The Trustees
IFRS Foundation
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21 March 2024

Dear Trustees of the IFRS Foundation,

Invitation to comment – Exposure Draft on Financial Instruments with Characteristics of Equity, Proposed amendments to IAS 32, IFRS 7 and IAS 1

The International Swaps and Derivatives Association ('ISDA')[1] welcomes the opportunity to provide input on the above referenced Exposure Draft ('ED') issued by the International Accounting Standards Board ('IASB') on 29 November 2023.

We support the efforts made by the IASB to address the application issues with IAS 32, *Financial Instruments: Presentation,* that have been identified in the course of the project on Financial Instruments with Characteristics of Equity (FICE). We note some areas of the proposed amendments which we suggest would benefit from further consideration by the IASB, including of potential alternatives to what has been proposed in the ED, before the amendments are finalised as follows:

- With respect to the proposals for laws and regulations, we are concerned that it is not clear how they would apply for certain instruments. This includes certain banks' AT1s where the regulations require the inclusion of a loss absorption feature, but the precise terms are not specified by the regulations. We suggest the proposals should be suitably clarified or if this is not possible, they should be withdrawn.
- For obligations to purchase own equity instruments, where entities will be required to assess whether the change in compensation adjusted for the passage of time is proportionate, the proposed amendments would benefit from some additional application guidance to help explain how to make the necessary judgements.
- For obligations to purchase own equity instruments, the proposal that measurement of the financial liability should ignore the probability and estimated timing of the counterparty exercising their right to redeem, is a new requirement. We therefore suggest that additional application guidance is provided to help explain how this would be applied in practice. For contingent settlement provisions of the liability component of a compound financial instrument, the proposals introduce new

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org. Follow us on X, LinkedIn, Facebook and YouTube.

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measurement requirements into IAS 32 which are different to those in IFRS 9. We are concerned that this change goes beyond the intended scope of the FICE project. We encourage the IASB to reconsider the proposals for compound instruments and note that, on balance, it may be preferable to withdraw them and maintain the status quo.

- For reclassifications, our members are concerned that the proposals will not result in an improvement to financial reporting as there will be instances when it is appropriate for the classification to change. We also suggest that further explanation is provided for when a change to the contractual terms could result in the derecognition of an equity instrument and the recognition of a financial liability, or vice versa.
- For the proposals with respect to expanding the disclosure and presentation requirements, whilst it has the potential to provide additional useful information to users of the financial statements, we are concerned at the risk of disclosure overload. We suggest that to prevent this, additional guidance is provided in the final amendments on assessing the materiality of the information in the specific context of entities' capital structure and the information needs of users. We encourage the IASB to consider the results of EFRAG's field-test and whether to perform their own field-test before finalising the amendments.
- For the transition requirements, we are concerned that the proposal that all changes should be applied on a fully retrospective basis, may be impracticable to apply without incurring a disproportionate cost for preparers. We encourage the IASB to consider providing transition reliefs to reduce the challenges associated with specific areas covered by the amendments. These may include (but would not necessarily be restricted to) those changes that arise from the amendments relating to reclassifications, contingent settlement provisions and the effects on hedge accounting.

We discuss these points above in more detail in the appendix to this letter, along with detailed responses to each of the questions raised in the ED.

We look forward to supporting the IASB as its work progresses in this area. If it would be helpful, we would be happy to discuss in further detail the points we raise.

Should you have any questions or would like clarification on any of the matters raised in this letter please do not hesitate to contact the undersigned.

Yours faithfully,

Fiona Thomson
Managing Director
Goldman Sachs International
ISDA European Accounting WG Chair

Antonio Corbi
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Appendix attached.

The effects or 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

We understand the intention of the proposed amendments, which is to provide clarification in area where there are some differences in practice.

We support the board's decision not to proceed with an 'all-inclusive' approach to classification as described in BC14. Had this been followed, it would have resulted in a fundamental change to the classification requirements in IAS 32. The proposed amendments introduce some new areas of judgment in applying the guidance to assess laws and regulation that would benefit from further clarification in the final amendments. In particular, we have some concerns regarding paragraph 15A, the potential consequences of the amendments and how they will apply in practice in certain instances.

For example, we are aware that in certain jurisdictions, including France, some savings products carry a minimum interest rate which is required by regulation. One reading of the proposals could result in the payment of interest not being considered a liability of the entity. If that were the case, the payment of statutory interest could potentially be treated as an equity distribution, which seems counterintuitive.

