

EFRAG
35 Square de Meeûs (fifth floor)
Brussels 1000
Belgium

Secretariaat:
Antonio Vivaldistraat 2-8, 1083 GR Amsterdam
Postbus 7984, 1008 AD Amsterdam

T +31(0)20 301 03 91
secretariaat@rjnet.nl
www.rjnet.nl

Our reference: RJ-EFRAG 588 E

Direct dial: +3120 3010235

Date: December 19, 2018

Re: Draft Comment Letter on IASB Discussion Paper DP/ ‘*Financial Instruments with Characteristics of Equity*’

Dear members of the Technical Expert Group,

The Dutch Accounting Standard Board (DASB) appreciates the opportunity to respond to your draft comment letter to the IASB regarding the Discussion Paper *Financial Instruments with Characteristics of Equity*. We take this opportunity to respond to your requests relating to the questions posed to constituents within this letter and you can find the responses to these questions in the Appendix attached to this letter.

We agree with the contents within your draft comment letter to the IFRS foundation. We agree that an impact analysis is of utmost importance to fully comprehend the application and implementation of the new standard, in light of the capital structure of entities issuing financial instruments for financing. We would support the EFRAG taking a firmer stance or using stronger language in stating there is no support for the new FICE model.

Since the capital structure is one of the most important objects in financial analysis, having a clear and solid standard that sets the classification of financial instruments with characteristics of equity is important. The biggest challenge lies in defining these instruments as either liabilities and/or equity. Interpretation should be expanded on this and developed further. Fundamental changes in standards are only acceptable when they solve severe and widespread problems or provide a significant improvement over existing standards. We believe that the model as proposed in the discussion paper is a fundamental change of the current principles of IAS 32 and are not a narrow scope amendment. Furthermore, the DP does not address all issues with the current standard (for example the lack of guidance on reclassifying instruments from debt to equity). A fundamentally different approach as proposed has far-reaching and possibly unintended consequences. We do not observe widespread problems in current practice nor significant improvements that would justify such far reaching consequences.

Our general remark is that although current IFRS has shortcomings on the distinction between liabilities and equity, most companies have no problems applying current IAS 32. Most companies are familiar with the fundamentals of IAS 32, and are able to predict how new instruments would affect their balance sheet.

Due to the vast range of different types of capital in practice, and the complex and sometimes unclear description of the new concepts within the proposal such as ‘independent’ and ‘available economic resources’

in the standard, we think that by replacing a well understood standard (with its shortcomings), with a new complex standard will prove to be challenging.

The IASB Discussion Paper does not convince that the new presentation approach are both more simple to apply and renders more relevant information. Any new approach will lead to increased uncertainty and additional structuring possibilities. Therefore any new approach should be well supported in the market. In absence of this support we believe more disclosure requirements have to be considered to overcome the issues identified in the current standard. In addition to some detailed changes, we think that any fundamental change should only be made when the benefits significantly outweigh the costs. We support limited changes or additional guidance to the current standard on:

1. puts on non-controlling interests,
2. clarifying fixed for fixed,
3. treating derivatives over own equity net, and
4. increased disclosure requirements on elements of equity with respect to their priority on liquidation, potential dilution effects and details on contractual terms and conditions.

Therefore, we conclude that the shortcomings are better addressed by specific amendments to the current approach instead of introducing an entirely new approach.

Our detail comments on the questions to constituents within the draft comment letter to the EFRAG are set out in the appendix to this letter.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Sampers', with a long horizontal line extending to the right.

Prof. dr. P.A.M. Sampers
Chairman DASB

Appendix 1: Detailed response to each question

Appendix 1

Question to Constituents

21 Are constituents aware of any other challenges with IAS 32 that have not been identified by EFRAG and the IASB?

Response to question

No, we are not aware of any other challenges within IAS 32 apart from those already identified.

Questions to Constituents

41 In paragraph 33 EFRAG agrees that information provided in the financial statements about claims on an entity should help users to assess the entity's liquidity and solvency. These information needs are also identified in the Conceptual Framework for Financial Reporting. The DP suggests providing information on both these factors by considering both 'timing' and 'amount' when distinguishing equity from a liability. EFRAG has considered whether it provides the most useful information to consider both these dimensions when distinguishing equity and liabilities. Do you think that information about both liquidity and solvency should be provided through the classifications of claims on an entity? If so, do you agree with using both the 'timing' and the 'amount' features when distinguishing equity from a financial liability from equity? If not, how should the distinction be made?

42 The IASB decided that, while the objective of the FICE project is to respond to challenges in distinguishing financial liabilities from equity instruments when applying IAS 32, any potential solution should limit unnecessary changes to classification outcomes that are already well understood. Considering the IASB's preferred approach described in the DP, do you expect significant classification changes? If so, please describe the type(s) and extent of instruments affected, the existing classification in accordance with IAS 32 and why the classification could or would change in accordance with the IASB's preferred approach.

