STAFF PAPER

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IASB® meeting

Project	**Financial Instruments with Characteristics of Equity (FICE)**		
Paper topic	Disclosures: Potential refinements—Terms and conditions		
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Purpose of this paper

1. In this paper the staff recap some of the key concerns raised and suggestions made by stakeholders on the proposals related to terms and conditions set out in 2018 Discussion Paper *Financial Instruments with Characteristics of Equity* (2018 DP) and then present potential refinements for to address some of these concerns and suggestions. The staff also provide feedback from additional outreach conducted with stakeholders to discuss these potential refinements. Based on the additional feedback and the staff's analysis, the staff then present their views on the way forward.

2. This paper is structured as follows:

    (a) 2018 DP proposal and feedback (paragraphs 3–4);

    (b) potential disclosure refinements, which include a summary of feedback from further outreach with stakeholders (paragraphs 5–15);

    (c) next steps (paragraph 16); and

(d) question for the Board (paragraph 17).

2018 DP Proposal and feedback

3. The Board's preliminary view was that information about terms and conditions affecting the amount and timing of cash flows of both financial liabilities and equity instruments would be useful if provided in the notes to the financial statements. The objective of these disclosures was to help users of financial statements make assessments of the company's financial position and performance by considering the effects of financial instruments issued by the company on its liquidity and solvency. The 2018 DP provided examples of terms and conditions that are relevant to determining the timing and amount of cash flows of a financial instrument, for example, if the issuer has an option to redeem an instrument earlier than its maturity, the timing and the amount of the redemption and if it depends on a trigger event, the description of that event.

4. The following challenges were raised in the 2018 DP feedback:

   (a) concerns about disclosure overload especially for:

      (i) multinational entities which have a large number of issued instruments. If disclosure requirements are complex and excessive, they may result in obscuring other information that might be useful to users of financial statements.

      (ii) regulated entities that already provide information about contractual terms and conditions of financial liabilities and equity instruments as part of their regulatory reporting under regulatory frameworks applicable for financial institutions, eg Basel III Pillar 3 for banks. They are also required to disclose highly detailed and granular information about the terms and conditions of TLAC instruments. Market participants often complain that volumes of disclosure continue to balloon with little or no incremental benefit to them as users of financial statements.

   (b) concerns that the proposed requirements will not provide users of financial statements with all the information that they find useful. For example, users of financial statements are primarily interested in understanding:

(i) the uncertainty about future cash flows of the entity;

(ii) significant restrictions on an entity's ability to transfer funds to shareholders or repay debt; and

(iii) the voting rights attached to financial instruments. Some users of financial statements consider voting rights to be one of the features that distinguishes equity from financial liabilities because they associate voting rights with the ownership of an entity.

(c) when financial instruments have many features, it is often difficult to understand what the key features are that lead to the classification of equity or financial liability.

Potential disclosure refinements

5. Based on the feedback on the 2018 DP the staff developed the following disclosure refinements for the additional outreach conducted in 2020. Disclose in a single note to the financial statements:

(a) for capital instruments issued for longer term funding purposes—the key terms and conditions affecting the nature, timing, amount and uncertainty of future cash flows eg conditions that trigger early redemption or conversion into ordinary shares, step-up clauses, terms that allow for payment deferrals;

(b) for instruments where classification involves judgement because instruments have characteristics of both equity and debt—the key features that led to the classification;

(c) information about any voting rights.

6. The information can be provided in a tabular format ie a table of key terms where possible. Cross references can be made to other statements where information is available at the same time and on the same terms as the financial statements.

7. A simplified example of the potential disclosure refinements is as follows:

Company X issues a perpetual bond. Key terms and conditions that affect its cash flows are as follows:

Nature	Timing	Amount	Uncertainty
Coupon	Semi-annually	5% per annum	Company X may defer interest payment at its discretion. Any deferred amounts accumulate and are added to the amount payable at the earlier of the redemption of the instrument or at the liquidation of Company X.
Principal repayment	Contractually due at the liquidation of Company A	Par value of £1 million if paid at liquidation of the entity	Company X holds a call option that can be exercised at the fifth anniversary after the issuance of the instrument. If called, the instrument is redeemable at 101% of the par value plus any unpaid and accumulated interest.

The perpetual bond carries no rights of conversion into ordinary shares of Company X and no right to attend or vote at shareholder meetings of Company X.

