IFRS Accounting

Staff paper

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IASB® meeting

Date	**July 2025**
Project	**Financial Instruments with Characteristics of Equity (FICE)**
Topic	**Detailed feedback and staff analysis—effects of relevant laws or regulations**
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Purpose of the paper

1. In this paper the staff:
   (a) summarises the feedback from comment letters and outreach on the proposals about the effects of relevant laws or regulations in the Exposure Draft *Financial Instruments with Characteristics of Equity* (the ED) issued in November 2023; and
   (b) provides our analysis and recommendation on this topic.

2. At this meeting we will ask the IASB whether it agrees with the staff recommendation.

3. This paper is structured as follows:
   (a) staff recommendation;
   (b) questions for the IASB;
   (c) background and questions in the ED;
   (d) summary of feedback; and
   (e) staff analysis.

4. The Appendix to this paper provides, for reference purposes, the text of draft paragraphs 15A and AG24A–AG24B of IAS 32 and draft paragraph B5A of IFRS 7 in the ED.

Staff recommendation

5. The staff recommends that the IASB not proceed with, and therefore withdraw, the proposed requirements related to the effects of relevant laws or regulations on the classification of financial instruments as set out in the ED. We recommend maintaining the status quo at the present time.

Questions for the IASB

Questions for the IASB
1. Do you have any questions on the summary of feedback set out in paragraphs 9–38 of this paper or the staff analysis set out in paragraphs 39–55 of this paper? 2. Do you agree with the staff's recommendation summarised in paragraph 5 of this paper?

Background and questions in the ED

6. The definitions of a financial asset and a financial liability in paragraph 11 of IAS 32 and the requirements for classifying an instrument as an equity instrument in paragraph 16 of IAS 32 refer to contractual rights and contractual obligations. However, questions arise in practice about whether and how laws or regulations (such as statutory or regulatory requirements) applicable to a financial instrument affect the contractual rights and obligations and therefore the classification of the instrument as a financial liability or equity instrument.

7. The IASB proposed in the ED that only those contractual rights and obligations that are enforceable by law and are in addition to those created by relevant laws or regulations are considered in the classification of a financial instrument (or its

component parts) as a financial liability, financial asset or equity instrument. If a right or obligation is created by relevant laws or regulations and would arise regardless of whether it is included in the contractual arrangement, an entity would not consider that right or obligation in classifying the instrument (or its component parts) as a financial liability, financial asset or equity instrument.

8. The IASB asked these questions in the ED:

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.

Summary of feedback

Overview

9. Most respondents that submitted comment letters on the ED included comments on the proposals about the effects of relevant laws or regulations. Of these respondents:

(a) many disagreed with the proposals, identifying significant concerns and suggesting that the IASB not proceed with the proposals;

(b) many provided mixed views, stating that they agreed with some aspects of the proposals but disagreed with others, identifying significant concerns and raising questions for the IASB to consider before deciding whether to finalise the proposals; and

(c) some largely agreed with the proposals for the reasons set out by the IASB in the ED, while providing suggestions for illustrative examples and wording clarifications.

10. Respondents that disagreed or provided mixed views included all the accounting firms and a majority of the preparers, standard-setting bodies, accountancy bodies, regulators and others that commented on this question. Respondents that agreed with the proposals included a small minority of respondents across a range of stakeholder types.

11. Of the small number of users of financial statements that commented on this question, some agreed with the proposals and some raised concerns. These concerns included that the proposals are overly conceptual and difficult to understand and could undermine comparability or not provide relevant information based on economic substance to investors.[1]

12. The primary themes of the concerns raised by respondents that disagreed with or provided mixed views on the proposals are as follows, each of which is discussed separately in this paper:

(a) inconsistency with IAS 32 and other IFRS Accounting Standards;

(b) potential unintended consequences on classification, including:

(i) potential diversity arising from different legal frameworks; and

[1] This summary includes feedback gathered through user outreach meetings as summarised in Agenda Paper 5A for the IASB's July 2024 meeting.

