement and apply the IASB proposals.

3 The extensive field-test covers the IASB proposals on classification, disclosures, presentation and transition.

## Timeline

4 The deadline to submit this field-test is **8 March 2024**.

5 The findings of the participants will be discussed in a workshop in March 2024 and the exact date will be communicated to you. The workshop will be run by the EFRAG Secretariat in cooperation with the representatives of the European National Standard Setters. In order to prepare for this workshop, participants will be asked to provide a one-page summary of their results, in advance, to be discussed during the workshop.

6 Results from the field test will be used as input to EFRAG's comment letter and a summary report of the field-test will be published on EFRAG's website. Any information included in the comment letter or summary report will not allow readers to identify data about individual participants. EFRAG currently has published its draft comment letter on xx January 2024 with a comment period deadline of 20 March 2024.

## What are participants expected to do?

7 Field-testing involves the participants testing the IASB's proposals by applying the IASB's proposals to their financial statements.

8 More specifically, participants will be asked to run a simulation exercise by applying the IASB proposals and comparing the results with existing accounting (where applicable). That is, participants will be asked to apply the IASB proposals:

(a) related to classification and compare the results with existing accounting;

(b) related to disclosures and create notes to the entity's financial statements;

(c) related to presentation and produce the related statement of financial position, the statement of comprehensive income and statement of changes in equity; and

(d) provide a qualitative assessment on transition proposals.

9 Participants are not required to respond to all field-testing questions. Whilst EFRAG would be eager to obtain feedback on as many elements as possible, we are mindful of the short comment period. Therefore, participants are invited to focus on the issues which they find the most relevant.

10 This field-test is structured as follows:

(a) Appendix 1 reflects that extensive field-test questions for the participants which correspond to the IASB questions raised in the ED; and

(b) Appendix 2 provides a list of financial instruments that may be impacted by the IASB proposals.

### Identification of financial instruments for field-testing

11 Participants may select the financial instruments that are most significant to their entity. Appendix 2 provides a list of instruments whereby comments/concerns have been raised in EFRAG's draft comment letter and it also provides a list of other instruments.

### EFRAG Secretariat availability

12 If you have any questions on the field-testing, please contact Sapna Heeralall (sapna.heeralall@efrag.org) and Sergey Vinogradov (sergey.vinogradov@efrag.org).

# Appendix 1: Extensive field-test questions

## Introduction and general description

1 Please provide the following details:

(a) The name of the entity you are responding on behalf of:

(b) Country where head office is located:

(c) Contact details, including e-mail address:

(d) Type of entity:

☐ Bank

☐ Insurer

☐ Financial conglomerates

☐ Corporates

☐ Other, please specify

## Classification

2 State below the most significant financial instruments you have selected to apply the field-test. You may choose to select different instruments for different sections of classification, disclosures, presentation and transition, where relevant.

*The effects of applicable laws on the contractual terms of financial instruments (Question 1 of the ED)*

3 Applying the IASB proposals on the effects of applicable laws on the contractual terms of financial instruments, were there any classification changes:

(a) on your instruments?

| Type of instrument | Impact on classification |
|---|---|
| | |

(b) on the following instruments (where applicable and if not already responded in paragraph 3(a) above):

(i) Bail-in instruments, (ii) Ordinary shares with statutory minimum dividends, (iii) IFRIC 2-type instruments and (iv) limited life companies?

| Type of instrument | Impact on classification |
|---|---|
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4 Do you consider that the IASB should address Mandatory Tender Offers? Please explain.

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*Financial instruments settled in own equity instruments (including 'fixed-for-fixed' condition in IAS 32) (Question 2 of the ED)*

5 Did the fixed-for-fixed condition help you in determining the classification of the financial instruments that you currently issue? Please explain.

| Type of instrument | Comments |
|---|---|
| | |

6 Please identify below the derivatives on own equity that would be affected by the IASB proposals.

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(a) Applying the IASB proposals on the fixed-for-fixed condition, were there classification changes to derivatives on own equity (e.g., options with predetermined dates)?

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(b) If there were classification changes, are they related to the foundation principle, preservation adjustments and/or passage of time adjustments? Please explain.

