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International Accounting Standards Board
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Dear IASB members,

Re: Financial Instruments with Characteristics of Equity (ED/2023/5)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Financial Instruments with Characteristics of Equity" issued in November 2023.

Our process

This response letter represents the views of AcSB members and staff based on their knowledge and experience.

As part of our due process for this Exposure Draft, we consulted with 120 interested and affected parties across Canada. This included discussions with our User Advisory Committee and IFRS® Accounting Standards Discussion Group, preparers from Canadian financial institutions, representatives from the Office of the Superintendent of Financial Institutions, and broader public outreach. Through these discussions, we heard from users, preparers, practitioners and regulators. We took their feedback into account when developing this letter.

Our view

We appreciate the opportunity to comment on this Exposure Draft and commend the IASB for striving to improve the information entities provide regarding financial instruments within the scope of IAS 32 *Financial Instruments: Presentation* (IAS 32) through its Financial Instruments with Characteristics of Equity Project.

Overall, we are supportive of the IASB's proposed disclosure and financial statement presentation requirements in the Exposure Draft. We think these proposals are responsive to feedback heard on the June 2018 Discussion Paper "Financial Instruments with Characteristics of Equity" (2018 Discussion Paper). These proposals will provide more decision-useful information to financial statement users regarding complex financial instruments and enhance comparability. We think that in consideration of the feedback received on the 2018 Discussion Paper, the IASB's current Exposure Draft should have focused on disclosures and financial statement presentation only.

Beyond the Exposure Draft proposals related to financial statement presentation and disclosure, we think that the specific classification and measurement proposals do not achieve the IASB's objectives for this project. However, if the IASB proceeds with these classification and measurement proposals, we recommend a number of further changes and clarifications to the proposals.

Objective of the Exposure Draft

The IASB's objective for the proposals, as set out in the Basis for Conclusions, is to address various application issues that have been identified when applying the existing classification requirements in IAS 32. Furthermore, the IASB's stated intention is to limit changes in classification outcomes to cases for which there is sufficient evidence to support that such changes provide better information to users.

In determining certain clarifications proposed in the Exposure Draft, the IASB has looked to the original intent of the IAS 32 requirements when the Standard was established in 2003. However, we observe there have been significant environmental changes since that time – for example, changes to financial markets driven by the global financial crisis and resulting regulatory reforms, as well as globalization, increasing alternative investments and sustainable finance. These factors, and the continuing need for entities to explore new ways to obtain efficient financing, have resulted in financial instruments with considerably different characteristics and complexity than those that existed in 2003. At the same time, there have been significant changes to IFRS Accounting Standards impacting financial reporting requirements. The IASB issued IFRS 9 *Financial Instruments* (IFRS 9) and IFRS 13 *Fair Value Measurement* (IFRS 13), which comprehensively address the measurement of financial instruments, and updated the *Conceptual Framework*.

Overall, we think that amending IAS 32 in line with the IASB's original intent will result in changes to classification and measurement outcomes that may not increase the decision-usefulness to financial statement users, and therefore does not achieve the objective of the proposals.

Measurement principles within IAS 32

Guidance for the initial and subsequent measurement of financial liabilities is contained within IFRS 9, with the exception of the existing guidance in paragraph 23 of IAS 32 on "redemption value" measurement. We think the proposal to clarify that the "redemption value" measurement basis also applies to contingent settlement provisions creates confusion and conflicts with initial and subsequent measurement requirements of IFRS 9. Additionally, including measurement guidance in IAS 32 is inconsistent with its objective as a classification standard.

We are also concerned that the amendments ignore the impact of probability, which is a departure from the key principle in IFRS 9 to initially measure financial instruments at fair value. If the IASB believes that clarifications are needed for the measurement of certain financial liabilities, we think this should be done as a separate, more comprehensive measurement project within IFRS 9. This will better enable the IASB to further explore the broader implications of changes to measurement and better assess whether they result in more useful information.

The impact of laws and regulations

We have not been made aware of ongoing or pervasive issues in Canada regarding the classification requirements in IAS 32 and how the legal and regulatory framework in a jurisdiction affects classification. We think applying the proposals in the Exposure Draft will require significant judgments and will result in new application questions arising. Furthermore, these proposals may result in broad changes to classification and reduced consistency of classification outcomes. Specifically, we think the proposed approach could result in inconsistent outcomes for economically similar instruments, and therefore does not improve the comparability of financial statements. As such, we suggest the IASB not proceed with this classification proposal and instead consider disclosure requirements regarding how an entity's legal and regulatory environment has affected classification of financial instruments.

Our responses to your questions

Appendix A to this letter responds to the questions posed in the Exposure Draft and expands on the points raised above.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Katharine Christopoulos, Director, Accounting Standards (+1 416 204-3270 or email kchristopoulos@acsbcanada.ca), or Eric English, Principal, Accounting Standards (+1 647 264-8277 or email eenglish@acsbcanada.ca) or Prajesh Marwaha, Principal, Accounting Standards (+1 647 956-7335 or email pmarwaha@acsbcanada.ca).

