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## **Comments on EFRAG's draft comment letter on IASB Discussion Paper on Financial Instruments with Characteristics of Equity (“DP”)**

We are pleased to provide BNP Paribas’ comments on EFRAG's draft comment letter on IASB Discussion Paper on Financial Instruments with Characteristics of Equity.

We welcome the efforts and work accomplished by EFRAG and the IASB and the objective pursued of setting out clear and consistent rationale on the principles of classification of instruments as equity or liability without necessarily modifying the classification of the majority of financial instruments.

While we acknowledge that IAS 32 has a number of areas of improvement and could be viewed as complex to understand, it generally works rather well with some exceptions which lead to issues raised at IFRIC those last past years, notably on the presentation of written puts on NCI, contingent convertible bonds...

We are therefore concerned by the concepts proposed in the DP to define principles of classification. Indeed, the new principles of classification could be viewed as insufficient as many exceptions of IAS 32 would need to be anyway reconducted. And these principles introduce new concepts such as the “amount” criterion which is rather unclear and has already triggered discussions on how to interpret it. These new principles could affect the accounting classification of Additional Tier One instruments. If the IASB were to pursue this project, we think that it would be necessary to bring some guidance around this concept of “amount independent of the entity resources” in order to avoid undue interpretation issues and significant cost of implementation of the new standard and ensure that any change in the accounting classification, if any, compared with current classification are relevant and provide more faithful information.

Regarding the presentation we do not support any presentation which would lead to unduly extend the use of OCI, and in particular the proposal of the IASB to present in other comprehensive income (OCI) income and expenses arising notably from financial liabilities or from derivative financial assets and derivative financial liabilities which do not meet the “amount” criteria.

We would prefer the IASB to solve the issue of written put on non-controlling interests (“NCI put”) by considering the concept of transaction with owners acting in their capacity as owners. Such an approach could justify to present revaluation of the liability of NCI put through shareholder equity without extending the use of OCI.



Regarding derivatives on own equity that do not meet the “amount” feature, these instruments are common in our trading book and if net cash settled are recognised as derivatives assets or liabilities. According to the DP proposal, these instruments would be revalued through OCI whereas the instruments which are economically hedging them are recognised at fair value through P&L. We are not convinced that such presentation would more faithfully represent the transactions or provide with more relevant information than under the current framework.

For the same reasons we do not support the proposal to expand the attribution of total comprehensive income to equity instruments other than ordinary shares, which is highly complex and costly to implement for a benefit which could be questionable or which should rather be addressed through a project on IAS 33 *Earnings Per Share* or through disclosures.

The IASB underlines that users of financial statements have consistently requested more information about equity instruments and about the priority of financial liabilities and equity instruments on liquidation. We however would like to draw the attention of the IASB that as a banking Group we are highly regulated and are subject to “Pillar 3 disclosures which among other require us to already publish all the characteristics of financial instruments we issue which qualify as regulatory “own funds”. These disclosures are therefore provided for all our “own funds” instruments, whether they are classified as debt or equity instruments in our financial statements. For these reasons, if extended disclosures were required, cross references (with the mention of “audited”) should be permitted and such disclosures should be limited to instruments classified as equity instruments in the financial statements.

Finally we consider the IASB should address whether there is a need, and to which extent, to consider laws and regulations beyond contractual terms for the classification of financial instruments as considering only contractual provisions could lead to different representation in the financial statements of MREL/TLAC instruments having exactly the same characteristics.

Thus, while we acknowledge that IAS 32 raises some issues, we are not convinced that the DP will solve them, for the reasons summarised above. As a consequence we would rather encourage the IASB to achieve the needed improvements through disclosures and targeted amendments on presentation.

Should you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Lars Machenil', written over a light blue horizontal line.

Lars Machenil



### Question 1

Paragraphs 1.23–1.37 describe the challenges identified and provide an explanation of their causes.

