CFOFORUM

insurance europe

International Accounting Standards Board
7 Westferry Circus, Canary Wharf,
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26 March 2024

Response on IASB Exposure Draft - Financial Instruments with Characteristics of Equity

Dear Mr Barckow,

This letter has been drafted by the European Insurance CFO Forum ("CFO Forum") which represents the views of Europe's 22 largest insurance companies and Insurance Europe, representing 95% of the premium income of the European insurance market. Accordingly, it represents the consensus view of a significant part of the European insurance industry.

We welcome and appreciate the opportunity to comment on the questions raised in the IASB's Exposure Draft IASB/ED/2023/5 Financial Instruments with Characteristics of Equity Proposed amendments to IAS 32, IFRS 7 and IAS 1, issued by the IASB in November 2023 (the 'ED').

Except the concerns summarised below, the Europe's insurers welcome the IASB's approach to address the issues that arise in practice on classification and the list of issues that the IASB considered in this project.

Our main concern on the IASB Exposure Draft relates to the proposed amendment on obligations to purchase an entity's own equity instruments (e.g. written put-options on non-controlling interest). Indeed, Europe's insurers disagree with the approach suggested by the IASB on their initial accounting as well as their subsequent measurement in profit or loss. We consider that, at initial recognition of the financial liabilities related to these put-options, non-controlling interests should be remeasured, because their value has to be reduced by the corresponding amount reflected in the measurement of the financial liability. Without this remeasurement, the consolidated statement of financial position would show misleading balances that do not represent the economic reality of the parent's obligations. We also consider that having the full impact of remeasurement of the financial liability in profit or loss is not adequate as it does not reflect the substance of the agreement with non-controlling shareholders which relates to an equity transaction (such as described in IFRS 10 for the change in a parent's ownership interest in its subsidiary).

Furthermore, regarding the proposed amendments on:

- the effects of relevant laws or regulations, we believe that they may yield unintended consequences, including potential misleading reclassifications and classification asymmetry between holders and issuers;
- disclosures, we would like to raise that, for insurers, disclosures related to the nature and priority of claims against the entity on liquidation as well as of the characteristics of financial instruments issued do not add any significant or substantial benefit to the users of financial statements while they also create a significant reporting burden on reporting entities;
- presentation of amounts attributable to ordinary shareholders, we believe that the proposed additional requirements do not provide significant benefit for the investors or users of financial statements. In addition, we would raise that there are difficulties on splitting the rights of the different categories of group shareholders at the level of consolidated financial statements.

Our detailed comments and responses to these topics in the ED are set out below.

We would welcome an opportunity to discuss these issues with you and your team.

Yours sincerely,

CFOFORUM

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Chair
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About the European Insurance CFO Forum and its work

The European Insurance CFO Forum ('CFO Forum') is a high-level discussion group formed and attended by the Chief Financial Officers of major European listed, and some non-listed, insurance companies. Its aim is to influence the development of financial reporting, value based reporting, and related regulatory developments for insurance enterprises on behalf of its members, who represent a significant part of the European insurance industry. The CFO Forum was created in 2002.

About the Insurance Europe and its work

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers pay out over €1 000bn annually — or €2.8bn a day — in claims, directly employ more than 920 000 people and invest over €10.6trn in the economy.

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.

European insurers response

With reference to paragraph 15A of the Exposure Draft and to paragraphs BC20 and BC22 of the Basis for Conclusions accompanying the Exposure Draft, the IASB concluded that rights and obligations solely created by laws or regulations should not affect the classification of financial instruments. According to the IASB, such rights and obligations are inherent to all instruments of the same type and cannot be modified by contractual agreement.

However, the application of the Board's current proposals to such instruments may yield unintended consequences, including:

- **Potential misleading reclassifications** to equity of some financial instruments currently classified as financial liabilities because they have contractual terms established by law.
- **Classification Asymmetry:** A discrepancy may arise between the classification applied by the instrument holder (solely based on contractual terms under IFRS 9) and the classification applied by the issuer (considering both contractual terms and legal effects under IAS 32).

