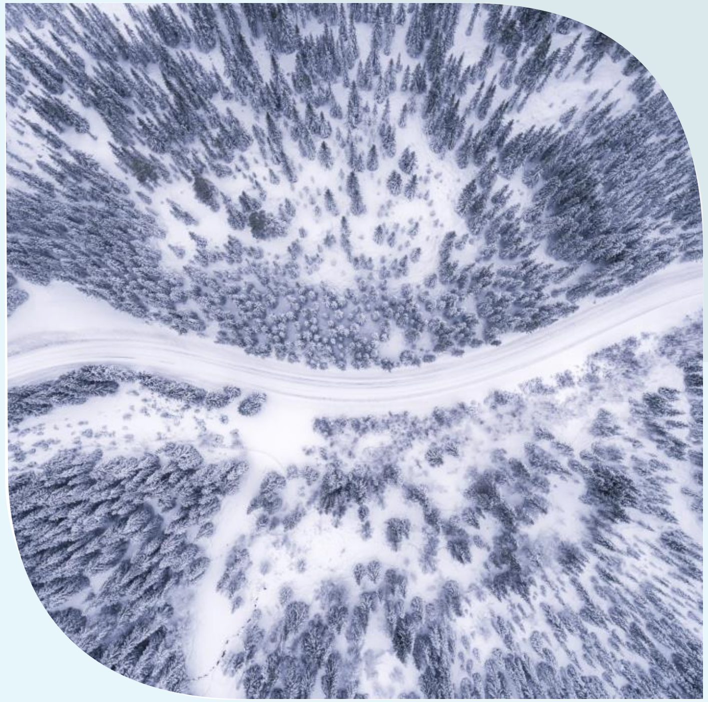
SUMMARY OF EFRAG SURVEY RESULTS

FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY

ASAF meeting, 26 March 2024



DISCLAIMER

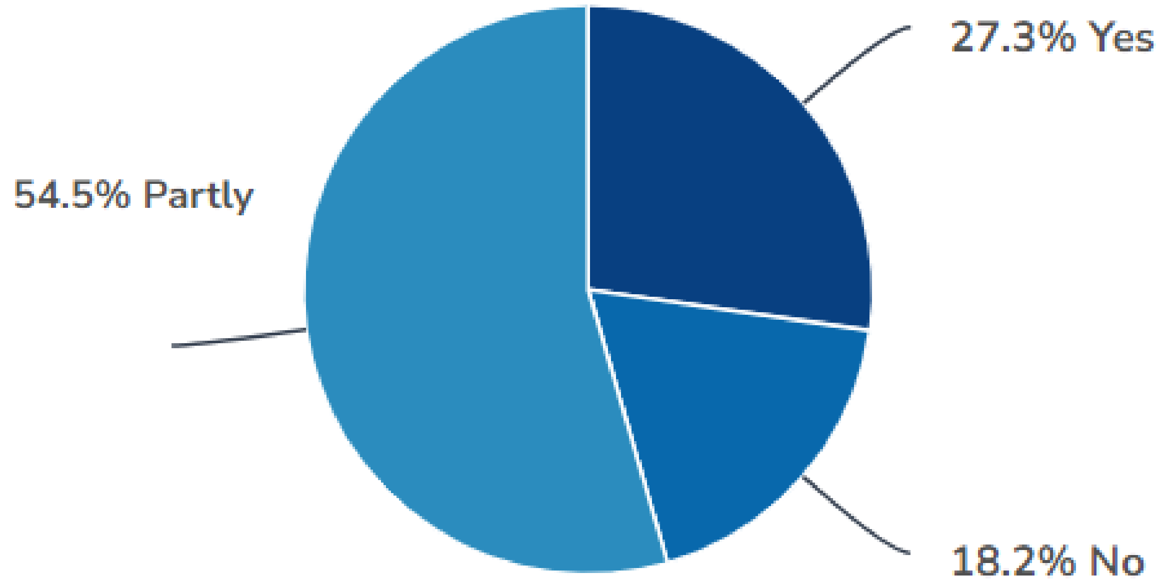
The views expressed in this presentation are those of the presenter, except where indicated otherwise. EFRAG positions, as approved by the EFRAG FRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances

