Brussels, 28th March 2024

EACB comments the IASB's Exposure Draft
"Financial Instruments with Characteristics of Equity - Proposed amendments to IAS 32, IFRS 7 and IAS 1"

General remarks

The European Association of Cooperative Banks (EACB) gladly takes the opportunity to comment the IASB's Exposure Draft *"Financial Instruments with Characteristics of Equity - Proposed amendments to IAS 32, IFRS 7 and IAS 1"*.

The EACB welcomes the IASB's efforts to address existing challenges in the classification of financial instruments that combine characteristics of both financial liability and equity related to IAS 32 *Financial instruments: Presentation*. Furthermore, we appreciate the intention to improve disclosures under IFRS 7 *Financial Instruments: Disclosures* to further explain complexities around such instruments, as well as presentation requirements related to IAS 1 *Presentation of Financial Statements*.

However, the EACB members have concerns regarding the approach outlined in the ED for addressing the IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* issue, namely regarding the classification of cooperative shares as equity instruments. Given the paramount importance of the topic for cooperative banks, we would like to stress a critical need of preventing any potential uncertainty stemming from IASB guidance in this regard. Specifically, there are doubts concerning the approach developed by the Board for evaluating the effects of relevant laws or regulations on the IAS 32 classification, i.e., to what extent the legal requirement is part of the contractual terms and must therefore lead to the identification of a financial liability or equity instrument.

Please see below the detailed answers to the questions in the IASB's ED on FICE.

Question 1. The effects of relevant laws or regulations (paragraphs 15A and AG24A–AG24B of IAS 32)

The IASB proposes to clarify that:

(a) only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations are considered in classifying a financial instrument or its component parts (paragraph 15A); and

(b) a contractual right or obligation that is not solely created by laws or regulations, but is in addition to a right or obligation created by relevant laws or regulations shall be considered in its entirety in classifying the financial instrument or its component parts (paragraph AG24B).

Paragraphs BC12–BC30 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We find the approach developed by the Board for evaluating the effects of relevant laws or regulations on the IAS 32 classification to be questionable. Firstly, we advocate for an all-inclusive classification approach, consistent with paragraph 4.60 of the Conceptual Framework for Financial

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

Reporting[1]. This approach ensures that comprehensive and consistent classification criteria are applied across financial reporting and contractual terms and obligations are thoroughly evaluated, thereby promoting transparency and accuracy in financial reporting practices.

The ED proposes that contractual obligations should only be taken into account in the classification if they do not simply reflect legal obligations but go beyond them, a shift we view as substantial with respect to the status quo and potentially misleading. In our opinion, this implies that contractually agreed rights and obligations (must) be completely disregarded if they merely correspond exactly to a legal requirement, such as in cases where a contract (instrument) has different effects due to different laws in different countries. This also shows that the IASB's intended clarification may not reduce diversity in practice or application problems, but could in fact exacerbate them.

In addition, we have concerned regarding the phrase "in addition to", particularly regarding its interpretation and operationalization. If all contractual components are derived from the law and no further contractual agreement is concluded, certain instruments like cooperative shares may not be recognised in equity under this framework. Therefore, we suggest revising paragraph 15A to achieve a more coherent and meaningful outcome.

Moreover, it is evident that the objective of the Board was to address specific concerns and incorporate regulatory considerations related to financial instruments such as Additional Tier 1 (AT1) capital instruments issued by banks, or ordinary shares subject to statutory minimum distribution dividends required by law. While we expect no changes in classification of our AT1 instruments as equity instruments, there remains uncertainty regarding how the legal/contractual requirements might impact a change in the classification of those instruments. The contractual terms of these instruments generally reflect the current legal requirements, such as those outlined in the EU Capital Requirements Regulation (CRR), to achieve the recognition as core capital. Similarly, common bail-in instruments reflect in their contractual terms the legal requirements, like the Minimum Requirement for Own Funds and Eligible Liabilities (MREL). However, it remains unclear how the requirement in paragraph 15A would affect the classification in cases when the legal requirements change after signing the contract. Besides, different countries may have different laws resulting in different classification outcomes. This leads to more diversity in practice – the exact opposite of what the IASB intended.

