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EFRAG Secretariat: Sapna Heeralall, Sergey Vinogradov, Filipe Alves

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Financial Instruments with Characteristics of Equity

Summary and analysis of the comment letters received and outreach feedback

Objective

1 The objective of this agenda paper is to:

(a) present a summary of the feedback received during outreach activities;

(b) present a summary of the comments received in response to EFRAG's request for comments; and

(c) present EFRAG Secretariat’s recommendations to EFRAG FR TEG members on EFRAG's proposed final position.

2 Based on the comments received, the EFRAG Secretariat has developed a revised draft EFRAG final comment letter that is presented as agenda paper 01-03 (for the clean version) and 01-04 (for the marked-up version).

Structure of the paper

3 This comment letter analysis contains:

(a) Summary of the feedback received from EFRAG Outreach Activities;

(b) Definition of terms;

(c) Summary of comment letters received from respondents;

(d) Executive summary of respondents' views;

(e) Appendix 1 - detailed analysis of responses to questions in EFRAG's draft comment letter, EFRAG Secretariat's recommendations and questions to EFRAG FR TEG; and

(f) Appendix 2 - list of respondents.

Summary of the feedback received from EFRAG Outreach Activities

4 EFRAG has conducted several outreach activities on the Financial Instruments with Characteristics of Equity ('FICE') ED and issued the EFRAG's draft comment letter ('DCL').

5 The following joint outreaches were held:

Location	Co-host(s)	Date
Virtual	ASCG (The Accounting Standards Committee of Germany) together with AFRAC (Austrian Financial Reporting Advisory Committee) – Link to the report is here.	4 March 2024
Virtual	EAA (European Accounting Association)	11 March 2024
Italy with virtual streaming	OIC (Italian Standard Setter)	12 March 2024

6 EFRAG staff also presented at/attended a further 10 meetings which included mostly meetings of accounting committee groups, EFRAG working groups (EFRAG IAWG, FIWG, User Panel) and other external meetings.

7 EFRAG also presented a summary of the survey results at the March 2024 ASAF meeting. A summary of the discussions can be found in paragraphs 29 to 30 below.

8 The feedback received as part of these activities is summarised below. Most of the concerns and comments related to the effects of law and regulation (ED Q1) and NCI puts (ED Q3).

Effects of laws and regulations

9 There were concerns with this proposal including potential unintended consequences:

(a) there were concerns that stocks and co-operative shares would not be classified as equity. There were comments about why the law/regulation and the contract arrangement should be considered differently.

(b) some banking products in France, notably savings deposits, where all key parameters are highly regulated by law and the same conditions would be proposed by any bank. Therefore, applying the IASB proposals about the effects of laws and regulation may lead to unintended consequences.

(c) further examples of issues concerning the impact of laws and regulation (e.g., in Bulgaria, any specific terms that deviate from what the regulator perceives as

ordinary market conditions is not considered to be covered and protected by the deposit protection program; in Germany, there are some puttable features which are enshrined in the law and not in the contract).

(d) the classification of puttable instruments in partnerships was still unclear based on the IASB proposals.

10 Also, there were comments that in Germany, the law can refuse redemptions in certain cases and may also restrict when an entity can pay out. Also, some questioned the interaction between the proposals on the effects of laws and regulations and IFRIC 2.

11 Suggested solutions were as follows:

(a) At the OIC event, stakeholders had no particular need for clarification on this topic. A practice common practice has been developed. The new proposals could lead to operational challenges and changes to the current practice.

(b) An all-inclusive approach without significant unintended consequences.

Fixed-for-fixed condition for derivatives

12 In general, there was agreement with, or not objecting to, these IASB proposals.

Obligations to purchase an entity's own equity instruments

13 In general, there was support for gross presentation rather than net presentation.

Initial recognition

14 In general, the majority disagreed with the IASB's proposals on initial recognition and considered that the debit should go to NCI. Some reasons provided were double counting ((i.e., simultaneously recording the financial liability as possible cash outflows under the written put option and the equity attributable to NCI shareholders reflecting their rights to receive future cash flows from the subsidiary, e.g. dividends); negative effect on bank's equity for regulatory purpose; and practice disruptions.

15 At the German/Austrian event, around half of the participants agreed with the IASB proposals both on initial recognition while a large minority agreed with debiting NCI equity.

16 In general, there were questions raised, for example, what happens if the initial debit exceeds the NCI balance. Some had concerns against reflecting a negative value of NCI part of equity (both at initial recognition and during subsequent remeasurement) and were supportive of limiting it to zero.

Subsequent measurement

17 In general, there was more support for changes in the financial liability going to equity rather than to profit or loss. Some reasons for this were that there is a transaction between shareholders, therefore recognition in profit or loss is counterintuitive; practice disruptions; conflict with the nature of the transaction; and the performance of the entity may not be appropriately understandable.

18 At the German/Austrian event, there were mixed views with nearly half agreeing to the IASB's proposals while the other half preferring changes in the liability going to equity. For those who chose equity - there were mixed views on whether it should be parent equity or NCI equity.

19 There was no support for changes in the financial liability going to other comprehensive income ('OCI').

20 There were questions raised, for example, would there be continued attribution of the NCI share of profit in the year. One stakeholder indicated that EFRAG's preliminary position (i.e. subsequent changes going to equity) worked well if the exercise price is at fair value. However, if the exercise price is fixed, NCI shareholders, in substance, no longer have an interest in performance of the underlying business. In effect, NCI shareholders become lenders to the group and reporting a liability with a related accretion interest expense in profit and loss (and to not attribute any profit to NCI) made a lot of sense.

21 It was also questioned what the effect of the new proposal on the accounting treatment of NCI puts would be in the separate financial statements.

Contingent settlement provisions

22 In general, there were mixed views on whether the probability and estimated timing of the contingent event occurring should be considered. Some considered that not including probability could lead to misleading results because for example the liability could be higher than its fair value. Also, more clarity is needed about the meaning of "process for permanently ceasing operations" to avoid different interpretation among jurisdictions and thus different classification outcomes.

Shareholder discretion

23 There seemed to be support for the factors and in line with the widely used principle of "control". Also, the clarifications seemed to be in line with current practice in one jurisdiction.

Reclassification of financial liabilities and equity instruments

24 There were mixed views for those who spoke on this topic. In the ASCG/AFRAC outreach, there was agreement with the proposals or no objection to them.

25 In another meeting, there were concerns about non-reclassification/non-derecognition of non-derivative financial liabilities on expiration of contingent settlement provisions.

Disclosures

26 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.

Presentation

27 In general, further guidance would be needed to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent. This distinction may be particularly difficult for earning reserves and valuation reserves.

28 A user at the OIC outreach event did not consider particularly useful this type of information.

March 2024 ASAF meeting

29 On classification requirements:

(a) The Canadian member stated that it was good to know there is some commonality for some of the issues. In Canada, they have the issues on contingent settlement provisions and the effects of laws and regulations. He was, however, surprised by the comments on the requirements regarding passage of time for the fixed for fixed condition whereby there was agreement with the IASB's proposals. He indicated that there is a well-established practice with the Bermudian style options that can be exercised at predetermined amounts at predetermined dates. Currently entities do not consider whether it is a reflection of present value and just look at it as distinct at each period of time.

(b) The IASB Chair indicated that the purpose is not to seek new accounting but rather to bring about clarity. However, this did not mean that some of the proposals would not come with change, especially in areas where there is diversity. They would look at the robustness of the technical arguments and will consider other proposals.

(c) One of the IASB Staff considered helpful to include in the comment letter whether reference is made to NCI puts exercisable at fair value or at fixed price.

30 On the disclosure requirements:

(a) The Canadian member heard similar comments as EFRAG from preparers and not from users who agreed with the disclosures. Users felt that the disclosures were more important than correcting diversity on the classification. If they know, for example, the terms and conditions and dilutive effect, they can make their decisions rather than the IASB focussing on getting the classification right as the instruments are too complex. Therefore, they preferred to keep the disclosure requirements and not proceed with classification requirements.

(b) The UK member heard similar messages from the users as the Canadian member. Even though it would be a challenge for preparers. It was Important to maintain the disclosures requirements.

Definition of terms

31 The % in this document refers to the total number of respondents to the relevant question, unless indicated differently.

Term	No. of respondents as a %
Almost all	90% - 100%
Most	75% - 89%
Majority, Significant majority	51% - 74%
Half	50%
Many	25% - 49%
Some, others	0% - 24%

Summary of comment letters received from respondents

32 At the time of writing, 18 comment letters have been received. The letters are summarised below.

Executive summary of respondents' views

The effects of relevant laws and regulations

33 Many respondents generally welcomed the IASB´s discussions and efforts to address the questions that arise in practice on how laws or regulations applicable to a financial instrument affect the classification of the instrument.

34 However, when specifically responding to the IASB´s questions set out in the ED, most respondents, particularly preparers and regulators, **expressed significant concerns on the IASB´s proposals on the effects of relevant law and regulations.**

35 In general, these respondents indicated that the IASB´s proposals were not sufficiently clear, raised application challenges and uncertainty on the outcome of the IASB´s proposals, could lead to a significant change to current practice, introduced a risk of unintended consequences, and could lead to a new diversity in practice. Some of these respondents explicitly disagreed with the IASB´s proposals.

36 In particular, many respondents expressed significant concerns on how the IASB's proposals would apply to instruments for which some or all all key parameters are regulated by law or regulation, including regulated saving accounts, some cooperative banks' products and bail-in instruments, which currently do not raise significant classification issues.

37 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 the EFRAG's draft comment letter.

38 On how to move forward, many respondents encouraged the IASB to **reconsider the project direction** on the effects of relevant laws and regulations. These respondents considered that the best way forward would be to adopt an **"all-inclusive".** As an all-inclusive approach may disrupt some current practices, two respondents considered that the IASB may provide limited exceptions, especially for bail-in instruments.

39 Still, many respondents called for the IASB to further consider its proposals (revise), make more field-testing and provide more clarifications and examples to illustrate the application of the IASB's proposals. This with the objective of helping the assessment of whether a contractual right or obligation is required by laws or regulations, ensure comparability across companies, ensure effectiveness and coherence of the requirements, and avoid unintended consequences on the classification of financial instruments.

Fixed-for-fixed condition for derivatives

40 Many respondents **generally agreed with the IASB's proposals** for instruments settled with an entity´s own equity instruments, considered that these clarifications will reduce the existing diversity in practice.

41 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 rate. There were also concerns on the IASB´s proposals related to which functional currency should be the reference point.

Obligations to purchase an entity's own equity instruments

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

42 Most of the respondents 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, if the entity does not yet have access to the rights and returns associated with ownership of those equity instruments. Instead, these respondents prefer that the debit side at initial recognition goes against the NCI share of equity.

43 The key arguments provided by the respondents were the concerns about double recognition (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; punitive impact on banks prudential own funds and an existing guidance in paragraphs BC11, BC68 and AG29 of IAS 32.

Net presentation

44 Even though many respondents expressed various degree of sympathy for the 'net presentation', however, a majority of these respondents mentioned their understanding that such a change would be too fundamental, given the scope of the IASB's project.

Subsequent measurement of the financial liability

45 Respondents 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 is treated via profit or loss.

46 It is worth noting that many respondents were either not categorical in their choice (eg., acknowledged the merits of the alternative approach) or preferred not to express a preference at all, citing mixed views of their members.

47 The respondents opposing 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; (d) accounting complications if the put option expires without exercise.

Other issues

48 Presentation in profit or loss – some respondents appreciated that entities can develop the appropriate accounting policy on how to present the value changes and decide whether an interest component would be recognised separately.

49 Some respondents specifically pointed out that the IASB's proposals could result in a significant change of the established accounting practice in their jurisdiction.

Contingent settlement provisions

50 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).

51 On subsequent measurement, there are 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 see the benefits of the IASB's approach on subsequent measurement where an entity is 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. 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.

