FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY

Discussion Paper published by the IASB – 28/06/2018 (DP/2018/1)

Comments on EFRAG's draft comment letter

The Crédit Mutuel Group welcomes the opportunity to share its comments on EFRAG's draft comment letter about the discussion paper on financial instruments with characteristics of equity, published by the IASB. The comments below will be which carried, on the substance, by the International Co-operative Alliance (ICA).

Section 1 – Objective, scope and challenges

21. Are constituents aware of any other challenges with IAS 32 that have not been identified by EFRAG and the IASB ?

The CMG's position

We have identified two other main challenges with the DP published by the IASB.

The first one concerns the definition of equity as "the residual interest in the assets of the entity after deducting all of its liabilities". Unlike the EFRAG's position, and as we have stated in previous correspondence with the IASB, we would have preferred that equity must be defined in a positive way, and not as a residual.

The second is that the co-operative business model is still not taken into account in the DP's amendment proposals (see below).

Section 2 – The Board's preferred approach

41. In paragraph 33 EFRAG agrees that information provided in the financial statements about claims on an entity should help users to assess the entity's liquidity and solvency. These information needs are also identified in the Conceptual Framework for Financial Reporting. The DP suggests providing information on both these factors by considering both 'timing' and 'amount' when distinguishing equity from a liability. EFRAG has considered whether it provides the most useful information to consider both these dimensions when distinguishing equity and liabilities. Do you think that information about both liquidity and solvency should be provided through the classifications of claims on an entity ? If so, do you agree with using both the 'timing' and the 'amount' features when distinguishing equity from a financial liability from equity? If not, how should the distinction be made ?

The CMG's position

We believe that information about both liquidity and solvency would represent a significant extension of current disclosures on financial instruments. The elements requested by the IASB, such as the terms and conditions, seem to be too ambitious, especially for financial

institutions that have a variety of debt and equit instruments with differents levels of seniority and subordination, in response to regulatory requirements.
We do not think that these elements must appear in the annex of the financial statements. It is already in the documents disclosed as requested by the financial market authorities and on the extranet websites (for example the pillar 3 disclosure requirements for financial institutions).

42. The IASB decided that, while the objective of the FICE project is to respond to challenges in distinguishing financial liabilities from equity instruments when applying IAS 32, any potential solution should limit unnecessary changes to classification outcomes that are already well understood. Considering the IASB's preferred approach described in the DP, do you expect significant classification changes ? If so, please describe the type(s) and extent of instruments affected, the existing classification in accordance with IAS 32 and why the classification could or would changes in accordance with the IASB's preferred approach.

The CMG's position
Clarifications should be provided on the second condition to classify a claim as a liability or an equity. The amount feature could lead to a reclassification of member's shares issued to co-operative entities because the redemption value of a member's share is, in most cases, a fixed amount.
It appears essential to us that the revised version of IAS 32 doest not affect the existing accounting policies relating to simple instruments. As the IASB has done in the past, the IFRS framework has also to take into account the co-operative business model and any other business models. Indeed, the functioning of cooperatives lead to the fact that the redemption value of a member's share is, in most cases and for the CMG, the face value, because the instrument is not listed and members of a co-operative have a long-term relationship (the goal is not a short-term speculation). This specific characteristic is provided clearly to investors at the start of the relationship and all documents disclosed to the financial markets mention it. There is no secondary market.
Finally, the IASB's preferred approach, and especially the "amount" feature, questions the existing classification outcome of IAS 32, through the example of members' shares in cooperative entities We think that this is contrary to the board stated intention.

Section 3 – Classification of non-derivative financial instruments

73. What are the most common non-derivative financial instruments with characteristics of equity in your jurisdiction (e.g. perpetual bonds, reverse convertible bonds, callable shares with discretionary dividend, non-cumulative and cumulative preference shares, etc.) ?

The CMG's position
The CMG mainly issues member's shares.

Section 8 – Contractual terms

387. To what extent is the IFRIC 2 interpretation being used by the entities in your jurisdiction ?

The CMG's position

The IFRIC 2 interpretation is used by co-operative entities to classify member's shares as equity. Co-operatives and other similar entities are formed by groups of persons to meet common economic or social needs. These financial instruments, i.e. member's shares and other shares/certificates, have characteristics of equity (right to participate in dividend distributions and voting right). Member shares and other shares / certificates are the most subordinate claims in liquidation.

We welcome that "EFRAG considers that the IASB should take the opportunity to integrate IFRIC 2 in a revised IAS 32" (§386). The IASB should take into account the co-operative business model in the DP's amendment proposals.

This interpretation is indeed very important for co-operative entities, and the fact that IFRIC 2 to be integrated in IAS 32 allows to underline full recognition by the IASB of member's shares, and to mitigate the fact that they are treated by exception.