EFRAG TEG meeting
07 – 08 March 2018
Paper 12-03
EFRAG Secretariat: Filipe Alves,
Fredré Ferreira, Joachim Jacobs

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Brief summary of the IASB discussions	Summary of feedback received by EFRAG Secretariat
Objective and scope of the project	
The IASB discussed the scope of the research project and decided to pursue the following two overlapping streams of work: • *Classification* - investigating potential improvements to the classification of liabilities and equity in IAS 32 *Financial Instruments: Presentation*. This stream would also include an investigation of potential amendments to the definitions of liabilities and equity in the Conceptual Framework; and • *Presentation and Disclosures* - investigating potential improvements to the presentation and disclosure requirements for financial instruments with characteristics of equity, irrespective of whether they are classified as liabilities or equity.	**EFRAG User Panel** When discussing the objective and scope of the research project, EFRAG User Panel members provided the following feedback at their meeting in December 2015: • the project should consider hybrid capital whose classification can change between equity and liability based on small contractual changes; • the project on FICE is closely linked to the IASB' project on Primary Financial Statements and it is important to ensure coherence in these two projects; and • acknowledged the shortcomings of an approach based on a single distinction when financial instruments contained many different features. Some EFRAG User Panel members considered that the classification of claims as liabilities or equity was not sufficient in isolation to provide useful information to users. These members considered that the classification needed to be supported by suitable disclosures about the contractual terms and conditions of the contracts. **EFRAG FIWG** When discussing the objective and scope of the research project, EFRAG FIWG members provided the following feedback in November 2016 and November 2015:

	• the major issues with IAS 32 were related to the notion of economic compulsion, the distinction between derivatives and non-derivatives and the puttable instruments that opened an exception to the liability definition; • although IAS 32 had some issues that needed to be solved and new financial products (e.g. bail in instruments) had been stretching the requirements to their limits, they considered that IAS 32 was not broken and worked well in general; • one member asked why the IASB seemed to choose a "fresh start approach". This member questioned whether the FICE project could, considering the past developments, successfully reach a solution by developing new approaches (Alpha, Beta and Gamma) and considered that the IASB should focus instead on the existing accounting issues such as NCI puts, contingently convertible instruments and bail-in instruments; • in contrast, some other EFRAG FIWG members were concerned about focusing only on specific accounting issues as this could result in a new set of rules rather clarification of the principles in IAS 32. These members considered that developing a conceptual solution, even when involving a few compromises, might be worth the effort. Still, these FIWG members considered that the IASB should apply the new conceptual definitions to the existing difficult issues at an early stage of the project; • some EFRAG FIWG members noted that banks cannot look at the classification of instruments without considering regulatory aspects. Thus, it would be useful to involve financial regulatory authorities in the discussion related to financial instrument with characteristics of equity. FIWG members considered that discussions should not necessarily be about aligning the accounting and regulatory treatments but rather through understanding the regulators' perspective; and • one EFRAG FIWG member noted that some companies, in particular financial institutions, may hold their own shares for trading purposes. For example, a financial institution may issue a bond whose principal amount varies with the movement in a share index (sometimes referred to as an 'index tracker bond'). In order to hedge the equity derivative that is embedded in the bond, it may purchase a portfolio of the shares contained in the relevant index and classify them as held for trading. If the financial institution is one of the companies in the index, the result will be that it holds its own shares for trading purposes. He considered that the current treatment (deduction from equity) was inconsistent with the economic activity and suggested that this issued should be addressed in the FICE project.
Potential improvements to the classification criteria	

