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Intenational Accounting Standard Board
7 Westferry Circus, Canary Wharf
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26 March 2024

Re: IASB/ED/2023/5 Exposure Draft Financial Instruments with Characteristics of Equity - Proposed amendments to IAS 32, IFRS 7 and IAS 1

Dear Mr Barckow,

We are pleased to have the opportunity to provide our comments on the IASB Exposure Draft Financial Instruments with Characteristics of Equity (IASB/ED/2023/5), issued by the IASB in November 2023 (the 'ED').

We welcome the IASB's decision to address known issues that arise in practice in applying the classification requirements of IAS 32. The IASB's approach is aligned with the suggestion, we expressed in our comment letter to the IASB's DP 2018, that if the IASB found out that the DP's proposals would have unintended consequences it would be better addressing only the specific challenges identified.

We acknowledge that the IASB focused on clarifying the classification requirements in IAS 32, however we would like to highlight the importance to avoid unintended classification changes and disruptions of established practices. Any classification changes resulting from the ED should be justified and explained by the IASB.

Having this in mind, we have some concerns mainly on the proposals on: laws and regulations, NCI puts and shareholder's discretion. This is also because we understand that there may be some contrasts between accounting conventional rules and the legal system. As better highlighted in the Appendix we understand that such a misalignment is particularly relevant for the role of legal obligation and how to consider the shareholders' meeting decisions. Moreover, we consider that such proposals could have unintended consequences. For example, new interpretation issues may arise in practice to distinguish between contractual obligations and legal obligations, the recognition of the liability for NCI puts against the parent's equity could have negative effects in terms of capital requirements, not considering shareholders decisions as decisions of the entity could generate doubts on the

classification of some financial instruments. Consequently, we suggest to reconsider these proposals.

Regarding the presentation of amounts attributable to ordinary shareholders and the new proposed disclosures, we suggest to carefully assess the cost-benefit trade off of these new proposals.

Our detailed comments are set out below.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,

Michele Pizzo
(OIC President of the Board of Directors)

Appendix

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.

From a conceptual point of view, the all-inclusive approach would be the preferable one. This is because, in a civil law framework like the Italian one, contractual obligations and legal obligations are equivalent. However, we acknowledge that this approach would represent a substantial change to IAS 32 and could result in a greater number of instruments being classified as liability (e.g. AT 1 for which the resolution authority could impose the conversion in a variable number of shares). Nevertheless, we acknowledge that on this topic a common practice has been developed and that new proposals can bring to new uncertainties and interpretation issues. In addition, it could happen that the same financial instrument is classified differently by two entities operating in countries with different legal frameworks. Therefore, we suggest to consider whether the proposals is really needed.

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.

We appreciate the IASB's efforts to address a topic that give rise to different application questions. However, we have several concerns on the IASB's proposals. In particular, the decision to remove the initial amount of the financial liability from a component of equity other than non-controlling interests implies that:

a. the parent's equity is penalized and this may have negative effects in terms of capital requirements;

b. the same obligation is recognized twice: through the liability and through the NCI equity. Such accounting treatment provides a misleading information to users;
c. a disruption of the practice: in Italy the prevalent practice is to recognize the financial liability against the NCI;

We also have some doubt about the proposal to recognize in profit or loss any gains or losses on remeasurement of the financial liability. The proposal could lead to some disruption of the practice, it seems in conflict with the nature of the transaction (IFRS 10 requires that transactions with owners in their capacity as owners are equity transactions) and it would be counterintuitive because the company should recognize a loss when it performs well and the value of the shares underlying the put increases.

In addition, we acknowledge that according to BC 82 issues relating to the measurement of financial liabilities are outside the scope of the project and that developing a solution to address these issues would require a major standard-setting project. However, we suggest to provide additional guidance for the initial and subsequent measurement of the financial liability, because this is an issue in practice.

Lastly, we observe that the ED does not address the NCI-put in the separate financial statement where they are generally recognized on a net basis. This accounting treatment has been justified also considering that in the consolidated financial statements the liability could be recognized against the NCI equity. The IASB's proposal makes even more important to address this issue also in the separate financial statement.

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.

The IASB's proposal to disregard the probability and estimated timing of occurrence or non-occurrence of the contingent event in the initial and subsequent measurement of the financial liability represents a simplification. However, this approach could lead to distortive effects and could risk not being representative of the value of the liability. This may happen, for example, in the case an instrument with a contingent event with a low probability of occurrence that trigger a significant cash flow. The IASB's approach would lead to the recognition of a liability higher than its fair value. Therefore, even considering that the

probability could introduce some complexity and judgmental elements, we suggest the IASB to reconsider this issue.