OVERVIEW

- GENERAL REMARKS ON CLASSIFICATION
- THE EFFECTS OF LAW AND REGULATION (ED Q1)
- FIXED FOR FIXED CONDITION (ED Q2)
- OBLIGATIONS TO PURCHASE AN ENTITY’S OWN EQUITY INSTRUMENTS (ED Q3)
- CONTINGENT SETTLEMENT PROVISIONS (ED Q4)
- SHAREHOLDER DISCRETION (ED Q5)
- RECLASSIFICATION OF FINANCIAL LIABILITIES AND EQUITY INSTRUMENTS (ED Q6)
- DISCLOSURES (ED Q7)
- PRESENTATION OF AMOUNTS ATTRIBUTABLE TO ORDINARY SHAREHOLDERS (ED Q8)
- TRANSITION (ED Q9)
- DISCLOSURE REQUIREMENTS FOR ELIGIBLE SUBSIDIARIES (ED Q10)

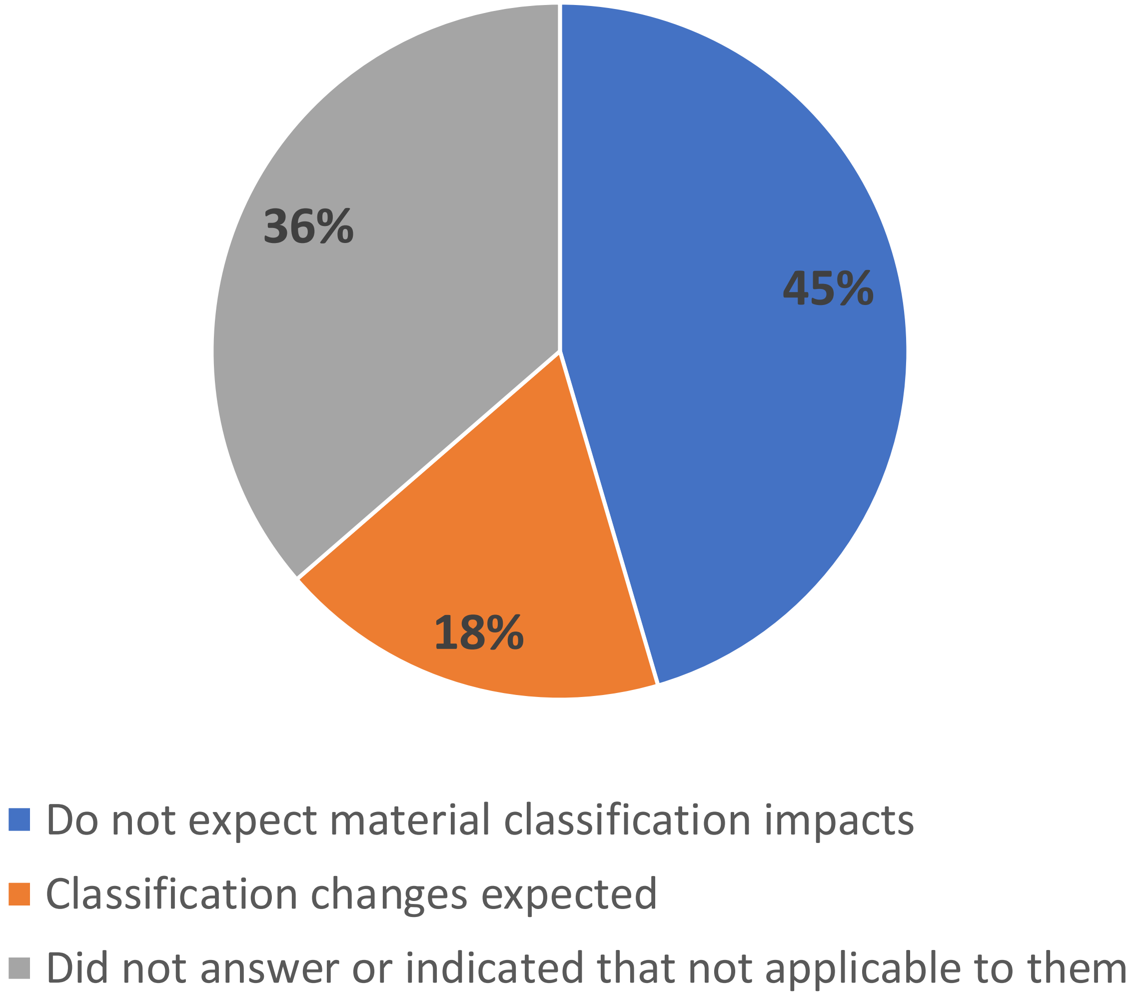
GENERAL REMARKS ON CLASSIFICATION

WHETHER THE IASB'S PROPOSALS ON CLASSIFICATION ARE UNDERSTANDABLE



Partly or not understandable mainly due to the effects of relevant laws and regulations not being understandable or sufficiently clear