Furthermore, a clarification provided in the Basis for Conclusions (BC 30) states that the proposed amendments would be consistent with the principles outlined in IFRIC 2. The members of the EACB highly appreciate that the IASB shall not reconsider the guidance in IFRIC 2. However, we advocate that the IASB should take the opportunity to specify directly in the IAS 32 amendments, rather than only, as currently, in the Basis for Conclusions, to affirm that this approach remains in line with the principles of IFRIC 2. The integration of this specific reference to IFRIC 2 in a revised IAS 32 would reaffirm the consistency and coherence of the accounting standards, ensuring a clear and unambiguous framework for the classification of cooperative shares as equity instruments. In fact, the IFRIC 2 interpretation builds upon the distinct features of members' shares and determines the conditions for their treatment as equity. The approach of IFRIC 2 for the classification of cooperative members' shares as accounting equity is the basis for their recognition as Tier 1 capital under the Basel Accord[2]. Paragraph 15A of the Exposure Draft (ED) stipulates that *"in classifying a financial instrument, an entity shall consider only contractual rights and obligations that are enforceable by*

[1] 4.60 "All terms in a contract—whether explicit or implicit—are considered unless they have no substance. Implicit terms could include, for example, obligations imposed by statute, such as statutory warranty obligations imposed on entities that enter into contracts to sell goods to customers."

[2] Footnote 12, Basel III, June 2011: *"The criteria also apply to non joint stock companies, such as mutuals, cooperatives or savings institutions, taking into account their specific constitution and legal structure. The application of the criteria should preserve the quality of the instruments by requiring that they are deemed fully equivalent to common shares in terms of their capital quality as regards loss absorption and do not possess features which could cause the condition of the bank to be weakened as a going concern during periods of market stress. Supervisors will exchange information on how they apply the criteria to non joint stock companies in order to ensure consistent implementation."*

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

laws or regulations and are in addition to those created by relevant laws or regulations; and shall not consider any right or obligation created by relevant laws or regulations that would arise regardless of whether the right or obligation is included in the contractual arrangement". It is challenging to interpret paragraph 15A in a way that is exactly the same as paragraph IFRIC 2.8, and as noted by the IASB in BC 30.

Therefore, considering the aforementioned reasons, we believe it would be beneficial to provide further clarity on the interaction between paragraph 15A of the ED and IFRIC 2.8[3], which states that the member's shares are classified as equity if redemption is unconditionally prohibited by local law, regulation, or the entity's governing charter. This additional explanation would help mitigate any unforeseen consequences.

- **Regulated financial instruments**

Furthermore, we believe that the Board's intention in the proposed amendments in paragraphs 15A, AG24A and AG24B is to limit changes in classification compared to current practices. However, this approach creates uncertainties for regulated financial instruments**,** for which contractual rights or obligations are less extensive than those defined by laws and regulations outlined in the contractual agreement.

For example, the PEL (plan épargne logement) is a French savings product that, at the end of a savings phase, offers the possibility of obtaining a loan, subject to specific conditions, for property acquisition. It is formalised by a contract between the depositor and the credit institution in accordance with the characteristics defined by law for this regulated instrument. Notably, the deposit's remuneration is set by French law at the opening date (as per Articles R315-25 to R315-33[4] in the Code de la construction et de l'habitation). Finally, all the terms of the contract comply with legal requirements and are not extensive compared to statutory provisions. Therefore, it is imperative that the Board clarifies its proposal to avoid unforeseen effects for such regulated financial instruments.

Question 2. Settlement in an entity's own equity instruments (paragraphs 16, 22, 22B–22D, AG27A and AG29B of IAS 32)

The IASB proposes to clarify when the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 is met by specifying that the amount of consideration to be exchanged for each of an entity's own equity instruments is required to be denominated in the entity's functional currency, and either:

(a) fixed (will not vary under any circumstances); or

(b) variable solely because of:

(i) preservation adjustments that require the entity to preserve the relative economic interests of future shareholders to an equal or lesser extent than those of current shareholders; and/or

(ii) passage-of-time adjustments that are predetermined, vary with the passage of time only, and have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of the entity's own equity instruments (paragraphs 22B–22C).

