



LETTER OF COMMENT NO. 44



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Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
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File Reference No. 1550-100: Preliminary Views, *Financial Instruments with Characteristics of Equity*

Dear Mr. Golden:

PricewaterhouseCoopers appreciates the opportunity to comment on the FASB's Preliminary Views, *Financial Instruments with Characteristics of Equity*. Since this is a modified joint project of the FASB and IASB (the 'Boards'), we have consulted with members of the PricewaterhouseCoopers network of firms. This response summarizes the views of member firms who commented on the Preliminary Views document. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

The determination of whether a financial instrument is a liability or equity is an important decision that will not only affect balance sheet classification, but also the selection of its measurement attribute and whether any resulting measurement changes or related cash flows are recognized through the income statement. Under existing IFRS and US GAAP, making this determination has become very challenging for many financial statement preparers. Financial instruments have become increasingly complex and often contain both liability and equity characteristics. As a result, today's accounting is complicated and often dependent on the nature of the instrument and its legal form rather than the substance of the instrument.

Within US GAAP, the accounting standards have not kept pace with the development of these financial instruments and the standards typically have been "patched" over time to address each new issue as it has arisen. As a result, numerous pieces of literature must be considered, many of which do not always yield results that reflect economic reality. The more troublesome issues include: (1) the accounting for convertible debt that does not result in the economic cost of the borrowing being reflected in income, (2) the classification of derivative instruments that are indexed to or settled in equity, based in large part on whether there is any theoretical possibility that the instrument could be settled in cash outside of the issuer's control, and (3) the presentation of puttable equity instruments in the mezzanine section between liabilities and equity as if they are another class of instrument.



While in this area of accounting IFRS is fundamentally different from US GAAP, it faces its own set of challenges. The principles in International Accounting Standard 32, *Financial Instruments: Presentation* (IAS 32) do not always lead to a faithful representation of the economic characteristics of certain instruments. There are a number of exceptions, and if a financial instrument does not meet the definition of a financial liability, it is classified as an equity instrument. The mere existence of a contractual obligation to deliver cash could result in liability classification even though, in substance, the instrument has the economic characteristics of an equity instrument (for example, certain puttable instruments). Similarly, the absence of a contractual obligation to deliver cash results in an instrument being classified as an equity instrument, even if in substance that instrument displays the economic characteristics similar to a bond (for example, a perpetual non-participatory share).

We therefore support the efforts of the Boards to jointly develop a comprehensive framework for accounting for financial instruments that have characteristics of equity. We believe there is clearly a need for improvement to both US GAAP and IFRS and that this initiative presents an important opportunity for convergence. However, the development of a new accounting model for financial instruments that have characteristics of equity raises a number of conceptual issues such as: Should an economic entity or proprietary view be taken in determining classification? Should the project define an equity instrument or a liability or both? How should financial instruments be measured? To what extent should the changes in the instrument's recorded value affect the statement of financial performance and how? What is the most decision-useful presentation for these financial instruments? These are complex questions that cannot be considered in isolation, but rather need to be assessed as part of the overall financial reporting model. Most of these questions are currently being addressed or are planned to be considered by other projects on the Boards' agenda, in particular the Conceptual Framework and the Financial Statement Presentation projects.

Given the significance of these issues, we do not believe that a long-term solution to the accounting for financial instruments that have characteristics of equity can be adopted until some of the fundamental questions related to the overall financial reporting model and conceptual framework have been addressed. The conclusions reached on these projects can have a significant impact on whether a specific model is a workable approach for this project. As an example, the Board has rejected the Claims approach due in large part to income statement reporting and measurement concerns. However, the Financial Statement Presentation project is considering new reporting formats, one of which proposes the separation of the income statement into operating, financing and investing activities. Such a reporting model could alleviate some of the reporting and measurement concerns surrounding the Claims approach and possibly make it a viable solution.