52 The respondents that referred to payments at the issuer's discretion agreed with the IASB proposal that payments at the issuer's discretion are 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).

53 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.

Shareholder discretion

54 A significant majority of respondents agreed or (cautiously) welcomed the proposed requirements on how to treat shareholders' decisions. They considered that the proposals would provide useful and helpful guidance and would allow entity-specific judgments.

55 The majority of these respondents 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 improve comparability.

Reclassification of financial liabilities and equity instruments

56 Respondents, in general, were supportive or not objective of reclassification when a change of the substance of the contractual arrangement is due to a change in external circumstances.

57 However, the majority of respondents did not support the prohibition of reclassification for contractual terms that become, or stop being, effective with the passage-of-time ('passage-of-time changes'). They considered that the resulting information would be potentially misleading for the readers of the financial statements, i.e., may no longer faithfully represent the substance of the financial instrument. In addition, reclassification for passage-of-time changes would be consistent with transition requirements in paragraph 97W of the ED and with reclassification of puttable instruments.

(a) Half of these respondents considered that reassessing, at each reporting date, whether an instrument should be reclassified would not be onerous.

58 Many respondents, on the other hand, supported the IASBs proposals considering it a reasonable approach.

Disclosures

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

60 A significant majority of respondents had concerns on the disclosure requirements with many of them indicating that the package of disclosures does not strike the right balance between the benefit of disclosures to the users and the cost of preparers. However, many

respondents supported the disclosure requirements or indicated that they could be prepared at a reasonable cost and effort.

61 The main concerns on the proposed disclosure requirements stem from:

(a) Disclosures on liquidation:

(i) Many respondents indicated that IFRS Standards are based on a going concern principle and not liquidation or resolution. Therefore, disclosures on liquidation are contrary to the information based on a going concern view;

(ii) 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. For example, difficulty to perform a complex legal analysis in each relevant jurisdiction to determine the nature and priority of the claims especially if the liquidation rules significantly differ, for example, a group with international subsidiaries.

(b) 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 how the users of the financial statements are going to absorb and use all the mostly narrative information of different levels of granularity between entities.

62 On the other hand, many respondents supported the disclosure requirements or could be prepared at a reasonable cost and effort.

63 Some respondents provided some suggestions to reduce the burden of disclosure overload. For example, there was a suggestion to allow cross-referencing to other public disclosure documents required by existing regulatory bodies, similar to paragraph B6 of IFRS 7. Also, there was a suggestion to narrow the scope of the disclosures to only complex instruments. Another proposed solution was not to proceed with the proposed disclosures requirements in the Exposure Draft.

Presentation of amounts attributable to ordinary shareholders

64 Respondents had mixed views about the IASB's proposals in general. Whilst may respondents supported, sometimes strongly, the proposals, at least their objective, many others denied, sometimes categorically, the necessity of such presentation requirements.

65 Both supporters and opponents of the proposed disclosure requirements emphasised, from their perspective, the importance of the cost/benefit analysis of the IASB's proposals.

66 A majority of the respondents had concerns about the clarity of the IASB proposals and emphasised that additional application guidance and illustrative examples would be needed to be able to perform the split. In particular, they had concerns about the effect of various equity instruments other than ordinary shares, the illustrative examples in paragraph IG6A of draft Amendments to Guidance on Implementing IAS 1, calculation of the attribution for AT1 instruments.

67 Many respondents emphasised that lack of guidance and examples may result in inconsistencies in practice and would limit the usefulness of the proposed presentation requirements.

68 Some respondents had concerns about the use of the terms ''ordinary shareholders'' and ''Other owners of the parent'' in the ED.

Transition

69 Most of the respondents supported for the IASB's proposals in general. However, only four respondents expressed their support without having any significant issues, while the others mentioned one or more concerns.

70 The key concerns and suggestions of the respondents included complications that could arise for entities applying hedge accounting, the need to carefully assess the fully retrospective approach in terms of timing and cost-benefit analysis, a proposal to provide a transition relief for instruments that have been derecognised before initial application of the amendments and the issue of retrospective application and hindsight.

Disclosure requirements for eligible subsidiaries

71 Two respondents indicated that the reduced disclosures were not applicable to them, which they regret, as they are financial institutions while another two generally welcomed the reduced disclosure requirements.

Questions for EFRAG FR TEG

72 Does EFRAG FR TEG agree with EFRAG Secretariat's recommendations in Appendix 1: Analysis and Summary of Comments received?

Appendix 1 - Detailed analysis of responses to questions in EFRAG's draft comment letter, EFRAG Secretariat recommendations and questions to EFRAG FR TEG

Question 1 – Classification: The effects of relevant laws or regulations

Question 1 - The effects of relevant laws or regulations (paragraphs 15A and AG24A–AG24B of IAS 32) The IASB proposes to clarify that: (a) only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations are considered in classifying a financial instrument or its component parts (paragraph 15A); and (b) a contractual right or obligation that is not solely created by laws or regulations, but is in addition to a right or obligation created by relevant laws or regulations shall be considered in its entirety in classifying the financial instrument or its component parts (paragraph AG24B). Paragraphs BC12–BC30 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Summary of respondents' comments

73 Many respondents generally welcomed the IASB´s discussions and efforts to address the questions that arise in practice on how laws or regulations applicable to a financial instrument affect the classification of the instrument.

74 One respondent, a user representative, generally agreed with the IASB´s clarifications related to the effects of relevant law and regulation.

75 However, when specifically responding to the IASB´s questions set out in the ED, most respondents, particularly preparers and regulators, **expressed significant concerns on the IASB´s proposals on the effects of relevant law and regulations**.

76 In general, these respondents indicated that the IASB´s proposals were not sufficiently clear, raised application challenges and uncertainty on the outcome of the IASB´s proposals, could lead to a significant change to current practice, introduced a risk of unintended consequences, and could lead to a new diversity in practice. Some of these respondents explicitly disagreed with the IASB´s proposals.

77 When providing more details on their views, respondents:

(a) considered that the **combination of both contractual and legal regulations (enforceable framework) is necessary to understand the contract;**

(b) considered that it is complex, difficult and judgemental to make a distinction between contractual obligations and legal obligations. In particular, it is **complex and difficult to assess whether the terms explicitly stated in the contract are actually "in addition to" what is established by law**. This may lead to new diversity in practice;

(c) **considered that the IASB´s proposals are open to different interpretations, particularly when considering that the exposure draft lacks a definition of what laws or regulations are.** For example, whether "regulatory guidance" issued by the regulator, which is not a law or regulation by itself, is equivalent to statutory or regulatory requirements;

(d) **expressed concerns that the IASB´s proposals lead to conflicting requirements within IFRS Accounting Standards and inconsistent classification outcomes;**

(e) considered that **the IASB´s proposal to ignore relevant laws or regulations for classification purposes is inconsistent with the conceptual framework and generally accepted accounting practice of considering all relevant facts and circumstances when analysing accounting transactions**. It also contradicts certain requirements of the Conceptual Framework (e.g. paragraph 4.60) and the way entities currently apply IAS 32 (paragraph 15 and 15A of IAS 32). Thus, it seems conceptually inconsistent to require those contractual rights or obligations created solely by statute, laws or regulations to be ignored when determining the classification of a financial instrument;

(f) **expressed concerns that economically similar instruments could be treated differently depending on whether the relevant features of the instrument are based on legal or contractual terms that are in addition to the applicable laws and regulations,** leading to new diversity in practice;

(g) **instruments with similar obligations would have a different accounting classification depending on the legal environment of the entity**, which would lead to a new diversity in practice (even potentially within the same consolidated group). For example, if the relevant laws or regulations require a minimum divided, this would not be considered in the classification as equity or a financial liability, whereas if the same requirement would be included in a contract without a corresponding

legal requirement, it would have to be considered. A similar case would be the right of the holder to put the instrument to the issuer;

(h) **expressed significant concerns on how the IASB proposals would apply to instruments for which all key parameters are regulated by law or regulation, including regulated saving accounts, some cooperative banks' products and bail-in instruments** (for more detailed information, please see below);

(i) **were unsure of the practical implications of the amendments.** For example, for puttable instruments under paragraph 16A and 16B of IAS 32, it is difficult to conclude on how the IASB´s proposals should be applied. One could conclude that the financial instrument can be classified as equity instrument under the general terms of IAS 32 and not only on the basis of the exception in paragraph 16A and 16B of IAS 32. Thus, the FVOCI option for equity instruments in paragraph 5.7.5 of IFRS 9 would apply. The IFRS IC decision of 12 September 2017 would not apply anymore due to the changes to IAS 32;

(j) noted that a discrepancy may arise between the classification applied by the instrument holder (solely based on contractual terms under IFRS 9) and the classification applied by the issuer under the IASB proposals. That is, **there is the risk of classification asymmetry between holders and issuers**;

(k) **implementing the principles set out by the IASB could prove complex from an operational point of view and generate significant costs related to legal analysis**;

(l) **considered that there is lack of clarity on what the IASB intends to propose and whether the IASB proposals result in (more) relevant information** on the distinct treatment of contractual terms vs rights and obligations established by laws or regulations (paragraph 15A(a) second part and 15A(b)). Apart from this, one respondent fully agreed with the requirement to consider rights and obligations as far as they are enforceable by laws (paragraph 15A(a) first part); and

(m) **considered that the proposed amendments could have an impact on the classification of investments held as either equity or debt financial instrument**. In this case, the holder would be required to assess the contractual terms of each instrument held, understand the relevant legal and regulatory requirements that the issuer is exposed to and determine whether the contractual terms go beyond the legal and regulatory requirements. Especially for large institutional investors with

hundreds or thousands of investments, this could lead to substantial operational burden and undue costs and efforts.

Instruments for which some or all key parameters are regulated by law or regulation

78 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, some cooperative banks' products and bail-in instruments, which currently do not raise significant classification issues**.

79 These respondents:

(a) **noted that there is uncertainty on how to apply the IASB´s proposals** to instruments where all or large part of the terms are originated from law or regulation and for which the contracts only repeat the legal or regulatory provisions (in some jurisdictions, including France, these instruments are quite significative in the market). In accordance with the ED's proposals, these provisions would not be taken into account in the classification of the instruments. Some respondents could not conclude on how the IASB proposals should be applied to such instruments and were concerned about possible alternatives considered. For example:

(i) uncertainty on how to apply the IASB´s proposals to **regulated saving accounts**, for which all key parameters are regulated by law or regulation (no room to negotiate additional contractual terms). Currently, such instruments are classified as liabilities (include and are built around a cash remittance obligation, and do not represent a residual interest in the assets of an entity). However, there is uncertainty on how to the IASB proposals and there are concerns about possible alternatives considered, including equity classification; and

(ii) **uncertainty on how to apply the IASB´s proposals to instruments where all contractual clauses repeat the law/regulation, with the exception of instrument remuneration which would be contractually discretionary**. Respondents could not clearly conclude on how the IASB proposals should be applied to such instruments and were concerned about possible alternatives considered.