Another example relates to the application of paragraph 15A(a) to instruments such as AT1s that convert to a variable number of shares on the occurrence of a loss absorption event, and how to apply the phrase '…are in addition to…'. For these instruments the payments of the coupon are discretionary and the loss absorption feature, if triggered, results in the exchange of the instrument for a variable number of own shares. The discretionary coupon payments are required by the Capital regulation Requirements (CRR), and so under the amendments it could be interpreted that they would not meet the '…are in addition to…' requirement. If so, ignoring the discretionary coupons (which would otherwise be classified as an equity component) would result in these AT1 instruments being classified entirely as a financial liability. This is very different to the result under the proposed contingent settlement provisions (paragraph 25) where the AT1 instrument would be classified as a compound instrument with the discretionary coupons classified as an equity component. We suggest the IASB clarify what is meant by 'are in addition to' in paragraph 15A(a).

Another example relates to those Canadian banks that have issued preferred shares with a precise contractual conversion formula that converts to a variable number of ordinary shares in the contingent event of the issuer becoming non-viable (i.e., equivalent to bail-in events). These instruments may have contractual terms that are added at the discretion of the issuer to comply with the principle-based guidance published by the bank's prudential regulator, to obtain a specific capital treatment for those instruments. It is unclear whether choosing to issue an instrument that is governed by such regulatory guidance rather than legislation, would be considered as in addition to laws or regulations under paragraph 15A. It is also unclear whether setting a precise conversion formula that is included in the final terms of the instrument to comply with principle-based laws or regulations is considered in addition to laws or regulations. We recommend clarifying that the laws and regulations include regulatory guidance issued by a prudential regulator. We also recommend that the assessment of whether a contractual right or obligation is in addition to laws or regulations should be made in the context of the specific laws or regulations that govern the particular type of instrument issued. In addition, we suggest that setting precise contractual terms to comply with principle-based laws or regulations should not be considered in addition to laws or regulations, provided those contractual terms are not contrary to the principle-based laws or regulations and that the precise terms are within a rigid market convention approved by the prudential regulator and not negotiated between parties to the contract.

We are also note that the proposals could result in instruments which are economically similar but issued in different jurisdictions and subject to different laws and regulations could be classified differently under the proposals.

Another observation is that the interaction between paragraph 15A(a) and 15A(b) is not clear, as the requirements seem to be overlapping. Paragraph BC29 explains the overall rationale for paragraph 15A but not for the separate requirements in 15A(a) and 15A(b). We note that the second part of paragraph 15A(a) describes that only contractual terms that are in addition to laws or regulations should be considered, whilst 15A(b) excludes from the assessment those rights or regulations that would arise regardless, i.e., the paragraphs appear to state the same requirement expressed from a different perspective, which may not be necessary. We suggest that 15A(b) may not be required, or if the IASB consider that it is, the reason for it should be explained.

Whilst the points above identify the areas where our members consider it would be beneficial for the IASB to provide clarification and further explanation, we recognise the complexities involved. It may therefore be very difficult for the IASB to address these points (and those raised in other comment letters) in a way that allows for consistent application between different jurisdictions and different entities. We note that there is a risk that solving problems in some areas will create new problems in others. We therefore encourage the IASB to consider withdrawing the proposed amendments for laws and regulations, on the grounds that maintaining the status quo may be preferable to creating new areas of uncertainty and complexity.

<u>Settlement in an entity's own equity instruments</u>

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.

We support the proposed clarifications, which are largely consistent with developed practice and provide a more robust framework to support it.

We note that the requirement in paragraph 22C(b)(iii) that the compensation is proportional to the passage of time is a new concept for IAS 32. Entities will need to apply judgement when assessing whether any change in compensation is proportional. This could include in determining the discount rate that should be applied to adjustments to ensure that the present value of the amount of consideration that will be exchanged is fixed, regardless of when settlement takes place. It may also include an explanation of whether fixed conversion ratios, including those that step-up over time, may be considered acceptable if the increase is considered proportional to the particular risks faced by the entity. An example of this could be if the profitability of the entity has the potential to change during the conversion period, such that a step is proportional to the risks over time. We suggest that it should be made clear in what areas judgement should be applied and some additional application guidance to explain this point further would be beneficial.