Consequently, we believe that the Boards need to continue exploring various approaches, such as the Claims approach, in concert with the broader Conceptual Framework and Financial Statement Presentation projects before arriving at a long-term solution to the debt or equity question. In the interim, the Boards should search for a short-term solution in this project that solves some of the most difficult practice issues without making a radical change to the existing financial reporting model. In our view, the Basic Ownership approach is not the appropriate solution for this project. It defines equity very narrowly in an effort to reduce complexity, but at the expense of classifying as liabilities many instruments that we believe possess the fundamental characteristics of equity. Additionally, it potentially creates increased complexity in the accounting and measurement for those hybrid instruments (e.g., convertible debt) classified as liabilities and that have equity-related features that will need to be bifurcated and recognized at fair value through earnings. While we are a proponent of the simplification of accounting standards, we do not believe that the Basic Ownership approach strikes an appropriate balance between accounting simplicity and the need to reflect economic reality.

We believe that the fundamental characteristic of equity is that it provides the holder with a participation in the risks and rewards of ownership in an entity. Any ownership interest that



constitutes a direct participation in the earnings, losses and residual net assets of an entity should be classified as equity. Furthermore, a financial instrument that must be settled in equity-classified ownership interests and whose value is predominantly based on, and changes in the same direction as those ownership interests, should also be classified as equity because it participates in the earnings, losses and residual net assets, albeit not in a manner identical to the underlying ownership interest. Thus, in our view all participating perpetual preferred and common stock, regardless of their priority in liquidation, should be classified as equity. Additionally, financial instruments, such as physically settled written call options and forward sale contracts where the underlying instrument is an ownership interest, should likewise be considered equity for financial reporting purposes. However, nonparticipating interests, such as perpetual preferred stock that has a fixed dividend requirement, and other financial instruments, such as stock-settled debt, forward purchase contracts and written put options, should be classified as liabilities. Financial instruments with participating and nonparticipating features, such as a perpetual preferred stock that receives both fixed and participation returns, should be separated into equity and liability components.

Because these characteristics are largely embodied in the Ownership-Settlement approach, we recommend that the Boards adopt that approach as a short-term solution for this project. The Ownership-Settlement approach most closely reflects what we believe should be recorded as equity while not radically changing the current accounting. We recognize that this approach is more complex to apply, but believe that it strikes a better balance between accounting simplicity and the need to reflect economic reality. Additionally, this approach, along with the proposed separation, linkage and substance guidance, will help address a number of the current shortcomings in US GAAP and IFRS. We would however, propose certain modifications be made to the Ownership-Settlement approach and have included these in our detailed comments in response to the questions raised in the Preliminary Views document, which are attached in the Appendix to this letter.

As the Boards begin their joint deliberations on this project, we also recommend that they address the scope of this project early in that process. We believe that key differences between US GAAP and IFRS will impact how each Board views the need for new recognition and measurement guidance. The accounting for financial instruments under US GAAP has generally been established on an instrument-by-instrument basis, and therefore the Preliminary Views document proposes recognition and measurement models for those financial instruments that will be reclassified as liabilities (or assets) as a result of the new guidance. However, a measurement model for financial instruments not classified as equity already exists in IFRS in the form of International Accounting Standard 39, *Financial Instruments: Measurement* (IAS 39). Therefore no additional measurement guidance is required under IFRS for an instrument that is reclassified as a liability (or asset) as a result of this project. Introducing new measurement models to those that already exist in IAS 39 only for those instruments within the scope of this project would introduce further complexity and could result in economically similar transactions being measured differently. Attempts to converge measurement for only this subset of financial instruments would seem to contradict the Boards ongoing efforts to reduce complexity in this area of accounting as discussed in the FASB Invitation to Comment and IASB Discussion Paper on *Reducing Complexity in Reporting Financial Instruments*. It may be necessary for the Boards to consider the responses to these documents before concluding on the scope of this project as it relates to measurement.

We appreciate the opportunity to express our views on the Preliminary Views document. If you have questions regarding our comments, please contact John Althoff at (973) 236-7288, Michael J. Gallagher at (973) 236-4328, or David B. Kaplan at (973) 236-7219.