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7 Please provide information on any unintended consequences (e.g. foreign currency rights issue), if applicable?

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8 Do you consider that IASB's proposals on passage of time adjustments will lead to classification changes for options that can be exercised at different predetermined dates? If so, how pervasive would be these classification changes?

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## Obligations to redeem own equity instruments (e.g. put options on non-controlling interests) (Question 3 of the ED)

*Initial recognition of the obligation to redeem an entity's own equity instruments*

9 Applying the IASB proposals on obligations to redeem own equity instruments, were there classification changes to derivatives on own equity?

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(a) If so, please indicate the financial instruments that would be affected, how the classification would change and, where possible, the quantitative impact of the changes (i.e. the carrying amount of instruments subject to a change, where readily available)

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10 Currently, on initial accounting within equity, do you recognise the obligation to redeem an entity's own equity instruments against non-controlling interests ('NCI') equity component or another equity component? If another equity component, which one?

☐ NCI equity component

☐ Other equity component, please specify

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11 Do you support the gross presentation, as presented by the IASB, whereby an entity initially recognises a financial liability for the redemption amount with the debit side going against the parent's equity, if the entity does not yet have access to the returns associated with ownership of those equity instruments? If so, are you not concerned that the accounting depends on whether the entity does have access to the returns associated with ownership of the equity instruments? Please explain.

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(a) What, in your view, are the most significant advantages and disadvantages of this approach?

| | |
|---|---|
| Significant advantages | |
| Significant disadvantages | |

12 Do you support the gross presentation, whereby an entity initially recognises a financial liability for the redemption amount with the debit side going against non-controlling interests, on the basis that not doing so would not reflect the economic substance of the transaction and would result in double-count of the non-controlling interest as highlighted in paragraph BC77 of the Basis for Conclusions, or as argued by Mr Uhl in paragraph AV5 of the Basis for Conclusions? Please explain.

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| |

(a) What, in your view, are the most significant advantages and disadvantages of this approach?

| | |
|---|---|
| Significant advantages | |
| Significant disadvantages | |

13 Do you support the net approach resulting in the recognition of a stand-alone derivative measured at fair value as indicated by Mr Uhl in the Basis for Conclusions (paragraphs AV1 to AV6)? Please explain.

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(a) What, in your view, are the most significant advantages and disadvantages of this approach?

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|---|---|
| Significant advantages | |
| Significant disadvantages | |

*Subsequent measurement*

14 Assuming that the gross presentation is retained, do you consider that subsequent changes to the carrying amount of the financial liability should be presented:

☐ (a) in profit or loss (as proposed by the IASB);

☐ (b) within equity (on the basis that it is a transaction with owners in their capacity as owners (particularly if NCI and other owners of the parent retain ownership rights)); or

☐ (c) based on any other approach, such as in OCI in full or a split between profit or loss and OCI?

Explain your choice in question 14 above.

15 Assuming the net approach is retained, do you consider that subsequent changes to the fair value of the stand-alone derivative should be presented:

☐ (a) in profit or loss (in line with all other derivatives); or

☐ (b) within equity (on the basis the derivative stems from a transaction with owners in their capacity as owners).

Explain your choice in question 15 above.

## Financial instruments with contingent settlement provisions (Question 4 of the ED)

16 Applying the IASB proposals on financial instruments with contingent settlement provisions, indicate below if there were classification changes, how the classification would change and, where possible, the quantitative impact of the changes (i.e. the carrying amount of instruments subject to a change, where readily available)

| Type of instrument | Impact on classification |
|---|---|
| | |

17 Do you consider whether measurement of a financial liability (or liability component) arising from a contingent settlement provision should reflect the probability and estimated timing of occurrence of the contingent event on and after initial recognition? Please explain.

☐ Yes

☐ No

18 From the IASB's proposals, were there any classification changes on how payments to holders are recognised in the financial statements (in the statement of profit or loss or equity)? Will such changes affect your hedge accounting?

19 Do you consider that the clarifications of the terms 'liquidation' and 'non-genuine' are sufficient? If not, what issues are remaining?

