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EQUITY INSTRUMENTS – ALTERNATIVE MEASUREMENT APPROACHES

EFRAG

DISCUSSION PAPER

MARCH 2018

European Financial Reporting Advisory Group ('EFRAG') issued this Discussion Paper.

Copies of the Discussion Paper are available from EFRAG's website.

EFRAG welcomes comments on proposals explored in this paper via the 'Questions to Constituents'. Such comments should be submitted through the EFRAG website by clicking here or should be sent by post to:

EFRAG
35 Square de Meeûs
B-1000 Brussels
Belgium

Comments should arrive no later than xx xxxx 2019. EFRAG will place all comments received on the public record unless confidentiality is requested.

EFRAG Research Activities in Europe

This paper is part of EFRAG's research work. EFRAG aims to influence future standard-setting developments by engaging with European constituents and providing timely and effective input to early phases of the IASB's work. Four strategic aims underpin our research work:

- engaging with European constituents to understand their issues and how financial reporting affects them;
- influencing the development of International Financial Reporting Standards ('IFRS Standards');
- providing thought leadership in developing the principles and practices that underpin financial reporting; and
- promoting solutions that improve the quality of information, are practical, and enhance transparency and accountability.

More detailed information about our research work and current projects is available on the EFRAG website.

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Executive Summary

ES 1 [To be added once main sections agreed]

QUESTIONS TO CONSTITUENTS

EFRAG invites comments on all matters in this DP, particularly in relation to the questions set out below. Comments are more helpful if they:

a) address the question as stated;

b) indicate the specific paragraph reference to which the comments relate; and/or

c) describe any alternative approaches EFRAG should consider.

EFRAG should receive all comments by **xx XXXX 2019**.

EFRAG has not expressed a preliminary view on the issues explored in this DP. The objective of the DP is to obtain feedback from constituents that EFRAG will consider in developing its technical advice to the EC.

Question 1 –

TO BE ADDED

Q1.1
Q1.2

Question 2 –

TO BE ADDED

Q2.1
Q2.2

Question 3 –

TO BE ADDED

Q3.1
Q3.2

Chapter 1: Objective and background

The objective of the Discussion Paper

1.1 The main objective of this Discussion Paper ('the DP') is to gather constituents' views on alternative measurement bases for equity instruments other than fair value through comprehensive income ('FVOCI') as included in IFRS 9, *Financial Instruments*. The purpose would be to depict returns in the context of long-term investment management.

The accounting requirements in IFRS 9 for equity instruments

1.2 The IASB issued IFRS 9 in July 2014. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Entities undertaking insurance activities are permitted to apply IFRS 9 or on after 1 January 2021[1]. In accordance with IFRS 9, equity instruments are measured at fair value with changes in fair value recognised in profit or loss ('FVPL'). At initial recognition, an entity may make an irrevocable election to present changes in the fair value in other comprehensive income ('FVOCI'). This FVOCI election is not available for equity instruments that are held for trading or contingent consideration recognised by an acquirer in a business combination. The entity may apply the FVOCI election on an instrument-by-instrument basis.

1.3 If the entity elects FVOCI, changes in fair value are presented in other comprehensive income ('OCI'). These changes are not reclassified into profit or loss ('recycled') on disposal and there is no requirement to assess these instruments for impairment. However, dividends that are a return on investment from the instruments are recognised directly in profit or loss.

What are we looking at, and why?

1.4 In its Endorsement Advice to the European Commission ('the EC') on IFRS 9, EFRAG noted that the default requirement to measure all equity investments at FVPL might not reflect the business model of long-term investors, including entities undertaking insurance activities and entities in the energy and mining industries. EFRAG also noted that the FVOCI election was not likely to be attractive to long-term investors because the prohibition on recycling gains and losses may not properly reflect their performance. EFRAG had previously stressed the importance of profit or loss as a main indicator of financial performance.