It is important to avoid diversity in practice for instruments with similar intrinsic characteristics having different classifications as either equity or financial liability depending on whether their relevant terms (e.g. minimum dividends or termination rights) are solely created by laws or regulations or are contractual terms in addition to the prevalent laws and regulations. We believe that the economic substance of the instrument should be considered in priority when determining its classification.

This potential for uncertainty and inconsistencies therefore warrants further consideration to ensure the effectiveness and coherence of the proposed amendments.

Question 3—Obligations to purchase an entity's own equity instruments (paragraphs 23 and AG27B–AG27D of IAS 32)
The IASB proposes to clarify that: (a) the requirements in IAS 32 for contracts containing an obligation for an entity to purchase its own equity instruments also apply to contracts that will be settled by delivering a variable number of another class of the entity's own equity instruments (paragraph 23). (b) on initial recognition of the obligation to redeem an entity's own equity instruments, if the entity does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates, those equity instruments would continue to be recognised. The initial

amount of the financial liability would, therefore, be removed from a component of equity other than non-controlling interests or issued share capital (paragraph AG27B).

(c) an entity is required to use the same approach for initial and subsequent measurement of the financial liability—measure the liability at the present value of the redemption amount and ignore the probability and estimated timing of the counterparty exercising that redemption right (paragraph 23).

(d) any gains or losses on remeasurement of the financial liability are recognised in profit or loss (paragraph 23).

(e) if a contract containing an obligation for an entity to purchase its own equity instruments expires without delivery:

> (i) the carrying amount of the financial liability would be removed from financial liabilities and included in the same component of equity as that from which it was removed on initial recognition of the financial liability.
>
> (ii) any gains or losses previously recognised from remeasuring the financial liability would not be reversed in profit or loss. However, the entity may transfer the cumulative amount of those gains or losses from retained earnings to another component of equity (paragraph AG27C).

(f) written put options and forward purchase contracts on an entity's own equity instruments 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.

European insurers response

Our main concern on the IASB Exposure Draft relates to the proposed amendment on obligations to purchase an entity's own equity instruments (e.g. written put-options on non-controlling interest). Indeed, we disagree with the approach suggested by the IASB on their initial accounting as well as their subsequent measurement in profit or loss. We consider that, at initial recognition of the financial liabilities related to these put-options, non-controlling interests should be remeasured, because their value has to be reduced by the corresponding amount reflected in the measurement of the financial liability. In this respect we agree with Alternative View supported by Mr. Uhl in paragraph AV5 in the Basis for Conclusion accompanying this ED. Without this remeasurement, the consolidated statement of financial position would show misleading balances that do not represent the economic reality of the parent's obligations. We also consider that having the full impact of remeasurement of the financial liability in profit or loss is not adequate as it does not reflect the substance of the agreement with non-controlling shareholders which relates to an equity transaction (such as described in IFRS 10 for the change in a parent's ownership interest in its subsidiary).

Indeed, the relevance of the proposed amendments might be hindered by the following concerns:

- **Double effect on profit or loss with no economic basis:** First through allocation of the subsidiary's result of the period to the non-controlling interests (for their share) and, second, through the remeasurement of the financial liability reflecting the change in the value of the put-options, therefore, by definition, also including the share of non-controlling interests in the result of the period.
- **Counterintuitive dividend impact:** Dividends distribution creates a confusing outcome where a gain is recognized in the parent's profit or loss (through the remeasurement of the financial liability) against a decrease in non-controlling interests' equity. Instead, only a decrease in the liability carrying amount against the cash outflow should be recognized.

- **Inappropriate measurement of non-controlling interests**: The proposed measurement of non-controlling interests, which ignores the existing put-options, also leads to an illogical impact upon settlement. When the put option liability is settled, all non-controlling interests balance gets reclassified into parent's equity. This effect provides no value to users who generally don't expect a parent's equity increase upon settling a recognized liability.

To address these issues, we propose an **alternative view** that reflects the equity nature of the arrangement, consistently with the IFRS 10 treatment for changes in a parent's ownership interest.

- **At initial recognition of a put-option:**

Recognition of a financial liability with an initial fair value measurement based on the present value of the redemption amount (disregarding any probability of exercise), against:

a) a reduction of the minority interests value for the part concerned by the put-option,
b) and the remaining effect against shareholder's equity Group share for the difference in value between the financial liability and the minority interests' reduction.

