

[EFRAG SECRETARIAT PAPER FOR PUBLIC EFRAG TEG MEETING]

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EFRAG Research Project Equity Instruments - Impairment and Recycling Cover note

Objective of the session

- 1 The objective of this session is to discuss:
 - (a) whether a solution for an impairment approach should be developed in relation to all or a sub-set of equity instruments; and
 - (b) to discuss some possible alternative approaches to the impairment of equity instruments designated at fair value through other comprehensive income ('FVOCI') under IFRS 9 *Financial Instruments*.
- 2 At this point, the mechanics of each approach have not been developed. Moreover, other issues of impairment, such as reversal or disclosures will be addressed in a future session.

Background of the project

Objective of the project

- 3 IFRS 9 *Financial Instruments* was issued by the IASB in July 2014 and is effective for annual periods beginning on or after 1 January 2018. For equity instruments, other than those held for trading and contingent consideration recognised in a business combination, the IASB has introduced an irrevocable option at inception on an instrument-by-instrument basis that permits those instruments to be accounted for at FVOCI with no impairment losses recognised in profit or loss and no reclassification in profit or loss of gains or losses upon derecognition.
- 4 In the Basis for Conclusions of IFRS 9, the IASB notes that one of the primary reasons for not allowing recycling is that it would create the need to assess these equity instruments for impairment. The IASB also noted that the application of impairment requirements of available for sale ('AFS') in IAS 39 *Financial Instruments: Recognition and Measurement* was very subjective.
- 5 In its Endorsement Advice to the European Commission related to IFRS 9, EFRAG noted that the prohibition of recycling may be considered as limiting the relevance of the information, since profit or loss is the main indicator of performance, and could affect in particular long-term investors.
- 6 The objective of the project is to consider possible alternative approaches to the impairment of equity instruments designated at FVOCI under IFRS 9.

Scope of the project

- 7 During the development of the project, the following topics will be discussed:

- (a) improvement of the impairment test of AFS equity instruments in IAS 39; and
 - (b) identifying a different impairment model for equity instruments.
- 8 At this stage, the project assumes that fair value as the measurement basis for equity instruments be maintained. The project does not intend to discuss extensively the relevance of profit or loss versus OCI and will leverage on the prior work performed by EFRAG in the context of the endorsement of IFRS 9 and its discussions on the revision of the Conceptual Framework.

Past history

Past discussions of EFRAG TEG

- 9 EFRAG TEG discussed a paper outlining the project plan in September 2016 and supported the general direction of the project, as drafted in the project plan. It was suggested that the data collection should include a sample of insurance companies.
- 10 It was also suggested to investigate if the impairment model in IAS 36 could be adapted to apply to strategic investments.

Past discussions of EFRAG User Panel

- 11 The EFRAG User Panel discussed an issues paper in October 2016. The objective of that session was to gather a preliminary input from users to help the EFRAG Secretariat in its initial analysis. The EFRAG User Panel generally noted that it was difficult to draw a line between short-term and long-term equity investments and therefore, they were more in favour of developing an impairment solution that would apply to all equity instruments.

Past discussions of EFRAG FIWG

- 12 EFRAG FIWG discussed an issues paper at its conference call in November 2016. The objective of that session was to gather a preliminary input from the FIWG members to help the EFRAG Secretariat in its initial analysis. It was noted that the EFRAG Secretariat should also look at the issue of reversals of impairment losses. Some FIWG members were of the view that the instrument position on the fair value hierarchy should not lead to a different impairment calculation.
- 13 FIWG members agreed to be contacted individually by the EFRAG Secretariat, in order to provide some further information.

Future steps

- 14 Depending on the discussions made at this meeting, in March 2017, the EFRAG Secretariat plans to bring to EFRAG TEG an issues paper to focus more specifically on improvements to the current impairment model for AFS instruments under IAS 39. The EFRAG Secretariat expects also to present a summary of the quantitative and qualitative data collected.

Planned final outcome

- 15 The expected output of the project would be a discussion paper, assuming that EFRAG is able to identify some potential alternatives to present to its constituents. The discussion paper is expected to be published in the first quarter of 2018.

Agenda papers

- 16 In addition to this cover note, agenda paper 06-02 *Issues paper on Equity Instruments - Impairment and Recycling* TEG 17-01-25 has been provided for the session.

Appendix 1: Project timeline

Month	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	Notes		
	Sep '16	Oct '16	Nov '16	Dec '16	Jan '17	Feb '17	Mar '17	Apr '17	May '17	Jun '17	Jul '17	Aug '17	Sep '17	Oct '17	Nov '17	Dec '17	Jan '18	Feb '18	Mar '18			
	EFRAG TEG agrees project plan																					
		Quantitative data and initial ideas for impairment approaches																				
					EFRAG TEG meeting																	
					Data collection from EFRAG FIWG and ideas for improvements to AFS																	
							EFRAG TEG meeting															
								Develop other possible impairment models														
								Input from users														
								Next EFRAG TEG meetings														
																		Finalisation of discussions				