

FEEDBACK STATEMENT

ON FINANCIAL INSTRUMENTS WITH
CHARACTERISTICS OF EQUITY

EFRAG SECRETARIAT WORKING PAPER:

EARLY-STAGE ANALYSIS

Potential Effects of the IASB Discussion Paper

JULY 2019



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Overview and key findings

In February 2019, EFRAG issued the Financial Instruments with Characteristics of Equity - EFRAG Secretariat Working Paper: Early-Stage Analysis (Working Paper). The Working Paper can be found ([here](#)). The Working Paper was issued at the end of February 2019 and EFRAG requested for public comments to be provided through either comment letter submission or by responding to an online survey that had questions on the usefulness, findings and areas for enhancement of the early stage analysis. The EFRAG Secretariat also received feedback from respondents who were unable to submit formal written responses but were willing to give feedback through other channels (e.g. via email, verbal feedback). The comment period ended on 17 May 2019.

EFRAG is now issuing a feedback statement, which highlights the main comments received.

Working Paper objective

The Working Paper provides an early-stage analysis of some possible effects of the IASB's Discussion Paper DP/2018/1 *Financial Instruments with Characteristics of Equity* (IASB DP) which can be found ([here](#)). Although the Working Paper was approved by the EFRAG Board for issuance for the information of its stakeholders, it does not set out nor should it be construed as representing any EFRAG positions. EFRAG formal positions are established through an extensive due process and are articulated in the 01 February 2019 final comment letter which can be found ([here](#)).

The Working Paper is a pioneering¹ document developed in the spirit of walking the talk by adopting an evidence based approach through all the stages of standard setting as has been severally called for by EFRAG in the past. The Working Paper is intended to inform and be one of the inputs to a potential more comprehensive impact analysis if the IASB were to further proceed with the FICE project.

Purpose and use of this feedback statement

As the Working Paper was issued as a pioneering document, EFRAG also sought public comments to allow a learning process to occur, which identifies what is useful and where improvements could be made should a similar exercise be undertaken in the future.

This feedback statement has been prepared as a formal record of the responses received. It summarises the messages received from constituents and notes any key themes identified. In conjunction with the Working Paper, this feedback statement will be considered by EFRAG as one of the inputs to a potential comprehensive impact analysis if the IASB were to further proceed with the FICE project.

Profile of responses from constituents

EFRAG has received feedback from 13 respondents which includes eight comment letters. These comment letters are available on the EFRAG website ([here](#)). The comment letters received came from national standard setters, business associations, auditors, preparers and users of financial statements.

¹ Due to its issuance at the discussion paper stage.

In addition to the eight comment letters, EFRAG also received either verbal or email feedback from five respondents including two user organisations, two business associations and a representative from the accountancy profession.

Key messages

Below is a thematic organisation of key messages received from constituents in respect of their responses to four questions² posed.

Feedback on usefulness of the Working Paper and its findings

Overall respondents found the early stage analysis exercise performed by EFRAG to be a comprehensive and useful supplement to EFRAG's current due process for influencing the development of standards, which includes outreaches and the issuance of a draft and final comment letter. Some of the respondents proposed that the early stage analysis should be a standard part of EFRAG's process for key future standard setting projects.

Contribution to stakeholders: One respondent observed that by conducting an early stage analysis type exercises and impact assessments, EFRAG could encourage and contribute to the greater adoption of an evidence based approach by the IASB and other standard setters. Another respondent suggested that the early stage analysis can contribute to a faster endorsement process at later stages of the project. Several standard setter respondents indicated that the Working Paper findings were confirmatory of what they had heard from stakeholders in their jurisdictions. Other respondents indicated that it was useful for the smaller standard setters and their working groups who may be resource constrained towards conducting such an exercise. A user respondent indicated that the inclusion of specific examples was helpful in reducing uncertainty on the topic.