IMPACT ON CLASSIFICATION CHANGES



Classification changes expected for:

- the effects of relevant laws and regulations
- financial instruments with contingent settlement provisions

THE EFFECTS OF LAW AND REGULATION (ED Q1)

THE EFFECTS OF LAW AND REGULATION

UNDERSTANDABILITY OF THE IASB PROPOSALS AND RISK OF UNINTENDED CONSEQUENCES

- Most of the respondents that indicated the proposals are partly or not understandable referred to the proposals on the effects of relevant laws and regulations
- When referring to “unintended consequences” of the IASB proposals, the effects of laws and regulations was the most referred topic
- Based on the proposed amendments in the ED, there is a significant risk of having unintended consequences as the level of application and the principles are not sufficiently clear
- Respondents often expressed concerns on the concept of “in addition to” and the interaction with IFRS 9, an IFRS Accounting Standard based only on *contractual terms* and *contractual rights and obligations*

THE EFFECTS OF LAW AND REGULATION

MANDATORY TENDER OFFERS

- Respondents that replied to the question on whether the IASB should address Mandatory Tender Offers (MTOs) provided mixed view: some considered that the IASB should address this issue (as it is relevant in practice), while others considered that there was no need for the IASB to provide guidance.
- Those against argued that it would introduce "rules-based" elements to IAS 32 and that the proposed accounting treatment for NCI puts could be applied by analogy.

LOAN PRODUCTS WHERE ALL KEY PARAMETERS ARE REGULATED BY LAW OR REGULATION

- Two respondents noted that in certain jurisdictions, loan products (financial assets) are offered of which all key parameters are regulated by law or regulation. They considered that the IASB proposals on the effects of law are unclear and could lead to unintended consequences* on the classification of these products
- The remaining respondents mentioned that further analysis had to be done on possible consequences (e.g. classification of certain fund shares as debt or equity instrument)

* It was not specifically mentioned by the respondents but stakeholders consider that there may be unintended consequences whereby these products would be classified as equity in the entity's financial statements (instead of a financial liability) or being excluded from the scope of IFRS 9 / IAS 32.

FIXED FOR FIXED CONDITION (ED Q2)

FIXED FOR FIXED CONDITION

EXPECTED CLASSIFICATION CHANGES

- In general, respondents did not expect that the IASB´s proposals on passage-of-time adjustments would lead to classification changes for options that can be exercised at different predetermined dates
- Most respondents had limited or no involvement with these products
- Two respondents specifically supported the IASB proposals

OBLIGATIONS TO PURCHASE AN ENTITY'S OWN EQUITY INSTRUMENTS (ED Q3)

OBLIGATIONS TO PURCHASE AN ENTITY'S OWN EQUITY INSTRUMENTS

CURRENT PRACTICE

- The responses reflected a significant diversity of the accounting treatments under the existing Standards, for example, debit entry going against equity relating to non-controlling interests or to parent equity.

INITIAL RECOGNITION

- A significant majority of the respondents disagreed with the proposals of the IASB whereby an entity initially recognises a financial liability for the redemption amount with the debit side going against the parent's equity
- These respondents were of the view, that the debit entry should go to the NCI share of equity, instead of the parent's share of equity.
- The reasons provided were the concerns about double recognition (i.e. NCI in equity and purchase obligation as financial liability), the transaction does not affect interests of the owners of the parent and punitive impact on banks prudential own funds.

OBLIGATIONS TO PURCHASE AN ENTITY'S OWN EQUITY INSTRUMENTS

SUBSEQUENT MEASUREMENT

- A significant majority of respondents did not support the proposals of the IASB on presenting these changes in profit or loss, preferring to have them presented within equity.
- One of the reasons provided was that the financial liability should be considered as part of transactions with owners in their capacity as owners.

