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Financial Instruments with Characteristics of Equity Cover Note

Objective

- 1 The objective of the session is to:
 - (a) consider the feedback received in response to EFRAG's draft comment letter on the IASB's Discussion Paper *Financial Instruments with Characteristics of Equity* (FICE);
 - (b) recommend an EFRAG comment letter to the EFRAG Board on the IASB's Discussion Paper on FICE; and
 - (c) present EFRAG's early stage impact assessment of the IASB's Discussion Paper on FICE.

Background

- 2 In December 2018, EFRAG TEG received an update on the feedback received during the outreach activities as well as from comment letters on the EFRAG Draft Comment Letter.
- 3 In addition, EFRAG TEG discussed EFRAG's overall position in its final comment letter to the IASB Discussion Paper on FICE. Since then:
 - (a) more than 10 additional comment letters (click [here](#) to access the comment letters);
 - (b) the summary of the feedback received from comment letters on EFRAG Draft Comment Letter has been updated (agenda paper 10-02);
 - (c) feedback statements relating to the outreach events organised together with National Standard Setters, the IASB and other organisations have been published ([Amsterdam](#), [Brussels](#), [Copenhagen](#), [Frankfurt](#), [London](#) and [Milan](#));
 - (d) EFRAG Secretariat has updated the EFRAG comment letter to reflect the comments received by EFRAG TEG, the EFRAG Board and the additional comment letters received (agenda paper 10-03); and
 - (e) EFRAG Secretariat has updated the EFRAG early stage impact assessment to reflect the comments received by EFRAG TEG and the EFRAG Board.

EFRAG Secretariat proposed changes to EFRAG Comment Letter

- 4 The EFRAG Secretariat updated EFRAG's comment letter to the IASB based on the following feedback received from EFRAG TEG:
 - (a) As respondents to EFRAG's draft comment letter and participants in the outreach events had either disagreed with or expressed only limited support

for the IASB's preferred approach, EFRAG TEG considered suggesting potential targeted improvements to IAS 32 *Financial Instruments: Presentation*.

- (b) EFRAG TEG members recommended the inclusion of specific suggestions for potential targeted improvements to IAS 32 in the revised comment letter, highlighting that additional disclosures on equity instruments were key.
- (c) EFRAG TEG members provided a number of suggestions to improve the comment letter such as:
 - (i) highlighting some of the IASB's proposals that could be used to improve IAS 32 (e.g. disclosures on equity instruments);
 - (ii) explaining better the concerns related to the amount feature; providing more details on the cost-benefit trade-off of the IASB preferred approach;
 - (iii) providing a better framework to the suggestion of having a long-term project; improving the internal consistency of the letter (e.g. IAS 32 is not broken versus pervasive enough for standard setting activity); and
 - (iv) addressing more extensively the issue of hybrid instruments.

Questions for EFRAG TEG

- 5 Does EFRAG TEG recommend EFRAG comment letter on the IASB DP on FICE to the EFRAG Board?

EFRAG Secretariat proposed changes to EFRAG Early-stage Impact Assessment

- 6 The EFRAG Secretariat updated EFRAG's early-stage impact assessment based on the feedback received from the December joint meeting of EFRAG Board and EFRAG TEG by:
- (a) refining the description of the interaction between FICE proposals and prudential regulatory requirements and the consequential impact on financial stability.
 - (b) clarifying that although remeasurements of instruments that could be reclassified from equity to financial liabilities under the IASB DP proposals - could potentially impact on retained earnings and CET1 volatility- such volatility is unlikely to occur in practice in an EU context. For example, remeasurements of AT1 instruments that may be reclassified from equity to debt- would likely only impact retained earnings if there was a temporary write-down gain that is taxable.
 - (c) Updating the limitations section to emphasise that the early stage impact assessment cannot exhaustively cover all possible second order effects such as structuring.
 - (d) Updating the report to reflect the costs of switching from "cheap equity" to "expensive debt".
 - (e) Updating the report to reflect that at this stage it is difficult to accurately predict the transitional and long run impact on cost of capital.

Questions for EFRAG TEG

- 7 Does EFRAG TEG recommend EFRAG early-stage impact assessment on the IASB DP on FICE to the EFRAG Board?

Agenda Papers

- 8 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 10-02 – Updated overview of comments received;
 - (b) Agenda paper 10-03 – Proposed Final Comment Letter; and
 - (c) Agenda paper 10-04 – Early Impact Assessment
 - (d) Agenda paper 10-05 – Proposed Final Comment Letter – Track Changes (for background only).