Financial Instruments with Characteristics of Equity

Survey 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 survey is to provide information on the expected 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 This survey covers the IASB proposals on classification, disclosures, presentation and transition.

Timeline

4 The deadline to fill out the survey is **8 March 2024**.

5 Results from this survey will be used as input to EFRAG's comment letter and a summary report of the survey 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?

6 Participants are asked to perform a qualitative assessment of expected impacts of the IASB proposals on classification, presentation, disclosures and transition and to identify any potential implementation and application concerns including a need for additional guidance. The relevant questions for participants to answer are in Appendix 1.

7 Participants are not required to respond to all questions of the survey. 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. For information purposes, Appendix 2 provides a list of financial instruments that may be impacted by the IASB proposals.

EFRAG Secretariat availability

8 If you have any technical questions or would like to receive more information about the field-testing, please contact Sapna Heeralall (sapna.heeralall@efrag.org) and Sergey Vinogradov (sergey.vinogradov@efrag.org).

Appendix 1: Survey 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

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

2 Applying the IASB proposals on the effects of applicable laws on the contractual terms of financial instruments, do you expect 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 (a) above):

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

3 Do you consider that the IASB should address Mandatory Tender Offers (MTOs)? Please explain.

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

4 Do you believe that the IASB's proposals on fixed-for-fixed condition help you in determining the classification of the financial instruments that you currently issue?

Type of instrument	Comments

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

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

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

6 Do you expect any unintended consequences (e.g. foreign currency rights issue)?

7 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?

Obligation to purchase an entity's own equity instruments (e.g., written put-options on non-controlling interest) (Q3 of the ED)

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

8 Applying the IASB proposals on obligations to redeem own equity instruments, do you expect classification changes to derivatives on own equity?

(a) If so, please indicate the financial instruments that would be affected and how the potential classification would change.

9 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

10 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.

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

Significant advantages	
Significant disadvantages	

11 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.

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

Significant advantages	
Significant disadvantages	

12 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.

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

Significant advantages	
Significant disadvantages	

Subsequent measurement

13 Assuming that the gross presentation is retained, do you consider that changes to the carrying amount of the liability of written put options to non-controlling interest holders 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 13 above.

14 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 14 above.

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

15 Applying the IASB proposals on financial instruments with contingent settlement provisions, do you expect classification changes and please explain how the classification would change.

Type of instrument	Impact on classification

16 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

17 From the IASB's proposals, do you expect 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?

18 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)

19 Do you expect any changes in classification arising from the IASB's clarifications on shareholders' discretion and explain the reasons for these expected changes?

Type of instrument	Impact on classification	Reason for expected change in classification

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

☐ Yes

☐ No

21 What other factors should be considered?

22 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)

23 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.

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

☐ Yes

☐ No

25 Do you expect significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

26 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 of financial instruments with both financial liability and equity characteristics.

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

☐ Yes

☐ No

28 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

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

Debt-like characteristics	
Equity-like characteristics	

30 Do you expect significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

31 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

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

☐ Yes

☐ No

33 Do you expect significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

34 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

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

☐ Yes

☐ No

36 Do you expect significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

37 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

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

☐ Yes

☐ No

39 Do you expect significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

40 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):

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

☐ Yes

☐ No

42 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

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

☐ Yes

☐ No

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

Disclosures for subsidiaries without public accountability ('SWPA')

Disclosures for SWPA

45 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?

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

☐ Yes

☐ No

47 Do you expect significant operational issues with providing these disclosure requirements? Please explain.

☐ Yes

☐ No

48 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.

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).