One area where further clarification of the proposals would be beneficial is with respect to the fixed for fixed test where an exchange ratio is applied and whether the passage of time criteria is met. The implementation guidance provides an illustration for when an exchange ratio changes in line with changes to an interest rate, the fixed for fixed test is passed (Implementation Guidance Example 14). It would be helpful if it were clarified that the fixed-for-fixed test could also be met if the exchange ratio were linked to changes in an (unleveraged) floating benchmark interest rate or relevant floating inflation index. As presently worded, it is not entirely clear whether Example 14 applies only when the interest rate is fixed or to floating rates too.

Obligations to purchase an entity's own equity instruments

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

Question 3 - Obligations to purchase an entity's own equity instruments (paragraphs 23 and AG27B–AG27D of IAS 32)
that are gross physically settled—consideration is exchanged for own equity instruments—are required to be presented on a gross basis (paragraph AG27D). 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

We note that the proposal for the initial and subsequent measurement of the financial liability for the obligation to repurchase an entity's own equity instruments extends the scope of IAS 32 beyond classification and presentation and creates a new measurement approach. This relates to the new requirement, which affects the subsequent measurement of the financial liability, that the measurement should consider the earliest possible redemption date, ignoring the probability and estimated timing of the counterparty exercising their right to redeem.

Our members observe that, as this new measurement is neither amortised cost, fair value or any other approach used elsewhere in IFRS, calculating it will create a new area of complexity, judgment and subjectivity. To assist preparers and to aid consistency and comparability, we suggest that the final amendments would benefit from a worked example illustrating the application of this calculation.

We also note that the proposed approach creates a conceptual inconsistency to the amendments for the effect of laws and regulations, which are referred to above in question 1 of the ED. This is that whilst for classification, the effect of laws and regulations must be broadly ignored, for the proposal for the initial and subsequent measurement of a financial liability arising from an entity's obligation to purchase its own equity, the potential effect must be considered. This is because laws and regulations could affect the timing, likelihood and amount an entity would have to pay, such as if bank bail-in regulations were triggered. This inconsistency is potentially confusing and we therefore suggest that further thought is given by the IASB to the consequences it may have and whether it creates any new problems.

Many entities that have written put options over non-controlling interests will be affected by the proposals, as there is presently diversity in practice in how to account for them. Some of our members are concerned that the amendments as proposed do not provide a notable benefit compared to the current treatment. The conceptual concerns raised include the points discussed in the BC, that under the proposed approach the minority interest is, in effect, double counted as it is reflected both by the liability and the entry reflected in equity. We suggest that the Board gives further consideration to the conceptual problems presented by this approach.

Since the proposed amendments will apply retrospectively, there could be effects from the changes which extend beyond the classification of the instruments themselves. This could include, for example, in the context of business combinations where any change to the accounting for a financial liability affects the calculation of goodwill. There may be other consequences including the interaction with IFRS 2 and IFRS 10. As a result, our members think that particular consideration should be given to the transition provisions, which we discuss further in our response to question 9 below.

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.

Measurement of contingent settlement provisions

If a financial liability component of a compound financial instrument is measured at the redemption value ignoring probability and estimated timing of the contingent event, the proposed amendments do not address the accounting for the difference at initial recognition between the cash received and the redemption value. Based on existing practice, it is presumed that the difference would not be recognized in profit or loss at initial recognition, and therefore, may potentially be recorded as a debit to equity (applying the approach described in IAS 32.31 to allocate the carrying amount of a compound financial instrument between equity and liability components). If the contingent event is not triggered but the financial liability component is subsequently derecognised, the difference between the redemption value and the cash paid (being an amount lower than the redemption value if the contingent event occurs) is recognized as a gain in profit or loss in accordance with existing IFRS 9 requirements. This gives rise to financial reporting that does not reflect the economics of the instrument, creating mismatches in timing and primary statement representation compared to the treatment at initial recognition.

Our members are concerned that the proposal creates structuring opportunities, which have the potential to produce significant artificial gains. For example, a compound instrument may contain a contingent settlement provision for the financial liability that is highly unlikely to occur, with the redemption value structured to equal 150% of the par value. Under the proposals, the liability component of such instruments would initially be recognized at 150% of the par value but would be subsequently redeemed at par value in the absence of the contingent event. This could result in an artificial gain for the 50% being recognized in profit and loss at the time of redemption.

Furthermore, the liabilities on the balance sheet may be significantly inflated compared to the view of market participants or other users (e.g., prudential regulators), which could mislead users to believe that an entity has a worse liquidity position than is really the case.