[3] IFRIC 2.8 Local law, regulation or the entity's governing charter can impose various types of prohibitions on the redemption of members' shares, e.g. unconditional prohibitions or prohibitions based on liquidity criteria. If redemption is unconditionally prohibited by local law, regulation or the entity's governing charter, members' shares are equity. However, provisions in local law, regulation or the entity's governing charter that prohibit redemption only if conditions—such as liquidity constraints—are met (or are not met) do not result in members' shares being equity.
[4] Chapitre V, Section 2, Sous-section 1: Mise en place et fonctionnement des plans d'épargne-logement.
https://www.legifrance.gouv.fr/codes/section_lc/LEGITEXT000006074096/LEGISCTA000006189235/#LEGISCTA000006189235

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

The IASB also proposes to clarify that if a derivative gives one party a choice of settlement between two or more classes of an entity's own equity instruments, the entity considers whether the fixed-for-fixed condition is met for each class of its own equity instruments that may be delivered on settlement. Such a derivative is an equity instrument only if all the settlement alternatives meet the fixed-for-fixed condition (paragraph AG27A(b)).

The IASB further proposes to clarify that a contract that will or may be settled by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments is an equity instrument (paragraph 22D).

Paragraphs BC31–BC61 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

xxx

Question 3. Obligations to purchase an entity's own equity instruments (paragraphs 23 and AG27B–AG27D of IAS 32)

The IASB proposes to clarify that:

(a) the requirements in IAS 32 for contracts containing an obligation for an entity to purchase its own equity instruments also apply to contracts that will be settled by delivering a variable number of another class of the entity's own equity instruments (paragraph 23).

(b) on initial recognition of the obligation to redeem an entity's own equity instruments, if the entity does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates, those equity instruments would continue to be recognised. The initial amount of the financial liability would, therefore, be removed from a component of equity other than non-controlling interests or issued share capital (paragraph AG27B).

(c) an entity is required to use the same approach for initial and subsequent measurement of the financial liability—measure the liability at the present value of the redemption amount and ignore the probability and estimated timing of the counterparty exercising that redemption right (paragraph 23).

(d) any gains or losses on remeasurement of the financial liability are recognised in profit or loss (paragraph 23).

(e) if a contract containing an obligation for an entity to purchase its own equity instruments expires without delivery:

(i) the carrying amount of the financial liability would be removed from financial liabilities and included in the same component of equity as that from which it was removed on initial recognition of the financial liability.

(ii) any gains or losses previously recognised from remeasuring the financial liability would not be reversed in profit or loss. However, the entity may transfer the cumulative amount of those gains or losses from retained earnings to another component of equity (paragraph AG27C).

(f) written put options and forward purchase contracts on an entity's own equity instruments that are gross physically settled—consideration is exchanged for own equity instruments—are required to be presented on a gross basis (paragraph AG27D).

Paragraphs BC62–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

EACB disagrees with the IASB's proposal to continue recognising non-controlling interest on initial recognition, as it would not provide relevant information to users of financial statements. To this end, we suggest that the IASB should reconsider the initial accounting within equity for written put options on non-controlling interest, and consider that the debit entry should be against non-controlling interests. In addition, EACB is of opinion that the IASB should consider that many stakeholders disagree with presenting subsequent changes to the carrying amount of the financial liability in profit or loss, as this would be in conflict with the requirement to account, in equity, effects of transactions with owners in their capacity as owners, and that it would be counterintuitive to have measurement changes being presented in profit or loss, as performance decreases when the value of the shares subject to the put option increases, and vice versa.