Sincerely,

PricewaterhouseCoopers LLP

Basic Ownership Approach

1. **Do you believe that the basic ownership approach would represent an improvement in financial reporting? Are the underlying principles clear and appropriate? Do you agree that the approach would significantly simplify the accounting for instruments within the scope of this Preliminary Views and provide minimal structuring opportunities?**
 - No. In our view, the Basic Ownership approach is not the appropriate solution for this project. It defines equity very narrowly in an effort to reduce complexity, but at the expense of classifying as liabilities many instruments that we believe possess the fundamental characteristics of equity. While we are a committed proponent of the simplification of accounting standards, we do not believe that the Basic Ownership approach strikes an appropriate balance between accounting simplicity and the need to reflect economic reality. Furthermore, while the Basic Ownership approach will simplify the classification of instruments, it should be noted that it will likely result in some added accounting and measurement complexity due to the resulting increase in the number of hybrid instruments (e.g., convertible debt) classified as liabilities and that have equity-related features that will need to be bifurcated and recognized at fair value through earnings. Therefore, we do not believe that the Basic Ownership approach would represent an improvement in financial reporting.
 - The conclusions proposed under the Basic Ownership approach would require liability classification for all share-based payments. The accounting for employee stock options and other share-based payments has been very controversial, and we do not believe that it should be changed again. Although the Boards could elect to exclude these instruments from the new guidance, we believe that such an approach undermines the intent of having a comprehensive framework for financial instruments that have characteristics of equity. We favor an approach that provides a consistent set of principles for all instruments.
 - The Preliminary Views document requires that the classification of an instrument that has characteristics of equity be determined at the subsidiary level and carried forward without change to the consolidated financial statements, unless the features of the instrument affecting classification are different at the parent level. This requirement raises a conceptual concern as the premise of the Basic Ownership approach is that equity represents the most subordinated class of interest that is neither limited nor guaranteed. However, the noncontrolling interests reflected as equity in the consolidated financial statements will represent interests that are limited only to the residual assets of the specific subsidiaries to which they relate. Additionally, the classification of noncontrolling interests as equity in the consolidated financial statements may also create a structuring opportunity. A contractual interest in a specific group of assets is generally treated as a liability under current GAAP. However, it appears that an entity would be able to place those same assets in a separate legal entity and sell an ownership interest in that subsidiary. Assuming that ownership interest is the most residual interest in the subsidiary, it will be classified as equity in the parent's consolidated financial statements. Such inconsistent treatment for identical economic interests should be addressed by the Boards.
 - The Preliminary Views document includes a simple example of the classification of a general partnership interest in Table 2 of Appendix C. However we believe that in practice many partnership agreements contain complex income sharing and distribution provisions that vary depending on the cumulative earnings achieved. It is unclear as to how these partnership interests would be classified under the Basic Ownership approach, which defines equity based on the most subordinated class of interest that is neither limited nor guaranteed.