☐ Yes

☐ No

### Shareholders' discretion (Question 5 of the ED)

20 Were there changes in classification arising from the IASB's clarifications on shareholders' discretion and explain the reasons for these changes?

| Type of instrument | Impact on classification | Reason for change in classification |
|---|---|---|
| | | |

21 Do you agree with the factors being proposed in paragraph AG28A of the ED? Please explain your reasons.

☐ Yes

☐ No

22 What other factors do you consider should be included?

23 Where local regulation or law is not clear about whether shareholders are part of the governance of the entity, should the IASB consider:

☐ (a) mandating a particular treatment thereby not leaving room for judgement in order to avoid lack of comparability; or

☐ (b) leaving room for judgement based on proposed factors, and if so, which additional factors (in addition to those given by the IASB) should be considered?

Please explain.

### Reclassification between financial liabilities and equity instruments (Question 6 of the ED)

24 Do you agree with the IASB's proposals not to reclassify a financial liability or an equity instrument 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? Please explain why.

(a) If you do not agree with the prohibition to reclassify 'passage-of-time changes', do you consider that it would be significantly costly to assess at each reporting date whether an instrument would be reclassified? Please explain why.

## Disclosures of financial instruments (Question 7 of the ED)

*Disclosures - The nature and priority of claims against an entity on liquidation.*

25 Were the disclosure requirements (disclosure requirements in paragraph 30B of IFRS 7 in the ED) understandable? Please explain.

☐ Yes

☐ No

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26 Did you encounter significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

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27 Do you have other significant concerns with providing these disclosure requirements and what additional guidance would be helpful (if any)? Please explain.

☐ Yes

☐ No

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*Disclosures - Terms and conditions of financial instruments with both financial liability and equity characteristics.*

28 Were the disclosure requirements (disclosure requirements in paragraph 30B of IFRS 7 in the ED) understandable? Please explain.

☐ Yes

☐ No

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29 Do you agree with the guidance provided on debt-like characteristics and equity-like characteristics (in paragraphs B5B–B5G of IFRS 7 in the ED) including providing both quantitative and qualitative information? Please explain.

☐ Yes

☐ Partly agree

☐ No

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30 Do you consider that there are other debt-like characteristics and equity-like characteristics which should be considered? Please explain.

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|---|---|
| Debt-like characteristics | |
| Equity-like characteristics | |

31 Did you encounter significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

32 Do you have other significant concerns with providing these disclosure requirements and what additional guidance would be helpful (if any)? Please explain.

☐ Yes

☐ No

*Disclosures - Terms and conditions about priority on liquidation*

33 Were the disclosure requirements (disclosure requirements in paragraph 30E of IFRS 7 in the ED) understandable? Please explain.

☐ Yes

☐ No

34 Did you encounter significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

35 Do you have other significant concerns with providing these disclosure requirements and what additional guidance would be helpful (if any)? Please explain.

☐ Yes

☐ No

*Disclosures - Potential dilution*

36 Were the disclosure requirements (disclosure requirements in paragraphs 30G–30H and B5I–B5L of IFRS 7 in the ED) understandable? Please explain.

☐ Yes

☐ No

37 Did you encounter significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

38 Do you have other significant concerns with providing these disclosure requirements and what additional guidance would be helpful (if any)? Please explain.

☐ Yes

☐ No

*Obligations to redeem own equity instruments*

39 Were the disclosure requirements (disclosure requirements in paragraph 30J of IFRS 7 in the ED) understandable? Please explain.

☐ Yes

☐ No

40 Did you encounter significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

41 Do you have other significant concerns with providing these disclosure requirements and what additional guidance would be helpful (if any)? Please explain.

☐ Yes

☐ No

## Presentation (Question 8 of the ED)

*Presentation of equity instruments, including obligations that arise only on liquidation (e.g., perpetual instruments):*

42 Considering the guidance provided by the IASB, did you encounter significant difficulties in allocating profit or loss to "Ordinary shareholders of the parent" and "Other owners of the parent"? Please explain.

☐ Yes

☐ No

43 In your jurisdiction do you anticipate any issues due to interaction of the IASB proposals with regulatory requirements on presentation of equity? Please explain.

