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Mr. Jean Paul Gauzès,
President of the Board

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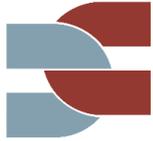
Re: IASB Discussion Paper Financial Instruments with Characteristics of Equity (FICE) (DP/2018/1) – EFRAG response letter to IASB

Dear Mr. Gauzès,

As the EFRAG is in the process of preparing its response to the IASB concerning the Discussion Paper on Financial Instruments with Characteristics of Equity (FICE), we want to flag our serious concern that arise from the proposals set forth by the IASB regarding the classification of cooperative shares as equity instruments. For more than a decade the members of the European Association of Cooperative Banks (EACB) have been closely following the discussions on equity/liability distinction. We enthusiastically welcomed IFRIC 2, when it was adopted in 2004 to complement IAS 32, since it confirmed the equity treatment of member shares of cooperatives. It calmed serious concern about an appropriate treatment of member shares under IFRS, when these standards became mandatory in the EU. Also by today, IFRIC 2 is a fundamental element for cooperative banks and other cooperatives¹. For cooperative banks the equity presentation of cooperative shares and certificates is essential: the presentation of a financial instrument as equity on the balance sheet is one of the global eligibility requirements for regulatory capital (common equity) under the global regulatory framework for banks of the Basel Committee. Now, as before, all cooperative banks' member shares in Europe are common equity. Different to many other instruments, cooperative shares never gave regulators a reason to question the stability and loss-absorbing capacity of cooperative share capital, especially during the last crisis.

But also from a more general perspective a liability treatment would impact relevant company figures (RoE, Debt-to-Liability) and create the impression that cooperatives are

¹ In particular, the 2008 amendment of IAS 32 regarding "Puttable Instruments and Obligations Arising on Liquidation" did not change the situation for cooperatives, since member shares do not meet the criteria of puttable instruments.



less stable and operate with low levels of capital. This would be highly inappropriate, since cooperatives very often are among the oldest corporates in their jurisdiction and delivered a record of financial stability and solvency over decades. When IASB published its Discussion Paper on FICE, we highly appreciated that it clearly stated that IFRIC 2 should not be affected and should be instead carried on. Nevertheless, we do not share the Board's analysis that *"it was developed for a very specific fact pattern with limited effect in practice"*. In fact, IFRIC 2 defines one parameter for the equity classification of tens of billions Euros of common equity in the European and global banking sector.

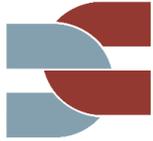
Due to this fundamental role and established importance as constituting piece and essential *acquis* of the accounting framework, we strongly advocate that IFRIC 2 should be included into the standard itself.

However, the redeemability of cooperative member shares, which is what IFRIC 2 addresses, is only one particularity of these instruments. There are other particularities as well. We are indeed seriously concerned that the key element of the discussion paper, i.e. the "preferred approach" and more precisely its "amount feature" ("amount independent of the entity's available economic resources"), is problematic. After an intensive analysis our members fear that the use of such "amount feature" would place a large question mark upon the equity classification of cooperative member shares and member certificates.

Cooperative Member Shares are the instrument to create and steer a cooperative. They grant the right to dividends, the right to attend and vote in the general assembly and the right to use the services of the cooperative. In terms of capital there are two features of member shares on which we would focus:

- Cooperatives are variable capital companies: when a member enters, shares are generated according to the capital paid in (in common denominations). When a member leaves the cooperative that paid-in amount is redeemed. During the time of adherence, members will receive dividends, if profit is generated. However, usually the biggest part of the profit is transferred into retained earnings. Such increases of retained earnings over the years will however not affect the redeemable amount when a member leaves the cooperative. Losses will not affect the redeemable amount unless retained earnings are consumed and the subscribed capital is affected. In such case the share capital reduced by such losses could be redeemed.
- In liquidation, member shares are the most subordinate claim and are paid back after all other claims. However, only in some jurisdictions the remaining residual after repayment of shares is divided among members per shares or by another formula. In some jurisdictions the remaining residual would be transferred to a cooperative fund, to charitable organisations or deposited at the national central bank until the cooperative can be re-established.

These features are the reflex of the specificities of cooperatives, which according to Regulation (EC) 1435/2003 are *"legal entities with particular operating principles that are different from those of other economic agents. [...] These particular principles include notably the principle of the primacy of the individual which is reflected in the specific rules"*



on membership, resignation and expulsion, where the 'one man, one vote' rule is laid down and the right to vote is vested in the individual, with the implication that members cannot exercise any rights over the assets of the cooperative." The limited rights to the assets is a logical consequence of the primary purpose of a cooperative which is not the generation of profit. Its "*principal object the satisfaction of its members' needs and/or the development of their economic and social activities.*" Cooperatives and their specific economic model contribute to the diversity and thereby to the stability of the economy. In fact, we are proud to underline that especially our capital features very much contributed to the stability of the capitalization of cooperative banks during the recent crisis.

Thus for us there can be no doubt that cooperative member shares and certificates are equity in the financial statement.

The discussion paper does not give a clear answer in this respect, as the "amount feature" as specified in the paper does not take into account the way in which members participate in the capital of the cooperative, instead it rather raises doubts. We therefore believe that the preferred approach and especially the "amount feature" as they are defined today should be rejected.

IAS 32 has worked well so far, and beside possible targeted amendments to reflect new instruments, we see no need for an overhaul of its philosophy. We appeal to EFRAG to stress these elements in its response to the IASB and exclude any doubts on the classification of cooperative shares as equity instruments.

Yours sincerely

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