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Submitted via the IFRS website

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Subject: IAIS' response to the IASB's exposure draft on proposed amendments to Financial Instruments with Characteristics of Equity

Dear Dr Barckow:

The International Association of Insurance Supervisors (IAIS) welcomes the opportunity to comment on the recent International Accounting Standards Board (IASB) exposure draft on proposed amendments relating to Financial Instruments with Characteristics of Equity (FICE), issued in November 2023.

As the IASB assesses the proposed amendments made to address the existing challenges in companies' financial reporting on FICE, it may wish to consider the following points:

General

Overall, the IAIS is supportive of the IASB clarifying the FICE principles as well as dealing with some of the common practice issues that have arisen in relation to FICE without fundamentally changing the approach.

Requirements relating to FICE are relevant for insurers given that the classification of instruments as debt or equity impacts both the general user views with respect to financial position, and the views of prudential regulators. Many insurers issue financial instruments that have elements of debt and equity, for example hybrid capital instruments that often are similar to the more widely-known "Additional Tier 1" (AT1) for banks.

Laws and regulations

It seems clear that, in classifying a financial instrument, an entity would not consider contractual terms that replicate legal requirements that would have effect regardless of whether the term is included in the contract (paragraph 15A). However, there are several other areas where the IAIS thinks that the principles should apply in relation to laws and regulations and the application of paragraph 15A could usefully be clarified. This includes circumstances where:

- Firms are required to include a specific term in the contract, but legislation may not otherwise automatically give effect to such a clause. Establishing the approach in these circumstances would help to clarify the accounting considerations for circumstances where contractual clauses are required in order to give effect to a bail-in for foreign law contracts (ie bail-in recognition clauses). In such cases, contractual rights and obligations exist; however, given the guidance in AG24A about the potential for negotiation, it may not be clear whether these contractual rights should affect the classification of the financial instrument.
- Firms are not required to issue particular instruments but choose to do so. For example, financial institutions could be viewed as required to include certain contractual terms to meet a regulatory capital classification but are able to issue instruments without those terms if they wish (eg a hybrid capital instrument, similar to AT1).
- The contractual terms of the instruments are more specific than those specified by the law but are still a term that is envisaged by the law. It would be useful to clarify whether these would be considered in the classification of the instrument. For example, this could include circumstances where legislation requires one of several contractual terms (e.g. a conversion or write-down) and one of those is selected for the contract. Clarity could be provided as to whether these would be viewed as contractual rights and obligations that are "in addition to" those created by relevant laws or regulations…" (paragraph 15A).
- The instrument is strongly regulated by applicable laws and regulations, and there are few contractual terms and conditions that can be considered as "in addition to".

The principles relating to laws and regulations are largely included in paragraph 15A with some additional guidance in paragraph A24. However, this approach increases reliance on the "Basis for Conclusions" in trying to understand the principles to apply. In clarifying the principles, the IAIS would encourage the IASB to make sure that these are clear in the standard rather than relying on what constitutes "Basis for Conclusions" to the extent possible. For example, it would be appropriate to further specify the scope of what constitutes relevant laws and regulations. For financial institutions this may include guidance issued and enforced by a relevant competent authority, such as a financial institution's prudential regulator who has statutory authority to enforce the contractual clauses.

In addition, the examples that are used in relation to the bail-in power and specific conversion triggers relating to AT1 are unclear, as these are quite different issues. It would be useful for the IASB to extend its use of examples to more clearly set out the principles that are relevant and include worked examples in the standard.

The IAIS supports the Board's view as mentioned in paragraph B30 that the clarification proposed is consistent with the principle in paragraph 8 of IFRIC 2, that if redemption of an instrument is unconditionally prohibited by local law, regulation or an entity's governing charter, the instrument is classified as equity.

Reclassification of financial liabilities and equity instruments

The IAIS notes that a prohibition in relation to the reclassification of financial instruments due to the passage of time could lead to a lack of comparability between similar instruments (paragraphs 32B-32D), as contractually identical instruments could be treated differently for instance after the expiration of time limited clauses. The IASB may wish to consider further whether any perceived advantages of this approach exceed the disadvantages of doing so.

Contingent settlement provisions

The IAIS welcomes the attempt to reduce diversity of accounting practice in this area. However, we think that there may be some complexity and unintended consequences with a new measurement model in IAS 32 that is not fair value and is not the same as amortised cost. For example there could be a potential conflict with IFRS 9 paragraph 5.1.1 relating to the treatment of transaction costs. In addition, for some instruments in certain jurisdictions, this new measurement model could be perceived as inconsistent with the IASB's intention to clarify the standard without fundamentally changing IAS 32.

For a basic instrument that is both convertible into shares for the full value of principal and can be converted immediately, the accounting treatment is straightforward. However, there may be other cases that are much more complex (eg different settlement amounts at different dates, uncertain first dates). Further clarification on how to determine the discount rate and the discounting period to be used in calculating the present value of the settlement amount would be helpful, particularly in cases where the contingent event has yet to occur.

Disclosures

The IAIS sees value in enabling 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. Although resolution frameworks for insurers are typically less developed than those for banks, understanding the ownership structure remains relevant whether or not resolution powers are currently in place.

Transition

Given that time may be needed to adjust to the new standard, the IAIS encourages the IASB to consider providing sufficient time for the implementation of the standard.

In addition, as changes in classification might lead to discontinuation in hedging relationships, the IAIS encourages the IASB to consider providing specific transitional arrangements related to hedge accounting.

This comment letter was prepared on behalf of the IAIS by its Accounting and Auditing Working Group (AAWG) chaired by Markus Grund of BaFin, in consultation with IAIS Members. If you have further questions regarding this letter, please contact Lydia Kimumwe at the IAIS Secretariat (tel: +41 61 280 8679; email: lydia.kimumwe@bis.org).

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About the IAIS

The IAIS is a global standard-setting body whose objectives are to promote effective and globally consistent supervision of the insurance industry to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders and to contribute to the maintenance of global financial stability. Its membership includes insurance supervisors from more than 200 jurisdictions. Learn more at www.iaisweb.org.