Furthermore, since the proposed measurement approach for contingent settlement provisions is applicable only to compound financial instruments, it creates a potentially significant inconsistency with the accounting for economically similar financial liabilities measured wholly under IFRS 9. For example, two different financial instruments may have the same contingent settlement provision, but one pays a discretionary coupon and the other pays a contractual coupon. The instrument with the discretionary coupon would be accounted for as a compound instrument under the proposals with the liability recognised for the full settlement value in the event of the contingent event occurring. The instrument with the contractual coupon would be measured at fair value at initial recognition and subsequently under IFRS 9. This difference in accounting may make comparison difficult for economically similar financial instruments.

Some members suggest the IASB reconsider the proposed new measurement approach and require that the IFRS 9 measurement principles should be applied for the initial and subsequent measurement of contingent settlement provisions included in compound financial instruments. This will ensure the assumptions used for initial and subsequent measurement are consistent, which should eliminate artificial gains/losses and remove the need for additional application guidance to address the interaction between a new measurement approach being included in IAS 32, versus the existing IFRS 9 measurement principles.

Alternatively, if the IASB decides to retain the new measurement approach as proposed in the ED, our members suggest providing an exemption from it for contingent settlement provisions involving resolution events. Resolution is the process by which the impact of a failure of a globally or domestically systematically important bank is managed and contained by national authorities. The resolution regime makes it possible for a bank's operations to be resolved without severe disruption to financial stability, minimizing taxpayer exposure to losses by ensuring that losses are borne by shareholders and creditors of the failing institution. Resolution regimes include multiple stabilization options, including asset and liability transfers to other institutions, recapitalization, bail-in and loss absorption mechanisms. This would be consistent with how an obligation arising upon liquidation is exempted from being a financial liability under paragraph 25(b) of existing IAS 32. Extending this exemption to include instruments with contingent resolution events aligns with the intention of the liquidation exemption, which would then be scoped out of the new measurement approach. Under this approach, the initial and subsequent measurement of the contingent resolution event would follow the IFRS 9 measurement principles.

Other members favour a simpler more intuitive approach where the discretionary coupon is recognised in the profit or loss if the host instrument is classified as a financial liability. They consider that this treatment would be easier for users to understand. It also avoids the measurement complexity as the entire instrument would be recognised initially at fair value (in most cases likely to be the transaction price in line with the normal principals in IFRS 13). Finally, this approach is more conducive to designating the liability in a fair value hedging relationship. Indeed, if the IASB decides to retain the approach which would lead to an outcome with the principal classified as a liability, but the coupons classified as dividends, further clarity would be required on the application of hedge accounting. The observations above identify the aspects of the proposed amendments for measuring the liability component of contingent settlement provisions, which our members believe it would be beneficial for the IASB to consider further. We recognise though that it may be difficult to arrive at a satisfactory solution for all scenarios. Our members therefore suggest that the IASB may wish to consider withdrawing the proposed amendments in this area, to maintain the status quo and thereby avoid creating new areas of complexity and inconsistency.

Scope of contingent settlement provisions

In the absence of the new measurement approach, it is common industry practice to consider the expected timing of contingent events in the effective interest rate measurement of the financial liability component and it is currently not important to analyse the scope of the contingent settlement provision. With the proposed new measurement approach (that can produce significantly different results), it is critical for entities to understand what is in the scope of contingent settlement provisions. For example, one interpretation of paragraph 25 of the ED suggests that benchmark interest rate, interest rate step up features (e.g., interest rate changes linked to meeting ESG metrics or credit ratings), or covenant default events of liability components are within the scope of the contingent settlement provision proposals, thus requiring entities to ignore probability and estimated timing of such contingent events. This would result in inflating the measurement of the financial liabilities to reflect maximum redemption value given the contingent events, rather than reflecting expected cash flows under the effective interest rate or fair value methods as required under IFRS 9. We recommend clarifying to narrow the scope of the contingent settlement features as it appears to be very broad with potentially unintended consequences to common features.

We recommend clarifying that paragraph 25 of the proposals is only applicable to the liability component of compound financial instruments. Our members are concerned that it is possible to interpret paragraph 25 as applying to instruments that are wholly financial liabilities as well as to compound financial liabilities. Whilst we do not believe this was the IASB's intention, we are concerned that as drafted the proposed amendments could be easily misunderstood.