General positive comments on the findings and analysis within the Working Paper were made on the following:

- *Inclusion of both preparer and user perspectives:* There was positive feedback on the inclusion of both the preparer and user perspectives in the Working Paper. A respondent found the differing views between preparers and users on the anticipated cost-benefit analysis and impact on cost of capital, as highlighted by the Working paper, to be useful.
- *Coverage of economic and financial stability consequences:* Several respondents had positive comments about the Working Paper's coverage of economic and financial stability consequences. A respondent commented that taking a broad approach that incorporates issues of relevance to the EU was value adding to the document. A respondent had particular positive feedback on the consideration of the role of rating agencies classification versus accounting classification in the issuance of perpetual hybrid instruments. Another respondent indicated that the assessment of the interaction of accounting and regulation on the FICE topic was helpful. However, in the feedback, there was also a recognition of the inherent difficulty in assessing economic and financial stability consequences.

² Question 1 - Do you find this type of early stage analysis to be useful? Question 2 - Do you have any comments on the findings included within this Working Paper? Question 3 - Do you have any suggestions to enhance the usefulness for future work on this project on *Financial Instruments with Characteristics of Equity*? Question 4 - Do you have any suggestions to enhance the usefulness for other standard setting related early-stage exercises?

- *Inclusion of quantitative aggregate data:* Positive feedback was received on the inclusion of quantitative aggregate data related to key instruments (e.g. related to the potential market disruption in issuance of perpetual bonds with payment deferral features).
- *Highlighting instruments where changes in classification could occur:* A respondent had positive feedback on the brief description in Chapter 3: *IASB DP Proposals Relative to Current Requirements* of the Working Paper for potential changes in classification not identified by the IASB DP. One respondent also found the highlighting of potential changes in classification of some Additional Tier 1 (AT1) instruments to be useful and suggested the findings would have been more useful if aggregate data on prevalence of potentially affected AT1 instruments were available. However, another respondent expressed the view, that the survey feedback highlighting concerns by some financial institutions on reclassification of different types of AT1 instruments may have overstated the potential changes due to the IASB DP proposals. This respondent³ expressed the view that the uncertainty of classification of AT1 instruments persists rather than is caused by the IASB DP proposals.

Suggested enhancements for future similar work on the FICE project and other standard setting projects

Some of the respondents suggested that the impact analysis ought to be a dynamic exercise that takes account of developments in the thinking of the IASB on the FICE project and any relevant market developments.

Other suggestions to improve the usefulness of the early stage analysis were made in respect of the following:

- *Earlier timing and alignment to EFRAG comment letter:* Some respondents indicated that an early stage analysis exercise would be more useful if issued at the same time or earlier to the EFRAG draft and final comment letters. In addition, all key findings of the early stage analysis ought to be included in the EFRAG final comment letter. Furthermore, whenever similar topics are addressed across both the early stage analysis and EFRAG formal due process documents, there should be a consistent articulation of EFRAG's positions.
- *Broader scope:* Some respondents proposed that the scope of the analysis could go beyond financial instruments where changes in classification would occur if the IASB DP proposals were to be adopted. The early stage analysis should include a description of the pros and cons of alternatives including but not limited to the IASB DP proposals. A respondent proposed that the Working Paper should have had more coverage on transitional provisions.
- *Definition and clarity on intended audience:* There was a suggestion that the intended audience for the early stage analysis exercise by EFRAG should be defined and clarified (i.e. whether the primary audience is the European Commission or the IASB).

³ This respondent expressed the view that potential classification changes should be analysed based on general principles of the timing and amount feature. In their view, the timing feature, in general, is not different to IAS 32. The application of the amount features would be equivalent to the fixed-for-fixed condition in IAS 32 (for instruments with the conversion feature) or would bring no changes for instruments with the write-down feature. In effect, they consider that the situation in the IASB DP is unchanged to IAS 32.