(ii) potential introduction of new areas of judgement; and

(c) other matters.

Inconsistency with IAS 32 and other IFRS Accounting Standards

13. Some respondents disagreed with the proposed addition of draft paragraph 15A to IAS 32 because, in their view, that proposed requirement would result in an entity not taking into account all relevant laws and regulations that create rights and obligations when classifying an instrument. These respondents said that this proposal:

(a) could lead to counter-intuitive or incorrect outcomes that do not reflect the substance or totality of a contractual arrangement as required by paragraph 15 of IAS 32 (see paragraph 14 of this paper); and

(b) is inconsistent with IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* as well as the *Conceptual Framework for Financial Reporting* and requirements in other IFRS Accounting Standards, including IFRS 15 *Revenue from Contracts with Customers* and IFRS 17 *Insurance Contracts* (see paragraphs 15–17 of this paper).

Substance of the contractual arrangement

14. Some respondents said that draft paragraph 15A of IAS 32 might not be helpful—and could lead to confusion and application challenges—because it is inconsistent with the principle in paragraph 15 of IAS 32. Paragraph 15 of IAS 32 requires the issuer of a financial instrument to classify the instrument, or its component parts, in accordance with the *substance* of the contractual arrangement as well as the definitions of a financial liability, a financial asset and an equity instrument. An accountancy body said the proposals seem to be an amendment, rather than a clarification, of the principle of considering the substance of the contractual arrangement. A standard-setting body suggested that the IASB consider explicitly linking the requirements in draft paragraphs 15A and AG24A–AG24B of IAS 32 with the principle in paragraph

15 of IAS 32 to emphasise the importance of considering the substance of the contractual arrangement.

IFRIC 2

15. Some respondents identified what they view as an inconsistency between draft paragraph 15A(b) of IAS 32 and paragraph 5 of IFRIC 2.[2] Paragraph 5 of IFRIC 2 states [emphasis added] that 'the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or equity. Those terms and conditions *include relevant local laws, regulations* and the entity's governing charter in effect at the date of classification …'. These respondents said they find it challenging to reconcile this requirement in IFRIC 2 with the proposal in draft paragraph 15A(b) of IAS 32 as summarised in paragraph 7 of this paper.

Conceptual Framework, IFRS 15 and IFRS 17

16. A few respondents expressed concerns that the proposals differ from the principle in paragraph 4.60 of the *Conceptual Framework* and the requirements in IFRS Accounting Standards such as IFRS 15 and IFRS 17:

    (a) paragraph 4.60 of the *Conceptual Framework* states that all terms in a contract—whether explicit or implicit—are considered unless they have no substance. Implicit terms could include obligations imposed by statute.

    (b) paragraph B12 of IFRS 15 requires an entity to consider contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms.

[2] IAS 32 establishes principles for the classification of financial instruments as financial liabilities or equity, which apply to the classification of puttable instruments that allow the holder to put those instruments to the issuer for cash or another financial instrument. To address challenges in applying IAS 32 to members' shares in co-operative entities and similar instruments, the IASB issued IFRIC 2, which provides guidance on how redemption terms should be evaluated in determining the classification of those shares.

(c) paragraph 2 of IFRS 17 requires an entity to consider its substantive rights and obligations, whether they arise from a contract, law or regulation.

17. A standard-setting body said the apparent tension between these IFRS Accounting Standards and the proposed amendments to IAS 32 could diminish comparability amongst similar reporting entities and create structuring opportunities.

Potential unintended consequences on classification

18. Many respondents expressed concerns about the potential for unintended consequences associated with the proposals, including:

(a) potential diversity arising from different legal frameworks; and

(b) potential introduction of new areas of judgement.

