

This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

## **Financial Instruments with Characteristics of Equity Cover Note**

### **Objective**

- 1 The objective of the session is to:
  - (a) Approve the EFRAG comment letter to the IASB's Discussion Paper *Financial Instruments with Characteristics of Equity* (FICE); and
  - (b) Note the EFRAG Secretariat early-stage impact analysis.

### **Background**

- 2 In December 2018, the EFRAG Board received an update on the feedback received during the outreach activities as well as from comment letters on the EFRAG Draft Comment Letter. Since then:
  - (a) EFRAG published the feedback statements relating to the outreach events organised together with National Standard Setters, the IASB and other organisations ([Amsterdam](#), [Brussels](#), [Copenhagen](#), [Frankfurt](#), [London](#) and [Milan](#));
  - (b) EFRAG received in total 29 comment letters, which can be found on EFRAG's Website (click [here](#));
  - (c) EFRAG TEG discussed the summary of the feedback received from the 29 comment letters (click [here](#)); and
  - (d) EFRAG TEG decided to recommend a comment letter on FICE to the EFRAG Board.

### **Overview of the comment letters received**

- 3 In general, respondents acknowledged the challenges with IAS 32 *Financial Instruments: Presentation* and appreciated the IASB's efforts to address these challenges and diversity in practice by attempting to better articulate principles underlying the classification of claims between debt and equity. These respondents acknowledged that there is room to improve IAS 32, particularly on disclosures about equity instruments and the accounting for new complex instruments such as contingent convertible bonds.
- 4 However, there was less support for the IASB's preferred approach as described in the Discussion Paper (i.e. comprehensive specification of the principles underpinning classification) to address the challenges that currently arise in practice. Most concerns were related to the lack of clarity of the new terminology, the use of the 'amount feature' on liquidation and the cost-benefit trade-off of implementing new principles intended to result in (mostly) the same outcome.

- 5 There was more support for specific improvements to current requirements in IAS 32, particularly for the classification of new complex instruments and improvements to current presentation and disclosure requirements. Some respondents highlighted that the Discussion Paper already identified some solutions to the issues that arise in practice which could be a good basis for further discussions.
- 6 Finally, some respondents called for a more conceptual and less rule-based approach to distinguish debt from equity. However, these respondents provided mixed and sometimes contradictory views. For example, some supported the IASB approach, others supported an approach based on the timing feature only while others suggested an approach more aligned with the conceptual framework.

#### **EFRAG TEG discussions on EFRAG Comment Letter**

- 7 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 proposed that the final comment letter should reject the IASB's preferred approach for classification and suggest potential targeted improvements to IAS 32.
- 8 EFRAG TEG acknowledged that some constituents are calling for a more conceptual to distinguish debt from equity. However, at this stage EFRAG has not identified any consensus among those constituents on how to achieve this in a reasonable timeframe. Therefore, developing a more conceptual and less rule-based approach is going to be very challenging and any alternative that results in widespread classification changes is likely to prove controversial (as with previous approaches discussed by the IASB and EFRAG).

#### **Questions for EFRAG Board**

- 9 Does EFRAG Board approve EFRAG comment letter on the IASB DP on FICE?

#### **EFRAG Secretariat Early-stage Impact Analysis**

- 10 EFRAG Secretariat undertook an early-stage impact analysis of the proposals in the DP to demonstrate how impact analyses should develop for major projects. The EFRAG Secretariat early-stage impact analysis covers the expected impact of the proposals in the DP, including EU public good aspects related to the economic consequences of the proposals, impact on financial stability; and improvements to financial reporting. The analysis has been undertaken with data gathered from surveys to preparers and users, outreach feedback, and academic evidence.
- 11 It is envisaged that this early-stage impact analysis should be a 'living document' that is updated as the FICE project develops. Accordingly, it is suggested that the current version should be published as an EFRAG Secretariat working paper. The EFRAG Secretariat early-stage impact analysis does not reflect a formal position of EFRAG as that would require further due process and more extensive evidence gathering around economic consequences and likely costs and benefits of any potential updates to existing requirements. This type of evidence is not available at such an early stage of the project.

#### **Questions for EFRAG Board**

- 12 Does EFRAG Board agree with the proposal to publish the early-stage impact analysis as an EFRAG Secretariat working paper?

#### **Agenda Papers**

- 13 In addition to this cover note, agenda papers for this session are:

*Financial Instruments with Characteristics of Equity – Cover Note*

- (a) Agenda paper 07-02 – Proposed Final Comment Letter; and
- (b) Agenda paper 07-03 – EFRAG Secretariat Early-stage Impact Analysis.