- *Caution in interpretation of stakeholder feedback:* Some respondents suggested the need for caution and a discriminating mindset whilst interpreting and reporting on stakeholder feedback on possible economic consequences. A comment was made that EFRAG should consider the issues raised by the constituents in light of their merits and reflect expected quantitative impacts in order to avoid potential bias in the presented analysis. The need for cautious interpretation was made in respect of reported concerns on potential reclassification of some AT1 instruments as highlighted above in the feedback on Working Paper findings. However, it should be emphasised that it is not the role of the EFRAG Secretariat to interpret how the IASB DP proposals will work in practice for different financial instruments. The Working Paper simply reported the survey feedback on what preparers and users anticipated as impacts of the IASB DP proposals.
- *Enhance methodology and inputs for anticipating economic and financial stability consequences:* A respondent suggested that EFRAG should draw on the expertise of economists and prudential regulation experts to enrich and ensure robust analysis of economic and financial stability consequences.
- *More conclusive analysis:* Although several respondents acknowledged the inherent limitations of the evidence gathered at the discussion paper phase of the due process, which only warrant tentative conclusions being made on possible consequences, some respondents proposed the need for a more conclusive analysis by EFRAG (e.g. on the impact on the reclassification of different types of AT1 instruments).
- *Distinction of empirical findings by EU regions:* A respondent highlighted the usefulness of empirical analysis that distinguishes findings from the Anglo-Saxon and Continental Europe regions. Such a distinction would indicate how the IASB DP proposals could be perceived by stakeholders in these different regions.

The above suggestions can be considered by EFRAG to the extent that they are feasible and do not adversely impact on the cost-benefit of conducting an early stage analysis.

Appropriateness of early stage analysis for other ongoing and forthcoming projects

Respondents suggested that there should be a balance between the costs and benefits of performing such an assessment. Outreaches and analytical efforts should be proportional to the significance of the project. Respondents specifically asked for such an assessment for '*Business Combinations under Common Control*', '*Rate-regulated Activities*' and '*Primary Financial Statements*'.

Other feedback- comments on specific topics

Beyond giving comments on impacts and responding to the broad questions about usefulness of the early stage analysis, some respondents had comments affirming their positions on the IASB DP proposals including those that had already been expressed in their submitted comment letters. Some respondents reiterated their views on the general direction, whether there is an adequate case for change and complexity of the FICE project.

One financial institution respondent emphasised the uncertainty on whether the classification of co-operative shares as equity would change were the IASB DP proposals to be adopted. The respondent

emphasised that the uncertainty on classification remained regardless of whether, as had been mentioned in the Working Paper, the IASB has indicated that the requirements of IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* will be carried over.

A user organisation respondent reiterated their position on several aspects of reporting financial instruments with characteristics of equity including recommending that there should be sufficient disclosure with regards to individual capital instruments, emphasising the importance of disclosure of terms and conditions and an appropriate criteria for the classification of instruments as either equity or debt.

Appendix – List of Respondents

<i>Respondent</i>	<i>Country</i>	<i>Type</i>
Erste Group	Austria	Preparer
European Association of Co-operative Banks (EACB)	Europe	Business Association
European Savings and Retail Banking Group (ESBG)	Europe	Business Association
Financial Reporting Council (FRC)	United Kingdom	National Standard Setter
FSR – Danish Auditors	Denmark	National Standard Setter
Comissão de Normalização Contabilística (CNC)	Portugal	National Standard Setter
The European Federation of Financial Analysts Societies (EFFAS)	Europe	User Association
Polish Accounting Standards Committee (PASC)	Poland	National Standard Setter
Corporate Reporting Users Forum (CRUF)*	Europe	User Organisation
Business Europe*	Europe	Business Association
Accountancy Europe*	Europe	Accountancy Association
European Fund and Asset Management Association (EFAMA)*	Europe	User Organisation
Association for Financial Markets in Europe (AFME)*	Europe	Business Association

*Respondents provided their comments verbally or via email.