(a) Do you agree with this description of the challenges and their causes?

Why or why not? Do you think there are other factors contributing to the challenges?

(b) Do you agree that the challenges identified are important to users of financial statements and are pervasive enough to require standard-setting activity? Why or why not?

We agree with the description of the challenges identified by the board and their causes: market forces, financial innovation and changes in bank capital regulations have generated a wide range of financial instruments that combine various features, including features of both simple bonds and ordinary shares (financial instruments with characteristics of equity) presenting challenges when entities apply IAS 32.

We however note that the challenges mainly arise around derivatives on own equity and compound instruments.

While we agree that the challenges identified are important and we acknowledge that IAS 32 has a number of areas of improvement and could be viewed as complex to understand, it generally works rather well with some exceptions which lead to issues raised at IFRIC those last past years, notably on the presentation of written puts on NCI, contingent convertible bonds...

While these challenges can be viewed as pervasive enough to require standard setting activities, we would like to draw the attention of the board to the fact that following the crisis, Basel III regulatory framework has been modified to strengthen the resilience of the banking sector. One of the modification consisted in raising the quality of the “capital base”. Thus, according to the new Basel III framework (currently applied in Europe as transposed in the CRR), CET1 capital mainly consists in common shares and retained earnings. And Additional Tier 1 instruments must be comprised of instruments that are subordinated, have fully discretionary noncumulative dividends or coupons and have neither a maturity date nor an incentive to redeem. Innovative hybrid capital instruments with an incentive to redeem through features such as step-up clauses are no longer eligible as AT 1 instruments in Europe<sup>1</sup>.

The issue of economic compulsion for hybrids instruments issued by banks thus no longer exist in the same terms as when IAS 32 was issued, as regulatory requirements are such that instruments eligible for an AT1 classification cannot have any incentive to redeem them.

We are not convinced that the DP will solve the issues raised by IAS 32 and we are concerned that the new principles may raise specific issues as described further in our comments below. As a consequence we would rather encourage the IASB to achieve the needed improvements through disclosures and targeted amendments on presentation.

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<sup>1</sup> Cf. CRR article 52.1 “Capital instruments shall qualify as Additional Tier 1 instruments only if the following conditions are met: (...) (g) the instruments are perpetual and the provisions governing them include no incentive for the institution to redeem them;”



## Question 2

The Board's preferred approach to classification would classify a claim as a liability if it contains:

- (a) an unavoidable obligation to transfer economic resources at a specified time other than at liquidation; and/or
- (b) an unavoidable obligation for an amount independent of the entity's available economic resources.

This is because, in the Board's view, information about both of these features is relevant to assessments of the entity's financial position and financial performance, as summarised in paragraph 2.50.

The Board's preliminary view is that information about other features of claims should be provided through presentation and disclosure.

Do you agree? Why, or why not?

### *Classification and presentation*

We agree with the board that classification only cannot address the challenge of reflecting faithfully all the features and differences in the features of financial instruments issued by entities.

However, as we do not support any presentation which would lead to unduly extend the use of OCI. (cf. also our comments on questions 6, question 7 and question 9), we would favour that information about other features of claims, which are not captured through classification, are provided through disclosure mainly and not necessarily through presentation (cf. also our comments on question 9).

We understand that users in the banking industry focus on the prudential classification (i.e. as CET1, AT1 or Tier 2) rather than on the accounting classification of "hybrids instruments" (namely those which are neither shares nor vanilla debt instruments). We understand that users mainly focus on the loss absorbency capacity of the instrument.

From a prudential standpoint, a capital instrument shall qualify as Additional Tier 1 instrument (the second best quality of capital after Common Equity Tier 1 which mainly consists of shares and retained earnings) only if it meets the 16 criteria<sup>2</sup> pointed out in the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 ("CRR"). In Europe, depending on the characteristics of the instruments, AT1 instruments can be classified in the accounting either as debt instruments or as equity instruments..

