Introduction

1. At its April 2021 meeting, the Board discussed further refinements to disclosure proposals explored in its 2018 Discussion Paper Financial Instruments with Characteristics of Equity (the 2018 DP), including for priority on liquidation disclosures. At that meeting, the Board discussed responding to two separate needs of users of financial statements with two separate sets of disclosure proposals, namely disclosures of information on an entity’s ‘capital structure’ (ie the nature and priority of claims against the entity) and information on terms and conditions about the priority on liquidation for particular types of financial instruments. The Board asked the staff to clarify some aspects of the proposals, particularly relating to the capital structure disclosures.

2. The staff’s recommendations regarding the disclosures of the nature and priority of claims against entity are broadly consistent with what was proposed in April 2021. However, in this paper the staff propose updated wording for the objective and a revised scope and clarify what information should be provided.

3. The staff’s recommendations regarding the disclosure of terms and conditions about priority on liquidation of some types of financial instruments, remain the
same as what was proposed in April 2021. However, in this paper the staff include some clarifications about the information to be provided.

4. For the avoidance of doubt, although the disclosures set out in this paper are in the context of a consolidated set of financial statements, they would equally apply to the separate set of financial statements as would other IFRS disclosure requirements, in the absence of specific requirements in this regard.

5. This paper is structured in the following way:

   (a) summary of the staff’s recommendations (paragraphs 6–8);

   (b) disclosures about the nature and priority of claims against the entity that arise from financial instruments (paragraphs 9–22);

   (c) disclosure of terms and conditions about priority on liquidation for particular financial instruments (paragraphs 23–30);

   (d) illustrative example (paragraph 31); and

   (e) question for the Board (paragraph 32).

Summary of the staff’s recommendations

6. In this paper, the staff recommend two sets of disclosure requirements to be incorporated into IFRS 7 Financial Instruments: Disclosures. The staff recommend that the Board requires an entity to provide these disclosures in the notes. Any quantitative information would be based on the carrying amounts of the financial instruments at the reporting date with an indication of which line item in the statement of financial position the financial instruments are included in, if not otherwise clear.

7. To provide information about the nature and priority of claims against an entity that arise from financial instruments, the staff recommend the Board requires:

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1 In the 2018 DP, the Board had considered and asked for feedback on whether the information about priority should be provided on the face of the statement of financial position. Most respondents supported providing such information in the notes instead. See Agenda Paper 5B of the July 2019 Board meeting.
(a) the disclosures to apply to all financial liabilities and equity instruments that are within the scope of IAS 32 *Financial Instruments: Presentation*;

(b) an entity to categorise its claims that are financial instruments in a way that reflects differences in their nature and priority, and at a minimum, distinguish between:

(i) secured and unsecured financial instruments;

(ii) contractually subordinated and unsubordinated financial instruments; and

(iii) those issued/owed by the parent and those issued/owed by subsidiaries.

8. To provide information about the risks and returns of particular instruments in the event the entity is liquidated, the staff recommend the Board requires:

(a) disclosure to apply to all financial instruments with characteristics of both debt and equity (including compound instruments) except for standalone derivative instruments.

(b) disclosure of the following information together with disclosures on terms and conditions of financial instruments:

(i) terms and conditions that indicate priority on liquidation;

(ii) terms and conditions that could lead to changes in priority on liquidation;

(iii) if applicable, a description of multiple levels of contractual subordination that exist within a particular type of financial instrument (for example, if some subordinated liabilities contractually subordinated to other subordinated liabilities);

(iv) narrative disclosures when there is significant uncertainty about the application of relevant laws or regulations that could affect how priority will be determined on liquidation; and
(v) details of intragroup arrangements such as guarantees that may affect their priority on liquidation (for example, which entities are providing and receiving guarantees).

Disclosures about the nature and priority of claims against the entity that arise from financial instruments

Disclosure objective

9. In the staff’s paper discussed in April 2021, the objective of these disclosures was phrased as “to enable investors to better understand an entity’s capital structure facilitating the assessment of the strength of the entity’s financial position, the nature of the claims against the entity’s assets and how those claims affect the liquidity and solvency of the entity.”

10. The term ‘capital structure’ is a widely used term in the investor community and it typically indicates the way an entity finances its assets through some combination of equity, debt, or ‘hybrid’ instruments. It is also referred to as the mix of different sources of long-term funds such as equity shares, preference shares, long term debt, and retained earnings. Although there appears to be a shared understanding on the general meaning of the term, the staff do not think it is sufficiently precise to define the scope of a disclosure requirement in IFRS Standards. Some questions may arise around the boundary of what falls within or outside of an entity’s capital structure. In addition, the term ‘capital’ is commonly used in regulatory disclosures for financial institutions and IAS 1 Presentation of Financial Statements contains requirements for disclosing an entity’s capital and capital management.

