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The European Federation
of Financial Analysts Societies

Mr. Wolf Klinz
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**Re: DCL-Exposure Draft Financial
Instruments with Characteristics of
Equity**

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Dear Mr., Klinz,

The EFFAS Commission on Financial Reporting (“Commission”, “We”) would like to share with you its views on EFRAG’s Draft Comment Letter (“DCL”) *IFRS ED, Financial Instruments with Characteristics of Equity*.

The Commission acknowledges EFRAG’s view supporting the amendments to the ED and the observations suggesting additional clarification in certain classification points. We also support EFRAG’s outreach undertaking to include the feedback of different stakeholders to enhance EFRAG’s comments on the ED.

Regarding the key points of the DCL, we would like to comment as follows:

1. The effects of relevant laws and regulations

The Commission agrees with EFRAG that it is necessary to understand the contract and the legal regulation of a given jurisdiction. A classification solely based on the contract may cause inconsistent results given the principle-based nature of the IFRS standards.

The Commission supports the clarification proposal regarding paragraph 15A and paragraph AG24B of the ED. We think that points (a) and (b) of paragraph 15A of the ED will provide a better understating of whether a financial instrument is a financial liability, a financial asset, or an equity instrument.

Regarding EFRAG’s question on paragraph 12, the Commission is uncertain of the practical challenges mentioned by EFRAG. It agrees that the disclosures should be clear to understand the connection between contractual terms and the applicable law. We would like to underline that disclosures should be presented clearly and concisely to facilitate the understanding of an already difficultly subject.



Regarding MTOs, the Commission agrees with EFRAG that the IASB should provide specific guidance on the treatment of the mandatory tender offers. Also, specific disclosure requirements should contribute to a more transparent interpretation of regulations in the different jurisdictions related to financial instruments.

2.-Settlement in an entity's own equity instruments

EFFAS agrees with EFRAG's comments supporting the IASB proposed foundation principle by which the issuer knows the exact exchange or conversation ratio at the inception of the derivative. It also agrees with the proposed clarification related to the fixed-for-fixed condition. The Commission is commenting on the ED to the IASB as follows:

"We agree that a financial instrument that includes no contractual obligation as mentioned in paragraph 16 (a) and that can be settled in the issuer's own equity instruments, as mentioned in 16 (b)(ii) is considered an equity instrument. It is useful for users to know the fixed number of an entity's own equity instruments that are settled in exchange for options, or warrants. Clarification on the presentation of these instruments is key to understand the total equity position of an issuer.

We consider this to be an important point to better understand the characteristics of a financial instrument that could be interpreted to be a liability".

3.- Obligations to purchase an entity's own equity instruments (put option on the NCI)

The Commission coincides with EFRAG that the IASB approach should be changed. As stated in EFRAG's DCL in paragraph 49 (a), we also consider that to have a redemption amount recognized as a liability and at the same time have related NCI recognized with the equity against the parent's ownership can be considered double counting of the non-controlling interest subject to the contract.

Regarding the gross presentation and net presentation approaches discussed with EFRAG, the Commission will support the net approach, as expressed to the IASB, subject to a full disclosure of the characteristics of the contract and of the contingent liability that is not recognized in the balance sheet at inception. The support of this approach is based on the understanding that while the put option is not exercised an obligation by the parent company does not arise. Moreover, if the put option becomes highly probable of being exercised it should be accounted as a liability. This should be based on a reliable measure of the probability of the NCI exercising the put option.

**4.- Contingent settlement provisions**

The Commission welcomes the clarification introduced in the IASB ED. We consider that the clarification proposed in the ED specifying the compound nature of an instrument with liability and equity components with a potential contingent settlement should be appropriate. We agree with an entity providing a maximum amount of a potential contingent event indicating the probability and estimated time of the potential occurrence of a contingent event.

However, we have pointed out to the IASB that regarding point (c), additional clarification would be helpful. If an instrument has an initial equity carrying amount of zero, it should be clarified why there is a payment at the issuer's discretion and this payment is recognized in equity. An example of the type of financial instruments that relates to this approach would be helpful.