(b) **questioned whether the IASB's proposals led to the right accounting treatment** as they could potentially mislead reclassifications to equity of some financial instruments currently classified as financial liabilities just because they have

contractual terms established by law and regulation. For example, bank loans and savings products such as mortgage loans, consumer loans, demand deposits and saving accounts are often strongly regulated by law in some jurisdictions. The main terms of such financial instruments (e.g. repayment, duration) are pre-defined by law and may only be incorporated by reference into the contractual terms. Therefore, only few contractual aspects would be considered additional to a right or obligation created by laws (e.g., interest). The proposed wording may result in some financial institutions reclassifying almost all of their financial instruments as equity;

(c) **expressed significant concerns on how the IASB's proposals would apply to cooperative shares (which are currently accounted for under IFRIC 2)**, even if the IASB´s mentions in its basis for conclusions that the IASB´s proposals would be aligned with IFRIC 2. In particular, for cooperative shares for which the "member's right to reimbursement" and the "unconditional right to refuse redemption of the entity" have both their origins in the law (which would not be considered for classification purposes), there is a risk of not being able to classify such instruments as equity (instead, could be classified as compound instruments);

(d) **considered that the proposed clarifications deviate from the statement in paragraph 5 of IFRIC 2** that an entity must consider all the terms and conditions of a financial instrument, including relevant local laws and regulations, which is also the principle stipulated in the Conceptual Framework (paragraph 4.60) and applied in other standards (e.g. IFRS 15, IFRS 17);

(e) **there is a need to clarity the interaction between paragraph 15A of the ED and paragraph 83 of IFRIC 2** stating that the member's shares are classified as equity if redemption is unconditionally prohibited by local law, regulation, or the entity's governing charter. This additional explanation would help mitigate any unforeseen consequences;

(f) **there may be unintended consequences for some instruments whose terms and conditions are closely derived from law and regulation**. For example, specific banking instruments in some European countries that contain a statutory/legal redemption feature when comparing to a similar instrument in other jurisdiction without such legal requirement;

(g) **considered that the IASB´s approach creates uncertainties for regulated financial instruments** for which contractual rights or obligations are less extensive than those

defined by laws and regulations outlined in the contractual agreement (e.g. savings product that, at the end of a savings phase, offers the possibility of obtaining a loan, subject to specific conditions, for property acquisition);

(h) **it was noted that the description of the 'bail-in' provisions in paragraph BC13(a) of the ED using Additional Tier 1 (AT1) instruments as an example is not correct**. The loss-absorption feature referred to in this paragraph which, upon the occurrence of a trigger event, requires either write down or conversion into ordinary shares of the issuer should not be viewed as resulting from legislation. This is a key qualifying condition which the contractual terms must include for such instruments to qualify as a specific part of Tier 1 banking capital (i.e. the legislation provides a framework how contractual terms should be drafted so the instrument is granted a specific regulatory treatment);

(i) unclear how the requirement in paragraph 15B of IAS 32 would affect the classification in cases when **the legal requirements change after signing the contract;** and

(j) doubts concerning the approach developed by the IASB for evaluating the effects of relevant laws or regulations on the IAS 32 classification for instruments under the scope of IFRIC 2, i.e., to what extent the legal requirement is part of the contractual terms and must therefore lead to the identification of a financial liability or equity instrument;

(k) the IASB proposals are a substantial change to current situation, potentially misleading, create application problems and lead to new diversity in practice.

Mandatory Tender Offers

80 Many respondents, including regulators and users, considered that the IASB should address this issue due to unclarities regarding the treatment of MTOs mentioned in the EFRAG’s draft comment letter.

81 One respondent, user representative, added that specific disclosure requirements should contribute to a more transparent interpretation of regulations in the different jurisdictions related to financial instruments.

82 In addition, one respondent emphasised that applying the IASB’s proposals, no financial liability would be recognised after legal requirements for a mandatory offer have been met because the obligation is created by law. This accounting treatment does not seem to be

fully consistent with the accounting for written put options on non-controlling interests which are considered financial liabilities.

Moving forward – All-inclusive approach

83 Many respondents encouraged the IASB to **reconsider the project direction** on the effects of relevant laws and regulations. These respondents considered that the best way forward would be to adopt an **"all-inclusive"** (that is considering contractual rights and obligations as well as obligations established by laws and regulations).

84 These respondents argued that:

(a) such an approach would be more consistent and provide more useful information to the users of financial statements. This acknowledging that adopting such a principle may result in significant change to the current requirements and therefore to the current practice and may have to be accompanied by some limited exceptions to address some specific situations (e.g. bail-in features);

(b) such an approach would be consistent with the conceptual framework (paragraphs 1.23 and 4.60);

(c) such an approach ensures that comprehensive and consistent classification criteria are applied across financial reporting and contractual terms and obligations are thoroughly evaluated, thereby promoting transparency and accuracy in financial reporting practices;

(d) the most appropriate approach would be to require all relevant information to be taken into account and then to provide further guidance upon how the effect of certain statutes might be assessed, such as the case of legally imposed dividends in some jurisdictions. This would ensure that potentially important substance is not ignored summarily but considered and dealt with properly;

(e) conceptually, this seems the most appropriate approach, as it treats similar rights and obligations similarly, regardless of its source and/or different legal mechanisms in different jurisdictions;

(f) the "all-inclusive" approach was successfully applied by the IASB in drafting recent standards such as IFRS 15, IFRS 16 and IFRS 17;

(g) the "all inclusive" approach results in instruments presenting the same cash-flows characteristics, but arising from potentially different contractual or legal sources, to be classified identically. Such a result cannot be reached when the classification

depends on the legal framework in which the instrument was created and is unlikely to result in distinctions that will be useful to users of the financial statements;

(h) any legal rights or obligations that may have an impact on the contract are taken into account by investors and contribute to their overall understanding of the instrument issued and the decision to invest.

85 As an all-inclusive approach may disrupt some current practices, two respondents considered that the IASB may provide limited exceptions, especially for bail-in instruments. However, these two respondents considered that if the IASB does not proceed with an "all-inclusive" approach, the IASB should withdraw its current proposal, while requiring transparency on the approaches and judgements applied by an entity.

86 One respondent that supported the all-inclusive approach called for the IASB to specify directly in the amendments to IAS 32 (rather than simply in the Basis for Conclusions) to affirm that the IASB's proposals remain in line with the principles of IFRIC 2. The integration of this specific reference to IFRIC 2 in a revised IAS 32 would reaffirm the consistency and coherence of the accounting standards, ensuring a clear and unambiguous framework for the classification of cooperative shares as equity instruments.

87 One other respondent stated that although the all-inclusive approach would be the preferred approach from a conceptual point of view, this approach could represent a significant change to IAS 32 and could result in a greater number of instruments being classified as liability. Considering that the new proposals can bring new uncertainties and interpretations issues and that common practice has been developed, this responded questioned whether the IASB's proposals on the effects of relevant laws and regulations were needed.

88 By contrast, two respondent **expressed concerns that an all-inclusive approach could lead to continuous classification changes when there are frequent changes in the law, would be a significant to current practice and current requirements**. Further, this might impact the equity of an entity and accordingly may impact the lending decisions of a financial institution giving loans to such entity.

89 One of these respondents considered that the current standard and the interpretations thereof have generally led to an acceptable classification outcome in many jurisdictions. Therefore, current practice may be continued and not in favour of the proposed clarifications.

Moving forward – other approaches

90 Many respondents **called for the IASB to further consider its proposals (revise), make more field-testing and provide more clarifications and examples to illustrate the application of the IASB's proposals.** This with the objective of helping the assessment of whether a contractual right or obligation is required by laws or regulations, ensure comparability across companies, ensure effectiveness and coherence of the requirements, and avoid unintended consequences on the classification of financial instruments.

91 When providing more details on their views, respondents asked for the IASB to:

(a) **clarify the implications of the new paragraph 15A of IAS 32, specifically regarding its interaction with paragraph 16A and 16B of IAS 32** ('puttable instruments') and the IFRS IC Agenda Decision of 12 September 2017. Otherwise, it would lead to uncertainty, questions and unnecessary discussions with statutory auditors;

(b) **clarify how its proposals should apply to different types of instruments that are highly regulated**, such as puttable instruments where the obligation to repurchase for the issuer is set by regulation and compound instruments when the remuneration is set by law;

(c) revise the current proposal or provide additional guidance on how it should be applied to instruments that are heavily regulated by law;

(d) **define what laws or regulations are**, in particular it is important to clarify whether the regulatory guidance issued by a prudential regulator - which is expected to be applied by the entity although it is not a law or regulation by itself - is equivalent to those required by laws or regulations to ensure comparability across companies and to minimise diversity in practice;

(e) clarify how to treat features which are specified directly in the law and must be included in the contract in as qualifying conditions for a specific type of instrument to exist; and

(f) clarify and remove the confusion in the Basis for Conclusions which may lead to viewing the loss absorption feature in Additional Tier 1 instruments as legal rather than contractual feature.

92 One respondent supported the need for further guidance requested by EFRAG on the potential impact to the classification of financial instruments under IFRS 9 Financial Instruments from the holder perspective.

93 Finally, one respondent did not agree with the IASB proposals related to the effects of relevant laws or regulations. This respondent argued that:

(a) For bail-in instruments, an entity should not only consider what was foreseen by the relevant parties in the contractual obligation but also the (legal) bail-in powers. This is because "banks are required by law to include a loss-absorption feature in these instruments" and thus in the contractual terms of the instrument,

(b) the IASB efforts to address issues that arise in practice for financial institutions (e.g. bail-in instruments) should not disrupt the accounting requirements applicable for all the other industries;

(c) the IASB proposals when applied to instruments where in the contractual terms the entity is required to pay dividends (15%) above those required by law (10%) would lead to an entity considering that obligation in its entirety (related to 15% rather than 5%). Such an approach was inconsistent with the principles proposed by the IASB in paragraph 15A; and

(d) The IASB’s proposals are likely to have unintended consequences on the classification of other instruments not mentioned by the IASB (e.g. different types of shares with different minimum mandatory dividends imposed by law).

EFRAG Secretariat's recommendations to EFRAG FR TEG on EFRAG's proposed final position

94 The EFRAG Secretariat recommends changing EFRAG´s initial position on the effects of relevant law and regulation to express significant concerns on the IASB´s proposals and suggest that the IASB reconsiders its proposals on the effects of relevant laws and regulations, as the IASB´s clarifications as proposed in the ED are likely to raise application challenges and uncertainty, lead to a significant change in practice, and introduce the risk of unintended consequences and new diversity in practice, particularly for instruments for which some or all key parameters are regulated by law or regulation.

Question 2 Classification: Settlement in an entity’s own equity instruments (including fixed-for-fixed condition in IAS 32)

Question 2 - Settlement in an entity’s own equity instruments (paragraphs 16, 22,22B–22D, AG27A and AG29B of IAS 32)

The IASB proposes to clarify when the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 is met by specifying that the amount of consideration to be exchanged for each of an entity’s

own equity instruments is required to be denominated in the entity's functional currency, and either:

(a) fixed (will not vary under any circumstances); or

(b) variable solely because of:

(i) preservation adjustments that require the entity to preserve the relative economic interests of future shareholders to an equal or lesser extent than those of current shareholders; and/or

(ii) passage-of-time adjustments that are predetermined, vary with the passage of time only, and have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of the entity's own equity instruments (paragraphs 22B–22C).

The IASB also proposes to clarify that if a derivative gives one party a choice of settlement between two or more classes of an entity's own equity instruments, the entity considers whether the fixed-for-fixed condition is met for each class of its own equity instruments that may be delivered on settlement. Such a derivative is an equity instrument only if all the settlement alternatives meet the fixed-for-fixed condition (paragraph AG27A(b)).

The IASB further proposes to clarify that a contract that will or may be settled by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments is an equity instrument (paragraph 22D).

Paragraphs BC31–BC61 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why

Summary of respondents' comments

Fixed-for-fixed condition for derivatives

95 Many respondents **generally agreed with the IASB's proposals** for instruments settled with an entity´s own equity instruments, considered that these clarifications will reduce the existing diversity in practice.

96 Two respondents detailed that there is limited guidance in IAS 32 on the fixed-for-fixed condition, various questions have arisen on how requirements in IAS 32 should be interpreted and applied in practice (e.g., adjustment clauses that alter the conversion ratio

to prevent dilution). This lack of clarity has also led to diversity in practice. The proposal has provided a clarity on the principles in IAS 32 on the fixed-for-fixed condition to particular derivatives on own equity and would improve consistency and are fairly aligned with current practice.

97 One user representative added that this clarification together with the proposed presentation improvements will help users better understand the total equity position of an issuer.