11. Although it might be possible to define the meaning of ‘capital structure’ for the purpose of this particular disclosure requirement, we think there would be a risk of causing confusion for users of financial statements due to the terms ‘capital structure’ and ‘capital’ already being commonly used outside and inside financial reporting. For this reason, the staff is of the view that it would be better to rephrase the disclosure objective to be specific about the information the disclosure requirement is aimed at rather than using the term ‘capital structure’.
12. The staff therefore propose describing the objective of this disclosure as “to provide information about the nature and priorities of claims against an entity that arise from financial instruments”. Such information would facilitate an assessment of the potential allocation of any shortfall in an entity’s economic resources among the financial instruments and the strength of its financial position.

Scope

13. In April 2021, the staff recommended that this disclosure be made for the particular combination of debt and equity used by an entity to fund/finance its overall business activities and operations. Some Board members expressed views that the scope needs to be defined more clearly with a preference for a broader scope that incorporates all sources of finance, even if some of them may arise from ‘operating activities’ of an entity.

14. The recommended disclosure was intended to respond to requests from investors and other stakeholders for the disclosure of information that focuses on financial instruments used as long-term sources of funding. However, the staff acknowledge that it may not always be clear which sources of funding should be considered as long-term. Introducing a bright line threshold, eg funding sources repayable after 12 months, may not adequately capture the nature of the funding sources because instruments repayable on demand or within 12 months may also be a recurring source of funding. A good example to consider is supply chain financing which is becoming increasingly common, illustrating that the boundary of what was traditionally considered as funding sources, is becoming less clear.

15. The staff think the most straightforward way to ensure the disclosure requirement applies to all relevant financial instruments would be to require disclosure for all financial liabilities and equity instruments of the entity that are within the scope of IAS 32. Scoping the disclosure requirements in this way would also help to ensure information provided is comparable, both from period to period for a reporting entity and in a single reporting period across entities.
16. The staff note that the following financial liabilities are scoped out of IAS 32: 2

(a) employers’ obligations arising from employee benefit plans, to which IAS 19 *Employee Benefits* applies;

(b) insurance contracts as defined in IFRS 17 *Insurance Contracts* or investment contracts with discretionary participation features within the scope of IFRS 17 (other than those specified in paragraph 4(d)(i)–(v) of IAS 32); and

(c) financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies (other than those specified in paragraph 4(f)(i)–(ii) of IAS 32).

**What information should be provided?**

17. Consistent with the proposals discussed in April 2021 (see paragraph 16 of *Agenda Paper 5B*), the staff recommend that an entity be required to categorise its claims that are financial instruments in a way that reflects differences in their nature and priority. At a minimum, an entity would be required to distinguish between:

(a) secured (ie collateralised) and unsecured financial instruments;

(b) contractually subordinated and unsubordinated financial instruments; and

(c) those issued/owed by the parent and those issued/owed by subsidiaries.

18. To meet the disclosure objective as set out in paragraph 12 of this paper, an entity needs to determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation, the terminology it uses to describe the various categories of the financial instruments and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed.

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2 IFRS 7 *Financial Instruments: Disclosures* scopes out similar types of financial liabilities as well as financial instruments classified as equity instruments. In addition, IFRS 7 applies to unrecognised financial instruments. If the proposed disclosures discussed in this meeting and in April 2021 were to be finalised and incorporated into IFRS 7, the scope paragraph of IFRS 7 would be amended accordingly for the purpose of these specific disclosures.
19. In relation to the proposed requirement in paragraph 17(a) of this paper, the staff note that an entity should be able to identify which financial instruments are secured (ie collateralised) based on their contractual terms. In addition, paragraph 14 of IFRS 7 already requires disclosure of the carrying amount of financial assets pledged as collateral for liabilities and the terms and conditions relating to its pledge.

20. In relation to the proposed requirement in paragraph 17(b) of this paper, the staff would like to highlight that an entity would not be required to analyse the relative ranking of the financial instruments at an individual entity or a consolidated level. The proposed requirement means that an entity would highlight which financial instruments have contractual subordination. For example, if the contractual terms of trade payables and term-loans of an entity do not include a clause that they are contractually subordinated to other claims against the entity, the entity would not be required to disclose a relative ranking of these financial liabilities. They would be disclosed as part of an ‘unsubordinated’ category—separately for secured and unsecured and separately for issued/owed by the parent and by subsidiaries.