Response to question

Paragraph 41

We agree that the terms 'independent' and 'available economic resources' must be considered as a key feature. We agree that both solvency and liquidity provides crucial information regarding an entity and is of utmost importance and relevance for investors.

The amount feature does address another feature that is a key consideration in the classification, i.e. returns (or payoffs/risks & rewards of ownership). However, we believe the amount criteria should only focus on obligations arising during the life of the entity and not on those arising only at liquidation. We do not believe that settlement only upon liquidation requires liability classification, regardless of whether the amount is or is not independent of the entity's resources. This is because all of the issued instruments of the balance sheet are settled at liquidation, and information about relative rankings and amounts can be covered by presentation and/or disclosure.

We therefore suggest the articulation of the principles included within the discussion paper to classify 'available economic resources' and 'independent'.

Above approach would achieve consistency with IAS 32 for irredeemable cumulative preference shares. However, for this approach to be operational, we believe the word "obligation" needs to be defined in more detail.

Paragraph 42

Significant classification and presentation changes (impacted by the subsequent change in classification) for some financial instruments are expected. Some of these outcomes to the changes relating to classification and measurement compared to IAS 32 are summarised below:

1. Financial instruments with obligations for fixed cumulative returns, such as cumulative perpetual preference shares, would be classified as financial liabilities. However, when applying the existing rules within IAS 32, some of these obligations, for which an entity has an unconditional right to defer cash payment indefinitely, are classified as equity instruments.
2. On the contrary, to above, non-cumulative preference shares that pay discretionary dividends with an obligation to pay a fixed amount at liquidation would under the proposal be treated as a compound instrument where the liability component is the obligation to pay a fixed amount of cash at liquidation and the equity component reflects the discretionary dividends which differs from current practice.

Question to Constituents

73 What are the most common non-derivative financial instruments with characteristics of equity in your jurisdiction (e.g. perpetual bonds, reverse convertible bonds, callable shares with discretionary dividend, non-cumulative and cumulative preference shares, etc.)?

74 Do you consider that it is relevant to classify financial instruments that are only settled on liquidation (e.g. cumulative preference shares) as financial liabilities?

Response to question

Paragraph 73

Within the Dutch market the most common non-derivative financial instruments with characteristics of equity are perpetual bonds with discretionary coupons. Other instruments used are shareholder loans in many forms, callable shares with discretionary dividends and cumulative and non-cumulative preference shares. This list is not exhaustive.

Paragraph 74

No, we do not believe that settlement only upon liquidation requires liability classification, regardless of whether the amount is or is not independent of the entity's resources. This is due to the fact that all of the credit side of the balance sheet is settled at liquidation, and information about relative rankings and amounts can be covered by presentation and/or disclosure. We are of the opinion that the terms 'independent' and 'available economic resources' should focus on the life of the entity.

Questions to Constituents

86 To what extent is the 'puttable instruments' exception in paragraph 16A-B used in your jurisdiction?

87 To what extent is the 'obligations arising on liquidation' exception in paragraph 16C-16D used in your jurisdiction?

88 What are the application challenges that arise with these two exceptions?

Response to question

Within Dutch (European) market, entities currently do apply the requirements of IAS 32. 'Puttable instruments' are mainly issued within the Asset Management industry (eg investment funds) and instruments that relate to the exceptions in paragraph 16C-16D are non-redeemable cumulative preference shares within the Private

Equity industry. The issuance of these type of instruments are common practice within the industry for structured deals.

However, if the Board decides to classify obligations arising only upon liquidation as equity, the exception for date-certain liquidations in 16C and 16D would no longer be needed as the life of the entity will be considered and not only the date of liquidation. Therefore, the application challenges relating to the terms ‘on liquidation’ or rather the timing will be avoided.

Questions to Constituents

112 Considering the arguments provided in paragraph 105 above, do you consider that accounting for all derivatives on own equity as derivatives assets or derivatives liabilities under the scope of IFRS 9 together with disclosures on the maturity of any redemption amount under IFRS 7 would be a simpler approach and still provide relevant information to users of financial statements?

Response to question

Yes, we agree that the individual legs of assets and equity exchanges are not separated but the resulting derivatives from these transactions are presented and disclosed on a net basis regardless of the settlement options. We agree that this will be a simpler approach and provide relevant information to investors.

Questions to Constituents

206 To what extent are contingent convertible bonds (CoCo's) and written puts on NCI used by the entities in your jurisdiction?

207 What types of entities are using them the most?

Response to question

The issue of contingent convertible bonds is common practice within the Dutch (European) market and are the used especially within banks that do not have the sufficient levels of capital.

Written puts on NCI are common practice within corporate groups especially in relation to business combinations.

Question to Constituents

387 To what extent is the IFRIC 2 interpretation being used by the entities in your jurisdiction?

Response to question

Member cooperatives generally are declining within the Dutch (European) market. Interest within membership cooperatives have become a specialized and niche industry mainly focusing on food enterprises and other resources for entities to raise flexible funding.