We furthermore understand that users also focus on the loss absorbency capacity of the instruments for corporate entities. As the DP could affect the classification of irredeemable cumulative preference shares which are notably issued by corporates, we would like to draw the attention of EFRAG that any change in the accounting classification of instruments issued by corporates entities could affect debt covenants and as consequence could have some consequential impacts in the market of hybrids instruments.

### *Disclosures*

The IASB underlines that users of financial statements have consistently requested that preparers be required to provide more information about equity instruments and about the priority of financial liabilities and equity instruments on liquidation. We would like to stress that as a banking Group we are highly regulated and are subject to "Pillar 3 disclosures" which among

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<sup>2</sup> Cf. CRR article 52.



other require us to already publish the list and the characteristics of all financial instruments we issue which qualify as regulatory “own funds”. These disclosures are therefore provided for all our “own funds” instruments, whether they are classified as debt or equity instruments in our financial statements. For these reasons, if extended disclosures were required, cross references (with the mention of “audited”) should be permitted and such disclosures should be limited to instruments classified as equity instruments in the financial statements. (cf. our website <https://invest.bnpparibas.com/en/debts/tier-1-hybrids-subordinated-debt/capital-instruments-main-features-template#> for the detailed provided by instrument for Tier 1 hybrids and subordinated debt). (cf. also our comments to question 9).

### Question 3

The Board’s preliminary view is that a non-derivative financial instrument should be classified as a financial liability if it contains:

- (a) an unavoidable contractual obligation to transfer cash or another financial asset at a specified time other than at liquidation; and/or
- (b) an unavoidable contractual obligation for an amount independent of the entity’s available economic resources.

This will also be the case if the financial instrument has at least one settlement outcome that has the features of a non-derivative financial liability.

Do you agree? Why, or why not?

We welcome the efforts and work accomplished by the IASB and the objective pursued of setting out clear and consistent rationale on the principles of classification of instruments as equity or liability without necessarily modifying the classification of the majority of financial instruments.

We agree with the aim pursued by the IASB to capture both liquidity and solvency through classification of instruments as equity or liability as these notions are in fact inextricably linked (cf. EFRAG DP on classification of claims – July 2014) and as they are important to assess financial performance and financial structure of entities. These two notions are also considered to define eligibility criteria of regulatory instruments (such as CET1, AT1 and Tier 2 instruments which all qualify as “own funds” from a prudential perspective<sup>3</sup>) and can be viewed as related to loss absorbency capacity of instruments.

However we are concerned by the concepts proposed in the DP as they introduce new terminology but also new criteria for classification and notably the “amount” criteria.

*“Timing criteria”: an unavoidable contractual obligation to transfer cash or another financial asset at a specified time other than at liquidation.*

While the “timing criteria” is rather simple to appraise and already existing in IAS 32, we would like to draw the attention of the board on the notion of liquidation.

It is not clear how an instrument which would entail an obligation for the issuer to transfer cash or another financial asset upon a resolution or other insolvency arrangements would be analysed or should be classified. These situations of resolutions or insolvency arrangements are very

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<sup>3</sup> CET1 and Additional Tier 1 capital are designed to absorb losses on a going concern basis whereas Tier 2 capital are designed to absorb losses on a gone concern basis.



specific and in between a going concern and a gone concern basis. Please confer also our comments on question 11 on this matter.

Irredeemable non-cumulative preference shares with discretionary dividends may provide for either conversion into a variable number of shares in case of trigger breach or a write-down provision or both, the two features being similarly perceived by the market. Whether there is a conversion mechanism or a write-down mechanism in an instrument does not necessarily affect the liquidity or solvency of a banking issuer and thus it could be questionable if the criteria as set by the Discussion Paper could lead to a different classification.

*Amount criteria: an unavoidable contractual obligation for an amount independent of the entity's available economic resources*

This concept of “amount criteria” is not sufficiently described and has already triggered discussions on how to interpret it and how it is articulated with settlement provisions or derivatives on own equity embedded within an instrument.