Potential diversity arising from different legal frameworks

19. Some respondents, including users of financial statements in outreach meetings, said the proposals could potentially reduce the comparability of financial statements across different regions, because economically similar instruments could be classified differently resulting from differences in jurisdictions' legal frameworks. This concern arises both in the context of diversity between entities operating in different jurisdictions and diversity within a consolidated group that includes subsidiaries subject to the laws or regulations of multiple jurisdictions.

20. In particular, these respondents highlighted differences between civil and common law frameworks that affect the classification of financial instruments. For example:

(a) in legal frameworks based on code (or civil) law, it is not necessary to include key characteristics of a financial instrument or product (such as loans, deposits and unit trust instruments) in the contractual arrangements because these characteristics apply automatically under the jurisdictional laws or regulations; whereas

(b) in legal frameworks based on common law, the same key characteristics might not apply automatically under the relevant laws or regulations and therefore need to be included in the contractual arrangements to achieve the same economic outcome.

21. Some respondents provided examples of potential diversity that could arise from the different treatment of regulated savings or deposit accounts across jurisdictions. These respondents noted that, for example, Livret A savings products in France are defined by the legal and regulatory framework, with little or no room for contractual negotiation, and include a statutory interest rate. Respondents expressed differing views about how application of the proposals would affect the classification of obligations associated with these savings products, including:

(a) the legal rights and obligations of these savings or deposit products would be ignored, leading to payment of statutory interest being classified as an equity distribution;

(b) the interest and redemption amounts would be classified as financial liabilities, because when an individual depositor signs up for the savings product, the amount and timing of deposits create contractual terms that are 'in addition to' laws or regulations; and

(c) rights and obligations that are not contractual cannot be ignored entirely and might need to be accounted for applying another IFRS Accounting Standard.

22. Additionally, some respondents said that without further clarity, it is unclear which jurisdiction's law an entity should consider when classifying a financial instrument. For example, an accounting firm said a contract might be issued by an entity incorporated in jurisdiction A while being governed by laws in jurisdiction B, and it is unclear whether the entity should consider laws in jurisdiction A, jurisdiction B or both when classifying the financial instrument. The proposals might therefore create the need for additional legal consultations in multiple jurisdictions that would add costs with unknown or little benefits for users of financial statements.

Potential introduction of new areas of judgement

23. Many respondents said the proposed amendments would introduce new areas of judgement and uncertainty in applying the requirements and could result in a significant change in existing practice, unintended consequences and significant or new diversity in practice. Some of these respondents said the proposed amendments would require entities to reconsider their specific facts and circumstances and make additional judgements to reassess prior conclusions reached regarding contractual and non-contractual terms. These new areas of judgement include:

(a) whether contractual terms are 'in addition to' laws or regulations, as stated in draft paragraph 15A(a) of IAS 32 (see paragraphs 24–26 of this paper);

(b) whether 'regulations' include prudential guidelines or regulatory frameworks (see paragraphs 27–28 of this paper);

(c) the meaning of 'solely created by laws or regulations' as used in draft paragraph AG24A of IAS 32 (see paragraphs 29–30 of this paper); and

(d) how to evaluate linked transactions (see paragraph 31 of this paper).

Whether contractual terms are 'in addition to' laws or regulations

24. Many respondents said it is unclear how to determine whether contractual terms are 'in addition to' laws or regulations, as stated in draft paragraph 15A(a) of IAS 32. Some of these respondents noted that laws or regulations can be very specific in how they must be satisfied or, alternatively, can use a principles-based approach that might not identify or specify every detail of the requirements. These respondents said that it is not clear whether contractual terms added to satisfy principles-based laws or regulations form part of, or are 'in addition' to, those laws or regulations. A standard-setting body said that assessing whether contractual terms are 'in addition to' relevant laws or regulations could be complex and generate significant costs associated with performing a legal analysis for each contract.

