Financial Instruments with Characteristics of Equity
High level preliminary impact assessment

Objective

1 The objective of this paper is to discuss the EFRAG Secretariat's high level preliminary impact assessment of the IASB discussions on its research project *Financial Instruments with Characteristics of Equity* ('FICE') and future EFRAG activities after the publication of the IASB's Discussion Paper.

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Background and scope of the preliminary impact assessment

2 The IASB's discussion on its research project FICE started in May 2015 and EFRAG Secretariat has been regularly providing updates to EFRAG TEG. These updates covered the following discussions:

(a) the features of claims that are relevant for primary users of financial statements in making economic decisions (i.e. type, amount, timing and priority of the claim). This analysis formed the basis for the classification, presentation and disclosures of claims in the IASB's project;

(b) **improvements to the classification requirements**: the IASB identified three new approaches (Alpha, Beta and Gamma);

(c) **improvements to the presentation of financial instruments classified as liabilities**: the IASB discussed the presentation of liabilities with different features on the face of the statement of financial position and the presentation of income and expenses that arise from different subclasses of liabilities in the statement of financial performance, including the use of other comprehensive income (OCI);

(d) **improvements to the presentation of financial instruments classified as equity**: the IASB discussed how subclasses of equity could help in providing additional information about the features identified as relevant. This included discussions on whether subclasses of equity should include "ordinary shares" and "senior classes of equity", whether the attribution of profit or loss and OCI should be expanded to senior classes of equity (and if so how) and whether the carrying amount of each subclass of equity should be updated to reflect the attribution of profit or loss and OCI;

(e) **derivatives on own equity**: the IASB discussed the application of the Gamma approach to different types of derivatives on own equity, the unit of account for accounting for derivatives on own equity and whether derivatives should be split into components for classification purposes. It also discussed the existing puttable instruments exception in IAS 32 *Financial Instruments: Presentation* and how the Gamma approach addresses some issues that arise in practice when applying the fixed-for-fixed condition in IAS 32;

(f) **claims with conditional alternative outcomes**: the IASB considered the challenges in accounting for claims with conditional alternative liability and equity settlement outcomes. For example, it considered whether economic incentives that may influence the entity's decision to exercise its option should be considered for classification purposes;

(g) **improvements to the disclosure requirements**: the IASB discussed improvements to disclosure requirements including improvements to disclosures on priority of claims on liquidation and potential dilution of ordinary shares;

(h) **the accounting within equity**: the IASB discussed illustrative examples that clarify how its decisions on the Gamma approach apply to accounting within equity, including convertible bonds and put options written on own equity;

(i) **the scope of contractual rights and obligations**: the IASB discussed whether the effects of law should be considered for the purposes of classifying financial instruments under the Gamma approach. In particular, whether the Gamma approach should focus only on the contractual terms of a financial instrument (as in IAS 32 and IFRS 9 *Financial Instruments*) or whether it should consider both the rights and obligations arising from the contract and the law for classification purposes (as in IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*);

(j) **the classification of derivatives on non-controlling interests with an exercise price denominated in a foreign currency**: the IASB discussed which functional currency should be the reference point in determining whether a derivative is denominated in a foreign currency;

(k) a summary of interactions with other IFRS Standards, IFRIC Interpretations and the *Conceptual Framework for Financial Reporting*; and

(l) **classification of non-derivative financial instruments with complex payoff structure:** the issue arises when an entity has the option to limit the amount of a claim to that entity's available economic resources but also has the option to settle at an amount that is affected by other variables that are independent of the entity's economic resources. The IASB discussed whether such an instrument could be analysed as an equity host and an embedded derivative asset if the issuer held the option to settle the claim.

3 The EFRAG Secretariat preliminary impact assessment has been based on the IASB discussions and tentative decisions mentioned above.

4 EFRAG preliminary impact assessment is mainly focused on the classification and presentation changes that arise with the new Gamma approach developed by the IASB. For that purpose, the EFRAG Secretariat made a qualitative and quantitative high level impact assessment on the classification of financial instruments under the Gamma approach and presentation of subclasses of equity and liabilities.