2. **Under current practice, perpetual instruments are classified as equity. Under the basic ownership approach (and the REO approach, which is described in Appendix B) certain perpetual instruments, such as preferred shares, would be classified as liabilities. What potential operational concerns, if any, does this classification present?**
 - We believe that perpetual instruments that participate in the risks and rewards of ownership of an entity should be classified as equity. However, we agree that non-participating perpetual instruments do not possess the fundamental characteristics of equity and therefore should be classified as liabilities.
 - The description of the scope of the proposed guidance contained in paragraph 15 of the Preliminary Views document appears to include only perpetual instruments that are ownership interests in legal form. We believe that the scope should be clarified to include perpetual instruments that have the characteristics of equity, regardless of their legal form.
3. **The Board has not yet concluded how liability instruments without settlement requirements should be measured. What potential operational concerns, if any, do the potential measurement requirements in paragraph 34 present? The Board is interested in additional suggestions about subsequent measurement requirements for perpetual instruments that are classified as liabilities.**
 - We believe that participating perpetual instruments should be classified as equity. Therefore, only a nonparticipating perpetual instrument would be recognized as a liability. Such an instrument should initially be recognized at fair value and subsequently measured at amortized cost or at fair value (i.e., if the fair value option is elected) consistent with the guidance for other liabilities.
4. **Basic ownership instruments with redemption requirements may be classified as equity if they meet the criteria in paragraph 20. Are the criteria in paragraph 20 operational? For example, can compliance with criterion (a) be determined?**
 - We understand that in some jurisdictions, legal requirements provide owners in nonpublic entities with certain liquidity rights with respect to their ownership interests. Frequently, this is achieved by providing the owners with a right to put their ownership interest to the entity at a formula value. Because the formula may not have been designed to approximate fair value, all such ownership interests in these jurisdictions would fail to meet the criterion in paragraphs 20 and 21. We believe that the definition of a redeemable ownership instrument that is classified as equity should be expanded to include all instruments that would otherwise meet the definition of a basic ownership instrument and that provide all holders of that class of instrument with the same formula value put right. Although that amount may not approximate fair value, we support equity classification for these instruments because it is equally available to all members of the most residual classes, and as a group, they constitute the ownership of the entity.
 - Although we generally understand what is meant by the statement: ". . . if redemption would impair the claims of any instruments with a higher priority . . ." in paragraph 20(b), we recommend that the Boards consider clarifying the guidance. The purchase of a redeemable ownership interest will reduce the assets of an entity, and if significant enough, could result in a credit rating downgrade. Is such a downgrade following a stock redemption considered an impairment, even though sufficient assets remain in the entity to settle higher priority claims? We don't believe so, even though the risk associated with the remaining claims has increased and the fair value of the claim has decreased.
5. **A basic ownership instrument with a required dividend payment would be separated into liability and equity components. That classification is based on the Board's**

understanding of two facts. First, the dividend is an obligation that the entity has little or no discretion to avoid. Second, the dividend right does not transfer with the stock after a specified ex-dividend date, so it is not necessarily a transaction with a current owner. Has the Board properly interpreted the facts? Especially, is the dividend an obligation that the entity has little or no discretion to avoid? Does separating the instrument provide useful information?

- We generally agree that the separation of hybrid instruments is appropriate to achieve representational faithfulness. Therefore, an instrument that participates in the risks and rewards of ownership but also has a non-participatory fixed dividend payment requirement should be separated into a liability and equity component. However, we believe the guidance for the separation of a basic ownership instrument that has a required dividend payment into liability and equity components should be clarified with respect to the nature of the dividend payments. While we agree that a fixed dividend requirement should be accounted for as a liability, we don't agree with such accounting for a participating dividend requirement. We understand that some jurisdictions have a statutory requirement to pay shareholders a minimum dividend based on the entity's earnings each period. In our view, such required dividend payments should be classified as equity, as they are not substantively different from the payments that are made when a redeemable equity instrument is redeemed at an amount equal to the holder's share in the issuer's net assets.
- 6. **Paragraph 44 would require an issuer to classify an instrument based on its substance. To do so, an issuer must consider factors that are stated in the contract and other factors that are not stated terms of the instrument. That proposed requirement is important under the ownership-settlement approach, which is described in Appendix A. However, the Board is unaware of any unstated factors that could affect an instrument's classification under the basic ownership approach. Is the substance principle necessary under the basic ownership approach? Are there factors or circumstances other than the stated terms of the instrument that could change an instrument's classification or measurement under the basic ownership approach? Additionally, do you believe that the basic ownership approach generally results in classification that is consistent with the economic substance of the instrument?**
- We do not support the Basic Ownership approach principally because it does not fully capture what we believe to be the fundamental characteristic of equity. Any ownership interest that constitutes a direct participation in the earnings, losses and residual net assets of an entity should be classified as equity. Furthermore, a financial instrument that must be settled in equity-classified ownership interests and whose value is predominantly based on, and changes in the same direction as those ownership interests, should also be classified as equity because it participates in the earnings, losses and residual net assets, albeit not in a manner identical to the underlying ownership interest. The Basic Ownership approach therefore defines equity too narrowly and classifies as liabilities many instruments that substantively are ownership interests.
- We support the inclusion of a substance principle and generally agree with the guidance provided for its application. However, in developing any additional guidance, the Boards should recognize that there are likely going to be factors or circumstances other than the stated terms of an instrument that could affect an instrument classification or measurement. For example certain jurisdictions require the distribution of a percentage of profits to shareholders each period. This requirement although not contractually stated, could potentially impact classification and measurement of the instrument under certain models, including the Basic Ownership approach. Local law, regulation or the entity's governing charter can also impose various types of prohibitions on the redemption of financial instruments. For example if redemption is unconditionally prohibited by local law, regulation



or the entity's governing charter, this should be considered in determining a financial instrument's classification under the standard.