25. Many respondents provided examples of instruments that, in their view, might be difficult to assess applying the proposals. Common themes in the questions from respondents include:

(a) whether choosing to issue a particular instrument, or setting precise contractual terms that are more specific than the general regulations, creates a contractual right or obligation that is 'in addition to' those created by relevant laws or regulations. In many cases, a term or condition is required by laws or regulations to be included in a contract for *an instrument* to receive a particular legal or regulatory treatment. Examples include how an entity incorporates a loss absorption feature or a discretionary coupon in the contractual terms and conditions of an Additional Tier 1 instrument issued to meet regulatory capital requirements.[3]

(b) whether entities should ignore regulatory requirements that apply to the *issuer entity*, rather than to specific instruments, in determining whether contractual rights and obligations are 'in addition to' those created by relevant laws or regulations. For example, to qualify as a Real Estate Investment Trust in some jurisdictions, an entity is required to issue shares that are puttable with specified terms and conditions, such as a required distribution of at least 90% of taxable income to shareholders to maintain a favourable tax status. Similarly, in some jurisdictions, unit trusts are required by law to allow investors to redeem their units at their share of the net asset value of the entity.

(c) whether a contractual offer that is issued after a legal obligation is triggered is considered 'in addition to' the legal requirement. For example, in many jurisdictions there is a legal requirement governing Mandatory Tender Offers that is triggered once an investor owns more than a specified percentage (often 30%) of the shares of an entity. After the requirement is triggered, the investor

[3] As described in paragraph BC13 of the Basis for Conclusions on the ED, Additional Tier 1 (or AT1) instruments are financial instruments issued by banks to meet regulatory capital requirements. Many such instruments are perpetual instruments with obligations that arise only on liquidation of the issuer. However, banks are required by laws or regulations to include a loss-absorption feature in these instruments. That feature might require, for instance, conversion of the instrument into ordinary shares of the issuer, or the write-down of the principal amount, upon the occurrence of a trigger event linked to the capital ratio of the issuer.

must extend an offer to other shareholders to purchase the remaining shares, and that offer describes the timing, price and other contractual details to meet the legal requirement.

26. More generally, an accountancy body said it sees ‘low merit in tricky provisions’ such as ‘in addition to those created by relevant laws or regulations’ and expressed ‘doubt that the IASB will succeed in defining supra-national principles covering each possible legal circumstance’. This respondent said the proposals are too difficult to understand, risk misunderstanding and provoke unintended consequences.

Whether ‘regulations’ include prudential guidelines or regulatory frameworks

27. Many respondents said it is unclear what constitutes ‘laws or regulations’ and, in particular, whether ‘regulations’ include prudential guidelines or regulatory frameworks. These respondents noted that the form of laws or regulations differs across jurisdictions. Government agencies may issue rulings, interpretations or guidelines on laws or regulations and may have the statutory authority to enforce those rulings, interpretations or guidelines. These respondents said that diversity in applying the proposals in the ED could arise unless the IASB provides further clarity on the meaning of ‘laws or regulations’.

28. Some respondents provided examples of bail-in instruments that are governed by regulatory guidelines or guidance, and said that not all prudential regulators regard those guidelines or guidance as ‘laws or regulations’. A prudential regulator said further clarity in the proposed IAS 32 application guidance would enhance comparability for users of financial statements, especially given that some jurisdictions implement the Basel Framework via guidance issued by prudential regulators instead of through, or in addition to, national laws and regulations. This respondent said that in some jurisdictions, such supervisory guidance is not enforceable by law but is deemed in practice as binding on banks and the supervisory authorities and therefore should be considered holistically with laws or regulations.

The meaning of 'solely created by laws or regulations'

29. A few respondents said the meaning of the phrase 'solely created by laws or regulations' as used in draft paragraph AG24A of IAS 32 is not clear and could lead to diversity in application of the proposals. A standard-setting body said that it might be difficult to draw a clear line 'in differentiating original contractual terms from those that are solely created by laws'.