Methodology

5 EFRAG Secretariat's preliminary impact assessment focused mainly on financial institutions that issue hybrid instruments and derivatives on own equity. More specifically, the EFRAG Secretariat:

(a) analysed the 2016 financial statements of a sample of 16 listed European financial institutions (selection based on market capitalisation)[1];

(b) analysed the equity components of the same 16 European listed financial institutions;

(c) used databases (SNL, S&P Capital IQ and Orbis) to better understand the equity components of financial institutions; and

(d) conducted a limited literature review on key topics related to the project.

6 Although non-financial corporate entities that issue hybrids and derivatives on own equity will also be affected by the proposals, the EFRAG Secretariat had difficulties in identifying such companies within databases, as they currently do not provide a detailed disaggregation of the equity components, particularly on financial instruments with characteristics of equity ('FICE').

Executive Summary

Why an impact assessment?

7 In this agenda paper, the EFRAG Secretariat considers both the technical accounting aspects and the wider impact in Europe of the IASB's discussions up to date on its research project FICE.

8 This high level preliminary impact analysis gives emphasis to the real-world consequences of changing current IFRS requirements and is intended to help EFRAG TEG members understand the potential impact of the new approach developed by the IASB on classification and presentation of financial instruments under the scope of IAS 32.

9 In particular, an impact assessment should help in understanding the impact of such a change on the statement of financial position and the solvency of European financial institutions. It is also intended to identify information needs for a more comprehensive impact assessment to be developed in the future.

Limitations of this impact assessment

10 When analysing different elements of the statement of financial position, the EFRAG Secretariat observed that currently databases do not provide a detailed disaggregation of the equity components within total equity. In addition, we have also observed that the level of disaggregation of equity within the statement of

[1] The EFRAG Secretariat notes that the sample of 16 financial institutions is not statistically representative of all European financial institutions.

financial position varies, particularly when dealing with derivatives on own equity and hybrids.

11 The EFRAG Secretariat considers that this is partly due to the fact that IAS 1 *Presentation of Financial Statements* has limited requirements on the presentation of line items on equity components on the face of the statement of financial position (i.e. 'issued capital and reserves attributable to owners of the parent' and 'non-controlling interest') and statement of changes in equity (i.e. amounts attributable to owners of the parent and to non-controlling interests).

12 The lack of detailed information about the different components of equity represented a significant limitation to this impact assessment. To overcome this, the EFRAG Secretariat considers that in the future, it will need to reach out directly to preparers, business organisations and regulators (e.g. outreach activities, questionnaires) to obtain detailed information that can be used in a more comprehensive impact assessment.

Impact on classification and presentation of financial instruments

13 When discussing this project, the IASB noted that notwithstanding the challenges identified, IAS 32 has worked well for the majority of liabilities and equity. Therefore, the IASB did not intend to begin from a blank sheet of paper and used IAS 32 as the starting point.

14 Nonetheless, as further explained below, the Gamma approach may introduce significant changes to the classification of some financial instruments and the presentation of equity 'other than ordinary shares'. More specifically, the EFRAG Secretariat assesses that the most significant impact will be on:

(a) potential remeasurement of subclasses of equity 'other than ordinary shares' such as cumulative preference shares, derivatives on own equity and compound instruments;

(b) the classification of financial instruments that currently meet the foreign currency rights exception in paragraph 16 of IAS 32; and

(c) the classification of non-redeemable cumulative preference shares[2] and perpetual cumulative hybrid securities that currently are classified as equity in their entirety.

Current requirements on classification and presentation of equity instruments

15 A fundamental principle in IAS 32 is that a financial instrument should be classified as either a financial liability or an equity instrument in accordance with the substance of the contract, not its legal form, and the definitions of financial liability and equity instrument. There are a number of exceptions from this principle, such as certain puttable instruments that meet specific criteria and certain obligations arising on liquidation.

16 In accordance with IAS 32, a financial instrument is an equity instrument only if the entity has no obligation under any circumstances to settle with cash or to deliver a variable number of its own equity instruments. The entity must make the decision at the time the instrument is initially recognised and the classification is not subsequently changed based on changed circumstances (unless there is a modification of the terms of the contract).

17 In terms of presentation, for financial instruments classified as equity, IAS 32 does not specifically mention which components of equity should be presented or used.

[2] Instruments with similar features are also sometimes called perpetual bonds and are classified as equity under IAS 32 because of the unconditional right to defer payment of principal and interest. The IASB called the instruments cumulative preference shares to avoid confusion with perpetual bonds that require specified annual coupon payments in perpetuity.