Liquidation

Our members note that the proposed definition for liquidation is different to what has been applied in practice in some jurisdictions, particularly for banking entities. For example, the terms of a preference share may have payments which are discretionary other than if the entity enters a recovery and resolution scenario to allow the entity to restructure its operations. Such instruments may currently be classified as equity, as entering into recovery and resolution would indicate that the entity is not a going concern, so the cash settlement term that arises in that instance would be ignored for the purpose of classification, such that the instrument is classified as equity. Under the proposals, the instrument would appear to be a liability. We suggest that in the definition of liquidation, priority should be given to whether the term is triggered if the entity is no longer a going concern, thereby emphasising the existing requirements of paragraph 25 of IAS 1, as described in BC115(c).

Shareholder discretion

Question 5 – Shareholder discretion (paragraphs AG28A-AG28C of IAS 32)
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.

Our members agree that this is an area where diverse practice currently exists. We therefore welcome the proposed amendments as providing helpful clarification.

We note that the inclusion in the application guidance of examples to consider, encourages a principles-based approach to be used. We consider this to be important because it allows entities to apply judgment in assessing the many different examples of shareholder discretion that presently exist (which are more diverse than any list of examples could realistically hope to cover in full) and those which could arise in future as corporate governance practices continue to develop.

We raise a concern with paragraph AG28C which indicates that an entity should not apply these requirements by analogy in applying other IFRS standards. Under IFRS 9, the classification of a financial asset as an investment in an equity or debt instrument by the holder is generally assessed by considering the perspective of the issuer under IAS 32. For example, only a pure debt instrument can pass the SPPI test and only a pure equity instrument can be elected fair value through other comprehensive income. The holder of the financial instruments may not have access to information to assess whether a decision is at the shareholder's discretion or is a decision of the entity, and therefore making such an assessment would be burdensome for holders. Therefore, we suggest that the IASB should specifically clarify that a holder would not need to apply these factors in the context of the SPPI test.

Reclassifications of financial liabilities and equity instruments

Question 6 – Reclassifications of financial liabilities and equity instruments (paragraphs 32B-32D and AG35A of IAS 32)

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.

Our members observe that IAS 32 does not presently provide any general guidance for reclassifications of financial liability and equity instruments, which the proposals seek to address.
In terms of the detailed requirements, some of our members are concerned that the proposals will give rise to information in the financial statements which is not useful. An example of this could be an instrument which at issuance is a financial liability for which the liability

feature expires after twelve months and is replaced by an equity only feature, where all payments are discretionary. Another example could be a bond with a conversion feature into a variable number of shares for the first twelve months for which the conversion ratio subsequently becomes fixed. If the proposed approach would require these instruments to continue to be recognised as liabilities even when the liability feature has expired, there is concern that this would not result in useful information as the contractual substance of the instrument has changed but the classification remains the same.

Alternatively, if the IASB's intention is that for a compound instrument the derecognition requirements would be applied to the liability feature when it expires such that only an equity instrument remains, this should be more fully explained in the final amendments. Our members note that whilst there is mention of derecognition in BC 128 and BC 129 which provides an indication of the IASB's thinking, some further explanation would potentially be beneficial. This should include the double-entries that would result, to explain how it would be applied.

Some members are concerned with the difficulty in operationalizing the monitoring of arrangements for external changes in circumstances. It may not be practicable as there are potentially unlimited possibilities that would need to be tracked that have not been identified and addressed in the ED, which may result in unintended consequences.

Our members suggest that it may be preferable if the guidance for reclassifications could identify a principle that would be applied to identify when reclassification is appropriate. This could be if specific contractual terms of the instrument either newly take effect or stop being effective as a result of the passage of time. Under this approach, an instrument would be reclassified to reflect the contractual substance of the terms that continue to be effective.

With respect to the transition requirements for reclassifications, in applying the fully retrospective approach on initial application, if the accounting for historic reclassifications is required to change on initial application of the amendments entities will need to adjust the accounting in prior periods. This may present challenges in terms of gathering the historic information needed to calculate the adjustment, which relates to the reclassification. We discuss these points further in our response to question 9 below.

Disclosure

Question 7- Disclosure (paragraphs 1, 3, 12^{E}, 17A, 20, 30A-30J and B5A-B5L of IFRS 7)
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.

Question 7- Disclosure (paragraphs 1, 3, 12E, 17A, 20, 30A-30J and B5A-B5L of IFRS 7)

(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

We have some concern about ensuring that there is sufficient guidance in the final amendments to enable entities to strike the right balance between providing enough information to meet users' needs, without giving rise to excessive information, otherwise known as disclosure overload. For example, some proposed disclosures, such as potential dilution and the terms and conditions of instruments are proposed to be disclosed on an instrument-by-instrument basis, and this level of granularity may make it difficult for users to digest the information where it is overly extensive. In addition, some proposed disclosures such as the priority of claims may be complex to implement for entities that operate in multiple jurisdictions.

