

International Accounting Standards Board (IASB)
IFRS Foundation
Columbus Building, 7 Westferry Circus
Canary Wharf, London E14 4HD
United Kingdom
Submitted electronically



29 March 2024

Re: IIF's Public Comment Letter on the IASB Exposure Draft on Financial Instruments with Characteristics of Equity (FICE) – Proposed amendments to IAS 32, IFRS 7 and IAS 1

Dear Sir or Madam,

The Institute of International Finance (IIF)¹ and its members, which broadly represent the global financial services industry, are pleased to submit industry perspectives in response to the International Accounting Standards Board (IASB or the "Board") consultation on its "Exposure Draft: Financial Instruments with Characteristics of Equity (FICE) – Proposed amendments to IAS 32, IFRS 7 and IAS 1"².

Overall, the IIF appreciates the IASB's efforts and focused direction of the project and we recognise it is difficult to set new principles without fundamentally changing existing practices given the intended scope of the project. At the same time, we would like to note that the comment period of 120 days, especially comparing it to the usual 180 days, makes it more difficult to deeply analyse the ED, as the topic is complex, involving many internal stakeholders within each IIF member institution. Furthermore, reading the ED, we see it quite burdensome as it is necessary to go back to staff papers to fully understand what is meant in some parts of the ED. To the extent possible, we would appreciate in future to have a more comprehensive version incorporating staff papers' key discussions.

The remainder of this letter provides detailed comments along the five main themes, in order of priority: (1) measurement, (2) classification (3) disclosures, (4) presentation, and (5) transition requirements. If applicable, it refers to the questions outlined in the ED.

¹ The Institute of International Finance (IIF) is the global association of the financial industry, with about 400 members from more than 60 countries. The IIF provides its members with innovative research, unparalleled global advocacy, and access to leading industry events that leverage its influential network. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial, and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, professional services firms, exchanges, sovereign wealth funds, hedge funds, central banks, and development banks.

²[Exposure Draft on Financial Instruments with Characteristics of Equity \(FICE\) – Proposed amendments to IAS 32, IFRS 7 and IAS 1](#)

1. Measurement

Related to question 4, the IIF strongly recommends that IASB withdraw the new measurement approach for contingent settlement provisions within IAS 32 and defer to IFRS 9 for measurement requirements.

While we appreciate IASB's efforts to propose changes for greater consistency across entities and with the intention of reducing implementation complexities for preparers, we strongly disagree with introducing a new measurement approach for contingent settlement provisions. We have included our key concerns on the new measurement approach below.

- *Misrepresents the economic substance of the instruments with contingent settlement provisions*

Ignoring the conversion probability of the contingent event would significantly misrepresent the economics of such instruments to the users of the financial statements. This approach results in instruments with different probabilities of the contingent events occurring having similar measurements. In cases where the probability of the contingent event is remote, it would considerably overstate the financial liability or liability component, diverging from a market participants' view as well as what users consider relevant. This can significantly misrepresent the financial position of entities, giving a false view of liquidity risk of such entities and provide less useful information to users as a typical user would consider probability associated with potential cash outflows in making investment decisions relating to an entity.

When a financial liability or liability component is measured at the redemption value ignoring probability and estimated timing of the contingent event, the accounting for the difference between cash received and such redemption value initially recognized is presumed to be recorded as a debit to equity to avoid day one gains/losses based on existing guidance. If the contingent event is not triggered and the financial liability is repaid at maturity, the difference between the redemption value and cash paid at settlement is recognized as a gain in profit or loss in accordance with existing IFRS 9 requirements. This would result in artificial gains, misrepresenting the financial performance of entities as it would create a geography and timing mismatch from initial recognition. We believe this concern is broadly applicable to both instruments that are entirely financial liabilities and liability components of compound instruments with contingent settlement provisions across jurisdictions whereby the cash amount (typically at fair value) differs from the redemption amount based on the broader interpretation of the scope of paragraph 25 of the ED. This issue is amplified for contingent settlement provisions with a redemption value that is structured to be higher than par value. For example, a compound instrument issued by an entity contains a contingent settlement provision for the liability component that is highly unlikely to occur, with the redemption value structured to equal 150% of par value. Under the proposals, 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. This further raises the concern of potential structuring opportunities to recognize artificial gains allowable under this new measurement approach.