7. **Under what circumstances, if any, would the linkage principle in paragraph 41 not result in classification that reflects the economics of the transaction?**
- We support the inclusion of a linkage principle and generally agree with the criteria provided for its application. However, the reference to whether instruments are contractually linked in paragraph 43(a) should be revised to clarify that both stated and unstated terms and arrangements should be considered in evaluating whether multiple instruments should be linked. The use of the word "contractual" could be misinterpreted to exclude unstated terms and arrangements.
 - The Boards may wish to consider clarifying further how an arrangement should be accounted for when the linkage principle requires multiple instruments involving different counterparties to be treated as a single instrument. For example, assume an entity issues a convertible debt instrument. At the same time, it enters into a purchased call option with another party that mirrors the written option embedded in the convertible debt instrument and requires its exercise when the investor in the convertible debt instrument exercises the conversion option. In applying the linkage guidance, the convertible debt instrument and the purchased call options will be combined and considered a single instrument. However, for purposes of classification and measurement, should the purchased and written call options be evaluated on a net basis because they economically offset each other, or separately because they have different counterparties?
8. **Under current accounting, many derivatives are measured at fair value with changes in value reported in net income. The basic ownership approach would increase the population of instruments subject to those requirements. Do you agree with that result? If not, why should the change in value of certain derivatives be excluded from current-period income?**
- We do not agree with the exclusion of all derivatives from equity classification as required by the Basic Ownership approach. We believe that a financial instrument that must be settled in equity-classified ownership interests and whose value is predominantly based on, and changes in the same direction as those ownership interests, should be classified as equity because it participates in the earnings, losses and residual net assets, albeit not in a manner identical to the underlying ownership interest. Thus, financial instruments, such as physically-settled written call options and forward sale contracts where the underlying instrument is an ownership interest, should likewise be considered equity for financial reporting purposes. However, other financial instruments, such as forward purchase contracts and written put options, should be classified as liabilities.
9. **Statement of financial position. Basic ownership instruments with redemption requirements would be reported separately from perpetual basic ownership instruments. The purpose of the separate display is to provide users with information about the liquidity requirements of the reporting entity. Are additional separate display requirements necessary for the liability section of the statement of financial position in order to provide more information about an entity's potential cash requirements? For example, should liabilities required to be settled with equity instruments be reported separately from those required to be settled with cash?**
- No. While information about financial instruments that will be settled with equity instruments and are classified as liabilities is likely to be useful to users of the financial statements, we do not believe that mandating a separate line item presentation on the statement of financial position is necessary. There are no separate display requirements for liabilities that are settled with non-cash assets. Additionally, information pertaining to redemption requirements



should be disclosed in the footnotes and preparers should have the ability to present them on a separate line item if they wish.

10. Income statement. The Board has not reached tentative conclusions about how to display the effects on net income that are related to the change in the instrument's fair value. Should the amount be disaggregated and separately displayed? If so, the Board would be interested in suggestions about how to disaggregate and display the amount. For example, some constituents have suggested that interest expense should be displayed separately from the unrealized gains and losses.

- We believe that providing disaggregated information that separates fair values changes from other components of net income will be decision-useful to investors and other users. The question as to how best to present fair value changes in the financial statements and related disclosures is not specific to instruments within the scope of this project but applies equally to all instruments that are marked-to-market on a recurring basis, with those fair value changes recorded in the income statement. We therefore believe that this question should be addressed as part of the broader reconsideration in the Boards' Financial Statement Presentation project.