Yours truly,

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About the Canadian Accounting Standards Board

We are an independent body with the legal authority to establish accounting standards for use by all Canadian publicly accountable enterprises, private enterprises, not-for-profit organizations and pension plans in the private sector. We are comprised of a full-time Chair and volunteer members from a variety of backgrounds, including financial statement users, preparers, auditors and academics; a full-time staff complement supports our work.

Our standards

We have adopted IFRS® Accounting Standards as issued by the IASB for publicly accountable enterprises. Canadian securities legislation permits the use of U.S. GAAP in place of IFRS Accounting Standards in certain circumstances. We support a shared goal among global standard setters of high-quality accounting standards that result in comparable financial reporting outcomes regardless of the GAAP framework applied.

We developed separate sets of accounting standards for private enterprises, not-for-profit organizations and pension plans. Pension plans are required to use the applicable set of standards. Private enterprises and not-for-profit organizations can elect to apply either the set of standards developed for them, or IFRS Accounting Standards as applied by publicly accountable enterprises.

Our role vis-à-vis IFRS Accounting Standards

Our responsibility to establish Canadian GAAP necessitates an endorsement process for IFRS Accounting Standards. We evaluate and rely on the integrity of the IASB's due process as a whole, and monitor its application in practice. In addition, we perform our own due process activities for each new or amended IFRS Accounting Standard to ensure that the standard is appropriate for application in Canada. We reach out to Canadians on the IASB's proposals to understand and consider their views before deciding whether to endorse a final IFRS Accounting Standard. A final standard is available for use in Canada only after we have endorsed it as Canadian GAAP.

Appendix A

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.

1. The IASB's proposals seek to clarify practice issues regarding the effects of laws and regulations, ensuring alignment with paragraphs 11 and 13 of IAS 32 as well as IFRS 9 and IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*. We have not been made aware of ongoing or pervasive issues on this matter in Canada. We think however, in many scenarios, the proposals will require entities to make significant new judgments based on their specific facts and circumstances to determine the distinction between contractual terms and laws or regulations. This may result in broad changes to classification, reduced consistency and new application questions.

2. Based on the above, we suggest the IASB does not proceed with this aspect of the proposals. Instead, we think the IASB should require disclosures about the effect laws and regulations have on classification and any significant judgments made in this regard. Proposed paragraph B5A of IFRS 7 should specify that judgments made in classifying financial instruments include the impact of laws and regulations. We also recommend that the IASB require disclosures describing changes in laws or regulations during the reporting period and the impact on the liquidity and cash flow characteristics of affected financial instruments. We think such disclosures will improve comparability by allowing users to understand terms and conditions that have been considered to be part of laws and regulations and those that are "in addition".

3. If the IASB decides to proceed with the proposals, we think the following needs to be clarified:

   (a) what comprises the scope of laws and regulations; and

   (b) how an entity applies paragraph 15A to any financial instrument it chooses to issue.

4. We have detailed our concerns below and included specific examples and suggestions to help improve the IASB's proposals and deliberations.

Scope of laws and regulations

5. The Exposure Draft refers to laws and regulations but does not provide sufficient clarity on what comprises the scope of laws and regulations or what may be considered to be "in addition" to those laws and regulations.

6. We recognize that the IASB may have intentionally not defined laws or regulations to keep the scope broad. However, the IASB's intention is not reflected in the current wording in the Exposure Draft and how this wording is being interpreted. The form of laws and regulations and how they are enacted differs across jurisdictions. Government agencies may issue rulings, interpretations or guidelines on laws and regulations and the agencies may have the statutory authority to enforce these rulings, interpretations or guidelines. Laws and regulations can also be very specific in how they must be satisfied or take a principle-based

approach that may not identify the exact terms and conditions required to satisfy those requirements. We think it is not clear based on the proposed authoritative guidance whether terms added to satisfy principle-based laws and regulations form part of, or are "in addition" to those laws and regulations. As a result of the variation in laws and regulations, a lack of specific guidance on what encompasses laws and regulations could lead to inconsistent outcomes under the proposals and further application questions.

7. Accordingly, we suggest the IASB provides guidance on what constitutes laws and regulations, such that it captures a broad spectrum of mechanisms, including laws, regulations, guidelines, rules and interpretations that are enforceable by governments or designated authorities. We also suggest the IASB provides guidance to determine when terms and conditions are considered "in addition to" laws and regulations. For example, in cases where there is a lack of specificity in the laws and regulations, or contract terms do not replicate exactly the wording of the legal or regulatory requirements. This guidance is required to address the unique circumstances of the various jurisdictions around the world and not leave a fundamental element of the proposal up to interpretation.

Instruments that an entity chooses to issue

8. We think it is unclear how instruments an issuer chooses to issue should be classified in accordance with paragraphs 15A and AG24A. For example, when the issuer voluntarily adds terms and conditions to the contract to achieve the outcomes of a given set of laws, regulations or similar requirements. We think the phrasing in the examples set out by the IASB in the Basis for Conclusions may imply that there must be a "requirement" to issue instruments with particular terms and conditions. As such, we think based on the proposals, it could be interpreted that the specified terms and conditions are a contractual feature because they are included in a contract voluntarily to achieve a desired regulatory outcome. However, we are unclear if this is the IASB's intention.