## Transition (Question 9 of the ED)

*Fully retrospective approach*

44 Do you agree with retrospective application of the IASB proposals with the restatement of information for one comparative period? Please explain.

☐ Yes

☐ No

45 Are there other significant concerns on transition that needs to be considered? Please explain.

## Disclosures for subsidiaries without public accountability ('SWPA') (Question 10 of the ED)

*Disclosures for SWPA*

46 Do you consider that the proposed reduced disclosure requirements for subsidiaries without public accountability (disclosure requirements in paragraphs 54, 61A–61E and 124 of Amendments to IFRS XX *Subsidiaries without Public Accountability: Disclosures* in the ED) and in particular disclosures on the nature and priority of claims on liquidation strike the balance between costs for preparers and benefits for the users of financial statements?

47 Were the disclosure requirements for SWPA understandable? Please explain.

☐ Yes

☐ No

48 Did you encounter significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

49 Do you have other significant concerns with providing these disclosure requirements and what additional guidance would be helpful (if any)? Please explain.

☐ Yes

☐ No

## Appendix 2: List of financial instruments

1 Below are lists of financial instruments which may be impacted by the IASB proposals. Referring to paragraph 11 above on page 2, participants may select the financial instruments that are most significant to the entity.

2 We have segregated the instruments into instruments whereby potential issues have already been identified in EFRAG's comment letter and other instruments.

### Instruments which may be impacted

3 When completing the survey, please pay special attention to the instruments where potential issues have already been identified (e.g., please refer to EFRAG's draft comment letter), notably to the following instruments:

(a) Written put options on non-controlling interests;

(b) Bail-in instruments (AT1 instruments);

(c) Instruments with legal obligations to pay dividends;

(d) Mandatory tender offers;

(e) Instruments with contingent settlement provisions.

4 Also, please note a more comprehensive list of instruments which are in the scope of the IASB proposals:

(a) Common share;

(b) Perpetual preferred share;

(c) Share issued by a limited life entity;

(d) General partnership interest;

(e) Limited partnership interest;

(f) Ownership instrument that is redeemable at the option of the holder (other than upon retirement or death);

(g) Ownership instrument that is required to be redeemed if an uncertain event occurs;

(h) Ordinary share with a required dividend;

(i) Ordinary share with a substantive registration rights penalty;

(j) Preferred share convertible into variable number of ordinary shares at the option of the holder;

(k) Preferred share that is required to be converted into a variable number of ordinary shares on a specific date or event that is certain to occur (other than death or retirement);

(l) Instrument issued by a cooperative that gives the holder the right to request redemption, but the cooperative can refuse that request;

(m) Instrument issued by a cooperative that must be redeemed upon the holder's death, retirement, or decreased participation;

(n) Instrument that converts mandatorily on a specific date or event that is certain to occur (other than death or retirement) into a variable number of share instruments with a fixed monetary amount (for example, share-settled debt);

(o) Physically (gross) settled written call option;

(p) Net-share-settled written call option;

(q) Physically (gross) settled employee stock option;

(r) Physically (gross) settled instruments that give the holder the right to acquire a fixed number of the entity's own equity instruments at a fixed price (a rights issue) denominated in a currency that is not the entity's functional currency (example assumes that the options were offered prorata to all existing shareholders);

(s) Net-cash-settled written call option and cash SAR;

(t) Net-cash- or netshare-settled forward purchase contract at a fixed price;

(u) Physically settled forward purchase contract;

(v) Prepaid forward purchase contract for a fixed number of shares;

(w) Net-cash- or netshare-settled written put option;

(x) Physically settled written put option;

(y) Prepaid written put option for a fixed number of shares;

(z) Convertible debt for fixed number of shares;

(aa) Share redeemable at the option of the issuer (callable share);

(bb) Preferred share convertible into a fixed number of ordinary shares at the option of the holder;

(cc) Preferred share required to be converted into a fixed number of ordinary shares;

(dd) Preferred share puttable, callable, and convertible;

(ee) Note receivable settled with cash or a variable number of shares; and

(ff) Debt indexed to shares (for example, convertible debt for which the entire conversion value is settled in cash).