11. The Board has not discussed the implications of the basic ownership approach for the EPS calculation in detail; however, it acknowledges that the approach will have a significant effect on the computation. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider?

- We continue to hear from investors that the EPS measure is important to them. The issuance of financial instruments that have characteristics of equity has EPS ramifications. Consequently, the selection of a new accounting approach for these instruments may have significant implications on the EPS calculation. We believe that there is a need for this project to address the EPS ramifications once the appropriate model has been selected and more fully developed.

Ownership-Settlement Approach

1. Do you believe the ownership-settlement approach would represent an improvement in financial reporting? Do you prefer this approach over the basic ownership approach? If so, please explain why you believe the benefits of the approach justify its complexity.

- We believe that the Ownership-Settlement approach would represent an improvement in financial reporting. This approach will better reflect the economics of these instruments in the financial statements because it will present as equity all instruments that provide the holder with a participation in the risks and rewards of ownership in an entity. The Ownership-Settlement approach will also address a number of the problems that exist with current accounting under US GAAP and IFRS.
- We acknowledge that the Ownership-Settlement approach is more complex and requires more separation of instruments into liability and equity components than does the Basic Ownership approach. However, we believe that this additional complexity compared to the Basic Ownership approach is necessary to more appropriately reflect the economic reality of these instruments in the financial statements.

2. Are there ways to simplify the approach? Please explain.

- While not necessarily simplifying the Ownership-Settlement approach, we recommend that the Boards consider the following:

- The definition of basic ownership instruments should be expanded to include all common stock that has priority in liquidation (i.e., not just common stock that is the most subordinated). We believe that all instruments that directly participate in the earnings, losses and residual net assets should be considered equity.
 - Only perpetual instruments that participate in the earnings, losses and residual net assets of an entity should be classified as equity. Non-participating perpetual instruments, such as a non-redeemable preferred stock that has a fixed dividend requirement, should be classified as liabilities. The distinction made between participating and non-participating perpetual instruments reflects our belief that all instruments that directly participate in the earnings, losses and residual net assets should be considered equity (i.e., including participating perpetual instruments).
 - The definition of an indirect ownership instrument should be clarified concerning the extent to which variables besides the issuer's own stock price can impact the settlement of such instruments and the impact the currency denomination of the strike price has on an instrument's classification.
- A number of entities such as partnerships and co-operatives do not have a traditional capital structure. Although the class as a whole would meet the definition of a redeemable basic ownership instrument, many entities include a mechanism for individual holders to put back their share based on a formula at something other than fair value. The Boards should widen the definition of a basic ownership instrument to include such instruments. Instruments that directly participate in the earnings, losses and residual net assets should be considered equity.
 - The Preliminary Views document requires that the classification of an instrument that has characteristics of equity be determined at the subsidiary level and carried forward without change to the consolidated financial statements, unless the features of the instrument affecting classification are different at the parent level. This requirement raises a conceptual concern with the definition of a basic ownership instrument, which represents the most subordinated class of interest that is neither limited nor guaranteed. However, the noncontrolling interests reflected as equity in the consolidated financial statements will represent interests that are limited only to the residual assets of the specific subsidiaries to which they relate. Additionally, the classification of noncontrolling interests as equity in the consolidated financial statements may also create a structuring opportunity. A contractual interest in a specific group of assets is generally treated as a liability under US GAAP and IFRS. However, it appears that an entity would be able to place those same assets in a separate legal entity and sell an ownership interest in that subsidiary. Assuming that ownership interest is the most residual interest in the subsidiary, it will be classified as equity in the parent's consolidated financial statements. Such inconsistent treatment for identical economic interests should be addressed by the Boards.
3. **Paragraph A40 describes how the substance principle would be applied to indirect ownership instruments. Similar to the basic ownership approach, an issuer must consider factors that are stated in the contract and other factors that are not stated in the terms of the instrument. Is this principle sufficiently clear to be operational?**
- We support the inclusion of a substance principle and generally agree with the guidance provided for its application. However, in developing any additional guidance, the Boards should recognize that there are likely to be factors or circumstances other than the stated terms of an instrument that could affect an instrument's classification or measurement. For example certain jurisdictions require the distribution of a percentage of profits to shareholders each period. This requirement although not contractually stated, could potentially impact classification and measurement of the instrument under certain models, including the Ownership-Settlement approach. Local law, regulation or the entity's governing charter can

also impose various types of prohibitions on the redemption of financial instruments. For example if redemption is unconditionally prohibited by local law, regulation or the entity's governing charter, this should be considered in determining a financial instrument's classification under the standard.