- We understand that an irredeemable non-cumulative preference shares with discretionary dividends and an obligation to pay a fixed amount at liquidation would be considered as a compound instrument with a liability component (obligation to pay a fixed amount of cash at liquidation) and an equity component (corresponding to the discretionary dividends, measured as a residual on initial recognition). Even if the DP asserts that the liability component would be nil or insignificant (cf. §3.24 (b)) on a going concern basis, we fear the jurisprudence which could be developed around the assessment of the liability component (determination of the rate to discount the principal amount, maturity...). Furthermore, as liabilities would be measured according to IFRS 9 principles, if the instruments are callable (which is rather common) we wonder how the likelihood of the exercise of the call would affect the measurement of the liability component and this even if the exercise is at the discretion of the issuer.
- If in case of liquidation/ resolution, the holder may not recover its principal amount due to write-down feature or conversion feature we wonder why it is not considered that there is no obligation for an amount independent of the entity's available economic resources. As a consequence the instrument would be entirely considered as an equity instrument.
- It is not clear how an irredeemable non-cumulative preference shares with discretionary dividends and a write-down or a conversion feature (meeting the “fixed-for-fixed” criteria) in foreign currency would be classified and presented according to the DP. It is common for banks to issue eligible Additional Tier 1 instruments in foreign currency (appetite from investors for AT1 instruments in USD for example) and they are currently classified as equity, as AT1 issue in euros with the same characteristics. We wonder how to analyse these instruments (notably those with a conversion option for a fixed number of equity shares) according to the DP: even if we assume that the liability component has a nil or insignificant value on a going concern approach, would the sole call option in “foreign currency” imply that a liability should be recognised for the whole nominal amount of the instrument?  
We are not convinced that the sole fact that these instruments are issued in foreign currency should justify a liability classification under new principles<sup>4</sup>.
- It is neither entirely clear how TLAC (Total Loss Absorbing Capacity) instruments or MREL (Minimum Requirement for own funds and Eligible Liabilities) would be analysed and classified according to the DP. TLAC or MREL instruments are unsecured, subordinated instruments which are designed to absorb losses in insolvency or resolution and allow regulatory authorities to write down, write off or convert the instrument into equity and can

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<sup>4</sup> Notwithstanding the fact that, for AT1 classified as equity there remains an issue as these instruments cannot be hedged for interest or foreign currency risk.



be triggered by an event specified in the contract or in statute. Should these features be analysed as embedded derivatives when they are contractually defined but merely replicating the legal requirements?

In summary, given the questions arising on the interpretation around the “amount” criteria it is not clear how the DP could impact the accounting of Undated subordinated notes or MREL/TLAC instruments following the DP principles (e.g. AT 1 issued in foreign currency with a write-down features or convertible in own shares without specifying neither the number of shares nor the amount to be converted, or irredeemable non cumulative callable preference shares).

If the IASB were to pursue this project, we think that it would be necessary to bring some guidance around this concept of “amount independent of the entity resources” in order to avoid over / undue interpretation, unintended consequences and significant cost of implementation of a new standard.

#### **Question 4**

The Board’s preliminary view is that the puttable exception would be required under the Board’s preferred approach. Do you agree? Why, or why not?

We do not have any comments nor objections on this point as we do not use this exemption for our consolidated accounts.

However, we note that considering puttable instruments as liabilities with an exemption for presentation as equity does not solve the issue for long term investors.

While we agree that both liquidity and solvency are determinant to classify an instrument as debt or liability we think that from an investor perspective what rather matters is whether the investor is exposed to a share price risk or to a credit risk.

According to IFRS 9 puttable instruments such as UCITS are not eligible for a presentation at “Fair Value through Other Comprehensive Income for Equity instruments”, when held by investors. The IASB could consider having a symmetric approach for these instruments meeting the puttable exception and extending the exception on the asset side. As a consequence a puttable instrument meeting the criteria to be presented as an equity instrument on the liability side would be eligible to a FVOCIE classification on the asset side.