Nonetheless, IAS 1 requires entities to present the following minimum line items in the statement of financial position, within equity:

(a) issued capital and reserves attributable to owners of the parent; and

(b) non-controlling interest.

18 In accordance to paragraph 85 of IAS 1, additional line items, headings and subtotals may be needed to fairly present the entity's financial position.

19 In regard to the statement of changes in equity, in accordance with paragraph 106 of IAS 1, companies have to present:

(a) the total comprehensive income for the period, showing separately amounts attributable to owners of the parent and to non-controlling interests;

(b) the effects of any retrospective application of accounting policies or restatements made in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, separately for each component of other comprehensive income;

(c) reconciliations between the carrying amounts at the beginning and the end of the period for each component of equity, separately disclosing:

(i) profit or loss;

(ii) other comprehensive income; and

(iii) transactions with owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

Current practice on classification and presentation of equity instruments

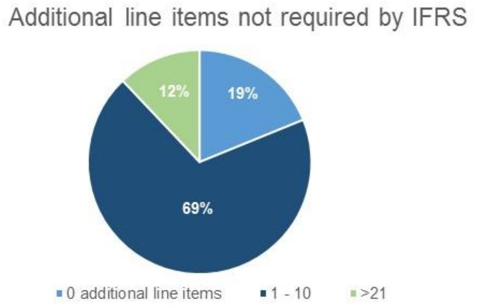
20 The EFRAG Secretariat analysed the current practices on classification and presentation of financial instruments classified as equity.

21 Based on the analysis of the financial statements of 16 financial institutions we have observed that companies provide different levels of disaggregation of their equity within the statement of financial position.

22 IAS 1 requires entities to present at least two line items in their statement of financial position within equity (i.e. ‘issued capital and reserves attributable to owners of the parent’ and ‘non-controlling interest’).

23 In general, most of the financial institutions (81%) presented additional equity components other than those required by IAS 1. However, the level of disaggregation of different equity components on the face of the statement of financial position varied. For example, two financial institutions provided very detailed information about the composition of their equity (showed more than 20 different line items) while three financial institutions did not provide any additional detail of the different equity components.

24 Even so, the majority of the financial institutions (69%) showed between 1 and 10 line items that are not explicitly required under IFRS.



25 The following items were included on the face of the statement of financial position by more than one entity:

(a) Issued capital (81%);

(b) Share premium (63%);

(c) Retained earnings (56%);

(d) Other reserves (44%);

(e) Other equity instruments (38%);

(f) Translation differences (19%); and

(g) Treasury shares (13%).

26 EFRAG Secretariat was able to find more disaggregation in the statement of changes in equity, even though there are limited requirements in terms of minimum line items that have to be presented.

27 When analysing in more detail, within the statement of changes in equity and disclosures, the main equity components identified within issued capital were:

(a) ordinary shares;

(b) ordinary shares under employee share based plans; and

(c) non-cumulative preference shares;

28 The EFRAG Secretariat also identified a number of instruments that were classified as 'other equity instruments' which typically encompassed *Equity Hybrid Securities*. To better understand these components, the EFRAG Secretariat observed the following instruments classified as equity as presented within 'other equity instruments':

Instrument	Description
Perpetual subordinated securities	No maturity date and coupon payments may be unpaid or deferred at the entity's discretion. Securities may be exchanged for shares (fixed conversion price) under certain conditions.
Contingent Convertible Securities	No maturity date and interest payable at the entity's discretion. Securities may be exchanged for shares (fixed conversion price) if certain ratio is breached (Common Equity Tier 1).
Undated Super Subordinated Notes	Redeemable at fixed dates at the entity's discretion.

Fixed Rate Resetting Perpetual Subordinated Contingent Convertible Securities	No fixed maturity or redemption date and interest payable at the entity's discretion. Principal Repayable at the entity's discretion. Securities may be exchanged for shares (fixed conversion price) if certain ratio is breached (Common Equity Tier 1).
Undated subordinated debt instruments	Early redemption clauses at the entity's option.
Perpetual deeply subordinated notes	Decision to pay at the entity's discretion.
Euro medium-term note (EMTN)	Interest may be deferred at the entity's discretion.
Additional tier 1 capital	No maturity date and interest payable at the entity's discretion. Securities may be exchanged written down if certain ratio is breached.
Vanilla convertible bonds	Equity component of compound financial instruments.
Options rights	Equity component of written call options.
Equity-settled share-based payments transactions	Equity component of equity-settled share-based payments.