98 Nonetheless, one respondent that generally welcomed the IASB approach, considered that a better solution would be to classify as equity both: *(a)* non-derivative financial liabilities that will be settled in the issuer's own shares subject to a cap where the entity has the possibility to issue new shares within the limit of the cap; and *(b)* derivatives that will be settled by the receipt of: (i) a variable amount of cash for the delivery of a fixed number of shares; or (ii) a fixed amount of cash for the delivery of a variable number of shares; or (iii) a variable amount of cash for the delivery of a variable number of shares. This respondent does not believe that such changes would contradict the principles of the Conceptual Framework. In addition, it considered that these changes would reduce the complexity in applying IAS 32 and improve the relevance of information for users of financial statements.

99 By contrast, one respondent **was not convinced by the IASB´s proposals**, as "they appear like adding rather casuistic requirements, and we wonder whether these proposals would indeed clarify and improve accounting". The proposed clarifications lead to more rules-based approach for fixed-for-fixed condition, thus moving away from a principles-based structure of the requirements. Since the requirements around settlement in own equity instruments (paragraphs. 16B, 22, 22A, 23) are already rather rules-based, "adding more details (paragraphs. 22B-22D) does increase this unfavourable character".

<u>Fixed-for-fixed condition – Passage of time adjustments</u>

100 On the **passage of time adjustments**, some respondents while supportive, expressed some concerns and called for additional guidance. More specifically, respondents:

(a) considered that the proposed requirements in paragraph 22C(b) of the ED should be complemented by a reasonability test for the compensation of the passage of time. It would prevent from using unrealistic interest rates discount rates in the present value calculations (the assessment of 'reasonable' is already applied in IFRS without having a specific guidance. For example, paragraph B4.1.11 of IFRS 9 says that the prepayment amount may include reasonable compensation for the early

termination of the contract. Such an assessment is common in the loan business and banks found the way to apply it without the accompanying guidance);

(b) called for the IASB to clarity on whether the fixed-for-fixed condition is met for a convertible loan of variable interest rate (where both principal and interest are compounded to the convertible amount);

(c) considered that the IASB's proposals on passage-of-time adjustments may lead to classification changes for options that can be exercised at different pre-determined dates as it may be difficult to demonstrate that the difference between the amount of consideration to be paid or received on each settlement date represents only compensation proportional to the passage of time;

(d) considered that the IASB's proposals are unclear on how variable interest rate convertible instruments should be analysed. The IASB should clarify that for convertible instruments, what is fundamental is that the conversion ratio is fixed and that the interest rate of the debt component can be fixed or variable;

(e) asked for additional clarifications to further improve the degree of comparability. For example, explanations on the need for the present value calculation and assessment for passage-of-time adjustments included in the Basis for Conclusion could be included in the text of the standard, to emphasise their mandatory character; and

(f) did not consider that an interest rate benchmark such as Euribor or inflation would alter the passage-of-time nature of the adjustment and therefore suggests that the IASB identifies more precisely which characteristics of a benchmark interest rate are likely to interfere with the notion of passage of time;

(g) asked for the IASB to clarify that fixed rate adjustments need to be a reasonable approximation of time value of money. Moreover, additional explanations, illustrative examples and/or educational materials could be helpful to clarify how this assessment should be performed.

101 One respondent did not understand, based on the explanations given in BC57 and in Illustrative Example 20, why adjustments made on the basis of indexation to a floating benchmark interest rate (such as Euribor) would not meet the criterion. In finance, the passage of time is considered to be reflected by a fixed or variable interest rate. In addition, from the perspective of classifying financial assets under IFRS 9, this type of index does not call into question the 'SPPI test' and is a representation of the time value of money, as

stated in IFRS 9.B4.1.13 (instruments B and C) and consistently with IFRS 9.4.1.9A-E. This respondent suggested that the passage of time can be reflected by a fixed interest rate or by a floating interest rate, and once this principle has been established to specify which specific characteristics of a floating rate could call into question the 'fixed-for-fixed' criterion.

102 By contrast, one respondent considered that the **IASB's proposals were neither clear nor principles based and that they raised more questions than answers**. Considering in detail the different approaches the IASB discussed, this respondent did not understand why the approach in paragraph BC54(c) is deemed more consistent with the fixed-for-fixed condition than the approach in paragraph BC54(a), or even why these are considered differently. It is not clear which variable interest rates would be permitted – e.g. the respondent expected index-based variable interests to be permitted but was not able to derive this from the wording.

Fixed-for-fixed condition – Preservation adjustments

103 On **preservation adjustments**, one respondent was supportive of the inclusion of preservation adjustments in IAS 32. Such adjustments are common in convertible instruments and are reasonable in classifying conversion features as equity.

104 However, some respondents provided suggestions for the IASB to improve its proposals. For example, respondents:

(a) noted that the IASB provided simplistic examples of preservation adjustments. This respondent recommended that the IASB provides additional examples of preservation adjustments that include more details on the assessment of the nature of the adjustments;

(b) noted that under proposed paragraph AG27A(b), the fixed-for-fixed condition can be met when one party has a choice of settlement between two or more classes of an entity's own equity instruments. One respondent suggested that the IASB clarifies whether this requirement also applies in the context of consolidated financial statements when those equity instruments are issued by different (consolidated) legal entities (e.g. parent company and a subsidiary);

(c) suggested changing the criteria in paragraph 22C of IAS 32 so that it reads: "is designed to preserve the economic interests of the future holders…"

(d) invited the IASB to revise the conclusion of illustrative example 19: change of control provisions for when a contract includes a formula that determines the conversion ratio if a change of control occurs and the inputs to the formula include the share price of an entity and the time remaining until the original conversion date. Current practice analyses the time value of an option as an adjustment representative of both the passage of time and preservation adjustments. In practice, the time value of an option includes the entity's share price, as in the fact pattern proposed in Illustrative Example 19. The conclusion of Example 19 would therefore prevent such clauses from qualifying as passage-of-time or preservation adjustments, and lead to their measurement at fair value through profit or loss, which seems to contradict the intention of the proposed principle on passage-of-time and preservation adjustments;

Fixed-for-fixed condition – functional currency

105 One respondent noted that the description of the fact pattern in Illustrative Example 15 includes an explicit indication that the foreign exchange rate is variable (which results in the fixed-for-fixed condition not being met in this case). This respondent questioned whether the fixed-for-fixed condition in this example would be met if there was a fixed exchange rate between the entity's functional currency and the foreign currency in which the amount of consideration to be exchanged for an entity's own equity instrument is denominated (or, alternatively, if the exchange rate fluctuated in a very narrow range so that any variability would be immaterial). The IASB should clarify this question.

106 One other respondent is against the IASB's proposals on functional currency (AG27A(a), AG29B). The IASB´s proposals require that the only currency that complies with the fixed-for-fixed condition is the functional currency of the entity whose instruments will be delivered or received on settlement ("reference point", BC44). The respondent did not agree with this proposal and deem it an unnecessary restriction. Instead, the respondent suggested allowing both the **functional currency of the entity within a group who initially issued the instrument** or, alternatively, **the functional currency of the group entity whose instruments will ultimately be delivered or received**.

107 One other respondent considered that the IASB´s proposals could be problematic for a consolidated group whose subsidiaries have different functional currencies. Instead, the appropriate reference point in draft paragraph AG29B of the Application Guidance should be the **functional currency of the entity where the amount of cash is exchanged on settlement**.

108 One respondent considered that the IASB proposals on functional currency denomination seemed to be restrictive and did not take into account the reality and economic environment of the instruments concerned, where many issuers do not have a choice of currency in which they issue. This respondent suggested using the existing guidance on embedded foreign currency derivatives in a host contract that is an insurance contract or not a financial instrument in IFRS 9.B4.3.8(d). It is logical and consistent to consider that **as long as such a foreign exchange component does not lead to bifurcate it as an embedded derivative, the fixed-for-fixed criterion is not called into question**.

109 One respondent understood the conceptual basis behind the **"functional currency"** criteria. However, it was noted that, in some countries, entities may be obliged to issue their capital in the local currency while they use another (generally considered as stronger) currency for their business. In this situation, the functional currency aspect might lead instruments to fail the fixed for fixed test;

EFRAG Secretariat's recommendations to EFRAG FR TEG on EFRAG's proposed final position

110 The EFRAG Secretariat proposes limited changes to EFRAG´s initial position. More specifically, improving EFRAG´s initial position by leveraging on the comments received. For example, request more illustrative examples and implementation guidance on passage of time adjustments, preservation adjustments and on which functional currency should be the reference point.

Question 3 Classification: Obligation to purchase an entity's own equity instruments (e.g., written put options on non-controlling interest)

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

The IASB proposes to clarify that:

(a) The requirements in IAS 32 for contracts containing an obligation for an entity to purchase its own equity instruments also apply to contracts that will be settled by delivering a variable number of another class of the entity's own equity instruments (paragraph 23).

(b) on initial recognition of the obligation to redeem an entity's own equity instruments, if the entity does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates, those equity instruments would continue to be recognised. The initial amount of the financial liability would, therefore, be

removed from a component of equity other than non-controlling interests or issued share capital (paragraph AG27B).

(c) an entity is required to use the same approach for initial and subsequent measurement of the financial liability—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 (paragraph 23).

(d) any gains or losses on remeasurement of the financial liability are recognised in profit or loss (paragraph 23).

(e) if a contract containing an obligation for an entity to purchase its own equity instruments expires without delivery:

   (i) the carrying amount of the financial liability would be removed from financial liabilities and included in the same component of equity as that from which it was removed on initial recognition of the financial liability.

   (ii) any gains or losses previously recognised from remeasuring the financial liability would not be reversed in profit or loss. However, the entity may transfer the cumulative amount of those gains or losses from retained earnings to another component of equity (paragraph AG27C).

(f) written put options and forward purchase contracts on an entity's own equity instruments that are gross physically settled—consideration is exchanged for own equity instruments—are required to be presented on a gross basis (paragraph AG27D).

(g) Paragraphs BC62–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Summary of respondents' comments

111 Fifteen respondents out of 18 responded to this section.

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

112 Most of the respondents [13 of 15] 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, if the entity does not yet have access to the rights and returns associated with ownership of those equity instruments.

Instead, these respondents prefer that the debit side at initial recognition goes against the NCI share of equity.

113 The following were the key arguments on these respondents:

(a) A majority of the respondents referred to the problem of **double-counting** (i.e. NCI in equity and purchase obligation as financial liability).

(b) Many respondents noted that the IASB's proposals **do not properly reflect the economic substance of the transaction in question and result in counterintuitive effects**. One of these respondents specifically mentioned that the transaction does not affect interests of the owners of the parent in any way.

(c) Two respondents noted that the IASB's proposals would lead to an undue and **punitive impact on banks prudential own funds** and that the obligation to purchase NCI would have a more detrimental impact on prudential own funds than the actual purchase of such NCI.

(d) Two respondents referred to **an existing guidance in paragraph BC11 of IAS 32**, which stipulates that "an entity's obligation to purchase its own shares establishes a maturity date for the shares that are subject to the contract. Therefore, to the extent of the obligation, those **shares cease to be equity instruments when the entity assumes the obligation**". In other words, paragraph BC11 observes that the put option operated a fundamental change in the nature of the equity instrument when the entity assumed the obligation which is further confirmed by paragraphs BC68 and AG29 of the existing IAS 32.

114 Some of these respondents specifically mentioned that the initial debit entry should not result in the NCI share of equity turning into a negative amount. In this case, this negative residual amount should be transferred to the parent's share of equity.

115 Some respondents mentioned specifically that the debit side should go to a separate component of the NCI share of equity as proposed in paragraph AV5 of the ED.

116 Some respondents were of the view that the debit side at initial recognition should (or could) be allocated between the NCI share and the parent's share of equity.

117 On the contrary, some respondents supported the IASB's proposals regarding the debit side going against the parent's equity. One of these respondents, while acknowledging some of the arguments to the contrary mentioned above, still supported the IASB's proposal as a pragmatical solution which prevent putting at risk finalisation of the FICE project. Another

respondent mentioned that whilst most of its members would prefer that the debit side at initial recognition goes to the NCI part of equity, a few of their members still supported the IASB's proposals in debiting the parent's equity, noting that NCI shall not be derecognised as they still have a right in the net assets of the entity. Other members of this respondent were of the view that judgement should be applied in determining whether to record the debit against parent equity or NCI share on the basis of whether the instrument gives the parent access to the returns associated with ownership of those instruments.

