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Exposure Draft:
Financial Instruments with Characteristics of Equity
Proposed amendments to IAS 32, IFRS 7 and IAS 1 (November 2023)

Dear Mr Barckow

On behalf of the German Insurance Association (GDV) we appreciate the opportunity to comment on the Exposure Draft: Financial Instruments with Characteristics of Equity, Proposed amendments to IAS 32, IFRS 7 and IAS 1 ('the ED'), released by the IASB on 29 November 2023 for public consultation. While we do not provide detailed comments on all the questions raised in the ED, we would like to share our general assessment and comment on some of the important issues as approached by the IASB in the ED.

As a matter of principle, we support the IASB's proposal not to change the requirements in IAS 32 fundamentally as we share the view that the standard works well for most financial instruments and its requirements can be applied by the reporting entities without major difficulties. Hence, we support the IASB's focus in the ED on "clarifying the classification requirements in IAS 32, including their underlying principles, to address known practice issues that arise in applying IAS 32" (para. IN4).

In this regard, while acknowledging the objective of the project, we specifically regret however that the IASB did not put forward an explicit proposal to address the interaction of classification requirements in IAS 32 with the holder's perspective, being subject to requirements in IFRS 9 *Financial Instruments*. We suggested in the past to verify how the deficiency in accounting treatment of puttable instruments in this

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regard could be overcome. We recommended to amend the requirements of IFRS 9 to clarify that the classification of puttable instruments as an equity instrument (para. 16A and 16B of IAS 32) is sufficient for the financial instrument to be eligible for the fair value through other comprehensive income option in para. 5.7.5 of IFRS 9. The GDV provided in its comment letter of 12 January 2022 (link) a detailed rationale why there is a need to fix and to properly align the accounting treatment for investments, for example in private equity structures, and to achieve consistency between the issuer's perspective and the investor's perspective. It would help to overcome the implications of the agenda decision of the IFRS Interpretations Committee of 12 September 2017 (link) in this regard. This important issue is linked to the Question 1 in the ED.

Therefore, as there is a natural link to it, we would like to express our regret, that the recycling issue for equity instruments accounted for at fair value through other comprehensive income, being the priority issue for the insurance industry, is also not addressed in the ED. The German insurers reinforce their firm view that realised gains or losses on equity instruments should be ultimately presented in the profit or loss statement once realised. A robust impairment model had been proposed. We acknowledge though that the IASB is committed to monitor the recycling issue from the perspective of the insurance industry. The GDV will contribute its further comments on this matter once the IASB's Post-implementation Review on IFRS 17 *Insurance Contracts* is conducted.

Regarding the proposed treatment of obligations to purchase an entity's own equity instruments (Question 3) we would like to highlight the need to revisit the amendment proposed in the ED, specifically regarding the proposed accounting for gains and losses on remeasurment of the financial liability. The IASB should reconsider whether the desirable objective to ensure a consistent accounting for obligations to purchase an entity's own equity instruments could be achieved differently, more aligned with the economic nature of the transaction, while avoiding double-counting.

Finally, regarding the proposed additional disclosure and presentation requirements we are not sure whether the incremental value they might provide to investors or other users of the financial statements exceeds the additional costs for preparers. In our detailed comments we highlight some of the specific proposals in the ED which we argue need to be thoroughly revisited when finalising the envisaged amendments to IFRS 7 and IAS 1.

In the annex to this letter, we provide nuanced comments on some of the questions raised in the ED and our respective rationale.

We would appreciate very much if our comments would be considered by the IASB when taking ultimate decisions on the way forward with the amendments proposed in the ED.

If you would like to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,

German Insurance Association (GDV)

Annex: Comments of the German Insurance Association (GDV) on the Exposure Draft: Financial Instruments with Characteristics of Equity, Proposed amendments to IAS 32, IFRS 7 and IAS 1 ('the ED'), released by the IASB on 29 November 2023.

Question 1: The effects of relevant laws or regulations (paragraphs 15A and AG24A–AG24B of IAS 32)

Overall, we are supportive of the envisaged amendments to clarify the interaction between the contractual rights and obligations and relevant laws or regulations. We also agree that only enforceable rights and obligations (in their entirety) should be considered.