The IASB identified three possible approaches for improvements: • **Approach Alpha** - classifies as liabilities obligations to transfer economic resources prior to liquidation; all other claims will be classified as equity. • **Approach Beta** - classifies as liabilities obligations for an **amount** independent of the entity's economic resources (e.g. a specified amount of currency units); all other claims will be classified as equity. • **Approach Gamma** - classifies as a liability obligations to transfer economic resources prior to liquidation or for an amount independent of the entity's economic resources. .	**EFRAG User Panel** When discussing the basis for the distinction between liabilities and equity, EFRAG User Panel members provided a number of different suggestions in September 2017 and December 2015: • one EFRAG User Panel member suggested that instruments should be classified as equity if the holder of an instrument had the right to an "unlimited upside" on participation of gains. In his view, the key definition of what constituted equity was related to any instrument that as of that day, in the event of a sale of the business, would give the holder the right to participate, with unlimited upside, in the proceeds of the disposal of a business. This User Panel member also highlighted the importance of the going concern assumption for classification of claims; • another User Panel member considered that it was important to distinguish between existing shareholders and potential shareholders. He also considered that derivatives on own equity were liabilities which were to be settled with equity and holders of such instruments were merely potential shareholders and not common equity holders; and • it was also suggested that the distinction between equity and liability could be based on whether an entity was capable of defaulting. **EFRAG FIWG** When discussing the basis for the distinction between liabilities and equity, EFRAG FIWG members provided the following feedback in November 2016, March 2017 and November 2017: • some members considered that the IASB's new approach on the FICE project introduced complexity and would require significant judgement; • one EFRAG FIWG member questioned whether the IASB should, when discussing classification issues, make a distinction between delivery of existing shares and delivery of new shares and how the entity intends to settle the contract (e.g. convertible bonds). He noted that if the entity did not own the shares and did not intend to issue new shares, this would create an indirect obligation to pay cash as the entity would have to buy the shares in the market. This member also noted that this issue was impacted by local legal requirements about issuance of new shares; • noted that concepts such as 'amount independent' and 'economic resources' were important for the discussion on classification of claims and suggested that these needed to be further clarified. For example, hybrid instruments with obligations for an amount 'partly independent' of the economic resources;

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indicated that the words “solely dependent on the residual amount” imply a higher hurdle to overcome for equity classification;
noted that the dual definition of liability, related to the obligation to pay cash and the guidance on derivatives on own equity, brought complexity to the classification criteria of financial instruments;
it was questioned why there was a need to have contracts that require the delivery of shares in the future (e.g. forward or option contract) being classified as equity. Entities should account for a contract as equity only when the potential owner actually receives an interest (i.e. shares) in the business;
considered the notion of ‘independent’ and ‘non-independent’ as something similar to the fixed-for-fixed rule, which would bring into the new model the existing problems related to derivatives on own equity, such as the rights issues denominated in a foreign currency;
were concerned that changes in classification under the Alpha, Beta and Gamma approach could impact the eligibility of hedged items;
questioned the classification outcomes of cumulative preference shares and non-cumulative preference shares under the Gamma approach and noted that the classification would depend on how management interpret the notion of “an amount independent of the economic resources”; and
referred to the new resolution concept and wondered whether liquidation would still be the right dividing line and whether the resolution should not be considered as a new key event together with the liquidation.

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<tr><td colspan="2">Potential improvements to presentation: subclasses of equity</td></tr>
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The IASB observed that existing IFRS Standards require the attribution of profit or loss and other comprehensive income between non-controlling interests and parent equity interests.
The IASB indicated that, under all of the approaches being considered, it would be useful to:

require entities to attribute profit or loss and other comprehensive income to some classes of equity other than the ordinary shares of the parent entity.
update the carrying amount of each subclass of equity to reflect any such attribution.

For non-derivative equity claims other than ordinary shares (such as non-cumulative preference shares), the IASB indicated that it would be useful
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EFRAG User Panel
When discussing the creation of subclasses of equity, EFRAG User Panel members provided the following feedback in September 2017 and February 2017:

Some EFRAG User Panel members considered the creation of subclasses of equity and their direct measurement to be useful to them to assess the allocation of the residual returns and better assess the solvency of entities, particularly of financial institutions;
Certain EFRAG User Panel members were concerned that the allocation of fair value gains and losses to the different components of equity could add complexity especially in illiquid markets where the underlying value of the instruments cannot be easily obtained;

