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**Comment letter on EFRAG Draft Comment Letter on the IASB Discussion Paper
*Financial Instruments with Characteristics of Equity***

Dear Mr. Gauzès,

Thank you for the opportunity to comment on the EFRAG draft comment letter.

Erste Group has sympathy for a principle-based classification model for claims on an entity which is based on the notions of the timing and amount features aimed at helping users to assess the entity's liquidity and solvency. Current rule-based requirements of IAS 32 are candidates for improvements.

When saying this we have to note that our bank currently operates with a relatively simple capital structure. Our equity instruments issued consist of common shares and additional tier 1 (AT1) instruments with write-down feature. Based on an analysis of the proposed requirements, we do not consider that their classification would change.

However, even when we do not face the classification issues related to the proposed requirements directly, we note that there are clear application issues related to the amount feature that the IASB would need to address before the model came into existence.

Below we provide our answers to the questions raised by EFRAG in the draft comment letter. Among them, we would highlight our support for treating certain gross settled derivatives with own equities as financial assets or liabilities rather than as equity instruments.

As the questions raised by EFRAG address only certain areas of the discussion paper we provide some additional comments at the end of our comment letter.

Question to constituents

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

No

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.

We consider that the distinction based on the timing and amount factors provides a sound basis for a principle-based classification model of claims on an entity. However, we note that the amount feature could result in many application issues which are not addressed in the discussion paper. An example would be how to treat the conversion feature for AT1 instruments. In particular, what would be the period over which the liability notional component should be discounted. This could lead to very different results ranging from full liability component if the trigger was considered to occur at any time to a negligible liability component if the trigger was considered to occur in a remote future.

We do not expect significant classification changes as also expressed in our responses to the EFRAG's FICE survey.

Questions 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?

Our bank has issued only two types of non-derivative equity instruments – ordinary shares and non-cumulative AT1 instruments with write-down feature.

We consider cumulative preference shares settled on liquidation as liability-like considering that normally the issuer has an economic compulsion to pay the dividends. This often holds also for non-cumulative preference shares but we do not believe that the changes should consider economic compulsion in these cases as this would complicate the classification model.

When saying this we have to note that our bank has not issued cumulative preference shares and we cannot consider practical aspects of the change, e.g. what impact it would have on the market with these types of instruments.

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?

At our bank we do not have any cases when this classification exception would apply.

Question 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?

At our bank we do not use derivatives with own shares to extinguish existing or issue new shares from long-term perspective. When entering into derivative trades with own shares which are settled gross Erste Group either acts as a market maker or does this for economic hedging purposes. The hedging e.g. covers our positions in equity indices where Erste Group shares are present but it is not possible to do the hedging by entering directly into the indices derivatives. As a result, we hedge the position by entering into derivatives on the shares underlying the index, Erste Group shares being one of them. We note that the overall volumes of these trades are not high as there are strict risk limits for own share derivatives.

In these circumstances, we believe that the own share derivatives would deserve the derivatives assets / liabilities treatment and thus should be measured at fair value through profit or loss. The market making activity generates a short-term profit from dealer's margin which is an IFRS 9 feature of held-for-trading financial assets and liabilities. As regards the hedging positions, treating the derivatives as equity instruments leads to accounting mismatch when the related index derivatives are measured at fair value through profit or loss.

As a result, we consider that the IASB should develop criteria which would define when it would be appropriate to treat gross settled derivatives with own shares as standard derivatives. IAS 32 and IFRS 9 already use similar approach in respect of contracts to buy or sell non-financial items.

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?

Our bank has issued AT 1 instruments, however, without the contingent conversion feature. If the contingent trigger event of CET1 ratio < 5.125% occurred the principal would be written down (fully or partially) on a temporary basis. The amount would be written up if the trigger event no longer applied and certain other conditions were met. We consider that such instruments would be treated fully as equity under the proposed requirements which would not be a change compared to the current IAS 32 practice.

Our bank has written two kinds of puts options on NCI. The exercise price is either fixed with adjustment for interest element or determined based on fair value of the subsidiary. Regarding presentation issues for NCI puts at fair value please see our comment below.

We are writing these comments on our behalf and we have not analysed the practices of other entities.

Question to constituents

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

IFRIC 2 is not applicable to our bank.

Other comments*Separate presentation of financial liabilities with amount depending on economic resources*

Regarding the separate presentation requirements for financial liabilities that contain no obligation for an amount that is independent of the entity's available economic resources in the statement of financial position and of financial performance (in OCI) we understand that the separate presentation with changes recognised through OCI would make sense due to specific features of such liabilities. However, we also note that in certain circumstances this could lead to revealing sensitive information.

For example, our bank has a written put option over non-controlling interests at fair value. The shares of the subsidiary are not quoted in an active market. As a result, the liability is measured by a model using many unobservable inputs. As currently there is only one liability of this kind in our financial statements the separate presentation could reveal the bank's perspective about the value of the subsidiary to the counterparty which could prejudice the position of the bank when negotiating the final price when the put is exercised.

We believe that the IASB could consider whether a different form of presentation such as merging the amounts with other kinds of liabilities and OCI reserves would be warranted in very specific cases. IAS 37.92 currently knows a similar case of prejudicing the position and provides disclosure concessions in well substantiated cases.

Disclosures about contractual terms and conditions

We would call for caution when extending the disclosures to the terms and conditions of financial liabilities and equity instruments. Especially this should not be understood as a mandatory list for disclosing all the details since this could overburden entities and users with unnecessary information.

Entities should have leeway to decide about disclosures of relevant features when depicting the instruments. For example, paragraph 7.27(a) refers to disclosures of interest rates which, in our view, would not be relevant for standard interest-bearing financial liabilities where the interest rate risk is captured by IFRS 7 disclosures. On the other hand, information about the dividend/coupon rates could be relevant for certain equity or hybrid instruments constituting significant funding sources.

If you have any questions to our comments please do not hesitate to contact Martin Svitek martin.svitek@erstegroup.com or me.

Yours sincerely,

Manfred Schmid
Head of Group Accounting and Group Controlling