Nevertheless, we are not fully sure what the concrete practical implications of the amendmends might be; for example and specifically of importance for us the case of puttable instruments in para. 16A and 16B of IAS 32. Our rationale why there is need for more analysis is as follows:

- As a starting point of our considerations, let us acknowledge that the respective clause of the statutory law (i.e. the right to withdraw the share in the partnership) cannot be overruled by a contractual agreement. Hence, it has to be considered to be always enforceable. Accordingly, the inclusion of its contractual exclusion is not enforceable. Consequently, and according to the proposal in the ED, it would imply to us that in such cases the financial instruments under consideration can be classified as equity instruments on general terms of IAS 32 already, not on basis of the exception in para. 16A and 16B of IAS 32 only. This outcome could be derived when reading the proposed clarification in para. 15A (a) that an entity "*shall consider <u>only</u> contractual rights and obligations that are enforceable by laws* (…).

  It would lead to a conclusion that in such cases the financial instrument under consideration can be classified as equity instrument on general terms of IAS 32, and not only on the basis of the exception in para. 16A and 16B of IAS 32 only. Consequently, the FVOCI option for equity instruments in para. 5.7.5 of IFRS 9 would apply. The IFRS Interpretations Committee's decision of 12 September 2017 would <u>not</u> apply any more, because of the change in the standard's set up. This outcome would allow for a more proper accounting for private-equity investments in IFRS 9.
- Moreover and from a different perspective, also according to the proposal in the ED, one might argue that rights of the investor not

being part of the contractual agreement but still being part of the relevant legal environment, are not to be considered when making the classification decisions. This outcome could be derived when reading the proposed clarification in para. 15A (b) that an entity "*shall not consider any right or obligation created by relevant laws or regulations that would arise regardless of whether the right or obligation is included in the contractual arrangement*". The related Board's rationale is provided in para. 22 of the the Basis for Conclusions:

> *"Applying the approach described in paragraph BC20 to these examples, the Board concluded that it would be appropriate for the rights and obligations established by the relevant laws or regulations not to be considered when classifying those instruments because the laws or regulations would exist regardless of whether they are included in the contract."*

Overall, also this reading would imply for us that in such cases the financial instruments under consideration can be classified as equity instruments on general terms of IAS 32 already, again not on the basis of the exception in para. 16A and 16B of IAS 32 only.

Consequently, the FVOCI option for equity instruments in para. 5.7.5 of IFRS 9 could be applied, irrespective of the [outdated then] IFRS Interpretations Committee's decision of 12 September 2017. Hence, also this interpretation would allow for a more proper accounting for private-equity investments in IFRS 9.

It is our firm expectation that the IASB needs to provide explicit clarity whether the above interpretations of potential implications of para. 15A of IAS 32 would hold. Otherweise it would lead to uncertainty, questions and unnecessary discussions with statutory auditors in relevant cases in accounting practice, which we believe can and should be avoided via a preemptive clarification. Hence, we like to recommend the IASB to explicitly clarify the issue of implications of the envisaged IAS 32.15A, specifically for the application of para. 16A and 16B of IAS 32.

Overall, we respectfully suggest the IASB to carefully reconsider the proposal and its wording in the ED to avoid any unintended consequences, not envisaged by the IASB with this narrow-scoped ED.

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

As a matter of principle, we are supportive of the proposed amendments to IAS 32 to clarify how fixed-for-fixed condition is intended to work and the the condition is met. From our perspective, the proposed amendments are capable of providing more clarity in relevant cases intended.

We do not have any specific further comments.

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

While we generally support the envisaged clarification how the obligations to purchase an entity's own equity instruments are accounted for, we have some serious reservations whether the proposed approach is the only proper one. In particular, we tend to disagree with the proposal that any gains or losses on remeasurement of this specific financial liability are to be recognised in profit or loss. It is our perspective that it would be rather counterintuitive to recognise those changes in profit or loss. It would be from our perspective more obvious and more reasonable to investors and other users of the financial statements to present those movements transparently in the statement of changes in equity. In particular, those remeasurments reflect the interrelation between the entity and its shareholders in their capacity as owners.