1.5 If neither option in IFRS 9 is attractive to some long-term investors, there may be a disincentive for those investors to hold equity instruments on a long-term basis. In its endorsement advice, based on the limited evidence available at that time, EFRAG assessed that it was unlikely that long-term investors would change their investment strategy as a result of IFRS 9. EFRAG noted that broader economic considerations,

[1] The IASB tentatively agreed at its November 2018 meeting to defer the effective date of IFRS 17 *Insurance contracts* with one year with a consequential amendment to the mandatory effective date of IFRS 9 for insurers.

such as the need for entities undertaking insurance activities to obtain a yield on their asset portfolio sufficient to meet their obligations to policy holders, are likely to outweigh any accounting concerns.

1.6 The EC completed the endorsement process of IFRS 9 with the adoption of Commission Regulation No 2016/2067 on 22 November 2016. During the endorsement process, the European Parliament and some Member States called for close monitoring of the impact of IFRS 9 to ensure that it serves the European Union's long-term investment strategy.

1.7 In May 2017, EFRAG received a request from the EC for technical advice. The EC request is provided in Appendix 1. The request has two distinct phases:

a) in the first phase ('the assessment phase'), the EC requests EFRAG to investigate the significance of the equity portfolio for long-term investors under IAS 39 and whether the new requirements in IFRS 9 are expected to affect asset allocation decisions; and

b) in the second phase, the EC requests EFRAG to assess, from a conceptual perspective, the significance of an impairment model to the re-introduction of recycling. If EFRAG concludes that an impairment model is an important element in order to re-introduce recycling, then EFRAG should consider how the impairment model under IAS 39 for equity instruments could be improved or propose other impairment approaches. The EC also requests EFRAG to consider if, in the absence of a robust impairment model, alternative presentation or disclosure requirements that could enable users to form a view about the performance of the equity investments.

1.8 EFRAG reported its findings from the assessment phase to the EC in January 2018 and presents a summary of the main findings in Appendix 2. The assessment phase has indicated that for some entities that consider themselves long-term investors, the aggregate amount/value of equity instruments classified as AFS under IAS 39 is substantial. On the other hand, some other entities that also consider themselves as long-term investors make little or no use of the AFS classification and as a result, they will not be affected by IFRS 9's requirements.

1.9 In terms of the impact of IFRS 9 on respondents' decisions to invest and hold equity instruments or other class of assets, most respondents indicated that a variety of factors, including business, economic and regulatory factors, affect such decisions. However, almost half of the respondents (mainly insurance entities) reported that they expect to modify their asset allocation decisions as a result of IFRS 9's requirements, although most did not specify to what extent.

1.10 EFRAG reported its technical advice for the second phase of the EC request in November 2018 on possible ways to improve the requirements of IFRS 9 on accounting for equity instruments from a long-term investing perspective. In EFRAG's view a strong impairment model is a necessary complement to any reintroduction of recycling for equity instruments carried at FVOCI. This is due to several reasons including: a desire for consistency with other IFRS Standards and categories of assets; to provide information for users to evaluate stewardship; to achieve comparability among financial statements, to provide an assessment of future cash flow prospects; to eliminate or reduce any accounting-related incentive to maintain loss-making equity investments for an indefinite period; and to avoid recognition of losses only upon realisation which would not be consistent with the notion of prudence.

1.11 EFRAG maintains that a degree of rigour in the use of the election or an impairment model would be essential to ensure comparability and concluded that any impairment model similar to the IAS 39 model should allow the possibility to reverse such losses. However, the development of an impairment model is difficult, complex, and judgemental.

1.12 The High-Level Expert Group on Sustainable Finance final report to the EC on 31 January 2018 recommended, among other things, to investigate alternative accounting approaches to fair value/mark-to-market valuation for long-term investment portfolios of equity and equity-type instruments.

1.13 In June 2018, EFRAG received a new request for technical advice from the EC in relation to the accounting treatment of equity instruments. The new request asks EFRAG to consider alternative accounting treatments to fair value through profit and loss for equity instruments. In the words of the request, 'possible accounting treatments should properly portray the performance and risks of long term investment business models in particular for those equity and equity type investments that much needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on climate change.'

