Attn. of Mr A. Barckow (Chair)
International Accounting Standards Board (IASB)
Columbus Building
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Canary Wharf
London E14 4HD
UNITED KINGDOM

Submitted via https://www.ifrs.org/projects/open-for-comment/

The Hague, 20 March 2024

Our ref: B24.08
Subject: 'Eumedion's response to Exposure Draft 'Financial Instruments with Characteristics of Equity'

Dear Mr. Barckow,

Eumedion welcomes the opportunity to provide feedback on your Exposure Draft (ED) 'Financial Instruments with Characteristics of Equity' (FICE). Eumedion is the dedicated representative of the interests of 54 institutional investors, all of whom are committed to a long term investment horizon. Collectively, our participants invest over € 8 trillion of capital in equity and corporate non-equity instruments. Eumedion aims to promote good corporate governance and corporate sustainability at the companies our participants invest in.

Eumedion sees the ED improving understandability and comparability of corporate financial reports for investors. The ED brings clarity to the classification of FICE, and we expect the proposals to reduce diversity in practice. We equally welcome the significant improvements to the disclosure requirements, as investors are in need of a better basis to understand the complexity of FICE. The ED by and large contains proposals the Eumedion fully supports, and for reasons in line with the Basis For Conclusions. We therefore confine our response to some more detailed comments to certain specific topics we wish to draw your attention to.

Potential Dilution

We welcome the attention for enhancing disclosures on the potential dilution of ordinary shares. Eumedion has been a longstanding proponent[1] of such disclosures, and we commend you for the concrete requirements that surfaced in this ED. We do note that paragraph 30G (a) might be interpreted as allowing reporting entities to forego on providing potential dilution disclosures on existing classes that already have ordinary shares outstanding:

> 'the maximum number of additional ordinary shares the entity might be required to deliver for each class of *potential ordinary shares* outstanding at the end of the reporting period;'

We would suggest that the bullets of paragraph 30G more explicitly set requirements for both ordinary share classes with shares outstanding, and ordinary share classes that currently may not yet have any shares outstanding.

Potential dilution of shareholder rights is unfortunately not limited to shareholder's share in dividends, as our voting rights can be affected as well. We would suggest to therefore expand this section with a requirement to disclose the maximum number of votes related to ordinary share classes, only insofar these are different from the already reported maximum dilution of ordinary shares. Since voting rights are not the exclusive domain of ordinary shares, we would like to suggest that the scope for maximum dilution disclosures is expanded to include preference shares with voting rights that the entity might be required to deliver.

Primary financial statements

We agree with the requirement to disaggregate 'Other owners of the parent' from 'Ordinary shareholders of the parent' in the financial position and in the attribution of net income, and the attribution of 'Other comprehensive income'. Paragraph 107 extends this requirement to the Statement of changes in equity or the notes'. However, we notice that the disaggregation requirements in the ED do not extend to the cash flow statement. We suggest to also formulate a requirement to provide a similar disaggregation for distributions in the cash flow statement.

[1] https://www.eumedion.nl/clientdata/215/media/clientimages/Response-to-IASB-Agenda-Consultation-def.pdf, page 13

Reclassification of FICE

> *32D (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).'*

We support the ED's notion that reclassification (and possible remeasurement) of FICE should be effectuated within the realm of the equity account, and that it should not affect the income statement.

The ED then outlines an approach where only in conditions that meet the conditions of paragraph 16E of IAS 32 a reclassification should be effectuated. We would like to highlight to the Board what we see as a disadvantage of this approach. The consequence of not requiring reclassification, except in circumstances specified in 16E, is that the financial position might, in some cases, present FICE in a category that contradicts the rules for initial recognition, potentially for years. We consider this as diluting the intended clarity that the ED aims to bring to investors. Insofar the disclosure requirements are different for the two categories, the ED's proposal will cause certain disclosure requirements to become less relevant on some FICE, and missing on other FICE. We also attach a heightened risk of gaming to the prohibition of reclassification after initial recognition. FICE might be intentionally constructed to be recognised as equity initially, even though (soon) thereafter their character changes to debt-like. We understand that there are pros and cons against sticking to the initial classification and requiring reclassification along the lines of consistency and relevance. Eumedion's clear preference in this case is to let 'relevance' in the financial position prevail, i.e. the Standards should in our view require reassessment of FICE at each reporting date against the set criteria.