In this context, we would like to point out to the following:

- According to BC78(a), non-controlling interests represent existing ownership interests. Consequently, we conclude that writing a put option on own equity instruments with non-controlling interstest is a transaction between owners in their capacity as owners and should be treated as such.
- BC87(c) refers to the IFRS 9 requirements to recognise gains or losses on remeasurement of the liability in profit or loss, while BC85 explicitly mentions that the IASB intends to delete the reference to IFRS 9 in para. 23 of IAS 32 to avoid potential confusion about how an entity measures a financial liability for an obligation to purchase its own equity instruments after initial recognition.
- Further, in the case of expiry of the put option without exercise the amounts removed from the liability are recognised in equity and not in profit or loss. This means that in this case, the derecognition is not accounted for in accordance with IFRS 9, which requires the

impacts to be recognised in profit or loss (para. 3.3.3 of IFRS 9). Instead, BC93 refers to the recognition of "original transaction" that was accounted for through equity in this case.

In our view, the reasoning within the Bases for Conclusion for the approach to measure the changes of the liability in profit or loss is inconsistent in itself. Therfore, we believe that this approach is not superior to the view that the changes in the measurement of the put option are reflective of a transaction between owners in their capacity as owners, which is accounted for in equity.

In this context, we would also like to point out that the proposal in the ED would significantly change established practice of accounting for written put options on NCI for German insurers. For the initial recognition we would prefer to support the debit entry against the NCI position, in line with the alternative view presented in the para. AV5 of the Basis for Conclusions.

Overfall, in any case the final IASB's conclusions on how to proceed with the proposal in the ED should ensure that no double-counting arises, considering the nature of the NCI position and the related transactions as explained above.

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

We generally support the intended clarifications for the consideration how to account for contingent settlement provisions and the intention to provide consistency between initial and subsequent measurement.

Nevertheless we would like to emphasise an issue related the measurement of the contingent settlement provisions. We are concerned that it might have unintended consequences for the measurement of the financial instruments with contingent cash flows. In some more detail:

Disregarding probabilities when determining the fair value does not seem to be consistent to the measurement requirements of IFRS 9 and IFRS 13. In principle, para. 5.1.1 of IFRS 9 requires the initial measurement of financial instruments at fair value (not nominal or highest possible amount). It is not explicitly clear from the definition of contingent settlement provisions (para. 25 of IAS 32) that contractual obligations for which various cash flow settlement scenarios are conceivable at inception (i.e. various probability-weighted individual cases) are excluded. According to the ED's proposal, the highest possible amount

(which may differ from the consideration received) would always have to be recognised, although this (alone) is considered unlikely (but not non-genuine). This could result in unintended implications.

Regarding the proposed definition of the term 'liquidation' in para. 11 of IAS 32 we support the suggestion to refer to "the process that begins after an entity has permanently ceased its operations."

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

We agree with the intended explicit clarification that whether an entity has an unconditional right to avoid delivering cash or another financial asset (para. 19 of IAS 32) depends on the facts and circumstances in which shareholder discretion arises. And we also agree that entities are required to exercise (entity-specific) judgement to assess whether shareholder decisions are treated as entity decisions or not.

We also have the view that it might be useful and helpful to proceed with the proposed factors an entity is required to consider in making their assessment. We agree that it would be indeed rather difficult for the IASB to develop a more prescriptive approach as noted in para. 125 of the Basis for Conclusions.

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

We agree with the envisaged amendment to clarify that reclassification of the financial instrument is generally prohibited unless a change in circumstances external to the contractual arrangement occurs. We also welcome the examples of changes in circumstances external to the contractual arrangement requiring reclassification proposed for inclusion in para. AG35A in Application Guidance to IAS 32.

We have no critical comments on the proposed specifications how the accounting would work when reclassification exceptionally does take place. We agree that it is a reasonable approach to require that an entity needs to reclassify the instrument prospectively from the date when that change in circumstances occurred, as proposed for para. 32d of IAS 32, for the reasons provided in para. 150-156 of the Basis for Conclusions.

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

While we acknowledge the relevant rationale provided, we are not fully convinced whether the proposed additional disclosure requirements meet the relevant cost-benefit threshold, specifically when taken as a whole package. The adoption of the additional disclosure requirements proposed in the ED will be a significant operational challenge for insurers, but at the same time we are not aware of preceding relevant urgent users' requests in this regard. Consequently, we propose to revisit the proposed amendments to IFRS 7. Specifically, the proposal to shift particular requirements from IAS 1 to IFRS 7 should be reconsidered, and we are not supportive of the proposal to expand the objective of IFRS 7. The relevant disclosure requirements on equity structure etc. are directly related to the statement of changes in equity being required by IAS 1 and well placed there or in the future IFRS 18 *Presentation and Disclosure in the Financial Statements*.