9. We suggest that the IASB clarify language around its intent within the authoritative guidance.

Effects of the proposals

10. The proposed amendments will require entities to reconsider their specific facts and circumstances and make additional judgments in order to reassess conclusions reached regarding contractual and non-contractual terms. Given the different legal and regulatory frameworks across jurisdictions and nuances therein, making this assessment may result in new application questions and diversity in practice. Entities within the same jurisdiction may also apply judgment differently and reach different conclusions. Therefore, we think that the proposals could reduce the quality and comparability of financial statements and have other unintended consequences.

11. We have outlined some examples in Appendix B that demonstrate the issues we have set out above and the potential effects of the proposals. The examples also highlight how differently the proposals may be interpreted and applied within the same jurisdiction.

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.

12. As discussed above, we think that the IASB should only proceed with the financial statement presentation and disclosure proposals as they will provide users with sufficient decision-useful information regarding complex financial instruments. However, should the IASB proceed with clarifications to the fixed-for-fixed condition, we do not agree with the proposals related to functional currency and passage-of-time adjustments, as we think these proposals are overly restrictive relative to existing well-established practice.

Instruments denominated in foreign currencies

13. Current practice for some multicurrency reporting groups is contrary to proposed paragraph 22B and AG29B. Some entities conclude that the fixed-for-fixed condition is met if consideration is fixed in the functional currency of either the issuer of the financial instrument or the issuer of the underlying equity. It is not clear why the IASB has concluded that users would be provided with better information by limiting equity classification to those issuances in the functional currency of the entity whose equity is being delivered rather than providing a choice.

14. In addition, we acknowledge that within the scope of the current project, the IASB is unable to address concerns raised in our response letter to the 2018 Discussion Paper related to convertible instruments or warrants denominated in a foreign currency. However, this continues to be an area of concern for users. From an investor perspective, the fact that the currency of the financial instrument automatically results in liability classification appears to be a suboptimal result. The difference in classification does not provide useful information about risk, cash flows or potential dilution. Some users view pro rata rights issues and other issues of convertible bonds or warrants denominated in a foreign currency as similar instruments. We think similar instruments should have similar outcomes and, in both cases, the entity is exposed to foreign currency risk as well as variability and residual interest from holding an equity interest. Therefore, we think the IASB should explore the classification outcomes for these instruments in a separate project.

Passage-of-time adjustments

15. We think the proposal that passage-of-time adjustments must fix the present value of the consideration on initial recognition is overly restrictive and would result in a significant change from current practice. Furthermore, we think that paragraph 22C(b)(iii) is unclear and will result in new application issues related to determining the present value of compensation or whether it is "proportional" to the passage of time.

16. Consider an example in which an entity issues a Bermudian option on their own shares that can be exercised at predetermined amounts at predetermined dates. Under current practice the variation in consideration is not required to be mathematically precise, as long as the entity fixes the amount of consideration at the outset of the contract. Under the IASB's proposals, the variability in the consideration received per share may not meet the criteria to be considered a passage-of-time adjustment. We think the criteria in paragraph 22C(b)(iii) could result in inconsistent treatment for otherwise similar instruments and it is not clear if the difference results in more relevant information to financial statements users.

17. We also think that clarification is needed to help determine if an instrument with a variable rate of interest would meet the passage-of-time criteria. Example 20 from the Illustrative Examples accompanying the Exposure Draft indicates that a strike price that varies with an interest rate benchmark or an inflation index would not meet the passage of time requirement. However, we think it is not clear if the presence of any variable rate impacting the strike price would cause the instrument to fail the requirement. It is not clear what additional useful information is provided by permitting variation if rates are fixed but not if rates are variable.

18. We recommend that the IASB remove paragraph 22C(b)(iii) of IAS 32 from the proposals. We think that paragraphs 22C(b)(i) and 22C(b)(ii) clarify the application challenges with the fixed-for-fixed condition. Removing sub-paragraph (iii) would make the passage-of-time requirements less restrictive and allow instruments such as the ones described above to be classified consistently with other instruments that have similar economic substance.

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 recognized from remeasuring the financial liability would not be reversed in profit or loss. However, the entity may transfer the cumulative amount of those gains or losses from retained earnings to another component of equity (paragraph AG27C). (f) written put options and forward purchase contracts on an entity's own equity instruments that are gross physically settled—consideration is exchanged for own equity instruments—are required to be presented on a gross basis (paragraph AG27D). 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.

19. Overall, we do not agree with the proposals regarding obligations to purchase an entity's own equity instruments. We are concerned about the proposed amendments to the measurement requirements embedded within IAS 32, given the objective of the Standard is only to provide guidance on classification. If the IASB continues to think that clarifications are needed regarding the measurement of certain financial liabilities, we think that this should be done as a separate project within IFRS 9. We also think the proposals result in new application questions for certain puttable instruments. Further, as noted in our response letter to the 2018 Discussion Paper, we do not agree with the proposal regarding gross presentation.