29 The amounts related to these equity hybrid securities are so significant that many financial institutions have been, even if not required, presenting these instruments separately as other equity instruments.

30 For vanilla convertible bonds and derivatives on own equity, the EFRAG Secretariat noticed that although the IASB often requires the separation, for accounting purposes, of the different components of the financial instruments, it is difficult to identify and locate the equity components of these financial instruments which may be presented within different line items such as reserves, share premium and other equity instruments. The same applies to equity-settled share-based payments under the scope of IFRS 2 *Share-based Payments*.

31 Therefore, for these types of instruments, it is often difficult to identify and locate within the primary financial statements and related notes the amounts related to 'quasi-capital' components (i.e. instruments that are classified as equity but are not issued capital; give only third parties the right to buy equity in the future).

Expected classification changes with Gamma approach

32 In terms of classification, the IASB discussions focused on the Gamma approach which will classify as equity the claims that require the transfer of economic resources only at liquidation and the amount of economic resources required to be transferred at liquidation is not independent of the entity's economic resources.

33 When considering the IASB discussions on the Gamma approach, the EFRAG Secretariat assesses the classification changes described below.

Foreign currency rights issue

34 When comparing the Gamma approach with IAS 32, a key classification change is related to forwards to sell own shares, written call options on own shares and purchased put options on own shares (and other derivatives for the receipt of cash or other financial assets in exchange for the delivery of equity instruments) that are physically settled in a foreign currency and meet the foreign currency rights issue exception in IAS 32 ('**foreign currency rights issue'**). These instruments will be classified as liabilities under the Gamma approach while these instruments are classified as equity under IAS 32.

35 These instruments would not be classified as equity because the amount does not solely depend on the residual amount; it also depends on the foreign exchange rate. This would be a strict form of the fixed-for-fixed principle which reverses the amendments issued in October 2009 on the foreign currency rights issue exception.

Instruments that do not require a transfer of economic resources before liquidation but the amount of the claim is independent of the entity's available economic resources

36 When comparing the Gamma approach with current requirements in IAS 32, a key difference is the introduction of the 'amount' feature. This feature will affect the classification of instruments that do not require the transfer of economic resources before liquidation but the claim is for a fixed amount that is independent of the entity's available economic resources. For example:

(a) non-redeemable cumulative preference shares;

(b) the classification of perpetual cumulative hybrid securities that currently are classified as equity in their entirety where the issuer has the unconditional right to defer payment of any coupons or principal, including those that are contingent and can be exchanged for shares (fixed conversion price) if certain ratio is breached (e.g. Common Equity Tier 1 below certain level)..

37 Currently, these instruments are classified as equity in their entirety under IAS 32 as the entity has no contractual obligation to deliver cash or a variable number of its own shares under any circumstance.

Net-share settled derivatives on own equity

38 When discussing derivative instruments, 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 (e.g. forward contracts to deliver equity) if:

(a) 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; and

(b) they are either physically settled or net-share settled.

39 In addition, the IASB tentatively decided to classify as equity derivatives those 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.

40 Currently, **net-share settled derivatives** are not classified as equity under IAS 32. Thus, this new criteria will impact the classification of some net-share settled derivatives on own equity such as forwards to sell own shares, written call options on own shares, purchased put options on own shares, contingent sale of equity, forward contracts to convert financial liability to equity, written options to convert a financial liability to equity, purchased options to convert a financial liability to equity and contingent conversion of financial liability to equity.

41 These instruments will be classified as equity under the Gamma approach while they are currently classified as liabilities under IAS 32. For example, the embedded derivative on mandatorily convertible bond with a cap and floor may be classified as

equity if it is net-share settled. Currently such instruments are classified as liabilities under IFRS 9 with fair value changes recognised in profit or loss.

NCI puts

42 An NCI put is a contract to purchase the group's own equity instruments and thus gives rise to a financial liability for the present value of the redemption amount in accordance with paragraph 23 in IAS 32. When the financial liability is recognised initially, that amount is reclassified from equity.

43 The EFRAG Secretariat considers that the Gamma approach may change the existing requirements on the "reclassification from equity" and "equity component" of derivatives on own equity that represent equity/liability exchanges (e.g. change to existing requirements on written put options).