1.14 EFRAG is addressing the research question specifically raised in the request for technical advice. Other alternatives treatments considered in this DP are not meant to replace IFRS 9's default treatment of FVPL. The alternative treatments are instead meant to be a possible replacement for the FVOCI without recycling option in IFRS 9. Other aspects of IFRS 9 are outside the scope of this project.

Structure of the DP

1.15 In **Chapter 2** EFRAG discusses the scope of the DP, i.e. the type of instruments the discussion applies to.

1.16 In **Chapter 3** EFRAG discusses the alternative ways in which the equity instruments might be measured for performance purposes.

1.17 **Chapter 4** presents EFRAG's consideration of the implications of each alternative by looking at both the technical criteria used for endorsement purposes and potential impact on behaviour by preparers.

1.18 **Appendix 1** provides the EC request for technical advice.

1.19 **Appendix 2** contains a high-level summary of the debate on fair value versus cost as measurement basis.

1.20 **Appendix 3** provides further information on the illustrative example of how the measurement approaches would work.

Chapter 2: Scope of application

2.1 *TO BE COMPLETED - In this chapter the DP will specify what financial instruments the proposals would be applied to, and in particular refer to the current definition of equity instruments in IAS 32 Financial Instruments: Presentation and the potential changes brought by the approach explored in the IASB's DP Financial Instruments with Characteristics of Equity.*

Chapter 3: Alternative measurements and their significance

3.1 The basic choice for measuring equity instruments is between cost and fair value. Before IFRS 9 became effective, IAS 39 *Financial Instruments: Recognition and Measurement* was requiring fair value for equity instruments with the changes recognised either in profit or loss (for instruments classified as held-for-trading) or OCI (for instruments classified as available-for-sale ('AFS')). Only instruments without a quoted price on an active market and whose fair value could not be reliably measured were carried at cost. For equity instruments classified as available-for-sale, the amounts recognised in OCI were recycled to profit or loss upon disposal or impairment.

3.2 IAS 39 became effective in 2001 and superseded the portions of IAS 25 *Accounting for Investments* that dealt with debt and equity instruments. Previously, IAS 25 required the measurement of marketable equity instruments classified as long-term assets at the lower of cost and market value determined on a portfolio basis.

3.3 IAS 27 Separate Financial Statements allows entities to measure investments in subsidiaries, joint ventures and associates either at cost, in accordance with IFRS 9 or using the equity method.

3.4 The aim of considering alternative measurement approaches for equity instruments is not to change the balance sheet measurement of equity instruments which has been at fair value since IAS 39 became effective. Fair value on the balance sheet has been broadly accepted for many years. This discussion paper instead is considering alternative measurements of performance. Any difference between an alternative measurement of an equity instrument for performance and its fair value is expected to be represented in OCI.

3.5 The rest of this chapter outlines three measurement families under consideration in this DP:

a) Cost-based measurement approaches such as AFS or equity method.

b) Fair value measurement approaches with changes in profit or loss such as using averages.

c) Allocation based approaches where amounts are allocated to profit or loss on an actual or expected basis.

3.6 EFRAG considered other approaches to the three families above such as a value in use approach. However, in the case of unlisted instruments value in use would practically be undistinguishable from fair value.

Cost-based measurement approach

3.7 A cost-based approach makes a distinction between unrealised and realised gains and losses. It is based on the notion that performance corresponds to cash realisation and therefore only includes dividends and realised gains as part of it, but not unrealised gains. Unrealised losses are also not considered unless the loss is considered an impairment.