Variable share-settled instruments

20. We think the proposed amendment to paragraph 23 expands the scope of the measurement basis included in IAS 32 to include transactions that result in an exchange of equity instruments. While the definition of a liability in paragraph 11 of IAS 32 has always included variable share-settled instruments, paragraph 23 has not. This will create a significant change in practice by increasing the number of transactions to which paragraph 23 will apply. For equity instruments that are eventually settled by issuing another class of equity instruments it is unclear what information value is provided by measuring the exchange obligation at redemption value on an intermittent basis. In such transactions, both legs represent a residual interest in an entity, and do not expose the issuer to liquidity risk. Therefore, we think such instruments are derivatives that should be measured net at fair value in accordance with IFRS 9.

21. We also think that measuring such instruments at redemption value in accordance with paragraph 23 results in new application challenges. Consider a perpetual preferred share with discretionary dividends that may be converted into a variable number of common shares based on the market price of the common shares, subject to a floor and cap price. In this case, it is unclear whether the redemption amount is based on the number of shares presently issuable, the minimum number of shares or the maximum. Assume the price of the common shares increases significantly beyond expectations such that the cap price is triggered and the lowest number of shares would be issued. The redemption value may significantly exceed the value of the preferred shares. On the other hand, if the price decreases significantly such that the floor price is triggered and the maximum number of shares would be issued, the redemption value could be well below the value of the preferred shares. The resulting volatility will distort the entity's net income and balance sheet liquidity.

22. We recommend that the IASB remove the reference to *"or a variable number of another class of the entity's own equity instruments to the value of the contractual obligation"* from paragraph 23 in the proposed amendments.

Puttable instruments

23. For puttable instruments (such as REIT units or member shares discussed in Appendix B) where the exceptions in paragraph 16A-F of IAS 32 do not apply (for example because of IAS 32.22A or AG29A), we think the proposals lack clarity on whether such instruments should be considered compound instruments. These instruments typically contain discretionary payment streams such as dividends and are puttable immediately on demand by the holder. The issuer only has discretion regarding dividends if the holder does not demand repayment. It is unclear if the IASB's intention is for such discretionary streams to be considered a separate equity component. We understand current practice on these instruments may be mixed, with some instruments classified solely as liabilities. Therefore, while we think the IASB should add clarity regarding whether these are compound instruments, this could result in a change in practice regarding the treatment of the discretionary dividends as equity distributions for entities that currently classify these instruments solely as liabilities.

Gross presentation

24. As noted in our response letter to the 2018 Discussion Paper, we do not agree with the proposal to gross up and separately present both the obligation to redeem an entity's own equity and the underlying equity instruments. We agree with the alternative view of Mr. Uhl, noting that such obligations should be accounted for net as one contract, similar to other derivative instruments. Net presentation would result in better and more comparable information across all types of derivative instruments in the financial statements of the issuer. As this would be a change from the current requirements in IAS 32, we think that this should be undertaken as part of a potential measurement project within IFRS 9.

25. We believe paragraphs B89 and B90 of IFRS 10 *Consolidated Financial Statements* provide sufficient guidance on the allocation of income or loss when the underlying shares are subject to options.

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.

26. We do not agree with the proposal in paragraph 25A of IAS 32 that would require entities to ignore the probability and expected timing of the contingent event when measuring contingent settlement provisions. We are also concerned about the embedded measurement requirements within IAS 32, as the objective of this Standard is only to provide guidance on classification. If the IASB continues to think that clarifications are needed regarding the measurement of certain financial liabilities, we think that this should be done as a separate, more comprehensive project within IFRS 9.

Conflicts and inconsistencies with other IFRS Accounting Standards

27. With the exception of the existing guidance in paragraph 23 of IAS 32 on "redemption value" measurement, guidance for the initial and subsequent measurement of financial liabilities is contained within IFRS 9. We think the proposal to clarify this redemption value measurement, including how it applies to contingent settlement provisions, could create broader implications, including confusion and conflicts with initial and subsequent measurement requirements of IFRS 9 and other application challenges. Additionally, including measurement guidance in IAS 32 is inconsistent with the stated objectives of this Standard, which is that "*It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments*."

28. We think the redemption value measurement basis, which ignores the impact of probability, is a fundamental shift from the key principle in IFRS 9 to initially measure financial instruments at fair value. This is because a market participant would not ignore the probability of critical terms and conditions in the instrument, and therefore redemption value will not always equal fair value. Furthermore, there are other IFRS Accounting Standards, such as IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 13 for example, that reference probability when measuring assets and liabilities. Therefore, the proposal to exclude probability is inconsistent with measurement bases across IFRS Accounting Standards.

