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14 December 2018

By email: [eky@hkicpa.org.hk](mailto:eky@hkicpa.org.hk)

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Dear Eky

**HKAB Responses to HKICPA's Further Questions on IASB Discussion Paper DP/2018/1  
Financial Instruments with Characteristics of Equity**

We refer to your email of 28 November 2018 requesting HKAB to clarify its responses regarding various questions set out in the Discussion Paper.

We are pleased to elaborate our responses as follows:

***Question 4: The Board's preliminary view is that the puttable exception would be required under the Board's preferred approach. Do you agree? Why, or why not?***

*We agree that the exception should be retained. However, we consider that the Board should take the opportunity to understand the extent to which the exception is used in practice, the application challenges arising from it and whether potential improvements can be identified. The principle that is articulated in paragraph 2.49 does not appear to fully address the principles that the Board would like to be in place, since an exception for puttable instruments is still desired by the Board. It would be helpful to understand if any other proposals were considered that would have addressed all the key concerns in paragraph 3.31 without the need for exception to the key principle, and why those proposals are not the preferred approach.*

***Could you explain why HKAB agrees to retain the puttable exception?***

We agree to retain the puttable exception for the same rationales as set out in paragraph 3.37 of the Discussion Paper.

Chairman The Hongkong and Shanghai Banking Corporation Limited  
Vice Chairman Standard Chartered Bank (Hong Kong) Limited  
Bank of China (Hong Kong) Limited  
Secretary Steve Choi

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副主席 渣打銀行(香港)有限公司  
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秘書 蔡兆昌

***Question 6: Do you agree with the Board's preliminary views set out in paragraphs 5.48(a)–(b)? Why, or why not? Applying these preliminary views to a derivative that could result in the extinguishment of an entity's own equity instruments, such as a written put option on own shares, would result in the accounting as described in paragraph 5.30 and as illustrated in paragraphs 5.33–5.34.***

*For financial instruments with alternative settlement outcomes that do not contain an unavoidable contractual obligation that has the feature(s) of a financial liability as described in paragraph 5.48(c), the Board considered possible ways to provide information about the alternative settlement outcomes as described in paragraphs 5.43–5.47.*

***(a) Do you think the Board should seek to address the issue? Why, or why not?***

***(b) If so what approach do you think would be most effective in providing the information, and why?***

*We acknowledge that the Board's preferred approach to redemption obligation arrangements will ensure that arrangements with the same liability and equity outcomes are classified consistently regardless of how they are structured, and it also provides financial statement users better visibility of the obligation that exists. However, we are not convinced that written put options on own shares are similar to convertible bonds and thus should be treated similarly. In case of a written put option on own shares, the entity has issued shares and might be required to repurchase them. In addition, the holder of the put option may be different from the party holding the entity's shares. However, in case of a convertible bond, the entity might be required to issue shares in the future to settle the claim and the holder of the convertible bond would be the same party who receives the entity's shares should the bonds be converted.*

*The discussion paper proposes new guidance on accounting within equity for written put options on own shares. It introduces a new concept of derecognising equity which may potentially cause confusion since legally the shares are still outstanding and the entity still has to pay dividends on them if dividends are declared. Though the discussion paper notes that the derecognition does not mean that the equity instrument have been extinguished, but it merely reflects the change in the characteristics of the equity instruments because of the written put option, it is not clear what, if any, implications of such a new type of derecognition would have. In addition, a gross-up liability is recognised when there is still optionality on the obligation though this is the same treatment under IAS 32.23.*

*We are concerned that the notion of what is an amount independent of the entity's available*

*economic resources will involve judgment and could create confusion. In particular, the discussion paper states that share price is dependent on an entity's economic resources, this is not intuitive to the reader, thus further explanation and guidance would be required. Likewise, it is not clear that only qualitative assessment should apply to make the assessment, nor how dependent the variable needs to be on the available economic resources. The analysis of the separate legs of the derivative for assessment of the net amount is also confusing as the principle is only if the net amount is affected by a variable that is independent of the entity's available economic resources.*

*Additional disclosures on the potential outcome of different types of derivatives on own equity may be an effective way to provide information to the investors.*

*As mentioned in our response to Question 5, we suggest the Board should further analyse the option of accounting for all derivatives on own equity as derivative assets or liabilities under the scope of IFRS 9 to facilitate the accounting for derivatives in general.*

***Instead of gross up accounting, HKAB tends to support accounting for all derivatives on own equity as derivative asset or liabilities because this would facilitate the accounting for derivatives in general. Does that mean the accounting (classification – no need to distinguish whether there is equity component) would be simplified?***

We do not have any further comment. However, to provide more context to preparers of financial statements, we suggest that the Board can provide more practical examples of “written put option on own equity” and develop them into illustrations using both the Board's preferred approach and contrast it with the alternative approach (i.e. account for as derivative assets/liabilities). This will help users to visualise the difference in terms of impact to the financial statements.