#### **Question 5**

The Board’s preliminary view for classifying derivatives on own equity—other than derivatives that include an obligation to extinguish an entity’s own equity instruments—are as follows:

(a) a derivative on own equity would be classified in its entirety as an equity instrument, a financial asset or a financial liability; the individual legs of the exchange would not be separately classified; and

(b) a derivative on own equity is classified as a financial asset or a financial liability if:

(i) it is net-cash settled—the derivative requires the entity to deliver cash or another financial asset, and/or contains a right to receive cash for the net amount, at a specified time other than at liquidation; and/or

(ii) the net amount of the derivative is affected by a variable that is independent of the entity’s available economic resources.

Do you agree? Why, or why not?



We agree that a derivative on own equity should be classified in its entirety as an equity instrument, a financial asset or a financial liability; and the individual legs of the exchange should not be separately classified in order to provide useful information, to faithfully represent the instrument without introducing undue complexity.

As for non-derivative financial instrument we are concerned by the “amount criteria” (the net amount of the derivative is affected by a variable that is independent of the entity’s available economic resources) and we are not sure that it would be easier to interpret than the current “fixed-for-fixed” condition.

In practice we can have position on index (which include our name) in our trading book, hedged economically by derivatives on own equity instruments. Even if the derivative on own equity instruments is net settled in cash, we understand that according to the DP, as the net amount of the derivative is not affected by a variable that is independent of the entity’s available economic resources (meaning the “amount criteria” is not satisfied), the derivative would be measured at fair value through OCI, whereas the index would be measured at fair value through P&L, creating an accounting mismatch. We do not agree that such presentation would more faithfully represent the transactions or provide with more relevant information than under the current framework. If the board were to pursue on these classification and presentation principles, it would be necessary to have the option to designate such derivatives at fair value through profit or loss.

While we see the merits of classifying derivatives on own equity instruments as equity instrument to avoid an increased volatility in retained earnings for instruments that give right to a residual interest on the entity’s net asset, we are not convinced it is necessarily appropriate for all derivatives equity instruments and notably those included in our trading book to be classified as equity instruments.

However, we do not support EFRAG’s proposal that the IASB should further analyse the option of accounting for all derivatives on own equity as derivative assets or liabilities under the scope of IFRS 9.

#### **Question 6**

Do you agree with the Board’s preliminary views set out in paragraphs 5.48(a)–(b)? Why, or why not? Applying these preliminary views to a derivative that could result in the extinguishment of an entity’s own equity instruments, such as a written put option on own shares, would result in the accounting as described in paragraph 5.30 and as illustrated in paragraphs 5.33–5.34.

For financial instruments with alternative settlement outcomes that do not contain an unavoidable contractual obligation that has the feature(s) of a financial liability as described in paragraph 5.48(c), the Board considered possible ways to provide information about the alternative settlement outcomes as described in paragraphs 5.43–5.47.

(a) Do you think the Board should seek to address the issue? Why, or why not?

(b) If so what approach do you think would be most effective in providing the information, and why?

We understand why, according to the DP, derivatives that create an obligation for the entity to transfer economic resources or compound instruments with redemption obligation features should be classified as a liability as under IAS 32.

While the IASB’s preferred approach enables to address some concerns expressed in the May 2012 Draft Interpretation on the accounting for NCI puts, the DP does not solve entirely the issue and we wonder whether the issue couldn’t have been addressed differently.



Indeed, while we appreciate the will of the IASB to achieve consistent classification of similar rights and obligations, we are not convinced that convertible bonds (with a conversion option for a fixed number of equity shares) should necessarily be represented in the financial statements in the same way as written puts on NCI.

Convertible bonds are issued mainly by corporate entities to finance their activity whereas written put options on NCI result from business combination where a minority shareholder is involved.