Expected presentation changes with Gamma approach

44 When discussing the creation of subclasses of equity, the IASB observed that the 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 it would be useful to:

(a) 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 (e.g. equity components of compound instruments and derivatives on own equity); and

(b) update the carrying amount of each subclass of equity to reflect any such attribution.

Remeasurement of senior classes of equity

45 For **non-derivative equity claims** other than ordinary shares (such as non-cumulative preference shares), the IASB indicated that it would be useful, and impose little additional cost, to attribute amounts based on the existing requirements for such instruments in IAS 33 *Earnings per Share*. For **derivative equity claims**, the IASB discussed four possible approaches of attributing amounts of equity to derivatives which could be based on the fair value of the derivative or relative fair value of the derivative.

Fair value NCI puts

46 Under the Gamma approach, when accounting for written put options where an entity repurchases equity instruments by transferring a variable amount of cash equal to the value of the underlying shares (e.g. fair value puts) the equity component (equivalent to a conversion option) will be nil and all of the returns on the claim will be captured by the liability component.

47 The separate presentation requirements will apply for liabilities that solely depend on the residual amount. Therefore, although the classification of fair value NCI puts will not change, the returns of such claim will be presented in OCI.

Shares redeemable at fair value

48 As mentioned above, the separate presentation requirements will apply for liabilities that solely depend on the residual amount. Therefore, although the classification of shares redeemable at fair value will not change, the returns of such claim will be presented in OCI.

Preliminary impact assessment on classification changes

49 From our analysis of the financial statements, databases and existing literature review we have noted the following.

Foreign currency rights issue

50 In October 2009, the IASB issued an amendment to IAS 32 on the classification of rights issues which stated that that rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments.

51 When analysing these types of instruments, the EFRAG Secretariat noticed that it is difficult to obtain detailed information related the issue of rights in a foreign currency directly from databases, including when an entity is actually using the foreign currency rights issue exception in IAS 32.

52 However, when analysing the financial statements of a sample of 12 banks[3], the EFRAG Secretariat observed that most of these banks had issued rights in the last 9 years and those rights can be relatively large transactions (those analysed amounted from 4 to 15 billion euros) that have a substantial effect on the financial statements of an entity.

53 The EFRAG Secretariat also observed that many of these rights were issued between 2009 and 2011, a period of significant turbulence in economies and markets around the world, particularly in Europe with the sovereign debt crisis.

54 Although the financial statements and management information usually do not provide detailed information of whether the rights issues are in foreign currency and their significance, we highlight that the financial institutions analysed are multinational financial institutions that operate globally.

55 The EFRAG Secretariat also observed that one financial institution raised £12.5 billion in 2009 by way of a fully underwritten rights issue, which was offered mainly in foreign currency. In this case, if the rights issued in foreign currency had been accounted for as a derivative financial liability, under IFRS 9, the liability would have been measured at its fair value at the inception of the offer, which is basically the difference between the share price on that date and the issue price. The corresponding entry upon its inception would have been made to shareholders' equity. Subsequently, the liability would have been re-measured at fair value with movements in fair value recognised in the income statement until the rights were exercised. If this accounting treatment had been adopted, significant losses or gains would be recognised due to increases or decreases in the share price during the offer period. This would also mean that the financial institutions would not be able to reinforce its equity from an accounting perspective.

56 Laws or regulations in different jurisdictions throughout the world may require the use of rights issues when raising capital. Many issuing entities fixed the exercise price of the rights in currencies other than their functional currency because the entities were listed in more than one jurisdiction and might be required to do so by law or regulation. Therefore, the costs related to the removal of the exception are related to the fact that companies would need to use other instruments to raise capital.

57 The removal of this exception is likely to reach beyond the impact on financial statements and lead to changes of behaviour. For example, it may lead to a decrease, when possible, of the issue of rights in foreign currency.

58 In accordance with study *The Economic Consequences of IFRS: The Impact of IAS 32 on Preference Shares in the Netherlands (2016)*, the application of IAS 32 caused most preference shares to lose their classification as equity. This academic study found that 71% of the firms that were affected by IAS 32 bought back their

[3] Due to time constrains, for foreign currency rights issue the analysis on was focused on the biggest banks by market capitalisation

preference shares or altered the specifications of the preference shares in such a way that the classification as equity could be maintained. There was also the decrease in the use of preference shares in the Netherlands.

