CRÉDIT AGRICOLE S.A.

Paris, 20 March 2024

Exposure Draft—Financial Instruments with Characteristics of Equity—Proposed amendments to IAS 32, IFRS 7 and IAS 1

Crédit Agricole Group welcomes the opportunity to provide comments on the proposed amendments to IAS 32, IFRS 7 and IAS 1 regarding Financial Instruments with Characteristics of Equity.

Crédit Agricole Group is one of the leaders in universal retail banking in France and one of the leading banking players in Europe. As one of the largest financers of the French economy and a major European player, the Crédit Agricole Group supports the projects of its customers in France and around the world in all the retail banking and specialized trades associated with it: insurance, asset management, leasing and factoring, consumer finance, corporate and investment banking.

Crédit Agricole Group welcomes the IASB's efforts and approach to addressing issues that arise in practice related to IAS 32 "Financial Instruments: Presentation" by clarifying some of the underlying principles in IAS 32 and adding application guidance to facilitate the consistent application of the principles and improve the comparison between financial institutions.

We do have concerns about the outcome of the proposals concerning the effects of relevant laws or regulations for instruments which have all or a large part of the terms whose origins are legal or regulatory in French jurisdiction. We have doubts to determine the correct conclusion when applying the ED's proposals to those instruments.

In paragraphs 24 to 28, we explain the possible conclusions within the framework of the ED and consider that these proposals may always lead to inconsistent classifications for the instruments that we take as an example.

We therefore think that the only acceptable view is one where all relevant laws and regulations creating rights and obligations are taken into account in the analysis, in addition to contractual rights and obligations. This leads us to support the "all-inclusive" view presented in paragraph BC14.

We hope you find our comments useful and would be pleased to provide any further information you might require.

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.

1. We are unsure of the outcome of those proposals and believe that they could have significant and harmful side effects, particularly in French jurisdiction.

2. French banks issue instruments which have all or a large part of the terms whose origins are legal or regulatory, and for which the contracts only repeat the legal or regulatory provisions. We understand from the ED's proposals that these provisions should not be taken into account in the classification analysis of these instruments, as indicated in paragraph BC22: "*Applying the approach described in paragraph BC20 to these examples, the Board concluded that it would be appropriate for the rights and obligations established by the relevant laws or regulations not to be considered when classifying those instruments because the laws or regulations would exist regardless of whether they are included in the contract* […]". This provision is fully reflected in proposed paragraph 15A.b): "*In classifying a financial instrument (or its component parts) as a financial liability, a financial asset or an equity instrument, an entity:* […] *(b) 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*."

3. We fail to determine the correct conclusion when these proposals are applied to an instrument governed entirely by law or regulation, and consider three possible antagonistic conclusions:

    a. In the absence of any element to analyse, i.e., because all the contractual clauses only repeat the law/regulation, the instrument does not contain a clause requiring the transfer of cash or another financial asset to another entity. This position suggests that in the silence of the contract, everything is considered to be discretionary. The instrument would therefore be qualified as an equity instrument[1].

    b. In the absence of any element to analyse, all the contractual clauses only repeating the law/regulation and IAS 32 analysing equity instruments only by default as not being debts, it is not possible to demonstrate that the instrument falls within the "exception"[2] for equity instruments. The instrument would then be qualified as a liability.

    c. In the absence of any element to analyse, the instrument does not contain a <u>contractual</u> clause requiring the transfer of cash or another financial asset to another entity, therefore there is no contractual obligation in the sense of IAS 32.16. However, since the law/regulation may require a said transfer, in this case, this contractual obligation would not be enforceable

[1] We would like to point out that this proposal seems to be the one retained as a general principle by our auditors in view of the ED's proposals.
[2] Since to be classified as equity, it may be considered necessary to "actively" demonstrate that there is in particular no contractual obligation to deliver cash or another financial asset to another entity (since IAS 32.16 contains an "if an only if" condition: "[…] *the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met*.[…]"), which corresponds to demonstrating that the instrument is not a debt.

by law and would fail the criteria of paragraph 15A.a of the ED. The classification would therefore depend on all relevant laws or regulations which could cancel the enforceability of contractual rights and obligations. In this view, it would be necessary to check every relevant law/regulation, since it is the nature of the law to legislate in the absence of a contractual clause, which would contradict the position of the IASB expressed in paragraph BC15 of the ED. We therefore do not consider this proposal in our developments below.

4. A similar problem arises when all contractual clauses repeat the law/regulation, with the exception of instrument remuneration which would be contractually discretionary:

    a. In the absence of any other element to analyse, the instrument does not contain a clause requiring the transfer of cash or another financial asset to another entity since remuneration is discretionary, and therefore the instrument would be qualified as an equity instrument as a whole.

    b. Applying similar reasoning to paragraph 32A of the ED, the instrument contains an equity component (the discretionary remuneration), but in the absence of any element to analyse for the rest of the contract, it is not possible to demonstrate that the instrument falls within the "exception" for equity instruments, therefore the instrument also contains a liability component (compound instrument).