Net presentation

118 Many respondents expressed various degree of sympathy for the 'net presentation', ranging from acknowledging that it has some merits (while still preferring the gross presentation) to clearly declaring their preference for this approach. However, a majority of these respondents mentioned their understanding that such a change would be too fundamental, given the scope of the IASB's project, and would also go against the existing traditional accounting practice to recognise the gross amount of the financial liability.

119 One respondent noted that the net presentation could be particularly appropriate in certain cases, e.g. for derivatives over own equity held in the trading book by banks where such derivatives are used for market making or economic hedging purposes. In such a case revaluation through profit or loss would be fully appropriate because such transaction are not used to extinguish existing or issue new shares from long-term perspective.

Accounting for NCI puts in separate financial statements

120 Two respondents noted that, in separate financial statements, accounting for such contracts as a derivate under IFRS 9 would provide the most useful information to the users.

Subsequent measurement of the financial liability

121 Respondents 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 is treated via profit or loss.

122 It is also noteworthy that the tone of some replies on this issue was not categorical in favour of one or another option. E.g., one respondent while supporting the IASB's proposals, also acknowledged some merits of the alternative approach. Another respondent presented arguments in favour of both approaches without clearly expressing a preference for any of

them. Another respondent noted that its members had mixed views on the preferred approach and did not express and preference in this respect as no agreement was reached.

123 The following arguments were given by the respondents who opposed the IASB's proposals:

(a) A majority of respondents noted that these instruments should be viewed as **transactions with owners in their capacity as owners**.

(b) Many respondents argued that it would be **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) Many respondents noted **double effect on profit or loss** (through allocation of the subsidiary's result of the period to the non-controlling interests and through the remeasurement of the financial liability reflecting the change in the value of the put options).

(d) Many respondents noted that in the case of **expiry of the put option without exercise** the amounts removed from the liability are recognised in equity and not in profit or loss. This means that in this case, the derecognition is not accounted for in accordance with IFRS 9, which requires the impacts to be recognised in profit or loss.

124 The respondents who supported the IASB's proposals, fully or partially, argued that subsequent remeasurement of the financial liability through profit or loss is in line with the standard accounting practice under IFRS 9.

125 Many respondents proposed that the effects of subsequent remeasurement should be allocated either to the parent's share of equity and the NCI share of equity or also to profit or loss.

126 One respondent suggested to make the classification of any gains or losses on remeasurement of the financial liability dependent on whether the entity has access to the rights and returns associated with ownership of the equity instruments to which the obligation relates. If the entity has access to the rights and returns associated with ownership of the equity instruments and thus the NCI is derecognized, any gains or losses on remeasurement of the financial liability should be recognized in profit or loss. However, if access to the rights and returns associated with ownership of the equity instruments remains with the NCI any gains or losses on remeasurement of the financial liability should be recognised in equity.

Other issues

127 Two respondents noted that there is no reference to IFRS 9 regarding the subsequent measurement of the financial liability, in particular under which captions of profit or loss should be recognised the changes in the liabilities' measurement. There are cases when no measurement category under IFRS 9 suits the substance of the transaction. As a result, they appreciated **entities can develop the appropriate accounting policy on how to present the value changes and decide whether an interest component would be recognised separately.**

128 Two respondents specifically pointed out that the IASB's proposals could result in a **significant change of the established accounting practice** in their jurisdiction.

129 One respondent pointed to the fact that diversity in practice often occurs because transactions are not equal and, hence, are not accounted for equally. Therefore, **applying the requirements differently can be appropriate, as far as they affect unlike transactions**. Whenever this is the case, the IASB's proposal would no longer provide that room for judgement and differentiation.

130 One respondent argued that **further guidance or illustrative examples** should be provided to address certain concerns (eg., to clarify the calculation of the present value of the redemption amount in cases where the redemption amount is not fixed upfront; to clarify that contracts containing an obligation for an entity to purchase its own equity instruments also apply to contracts that will be settled by delivering a variable number of another class of the entity's own equity instruments).

EFRAG Secretariat's recommendations to EFRAG FR TEG on EFRAG's proposed final position

131 Based on the feedback received from the respondents, the EFRAG Secretariat recommends retaining the preliminary views with regard to the accounting treatment at initial recognition as expressed in paragraph 49 of the DCL, i.e. to explicitly disagree with the IASB's proposals and to propose instead that the debit side at initial recognition goes to the NCI share of equity.

132 The EFRAG Secretariat also proposes to further reinforce the argumentation of this approach by adding the reference to existing guidance in IAS 32 (paragraphs BC11, BC68 and AG29).

133 The EFRAG Secretariat recommends to retain the preliminary views with regard to remeasurement of the financial liability as expressed in paragraph 56 of the DCL and to

further clarify that the views on this issue were mixed even though many respondents disagree with the IASB proposals.

134 With regard to the net presentation, the EFRAG Secretariat proposes to amend paragraph 50 of the DCL to elaborate that whilst many respondents see some merits of this approach, they equally acknowledge that such a change would be too fundamental for the current project and would go beyond its scope.

Question 4 Classification: Contingent settlement provisions

Question 4 - Contingent settlement provisions (paragraphs 11, 25, 25A, 31, 32A, AG28 and AG37 of IAS 32)

The IASB proposes to clarify that:

a. some financial instruments with contingent settlement provisions are compound financial instruments with liability and equity components (paragraphs 25 and 32A);

b. the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision would not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event (paragraph 25A);

c. payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero (paragraphs 32A and AG37);

d. the term 'liquidation' refers to the process that begins after an entity has permanently ceased its operations (paragraph 11); and

e. the assessment of whether a contractual term is 'not genuine' in accordance with paragraph 25(a) of IAS 32 requires judgement based on the specific facts and circumstances and is not based solely on the probability or likelihood of the contingent event occurring (paragraph AG28).

Paragraphs BC94–BC115 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Summary of respondents'' comments

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

Initial and subsequent measurement of the financial liability

136 Many respondents agreed with the IASB´s proposals in paragraph 25A that the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision should be aligned and not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event, particularly when applied to Additional Tier 1 instruments. These respondents:

(a) considered that the clarification provided in ED was helpful for initial recognition and measurement of financial instruments with contingent settlement provisions such as those that are mandatorily convertible into a variable number of shares upon a contingent 'non-viability' event. Such clarifications seem to be aligned with current practice in certain jurisdictions and current requirements in IAS 32;

(b) welcomed that the initial and subsequent measurement of the liability component would not consider probability and estimated timing of occurrence or non-occurrence of the contingent event. This proposal results in a practicable treatment of Additional Tier 1 instruments (with conversion feature into variable number of own shares) leading to a full liability component at inception. It was noted that there is no need to estimate the discount rate and timing of the contingent event at inception and to periodically re-estimate the timing with potentially numerous catch-up adjustments over the instrument's life;

(c) the proposed measurement is consistent with existing principles in IAS 32 and would appropriately reflect the potential outflow. However, requested the IASB to clarify the interaction between the principles in IAS 32 and IFRS 9;

(d) considered that even though taking into account the probability of occurrence in the measurement of the liability would provide relevant information to users, it generally supported the IASB´s proposals which will address some of the diversity; and

(e) stated that considering the timing and probability of occurrence makes the measurement complex.

137 However, many respondents expressed some concerns and provided some suggestions on the IASB´s proposals. More specifically, respondents:

(a) shared EFRAG's position on the need to clarify the accounting treatment for certain financial instruments with contingent settlement features or a liability component, which may include the presence of caps, exceeding the total consideration received by the entity upon issuance of the instrument (i.e. clarifying the accounting treatment regarding the difference between the obligation amount (which may exceed the consideration received) and the consideration received at the issuance of the instrument;

(b) considered that the IASB should refine the principle when the amounts that might have to be repaid might vary and when such amounts could exceed the initial fair value of the instrument. The initial measurement of the liability component should not give rise to a negative amount for the equity component which the IASB's proposal could lead to. Any redemption feature for an amount above the initial fair value of the instrument should be recognised as an embedded derivative;

(c) considered that it was important to provide additional explanations and/or examples of the treatment of contingent events, which may differ both in terms of timing (particularly if there are multiple dates or multiple periods when the contract can be settled) and in terms of the impact on the settlement amount;

(d) raised questions on the scope of the IASB´s proposals (i.e. whether the IASB´s proposals should only apply to contingent settlement provisions included in compound financial instruments, to all financial instruments or to any type of contingent settlement feature, including those present in non-financial contracts) and highlighted the implications of extending these measurement requirements to a wider scope which could create problems of practical application in relation to existing standards. More specifically, the IASB´s proposal could have a significant impact regarding the number of instruments containing clauses that would comply with the general definitions in paragraphs 25 and 25A (such as loans with covenants, ESG loans, loans indexed to the issuer's profits, or even contingent consideration in the context of a business combination under IFRS 3). Thus, there was a call for the IASB to clarify the scope of its proposals;

(e) noted that ignoring the probability and expected timing of the contingent event may in some situations create practical issues due to conceptual differences with IFRS 9 requirements for the initial and subsequent measurement of financial liabilities. Disregarding the range of possible outcomes in the initial measurement of a financial instrument issued and retaining only the amount corresponding to the worst-case scenario, could result in a mismatch between the fair value in accordance with IFRS 13, and the requirement to recognise the financial liability (or liability component of a compound financial instrument) at its maximum amount, without any clear standard specification on how to deal with this mismatch;

(f) considered that the IASB´s proposal to subsequently measure a financial liability arising from a contingent settlement provision at the present value of the full redemption amount would be inconsistent with this general measurement principle in IFRS 9, because when revising its estimates of payments or receipts, an entity would take into account the probability and expected timing of the contingent event in the estimated future contractual cash flows. There was a call for the IASB to clarify how its proposal should relate to the existing initial and subsequent requirements of IFRS 9, IFRS 13 and the other standards concerned by such features (e.g. IFRS 3).

(g) recommended clarifying that only compound instruments are in scope of the new guidance; and

(h) considered that the IASB should clarify and include practical examples of how to determine the appropriate discount rate to use to calculate the present value of the contingent settlement obligation (based on similar existing guidance in IAS 37 or IAS 19), and the impact on the amortised cost and effective interest rate of eligible financial instruments.

138 By contrast, many respondents disagreed with the IASB´s proposal in paragraph 25A to ignore probability and estimated timing of occurrence or non-occurrence of the contingent event and called for the IASB to revise its proposal.

139 These respondents considered that:

(a) disregarding probabilities when determining the fair value does not seem to be consistent to the measurement requirements of IFRS 9 and IFRS 13. In principle, paragraph 5.1.1 of IFRS 9 requires the initial measurement of financial instruments at fair value. It is not clear from the definition of contingent settlement provisions (paragraph 25 of IAS 32) that contractual obligations for which various cash flow

settlement scenarios are conceivable at inception (i.e. various probability-weighted individual cases) are excluded. According to the ED's proposal, the highest possible amount (which may differ from the consideration received) would always have to be recognised, although this (alone) is considered unlikely (but not non-genuine). This could result in unintended implications;

(b) disregarding probabilities could lead to distortive effects and could risk not being representative of the value of the liability. This may happen, for example, for instruments with a contingent event with a low probability of occurrence that trigger a significant cash flow. The IASB´s approach would lead to the recognition of a liability higher than its fair value;

(c) disregarding probability seems to be counter-intuitive and contradictory to established measurement principles. As the concept of present value is well established, the idea of a weighted average (ie. considering different outcomes – timing and amounts –, weighing those outcomes by its probability, and discounting) is intuitive and implicitly assumed. Hence, measuring the liability at a settlement amount which is discounted assuming a settlement to occur at the earliest possible date is not conceptually sound. Considering different outcomes (timing, amount, probability) is a fundamental measurement principle throughout the IFRSs for current measurement bases, even when there are uncertainties that are out of the issuer's control.