CONTINGENT SETTLEMENT PROVISIONS (ED Q4)

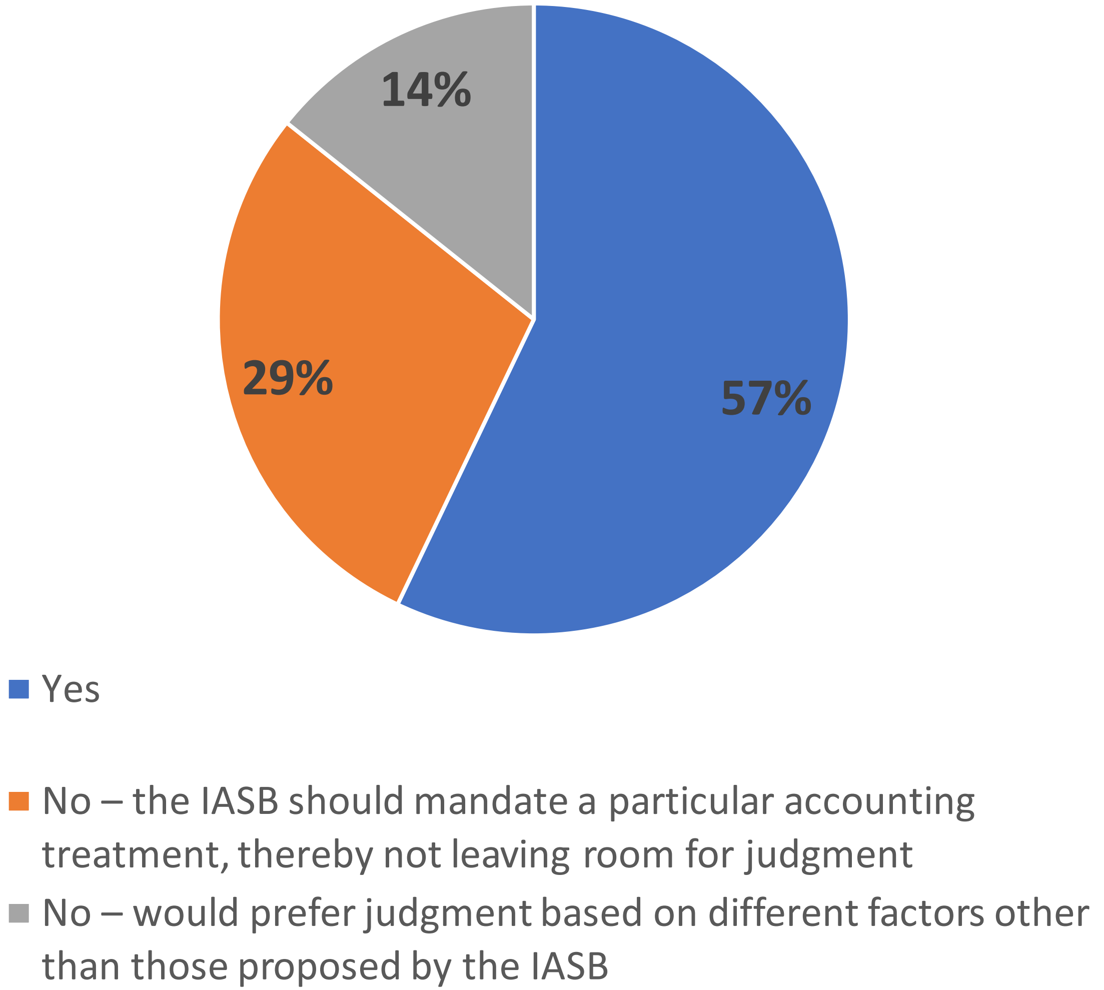
CONTINGENT SETTLEMENT PROVISIONS

EXPECTED CLASSIFICATION CHANGES

- Many respondents replied that they did not expect classification changes
- However, some respondents mentioned that the IASB proposals would change the classification instruments with contingent settlement provisions. For example, respondents referred to the classification change arising on specific bail-instruments where the payment of interest would be presented in equity rather than profit or loss (as the instrument was considered a liability in its entirety rather and a compound instrument with an equity component equal to zero) and put options settled in a variable number of own shares
- In addition, respondents referred to changes on the measurement of the financial liability that must be based on the redemption amount (rather than under the fair value option in IFRS 9)
- Such clarification puts pressure on the definition and measurement at the "present value of the redemption"