5. According to our understanding, both those proposals are based on an overly black-and-white vision of the debt-equity distinction, drawing conclusions in cases of silence of the contractual clauses, whereas we consider that it is not possible to draw conclusions from the contract in these cases and it is therefore necessary to refer to the laws and regulations.

6. We identified two categories of instruments that might be prone to these issues: regulated saving accounts and cooperative shares.

Regulated saving accounts

7. According to the annual report on regulated savings from the Banque de France, regulated saving accounts represent 874 billion euros at the end of 2022, or 15% of household financial savings. Those savings are carried out through numerous types of accounts ("livrets A", "livrets de développement durable et solidaire", "livrets d'épargne populaire", "comptes d'épargne logement" …) which notably share the following common characteristics: opening and operation conditions defined by law, remuneration set by ministerial order.

8. As an example, we can consider the case of the "Livret A". The terms of opening, operation and closing of a "Livret A" are specified by order in the Council of State (Order No. 2008-1263 of December 4, 2008 relating to in Livret A). This principle is also included directly in the law through the Monetary and Financial Code, which itself refers to the general regulations applicable to regulated saving accounts. The remuneration of the "Livret A" is currently set by the Order of July 28, 2023 relating to the interest rates of regulated savings products.

9. Those laws and regulations do not give any room for a negotiation[3] between the bank and the household. In particular, the credit institution receiving a request to close a Livret A account is required to do so and pay the amounts due within fifteen working days following receipt of the request[4], without the possibility of refusing this request.

10. Under these terms, Livret A accounts (and in general regulated saving accounts) are currently considered as liabilities.

11. Considering the ED proposals, the "Livret A" (and in general regulated saving accounts) could fall into the view presented in paragraph 3.a of this letter, which means that it would qualify as an equity instrument, since all the modalities allowing it to currently be qualified as liability have their origin in

[3] Within the meaning of paragraphs BC20 and BC28 of the ED
[4] Article R221-125 of the Monetary and Financial Code

the law. However, from an economical point of view, we are convinced that those regulated saving accounts should be classified as liabilities, without any possible interpretation, since they include and are built around a cash remittance obligation, and do not represent a residual interest in the assets of an entity.

Cooperative shares

12. Cooperative shares are the instruments to create and manage a cooperative. They have specific features, which are consistent with the specific objective of cooperatives that is to meet the common economic or social needs of its members. This objective is achieved by the application of particular principles including notably:

    a. Specific rules on membership, resignation and expulsion, particularly the "one man, one vote" rule and,

    b. The fact that members cannot exercise any rights over the assets of the cooperative.

13. They grant the right to dividends, to attend and vote in the general assembly and to use the service of the cooperative.

14. From a general perspective, most cooperatives are variable capital companies. In this type of companies, when a member enters, cooperative shares are issued for the paid amount. When a member leaves, this amount is redeemed subject to strict conditions such as, for example, the authorization of the board of directors for our organization, and, as regards banks, the one of European Central Bank or national supervisor pursuant to EU Capital Requirement Regulation and secondary regulations.

15. At the time of liquidation, member shares are the most subordinated claim and are paid back after all other claims. They absorb losses proportionately and pari passu with all the other shares. Consequently, the amount paid back to the member after the liquidation can be lower than the amount initially paid.

16. On going concern basis, cooperative shares can also absorb losses. The amount redeemed to the member when he leaves the cooperative can therefore be lower than the amount initially paid.

17. In France, the shares of cooperative banks are equity pursuant to Article L512-1 of the French Monetary and Financial Code. The last paragraph of the article states explicitly that shares of cooperative banks represent a part of their capital: "*The membership shares of the mutual and cooperative banks are capital shares"*. In addition, they comply with the strict criteria of the EU Capital Requirement Regulation n°572/2013 and amending EU Regulation n°648/2012 for eligibility for the highest quality of capital and also the EBA Regulatory Technical Standards (Commission Delegated Regulation EU n°241/2014).

18. From an accounting point of view, these cooperative shares are currently analysed under IFRIC 2 "Members' Shares in Co-operative Entities and Similar Instruments". The principle of paragraph 15A of the ED seems to us to be contradictory to the principles of classification of shares as specified by IFRIC 2.5: "[…] *the entity must consider <u>all of the terms and conditions of the financial instrument</u> in determining its classification as a financial liability or equity. <u>Those terms and conditions include relevant local laws, regulations</u> and the entity's governing charter in effect at the date of classification, but not expected future amendments to those laws, regulations or charter*" (emphasis added). IFRIC 2 does not limit the analysis of rights and obligations to contractual rights and obligations that are in addition to those created by laws relevant or regulations but seem to include all relevant laws, as explained in IFRIC 2.BC10: "[…] *it is local laws, regulations and the governing charter in effect at the classification date, together with the terms contained in the instrument's documentation that constitute the terms and conditions of the instrument at that date* […]".