When the measurement proposal for the contingent settlement provisions is narrowly interpreted to be applicable to only liability components of compound instruments, it also

creates inconsistency with IFRS 9's accounting for instruments that are wholly classified as financial liabilities with contingent settlement provisions which apply the fair value approach for initial measurement. For entities with both a compound instrument and a wholly financial liability instrument with the same contingent settlement event, the measurement outcome would significantly differ, making it incomparable within the financial statements of an entity as well as across entities.

- *Beyond the intended scope of this project*

Paragraph BC101 of the Basis of Conclusions states that applying the alternative approach of factoring in probability and estimated timing will be a significant change beyond the scope of the project and would be complex for entities to measure. We believe this new measurement approach is fundamentally different than existing industry practice, which currently factors in the probability and expected timing of contingent events in the effective interest rate and fair value measurement of the financial liability under IFRS 9. The ED would also expand the unintended scope of this project, especially given that the current IAS 32 is a classification standard.

In addition, existing IFRS standards have established other complex measurement requirements such as expected credit losses in IFRS 9, fair value measurement in IFRS 13, and general measurement approach in IFRS 17. Given that this new measurement approach is fundamentally different to existing industry practice, we believe taking the simplest measurement approach to achieve consistency is not the right path and the negative downstream consequential impacts (e.g., significantly misrepresent the financial results of entities) would outweigh the benefits of ease and consistency it achieves.

Due to the ED's new measurement approach, it is critical for entities to understand the scope of the ED's contingent settlement provision proposals. The broader interpretation of paragraph 25 of the ED suggests that benchmark interest rates, interest rate step-up features (i.e., interest rate changes linked to meeting ESG metrics or credit ratings), or covenant default events of all financial liabilities and liability components of compound instruments are within the scope of the contingent settlement provision proposals, thus requiring entities to ignore the probability and estimated timing of such contingent events. This raises the question of what would remain in the scope of the amortized cost or fair value approaches prescribed by IFRS 9 after the introduction of this new measurement approach.

- *Inconsistencies with other standards and with other guidance within the IAS 32 ED*

There is a lack of clarity on how to implement this new measurement approach practically when there is a significant disconnect with the existing IFRS 9 measurement approaches (i.e., fair value and amortized cost) that are currently applied to financial liabilities.

The approach is inconsistent with the going-concern assumption in paragraph 25 of IAS 1. For example, the new measurement guidance does not appropriately reflect the economic substance of the resolution events, such as bail-in or loss-absorption events, which are prevalent across jurisdictions. The approach ignores the remote probability of such resolution events, reflecting a non-going concern basis of measurement.

In addition, the approach is inconsistent with paragraph 74 of IAS 1. In the absence of a breach

of a provision (e.g., covenant) for a liability, a liability is classified as long-term (i.e., do not have to reflect the carrying value as due on demand). This is inconsistent with the new measurement guidance as the probability of breaching such provision is ignored in measuring the instrument, which would be measured at the redemption value as if it is payable on demand. Although it is reflected as due on demand, it would be classified as long-term, creating inconsistencies with IAS 1.

- *Inconsistencies with other principles within the ED*

The approach is inconsistent with paragraph 25(b) of the ED which provides an exception to the liability treatment of contingent settlement provisions if the provision is triggered only in an event of liquidation. Paragraph BC112 in the Basis of Conclusions noted that a contingent settlement provision that applies only in the event of liquidation should not influence classification. As resolution³ events such as bail-in or loss-absorption events are contractual terms included in instruments to avoid a liquidation event, resolution events are similar in substance to liquidation events and therefore should also not influence classification.