Question 4. Contingent settlement provisions (paragraphs 11, 25, 25A, 31, 32A, AG28 and AG37 of IAS 32)

The IASB proposes to clarify that:

(a) some financial instruments with contingent settlement provisions are compound financial instruments with liability and equity components (paragraphs 25 and 32A);

(b) the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision would not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event (paragraph 25A);

(c) payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero (paragraphs 32A and AG37);

(d) the term 'liquidation' refers to the process that begins after an entity has permanently ceased its operations (paragraph 11); and

(e) the assessment of whether a contractual term is 'not genuine' in accordance with paragraph 25(a) of IAS 32 requires judgement based on the specific facts and circumstances and is not based solely on the probability or likelihood of the contingent event occurring (paragraph AG28).

Paragraphs BC94–BC115 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

xxx

Question 5. Shareholder discretion (paragraphs AG28A–AG28C of IAS 32)

The IASB proposes:

(a) to clarify that whether an entity has an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle a financial instrument in such a way that it would be a financial liability) depends on the facts and circumstances in which shareholder discretion arises. Judgement is required to assess whether shareholder decisions are treated as entity decisions (paragraph AG28A).

(b) to describe the factors an entity is required to consider in making that assessment, namely whether:

(i) a shareholder decision would be routine in nature—made in the ordinary course of the entity's business activities;

(ii) a shareholder decision relates to an action that would be proposed or a transaction that would be initiated by the entity's management;

(iii) different classes of shareholders would benefit differently from a shareholder decision; and

(iv) the exercise of a shareholder decision-making right would enable a shareholder to require the entity to redeem (or pay a return on) its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) (paragraph AG28A(a)–(d)).

(c) to provide guidance on applying those factors (paragraph AG28B).

Paragraphs BC116–BC125 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

xxx

Question 6. Reclassification of financial liabilities and equity instruments (paragraphs 32B–32D and AG35A of IAS 32)

The IASB proposes:

(a) to add a general requirement that prohibits the reclassification of a financial instrument after initial recognition, unless paragraph 16E of IAS 32 applies or the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement (paragraphs 32B–32C).

(b) to specify that if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement, an entity would:

(i) reclassify the instrument prospectively from the date when that change in circumstances occurred.

(ii) measure a financial liability reclassified from equity at the fair value of that financial liability at the date of reclassification. Any difference between the carrying amount of the equity instrument and the fair value of the financial liability at the date of reclassification would be recognised in equity.

(iii) measure an equity instrument reclassified from a financial liability at the carrying amount of the financial liability at the date of reclassification. No gain or loss would be recognised on reclassification (paragraph 32D).

(c) provide examples of changes in circumstances external to the contractual arrangement requiring reclassification (paragraph AG35A).

Paragraphs BC126–BC164 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to reclassify the instrument prospectively from the date when a change in circumstances occurred give rise to any practical difficulties? If so, please describe those practical difficulties and the circumstances in which they would arise.

xxx

Question 7. Disclosure (paragraphs 1, 3, 12E, 17A, 20, 30A–30J and B5A–B5L of IFRS 7)

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

The IASB proposes s:

(a) to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its ownership structure is, including potential dilution to the ownership structure from financial instruments issued at the reporting date (paragraph 1).

(b) to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7.

(c) to move paragraphs 80A and 136A from IAS 1 to IFRS 7. These paragraphs set out requirements for disclosures relating to financial instruments classified as equity in accordance with paragraphs 16A–16B and/or paragraphs 16C–16D of IAS 32 (paragraphs 12E and 30I). The IASB also proposes to expand paragraph 80A to cover reclassifications if there are changes in the substance of the contractual arrangement from a change in circumstances external to the contractual arrangement.

(d) to amend paragraph 20(a)(i) of IFRS 7 to require an entity to disclose gains or losses on financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in its net assets, separately from gains or losses on other financial liabilities in each reporting period.

(e) to include disclosure requirements for compound financial instruments in IFRS 7 (paragraph 17A).