We note that EFRAG is conducting field testing of the disclosure proposals. We encourage the IASB to consider the results and whether it provides an indication of any further guidance that can be included in the final amendments, to help entities tailor the disclosures they provide. We also suggest that the findings from the EFRAG study may indicate if it would be beneficial for the IASB to perform its own field-testing before the proposals are finalised.

Our members suggest that one way to reduce the risk of disclosure overload would be to limit the scope of entities to which the proposed additional disclosures apply. This would ensure the entities that provide the disclosure are those where there is likely to be the greatest interest from users of the financial statements. This could be achieved by requiring that only entities with publicly traded ordinary shares are required to provide the additional disclosures, similar to the scope of IAS 33, Earnings per Share.

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.

Some members consider that the proposed changes to presentation should provide useful information to users of the accounts to help them understand how financial liabilities and equity instruments affect the position and performance of the entity. Some members question whether such attribution of profit and loss, other components of equity and equity reserves would be useful for users if there is no established methodology to ensure consistency and comparability. That is, there is a lack of clarity on the practical application of allocating amounts attributable to ordinary shareholders versus other equity holders in the ED.

If the Board is to proceed with such presentation requirements, additional application guidance and illustrative examples should be provided. Specifically, it would be beneficial to add detailed numerical examples on how to allocate amounts to ordinary shareholders versus other owners of the parent using for example, compound instruments.

We also question how an entity would be able to retrospectively attribute the equity reserves between ordinary shareholders and other shareholders to correctly reflect the attributions on the cumulative equity reserves. It appears nearly impossible to do, as it would require entities to analyse the source of all amounts booked cumulatively to equity reserves such as retained earnings. In contrast, if no retrospective application is required, we question whether such prospective attribution is meaningful without cumulative attribution presented.

Similar to our response to question 7 on disclosures, we are concerned that the proposals may result in the inclusion of excessive information in the financial statements. As with our comments on disclosure, we encourage the IASB provide sufficient guidance in the final amendments to help preparers ensure that there is an appropriate balance between meeting the information needs of users but not to overload them with disclosures. We also suggest that consideration should be given to limiting the scope of the proposed amendments to only those entities with publicly listed ordinary shares.

Transition

Question 9 - Transition (paragraphs 97U–97Z of IAS 32)
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 82 (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.

We understand the IASB's rationale for proposing the requirement for fully retrospective application of the amendments, to ensure that users of the financial statements receive information which is as consistent and comparable with prior periods as possible. However, we are concerned that the fully retrospective approach may give rise to significant practicability challenges where the change in classification took place in prior periods for which sufficiently detailed information is not available. This has the potential to reduce the value of the transition requirements if the practicability exemption must be applied in many instances. We suggest that it may be beneficial for the IASB to propose more transition reliefs which need less historic information to comply with, which would have the effect of reducing the need for entities to apply the impracticability exemption so frequently.

One area where the impracticability challenge may arise is with respect to applying the transition requirements to historic restatements. Where the financial liability and equity instrument has expired, it is not clear how the restatement entries should be reflected, where the instruments would have had a different effect on retained earnings and other sub-accounts of equity. We suggest that in order to address this challenge, for instruments that no longer exist, the previous accounting applied should not have to be amended on transition.

Our members note that for financial instruments in hedging relationships, if their classification would change under the proposed amendments, entities may be forced to retrospectively discontinue these hedging relationships when the amendments become effective. An example could be if a financial liability, previously designated in a hedging relationship, is reclassified as an equity instrument which is not an eligible hedged item under IAS 39 or IFRS 9. Another example could be a compound financial instrument presently classified as a liability, where following reclassification the remuneration is reclassified from interest expense to equity. A further possible complication is if a forecast cash flow for a floating rate financial liability can continue to be considered to be highly probable prior to the amendments taking effect, if upon initial application the financial liability will be reclassified to equity. We are therefore concerned that the potential consequences upon transition could be significant and result in substantial cost and disruption for entities that have to discontinue their previously designated hedging relationships. Upon first application of the amendments, it may not be possible for entities to enter into effective hedges prospectively if the hedging derivative has a starting fair value which is significantly different to the starting value of the hedged risk. In light of this, we suggest that IASB give consideration to allowing some relief to the transition requirements where financial liabilities and equity instruments are designated within pre-existing hedging relationships.

Disclosure 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

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

Our members have no comments or concerns with the proposals.