The outcome of this approach is inconsistent with the definition of an equity instrument. In relation to IASB's clarification that an obligation to deliver a variable number of another class of the entity's own instruments is a financial liability, we believe there is a fundamental difference between an instrument that will be settled by delivering cash or another financial asset versus an instrument that will be settled by delivering a variable number of another class of the entity's own equity instrument. The former results in a delivery of cash or another financial asset, resulting in an outflow of economic resources, while the latter does not result in such outflow of economic resources, rather evidences a residual interest in the net assets of the entity, which is by definition an equity instrument. If there is no obligation to deliver cash or another financial asset, we believe an equity instrument classification would be more appropriate in such circumstances. We question whether a different measurement approach should be provided for this scenario to ensure the economics of such instrument reflects an equity treatment.

Recommendations

To avoid the adverse consequences above, we strongly recommend that the IASB defer to the IFRS 9 measurement requirements for the initial and subsequent measurement of financial liabilities or liability components involving contingent settlement provisions, instead of introducing a new measurement approach in IAS 32. This will ensure the assumptions used for initial and subsequent measurement are consistent, which should minimize the recognition of artificial gains/losses and remove the need for additional application guidance to address the interaction between this new measurement approach in IAS 32 versus the existing IFRS 9 measurement principles. As a secondary alternative, we recommend withdrawing the new measurement approach from the ED to avoid creating new areas of complexity and inconsistency.

³ Resolution refers to the process by which the impact of a failure of a globally or domestically systematically important bank is managed and contained by national authorities. Resolution regimes include multiple stabilization options, including asset and liability transfers to other institutions, recapitalization, bail-in and loss-absorption mechanisms.

If the IASB is to proceed with the new measurement approach, we strongly recommend significantly narrowing the scope considering the conflicting interaction with IFRS 9 measurement approaches as explained above. We also recommend clarifying that the scope of the new measurement approach for contingent settlement provisions excludes instruments that are entirely classified as financial liabilities, and excludes compound instruments with contractual terms involving contingent resolution events as we view such terms to be similar to a liquidation event under the existing IAS 32.25(b) exemption as explained above. Furthermore, the measurement, if specified, should defer to IFRS 9 measurement requirements for such compound instruments.

Furthermore, for the definition of liquidation, considering that different jurisdictions have different requirements for the liquidation process, we recommend clarifying the meaning of the process for permanently ceasing operations and its interaction with the resolution events discussed above and insolvency if IASB believes it is different, as it would impact the classification outcome of instruments.

2. Classification

Related to question 1, the IIF raises the following key concerns and recommendations for consideration to be included in the final amendment.

In assessing whether a contractual right or obligation is required by laws or regulations, we raise the following key concerns:

A) What is in scope of laws or regulations?

The ED does not define what are laws or regulations. As the form of laws and regulations that govern each jurisdiction are different, we believe it is important to clarify what is in scope of laws and regulations to ensure the regulatory guidance issued by prudential regulators would result in similar accounting conclusions across different jurisdictions. For example, a prudential regulator in one jurisdiction published capital requirements for banks in the form of regulatory capital guidelines which banks may elect to comply with by adding a precise contractual term in individual instruments issued while another jurisdiction may require equivalent guidance in federal legislation for all instruments. While the election by the issuer appears optional, there is no economic compulsion to not comply given the importance of meeting overall capital requirements. A literal reading of 'laws or regulations' may suggest such optional regulatory guidance is not in scope of laws or regulations for the first jurisdiction and needs to be included in the classification assessment while ignored for the latter jurisdiction, resulting in different classification outcomes for economically similar rules (i.e., effectively following the overall Basel principles).

We recommend clarifying that regulatory guidance issued by a prudential regulator be treated as equivalent to those required by laws or regulations. The clarification will minimize diversity, enhance comparability across companies and ensure that jurisdictional differences in the application of the same framework would not result in different accounting outcomes.

B) Is having the choice to issue an alternative instrument relevant?

