



F.16 Subscription Rights

Sixteenth meeting of the Advisory Expert Group
on National Accounts

12-14 July 2021

Outline

- Issue
- Options
- FITT Recommendation
- Public Consultation
- Outcomes of BOPCOM
- Questions to the AEG

Issue

- *BPM6/2008 SNA* are silent on the classification and treatment of (detached, for separate trading) **subscription rights** (rights to subscribe newly issued equity for shareholders maintain the same ownership share).
- *Handbook of Securities Statistics* says, “subscription rights are equity”; *Handbook on National Accounting: Financial Production, Flows and Stocks in the System of National Accounts* says, “subscription rights are financial derivatives”.
- **What is the appropriate classification of subscription rights?**
What is the counterpart flow to the issuance of subscription rights?

Options

- **Option 1**, subscriptions rights (SRs) are **equity**:
 - ▶ the corporate value as (should be) reflected in “equity” does not change with the detachment of subscription rights
 - ▶ ensure shareholders the right to keep their percentage ownership: their share on the corporate net assets and therefore the maintenance of a claim on the corporation
- **Option 2**, SRs are **financial derivatives**:
 - ▶ The nature and operation of SRs are similar to those of call options on shares (and/ or to warrants and employee stock options)
 - ▶ SRs do not entail a claim on the corporation before being exercised; they do not provide other standard equity holder rights

Option 1 is Recommended

Subscription rights are equity:

- Interpretation of **equity as the residual value** (the corporate value)
- The value of the (supposed) “underlying” gets reduced by the value of the (supposed) “derivative” (i.e., SRs have a **dilution effect** that does not occur in standard options).
- It is not easy to find a **convincing counterpart** for the “derivative” creation:
 - ▶ cannot be “*dividends*”, as such treatment would violate the corresponding definition;
 - ▶ “*transaction in equity*” would lead to discrepancies with SEC statistics;
 - ▶ “*other changes in the volume of assets*” would be a far-fetched solution.
- The redemption of the “derivative” would lead to booking **equity issuance not equal to the funds raised** (leading to discrepancies with SEC) .

Dissenting Views on Option 2

“**Subscription rights are equity**”, but two dissenting views:

- SRs are financial derivatives, emerging via **other changes in volume of assets**.
- SRs are financial derivatives, emerging as the financial counterpart of a **dividend payment**; however, the equity solution is accepted on the grounds of its easier implementation due to the short life of SRs.

Public Consultation

- **Overwhelmingly in favor of** the treatment of SR's as recommended in **Option 1, Equity**—82 percent of the responses favored it.
- **Minority views in favor of Option 2**, derivatives:
 - ▶ SRs not being equity until the issuance of the actual shares;
 - ▶ SRs similar to warrants or employee stock options.
- One **opinion in favor of Option 2** however indicates that **practicality could dictate their treatment as equities**.

Outcomes of BOPCOM

- In line with the outcome of the public consultation, most Committee members supported Option 1 (the classification and treatment of subscription rights as equity).

Action:

- FITT to await feedback from the AEG and, also subject to its approval, prepare a final version of the GN stating the final recommendation and removing the questions to the Committee for posting on the *BPM6* Update website.

Questions for the AEG

- 1. Do you agree with the classification and treatment of subscription rights as equity (Option 1)?*
- 2. If not, and Option 2 is preferred, what would be the counterpart of the flow of creation of the new financial derivative (non-financial transaction—dividend or transfer, transaction in equity, or other flows in equity)?
How would the extinction of the financial derivative be recorded (transactions or other flows, with counterpart in equity)?*
- 3. Do you have any other views on the treatment of subscription rights?*