30. These respondents provided the example of a share buy-back obligation that could be viewed in more than one way when applying the proposals. In this example, when an entity chooses to issue non-transferrable shares by including in the contract a prohibition for its shareholders to sell those shares to third parties, a law in that jurisdiction obliges the entity to buy back its own shares if the holder decides to sell. The obligation to buy back shares arises from a law but only applies as a result of the entity's decision to include in the contract a prohibition on sales to a third party. In this situation, the respondents said it is unclear whether:

    (a) the non-transferrable shares should be classified as equity because the obligation to buy back shares is a statutory requirement that applies to the instrument and would 'arise regardless of whether the obligation is included in the contractual arrangement' (as described in draft paragraph 15A(b) of IAS 32); or

    (b) the buy-back obligation should be classified as a financial liability because it is not 'solely created by laws or regulations' (as referred to in draft paragraph AG24A of IAS 32) but arises from the entity's decision to include a prohibition on sales to a third party in the contract.

How to evaluate linked transactions

31. A few respondents asked how linked transactions would be considered when applying the proposals. An accounting firm provided an example of a bond that requires interest payments only if the issuing entity pays dividends on its ordinary shares. If the entity has full discretion over whether to pay dividends, neither the dividends on

the ordinary shares nor the bond interest payments would give rise to a financial liability. In contrast, if the issuing entity is required to pay a statutory dividend on the ordinary shares, the respondent is of the view that it is not clear how the obligation to pay interest on the bond would be classified and whether it would also be viewed as a statutory (rather than a contractual) obligation applying the proposed requirements.

Other matters

Lack of a need for change

32. Some respondents said it is not necessary for the IASB to amend IAS 32 to consider the effect of laws or regulations, because IAS 32's approach to contract-based classification is largely well understood and applied, and they do not observe significant diversity in practice. They observed that practice appears to be largely settled and consistent interpretations seem to have been reached within each jurisdiction considering local legal and regulatory frameworks. In their view, differences between jurisdictions result from applying judgement to differing circumstances and legal frameworks.

Changes in laws or regulations

33. Some respondents raised follow-on questions, such as whether a change in laws or regulations would trigger a reassessment of the classification of a financial instrument. For example, a change in laws or regulations might affect an obligation that was initially determined to be a contractual obligation, such that the obligation would be determined to be statutory after the change. These respondents noted that whilst the ED generally prohibits the reclassification of financial liabilities and equity instruments, a reassessment of the classification would be required when there is a change in circumstances external to the contractual arrangement. These respondents suggested the IASB clarify this requirement and provide an illustrative example. See Agenda Paper 5B for this meeting for further discussion on reclassification between financial liabilities and equity instruments.

Separating components of obligations

34. Some respondents disagreed with the proposed requirement in draft paragraph AG24B of the ED that an obligation should be classified in its entirety as a financial liability whenever a contractual obligation is incremental to a statutory obligation. An accounting firm said that IAS 32 already requires the separation of equity and liability components and this requirement has been applied in practice for a number of years. In their view, this application demonstrates that it is reasonably practicable to separate a contractual obligation from a statutory obligation. This respondent also said, for example, that an approach that requires separation of obligations to pay statutory dividends from contractual obligations to pay a dividend above the statutory minimum would provide a more faithful representation of the entity's obligations and enable a more relevant comparison across entities with different dividend offerings.

Effect on financial assets

35. Some respondents said the proposed application guidance on distinguishing between statutory and contractual rights and obligations would also affect the classification of financial assets, notably whether a financial asset would meet the 'solely payments of principal and interest on the principal outstanding test' ('the SPPI test') in IFRS 9 *Financial Instruments*. These respondents suggested that the IASB clarify in IAS 32 that the application guidance on differentiating statutory and contractual rights and obligations would apply to the classification of financial assets as well as financial liabilities and equity instruments.