Thus, we wonder why minority interests should be derecognised when a written put is granted to NCI as neither their right to dividends, nor their voting rights are extinguished.

At least we draw the board's attention to the fact that the exercise price is not necessarily the fair value and can be a percentage of the fair value for example. As a consequence, the proposal of the IASB would not solve entirely the issue of written puts on NCI.

For these reasons, we wonder why NCI written puts have not been analysed through the concept of transaction with owners acting in their capacity as owners. Such an approach would justify to present revaluation of the liability through shareholder equity without extending the use of OCI for all derivatives on own equity, as transactions with holders of equity claims do not meet the definition of income (cf. CF §4.68 Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.)

#### Question 7

Do you agree with the Board's preliminary views stated in paragraphs 6.53–6.54? Why, or why not?

The Board also considered whether or not it should require separation of embedded derivatives from the host contract for the purposes of the presentation requirements as discussed in paragraphs 6.37–6.41. Which alternative in paragraph 6.38 do you think strikes the right balance between the benefits of providing useful information and the costs of application, and why?

The IASB preferred approach in the DP would increase the use of OCI as an entity would present separately in OCI income and expenses arising from liabilities that contain no obligation for an amount that is independent of the entity's available economic resources, but also income and expenses on derivative financial assets and derivative financial liabilities that have net amounts that are unaffected by any independent variable and from partly independent derivatives. Those amounts presented in OCI would not be subsequently reclassified to P&L.

We do not support any presentation proposal which would lead to unduly extend the use of OCI. OCI is not necessarily well understood by users and definitions and discussions around the core concept of performance are lacking. Furthermore, the considered use of OCI in the DP is not necessarily consistent with the Revised Conceptual Framework (the Revised Conceptual Framework states that "*the Board may decide in exceptional circumstances that income or expenses arising from a change in the current value of an asset or liability are to be included in other comprehensive income when doing so would result in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that period.*"(CP 7.17) and it furthermore specifies in §7.19 that "*In principle, income and expenses included in other comprehensive income in one period are reclassified from other comprehensive income into the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that future period. However, if, for example, there is no clear basis for identifying the period in which reclassification would have that result, or the amount that should be reclassified, the Board may, in developing Standards, decide that income and expenses included in other*



*comprehensive income are not to be subsequently reclassified.);* thus any increase in the use of OCI would result in increased complexity.

The solution proposed by the IAS to present in other comprehensive income (OCI) income and expenses arising notably from financial liabilities that contain no obligation for an amount that is independent of the entity's available economic resources has the merit to seek to solve the issue of NCI put. However, it would not entirely solve the issue (cf. our comments to question 6) and we think it would be more relevant and appropriate to deal with this issue through transaction with owners principles (cf. our comments to question 6).

Regarding derivative financial assets and derivative financial liabilities that have net amounts that are unaffected by any independent variable and are in our trading book, we are not convinced that a presentation of income and expenses in OCI would provide more relevant information as already explained in question 5.

#### *"Partly independent" derivatives*

For the same reason as the one expressed above, we do not support the proposed approach in the DP for "partly independent" derivatives (meaning, affected by both independent – e.g. foreign currency variable- and dependent variables).

If the board were to pursue these proposals we would prefer Alternative A, namely not to extent the requirements of a separate presentation in OCI of partly independent derivatives that are not separated from the host contract (cf. DP §6.38 (a)).

#### **Question 8**

The Board's preliminary view is that it would be useful to users of financial statements assessing the distribution of returns among equity instruments to expand the attribution of income and expenses to some equity instruments other than ordinary shares. Do you agree? Why, or why not?

The Board's preliminary view is that the attribution for non-derivative equity instruments should be based on the existing requirements of IAS 33. Do you agree? Why, or why not?