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to attribute amounts based on the existing requirements in IAS 33 *Earnings per Share*. The IASB discussed four possible approaches of attributing amounts of equity to derivatives: • approach A would not result in any attribution; • approach B would attribute an amount equal to changes in the fair value of the derivative; and • approaches C and D would attribute an amount weighted by the relative fair value of the derivative and the fair values of other classes of equity. The IASB decided to include a discussion of the various approaches in a future discussion paper to obtain input regarding the potential costs and benefits of each approach. The IASB observed that some of the claims that would be classified as liabilities under the Gamma approach would be classified as equity under the Alpha and Beta approaches. Because of this difference, the IASB asked the staff to explore ways to present the attribution of amounts to instruments that are classified as equity under Alpha and Beta, but not under Gamma, more prominently than other classes of equity.	• Other EFRAG User Panel members called for clarity on the interaction of earnings per share attributable to potential shareholders and the attribution methods for derivative equity claims. **EFRAG FIWG** EFRAG User Panel members provided the following feedback in March 2017 and November 2016: • One EFRAG FIWG member considered that the allocation of equity to different types of shareholders was an interesting concept in terms of priority and distribution of the residual amount. This EFRAG FIWG member indicated that remeasurement at fair value would trigger a lot of complexity and supported an approach more aligned with the existing earnings per share approach as it is a better reflection of how equity is allocated among the different type of shareholders; • One member liked the idea of subclasses within equity and liabilities as regulators in the banking sector were encouraging the use of different types of regulatory capital instruments which carried different rights and obligations; and • Another member had reservations about having subclasses of equity and noted that having direct measurement of own equity derivatives would create complexity and would be more onerous to apply.
Derivatives on own equity	
The IASB discussed the application of the Gamma approach to different types of derivatives. The IASB also discussed whether derivatives should be split into components for classification. The IASB tentatively decided that entities should: • not classify all derivatives as assets or liabilities; and • classify derivatives on 'own equity' in their entirety rather than splitting them into smaller components. The IASB tentatively decided that, for the Gamma approach, an entity should: • classify as equity derivatives for the receipt of cash or other financial assets in exchange for the delivery of equity instruments if they are settled by the exchange of a fixed amount of cash or other financial assets for a fixed number of the entity's equity instruments (because	**EFRAG User Panel** At their meeting in February 2017, EFRAG User Panel members considered that it would be useful to see examples which would illustrate the potential practical impacts of the new proposals. For example, EFRAG User Panel members were interested in understanding the impact of the new proposals on the classification of different derivatives on own equity, particularly financial instruments with characteristics of equity. These members mentioned the Standard & Poors Hybrid Capital Handbook as a reference to analysis of hybrid instruments. **EFRAG FIWG** EFRAG FIWG members provided the following feedback in November 2017, March 2017, November 2016 and November 2015: • Some EFRAG FIWG members highlighted that there had been increasing issues of instruments together with derivatives entered into at the same time and in contemplation of the instruments. The resulting classification would differ depending on whether the two

they solely depend on the residual amount); and they are either physically settled or net-share settled (because they would not require a transfer of economic resources other than at liquidation). • classify as equity derivatives that result in the exchange of a liability for the delivery of equity instruments, if they are fixed-for-fixed and either physically settled or net-share settled. • apply a requirement similar to the existing redemption obligation requirement in paragraph 23 of IAS 32 for derivatives that extinguish equity in exchange for a claim that meets the definition of a liability (to ensure that arrangements with the same liability and equity outcomes are classified consistently regardless of how they are structured); and • reconcile the interaction of the redemption obligation requirement with the requirement that only fixed-for-fixed derivatives that exchange a liability for equity instruments are classified as equity. • classify as assets or liabilities all other derivatives for the receipt of cash or other financial assets, or for the extinguishment of financial liabilities, in exchange for the delivery of equity instruments. This is because such derivatives would either require a transfer of economic resources prior to liquidation, or they would be claims for an amount that would be wholly, or partly, independent of the entity's economic resources.	instruments are taken together or as single instruments. E.g. a convertible bond issued together with a derivative for repurchase of the shares used for conversion would effectively be an ordinary bond; • EFRAG FIWG members discussed the difficulties related to the classification of bail-in instruments. They noted that upon a trigger event, the financial instruments may be mandatorily convertible into a variable number shares or there may be a mandatory write-down. They noted that this raised difficulties in terms of classification as the former form of resolution (conversion) would be compliant with a liability classification and the latter (write-down) would be compliant with an equity classification. Furthermore, they also noted that it was the regulator who decided on the form of resolution (conversion or write-down) and that it was not clear in advance which form of resolution the regulator would choose. Finally, these financial instruments also raised questions about how to provide transparent information to users. FIWG members also explained that the substance of bail-in instruments was a resolution aimed at limiting the cases liquidations of credit institutions. From this perspective, resolution might be understood as a new key event to be considered in classification. For corporates which are not subject to the special resolution legislation such events might extend to restructuring of equity instruments negotiated between parties; • When discussing the accounting for written put options and convertible bonds, the IASB had noted that under the gamma approach, the accounting for a convertible bond would be similar to the accounting for a written put option on own shares that is issued together with ordinary shares. In both cases, the holder will have the option to either receive cash or shares of the entity. Nonetheless, some members highlighted the differences between the two instruments in terms of rights and obligations); • Some members questioned whether all derivatives on own equity should be classified as assets or liabilities (i.e. as derivatives at fair value); • In general, members called for more details on the accounting mechanics within equity for written put options on non-controlling interest, particularly if the written option is not exercised so the NCI that was previously derecognised would need to be re-recognised. In addition, they noted that: o if the strike price is equal to the underlying shares, then the changes in the liability will qualify for separate presentation in OCI. It was noted that practical challenges may arise in practice when measuring the fair value of the underlying shares. These members indicated that such shares are mostly non-listed and determining a fair value would require a significant amount of judgement; and