140 One respondent encouraged the IASB to consider measurement issues as part of a separate standard-setting project to amend IFRS 9. An attempt to provide an answer to such complex measurement issues within a narrow-scope amendments project presents a risk of proposing a solution that addresses only part of the issues.

Payments at the issuer's discretion are recognised in equity

141 Many respondents that referred to this topic agreed with the IASB´s proposal that payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero.

142 However, these respondents:

(a) highlighted the resulting consequences on the ongoing DRM project as such approach may transfer existing managed exposures to an equity classification.

(b) pointed out that if an instrument has an initial equity carrying amount of zero, it should be clarified why there is a payment at the issuer's discretion and this payment is recognized in equity. An example of the type of financial instruments that relates to this approach would be helpful;

(c) invited the IASB to propose a transition provision to those that currently recognise payment of interest in profit or loss, to avoid any unintended mismatch in profit or loss.

143 One respondent noted that some have concerns about the ability to continue to apply hedge accounting if certain payments to holders of compound instruments would be classified as equity as a result of the proposals. Thus, the respondent would welcome the IASB providing clarification on the impact on hedge accounting for different examples of hedges (cash flow hedges and fair value hedges) or to consider the potential impact in their final amendments.

144 One respondent disagreed with the IASB proposal that payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero. This respondent argued that:

(a) The IASB proposal is expected to create a significant accounting mismatch

(b) considered that instruments with contingent settlement provisions (regulatory change clauses) that trigger conversion into a variable number of an institutions' own shares are financial liabilities in full with interest payments recognised in the income statement

(c) if discretionary interest payments must be recognised in equity, the banks that today account for such interest payments in the income statement foresee issues primarily with applying hedge accounting under IAS 39 and IFRS 9. As Interest rate hedge accounting is not allowed for instruments, which are recognised in equity, financial institutions that manage the interest rate risk of those instruments will then have an artificial volatility in P&L.

<u>Clarifications of the terms "liquidation" and "non-genuine"</u>

145 One respondent considered that the clarifications of the terms 'liquidation' and 'non-genuine' were sufficient.

146 One respondent supported the IASB´s clarifications for the term "liquidation" and to refer to "the process that begins after an entity has permanently ceased its operations".

147 Some respondents called for the IASB to clarify the meaning of liquidation and the concept "process for permanently ceasing operations":

(a) as there is the risk of having different interpretations in different jurisdictions, and consequently, different classification outcomes. For example, in Italy and entity may be in liquidation and continuing its operations because the shareholders decided to liquidate but the entire still operates as it is profitable. Thus, called for the IASB to clarify that an entity is in liquidation when shareholders decide to liquidate the entity.

(b) and how it interacts with resolution, administration processes and insolvency,

(c) the proposed definition may be too narrow. It may for example be the case that instruments are repaid when the entity has not fully ceased its operations whilst at the same time liquidation, and thus the ultimate ceasing of its operations, is inevitable. In such a scenario, when it is certain that all shareholders will be repaid, the timing of such payments before or after the entity formally ceases operations should not impact an instrument's classification

148 One respondent encouraged the IASB to outline further, in the Basis for Conclusions, the situations that presented practical application difficulties and justified this amendment.

149 Finally, one respondent considered that the IASB should not attempt to define the concept liquidation more precisely given the absence of significant difficulties in interpreting the concept of liquidation in practice. In addition this respondent:

(a) questioned the impact of the liquidation of an entity within a consolidated group in which the parent entity issuing consolidated financial statements is not itself in liquidation. More specifically, whether this situation should lead the parent reporting entity to recognise a financial liability to NCI holders as soon as the liquidation process is launched or only when the process is completed.

(b) considered that the concept of liquidation is mainly a legal concept that can vary from one jurisdiction to another. The IASB´s proposal could create an inconsistency or even a contradiction with the already existing legal definitions of liquidation.

150 One respondent that supported the clarification related to the assessment of whether a contractual term is 'not genuine' (seems aligned with the generally observed practice) considered that the proposed example in AG28 about instruments with a 'regulatory change clause' could be open to interpretation and lead to a misinterpretation if the

circumstances and wording of this type of clause differs from the general example given. Therefore proposed removing this example from the paragraph AG28 and moving it to the illustrative examples to avoid turning a specific case into a general principle regardless of the circumstances.

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151 EFRAG received mixed views on the measurement of financial instruments with contingent settlement provisions.

152 EFRAG considers that the IASB´s proposals have the benefit of addressing the diversity in practice, however we acknowledge that there are mixed views among our stakeholders on the relevance of the IASB´s proposals (as described above) and that it is difficult to address complex measurement issues within a narrow-scope amendments.

153 Nonetheless, if proceeding with its proposals, EFRAG notes that the IASB´s proposals are putting pressure on the definition of “present value of the redemption amount” and that EFRAG would welcome more guidance in this area, including more guidance on the scope of the IASB´s proposals in paragraph 25A, more guidance on the calculation of the present value of the redemption amount (e.g. discount rates) and interaction of the IASB´s proposals with existing initial and subsequent requirements of IFRS 9 and IFRS 13.

Question 5 Classification: Shareholder discretion

The IASB proposes:

(a) to clarify that whether an entity has an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle a financial instrument in such a way that it would be a financial liability) depends on the facts and circumstances in which shareholder discretion arises. Judgement is required to assess whether shareholder decisions are treated as entity decisions (paragraph AG28A).

(b) to describe the factors an entity is required to consider in making that assessment, namely whether:

   (i) a shareholder decision would be routine in nature—made in the ordinary course of the entity's business activities;

   (ii) a shareholder decision relates to an action that would be proposed or a transaction that would be initiated by the entity's management;

   (iii) different classes of shareholders would benefit differently from a shareholder decision; and

   (iv) the exercise of a shareholder decision-making right would enable a shareholder to require the entity to redeem (or pay a return on) its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) (paragraph AG28A(a)–(d)).

(c) to provide guidance on applying those factors (paragraph AG28B).

Paragraphs BC116–BC125 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Summary of respondents' comments

154 Ten respondents out of 18 responded to this section.

155 Two respondents mentioned that the IASB's proposals on how to treat shareholders' decisions created divergence in practice.

156 The significant majority of respondents agreed or (cautiously) welcomed the proposed requirements considering the following comments.

(a) The majority of these respondents stated that the level of judgement required to perform the assessment would remain significantly high. Therefore, illustrating examples or further guidance/specific principles on the application of the factors would help to minimise the risk of diversity in application and improve comparability.

(b) One of the respondents indicated that clarifications clearly and adequately emphasise the principle of control which is a fundamental and widely-used concept throughout the IFRSs. In addition, the factors seemed to be in line with current practice. However, all factors describe circumstances when shareholder decisions are “more likely” or “unlikely” to be treated as an entity decision. the reference to likelihood leaves, or opens, room for too much interpretation or judgement.

(c) On factor (d)[1] of draft paragraph AG28A:

(i) One of these respondents was concerned that the current drafting of this factor may unintentionally lead an entity to conclude that shares that may be repurchased following a decision agreed by the General Shareholders’ Meeting qualify as a financial liability, while such shares should meet the definition of an equity instrument as long as the General Shareholders’ Meeting is the entity’s general governing body.

(ii) One of these respondents, indicated that paragraph AG28A (d) should not be considered in isolation to the other criteria. They considered that this criterion is part of the entity’s decision if it is a collective decision made as part of the entity’s governance structure where all the shareholders participate in the decision and not only one class of shareholders.

157 The reasons provided for those supporting the IASB’s proposals are the following:

(a) The proposals would bring useful and helpful guidance (two respondents);

(b) Allows entity-specific judgement and avoids a more prescriptive approach (two respondents); and

(c) Consistent with current practice (one respondent).

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[1] which requires an entity to consider whether exercise of a shareholder decision-making right enables a shareholder to require the entity to redeem its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Such decision-making rights indicate that the shareholders would make their individual decisions as investors in the shares, and the shareholder decision is unlikely to be treated as an entity decision.

158 On the other hand, two respondents did not agree with the proposals and provided the following explanations:

(a) Generally, shareholders' meeting decisions should be considered as entity decisions. The IASB's approach not starting from this presumption could create uncertainty about the classification of some financial instruments. They suggested that the IASB should reconsider the proposal in order to avoid unintended consequences.

(b) introducing uncertainty and subjectivity and preferred a more specific principle to eliminate the uncertainty and to be more simplistic. Depicting an example of different cases in which the decision is taken by a shareholder and is treated as an entity's decision would be useful (one respondent).

159 One respondent asked for additional guidance in a situation where multiple classes of shareholders exist.

160 Another respondent considered that any decisions made in the ordinary general meeting of shareholders should be considered a decision made by the entity.

161 Another respondent recommended that the IASB should perform some field testing to confirm whether such guidance will lead to the expected outcomes.

Questions to constituents

162 Question in the draft comment letter - Do you expect changes in classification from the IASB proposals, particularly changes to the classification of financial instruments from equity to liability? What would cause these expected changes to classification?

(a) One respondent did not expect classification changes while another respondent was unsure.

163 There were no responses supporting to mandate a particular accounting treatment.

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164 EFRAG's Draft Comment Letter indicated that EFRAG needed to gather evidence on the impact of the factors. Based on the responses from the survey results, the majority of the respondents supported the IASB's proposals and based on the comment letters received, a significant majority also supported the IASB's proposals.

165 Therefore, based on this support, the EFRAG Secretariat recommends supporting the IASB's proposals.

Question 6 Classification: Reclassification of financial liabilities and equity instruments

The IASB proposes:

(a) to add a general requirement that prohibits the reclassification of a financial instrument after initial recognition, 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 (paragraphs 32B–32C).

(b) to specify that if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement, an entity would:

 (i) reclassify the instrument prospectively from the date when that change in circumstances occurred.

 (ii) measure a financial liability reclassified from equity at the fair value of that financial liability at the date of reclassification. Any difference between the carrying amount of the equity instrument and the fair value of the financial liability at the date of reclassification would be recognised in equity.

 (iii) measure an equity instrument reclassified from a financial liability at the carrying amount of the financial liability at the date of reclassification. No gain or loss would be recognised on reclassification (paragraph 32D).

(c) provide examples of changes in circumstances external to the contractual arrangement requiring reclassification (paragraph AG35A).

Paragraphs BC126–BC164 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to reclassify the instrument prospectively from the date when a change in circumstances occurred give rise to any practical difficulties? If so, please describe those practical difficulties and the circumstances in which they would arise.

Summary of respondents' comments

166 Ten respondents out of 18 responded to this section.

167 Respondents, in general, were supportive or not objective of reclassification when a change of the substance of the contractual arrangement is due to a change in external circumstances and provided the following comments.

(a) Two respondents stated that it is important to clarify whether and when changes in the laws and regulations (especially those that result in some contractual terms no longer being enforceable) or a shareholder's decision should be viewed as external circumstances.

(b) One of the respondents asked for more examples of circumstances external to the contractual arrangement that could result in changes of the substance of the contractual arrangements.

168 The majority of respondents considered that contractual terms that become, or stop being, effective with the passage-of-time should result in reclassifications for the following reasons:

(a) counter-intuitive, and potentially misleading for the readers of the financial statements, i.e., may no longer faithfully represent the substance of the financial instrument (some respondents);

(b) Is consistent with:

(i) the proposed transition requirements in paragraph 97W[2] of the ED that do not require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision was no longer outstanding at the date of initial application (some respondents); and

(ii) the provisions of IAS 32.16E-F related to reclassification of puttable instruments (one respondent).

