This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the 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 discuss EFRAG's overall position in its final comment letter to the IASB Discussion Paper *Financial Instruments with Characteristics of Equity* ('FICE').

Introduction

2 EFRAG TEG has already received an update on the feedback received during the outreach activities as well as from comment letters on the EFRAG Draft Comment Letter.

3 EFRAG Secretariat is in the process of finalising the feedback statements of each meeting and is continuing to receive comment letters. EFRAG Secretariat will provide a more comprehensive review of all the feedback received at the January 2019 meeting of EFRAG TEG.

4 At this stage EFRAG Secretariat has focused only on key changes to EFRAG's overall position on the IASB project on FICE. EFRAG Secretariat will make refinements to EFRAG's final comment letter to reflect detailed comments received during the outreach activities, comment letters received and early stage preliminary impact analysis.

5 The proposed key changes to EFRAG Draft comment letter are summarised below. The summary does not cover editorial changes such as removing detailed explanations of the IASB discussion paper.

Summary of the key changes to EFRAG Draft Comment Letter

Cover letter	The cover note will reflect that: • EFRAG is concerned that the IASB's preferred approach introduces completely new terminology which is likely to cause disruption, create additional costs for preparers and risk the emergence of new issues and uncertainties; • EFRAG has significant concerns on basing the distinction between debt and equity on the amount feature, particularly on liquidation; • EFRAG is concerned that the overall benefits are not likely to outweigh costs associated with the implementation of the IASB's preferred approach and disruption in the market caused by reclassification changes;

	• EFRAG is not convinced that the IASB's preferred approach on classification is a significant improvement when compared to IAS 32 *Financial Instruments: Presentation*; • At this stage, EFRAG would prefer targeted improvements to current requirements in IAS 32, particularly improvements to the guidance on complex instruments that combine features of both liabilities and equity (e.g. CoCos), presentation and disclosure requirements. EFRAG notes that the DP already identifies some solutions to the issues that arise in practice which could be a good basis for further discussions; and • EFRAG acknowledges the need for a more consistent and conceptual approach to distinguish debt from equity. However in our view at this stage there is no consensus on what the best approach is for such distinction. Therefore, the IASB may consider further discussing improvements to its conceptual approach in a longer term project based on the feedback received on this project, particularly on the use of the amount feature on liquidation and considering an approach based only on the timing feature.
Section 1: Objective, scope and challenges	The main changes are related to: • expanding the list of issues with IAS 32 which have been identified by respondents but not identified in the IASB's Discussion Paper; and • removing references to Appendix 2 – *How the DP's proposals address the issues that arise in practice*, which has been deleted.
Section 2: the IASB's preferred approach	The main changes are explained in the cover letter.
Section 3: Classification of non-derivative financial instruments	The main changes are related to: • highlighting concerns on the relevance and impact of classification changes that arise from the amount feature; and • emphasizing the concerns on the use of new terminology.
Section 4: Classification of derivative financial instruments	The main changes are related to: • highlighting concerns on the relevance and impact of classification changes that arise from the amount feature; • welcoming the additional guidance on whether an instrument meets the fixed-for-fixed condition and suggesting that such guidance would be a good basis for targeted improvements to IAS 32; and • removing the suggestion that all derivatives on own equity should be under the scope of IFRS 9.
Section 5: Compound instruments and redemption	The main changes are related to: • Highlighting that due to the complexity of the IASB's preferred approach (particularly the amount feature on liquidation), EFRAG is not convinced that the uncertainty and diversity in practice that

obligation arrangements	exists today on the classification of complex financial instruments such as financial instruments mandatorily convertible into a variable number of shares upon a contingent 'non-viability' event would be resolved with the IASB's approach; and • removing the suggestion that all derivatives on own equity should be under the scope of IFRS 9.
Section 6: Presentation	The main changes to presentation of financial liabilities are related to: • highlighting that information about liabilities with equity-like returns could be provided in the disclosures and apply only to liabilities, derivatives and embedded derivatives that are solely dependent on entity's available economic resources. Similarly, they should only apply to embedded derivatives that are separated from the host and hybrid instruments that, as a whole, are solely depend on the entity's available economic resources. The main changes to presentation of equity instruments are related to: • giving more emphasis that the costs of the information provided by the attribution approaches would exceed the related benefits.
Section 7: Disclosures	No significant changes although this section will be improved to better incorporate EFRAG position on section 2 and reflect additional details on feedback received during consultation period.
Section 8: Contractual terms	The main changes are related to application of the IASB's preferred approach to cooperative entities that apply IFRIC 2. This section will be improved to reflect additional details on feedback received during consultation period.
Appendix 2	The appendix 2 – *How the DP's proposals address the issues that arise in practice* has been removed.
Appendix 3	This appendix will include the executive summary of EFRAG's early stage impact analysis and a link to the document.

Questions for EFRAG TEG members

6 Do EFRAG TEG members have comments on EFRAG's overall position on the IASB Discussion Paper that is being included in the draft of a final comment letter?

Agenda Papers

7 In addition to this cover note, the following agenda papers have been provided for the session

(a) Agenda Paper 04-02 - EFRAG Comment Letter

(b) Agenda Paper 04-03 - EFRAG Comment Letter – Track Changes