The Board did not form a preliminary view in relation to the attribution approach for derivative equity instruments. However, the Board considered various approaches, including:

- (a) a full fair value approach (paragraphs 6.74–6.78);
- (b) the average-of-period approach (paragraphs 6.79–6.82);
- (c) the end-of-period approach (paragraphs 6.83–6.86); and
- (d) not requiring attribution, but using disclosure as introduced in paragraphs 6.87–6.90 and developed in paragraphs 7.13–7.25.

Which approach do you think would best balance the costs and benefits of improving information provided to users of financial statements?

We share the IASB's objective to provide users with better information on equity instruments according to their different features (priority of claim, pay-offs, restrictions on dividends, buy backs or other distributions...).

We do not support the proposal of the IASB relating to the attribution approach for derivative equity instruments which we understand aims at enhancing the presentation requirements for different classes of equity through the statement of changes in equity as it raises several issues, while having some shortcomings.



We wonder what is the rationale or objective of the information provided through the three different approaches.

These approaches would increase complexity and the costs of establishing the statement of equity.

As these proposals seems aiming at providing more relevant information, notably on dilution, by affecting indirectly IAS 33 *Earnings per Share*, we would prefer the IASB to address the issue of providing users with better information on equity instruments through enhanced disclosures and/or potentially through a review of IAS 33 *Earnings per Share*.

### Question 9

The Board's preliminary view is that providing the following information in the notes to the financial statements would be useful to users of financial instruments:

(a) information about the priority of financial liabilities and equity instruments on liquidation (see paragraphs 7.7–7.8). Entities could choose to present financial liabilities and equity instruments in order of priority, either on the statement of financial position, or in the notes (see paragraphs 6.8–6.9).

(b) information about potential dilution of ordinary shares. These disclosures would include potential dilution for all potential issuance of ordinary shares (see paragraphs 7.21–7.22).

(c) information about terms and conditions should be provided for both financial liabilities and equity instruments in the notes to the financial statements (see paragraphs 7.26–7.29).

Do you agree with the Board's preliminary view? Why, or why not?

How would you improve the Board's suggestions in order to provide useful information to users of financial statements that will overcome the challenges identified in paragraphs 7.10 and 7.29?

Are there other challenges that you think the Board should consider when developing its preliminary views on disclosures?

### *Disclosures on priority of claims on liquidation and terms and conditions*

As previously mentioned notably in question 1 and question 8, as a banking Group we are highly regulated and are subject to "Pillar 3 disclosures" which require us to already disclose a description of the main features of the CET1 and AT1 instruments and Tier 2 instruments which qualify as regulatory "own funds"<sup>5</sup> and the full terms and conditions of these instruments.

These disclosures requirements are provided for all our prudential "own funds" instruments, whether they are classified as debt or equity instruments in our financial statements (which means that it does not apply to all financial liabilities).

The full terms and conditions requirements are defined in Annex II of EU ITS 1423\_2013 and consist in a list of 37 terms which include among others: the legal entity issuing the instrument, the accounting classification, the main characteristics of coupons (fixed or floating, existence of a dividend stopper, cumulative or non-cumulative, fully discretionary, partially discretionary or mandatory), convertible or non-convertible, write-down features, position in subordination hierarchy in liquidation (with a requirement to specify instrument type to which it is immediately subordinate).

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<sup>5</sup> Cf. also the CRR article 437.



For these reasons, we have no objections on extending disclosures required on liability and equity instruments to provide information about the priority on liquidation, dilution and terms and conditions as long as cross references if need be are permitted (with the mention of “audited”) and as long as information already provided would be deemed sufficient (cf. our website <https://invest.bnpparibas.com/en/debts/tier-1-hybrids-subordinated-debt/capital-instruments-main-features-template#> for the detailed provided by instrument for Tier 1 hybrids and subordinated debt). This implies that such information cannot be provided for all our liabilities but only those qualifying as Tier 2 instruments. If the IASB were to require the rank of subordination or terms and conditions of instruments, the scope should be limited, for example to instruments classified as equity from an accounting standpoint.