169 Examples provided which are misleading if there is no reclassification for passage-of-time changes:

(a) A compound instrument which remains classified as a financial liability even after the point where there is no contractual obligation to pay cash following the expiration of one of its contractual features. (e.g. a holder's put option has expired without being exercised). Should the same feature (e.g. a put option) be a standalone instrument, it would have been accounted for differently (the liability caused by a

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[2] Paragraph 897W of the ED states "*In first applying the amendments in paragraph 32A to a compound financial instrument with a contingent settlement provision, an entity need not separate the components if the liability component is no longer outstanding at the date of initial application*."

stand-alone put option on NCI is reclassified to Equity when it expires leading to the derecognition of the financial liability when the contractual obligation expires).

(b) The expiry of a contingent settlement provision and a change in terms that results in the instrument meeting the criteria for equity classification; and

(c) Expiration of a conversion option that would not meet the fixed-for-fixed condition.

170 Half of the respondents who did not agree with prohibiting reclassification for passage-of-time changes mentioned that reassessing at each reporting date whether an instrument should be reclassified would not be onerous or increase costs, in contrary to paragraph BC145 of the ED.

(a) Such terms and conditions must anyway be disclosed based on proposed paragraph 30F of IFRS 7 in the ED which involves tracking.

(b) Also, the financial instruments issued to finance an entity are few in number and are subject to ad-hoc negotiation and structuring and are therefore closely monitored.

171 A user organisation who also had concerns with prohibiting reclassification for passage-of-time changes, suggested that to ensure a consistent approach among preparers, it would be useful to have specific criteria (principle-based rules) for the reclassification between liability and equity, as well as including specific rules and guidance on calculation of diluted EPS for alignment with provisions of IAS 33.

172 However, many respondents agreed with the IASB's proposals considering it a reasonable approach.

Other comments on reclassification

173 One respondent suggested that the IASB should provide an example to illustrate the difference between derecognition and reclassification and should also provide guidance on how to account for modifications of compound financial instruments.

174 One respondent was concerned that the ban on reclassification goes wider to non-derivative situations (for example BC131(c) of the ED). This could result in outcomes which are not useful and create confusion and potential for diversity on the distinction between reclassification and derecognition.

175 Regarding the timing of reclassification[3]:

[3] The IASB decided that an entity should reclassify a financial instrument as a financial liability or an equity instrument from the date of the change in circumstances that affects the classification of that instrument.

(a) One respondent considered that illustrative examples would be helpful to determine the date of the change, in practice, in circumstances that affect the classification of an instrument.

(b) Another respondent indicated support the IASB's principle of reclassifying financial instruments at the date of the change in circumstances without waiting for the reporting date. However, this respondent believed that this requirement could be difficult to implement in order to define precisely when the change in circumstances occurred, and that the reporting date could in practice be used as a backstop with supporting disclosures explaining why the exact date of the change in circumstances could not be determined.

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176 Based on the responses from the comment letters received and the survey results, the majority of the respondents did not support the IASB's proposals specifically regarding the prohibition of reclassification for contractual terms that become, or stop being, effective with the passage-of-time.

177 Therefore, based on this, the EFRAG Secretariat recommends continuing to express concerns with the IASB's proposals specifically for the prohibition to reclassify passage-of-time changes.

Question 7: Disclosures

The IASB proposes:

(a) to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its ownership structure is, including potential dilution to the ownership structure from financial instruments issued at the reporting date (paragraph 1).

(b) to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7.

(c) to move paragraphs 80A and 136A from IAS 1 to IFRS 7. These paragraphs set out requirements for disclosures relating to financial instruments classified as equity in accordance with paragraphs 16A–16B and/or paragraphs 16C–16D of IAS 32 (paragraphs

12E and 30I). The IASB also proposes to expand paragraph 80A to cover reclassifications if there are changes in the substance of the contractual arrangement from a change in circumstances external to the contractual arrangement.

(d) to amend paragraph 20(a)(i) of IFRS 7 to require an entity to disclose gains or losses on financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in its net assets, separately from gains or losses on other financial liabilities in each reporting period.

(e) to include disclosure requirements for compound financial instruments in IFRS 7 (paragraph 17A).

The IASB proposes to require an entity to disclose information about:

(a) the nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments (paragraphs 30A–30B);

(b) the terms and conditions of financial instruments with both financial liability and equity characteristics (paragraphs 30C–30E and B5B–B5H);

(c) terms and conditions that become, or stop being, effective with the passage of time (paragraph 30F);

(d) the potential dilution of ordinary shares (paragraphs 30G–30H and B5I–B5L); and

(e) instruments that include obligations to purchase the entity's own equity instruments (paragraph 30J).

Paragraphs BC170–BC245 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with the proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Summary of respondents' comments

178 Fourteen respondents out of 18 responded to this section.

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

180 However, in general, a significant majority of respondents had concerns on the disclosure requirements or were not supportive of the disclosure requirements. and their comments are provided below.

181 On the other hand, many respondents supported the disclosure requirements or could be prepared at a reasonable cost and effort.

(a) One of the respondents, however, indicated that it is important to test these new disclosure requirements to ensure that they are clear and can be implemented by entities. Another mentioned that it does not use complex funding instruments and does not have a complicated group structure.

(b) The requirements allow a better understanding of how an entity is financed and what its ownership structure is, including potential dilution to the ownership structure from financial instruments issued at the reporting date (one respondent).

182 A user organisation asked for a better understanding of potential operational concerns when complying with disclosure requirements. They considered that some illustrative examples would be useful.

Expanding the objective of IFRS 7

183 Two respondents were generally supportive to expand the objectives of IFRS 7, and the clarifications proposed in paragraphs (a) to (e) in the box above.

184 Another respondent was not supportive of the proposal to expand the objective of IFRS 7. The relevant disclosure requirements on equity structure etc. are directly related to the statement of changes in equity being required by IAS 1 and well placed there or in the future IFRS 18 *Presentation and Disclosure in the Financial Statements*.

Any significant operational concerns?

185 Many respondents considered that the whole package of disclosures does not strike the right balance between the benefit of disclosures to the users and the cost of preparers and would result in significant operational challenges and implementation costs.

(a) Could lead to an overload of information which will eventually have the negative consequence of obscuring more relevant disclosures of an entity (two respondents).

(b) Much information required would be complex and difficult to produce in an operational manner.

(c) No real significant incremental value for users and risk of disclosure overload.

(d) The IASB should conduct a cost-benefit analysis before proceeding with the proposals.

(e) would require many additional disclosures (and associated data collection) for, in predictably many cases, only few existing transactions or instruments and asked for some reliefs, for example, accompanied by guidance allowing for some aggregation.

Suggested solutions for disclosure requirements

186 Below are some suggestions proposed by those who considered that the disclosure requirements do not strike the right balance between costs and benefits:

(a) Two respondents were in favour of allowing cross-referencing to other public disclosure documents required by existing regulatory bodies, similar to paragraph B6 of IFRS 7 which allows for cross-referencing to other reports.

(b) Two respondents indicated that the scope of the disclosures should be narrowed to focus only on complex instruments as it covers all types of issued financial instruments e.g. deposits.

(c) Not to proceed with the proposed disclosures requirements in the ED (one respondent).

(d) To reduce the disclosures by removing paragraphs 30A till 30F of IFRS 7 (one respondent);

Disclosures relating to liquidation (The nature and priority of claims against the entity on liquidation and Terms and conditions related to priority on liquidation)

187 Many respondents indicated that IFRS Standards are based on a going concern principle and not liquidation or resolution. Therefore, the perspective of such information given to the stakeholders is contrary to the information based on a going concern view.

188 One respondent indicated that information about liquidation exclusively pertains to a single consolidated entity and not to the reporting entity.

189 One respondent considered these disclosures on liquidation specifically burdensome to comply with and were unsure how the users of the financial statements are going to absorb all these mostly narrative information of different levels of granularity between entities.

The nature and priority of claims against the entity on liquidation

190 Many respondents questioned the operationality of this requirement and were unsure that the ED requirements could be implemented without undue cost and effort, and presented in a way that is useful to users. One of the respondents explicitly mentioned to withdraw this proposal. The reasons are provided below.

(a) Two of them indicated that complying with the proposed amendment would require complex legal analysis in each relevant jurisdiction to determine the nature and priority of the claims. Such analysis would be all the more difficult to produce when a group operates in several jurisdictions where liquidation rules may significantly differ, e.g. a group with international subsidiaries.

(b) Two of them believed that most investors in subsidiaries will be first concerned by the nature and priority of claims at a more granular level, e.g., the subsidiary level rather than aggregation of information at the parent entity level. Aggregating information at the parent's company level may not provide investors with useful information to understand their particular situation within the group.

Terms and conditions related to priority on liquidation

191 One respondent stated that they are not convinced of the usefulness of this requirement from the financial institution's standpoint. A set of financial institutions may never enter into liquidation because of their size and global impacts. Such entities are subject to regulatory resolution measures. However, resolution priority as set by the resolution board is not available to the entity affected and to other interested parties (prepared and shared only within the supervisor) and must remain outside of the possible solutions to improve transparency for users of financial statements. For these financial institutions, the respondent queries whether explaining in the notes to the financial statements that liquidation cannot happen would be enough for the purpose of the ED's disclosures.

192 Another respondent considered that this disclosure requirement seemed to neglect that it is the primary responsibility of the reporting entity to make the classification decisions, the statutory auditor is subsequently responsible to verify whether the decision of the audited entity has been conducted with proper care and whether the assessment is acceptable.

The terms and conditions of financial instruments with both financial liability and equity characteristics

193 Many respondents considered the disclosures on terms and conditions to be specifically burdensome to comply with and were unsure how the users of the financial statements are going to absorb all the mostly narrative information of different levels of granularity between entities and it would be a very extensive exercise.

194 In addition, one of the respondents is concerned that the terms and conditions of financial instruments with both financial liability and equity characteristics, including terms and conditions that indicate priority on liquidation for such instruments, are perceived that entities should disclose on an individual basis and not on an aggregate basis (considering

the illustrative example in draft paragraph IG14E of the Implementation Guidance accompanying IFRS 7.)

195 Two respondents agreed with the proposed disclosures about the terms and conditions of financial instruments that determine their classification as financial liabilities or equity instruments (paragraph 30D(a) of IFRS 7).

196 On debt-like characteristics and equity-like characteristics:

(a) one respondent agreed with the guidance provided; while

(b) another respondent disagreed with providing this information and did not think that the disclosures would significantly improve the relevance of the information. They considered that information on the contractual characteristics that determine the classification of financial instruments is sufficient to provide the users of the financial statements with useful information.

The potential dilution of ordinary shares

197 Two respondents did not understand why such disclosures should fall within the scope of IAS 32 when IAS 33 already requires a certain amount of information on dilution of ordinary shareholders, albeit on a different basis. They proposed to require this information in IAS 33 rather than IAS 32 in order to limit the scope of entities that would be required to provide this disclosure to listed entities only, for which this type of information is the most relevant and the least costly to produce compared to other non-listed entities.

198 One respondent called for consistency with IAS 33 *Earnings per Share* requirements on dilutive instruments.

Disclosures on reclassifications

199 One respondent agreed with the disclosures on reclassifications.

Additional disclosures proposed

200 One respondent suggested some additional disclosures as follows:

(a) specific disclosure requirements should be included to ensure transparency in relation to the effects of laws and regulations, in particular the disclosure of laws and regulations that could affect the timing and amount of future cash flows of financial instruments issued by an entity, even if these legal requirements do not affect their classification (related to ED Q1).

(b) The disclosure of legal requirements that prohibit the enforceability of contractual obligations would also be useful for users of financial statements, considering that

there could be different interpretations of whether a contractual right or obligation is enforceable by laws or regulations (related to ED Q1);

(c) Paragraph AG27C (b) allows transferring the cumulative amount of gains or losses previously recognised from remeasuring the financial liability 'from retained earnings to another component of equity' after the instrument expired without delivery. It would be useful if additional guidance were provided in relation to the potential components of equity (not) available for such transfer (i.e., non-controlling interests or issued share capital) and considers that disclosures should be required in order to ensure transparency regarding such transfers (related to ED Q3).