- 4. Statement of financial position. Equity instruments with redemption requirements would be reported separately from perpetual equity instruments. The purpose of the separate display is to provide users with information about the liquidity requirements of the reporting entity. What additional, separate display requirements, if any, are necessary for the liability section of the statement of financial position in order to provide more information about an entity's potential cash requirements? For example, should liabilities required to be settled with equity instruments be reported separately from those required to be settled with cash?**
 - No. While information about financial instruments that will be settled with equity instruments and are classified as liabilities is likely to be useful to users of the financial statements, we do not believe that mandating a separate line item presentation on the statement of financial position is necessary. There are no separate display requirements for liabilities that are settled with non-cash assets. Additionally, information pertaining to redemption requirements should be disclosed in the footnotes and preparers should have the ability to present them on a separate line item if they wish.
- 5. Are the proposed requirements for separation and measurement of separated instruments operational? Does the separation result in decision-useful information?**
 - While the separation of hybrid instruments into a liability and equity component may add some element of complexity, we believe that it is necessary to better reflect the economic substance of compound instruments. However, the Boards may wish to consider whether it is always necessary to value the liability component first and allocate the residual to the equity component. We believe that measurement challenges are likely to arise in determining the fair value of a liability component in situations where a market does not exist for the equivalent freestanding instrument, such as may be the case with non-investment grade borrowers. The Boards may wish to consider allowing preparers to determine the value of the equity component as an alternative when it is more readily determinable than the liability component.
- 6. The Board has not discussed the implications of the ownership-settlement approach for the EPS calculation in detail. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider?**
 - We continue to hear from investors that the EPS measure is important to them. The issuance of financial instruments that have characteristics of equity has EPS ramifications. Consequently, the selection of a new accounting approach for these instruments may have significant implications on the EPS calculation. We believe that there is a need for this project to address the EPS ramifications once the appropriate model has been selected and more fully developed.
- 7. Are the requirements described in paragraphs A35–A38 operational? Do they provide meaningful results for users of financial statements?**
 - The proposed accounting for settlement, conversion, expiration, or modification would appear fundamentally consistent with the initial separation requirements for hybrid instruments. We believe that the separation of hybrid instruments is necessary to achieve representational faithfulness.



- The Preliminary Views document also refers to the Loss Absorption approach. Since it was released for comment, the European Financial Reporting Advisory Group (EFRAG) issued its discussion paper, *Distinguishing Between Liabilities and Equity* which describes this approach in greater detail. Based on our initial analysis of the model, we do not believe that participation in accounting losses alone should be the basis for defining equity. This appears to be largely a legal form approach that will not necessarily reflect the economic substance of all instruments. However, we welcome the continued development of alternative approaches to classification and measurement as potential longer term solutions. We recommend that any longer term project to develop a new conceptual model for distinguishing debt and equity evaluate alternative models, such as this one, more thoroughly before reaching any final conclusion.

Other Comments

- While the FASB has identified and analyzed a significant number of different instruments that are typical in the US, we believe that the Boards should also consider a variety of instruments in other jurisdictions in order to validate the proposed models, ensure that there are no unforeseen consequences from applying the models, and determine whether any outcomes cannot be justified or appropriately explained. We are conducting research in multiple territories to identify financial instruments that regularly occur but have not yet been contemplated in this project, and will share the results of this research with the Boards when available.
- The Preliminary Views document contains substance and linkage principles to be applied to financial instruments within the scope of this project. We generally support these provisions, and upon completion of this project, believe that the Boards should consider expanding the application of the substance and linkage principles to other financial instruments.