29. We are also concerned with the fact that this proposal may create measurement diversity for similar instruments issued by the same entity. For example, under the proposal, a host equity contract with a contingent settlement provision would be a compound financial instrument, with the liability component measured at the redemption amount under proposed paragraph 25A. Conversely, if the same contingent

settlement provision was attached to a host liability contract, the measurement proposals in paragraph 25A would not apply to the liability. We do not think it provides useful or understandable information to users of financial statements for these two instruments, with the same contingent settlement feature, to be measured using different approaches.

30. If the IASB thinks redemption value measurement is appropriate for certain instruments, we strongly encourage the IASB to consider this measurement guidance as part of a separate project within IFRS 9. This would allow the IASB to maintain the objective of IAS 32 being a classification standard and to better assess potential interactions between this measurement guidance and IFRS 9 as well as other IFRS Accounting Standards.

Usefulness of redemption value measurement

31. As noted above, we think guidance on measurement of financial liabilities is outside the scope of IAS 32 and any clarifications to the measurement requirements should only be addressed through a project on IFRS 9. Regardless, if the proposals are retained through this Exposure Draft or another project, they would result in significant changes in the measurement of certain instruments in Canada. Current measurement outcomes are providing decision-useful information to users and the proposed disclosures will further enhance their understanding of complex financial instruments. Accordingly, we think that these measurement changes will not result in additional usefulness which would warrant the cost associated with changing the existing measurement requirements.

32. We agree with the clarification in the Exposure Draft that instruments with contingent settlement provisions can be compound financial instruments, and think it is helpful to make this clarification. In many cases, such as non-viability contingent capital (NVCC) preferred shares issued by financial institutions in Canada (see Appendix B), contingent settlement provisions are attached to a perpetual instrument with discretionary dividends. In this case, we think there is an equity component for the discretionary payments and a liability in the contingent settlement feature.

33. We acknowledge that the IASB's intention of the existing guidance in IAS 32 is for contingent settlements to be measured at the full amount of the conditional obligation, as noted in paragraph BC12 of the Basis for Conclusions issued in 2003. However, we observe there have been significant environmental changes since that time. This has resulted in financial instruments with considerably different characteristics and complexity than those that existed in 2003. At the same time, there have also been significant changes to IFRS Accounting Standards impacting the financial reporting requirements, such as IFRS 9, IFRS 13 and the updated the *Conceptual Framework*.

34. Existing practice has emerged based on the authoritative guidance, as written within IAS 32, that considers the likelihood of these contingent events. We have heard from both credit and equity analysts that they consider the probabilities associated with contingent events as well as the underlying terms and conditions when performing financial analysis. Therefore, we think that applying a measurement basis that ignores probability weighting to contingent settlement provisions would result in less decision-useful information for financial statement users.

35. Furthermore, we note that with this proposal, the IASB intended for the outcome of contingent settlement provisions to be consistent with other types of demand liabilities. We disagree with this rationale, as we think the economics of a demand loan are significantly different than a liability that is contingent on an event outside of the control of both the issuer and holder. These fundamental differences should be considered in the measurement of such liabilities.

Impacts to the Canadian financial reporting landscape

36. The proposed measurement criteria in paragraph 25A of IAS 32 could result in a fundamental change in practice in Canadian financial institutions. Canadian banks issue non-cumulative preferred shares with NVCC features (see Appendix B for details of these contracts). Under current practice, the liability

component of these compound instruments is measured initially at fair value. The fair value of the liability is determined based on a probability-weighted assessment of the contingent event occurring, resulting in the liability component often being measured initially at a nominal value, with the residual attributed to the equity component. Subsequently, the assessment of the contingent event occurring continues to be factored into the measurement criteria as required under IFRS 9. Therefore, under current practice there is already alignment between the initial and subsequent measurement of these instruments.

37. Under the proposals in paragraph 25A, the probability of the non-viability event happening would no longer be considered and the liability component of the compound instrument would be measured at the full contingent settlement amount (i.e. the face value of the preferred shares). The residual equity amount at initial recognition would be nominal. Based on discussions as part of our outreach activities, applying this measurement approach to NVCC instruments could result in an increase in financial liabilities and reduction in equity of approximately $35-40 billion at Canadian banks. These instruments currently qualify as Additional Tier 1 Capital but, absent any future regulatory changes to what qualifies as Additional Tier 1 Capital, could lose this treatment if the liability component is measured in the proposed manner.

38. The changes would result in significant costs, either to Canadian Banks that may need to renegotiate contracts or to regulators that may need to expose and enact necessary changes to regulations. We think these costs would far outweigh any benefit to financial statement users. As noted above from our outreach, both credit and equity analysts consider the probabilities associated with contingent events as well as the underlying terms and conditions when performing financial analysis. We think that users would derive more decision-useful information from the proposed disclosure requirements than a change in the measurement of such contingent settlement provisions.

Clarification on scope of the measurement criteria

39. Should the IASB move forward with the amendments related to contingent settlement provisions, we think that additional clarification is needed to determine the scope of paragraph 25A. We think it is unclear whether this paragraph should apply to all financial liabilities that contain contingent settlement provisions, or just those for which a contingent settlement provision triggers liability classification. We think that this proposal could be interpreted to mean that it should apply to all financial liabilities that contain contingent settlement provisions, however we think this was not the IASB's intention. This interpretation could have significant unintended consequences.