Suggestions on the way forward

36. Some of the respondents referred to in paragraph 12 of this paper said they would support requiring, as an alternative, the 'all-inclusive approach' that is described in

paragraph BC14 of the Basis for Conclusions on the ED.[4] These respondents said an all-inclusive approach—with or without exceptions for particular financial instruments—would be the most conceptual approach for classification purposes and would provide more useful information to users of financial statements. However, a few respondents acknowledged that such an approach would represent a fundamental change to the classification requirements in IAS 32 that would go beyond the scope of this project.

37. Many other respondents said the IASB should not proceed with the proposals and should rather explore other paths. Suggestions included that the IASB:

    (a) maintain the status quo until there is a fundamental review of IAS 32.

    (b) decouple the topic of the effects of relevant laws or regulations from the rest of the project and continue to explore the topic in a comprehensive way, including testing the proposals against a wide range of financial instruments and considering solutions to common questions (such as those discussed in paragraphs 23–31 of this paper) raised in response to the ED.

    (c) require robust and specific disclosures about the approaches and judgements applied by an entity when considering the effects of relevant laws or regulations on the classification of financial instruments. Some of these respondents would expect to see such disclosures in the context of disclosing material accounting policy information. They suggested draft paragraph B5A of IFRS 7 *Financial Instruments: Disclosures* should specify that judgements made in classifying financial instruments include the effects of relevant laws or regulations.

38. Many respondents said that if the IASB decides to finalise the proposals, it should make some changes to the proposed requirements, including:

[4] An 'all-inclusive' classification approach would require the issuer of a financial instrument to consider contractual terms and rights as well as obligations established by relevant laws or regulations, whether explicitly included in the terms of the contract or implied by laws or regulations.

(a) develop additional application guidance and illustrative examples to clarify areas of confusion identified in feedback, foster consistent application and reduce the chance of new diversity in application. A group of users of financial statements suggested the IASB develop educational materials to explain cases in which 'classification determined by contractual rights and obligations based on these proposals' and 'classification based on the laws or regulations of each jurisdiction' do not coincide.

(b) potentially expand the disclosure requirements. A few respondents suggested the IASB focus on expanding the proposed disclosure requirements in IFRS 7 related to the terms and conditions of a financial instrument that determine its classification or that could affect the nature, amount, timing and uncertainty of cash flows. In their view, these disclosures should include information about the interaction between an instrument's contractual terms and relevant laws, because such disclosures would be important for users of financial statements to understand the substance of the contractual arrangement of a financial instrument. Suggested disclosures include:

    (i) contractual rights and obligations that were <u>not</u> considered in the classification of a financial instrument, or its component parts, based on an entity's assessment of enforceability and relevant laws or regulations; and

    (ii) laws or regulations that could affect the timing and amount of future cash flows of financial instruments issued by an entity, even if these legal requirements do not affect their classification.

Staff analysis

39. In this section, we consider the best way for the IASB to respond to the feedback on the proposals in the ED, including respondents' suggestions on the way forward (as summarised in paragraphs 36–38 of this paper), taking into account the objective of the proposals.

Objective of the proposals

40. The objective of the IASB's proposals about the effects of laws or regulations, as for the project generally, was to address known application questions about the classification of financial instruments applying IAS 32 without fundamentally changing the requirements.

41. As discussed in Agenda Paper 5C for the IASB's December 2021 meeting, a more specific objective related to the effects of laws or regulations was for the IASB to:

    (a) develop principles that would help entities assess whether a legal requirement is 'part of the contractual terms'; and

    (b) do so in a manner consistent with the underlying principle in IAS 32 to classify a financial instrument in accordance with the 'substance of the contractual arrangement'.

42. In developing the proposals in the ED, the IASB considered several practical examples of instruments that have given rise to application questions related to considering the effects of laws or regulations, including bail-in instruments and ordinary shares with statutory minimum dividends. The IASB's objective was to find a principles-based solution—common underlying principles that could be applied to most instruments and result in an appropriate outcome—and not to provide answers for particular instruments or features.