21. Consistent with the proposals discussed in April 2021 (see paragraphs 20-21 of Agenda Paper 5B), the staff recommend the information is provided:

(a) on a consolidated basis in the consolidated financial statements—although a breakdown is required between those issued/owed by the parent and those issued/owed by subsidiaries, no individual subsidiary entity level breakdown would be required; and

(b) based on the carrying amounts of the financial instruments.

22. As discussed in April 2021 (see paragraph 19 of Agenda Paper 5B), the staff note that banks and other financial institutions could (but would not be required to) use existing regulatory capital disclosures as a starting point for the information specified in paragraph 17 of this paper (eg subordination of some financial instruments). The staff continue to believe that categorisation based on the loss absorption capacity of different tiers of regulatory capital is relevant to understanding the nature and priorities of claims against an entity, in particular, how shortfalls in the entity’s economic resources will be allocated among those claims. However, the staff do not think the regulatory disclosures can be a
complete substitute for the disclosures proposed in paragraph 17 of this paper. An entity would need to provide additional information to meet the requirements to the extent they are not provided by existing disclosures.

**Terms and conditions about priority on liquidation for particular types of financial instruments**

23. The staff’s recommendations for this set of disclosures remain unchanged from April 2021. The objective of these disclosures would be to enable users of the financial statements to understand the risk and returns of particular instruments in the event the entity (ie the entity that issues the particular instruments) is liquidated.

24. Consistent with the proposals discussed in April 2021, the staff continue to recommend that the scope of this set of disclosures should be aligned with the scope of the disclosures on terms and conditions discussed in Agenda Paper 5A of the April 2021 Board meeting ie financial instruments with characteristics of both debt and equity including compound instruments but excluding stand-alone derivatives. Information to be disclosed would include, at a consolidated entity level:

(a) terms and conditions that indicate priority on liquidation;

(b) terms and conditions that could lead to changes in priority on liquidation (for example, conversion or contingent features);

(c) if applicable, a description of multiple levels of contractual subordination that exist within a particular type of financial instrument (for example, if some subordinated liabilities are contractually subordinated to other subordinated liabilities);

(d) narrative disclosures when there is significant uncertainty about the application of relevant laws or regulations that could affect how priority will be determined on liquidation for these financial instruments; and

(e) details of intragroup arrangements over these financial instruments such as guarantees.
Where relevant, an entity would be required to provide the above information based on the carrying amounts of the financial instruments and if not otherwise clear, an indication of which line item in the statement of financial position the financial instruments are included in.

25. If the Board agrees with the staff’s recommendation to align the scope of the disclosures with the scope of the disclosures on terms and conditions the Board tentatively agreed on in the April 2021 meeting, an entity would provide information about priority on liquidation as part of the disclosures on terms and conditions. An entity would therefore use the same level of aggregation or disaggregation it uses for the disclosures on terms and conditions.

26. When determining the appropriate level of aggregation, an entity would group financial instruments on the basis that they have similar terms and conditions. There is an expectation that financial instruments with similar terms and conditions would have the same priority on liquidation. However, if financial instruments with similar terms and conditions do not have the same priority on liquidation, the staff propose (see paragraph 24(c) of this paper) that an entity would be required to describe the multiple subordination levels that exist to enable users of financial statements to understand the differences in priority on liquidation. For example, an entity would disclose that some subordinated liabilities are contractually subordinated to other subordinated liabilities, or that contractually-linked notes have multiple tranches with different levels of priorities.

27. The staff is of the view that such disclosure would alleviate concerns about disclosure overload and achieve a better balance between the costs to preparers and the benefits to the users of financial statements than requiring entities to analyse and disclose the relative ranking of the individual financial instruments or tranches of a financial instrument. By alerting users of the financial statements that such multiple levels of contractual subordination exist, they would be able to decide if they want to undertake further analysis of the relative ranking of those particular financial instruments by reading the prospectus or term sheets. The example in paragraph 31 of this paper illustrates how an entity may disclose that multiple levels of subordination exist within a particular type of financial instruments.
28. Multiple levels of subordination may also exist structurally when financial instruments are issued by different entities within the group. For example, if bonds are issued by the parent and by an operating subsidiary, those issued by the subsidiary would have a higher priority claim over the subsidiary’s assets than those issued by the parent. The proposed requirement in paragraph 24(c) of this paper would apply only to contractual subordination. Information that is relevant to understanding structural subordination would be provided through the first set of disclosures discussed this paper, in particular the proposed requirement in paragraph 17(c) of this paper which requires a breakdown between financial instruments issued/owed by the parent and those issued/owed by subsidiaries as well as the requirement proposed in paragraph 24(e) of this paper.