Written Put Option over Non-Controlling Interests ('NCI put option')

We commend the IASB for addressing the current diversity in practice with regard to NCI put options. Eumedion has consistently highlighted the valuation challenges investors face when analysing entities with NCI under IFRS' full consolidation methodology.[2] The choice of IFRS to require full consolidation of controlled, but not fully owned subsidiaries allows for an adequate valuation of 'the group'. However, investors in debt or equity claims of the entity are by definition not fully entitled to the cash flows of those parts of the group that are only partly owned. This poses a major challenge for investors to assess the value of those parts not fully owned. Currently, the two key line items for investors to assess are 'NCI share in profit' and 'NCI share in group equity', together with some in practice rather limited disclosures.

The EFRAG User Panel recently discussed the Board's proposal and alternatives for the treatment of NCI put options. Eumedion expresses its views based on the helpful example created by EFRAG:

[2] https://www.eumedion.nl/en/public/knowledgenetwork/position-papers/position_paper_full_consolidation_of_partly_owned_subsidiaries_requires_additional_disclosure.pdf

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Summary of 3 approaches at T1

	Approach 1 (IASB proposal)	Approach 2 (gross presentation - alternative)	Approach 3 (net presentation)
Balance sheet @ T1			
Assets:			
Net assets - subsidiary	**1.100**	**1.100**	**1.100**
Liabilities:			
Financial liability	400	400	0
Equity:			
Equity - parent	370	770	770
Equity - NCI	330	-70	330
Total liabilities and equity	**1100**	**1100**	**1100**
Profit of loss in Y1			
Parent share	20	70	70
NCI share	30	30	30
	50	**100**	**100**

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In investors' valuation practice, there is often little more that investors can practically do than to take the share of NCI in group equity and the share of NCI in group profit as indicators of what percentage of the value of the entire group is attributable to those outside shareholders.

1) It is therefore essential that the measurement and presentation of NCI put options should not unduly impair investors' ability to calculate these two metrics. (note: approach 1 and 2 distort both, respectively one of, these metrics)

In this light, including remeasurements of the NCI put liability into NCI share of profit poses a major distortion, with no predictive value.

2) Remeasurements of an NCI put liability should be effectuated in the Statement of Other Comprehensive Income, or directly in the Statement of Changes in Equity. (note: approach 1 distorts net income, and its attribution)

Investors need to also consider the liquidity position of an entity. The obligations that an entity faces from NCI put options can be formidable, and are in most cases short term. By definition they are not at the discretion of the entity itself. This justifies reporting the gross amount, irrespective of the probability that such put is called. NCI put liabilities are very distinct from other liabilities in that upon the calling the NCI put option, an NCI put liability will by and large become common equity. Therefore,

3) NCI puts are distinct liabilities that deserve a separate line item in the financial position.

4) The Statement of Financial Position should present the gross amount of the NCI put liability. (note: approach 3 does not show the gross NCI put liability)

Translated to the EFRAG example above, the primary financial statements should ideally show:

Equity of the parent	770
NCI put liability	400
NCI share in equity	330
Parents share in profit and loss	70
NCI share in profit and loss	30

Please find below a presentation format that would reflect all of our above suggestions:

Financial Position

[..]		[..]		
		NCI put liability		400
		Equity		
		Equity parent	770	
		NCI	330	
		Less: (NCI put liability)	(400)	
		Group equity		700
Total assets	**1,100**	**Total liabilities and equity**		**1,100**

Income Statement

[..]	
Net income	**100**
Attributable to ordinary shareholders	70
Attributable to NCI	30

If you would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Martijn Bos (martijn.bos@eumedion.nl, +31 70 2040 304).

Kind regards,

Rients Abma
Executive Director