19. Therefore, we do not understand the underlying position of the IASB expressed in paragraph BC30: "*In the Board's view, such a clarification would be consistent with the principle in paragraph 8 of IFRIC 2 Members' Shares in Co-operative Entities and Similar Instruments that if redemption of an*

instrument is unconditionally prohibited by local law, regulation or an entity's governing charter, the instrument is classified as equity".

20. Applying IFRIC 2.7[5] with the ED proposals, this statement can find meaning in a jurisdiction where the member's right to reimbursement is contractual and the law give the entity an unconditional right to refuse redemption if a right to reimbursement is granted contractually. In those cases, the right to reimbursement would not be enforceable within the meaning of paragraph BC27 of the ED and IAS 32.13.

21. However, this is not the situation encountered by Crédit Agricole Group in the French legislation. In France, concerning the cooperative shares of the Crédit Agricole Group:

    a. Articles L512-23 and L512-26 of the Monetary and Financial Code and Article 18 of the law of 1947 establishing the status of cooperation introduce a right to reimbursement for the member: "*The member who withdraws, who is struck off or who is expelled, in the event that he is entitled to reimbursement of his shares, is entitled to reimbursement of their nominal value*" and "*Members of the Crédit Agricole Mutuel branches can, in principle, only be released from their commitments to them after liquidation of the operations in progress at the time they withdraw*".

    b. Article L512-23 of the Monetary and Financial Code limits the member's right to reimbursement by requiring the approval of the Board of Directors of the entity: "*The capital of the Crédit Agricole Mutuel cannot be formed by share subscriptions. It must be subscribed by the members in the form of membership units. Said membership units are registered. They are transferable, but the Board of Directors must approve their sale*"[6].

22. Under these terms, Crédit Agricole cooperative shares are currently considered as equity. However, the member's right to reimbursement and the unconditional right to refuse redemption of the entity both have their origins in the law. Applying the ED proposals, both those rights would not be considered for the analysis, as they are applicable regardless of whether they are included in the contractual arrangement (i.e. the entity's governing charter), and therefore it would be impossible to refer to paragraph 7 of IFRIC 2 to classify cooperative shares as equity. Since the dividends of cooperative shares are discretionary, we could fall into the view presented in paragraph 4.b of this letter, with a risk to classify cooperative shares as compound instruments.

23. We are convinced that cooperative shares have to be classified as equity, without any possible interpretation. We think that especially the fact that cooperative shares are the most subordinated instrument in case of liquidation is determinant for their classification in equity. More generally, we believe that this "ranking" criterion should be taken into account in the classification between debt and equity.

Possible solutions

24. These two categories of instruments demonstrate in our opinion that, if the IASB wishes to continue with its proposals as indicated by paragraph BC20, it is necessary to question the classification of instruments for which the contractual clauses are entirely or almost entirely governed by law or regulation.

25. A first possibility is to continue with the view expressed in paragraph BC20 and consider that in the absence of an explicit contractual right to avoid handing over cash or another financial asset, the entity would be considered to have, by default, a contractual obligation to hand over cash or another financial asset (IAS 32.16). In our opinion, this view would lead to classifying Crédit Agricole cooperative shares in France as liability, and therefore is not acceptable to us.

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[5] IFRIC 2.7: "Members' shares are equity if the entity has an unconditional right to refuse redemption of the members' shares"

[6] It is considered and indicated in the contracts that the reimbursement is a sale to the Crédit Agricole regional branch (share buyback), the reimbursement is therefore subject to this legal clause.

26. A second possibility is to continue with the view expressed in paragraph BC20 and consider that in the absence of an explicit contractual obligation to hand over cash or another financial asset, the entity would be considered to have, by default, right to avoid handing over cash or another financial asset (IAS 32.16). In our opinion, this view would lead to classifying regulated saving accounts in France as equity, and therefore does not seem acceptable to us.

27. These possibilities both lead to IFRIC 2 being rendered meaningless in the application that the Crédit Agricole Group could make of it: the first leads to a result contradictory to the current interpretation, the second implies that at no time it is necessary to call the dedicated interpretation to classify the Crédit Agricole cooperative shares.

28. A third possibility is that as an exception to the principle of paragraph BC20, instruments strongly or entirely governed by law or regulation must be analyzed taking into account the rights and obligations introduced by these laws or regulations. It seems difficult to us to establish a boundary between an instrument "little" governed by law and an instrument "strongly" governed by law (such as cooperative shares or regulated saving accounts). Such an exception could lead to instruments that are very similar economically and in their terms being treated differently because one would be subject to more restrictive regulations than the other. This view therefore does not seem acceptable to us either.

29. Therefore, the only acceptable view in our opinion is one where all relevant laws and regulations creating rights and obligations are taken into account in the analysis, in addition to contractual rights and obligations. This leads us to support the "all-inclusive" view presented in paragraph BC14, resolving the problems linked to the categories of instruments explained above.