3.8 Types of cost-based measurement approaches include historical purchase cost, FVOCI with recycling and modified cost. Cost could be modified in one of the following ways:

a) adjusting the purchase price for the share of profit or loss of the investor. This would reflect the performance of the investee in the comprehensive income of the investor, in a way similar to the equity method but without the need to apply all the requirements; or

b) adjusting the purchase price for observable market transactions. This would reflect changes in value and align the historical cost to the current value although on a non-recurring basis. A similar approach is used in US GAAP for unquoted instruments where the fair value is not readily determinable. This adjustment is only suitable for equity instruments that have no quoted price. It would require the investor to monitor if observable transactions are occurring on their investment.

3.9 Both these two adjustments would require the entity to obtain information that may not always be readily available for equity investments, in particular unlisted ones. The first would require the entity to obtain access to the financial statements of the investee, and there could be issues with the timing of the availability of the financial statements and the fact that the investees may not be reporting under IFRS Standards or a comparable GAAP. The second is only suitable for equity instruments that have no quoted price and would require the investor to monitor if observable transactions are occurring.

3.10 Historical cost has its limitations as it loses relevance over time. This becomes especially relevant for assets held for a long period and the EC request focuses on the performance of certain long-term business models. As a result, for purposes of this discussion paper we include AFS as a historical cost approach because historical cost is the basis for determining profit and loss if recycling is permitted.

3.11 The equity method of accounting is also similar to a cost based approach. However, even if this approach could be justified it may be impracticable to apply more broadly especially for unlisted equity instruments. .

3.12 In the prior technical advice, EFRAG concluded that the reintroduction of recycling would require also an impairment model. The same conclusion applies for all cost-based measurement approaches.

Fair value based measurement approach

3.13 Fair value of an equity instrument represents the amount an equity instrument could be exchanged for in an orderly transaction between market participants under the market conditions as of the reporting date. For listed equity instruments the fair value is generally the quoted price. The fair value of unlisted equity instruments requiring a Level 3 measurement is based on estimates.

3.14 A fair value based measurement approach is based on the notion that value changes are relevant to the performance in the reporting period. Performance is affected both by selling and holding decisions.

3.15 The definition of fair value in IFRS 13 *Fair Value Measurement* refers to a single point in time, i.e. the measurement date. Some have suggested using an average of fair values reflecting a time period toward the end of a reporting period, which would mitigate the impacts of very temporary fair value change occurring on the last day of the reporting period. The use of averages is generally not allowed under current IFRS.

3.16 As mentioned above, fair value measurement has been a widely accepted measurement for equity instruments on the balance sheet for many years. Reflecting fair value changes in profit and loss for performance reporting is likely to become more frequent with the introduction of IFRS 9. This is due to the fact that some instruments previously held as AFS will not be eligible for the FVOCI option, and that some equity instruments will be moved from AFS to FVPL because of the lack of recycling.

An allocation based approach

3.17 The two preceding measurement approaches reflect in profit or loss either:

a) a disposal (or impairment) gain or loss; or

b) all changes in current values of equity instruments

3.18 Another approach would be based on the notion that the cumulative gain on the instruments should be systematically allocated over the term that reflects the investment perspective. This approach could be articulated in different ways and would require the identification of the relevant period and allocation pattern.

3.19 The relevant period could either be based on the anticipated holding period when the equity instrument was acquired or the expected duration of a designated (linked) liability.

3.20 The allocation pattern could be based on either an expected long-term rate of return or could offset the impact in profit or loss of the designated (linked) liability.

3.21 The systematic allocation over a relevant period has the advantage that it reduces exposure to short-term value changes that critics of a fair value based measurement approach do not consider part of a long-term investment performance. On the other hand, it takes away entities' ability to manage earnings by selectively selling specific instruments.

3.22 However, the allocation based approach is heavily reliant on management assumptions and would require constant reassessment over time. For instance, an allocation period and pattern based on the expected duration of a designated (linked) liability would raise issues if the liability is settled before time. It would also be necessary to discuss whether designation should be subject to eligibility criteria and whether effectiveness need to be assessed.

3.23 An allocation pattern based on expected return would require amounts to be trued up or down during the period and on disposal. Also, it would be necessary to discuss if an allocation method would treat unrealised gains and losses equally or whether it would need to be accompanied by an impairment model.