Furthermore, the specific proposals to require reporting entities to disclose information about

- "the nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments" (para. 30A and 30B of IFRS 7 as suggested in the ED);
- "the terms and conditions of financial instruments with both financial liability and equity characteristics" (para. 30C - 30E and B5B - B5H of IFRS 7 as suggested in the ED);

are going to be specifically burdensome to comply with. At the same time we question how the investors or users of the financial statements are going to absorb all these mostly narrative information of different levels of granularity between entities. Moreover, as long the entities are preparing their financial statements under the going concern assumption, the intensified focus on the case of liquidiation (as worst case not underlying the regular process when preparing the financial statements) does not seem to be reasonable.

In addition, the envisaged requirement to disclose terms and conditions of financial instruments with both financial liability and equity characteristics seems to neglect that it is the primary responsibility of the reporting entity to make the classification decisions, the statutory auditor is subsequently responsible to verify whether the decision of the audited entity has been conducted with a a proper care and whether the assessment is acceptable. Hence, the focus in the ED on the nature of narrative disclosures in this regard does not seem to provide significant added

value for users, and it inflates the notes even further. It questions somehow the established decision making processes in this regard. Moreover, considering the illustrative example in draft paragraph IG14E of the Implementation Guidance accompanying IFRS 7 we tend to perceive that the para. 30C - 30E of IFRS 7 are intended to require an entity to disclose the terms and conditions of financial instruments with both financial liability and equity characteristics, including terms and conditions that indicate priority on liquidation for such instruments, on a individual basis, not as an aggregate, if the terms and conditions are not exactly the same. As this case might be the most common one, we are already concerned about the significant increase of the mere volume of the information to be provided.

Finally, only the consideration of the combination of the proposed particular disclosure requirements makes the whole burden for reporting entities comprehensible. We argue for and respectfully recommend a clear reduction of it. Indeed, we believe that the IASB should not proceed with both proposed disclosure requirements mentioned above any futher as they would not provide decision useful information, and hence they would be without a real significant incremental value for users, irrespective of the level of disaggregation, while causing considerable costs to reporting entities. Consequently, we recommend to surrender the amendments proposed in the ED for para. 30A till 30F of IFRS 7. Otherwise the notes will be inflated permanently.

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

The proposed amendments are intended to nuance the presentation requirements in IAS 1 regarding the information an entity provides to users of financial statements about its issued financial instruments. The proposed amendments to IAS 1 would increase the granularity and require reporting entities to present amounts attributable to “ordinary shareholders of the parent” separately from amounts attributable to “other owners of the parent”.

In our view the term “other owners of the parent” as proposed in the ED is not sufficiently clear. This could lead to different interpretations and to diversity in practice. For the sake of clarity and should the IASB continue with the proposal, we like to suggest the more meaningful term “other holders of the entity’s own equity instruments” to be used. Our rationale is that not all holders of financial instruments classified as equity are necessarily owners of the entity in legal terms.

As a matter of principle, we consider the current requirements to be sufficient and well established in the financial reporting practice, based on the binary distinction between equity and debt. We are not aware of an urgent case for changing it. Hence, the proposed additional granularity for the presentation might be of limited added-value for investors or other users of financial statements, or would at least require a more substantiated justification why there is a case for a change and an additional reporting burden for prepares. What would be the incremental benefits for investors and other users of the financial statements and how would this new information be in detail processed by them? Consequently, we suggest to verify again whether the proposed new presentation requirements need to be finalised. Overall, we recommend not to proceed with the proposal.

Finally, we fully support the Board's decision not to propose amendments to IAS 32 for the classification of perpetual instruments containing obligations that arise only on liquidation (para. 165 – 169 of the Basis for Conclusions). As noticed in para. 165 of the Basis for Conclusions, entities used to classify these instruments as equity instruments and any changes to this established approach would be of significant relevance.

Question 9: Transition (paragraphs 97U–97Z of IAS 32)

We support the proposed transitional requirements, including the rationale for the retrospective application of the proposed amendments. We agree with the proposal not to specify any transition requirements in relation to IAS 34 *Interim Financial Reporting*, allowing for judgement in determining what to disclose to meet the existing requirements.

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

We do not provide any comments in this regard.