When a law or regulation mandatorily requires a contractual term to be included for all instruments issued, such term is not in addition to laws or regulations. In contrast, if the issuance of a particular type of instrument is at the discretion of the issuer, it is unclear whether this is in addition to laws or regulations. In certain jurisdictions, although the issuance of a particular type of instrument may be theoretically optional for an issuer, there may be significant consequences (e.g., to meet overall regulatory capital requirements) of not issuing such instruments that would result in the issuance of a particular type of instrument being non-discretionary in substance from the issuer's perspective. Therefore, we recommend clarifying that the assessment of whether a contractual right or obligation is in addition to laws or regulations is to be assessed in the context of the specific laws or regulations that govern the particular type of instrument that was issued.

This aligns with paragraph 26 of the *September 2021 Staff Paper - The effects of laws and contractual terms - potential solutions*. However, we noted that such discussion was not reflected in the ED basis of conclusion.

C) *What is in addition to laws or regulations?*

In assessing whether a feature is in addition to those created by laws or regulations (per paragraph 15A of the ED), we believe this is an area that would be crucial to add more clarification and examples to illustrate the application of judgment to different fact patterns. As jurisdictions have different laws and regulations, consideration should be given to entities in jurisdictions that have principles-based laws and regulations to ensure they are not at a significant disadvantage due to how their jurisdiction's laws and regulations are written. The following provides some examples of fact patterns that require clarity.

In Canada, the prudential regulator may prescribe principles (e.g., must have a market price and a cap in the conversion formula) rather than precise terms for the loss-absorption conversion of Additional Tier 1 (AT1) instruments into a variable number of common shares. An entity would set a precise conversion formula (e.g., conversion price using a 10-day weighted average trading price and capped at a \$5 floor price) to implement and comply with such regulatory guidance. The entity did not add any elements that were contrary to the principle prescribed by the prudential regulator, and such precisions were set by a rigid market convention approved by the prudential regulator (however, such precise terms are not published in the regulatory guidance). We view this fact pattern to be different from the ED's minimum dividend example in paragraph AG24B. If an entity goes above the minimum dividend threshold, there is an element of negotiation between parties to the contract that would provide an incremental economic benefit to the specific parties of the contract, aligning with paragraph AG24A of the ED. Comparing to the Canadian example above, such precision is set based on a rigid market convention, and not negotiated between parties to the contract. We ask the IASB to clarify this important distinction, as we view setting precise terms to comply with principles-based laws and regulations based on rigid market convention approved by prudential regulators and not negotiated between parties to be considered entirely created by laws or regulations in applying the ED.

In Europe, we noted that there are alternative ways of interpreting whether a feature is in addition to laws or regulations and are concerned that without further analysis and

clarifications by the Board, the proposed amendments on the effects of laws or regulations would give rise to new uncertainties and diversity in practice. A prime example is the AT1 capital instruments issued by banks to meet regulatory capital requirements with a specific loss-absorption feature, which is required by law that any coupon payments on the instruments are to be at the discretion of the issuer, which the Board has not addressed in the ED. For this discretionary coupon feature, we note that there could be two interpretations from reading the proposed requirements in paragraph 15A(a):

- One interpretation is that the discretionary coupon payments (an equity-like feature) is not considered in the classification since such term is required by the law is not subject to negotiation and agreement between the parties to the contract and, therefore, cannot be modified by mutual agreement (aligns with paragraph BC20). This interpretation would give rise to an outcome for an AT1 instrument, where the specific loss absorption feature involves an exchange of a variable number of the entity's own equity instruments, to be classified as a financial liability in its entirety. This is opposite to the outcome that would have resulted under the new requirements on contingent settlement provisions proposed in the ED where the AT1 instrument would be a compound instrument with the discretionary coupon payments constituting the equity component.
- An alternative interpretation is that since the coupon on the instrument is subject to negotiation and agreement between the parties to the contract, the discretionary nature of the coupon payments would therefore meet the proposed requirements as it is linked to the agreed coupon, and as such the instrument remains a compound instrument consistent with the proposed contingent settlement provisions.