40. For example, an entity may issue convertible debt which only becomes convertible by the holder in the event of a change in control of the issuing entity. The conversion rate into shares may be higher than the initial par value of the debt. The instrument is initially classified as a financial liability because it is a contractual obligation to deliver cash to the holder. It is unclear whether this example would fall under the scope of 25A, which would significantly impact how the entity measures this liability.

41. We encourage the IASB to consider adding additional wording to paragraph 25A to clarify that these measurement requirements would only apply to instruments for which the contingent settlement provision triggers liability classification. Such a clarification would better define the scope of this measurement criteria and avoid unintended consequences such as the example noted above.

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.

42. Considering the scope of the Exposure Draft, we support the IASB's proposal to provide clarity on when shareholder decisions are considered entity decisions. Entities currently apply judgment without an established framework. We think having the additional factors in paragraph AG28A to consider when making the assessment will be helpful to entities and could reduce some of the diversity in practice. However, we think entities will continue to need to apply judgment in assessing the factors in paragraph AG28A and may face challenges in doing so. It is unlikely that entities will apply judgment consistently and therefore diversity will not be eliminated.

Question 6— Reclassification 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 recognized 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 recognized 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.

43. We think the proposed amendments may result in classification outcomes that do not faithfully represent the substance of the instrument, create inconsistencies between obligations to redeem own equity instruments and other financial liabilities, and change established practice.

44. While IAS 32 does not include specific guidance on reclassification, we think this implies that reclassification is not generally prohibited. We think that reclassification is permitted to ensure financial instruments are classified in accordance with the substance of the contract at each reporting date. This is because the definitions of financial liabilities and equity in IAS 32 both use the present tense indicating that the definitions are applied at each reporting date.

45. As such, we think prohibiting reclassification when contractual terms become, or stop being, effective with the passage of time is inconsistent with the existing principles of IAS 32 and represents a fundamental change to practice. The proposal also appears to be inconsistent with the proposed amendments to paragraphs 23 and AG27C, which require obligations to purchase own equity to be reclassified to equity when they expire. This may lead to asymmetric results or misleading information for financial instruments that otherwise have a similar economic substance.

46. To demonstrate this point about asymmetrical outcomes, consider the following series of warrants which all result in the entity issuing a fixed number of shares. For the first series (Series A), the exercise price is variable until the end of year five. Upon initial issuance, the Series A warrants fail the fixed-for-fixed condition and would be classified as a liability. The second series of warrants (Series B) is issued at the end of year five, the exercise price is the same as Series A. As the exercise price is fixed on initial issuance, the Series B warrants would be classified as equity. Based on proposed paragraph 32B, Series A would

continue to be classified as a liability however, the holders of the Series A and Series B warrants will have identical rights and obligations.

47. We also think there is an inconsistency with the disclosure requirements introduced by the IASB in the Exposure Draft and the rationale for restricting reclassifications under IAS 32. Paragraph BC145 states that reclassification for all changes in the terms and conditions of a financial instrument may increase costs and complexity for preparers as they would need to assess the terms and conditions of the instrument at each reporting date. However, proposed paragraph 30F of IFRS 7 *Financial Instruments: Disclosures* requires disclosure of terms and conditions that become, or stop being, effective with the passage of time. As such, preparers will still need to make such an assessment. We think the disclosure objectives that the IASB is seeking to achieve would be better met if reclassification was permitted.

48. For the reasons above, we suggest that the IASB allow reclassifications when contractual terms become, or stop being, effective with the passage of time.

Question 7— Disclosure (paragraphs 1, 3, 12E, 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. (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.

49. We support the IASB's efforts to enhance the quality of disclosures for financial instruments with characteristics of equity. We think these proposals are responsive to user feedback to better understand how an entity is financed, its capital resources, the current and potential ownership structure and any potential dilution. We think the proposed disclosures will result in users having a better understanding of the cash flow characteristics of an entity's financial instruments and their financial statement impact, and ultimately lead to better decision making. While we are supportive of the disclosures, we have provided suggestions to improve areas we think there is a lack clarity.

50. We note that it may be challenging for large reporting groups to comply with some of the amended disclosure requirements. One area of difficulty may be determining and appropriately disclosing the priority of instruments on liquidation and how priority is impacted by significant uncertainties arising from laws and regulations. Entities may have subsidiaries operating in different countries with different legal frameworks and such information may not currently be collected at the group level.

51. The availability and effort required to prepare such information will be affected by the reporting regimes under which entities operate. For example, entities in highly-regulated industries may prepare financial statements and audits at various subsidiary entities. In other cases, frequent offerings of various securities may result in entities preparing and disclosing subsidiary public issuer financials. In both examples, it will be easier for such entities to provide this disclosure.