3.24 Below is an example of how an allocation based approach may work and compares the it to other alternatives in terms of performance reporting:

Measurement approaches example

Assume a reporting entity acquired an equity instrument for 100. The reporting entity anticipates it will hold the equity instrument for five years and collect dividends.

The entity expects a 4% annualised long-term return (excluding dividends) with an estimated disposal value of at the end of year 5 of 122. Also assume that the instrument is sold at the end of year five. The reported performance (excluding dividends which would be the same regardless of selected method) would be as follows under the various approaches:.

	Yr 1	**Yr 2**	**Yr 3**	**Yr 4**	**Yr 5**
Fair value of instrument	125	121	96	123	122
FVTPL					
Profit or loss	25	(4)	(25)	27	(1)
FVOCI					
OCI	25	(4)	(25)	27	(1)
AFS					
Profit or loss	-	-	-	-	22
OCI	25	(4)	(25)	27	(23)
Expected gain allocation approach					
Profit or loss	4	4.2	4.3	4.5	5
OCI	21	(8.2)	(29.3)	22.5	(6)

Under the allocation approach, if the reporting entity disposed of the equity instrument prior to the end of the anticipated holding period, the remaining gain or loss would continue to be allocated over the initial anticipated period.

Chapter 4: Evaluating the alternatives

Introduction

4.1 Chapter 3 presents possible basic measurement methods for equity instruments to portray performance. The central issue of this discussion paper is determining whether one of these methods better portrays performance and risks of long-term business models.

4.2 A good starting point for the discussion about the measurement of equity instruments may be to consider the portrayal of a reporting entity's performance with respect to its investment over time. Setting aside the recognition of dividends which is recognised on an accrual basis, most agree that for investments held for trading purposes that the portrayal of performance should include in profit and loss any gains or losses from current changes in fair value. This agreement on the portrayal of the performance is due to the short-term investment horizon and speculative nature of the business model.

4.3 This DP aims to address the performance of investments in equity instruments that are not part of a trading portfolio. For non-trading investments, there is no broad consensus on how to portray the performance of these business models. Some argue that whilst the business model may be different, it should not change the portrayal of performance. Others disagree and conclude that the business model makes a difference and should be reflected differently.

4.4 An issue with IFRS 9 for some, is that one of the choices of measuring performance does not reflect gains or losses in that performance. Realisation or the conversion of an equity instrument into cash may be an important event which necessitates recognition in profit or loss even if this may refer to an increase in value attained over a number of years.

4.5 For others, the gain or loss realised in the conversion into cash accrued in earlier periods should be reflected in those periods when it 'accrued'.

4.6 In this chapter, we consider aspects of each alternative method described in Chapter 3 in terms of technical criteria. We also consider whether the alternatives may have any potential effects on behaviour.

Relevance

4.7 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.

4.8 EFRAG's endorsement advice on IFRS 9 pointed out that the standard's FVOCI option for equity instruments that does not permit gains or losses from ever impacting profit or loss. In EFRAG's view, this may limit the relevance of the information as profit and loss is the primary indicator of performance.

4.9 Compared to the FVOCI option in IFRS 9, the cost-based approaches described in the prior chapter would result in recognition of gains on disposal, that may provide confirmatory value of the gains and therefore of stewardship.

4.10 Fair value based approaches, such as IFRS 9's FVPL treatment of equity instruments are often considered to provide users with the most relevant information for most business models. Management generally has the ability to purchase, hold or dispose of individual investments in equity instruments each reporting period. On that basis, recognising FVPL for investments in equity instruments provide users with valuable insight to assess the stewardship of the entity's investment decisions on an ongoing basis.

4.11 On the other hand, it is noted that fair value changes at the reporting date may not be more relevant for assets held in a long-term investment business model because the fair value changes may reverse before the entity actually disposes the investment. The allocation based approaches in this DP mitigates some of the volatility of the gains and losses and could be perceived as more relevant for long-term investment business models.