29. Intragroup arrangements such as intercompany guarantees may affect the priority of financial instruments with characteristics of debt and equity and should be disclosed (see paragraph 24(e) of this paper). For example, a parent may guarantee a financial instrument issued by a subsidiary to an entity outside the group (ie the holder of the instrument issued by the subsidiary). Examples of relevant information would include which entities are providing and receiving the guarantees.

30. The staff are aware that some stakeholders question whether the information about priority of financial instruments on liquidation can be provided on a consolidated basis. The staff understand that this question arises because it is the individual entity that is liquidated and not the group. In addition, the prospectus or term sheet of a financial instrument describes a financial instrument’s priority relative to other claims of that issuer, ie at an individual entity level. The proposed disclosure would require terms and conditions that indicate priority of financial instruments (see paragraph 24(a) of this paper) rather than an analysis of order of priority of each financial instrument. Just as terms and conditions that commonly apply to an aggregated group of financial instruments can be disclosed in the consolidated financial statements, the staff believe terms about priority can also be disclosed for a consolidated account balance in a manner that does not depend on the specific types of instruments issued by an individual entity. For example, an entity would disclose that subordinated liabilities issued by entities within the group rank junior to unsubordinated obligations of the respective issuer and rank
senior to ordinary shares and, if any, preference shares of the respective issuer. The staff therefore propose disclosure of terms and conditions about priority on liquidation in relation to a consolidated account balance.

**Illustrative example**

31. Consider the following example of how both sets of disclosures discussed in this paper could be provided in the consolidated financial statements.

### Note 12 Nature and priority of claims arising from financial instruments

<table>
<thead>
<tr>
<th>Issued/owed by</th>
<th>As of 31 Dec 2020 (CU million)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Consolidated</td>
</tr>
<tr>
<td><strong>Secured and unsubordinated</strong></td>
<td></td>
</tr>
<tr>
<td>Senior secured debt (a)</td>
<td>1,200</td>
</tr>
<tr>
<td>Lease liabilities (a)</td>
<td>920</td>
</tr>
<tr>
<td><strong>Unsecured and unsubordinated</strong></td>
<td></td>
</tr>
<tr>
<td>Trade and other payables</td>
<td>1,450</td>
</tr>
<tr>
<td>Senior unsecured debt (a)</td>
<td>450</td>
</tr>
<tr>
<td><strong>Unsecured and subordinated</strong></td>
<td></td>
</tr>
<tr>
<td>Subordinated liabilities (see note 15)</td>
<td>590</td>
</tr>
<tr>
<td><strong>Classified as financial liabilities</strong></td>
<td>4,610</td>
</tr>
<tr>
<td><strong>Unsecured and subordinated</strong></td>
<td></td>
</tr>
<tr>
<td>Perpetual notes (see note 18)</td>
<td>200</td>
</tr>
<tr>
<td>Irredeemable preference shares (See note 19)</td>
<td>500</td>
</tr>
<tr>
<td>Non-controlling interest</td>
<td>1,250</td>
</tr>
<tr>
<td>Shareholders’ equity</td>
<td>8,500</td>
</tr>
<tr>
<td><strong>Classified as equity</strong></td>
<td>10,450</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>15,060</td>
</tr>
</tbody>
</table>

(a) They are included in the 'Borrowings' line item in the statement of financial position.

### Note 15 Subordinated liabilities

<table>
<thead>
<tr>
<th>As of 31 Dec 2020 (CU million)</th>
<th>As of 31 Dec 2019 (CU million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR100mil 7.125% subordinated notes due 2025</td>
<td>110</td>
</tr>
<tr>
<td>GBP250mil 6.75% senior subordinated notes due 2030</td>
<td>230</td>
</tr>
<tr>
<td>USD225mil 7.20% subordinated notes due 2033</td>
<td>165</td>
</tr>
<tr>
<td>Other subordinated liabilities each less than CU50 millio</td>
<td>85</td>
</tr>
<tr>
<td><strong>Total subordinated liabilities</strong></td>
<td>590</td>
</tr>
</tbody>
</table>

In the event of the respective issuer’s liquidation, any amounts due in respect of the subordinated liabilities rank junior to all present and future unsubordinated claims of the respective issuer and rank senior to the respective issuer’s
ordinary shares, and if any, preference shares and perpetual notes. Subordinated liabilities listed in the table above do not rank pari passu with one another. Some subordinated liabilities are contractually subordinated to other subordinated liabilities.

[other key terms and conditions as discussed at the April 2021 Board meeting, for example, ‘equity-like’ features in these liabilities and the features that determine their financial liability classification]

**Question for the Board**

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

<table>
<thead>
<tr>
<th>Questions for the Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the Board agree with the staff’s recommendations set out in paragraphs 6–8 of this paper?</td>
</tr>
</tbody>
</table>