Overall consideration of feedback

43. In general, the staff note a misunderstanding amongst some respondents about the effect of the proposed amendments on the classification of some instruments. For example, some respondents were concerned that some instruments currently classified as financial liabilities, such as regulated savings and deposits, would be classified as equity applying the proposals. However, rights and obligations that are not considered when classifying financial instruments as financial liabilities or as equity might be recognised and measured by applying other IFRS Accounting Standards, such as

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Under the proposals in the ED, information about such rights and obligations would therefore continue to be provided in the financial statements through application of other IFRS Accounting Standards.

44. However, although we disagree with some of the arguments made by respondents, the extent of disagreement (as summarised in paragraphs 9–38 of this paper) by a broad range of stakeholders on a number of aspects of these proposals persuades us that the proposals, if finalised largely unchanged, would not achieve the IASB's objectives.

45. We have considered respondents' specific concerns that the proposals are inconsistent with the principle in paragraph 15 of IAS 32 and would likely increase, rather than decrease, diversity in application because new areas of judgement are expected to arise (see paragraphs 23–31 of this paper). We take note of respondents' views that while the proposed amendments could address some practical application questions, more application questions are likely to arise.

46. We have also considered stakeholders' views that application of the proposals would not necessarily lead to better information for users of financial statements. Stakeholder feedback indicates that this topic is broad, complex and difficult to be addressed in the scope of this project.

Respondent suggestions for potential ways to move forward

Proceed with refining the proposals including adding application guidance, illustrative examples and disclosures

47. Based on the feedback, there is no consensus on the underlying principles to be applied to assess, as set out in the objectives in paragraph 41 of this paper, whether a legal or regulatory requirement is part of an instrument's contractual terms. It is clear from the feedback that there are many different contractual terms that interact with laws or regulations—and both the form of laws or regulations, and the way they are enacted, can differ within a jurisdiction and across jurisdictions.

48. In our view, without consensus on the underlying principles, further efforts to refine the proposals and develop additional application guidance and illustrative examples would not be productive. Such efforts would be not only time-consuming and complex but also would not likely meet the IASB's objective of developing principles that can be consistently applied across a variety of instruments and jurisdictions.

49. We note that the IASB already considered, when it developed the ED, whether additional disclosures should be required regarding the effects of laws on the contractual terms when an entity assesses the classification of a financial instrument. The IASB did not think it was necessary to add disclosure requirements relating to laws or regulations that prevent the enforceability of a contractual term, or legal requirements that could affect the timing and amount of future cash flows of issued financial instruments. See Agenda Paper 5B (particularly paragraphs 42–45 of that paper) for the IASB's April 2023 meeting. We further discuss the request for potential new disclosure requirements in paragraph 52 of this paper.

Explore the 'all-inclusive' classification approach

50. The IASB already considered and rejected a more fundamental change such as adopting the 'all-inclusive' classification approach, for the reasons described in paragraph BC15 of the Basis for Conclusions on the ED. While some respondents expressed support for the IASB to pursue that approach, others explicitly rejected it. Even those respondents that supported the approach said that it might result in fundamental changes to the classification of particular instruments, and exceptions to the classification would still be needed. Feedback did not provide new information to support the IASB reconsidering its prior decision.

Decouple the topic and explore it more comprehensively

51. In our view, pursuing this suggestion (described in paragraph 37(b) of this paper) would present the same challenges and shortcomings as described in paragraph 48 of this paper. Without consensus on the underlying principles, it would not be productive

nor meet the project objective for us to pursue the suggested course of continuing to test the proposals against a wide range of financial instruments in search of solutions to common questions.