SHAREHOLDER DISCRETION (ED Q5)

EXTENT TO WHICH THESE RESPONDENTS AGREED WITH THE FACTORS BEING PROPOSED



Yes agree with IASB:

- Agreement to leave judgement and not to be too-rules based
- Assessment is considered straightforward

No: mandate one treatment – real cases need to be further investigated to develop a more complete guidance

No: other factors besides the IASB's proposals to be considered – do nothing until IAS 32 is more comprehensively revised as there may be unintended consequences with the proposals

RECLASSIFICATION OF FINANCIAL LIABILITIES AND EQUITY INSTRUMENTS (ED Q6)

IASB'S PROPOSALS ON RECLASSIFICATION

- Majority of those who responded disagreed with the IASB's proposals which prohibits reclassification for contractual terms that become, or stop being, effective with the passage-of-time
  - Relevant to change the classification if facts and circumstances change and would faithfully represent the financial position of an entity
- Many respondents who responded agreed with the IASB's proposals -> are a simplification that would help to reduce costs in preparing the financial statements

DISCLOSURES (ED Q7)

DISCLOSURES

- *Understandability of the disclosures* – Most of the respondents considered the proposed disclosures to be generally understandable. Some did not consider this to be the case due to the scope of the disclosure requirements being too broad potentially capturing nearly all financial liabilities.
- *Significant operational issues expected* –
  - The majority of respondents expected significant operational issues when providing the disclosure requirements mainly because they considered that there was an imbalance from a cost versus benefits and decision-usefulness versus disclosure overload perspective.
  - On the contrary, many respondents did not expect significant operational issues indicating that the information can be prepared at a reasonable cost and effort.
- *Other significant concerns* – The majority of respondents did not raise any other significant concerns apart from operational issues mentioned above.
- *Disclosures – Terms and conditions of financial instruments* - Most of the respondents agreed with the guidance provided on debt-like characteristics and equity-like characteristics in paragraphs B5B–B5G of IFRS 7 in the ED.

PRESENTATION OF AMOUNTS ATTRIBUTABLE TO ORDINARY SHAREHOLDERS (ED Q8)

PRESENTATION OF AMOUNTS ATTRIBUTABLE TO ORDINARY SHAREHOLDERS

- Half of the respondents expected significant difficulties in making an allocation between ‘ordinary shareholders of the parent’ and ‘other owners of the parent’ whilst the other half did not expect such difficulties.
- Respondents referred to difficulties in allocating profit or loss or other comprehensive income, or both, notably such elements of OCI as profits from hedging, revaluation result and FX adjustments. Some respondents raised an issue regarding the calculation of the attribution for AT1 instruments.
- A significant majority did not expect significant issues due to the interaction of the IASB’s proposals with regulatory requirements on presentation of equity.

TRANSITION (ED Q9)

TRANSITION

- The majority of the respondents did not agree with the proposal of the IASB regarding the restatement of information for one comparative period.
- Their arguments included concerns regarding the cost for the preparers and the usefulness for users, concerns about application of hedge accounting and regarding NCIs, a significant difficulty to recalculate all historical acquisitions.

DISCLOSURE REQUIREMENTS FOR ELIGIBLE SUBSIDIARIES (ED Q10)

DISCLOSURE REQUIREMENTS FOR ELIGIBLE SUBSIDIARIES

- All those that responded to this section indicated that the reduced disclosures were not applicable to them as they are financial institutions.

Follow us

35 Square de Meeûs, B-1000 Brussels
info@efrag.org - www.efrag.org

EFRAG is co-funded by the European Union through the Single Market Programme in which the EEA-EFTA countries (Norway, Iceland and Liechtenstein), as well as Kosovo participate. Any views and opinions expressed are however those of the presenter only and do not necessarily reflect those of the European Union, the European Commission or of countries that participate in the Single Market Programme. Neither the European Union, the European Commission nor countries participating in the Single market Programme can be held responsible for them.

THANK YOU

EFRAG
Financial reporting