Given the interpretation concerns above, we believe it is illogical that the effects of laws or regulations would result in a different outcome for the above-mentioned AT1 instrument (compared to the assessment under the proposed contingent settlement provisions) by not considering the equity-like feature, i.e., the discretionary coupon payments, when classifying the instrument. We suggest, to ensure consistent interpretation and application, additional guidance is provided in the final amendments that the discretionary coupon payments should be considered when classifying the AT1 instrument.

Related to question 2, we welcome the Board's effort to clarify the fixed-for-fixed condition and agree with the direction of the Board's proposals for preservation adjustments and passage-of-time adjustments. However, we have concerns with the practical application of the passage-of-time adjustments. First, we believe the proposal that an interest rate benchmark or an inflation index would not meet the passage of time criteria is counterintuitive and does not align with IFRS 9's view that a market rate of interest is compensation for time value of money. In addition, we observed that paragraph 22C(b)(iii) requires a present value analysis to be performed in order to demonstrate eligibility for the passage-of-time adjustment, but noted there is no illustrative examples. As such, we recommend that the Board include illustrative numerical examples to help the preparers to assess whether a passage-of-time adjustment is reasonable and what represents compensation proportional to the passage of time.

Related to question 3, the IIF recommends that IASB reconsider the accounting for written put options as outlined in question 3.

Relating to the guidance on written put options in scope of paragraph AG27B, we disagree with the approach to recognize the financial liability by removing the amount from a component of equity other than non-controlling interests (NCI). Our view is consistent with paragraphs BC77 and AV5-6. It is counterintuitive to reduce other components of equity other than NCI as it would result in credit balances for both the NCI and financial liability balances, which results in a double count of the same NCI obligation within the contract. In addition, for the subsequent changes in the redemption amount of such NCI, we believe it would be counterintuitive to present such gains and losses in profit or loss as the value of the NCI put decreases when the entity's value of the shares increases, and vice versa.

Therefore, we recommend removing the financial liability from NCI, and to recognise changes in the fair value within equity (considering that it is a transaction with owners in their capacity as owners) and supported by appropriate disclosures. Another option could be to consider the accounting as a derivative (similar to the alternative view of Mr. Uhl in paragraph AV3 of the Basis for Conclusions) as in separate financial statements.

Related to question 5, the IIF recommends that IASB consider retracting the factors in the assessment of shareholder discretion. We appreciate the IASB's efforts to establish factors to minimize diversity with respect to shareholder discretion. However, as the factors are not prescriptive, not meant to be exhaustive and entities can apply judgment based on different facts and circumstances, there is minimal value to add these amendments given that there is existing industry practice. Given that there is existing industry practice, we are concerned that the cost of implementing the proposed guidance may outweigh the benefits and may not significantly reduce diversity in practice. We also raise our concern on paragraph AG28C which indicates that an entity should not apply these requirements by analogy in applying other IFRS standards. We would appreciate IASB clarifying that a holder does not need to apply these factors in the IFRS 9 financial asset's solely payment of principal and interest (SPPI) test given the interaction of the SPPI test being dependent on IAS 32 classification. It would be difficult for a holder to have such detailed information to perform the assessment of those factors in contrast to the issuer's perspective.

Related to question 6, the IIF recommends that reclassifications should not be permitted. While we appreciate the IASB's intentions to clarify the reclassification of financial liabilities and equity instruments, we have concerns on the scope of the permitted reclassifications to include changes in circumstances external to the contractual arrangement arising from events not specified in the contract. We find that monitoring arrangements for external changes in circumstances is not practicable as there are unlimited possibilities that would need to be assessed. We foresee other unidentified circumstances being in scope that could have unintended consequences. For example, the proposed amendment would result in reclassification when there is a change in law or regulation in relation to a contractual term that is static as it would no longer mirror the revised law or regulation. Considering the practicality of implementing processes to monitor such changes that are external to the contractual terms, we would generally prefer no reclassifications to be permitted. This would also be consistent with IFRS 9 financial asset classification requirements from a holder's perspective that do not allow for reclassifications except for a change in business model, which is on a portfolio basis.