52. We think it may be helpful for the IASB to specify how disclosures may be aggregated. We acknowledge that proposed paragraph 30E of IFRS 7 states that the priority on liquidation is disclosed by "class of financial instrument." Further, "class of financial instruments" is defined in paragraph 6 of IFRS 7. However, we recommend that the IASB explicitly state that in meeting the objectives of the amendments, entities consider whether information may be aggregated based on operating segments, jurisdiction, terms and conditions or other characteristics. Accordingly, we recommend that entities should be required to disclose how the disclosures are aggregated including commonalities or differences between groupings and how the group structure affects aggregation.

53. While the overall reporting burden on preparers may be reduced by providing clarity on aggregation, we think there will still be a significant burden on entities to meet disclosure requirements. Furthermore, we note that there may be overlap between these disclosure requirements and other reporting and disclosure requirements outside the financial statements. Accordingly, we recommend that the IASB provide an extended transition period, such that preparers, auditors and regulators in a jurisdiction have time to consider ways to align or reduce duplicative disclosure requirements.

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.

54. Overall, we are supportive of the proposals that require an entity to provide additional information about amounts attributable to ordinary shareholders. We think that this information is useful to financial statement users in assessing an entity's financial performance. However, we are concerned regarding a lack of clarity in how to apply these proposals. We encourage the IASB to consider providing additional application guidance and illustrative examples to assist in applying these requirements. Additionally, we have identified some challenges related to the retrospective application of these requirements which we have discussed in Question 9 below.

55. In the proposed requirements, there is a lack of guidance to assist entities when determining how to attribute gains and losses for specific instruments. For instance, if an instrument is marked to its redemption amount with subsequent changes to this redemption amount recognized in profit or loss, it is unclear how to attribute such gains or losses to either ordinary shareholders or other owners of the parent. It could be argued that the gain or loss should be attributed to the other owners who hold the instruments. Conversely, common shareholders may be responsible to fund the settlement so there is a case that it could be attributed to them. This lack of guidance could lead to diversity in practice and a lack of comparability for financial statement users. More illustrative examples demonstrating how to make this attribution would be helpful.

56. Additionally, we think there is a lack of clarity surrounding the definitions of ordinary shareholders versus other owners of the parent. Some specific concerns include whether ordinary shareholders would also include preferred shareholders with voting rights, or preferred shareholders with a conversion feature to convert their investment into common shares. We think that providing additional application guidance would help entities to make this distinction.

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 8 (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.

Challenges with retrospective application

57. We think that the volume of required disclosures and potential implications of the proposed amendments (as discussed throughout our response letter) would make retrospective application difficult in practice for many entities. This is compounded by the existence of complex financial instruments which have been outstanding for long periods of time. Specifically, we note the following:

    (a) If implemented as proposed, we think the proposals will result in the reclassification of certain financial instruments. Entities would need to incur significant time and costs to review their financial contracts to assess their classification under the new requirements. Entities may also be required to make significant assumptions regarding classification at the inception of the contract, which could result in less useful information.

    (b) We also think that the retrospective presentation of equity attributable to ordinary shareholders and other shareholders would be both challenging and costly for entities to apply. For some longstanding contracts, entities may not have information to determine the equity balances that are attributable to ordinary shareholders versus other owners of the parent. Similar to the above point, entities may need to make significant assumptions in order to determine this split retrospectively, thereby decreasing the usefulness of the information presented.

58. We encourage the IASB to implement transition relief for the retrospective application of these proposals to reduce the implementation costs. We think that transitional relief from full retrospective application would be helpful for entities that would incur undue cost or effort to do so. Similar transitional relief is offered in IFRS 9

with regards to impairment requirements. Additionally, providing relief from retrospective application for instruments which have been derecognized as of the date of initial application would help to further reduce costs for preparers.

Additional transition challenges

59. Despite the intention of this Exposure Draft to clarify the requirements in IAS 32, we think that the proposals could result in significant changes to the measurement and/or classification of certain financial instruments. Two examples of Canadian entities that could be impacted are as follows:

    (a) As discussed in Question 4, these proposals may impact non-cumulative preferred shares with NVCC features issued by Canadian banks. Based on discussions as part of our outreach activities, applying the proposed measurement approach to NVCC instruments could result in an increase in financial liabilities and reduction in equity of approximately $35-40 billion at Canadian banks. Pending regulatory intervention, the instruments could lose their regulatory capital classification. This would have a significant impact on banks' capital ratios and requirements.

    (b) As discussed in Question 3 and Appendix B, the proposals could result in the reclassification of REIT units that do not qualify for the puttable instrument exceptions from financial liabilities to compound instruments. As a result, the accounting for dividends paid by REITs could also change from being charged as an expense in the P&L, to a charge through equity.

60. If the IASB proceeds with the proposals, we encourage the IASB to provide a significant implementation period – at least 24 months from the date of issuance. This would be critical to ensure that issuers have ample time to consider the effects of the proposals on contracts, renegotiate contracts as needed or make other arrangements to maintain capital requirements and/or other outcomes. Significant time will also be needed for regulators to expose and enact any necessary changes to regulations, if necessary. Furthermore, as highlighted in Question 7, this will also provide time to ensure any overlap between the proposed disclosure requirements and other disclosure requirements outside the financial statements can be addressed efficiently.