***Question 7: Do you agree with the Board's preliminary views stated in paragraphs 6.53–6.54? Why, or why not?***

***The Board also considered whether or not it should require separation of embedded derivatives from the host contract for the purposes of the presentation requirements as discussed in paragraphs 6.37–6.41. Which alternative in paragraph 6.38 do you think strikes the right balance between the benefits of providing useful information and the costs of application, and why?***

*For the disclosure requirements under paragraph 6.53, our view is that presenting separately the carrying amounts of partly independent derivatives that meet the criteria in paragraph 6.34 of discussion paper and financial liabilities based on if there is an obligation for an amount independent of the entity's available economic resources will introduce significant*

*operational complexity.*

*We also suggest the Board to consider to include the options of presenting the carrying amounts either on the statement of financial position or in the notes of the financial statements, depending on the size, nature and function of the amounts of financial instruments. Moreover, additional guidance on application and subsequent accounting is required for consistent application and fair value calculation.*

*Also, application should be limited to embedded derivatives that are separated from the host and hybrid instruments that, as a whole, are solely dependent on the entity's available economic resources.*

***Paragraph 1 – Are there any examples of potential operational complexity arising from presenting separately the carrying amounts / income and expenses of partly independent derivatives?***

We do not currently have specific examples; however, the operational complexity is in relation to the new terminology introduced by the Discussion Paper, which requires preparers to assess these instruments based on the timing and amount features and make disclosures/ presentations based on the outcome of its assessment of these two features. This would mean some system changes/ manual efforts to identify. For example, member banks may not track derivatives based on whether they contain dependent or independent variables. This is further complicated by the fact that it is not clear what is considered as a dependent or independent variable, which is also raised in Question 6.

Additionally, we suggest the Board provide more practical examples of partly independent derivatives with illustrative examples on how to adopt the “criteria-based approach” in the financial statements, covering both accounting and the expected presentation, so that financial statement preparers can better understand / identify any information gaps in meeting these new requirements as set out in the Board’s preliminary view.

***Question 9: The Board’s preliminary view is that providing the following information in the notes to the financial statements would be useful to users of financial instruments:***

- (a) information about the priority of financial liabilities and equity instruments on liquidation (see paragraphs 7.7–7.8). Entities could choose to present financial liabilities and equity instruments in order of priority, either on the statement of financial position, or in the notes (see paragraphs 6.8–6.9).***
- (b) information about potential dilution of ordinary shares. These disclosures would include potential dilution for all potential issuance of ordinary shares (see paragraphs 7.21–7.22).***
- (c) information about terms and conditions should be provided for both financial liabilities and equity instruments in the notes to the financial statements (see paragraphs***

7.26–7.29).

*Do you agree with the Board’s preliminary view? Why, or why not?*

*How would you improve the Board’s suggestions in order to provide useful information to users of financial statements that will overcome the challenges identified in paragraphs 7.10 and 7.29?*

*Are there other challenges that you think the Board should consider when developing its preliminary views on disclosures?*

*We agree that disclosures are a key part of the project and welcome the IASB’s discussions.*

*However, further guidance is required on how to apply those disclosure principles so as to enhance comparability of financial statements.*

*Are there any examples of the disclosures for which HKAB would like further guidance?*

Yes, for instance, the extent of disclosures in relation to the information of terms and conditions as required in paragraphs 7.26 to 7.29 of the Discussion Paper.

Additionally, banks incorporated in Hong Kong are subject to the requirements of Banking (Disclosure) Rules. One of the requirements is to disclose the main features (using a standard template) of the Core Equity Tier 1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments that are included in the bank’s regulatory capital as part of the semi-annual public regulatory disclosure to supplement the financial statements, together with a direct link to the full terms and conditions of these instruments in the bank’s website. Similar requirements are also set out by the Basel Committee on Banking Supervision in its Pillar 3 disclosure requirements. It would be helpful if the HKICPA / IASB can take into account the above-mentioned Pillar 3 disclosure requirements and provide further guidance on how banks could leverage on these existing disclosures as part of this Project to avoid unnecessary duplications or confusions due to overlapping disclosures.

***Question 11: The Board’s preliminary view is that an entity shall apply the Board’s preferred approach to the contractual terms of a financial instrument consistently with the existing scope of IAS 32. Do you agree? Why, or why not?***

*We generally support retaining the broad approach in paragraph 15 of IAS 32, which focus on the substance of the contractual arrangement in a financial instrument.*

*However, additional guidance is still required to address challenges that arise in practice from the interaction between the contractual rights and obligations and laws and regulations.*

***Are there any examples of the challenges for which HKAB would like additional guidance? Do these challenges relate to non-viability securities and if so which ones?***



Yes, for instance, the application guidance regarding the interaction between the contractual rights and obligations and regulation regarding innovative financial instruments such as contingent convertible bonds designed for banking capital's requirements.

We hope you find our additional comments useful. Should you have any further questions, please contact our Manager Ms Emily Ngan at 2526 6080 or our Officer Ms Hebe Hung at 2567 1780.

Yours sincerely

Grace Law  
Senior Manager