Reliability

4.12 Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

4.13 Level 2 or 3 fair values may include significant estimates which may impact its perceived reliability as bias could be part of assumptions used in the measurement. The impact of the allocation based approaches in this DP on profit or loss also rely on fair value so they have similar issues related to Level 2 or 3 fair values. The expected return allocation approach could be subject to further bias since that return is based on management judgement.

4.14 Some argue that a historical cost measurement is more reliable than a fair value measurement, however, a historical cost approach with impairment requires various judgements including whether such a loss should be recognised as well as the amount of such loss which may depend on estimates. Those impairment judgements could also be biased. As a result, the impact on reliability of each alternative other than those based on a Level 1 fair value measurement appears to be fairly similar to one another.

Comparability

4.15 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

4.16 IFRS 9 included an option to account for equity instruments in different ways. The standard has one approach that recognises all current fair value changes of an equity instrument through profit and loss and a second approach that never recognises fair value changes through profit and loss. These two approaches are as opposite as any two approaches can be and provide results that are not comparable. If two reporting entities made a similar investment in an equity instrument but chose to account for their investment differently under IFRS 9, over time one entity would recognise through profit or loss the gains or losses on that investment. The second entity would not report any profit or loss from its investment.

4.17 In terms of comparability, this DP assume that FVPL is maintained and any new measurement replaces the FVOCI option with no recycling. Having an option by itself reduces comparability.

4.18 That said, it may be argued that comparing a cost-based approach to FVPL is easier than comparing the FVOCI without recycling, because cost-based approaches result in recognising value changes in profit or loss, although it will occur in different periods. Instead, the allocation based approaches would likely reduce comparability because different entities would use different assumptions in relation to expected returns, holding periods or designated (linked) liability. It would be important to understand what disclosures would be required for users to overcome this.

Understandability

4.19 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.

4.20 The existing measurement approaches contained in IFRS 9 are well understood measurement approaches. FVPL and AFS have been used for many years under IAS 39. IFRS 9's recycling prohibition does not significantly impact understandability.

4.21 The allocation and averaging approaches discussed in this DP are systematic methods that provide a smoothing mechanism to fair value changes. If these approaches were adopted in IFRS it is unlikely understandability would be compromised as IFRS has other mechanisms that provide an allocated impact on profit and loss such as depreciation and amortisation. As a result, the impact on understandability of each measurement alternative appears to be fairly similar.

Prudence

4.22 For the purpose of this discussion paper, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated and liabilities or expenses are not understated.

4.23 Proponents of cost are likely to argue that fair value based measurements are not prudent and would prefer to recognise gains possibly only on realisation. As discussed earlier, proponents of fair value argues that cost-based measurement approaches in this DP relies on a robust impairment model. Such a robust impairment model is not immediately obvious. The allocation approaches as described would generally recognise gains over a period rather than immediately and therefore would be considered to be prudent, however, loss recognition would generally be delayed and so could be considered not to be prudent.

Effects on behaviour

4.24 Fair value increases volatility in profit or loss and/or the financial position of entities. Some claim that entities will reduce investments in equity instruments if the reporting becomes increasingly volatile. This could also lead to entities disinvesting when markets are experiencing losses, thus increasing the financial market downturn.

4.25 It is also suggested that the use of fair value can have pro-cyclical effects where capital regulations draw heavily on the accounting. The argument is that, if a bank has to write down its assets to reflect a decrease in market prices, the bank's regulatory capital may be depleted, which can negatively affect the availability of financing for the real economy. Others do not consider this a significant impact given the differences between capital regulations and accounting.

4.26 On the other side, it has been noted that the use of cost provides opportunity for selective profit-taking. In this way, the entity is able to decide the period in which a holding gain is recognised, although the gain has been accruing in other periods.

4.27 Others would instead consider that recognition of profit should be driven by cash realisation, as the sale changes the risk exposure of the holder of the assets.

Summary

4.28 [To be added once sections are agreed].