201 Regarding the effects of laws and regulations (ED Q1), another respondent indicated that disclosures should be clear to understand the connection between contractual terms and the applicable law.

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202 Considering the feedback, the two main areas of operational concern relate to the disclosures on liquidation (the nature and priority of claims against the entity on liquidation; and terms and conditions related to priority on liquidation) and the terms and conditions of financial instruments that determine their classification as financial liabilities or equity instruments.

203 On the other hand, the users agreed to or did not object to the disclosure requirements.

204 In order to find a balance between the benefits to users of financial statements and the costs for preparers, the EFRAG Secretariat recommends to agrees with the proposed disclosure requirements except for the disclosures relating to the significant operational concerns mentioned in paragraph 202 above.

Question 8: Presentation of amounts attributable to ordinary shareholders

Question 8 - Presentation of amounts attributable to ordinary shareholders (paragraphs 54, 81B and 107–108 of IAS 1)

The IASB proposes to amend IAS 1 to require an entity to provide additional information about amounts attributable to ordinary shareholders. The proposed amendments are that:

(a) the statement of financial position shows issued share capital and reserves attributable to ordinary shareholders of the parent separately from issued share capital and reserves attributable to other owners of the parent (paragraph 54);

(b) the statement of comprehensive income shows an allocation of profit or loss and other comprehensive income attributable to owners of the parent between ordinary shareholders and other owners of the parent (paragraph 81B);

(c) the components of equity reconciled in the statement of changes in equity include each class of ordinary share capital and each class of other contributed equity (paragraph 108); and

(d) dividend amounts relating to ordinary shareholders are presented separately from amounts relating to other owners of the entity (paragraph 107).

Paragraphs BC246–BC256 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposed requirement to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent give rise to any practical difficulties in determining the required amounts? If so, please describe the possible difficulties and specify areas in which further guidance would be helpful.

Summary of respondents' comments

205 Fourteen respondents out of 18 responded to this section.

206 Respondents had mixed views about the IASB's proposals in general. Whilst may respondents supported, sometimes strongly, the proposals, at least their objective, many others denied, sometimes categorically, the necessity of such presentation requirements.

207 Both the supporters and the opponents of the IASB's proposals, as well as some of those who did not clearly pronounce either in favour or against the direction of the proposals

referred to the costs vs benefits of the proposed requirements as an argument in favour of their views. Whilst the supporters referred to significant benefits for the users, their opponents emphasised that the costs to the preparers will exceed those benefits, and some even denied that the preparers will obtain any significant benefits at all.

208 A majority of the respondents including some of those who supported the proposed requirements in general, had concerns about the clarity of the IASB proposals and emphasised that additional application guidance and illustrative examples would be needed to be able to perform the split. Some of these concerns were of general nature, some others provided particular issues where such guidance or illustrative examples would be needed:

(a) Two respondents referred to the lack of guidance to determine how an entity would take into account **the effect of various equity instruments other than ordinary shares** (such as derivatives on ordinary shares and preference shares convertible into ordinary shares) when determining the amount to attribute to ordinary shares.

(b) Two respondents noted that sometimes it is not clear from the requirements how the total comprehensive income (in respect of both profit or loss and OCI) attributable to other owners of the parent would be calculated. In particular, in their view, **the illustrative examples in paragraph IG6A** of draft Amendments to Guidance on Implementing IAS 1 are confusing in this regard and it would be very helpful to understand how the attribution of total comprehensive income was calculated.

(c) Two respondents had concerns how should the attribution be calculated for **Additional Tier 1 (AT1) instruments** issued by banks classified entirely as equity (due to the write down feature). AT1 instruments do not participate in the issuer's performance other than through (discretionary) fixed coupon payments. Based on the logic for non-cumulative preference shares in paragraph 14(a) of IAS 33 the total comprehensive income would be attributed to these instruments to the extent of the coupon payments. Also, it would be deducted in the row 'Dividends' of the Statement of changes in equity. As a result, the end of year carrying amount of 'Equity attributable to other owners of the parent' would not be affected. The respondents were wondering whether their interpretation of the issue is correct.

209 Many respondents emphasised that lack of guidance and examples may result in inconsistencies in practice and would limit the usefulness of the proposed presentation requirements.

210 Two respondents had concerns about the use of the term ''Other owners of the parent'' (as proposed in the ED). They suggested several alternatives instead, e.g. "other holders of the entity's own equity instruments'', ''other equity providers'' or ''other equity holders''.

211 Two respondents had concerns about the term ''ordinary shareholders'', arguing that there could be different specific classes of shares (which have, eg., different ranks of subordination/dividend payment depending on the rights attached to them and being considered), which makes it difficult to assess which type of shareholder is considered to be ordinary.

212 One respondent noted that allocating of capital and capital reserves could be feasible, it could be difficult for other equity components (eg., revenue reserves or valuation reserves).

213 One respondent found it preferable to prioritise the application and implementation of IFRS 18 Presentation and Disclosure in Financial Statements, announced for publication in April 2024, over the introduction of new requirements.

214 One respondent noted that it could be appropriate that some of the information required by the presentation requirements is disclosed in the notes instead of the primary financial statements.

215 One respondent supported the IASB's decision not to propose amendments to IAS 32 for the classification of perpetual instruments containing obligations that arise only on liquidation (paragraphs 165 – 169 of the Basis for Conclusions), noting that entities used to classify these instruments as equity instruments and any changes to this established approach would be of significant relevance.

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216 Considering the feedback received from constituents and EFRAG FRB members' preliminary views, the EFRAG Secretariat recommends to introduce changes to Question 8 in the draft comment letter. Whilst continuing to welcome the IASB's proposals in principle, the EFRAG Secretariat proposes to take into account the objections of some of the respondents, notably urging the IASB to clarify the benefits of the requirements compared to their costs and to provide additional application guidance and illustrative examples.

Question 9: Transition

The IASB proposes to require an entity to apply the 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 the entity chooses or is required to present more than one comparative period in its financial statements.

For an entity already applying IFRS Accounting Standards, the IASB proposes:

(a) to require the entity to treat the fair value at the transition date as the amortised cost of the financial liability at that date if it is impracticable (as defined in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors) for the entity to apply the effective interest method in IFRS 9 Financial Instruments retrospectively (paragraph 97X);

(b) not to require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision was no longer outstanding at the date of initial application (paragraph 97W);

(c) to require the entity to disclose, in the reporting period that includes the date of initial application of the amendments, the nature and amount of any changes in classification resulting from initial application of the amendments (paragraph 97Z);

(d) to provide transition relief from the quantitative disclosures in paragraph 28(f) of IAS 84 (paragraph 97Y); and

(e) no specific transition requirements in relation to IAS 34 Interim Financial Reporting for interim financial statements issued within the annual period in which the entity first applies the amendments.

For first-time adopters, the IASB proposes to provide no additional transition requirements.

Paragraphs BC262–BC270 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to apply the proposed amendments retrospectively give rise to any other cases in which hindsight would be necessary? If so, please describe those cases and the circumstances in which the need for hindsight would arise.

Summary of respondents' comments

217 Twelve respondents out of 18 responded to this section.

218 Most of these respondents supported for the IASB's proposals in general. However, only four respondents expressed their support without having any significant issues, while the others mentioned one or more concerns.

219 The following concerns were mentioned by the respondents:

(a) Half of the respondents referred to the accounting mismatches that could arise for entities applying **hedge accounting**.

(b) Many respondents mentioned that the impact of the fully retrospective approach should be carefully assessed in terms of **timing and cost-benefit analysis.**

(c) Two respondents suggested that the IASB considers **a transition relief for instruments that have been derecognised before initial application of the amendments.**

(d) One respondent referred to the issue of **retrospective application and hindsight**. They expect hindsight questions to emerge in transitioning to the IAS 32 amendments, and deem it helpful for many preparers if additional transition guidance would embed the principle of "prospective application due to hindsight" into these specific amendments.

220 On the contrary, one respondent disagreed with an argument in the DCL that the IASB should not require full retrospective approach due to concerns that restatements may affect ratios linked to debt/equity and cause covenant breaches. On the contrary, a concern about a potential impact on the debt/equity covenant was mentioned by another respondent who was generally supportive of the IASB's proposals.

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221 Considering the feedback received from constituents, the EFRAG Secretariat does not recommend any changes to Question 9 in the DCL.

Question 10: Disclosure requirements for eligible subsidiaries

Question 10 - Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])

The IASB proposes amendments to the draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures], which will be issued before the proposals in the Exposure Draft are finalised.

[IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures.

The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures.

Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

Summary of respondents' comments

222 Two respondents indicated that the reduced disclosures were not applicable to them, which they regret, as they are financial institutions.

223 Two respondents welcomed the reduced disclosure requirements or considered them to be reasonable and provided the following comments:

(a) The reduced disclosure requirements strike a balance between costs for preparers and benefits for the users of financial statements.

(b) One of the respondents did not agree with disclosures relating to the nature and priority of claims in the event of liquidation (refer to paragraph 190(a)) and those relating to 'equity-like' and 'debt-like' characteristics (refer to paragraph 196(b)) both for the normal disclosures and for the reduced disclosures.

224 One of the respondents indicated that critical findings on the "disclosure" proposals (ED Q7), would analogously pertain to the disclosure proposals for IFRS 19.

225 The remaining respondents did not comment on this section or indicated that they had no comments/opinions.

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226 Most of the respondents from the comment letters received and the survey results either indicated that they had no comments or stated that the reduced disclosures were not applicable to them.

227 In its Draft Comment Letter, EFRAG generally agreed with the IASB's proposals. The EFRAG Secretariat recommends that EFRAG may continue to agree with the IASB's proposals as it is a fair balance between costs and benefits related to disclosing relevant information except for significant operational concerns raised in the response to Question 7 - Disclosures above, which would be equally valid in this section.

Other comments relating to aspects not in the Exposure Draft

228 One respondent expressed regret that recycling issue for equity instruments accounted for at fair value through other comprehensive income, being the priority issue for the insurance industry, is also not addressed in the ED. They acknowledged that the IASB is committed to monitor the recycling issue.

229 Another respondent believed that the IASB should not limit its scope to the clarification of these principles and should consider amending such principles when they do not result in relevant information for users of financial statements. They considered that the apparent conflict between paragraphs 20 and 25 of IAS 32, may have contributed to the development of financial instruments with discretionary payments, for which the entity has little if any practical ability to avoid delivering such discretionary cash-flows, including redeeming such instruments. Classifying such instruments as equity while many interested parties are viewing these as financial liabilities is not aligned with the principles of the Conceptual Framework, and may not result in relevant information for users of financial statements.

Appendix 2 - List of respondents

	Name of organisation	**Jurisdiction**	**Type of respondent**
CL01	Diogo Pesoa	Portugal	Academic researcher
CL02	WSBI-ESBG	Belgium	Preparer organisation
CL03	Accountancy Europe	Europe	Professional organisation
CL04	Credit Agricole	France	Financial Institution
CL05	European association of co-operative banks (EACB)	Europe	Preparer organisation
CL06	Finance Finland	Finland	Preparer organisation
CL07	ERSTE group	Germany	Preparer
CL08	GDV	Germany	Preparer
CL09	Allianz	Germany	Preparer
CL10	European Securities and Markets Authority (ESMA)	Europe	Regulator
CL11	Dutch Accounting Standards Board (DASB)	Netherlands	National Standard Setter
CL12	European Insurance CFO Forum	Europe	Preparer organisation
CL13	OIC	Italy	National Standard Setter
CL14	The European Federation of Financial Analysts Societies (EFFAS)	Europe	User organisation
CL15	BusinessEurope	Europe	Preparer organisation
CL16	Accounting Standards Committee of Germany (ASCG)	Germany	National Standard Setter
CL17	ANC	France	National Standard Setter
CL18	Mazars	France	Auditor