We however would like to draw the board attention to the fact that for a Group publishing consolidated accounts, the relevance of information on priority of claims on liquidation can be questionable, if not impossible to establish at consolidated level as different jurisdictions and legal entities are involved.

Furthermore, as the IASB has a project on *Better Communication and Disclosures initiatives*, any new information in the notes should be considered consistently with other requirements (e.g. Information on liquidity of financial liabilities<sup>6</sup> or on compound financial instruments with multiple embedded derivatives<sup>7</sup> is already required by IFRS 7 and more generally, information on financial liabilities is addressed through IFRS 7 requirements) to avoid any duplication in the information already required in other standards. We think the IASB should rather explore what could be the objectives of disclosing such information (rank of subordination on the one hand, terms and conditions on the other hand) and whether other standards wouldn’t be more appropriate to address the issue (e.g. IFR 7§39 (a) already requires a maturity analysis for liabilities based on contractual maturity).

#### *Disclosures about potential dilution*

We wonder whether information on potential dilution for all potential issuance of ordinary shares is not going beyond the FICE project (cf. also our comments on question 8).

Furthermore it presents some overlap with information already partly covered by IAS 33 which requires entities whose ordinary shares are traded in a public market to disclose notably the diluted earnings per share.

We are therefore not convinced on the usefulness of requiring more information than those already provided (cf. above comment).

#### **Question 10**

Do you agree with the Board’s preliminary view that:

- (a) economic incentives that might influence the issuer’s decision to exercise its rights should not be considered when classifying a financial instrument as a financial liability or an equity instrument?
- (b) the requirements in paragraph 20 of IAS 32 for indirect obligations should be retained?

Why, or why not?

<sup>6</sup> Cf. IFRS 7§39

<sup>7</sup> Cf. IFRS 7§17



The introduction of economic compulsion/ economic incentives when classifying an instrument as a financial liability or an equity instrument poses the issue of the “limits” of the economic compulsion to be considered. We agree with the preliminary view of the IASB that economic incentives that might influence the issuer’s decision to exercise its rights should not be considered when classifying a financial instrument as a financial liability or an equity instrument.

While we agree with retaining the requirements in paragraph 20 of IAS 32 for indirect obligations we wonder if this does not implicitly highlight that the criteria amount is “insufficient” by itself?

#### **Question 11**

The Board’s preliminary view is that an entity shall apply the Board’s preferred approach to the contractual terms of a financial instrument consistently with the existing scope of IAS 32. Do you agree? Why, or why not?

We consider the IASB should address whether there is a need, and to which extent, to consider laws and regulations beyond contractual terms for the classification of financial instruments.

The CRR and the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (“BRRD”) require banks to issue instruments with a capacity to absorb losses in case of resolution. The subordination of instruments eligible for MREL (Minimum Requirement for own funds and Eligible Liabilities) or TLAC (Total Loss Absorbing Capacity) requirements can be met either through a contractual subordination, a statutory subordination or through structural subordination. In Europe, the choice has been made to establish the subordination by law and contractually.

We wonder how the DP principles would apply to instruments subject to either statutory or contractual provisions recognising resolution actions, including write-down or conversion (in case of resolution such instrument would be converted into a variable number of equity shares or written down). Indeed, contrary to senior claims, the amount of these instruments could be reduced before liquidation.

We do not think relevant information would be provided if only contractual features were considered to determine the classification of these instruments, as depending on choices made by jurisdictions, it could lead to different representation in the financial statements of instruments having exactly the same characteristics.

For these instruments we would be keen to consider that if contractual dispositions merely reflect the law, these dispositions should not further affect the classification and presentation of these instruments. This view somehow considers that a resolution cannot be considered as a going concern situation and as a consequence there is no reason that provisions recognising resolution actions should affect the accounting representation of these instruments, whether stated contractually or statutory.