5.- Classification: Shareholder discretion

Leaving the classification of a financial instrument to the discretion of shareholders, embeds a great component of subjectivity. The Commission agrees with EFRAG's view of the potential difficulty in determining whether the shareholders are acting in their individual capacity or as part of the entity. As noted in the comments to the IASB, we consider that this point needs further clarification and elaboration.

CFR comments to the IASB on ED AG28A-AG28C:

The Commission considers unclear the classification proposed in the application guidance paragraph AG28A-AG28C. Paragraphs AG28A (a) through (d) should be particularly more specific. Leaving the decision of the classification to whether a shareholder decision represents or not the decision of the entity introduces an element of uncertainty and subjectivity.

As users, we prefer a more specific principle to eliminate the uncertainty. Depicting an example of different cases in which the decision is taken by a shareholder and is treated as an entity's decision would be useful.

We think that this paragraph needs simplicity and should be rephrased.

6.- Classification: Reclassification of financial liabilities to an equity

The Commission agrees that a change in reclassification is limited to circumstances that are external to the contractual agreements and require a reclassification.



Nevertheless, we understand EFRAG's concern on the prohibition to reclassify a financial instrument which at issuance has a liability component and the liability feature has expired after twelve months and is replaced by an equity. We agree with EFRAG's comment that the instrument should be reclassified from the passage of time as the financial liability is no longer applicable.

To ensure a consistent approach among preparers, we consider it useful that some specific criteria (principle-based rules) for the reclassification between liability and equity would be needed, as well as including specific rules and guidance on calculation of diluted EPS for alignment with provisions of IAS 33.

7.- Disclosures

The Commission agrees with EFRAG supporting the introduction of disclosures in IFRS 7. We think moreover that presenting some illustrative examples would also be useful.

For instance, as depicted in some of the IASB material, presenting in the statement of profit and loss the breakdown of (1) ordinary shareholders of the parent company and (2) other owner of the parent company will help to better understand the entity's shareholder structure and particularly the percentage of ownership of each of them. Likewise, presenting additional disaggregation in the balance sheet and the statement of change in equity would be very useful.

We will need a better understanding of EFRAG's comment on potential operational concerns when complying with disclosure requirements. We will state in our letter to the IASB that examples and additional disaggregation of items reflected in the statement of income and balance sheet would be very helpful.

8.- Presentation of amounts attributable to ordinary shareholders

The Commission supports EFRAG's response to the ED, as noted in-paragraphs 149-155. We also agree to the amendments to IAS 1 introduced in the ED, particularly the disaggregation introduced to differentiate amounts attributable to ordinary shareholders.

We consider it illustrative and helpful for investors to make a clear distinction between presenting separately the returns attributable to ordinary shareholders and returns attributable to other equity holders although an explanation of what includes other equity holders would be useful. If there are different types of shareholders with different rights it should be disclosed in the Notes.



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9.- Transition

The Commission agrees with EFRAG in the application of the transition period. We think that a retrospective application of the proposed amendments will enhance consistency and facilitate the analysis. However, users do not need a major change in the existing requirements that might imply broad amendments in the classification.

We also consider that the impact of the fully retrospective approach should be carefully assessed in terms of timing and cost-benefit analysis.

10. Disclosure requirements for eligible subsidiaries

No further comments.

If you would like to further discuss the views expressed in this letter, please do not hesitate to contact us.

Javier de Frutos, Chair
EFFAS Commission on Financial Reporting

EFFAS was established in 1962 as an association for nationally based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 14-member organizations representing more than 16,000 investment professionals. The Commission on Financial Reporting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. CFR members are Javier de Frutos (Chairman, IEF-Spain), Jacques de Greling (Vice-Chairman- SFAF, France), Friedrich Spandl (ÖVFA, Austria), Henning Strom (NFF, Norway), Serge Pattyn (BVFA/ABAF, Belgium), Luca D'Onofrio (AIAF, Italy), Dr. Carsten Zielke (DVFA, Germany), and Andreas Schenone (SFAA, Switzerland) and Mihail Stan (Romania).