Chapter 5: Other aspects

5.1 *TO BE COMPLETED – In this chapter, the DP may consider suggestions on other metrics entities may use to communicate their investment strategy and performance.*

Appendix 1 – EC request

EUROPEAN COMMISSION
Directorate General Financial Stability, Financial Services and Capital Markets Union

INVESTMENT AND COMPANY REPORTING
Accounting and financial reporting
Head of Unit

Brussels, 1 June 2018
FISMA B3/EVDP/fv/Ares(2018)3110211

Jean-Paul Gauzès
President
EFRAG
Square de Meeûs 35 B-1000 Brussels
jean-paul. gauzes@efrag. org

Subject: Request for technical advice on possible alternative accounting treatments to fair value measurement for long-term investment portfolios of equity and equity type instruments

Dear Mr Gauzes,

As part of its Action Plan on Sustainable Finance[1], the Commission announced it would ask EFRAG to explore potential alternative accounting treatments to fair value measurement for long-term investment portfolios of equity and equity-type instruments.

Under IFRS 9 equity instruments can be measured either as fair value through profit or loss (FVPL) or, as an irrevocable choice at initial recognition, at fair value through other comprehensive income (FVOCI). However, in case of FVOCI measurement IFRS does not allow gains or losses realized upon the disposal of the financial asset to be recognized as profit or loss (no "recycling" through P&L).

The Commission has already asked EFRAG to assess the FVOCI treatment for equity instruments in an earlier call for advice[2]. The Commission asked to assess in two phases: 1) the significance of the equity instruments portfolios measured at FVOCI and the possible impact on long-term investments, and 2) to explore possible alternative accounting treatments. The Commission notes that EFRAG's work is well under way for this call for technical advice.

This request for technical advice asks EFRAG to consider alternative accounting treatments to measurement at FVPL for equity instruments. Possible accounting treatments should properly portray the performance and risks of long term investment business models in particular for those equity and equity type investments that are much needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on climate change.

Alternative accounting treatments for long term equity investments should preferably enhance investors' insight in the long term performance of investments as opposed to recognizing point in time market based value changes in reported profit or loss during the duration of the equity investment.

[1] COM/2018/097 final : http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097

[2] https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F1606211130208837%2F06.02%20-%20Request%20from%20EC%20-%20Equity%20Instruments.pdf

We would be grateful if EFRAG could provide us with the outcome of its work by the second quarter of 2019.

We thank you in advance for your cooperation and would be happy to provide any clarification required on this letter to EFRAG representatives.

Should you have any questions, please contact Erik van der Plaats (Telephone: +32 2 29 55565).

Yours sincerely,

Alain DECKERS

cc.: A. Watchman, (EFRAG TEG Chairman)

Appendix 2 – Further details on the example

1. Further details that may be useful to understand the example, such as the balance sheets, is provided in this appendix.

Measurement approaches example

Assume a reporting entity acquired an equity instrument for 100. The reporting entity anticipated it would hold the equity instrument for five years and collect dividends. The entity expects a 4% annual return with an estimated disposal value of at the end of year 5 of 122. Also assume that the instrument is sold at the end of year five. The reported performance (excluding dividends which would be the same regardless of selected method) would be as follows:

	Yr 1	**Yr 2**	**Yr 3**	**Yr 4**	**Yr 5**
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Profit or loss	-	-	-	-	22
OCI	25	(4)	(25)	27	(22)
Expected gain allocation approach					
Profit or loss	4	4.2	4.3	4.5	5
OCI	21	(8.2)	(29.3)	22.5	(6)
Extracts from balance sheets					
Retained earnings	4	8.2	12.5	17	22
OCI – Allocation reserve	21	12.8	(16.5)	6	-
Investment	125	121	96	123	
Cash	-	-	-	-	122

EFRAG receives financial support of the European Union - DG Financial Stability, Financial Services and Capital Markets Union. The contents of this document is the sole responsibility of EFRAG and can under no circumstances be regarded as reflecting the position of the European Union.