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One member highlighted that the proposals on remeasurement of equity could conflict with local laws on presentation of some equity elements such as share capital and share premium.

Some EFRAG FIWG also questioned the current gross application accounting for derivatives on own equity (e.g. accounting for the redemption amount) which generated several issues such as lack of consistency on the treatment of “obligation to buy” and “obligation to sell own shares”.
EFRAG FIWG confirmed that there was an increase in complexity in the types of instruments classified as hybrid instruments due to the linkage of transactions that involve derivatives entered into at the same time and in contemplation of the issue of the instruments.

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<tr><td colspan="2">Claims with conditional alternative liability and equity settlement outcomes</td></tr>
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The IASB tentatively decided that, under the Gamma approach, economic incentives that might influence the issuer's decision to exercise its rights should not be considered when classifying a claim as either a liability or equity.
Thus, under the Gamma approach, classification would be based on the substantive rights and obligations established by a contract, including obligations that are established indirectly through the terms of the contract, which is similar to the requirements in IAS 32.
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In November 2016, EFRAG FIWG:

highlighted the importance to retain the contingent settlement provisions in paragraph 25 of IAS 32 as they were not sure whether the Gamma approach was going to solve the issues related to contingent convertible financial instruments. One other issue that needs to be addressed is the measurement of liabilities as there are different views on how contingent liabilities should be measured.
discussed the interaction between the notion of “economic compulsion” and “economic incentives” and noted that the IASB had not been in favour of considering economic compulsion in the new model as it could lead to constant reassessments and reclassifications of instruments over time.

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<tr><td>Contractual terms</td><td></td></tr>
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The IASB discussed the scope of contractual rights and obligations an entity should consider when applying the Gamma approach to a financial instrument. The IASB tentatively decided:

to require an entity to apply the Gamma approach to the contractual terms of a financial instrument consistently with IAS 32 and IFRS 9 Financial Instruments.
to consider whether it should take any action to address the accounting for mandatory tender offers, including potential disclosure requirements.

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EFRAG FIWG
In November 2017, March 2017 and November 2015:

EFRAG FIWG highlighted the importance of the interaction between ‘contractual rights and obligations’ and ‘regulatory and legal’ requirements (e.g. the impact of legal requirements to pay dividends on the classification of financial instruments).
Some EFRAG FIWG members considered that the IFRS guidance was not consistent, or even contradictory, when dealing with ‘contractual rights and obligations’ and ‘regulatory and legal’ requirements. For example, IFRIC 2 requires an entity to take into account local law when determining whether there is a financial liability while IAS 32 focuses on contractual features. Moreover, IFRS 9 disregards bail-in legislation in the contractual