The IASB proposes to require an entity to disclose information about:

(a) the nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments (paragraphs 30A–30B);

(b) the terms and conditions of financial instruments with both financial liability and equity characteristics (paragraphs 30C–30E and B5B–B5H);

(c) terms and conditions that become, or stop being, effective with the passage of time (paragraph 30F);

(d) the potential dilution of ordinary shares (paragraphs 30G–30H and B5I–B5L); and

(e) instruments that include obligations to purchase the entity's own equity instruments (paragraph 30J).

Paragraphs BC170–BC245 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with the proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Regarding the proposed amendments to the disclosure requirements, and especially about the nature and priority of claims against the entity on liquidation, we would like to stress that the IFRS are based on a going concern principle and not liquidation or resolution. Therefore, the perspective of such information given to the stakeholders is contrary to the information based on a going concern view. Furthermore, information about liquidation exclusively pertains to a single consolidated entity and not to the reporting entity. Additionally, it is very challenging to differentiate between claims based on contractual rights and those based on law, particularly within a group with international subsidiaries.

Question 8. Presentation of amounts attributable to ordinary shareholders (paragraphs 54, 81B and 107–108 of IAS 1)

The IASB proposes to amend IAS 1 to require an entity to provide additional information about amounts attributable to ordinary shareholders. The proposed amendments are that:

(a) the statement of financial position shows issued share capital and reserves attributable to ordinary shareholders of the parent separately from issued share capital and reserves attributable to other owners of the parent (paragraph 54);

(b) the statement of comprehensive income shows an allocation of profit or loss and other comprehensive income attributable to owners of the parent between ordinary shareholders and other owners of the parent (paragraph 81B);

(c) the components of equity reconciled in the statement of changes in equity include each class of ordinary share capital and each class of other contributed equity (paragraph 108); and

(d) dividend amounts relating to ordinary shareholders are presented separately from amounts relating to other owners of the entity (paragraph 107).

Paragraphs BC246–BC256 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposed requirement to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent give rise to any practical difficulties in determining the required amounts? If so, please describe the possible difficulties and specify areas in which further guidance would be helpful.

We find it preferable to prioritise the application and implementation of IFRS 18 *Presentation and Disclosure in Financial Statements*, announced for publication in April 2024, over the introduction of new requirements.

Question 9. Transition (paragraphs 97U–97Z of IAS 32)

The IASB proposes to require an entity to apply the proposed amendments retrospectively with the restatement of comparative information (a fully retrospective approach). However, to minimise costs, the IASB proposes not to require the restatement of information for more than one comparative period, even if the entity chooses or is required to present more than one comparative period in its financial statements.

For an entity already applying IFRS Accounting Standards, the IASB proposes:

(a) to require the entity to treat the fair value at the transition date as the amortised cost of the financial liability at that date if it is impracticable (as defined in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors) for the entity to apply the effective interest method in IFRS 9 Financial Instruments retrospectively (paragraph 97X);

(b) not to require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision was no longer outstanding at the date of initial application (paragraph 97W);

(c) to require the entity to disclose, in the reporting period that includes the date of initial application of the amendments, the nature and amount of any changes in classification resulting from initial application of the amendments (paragraph 97Z);

(d) to provide transition relief from the quantitative disclosures in paragraph 28(f) of IAS 8 (paragraph 97Y); and

(e) no specific transition requirements in relation to IAS 34 Interim Financial Reporting for interim financial statements issued within the annual period in which the entity first applies the amendments.

For first-time adopters, the IASB proposes to provide no additional transition requirements.

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop

Paragraphs BC262–BC270 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to apply the proposed amendments retrospectively give rise to any other cases in which hindsight would be necessary? If so, please describe those cases and the circumstances in which the need for hindsight would arise.

xxx

Question 10. Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])

The IASB proposes amendments to the draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures], which will be issued before the proposals in the Exposure Draft are finalised.

[IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures.

The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures.

Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

xxx

Contact:

For further information or questions on this paper, please contact:

- Mr. Volker Heegemann, Head of Department (v.heegemann@eacb.coop)
- Mr. Marco Mancino, Deputy Head (marco.mancino@eacb.coop)
- Ms. Maryia Sulik, Senior Adviser (maryia.sulik@eacb.coop)