Question 10— Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])
The IASB proposes amendments to the draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures], which will be issued before the proposals in the Exposure Draft are finalised. [IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures. The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures. Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

61. We are supportive of the IASB's proposals to amend the draft IFRS Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*] to include the disclosures the Board considers appropriate for eligible subsidiaries. We will continue to monitor the landscape of reporting entities in Canada to understand the applicability of this forthcoming standard.

Appendix B

Examples of the effects of the laws and regulations proposals on various industries in Canada

62. Below we have outlined some Canadian examples that demonstrate the issues we have set out above in Question 1 and the potential effects of the proposals.

Financial institutions

63. Financial institutions in Canada are regulated under the Bank Act, which empowers the Office of the Superintendent of Financial Institutions (OSFI) to set and enforce prudential standards. OSFI issues Guidelines to outline its supervisory expectations and explain how prudential standards must be met. While OSFI has the regulatory authority and tools to enforce its Guidelines, these Guidelines are not set in statute or otherwise prescribed by legislation.

64. For instruments other than common shares to form part of regulatory capital under OSFI Guidelines, a loss absorption feature must be included within the terms and conditions of each instrument. This feature converts the preferred shares into a variable number of shares at a market price (subject to a cap on the number of shares or floor price) when the entity is declared non-viable by OSFI. The specific terms and conditions set out in each contract are reviewed and approved by the regulator. Banks may choose to issue instruments without these terms but are economically compelled to issue instruments that meet the requirements for regulatory capital.

65. Under the current requirements of IAS 32, Canadian banks have concluded that these conversion features are contractual terms when determining the nature and classification of issued instruments. The proposed amendments will require banks to reassess these conclusions and make additional judgments, which may result in new application questions and diversity in practice. Consider regulatory instruments with a loss-absorption feature as noted above. A bank operating in Canada may conclude that the conversion feature is contractual. In another jurisdiction, with a law requiring an identical feature or providing choices between multiple features, the entity may conclude that the feature is not contractual. This may affect the classification assessment as well as the information an entity decides to disclose about its instruments.

Real Estate Investment Trusts

66. Real estate investment trusts (REITs) receive beneficial tax treatment based on their structure. The requirements to qualify as a REIT are dependent, in part, on the REIT maintaining its status as a mutual fund trust for purposes of the Income Tax Act (ITA). The requirements in the ITA are subject to rules and interpretations from the Canada Revenue Agency (CRA).

67. Under the ITA, a mutual fund trust may be an open-end unit trust or a closed-end unit trust. The REIT may choose either structure. However, if the REIT chooses an open-end structure, the ITA requires that at least 95% of the fair market value of the issued units be redeemable at the demand of the holder, at prices determined and payable in accordance with the conditions attached to the units. In addition, the CRA has and can express additional views on various features in the design of these redemption rights.

68. Entities do not need to invest in real estate or structure themselves to meet the requirements of a REIT. However, these entities would not be eligible for the preferential tax treatments (e.g. deducting distributions made to unitholders). Similar to the Canadian financial institution example above, REITs are economically compelled to meet the objectives of the tax rules and interpretations. Further, the requirements in the ITA and the CRA's interpretations may lack specificity.

69. Under the current requirements of IAS 32, these REIT units are not equity instruments. However, REITs may avail themselves of the exceptions in paragraph 16A through 16D of IAS 32 to achieve equity presentation. The proposed amendments will require REITs to reassess these conclusions and make additional judgments which may result in new application questions and diversity in practice. An unintended

consequence of not clarifying the scope of the proposals may be to result in potential changes to the classification of redeemable REIT units.

Credit Unions

70. Each province and territory are responsible for setting the laws and regulations which govern the operation and oversight of credit unions operating in that province or territory. Under these laws and regulations, credit unions are established on a co-operative basis to provide financial services wholly or primarily for their members. Credit unions are required to issue common shares to their members.

71. Similar to instruments issued by banks or REITs, the laws and regulations governing credit unions may require that the features be specified in the governing document of the shares. Membership agreements, bylaws or Articles of Incorporation of the credit union may also include additional terms and conditions as long as they are not contradictory to the requirements of the laws and regulations. One common requirement is for the common shares issued to members to include redemption rights.

72. Currently, based on IAS 32 and IFRIC 2, credit unions often classify their common shares as equity instruments if they have discretion related to redemptions. The proposed amendments will require credit unions to reconsider their facts and circumstances, the source of their discretion and consider the impact on classification. Consider a credit union that issues shares with a redemption clause that requires redemptions to be approved by its Board. It is unclear whether both the redemption feature and discretion to approve redemption would be considered part of laws and regulations. In some cases, the discretion may be considered a requirement of the law or regulation while the specific redemption rights added to the bylaws and terms of the shares are considered part of the contract. We think this outcome may not result in useful information for financial statement users.