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• not to reconsider IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*, given that it is not aware of any challenges to its application.	cash flows test (another example was Mandatory Tender Offers). The IASB should take into account that all contracts reside in a body of a law and that no contract arises in isolation. Contractual terms should be understood as something going above what is written in the legislation rather than those just repeating the legislation. However, legislation differs country by country and from this perspective the distinction between contractual and legal conditions may be different which could limit the usefulness of the information. • For the scope of contractual rights and obligations, some EFRAG FIWG members: ○ did not believe that the guidance developed will solve the issues because it does not really address the issue of inconsistency between IFRIC 2 and IAS 32; ○ highlighted the difficulties that might arise in distinguishing what comes from the law and what comes from the contract (i.e. does it matter that the contract repeats the law) as all contracts exist within a legal framework; and ○ questioned whether dividends in certain countries where an entity is required to pay a dividend by law which is not in the contract, should be taken into account or not.
Exception in Paragraphs 16A-16D of IAS 32 ("Puttables exception")	
The IASB is not aware of any issues with the application of the exception as set out in paragraphs 16A and 16B, or 16C and 16D, of IAS 32. The IASB also observed that applying the Gamma approach to instruments that meet the exception might address some, but not all, of the previous concerns which led to the exception. Hence, the exception might continue to be required under the Gamma approach. The IASB tentatively decided to include its discussion in the future FICE Discussion Paper.	**EFRAG User Panel** In February 2017, one EFRAG User Panel member stated that he would prefer a new approach without exceptions. **EFRAG FIWG** In March 2017 EFRAG FIWG members agreed to retain the puttables exception in paragraphs 16(A) – 16(D) of IAS 32 under the Gamma approach. However one member noted that the puttables exception raised a number of application issues which would not be solved in the FICE project. In particular in with regards to: • the most residual class of instrument to be considered in the scope of the exception • the requirement that they have to be identical; • dilution issues; and • the scope that should be clarified as the exception was very restrictive and this raised a lot of questions.

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<tr><th colspan="2">Disclosures</th></tr>
<tr><td>The IASB discussed the inclusion of disclosures about financial instruments with characteristics of equity in the notes to the financial statements. It tentatively decided to include a discussion of the following potential disclosures in the forthcoming Discussion Paper:
• the priority of claims on liquidation;
• the potential dilution of ordinary shares; and
• additional supporting information about the presentation and classification requirements of the Gamma approach.</td><td>EFRAG User Panel
In February 2017, EFRAG User Panel members considered that the classification of financial instruments needed to be supported by suitable disclosures and welcomed better disclosures about the contractual terms and conditions of the financial instruments, information about priority of claims and information that would help them assessing the effects of dilution resulting from instruments settled with own equity. Nonetheless, they highlighted that the IASB would have to take into account the level of the reporting entity which is being considered.
EFRAG FIWG
In November 2016 and November 2015, FIWG members:
• highlighted, the importance of having improvements to the disclosure requirements for financial instruments with characteristics of equity in many circumstances. For example, if the core equity Tier 1 ratio of a bank falls below 5.125%, additional Tier 1 instruments are automatically converted into core equity Tier 1 instruments or written down. The specific mechanism may be specified in the contractual conditions. One point to consider is how to disclose the information about write downs.
• mentioned that even though IFRS 7 Financial Instruments: Disclosures already requires the key terms of financial instruments to be disclosed, the disclosures are not always clear about how the instruments are classified and why an instrument had been classified as equity or as liability. The project could benefit from considering improvements to the existing disclosures requirements.
• also pointed out the diversity in practice. Apart from the IFRS 7 requirement about the key terms of the financial instruments to be disclosed, information provided was not always transparent in terms of where the instruments fall and why an instrument had been classified as equity and as liability. One EFRAG FIWG member considered the latest developments on disclosures were going to help and noted that IFRS lacked requirements in regard to disclosures on the terms and conditions of financial instruments, particularly for financial instruments with characteristics of equity.</td></tr>
<tr><th colspan="2">Interaction with the Conceptual Framework and other IFRSs</th></tr>
<tr><td>The IASB discussed the potential implications of the Gamma approach for other IFRS Standards, IFRIC Interpretations and other projects on its agenda.</td><td>EFRAG User Panel
In September 2017, EFRAG User Panel members needed clarity on the interaction of earnings per share attributable to potential shareholders and the attribution methods for derivative equity claims.</td></tr>
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