Instruments that do not require a transfer of economic resources before liquidation but the amount of the claim is independent of the entity's available economic resources

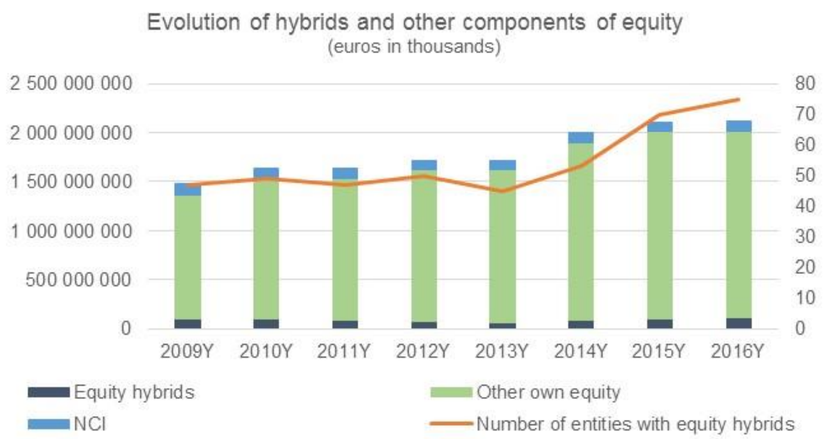
59 Currently databases and financial institutions do not separately present the amounts related to non-redeemable cumulative preference shares and perpetual cumulative hybrid securities. Thus, it is difficult to identify the amounts related to these types of instruments.

60 When analysing the financial statements of 16 financial institutions, we have identified a single case where an entity had cumulative preference shares that were authorized but not issued. The EFRAG Secretariat also observed that there were many hybrid instruments classified as equity within 'other equity instruments'. These include different types of bonds such as plain vanilla, convertible and contingent convertible bonds. Most of these instruments were undated/perpetual which allowed companies to classify them as equity in their entirety. This is because the entity has the unconditional right to defer payment of any coupon or principal amounts. In addition, for those that have a contingency feature, the trigger event may lead to a fixed-for-fixed transaction.

61 To better understand the amount of hybrid financial instruments currently classified as equity, the EFRAG Secretariat used SNL Financial database and analysed a sample of 260 European listed companies. To obtain this list of entities, we extracted all European public companies, which gave us a sample of 427 entities, and subsequently we made the following adjustments:

Extraction from SNL	**427**
- Non-IFRS	-92
- Subsidiaries for which the ultimate parent company is already in the sample	-42
- country of corporation outside EAA (except for Switzerland)	-33
Number of companies	**260**

62 This database identifies a line item called *Equity Hybrid Securities* (i.e. securities that have both debt and equity characteristics, classified as equity by the entity) which amounted to 110 969 millions of euros in 2016. This amount represents 5.24% of total equity and 5.51% total equity attributable to the parent company. The EFRAG Secretariat also noticed that the top 10 companies accumulate 72% of the total amount of *Equity Hybrid Securities.* The evolution since 2009 can be seen in the graph below.



63 When analysing the disclosures of the 16 financial institutions, the EFRAG Secretariat observed that equity hybrid securities are complex instruments with many different features and that companies structure these financial instruments to

obtain equity classification in their entirety. That is, these instruments are structured in a way that the entity has no contractual obligation to deliver cash or a variable number of its own shares under any circumstance.

64 Contingent convertible bonds (CoCos) have been a key pillar in the regulatory regime drawn up to strengthen banks' capital levels (e.g. European implementation of the Basel III Accord, European Capital Requirements Regulation, the European Bank Recovery and Resolution Directive and the European Banking Authority requirements on bank's liquidity coverage ratio) and to prevent taxpayer bailouts after the financial crisis. These regulatory developments also affected important design features of European CoCos, such as trigger level and maturity period. For example, the latest form of CoCos, known as additional tier 1 (AT1) bonds, force losses on investors when a bank's capital falls below a certain trigger level through conversion into equity or a write-down.

65 Since the financial crisis several banks and insurance companies have been issuing convertible debt to strengthen their balance sheets. In accordance with study *Contingent Convertibles: Can the Market handle them?* (2017), by the end of 2015, 64 European banks had raised additional capital through the issuance of CoCos and the total outstanding amount of CoCos issued by European banks tripled between 2012 and 2015 to reach a record high of EUR 157 billion.