With reference to the definition of the term "liquidation", we suggest to clarify what is meant by "process for permanently ceasing operations" because the risk is to have different interpretation among jurisdictions that could lead to different classification outcome. For example, in Italy an entity may be in liquidation and continuing its operations, because the shareholders decided to liquidate the entire business still in operation because it is still profitable. We suggest the IASB to clarify that an entity is in liquidation when shareholders decided to liquidate the entity.

Question 5—Shareholder discretion (paragraphs AG28A–AG28C of IAS 32)

The IASB proposes:
(a) to clarify that whether an entity has an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle a financial instrument in such a way that it would be a financial liability) depends on the facts and circumstances in which shareholder discretion arises. Judgement is required to assess whether shareholder decisions are treated as entity decisions (paragraph AG28A).
(b) to describe the factors an entity is required to consider in making that assessment, namely whether:
(i) a shareholder decision would be routine in nature—made in the ordinary course of the entity's business activities;
(ii) a shareholder decision relates to an action that would be proposed or a transaction that would be initiated by the entity's management;
(iii) different classes of shareholders would benefit differently from a shareholder decision; and
(iv) the exercise of a shareholder decision-making right would enable a shareholder to require the entity to redeem (or pay a return on) its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) (paragraph AG28A(a)–(d)).
(c) to provide guidance on applying those factors (paragraph AG28B).
Paragraphs BC116–BC125 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.

We are of the view that generally shareholders' meeting decisions should be considered as entity decisions. However, we admit that there may be particular circumstances in which shareholders' meeting decisions could be on behalf of the shareholders.

The IASB's approach, not starting from the presumption that shareholders' meeting decisions are generally entity's decisions, could create uncertainty about the classification

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of some financial instruments. We suggest the IASB to reconsider this proposal to avoid unintended consequences.

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

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We generally appreciate the IASB's efforts to respond to the users' needs, we acknowledge that disclosures are important to them, in particular that related to terms and conditions. This information could help users to understand how the company is financed and it is useful for comparative analysis, risk assessment and cash flow evaluation.
However, we observe that the proposed disclosure is extensive and may result in operational challenges and implementation costs. Preparers highlighted that the proposed disclosure could lead to an overload of information that could obscure the relevant information limiting the usefulness of the financial statements.
Therefore, we suggest to the IASB to conduct a cost-benefit analysis before proceeding with these proposals.

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 attibutable 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.

With reference to the proposed requirement to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent, we have some concerns, because it could be feasible to allocate capital and capital reserves among different shareholders of the parent, however this could very difficult for the other equity components

(e.g. revenue reserves or valuation reserves). Thus, this proposal could lead to a complex technical exercise not compensated by a useful information for users.

Question 9—Transition (paragraphs 97U–97Z of IAS 32)

The IASB proposes to require an entity to apply the proposed amendments retrospectively with the restatement of comparative information (a fully retrospective approach). However, to minimise costs, the IASB proposes not to require the restatement of information for more than one comparative period, even if the entity chooses or is required to present more than one comparative period in its financial statements.

For an entity already applying IFRS Accounting Standards, the IASB proposes:

(a) to require the entity to treat the fair value at the transition date as the amortised cost of the financial liability at that date if it is impracticable (as defined in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors) for the entity to apply the effective interest method in IFRS 9 Financial Instruments retrospectively (paragraph 97X);

(b) not to require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision was no longer outstanding at the date of initial application (paragraph 97W);

(c) to require the entity to disclose, in the reporting period that includes the date of initial application of the amendments, the nature and amount of any changes in classification resulting from initial application of the amendments (paragraph 97Z);

(d) to provide transition relief from the quantitative disclosures in paragraph 28(f) of IAS 8 (paragraph 97Y); and

(e) no specific transition requirements in relation to IAS 34 Interim Financial Reporting for interim financial statements issued within the annual period in which the entity first applies the amendments.

For first-time adopters, the IASB proposes to provide no additional transition requirements.

Paragraphs BC262–BC270 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 apply the proposed amendments retrospectively give rise to any other cases in which hindsight would be necessary? If so, please describe those cases and the circumstances in which the need for hindsight would arise.

We generally support the retrospective approach. However, we suggest to conduct a cost-benefit analysis also considering the potential classification changes arising by the new clarifications and the potential impact on the debt/equity covenant. We also suggest to

include an exemption from the application of the retrospective approach for those instruments that do not exist at the date of first application of the amendments.

Question 10—Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])

The IASB proposes amendments to the draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures], which will be issued before the proposals in the Exposure Draft are finalised.
[IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures.
The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures.
Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures. Do you agree with these proposals? Why or why not? If you disagree with any of the propsals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

We observe that IFRS XX *Subsidiaries without Public Accountability: Disclosures* has to be issued and endorsed in the EU.

Having said that, and considering our answer to question 7, at the moment we believe that the proposed reduced disclosures for eligible subsidiaries seem reasonable.