- **On subsequent measurement:**

Remeasurement of the financial liability for changes in fair value

a) by adjusting prior year debt for the cash of any dividend payment in the period related to non-controlling interests, then
b) by impacting Group share profit or loss for the part corresponding to the share of non-controlling interests in the result of the period,
c) and the remaining effect by impacting shareholder's equity Group share for the difference between a) and b).

Indeed, in case of a put option at fair value, if the subsidiary generates positive income during the period, this will increase the fair value of the financial liability. This evidences that the fair value of the financial liability includes the non-controlling interests' share in the result of the period. Therefore, it's consistent to record this impact in profit or loss.

In conclusion, we urge the IASB to reconsider its proposal, aligning them with the nature of the transactions and avoiding unnecessary volatility and counterintuitive effects.

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.

European insurers response

We would recommend amending the wording for contingent settlement provisions to clarify that only compound instruments are in scope of the new guidance.

Furthermore, there might be financial instruments in practice containing a contractual obligation to be settled upon a contingent event. At inception, the settlement amount includes several possible future cash flows with assigned probabilities which might differ from the consideration received. It is not explicitly clear from the definition of contingent settlement provisions (IAS 32.25) that contractual obligations for which various cash flow settlement scenarios are conceivable at inception (i.e. various probability-weighted individual cases) are excluded. However, even if the scenario with the maximum obligation possible is considered unlikely under economic considerations (but not as 'non genuine'), the maximum obligation possible would be relevant for the initial measurement of the liability instrument according to the ED. We have strong concerns relating to the economic substance which we think is not reflected appropriately under the approach proposed by the ED. Further, disregarding probabilities when determining the fair value does not seem to be consistent with the measurement requirements of IFRS 9 and IFRS 13. In general, IFRS 9.5.1.1 requires the initial measurement of financial instruments at fair value (not nominal or highest possible amount).

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 recognised in equity.
>
> (iii) measure an equity instrument reclassified from a financial liability at the carrying amount of the financial liability at the date of reclassification. No gain or loss would be recognised on reclassification (paragraph 32D).

(c) provide examples of changes in circumstances external to the contractual arrangement requiring reclassification (paragraph AG35A).

Paragraphs BC126–BC164 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to reclassify the instrument prospectively from the date when a change in circumstances occurred give rise to any practical difficulties? If so, please describe those practical difficulties and the circumstances in which they would arise.

European insurers response

Europe's insurers are generally supportive of the proposals in the exposure draft.

However, we would recommend permitting reclassification for passage of time adjustments, currently prohibited in the ED, which would bring the proposed treatment in line with some current relevant practice. Indeed, the prohibition of reclassification in respect of contractual terms that become, or stop being, effective with the passage of time could result in the provision of misleading information. This is because continuing recognition of a financial liability in such circumstances may no longer faithfully represent the substance of the financial instrument. Example circumstances include the expiry of a contingent settlement provision and a change in terms that results in the instrument meeting the criteria for equity classification.

Question 7—Disclosure (paragraphs 1, 3, 12E, 17A, 20, 30A30J 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.

European insurers response

Europe's insurers would like to raise that, for insurers, disclosures related to nature and priority of claims against the entity on liquidation as well as of the characteristics of financial instruments issued will be a significant operational challenge burdensome to comply with.
We recommend not to proceed with the proposed disclosures requirements in the ED, because they do not add any significant or substantial benefit to the users of financial statements while they create a significant reporting burden on reporting entities.

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.

European insurers response

We understand that the additional information required about amounts attributable to ordinary shareholders may be relevant to individual IFRS accounts, and it is easy to determine the respective rights of the ordinary shareholders and other shareholders. However, we see difficulties in providing these additional requirements at the level of consolidated accounts, with issues in splitting the rights of the different categories of group shareholders over the different natures of consolidated amounts; the allocation would be artificial and could lead to misleading information.

We therefore believe that there is no necessity to clarify IAS 1, since the proposed additional requirements do not provide significant benefit for the investors or users of financial statements. We recommend IASB to reconsider these new presentation requirements' proposals.