66 This increase is related to the fact that the use of CoCos:

(a) increase the capital levels of financial institutions;

(b) gives national regulators the authority to implement a fast-track recapitalisation via debt-equity swaps executed just prior to liquidation or resolution (a "bail-in"); and

(c) gives investors relatively high coupons.

67 The new amount feature of the Gamma approach (a claim for an amount that is independent of the entity's economic available resources) is classified as a liability may have an impact on the classification of the instruments identified in paragraph 28. The classification of undated or perpetual bonds (vanilla, convertible and contingent convertible) may change if such instruments have a payment deferral cumulative feature (i.e. the entity has the right to defer the payment of interest but not to cancel them).

68 As currently the cumulative feature is not significant, it is difficult to find information within the financial statements and databases on whether there are financial instruments with cumulative features.

69 Therefore, it is difficult to assess the amount of *Equity Hybrid Securities*, which in 2017 amounted for 110 969 millions of euros, that may be reclassified to a liability.

Preliminary impact assessment on presentation changes

70 The creation of subclasses of equity, their separate presentation and remeasurement represents a significant change to existing requirements in IAS 1 and IAS 32.

71 Companies that have senior classes of equity such as cumulative preference shares, derivatives on own equity and compound instruments will be significantly affected by the new classification and presentation requirements.

72 The EFRAG Secretariat considers that the remeasurement of senior classes of equity (within equity) would require companies to remeasure equity components identified as *Equity Hybrid Securities* that would not be reclassified as liabilities (e.g. cumulative perpetual bonds) under the Gamma approach. In addition, currently companies tend to include the equity components of compound instruments and

derivatives on own equity within different line items such as reserves, share premium and other equity instruments.

73 Therefore, the presentation impact of remeasurement of equity will depend on:

(a) the amount of *Equity Hybrid Securities* that are reclassified as liabilities under the Gamma approach; and

(b) amount of equity components reported within different line items within equity.

74 The EFRAG secretariat notes that the remeasurement of senior classes of equity will be made within equity and the total amount of equity will not be affected.

75 The biggest impact will be on the costs related to fair value calculations of own instruments, volatility within the different components of equity and changes in ratios (e.g. return on equity, return on invested capital, leverage, debt to capital ratio).

76 We also note that the IASB did not discuss whether it will require additional line items, subtotals or categories on the face of the balance sheet for senior classes of equity. Thus, it is not clear whether senior class of shareholders equity would be presented as a separate line item, a new subtotal or new category (e.g. mezzanine).

77 Finally, some entities have separate line items of OCI within equity. Considering that the IASB tentatively decided to require entities to attribute profit or loss and OCI to some classes of equity, this raises the question of how it should be done and how much the statement of financial position has to change to accommodate the measurement within equity. As a result, the EFRAG Secretariat considers that the IASB might need to consider a two column presentation approach within equity (separating ordinary classes of equity from senior classes of equity) to better understand the allocation of the different lines items of equity to the different classes of equity.

Financial instruments which have been scoped out or are difficult to make a preliminary impact assessment

78 As the IASB does not intend to change the current requirements on puttable instruments and obligations arising on liquidation (paragraph 16A, 16B and 16C) and IFRIC 2, the EFRAG Secretariat has not made any analysis on classification and presentation of such instruments.

79 In addition, the EFRAG Secretariat was not able to obtain detailed information related to net-share settled derivatives on own equity, NCI puts, shares redeemable at fair value and fair value puts options.

Questions for EFRAG TEG members

80 Does EFRAG TEG agree with the EFRAG Secretariat high level preliminary impact assessment?

81 Does EFRAG TEG consider that there are other areas that should be further investigated by the EFRAG Secretariat? For example, possible impacts on regulatory capital of credit institutions and investment firms and interactions with the prudential definitions of Tier 1, Common Equity Tier 1, total capital and leverage ratios?

82 Does EFRAG TEG has any suggestions on how to obtain data for non-financial corporate entities?

83 As mentioned in paragraph 12 above, to complete the impact assessment the EFRAG Secretariat will need to reach directly preparers, business organisations and regulators to obtain detailed information that can be used in a more comprehensive impact assessment. Considering that such an approach will require the use of significant resources and involvement of many stakeholders,

does EFRAG TEG consider that such activities should be done within the Discussion Paper or Exposure Draft phase?