The perpetual bond is classified as an equity instrument because the issuer has no contractual obligation to deliver cash or another financial asset in any circumstances outside its control, except in the event of the liquidation of Company X.

Scope

8. In light of concerns about disclosure overload, the staff sought views from stakeholders whether the scope of the terms and conditions disclosure should be limited, and if so, how. As a potential option, the staff asked stakeholders whether the scope should be limited to capital instruments issued for long-term funding purposes.

9. Users of financial statements were generally supportive of these disclosures and particularly, the disclosure of key features that led to classification for complex financial instruments such as perpetual instruments. They highlighted the following:

(a) limiting the scope of the disclosure would be vital. However, large financial institutions would need to make a lot of disclosure even if the scope was limited to capital instruments issued for long-term funding purposes.

(b) regulatory disclosures are already required for financial institutions.

(c) a summary of terms would be useful to highlight differences between instruments.

(d) Complex instruments eg perpetual instruments need better disclosures to understand their classification. The disclosures should therefore focus on complex instruments because the terms for other types of instruments can be obtained relatively easily from financial data vendors such as Bloomberg.

(e) it is very useful to know when potential cash flows take place especially for companies in financial trouble.

(f) disclosure of voting rights is important.

(g) relevant information may be hard to find for instruments issued a long time ago because older offering documents are not always available.

10. Most preparers agreed that the scope should be clearly defined to avoid disclosure overload. A suggestion was made that disclosing the specific terms giving rise to the classification across similar instruments would be more manageable. Some preparers questioned which instruments are subject to significant judgment because not everyone has the same judgement.

11. Some standard setters expressed support for aligning the proposed disclosures with the current requirements in paragraph 122 of IAS 1 (disclosure of significant judgements made) and limiting the scope of the disclosures to financial instruments for which classification involves significant judgement rather than all capital instruments issued for longer term funding. In addition, a standard setter suggested it may be better to specify the specific instruments that are subject to the disclosures to avoid creating diversity in practice.

12. As highlighted by many stakeholders, the staff think that the scope should be defined carefully for the resulting information from this disclosure to be useful. While we acknowledge the option to limit the scope to financial instruments for which classification involves significant judgement, it may be difficult to clearly specify how significant the judgement needs to be to require the disclosure. This is because for some instruments, there might not be any ‘judgement’ about classification. For example, perpetual instruments have characteristics of both equity and financial liabilities but classification hinges on one specific contractual term, namely the contractual ability to avoid making payment. Inconsistent

application of the scope would result in lower comparability and is not likely to result in useful information across different entities.

13. Therefore the staff are considering limiting the scope of the disclosure on terms and conditions to particular financial instruments that are more complex to understand because they have characteristics of both equity and debt. In addition, based on feedback from users of financial statements, the staff believe disclosure of all financial instruments that carry current or potential voting rights should be required. The discussion on perpetual financial instruments would also be relevant in considering the scope. See Agenda Papers 5E-5F of this meeting.

Old disclosure requirements in IAS 32

14. Some preparers highlighted that similar disclosure requirements existed in a previous version of IAS 32 (pre-IFRS 7) and questioned why they were removed when IFRS 7 was issued. The staff's research revealed that the Board considered that the IFRS 7 disclosure of a sensitivity analysis for market risk provided more useful information than the following requirements previously in IAS 32 that are intended to satisfy the same user needs:

    (a) disclosures of terms and conditions of financial instruments; and

    (b) disclosures about exposure to interest rate risk including contractual repricing or maturity dates.

15. Accordingly, the Board decided to delete these requirements. However, the complexity and variety of financial instruments have changed considerably since IFRS 7 was introduced, with new instruments and/or features being developed frequently. The staff therefore believe that adding disclosures about the terms and conditions of particular financial instruments would provide useful information to users of financial statements to understand the classification of those financial instruments and their impact on the future cash flows of the entity.

Next steps

16. Subject to the Board's feedback at this meeting, the staff plan to further analyse some aspects of the disclosure set out in the previous section for the Board's discussion at a future meeting. In particular, the staff plan to analyse potential ways to reduce the scope of this disclosure.

Question for the Board

17. The staff would like to ask the Board the following question.

Questions for the Board
Do Board members have any comments or questions on the staff's analysis and views on potential disclosure refinements and next steps set out in this paper?