Require specific disclosures about judgements applied when considering the effects of relevant laws or regulations on the classification

52. Draft paragraph B5A of IFRS 7 in the ED would require an entity to disclose the judgements management has made in classifying a financial instrument, or its component parts, as a financial liability or as an equity instrument, if those judgements are among the judgements that have the most significant effect on the amounts recognised in the entity's financial statements. We think this proposed requirement is sufficient to cover judgements made when considering the effects of relevant laws or regulations in classifying financial instruments, and it is not necessary for the IASB to expand it. There will be a number of judgements made by entities when classifying financial instruments as financial liabilities or equity, including those arising from other classification topics in this project. Feedback on draft paragraph B5A of IFRS 7 along with other proposed disclosure requirements will be discussed at a future IASB meeting.

Staff conclusion

53. Based on our analysis set out in paragraphs 39–52 of this paper, we recommend that the IASB not proceed with, and therefore withdraw, the proposed requirements related to the effects of relevant laws or regulations on the classification of financial instruments as set out in the ED.

54. As discussed in paragraphs 44 and 47–48 of this paper, the extent of disagreement by a broad range of stakeholders and the lack of consensus on the underlying principles persuades us that finalising the proposals would not achieve the IASB's objectives.

55. Solving all the concerns raised would involve addressing this topic in a more fundamental manner, including redeveloping underlying principles and potentially

reconsidering their interaction with other IFRS Accounting Standards (as discussed in paragraph 50 of this paper). Doing so would likely fundamentally change the approach in IAS 32 and would therefore be beyond the scope of the FICE project. We therefore recommend maintaining the status quo at the present time.

Appendix—Excerpts from the proposed amendments to IAS 32 and IFRS 7 in the ED

A1. The IASB proposed adding the following paragraphs to IAS 32 related to assessing the effect of relevant laws or regulations when classifying financial instruments:

Paragraph 15A:

In classifying a financial instrument (or its component parts) as a financial liability, a financial asset or an equity instrument, an entity:

(a) shall consider only contractual rights and obligations that are enforceable by laws (see paragraph 13) or regulations and are in addition to those created by relevant laws or regulations (such as statutory or regulatory requirements applicable to the instrument); and

(b) shall not consider any right or obligation created by relevant laws or regulations that would arise regardless of whether the right or obligation is included in the contractual arrangement.

Paragraph AG24A:

A contractual right or obligation typically applies only to the specific instrument and can be negotiated or modified by the parties to the contract. In contrast, a right or obligation solely created by laws or regulations applies to all similar instruments and cannot be modified by the parties to the contract. Therefore, a change in relevant laws or regulations would affect all instruments subject to those laws or regulations.

Paragraph AG24B:

> An entity shall consider a contractual right or obligation, which is not solely created by laws or regulations but is in addition to a right or obligation created by relevant laws or regulations, in its entirety in classifying that right or obligation. The entity shall not disaggregate such a contractual right or obligation into contractual and non-contractual parts. For example, if the relevant laws require the issuer to pay a minimum dividend on an instrument, but the instrument's contractual terms specify a higher minimum dividend to be paid (more than the minimum dividend requirement established by relevant laws), the issuer classifies the instrument (or its component parts) based on the entire contractual minimum dividend requirement. The entire contractual obligation to pay dividends would, therefore, be classified as a financial liability or liability component.

A2. The IASB proposed adding, amongst other disclosure requirements, the following paragraph to IFRS 7:

Paragraph B5A:

> Along with the requirements for disclosing material accounting policy information or other notes, paragraph 122 of IAS 1 (as revised in 2021) also requires an entity to disclose the judgements that management has made in applying the entity's accounting policies and that have the greatest effect on the amounts recognised in the financial statements. For example, an entity shall disclose the judgements that management has made in classifying a financial instrument (including all stand-alone derivatives), or its component parts, as a financial liability or as an equity instrument, if those judgements are among the judgements that have the most significant effect on the amounts recognised in

the entity's financial statements. Note, however, that an entity is not required to disclose judgements based on estimations.