Additionally, while some guidance is provided in the ED (paragraph 32C) relating to what external to the contractual arrangement means, we believe it is insufficient. For example, an

entity issues a perpetual instrument (Instrument A) that contractually requires interest payments only if the entity is contractually required to pay interest on a similar perpetual instrument. At initial recognition, the entity does not have other perpetual instruments outstanding and hence instrument A is entirely classified as equity. Subsequently, the entity issues another perpetual instrument with mandatory interest payments. It remains unclear whether this would trigger a reclassification of Instrument A.

3. Disclosures

Related to question 7, the IIF is wary that the volume of disclosures does not seem practical or digestible from a user perspective. Our overall concern is that the benefits of the disclosures will not outweigh the efforts to prepare them. We also question whether the granularity of this information is useful for the users. We recommend the proposed disclosures be reduced to focus on solely on additional disclosure on the terms and conditions of compound instruments rather than broadly all instruments with both debt-like and equity-like characteristics and passage-of-time adjustments. The latter has the unintended consequence of broadly scoping in many more instruments. Furthermore, we would appreciate if cross-referencing to other public disclosure documents required by existing regulatory bodies should be made possible, similar to existing paragraph B6 of IFRS 7 involving financial instrument risk disclosures.

4. Presentation

The IIF questions the usefulness of a new breakdown on the face of financial statements as outlined in question 8 – Presentation of amounts attributable to ordinary shareholders. We recommend that IASB weigh the cost versus benefits of providing such split presentation, including assessing how the retrospective application of allocating the cumulative equity reserves would be feasible for entities. In addition, we believe there will be challenges in practically implementing the guidance. If IASB is to retain these presentation proposals, we recommend providing illustrative examples on how to practically allocate amounts between ordinary shareholders and others. Furthermore, we ask IASB to help clarify and define ordinary shareholders in the context of this disclosure requirement to reduce interpretation risk.

5. Transition

Related to question 9, we recommend that the IASB permit prospective application of the classification of IFRS 9 financial assets and not require mandatory restatement of comparatives upon transition.

Some clarifications in the ED have downstream impacts to IFRS 9 financial assets' SPPI test such that if the classification of the instrument changes from the issuer's perspective, it can impact the classification from the holder's perspective. For example, under IFRS 9, only a pure debt instrument can pass the SPPI test and only a pure equity instrument can be elected fair value through profit or loss. To implement these amendments, financial institutions with a large volume of financial assets would require significant effort to reassess the financial assets' classifications. The cost of doing so would outweigh such benefits. Therefore, we ask the IASB

to provide a transition exemption to apply IAS 32 amendments prospectively for financial asset classification, rather than retrospective.

In addition, for financial instruments in hedging relationships, if their classification were to change under the proposed amendments, the entity may be forced to retrospectively discontinue these hedging relationships when the amendments become effective. One example could be if a financial liability, previously designated in a hedging relationship, is now reclassified as an equity instrument after the proposed amendment, which makes it ineligible as a hedged item under IAS 39 or IFRS 9. Another example could be a compound financial instrument presently classified as a liability, for which the remuneration (e.g., dividend) is reclassified from expense to equity. We ask IASB to consider potential transition relief on hedge accounting and allowing for hedge accounting to be eligible for certain equity components going forward.

Furthermore, we recommend that the IASB permit a policy choice on the retrospective restatement of comparatives. Given that IFRS 9 or other new IFRS standards did not require mandatory restatement of comparatives, we question why IAS 32 is different. We believe with adequate transition disclosures, it is not crucial to restate comparatives.

We thank the IASB for its consideration of our comments and welcome any additional stakeholder engagement around this topic. If you have any questions, please do not hesitate to contact Martin Boer at mboer@iif.com or Tim Steinhoff at tsteinhoff@iif.com.

Sincerely,

A handwritten signature in black ink, appearing to read 'M. Boer', with a stylized, cursive flourish at the end.

Martin Boer
Senior Director, Regulatory Affairs
Institute of International Finance (IIF)