

Comments to EFRAG Draft Comment Letter on the IASB DP/2018/01 on the distinction between liabilities and equity

30 November 2018

From Ørsted's side, we are pleased to submit our feedback to your draft comment letter on the IASB DP/2018/01.

Our ref. ALSKJ

Background

Ørsted has like many other European utilities and other corporates benefited from issuing hybrid capital as an alternative to issuing shares. Thereby strengthening our capital structure in a cost-efficient way.

Ørsted's first corporate hybrid capital was issued in 2005, and today we have three issues outstanding totalling EUR 1.8bn. Our hybrid capital has all been issued with a 1,000-year tenor and 5-10 years to first par call date. They also include, rating, accounting and other standard call features in the structure.

Following the suggested changes contained in the current discussion paper, Ørsted would no longer be able to account for our EUR 1.8 billion hybrid capital as equity and the classification of Ørsted's subordinated hybrid capital as debt would significantly reduce Ørsted's solvency ratio.

Our main concern is that this will lead to higher cost of capital either due to higher interest rates on Ørsted's debt in general or due to higher coupon on the hybrids when refinanced into hybrid structures to make it compliant with the new equity classification requirements.

Furthermore, the classification of the hybrid capital as debt would trigger the accounting call feature contained in Ørsted's hybrid structures. This gives Ørsted the opportunity to redeem outstanding hybrid capital at a price of 101 to par (to refinance in new hybrid capital or senior debt), thereby potentially inflicting losses to investors. Today, two of Ørsted's hybrid securities are trading above par, one of them significantly above.

Analysis

We acknowledge that our hybrid capital in the normal course of business behaves similarly to debt, as Ørsted would have a strong intention to make coupon payments on the hybrid capital and not to defer, as long as our financial condition allows for it. It may therefore from an economic point of view seem reasonable to classify this as debt.

However, we believe that accounting for Ørsted's hybrid capital as equity gives a more fair and true picture due to the below two reasons:

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- Ørsted's hybrid capital cannot trigger a default situation as there is no obligation to make any payments¹, and
- our hybrid capital is subordinated to all other debt.

We therefore do not see any significant differences to ordinary share capital. We also have a strong intention to pay dividend to our shareholders. But just as is the case with our hybrid capital this requires that our financial well-being allows us to do so.

Therefore, it makes sense that both our ordinary shares and hybrid capital is classified as equity. In addition, we would normally replace a hybrid security that is being repaid on the first call date with a new hybrid security to maintain a stable capital structure.

The Discussion Paper suggests that we need to consider what happens in a default situation when classifying an issue as debt or equity. We see this as a violation of the basic principle of going concern. Putting aside the going concern principle when making the assessment will increase complexity and dilute logic in financial reporting. Since we in all other aspects consider ourselves a going concern when making estimates.

Conclusion

Seen from the perspective of our senior bond holders and other simple creditors our hybrid capital will act as equity in a crisis and provide them with the same protection as equity. We therefore believe that it gives a more true and fair picture to present our hybrid capital as equity.

We are not aware of any users of our Financial Statement whom find our current classification of Ørsted's hybrid capital as equity as misleading. We therefore do not see a need to change the current accounting treatment. We also believe that the objectives that IASB are trying to achieve with the suggested change can be resolved with more informative disclosures without creating unnecessary costs and complexity.

We recommend that EFRAG should emphasise the above point in your comment letter to IASB among other to ensure continuous low cost of capital for European companies.

Yours sincerely
Ørsted

Nicolai Frederik's Schmidt Carøe
Director, Accounting Excellence
NIFSC@orsted.dk
Tel. +45 99 55 68 65

Alex Skjærris
Lead IFRS Specialist
ALSKJ@orsted.dk
Tel. +45 99 55 93 83

¹ Except that we are obligated to repay the nominal amount at maturity in 1000 years. The net present value of this is zero