



European Financial Reporting Advisory Group  
35 Square de Meeûs  
1000 Brussels  
Belgium

29th May 2018

Dear Sirs,

**Ref: EFRAG's Consultation on Equity Instruments – Impairment and Recycling**

The International Swaps and Derivatives Association ("ISDA") is pleased for the opportunity to respond to the above referenced Consultation on Equity Instruments – Impairment and Recycling issued by the European Financial Reporting Advisory Group ("EFRAG").

**Key Messages:**

While some of our members believe that there should be no change to the classification and measurement requirements of IFRS 9, others members would be in favour of introducing of an FVOCI model with recycling, if an appropriate impairment model can be agreed upon.

Should you have any questions or would like clarification on any of the matters raised in this letter please do not hesitate to contact the undersigned.

Yours faithfully,

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Chair of ISDA's European Accounting Committee  
Managing Director  
Head of Accounting Policy & Advisory Group  
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Director  
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**Appendix – Responses to specific questions raised by the EFRAG**

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<sup>1</sup> Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient. ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool. Today, ISDA has over 850 member institutions from 68 countries. These members comprise of a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals, to build robust, stable financial markets and a strong financial regulatory framework. Information about ISDA and its activities is available on the Association's web site - [www.isda.org](http://www.isda.org).

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## Appendix – Responses to specific questions raised by the EFRAG

### QUESTION 1 - RECYCLING GAINS OR LOSSES ON DISPOSAL

*Q1. What are your views on the arguments presented in paragraphs 2.3 – 2.10? Do you consider that the reintroduction of recycling would improve the depiction of the financial performance of long-term investors? Alternatively, do you consider that the existing requirements of IFRS 9 provide an adequate depiction? Please explain.*

This topic was thoroughly debated at the time that the standard was developed and it should form part of the Post Implementation Review that the IASB will conduct. While some of our members consider that the IASB should not wait until the PIR to re-examine this issue, all our members agree that only the IASB should make any changes to the standard.

We note that the IASB introduced the fair value through OCI (FVOCI) without recycling model for a narrow range of strategic investments that would not ever be expected to be sold, thereby also avoiding the need to develop a better impairment model for equity investments measured at FVOCI. The underlying concern of some constituents is therefore not so much the problem of recycling but that they do not believe that it is appropriate to record at fair value through profit or loss (FVPL) other long term equity holdings (i.e., those that are not 'strategic' but are also not held for trading).

Some of our members believe that there should be no change to the IFRS 9 classification and measurement categories and that investments that may one day be sold are best recorded at FVPL. These members are concerned that it would be inappropriate to reopen the debate on how to account for non-trading equity holdings without, first, a wider conceptual study of the uses of OCI.

Other members believe that long term holdings that may one day be sold should be recorded at FVOCI with recycling. They believe that all performance should ultimately be reflected in profit or loss, and that gains or losses on long term investments are performance. However, they also believe that there is an important distinction to be made for such instruments between realised and unrealised gains and losses and that only realised gains should be recorded in profit or loss. As set out in our response to Question 2, this would require development of an appropriate impairment model.

### QUESTION 2 - CONCEPTUAL RELATIONSHIP BETWEEN RECYCLING AND IMPAIRMENT

*2.1 What are your views on the arguments presented in paragraphs 2.11 – 2.17? Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.*

As we have already said in our response to Question 1, some of our members would prefer a FVOCI model with recycling, if a solution to impairment can be found. It would be inappropriate to permit recycling without an impairment model, as impairment is just as much a key measure of performance (and hence stewardship) as gains or losses on realization. The challenge is not deciding whether an impairment model is needed but how it would work.

### QUESTION 3 - ENHANCING PRESENTATION AND DISCLOSURE REQUIREMENTS

*Q3.1 What are your views on the arguments and analysis presented in Chapter 3 of the DP?*

*Q3.2 Are there other improvements in presentation and disclosure that you would support?*

As already mentioned in response to Question 1, some of our members believe that there should be no change to the classification and measurement requirements of IFRS 9. Hence, for these members, entities should provide disclosures to help 'tell the story', to explain which gains and losses on equity securities recorded at FVPL will only be realised in the longer term, but that there is nothing to stop such entities from already doing this under IFRS 9. As regards to scenario 3, they also note that there is

already a requirement to disclose unrealised profits and losses on level 3 financial instruments held at FVPL, by class. Our members have sympathy with extending this to other non-trading equity investments recorded at FVPL.

Also, our members would not support disclosure of the accumulated debits and credits on FVOCI equities, as proposed as a possible improvement in scenario 1, as the costs of preparing this information would not be commensurate with the benefits. The numbers, in themselves, would not be very meaningful. Also, the debits (the fair value losses) are not necessarily 'impairment' if they just reflect market volatility – a point we expand on in response to Question 4.

In contrast, those members who favour introduction of an FVOCI model with recycling, believe that disclosures, on their own, will not solve the challenge of recognising performance in profit or loss. As is set out in the Contractual Framework (and consistent with our members' experience of the views of users), profit or loss should be the primary source of information about an entity's performance:

#### QUESTION 4 - TWO MODELS

*Q4.1 What should be, in your view, the general objective and main features of a robust model for equity instruments (relevance, reliability, comparability...)?*

As explained further in our response to Question 4.3, our members believe that relevance is important. In particular, a key component of a robust model for equity instruments is that impairment is not necessarily the same as a decline in fair value and that there needs to be a principle as to what impairment is designed to measure. In particular, impairment should reflect a change in the economic circumstances of the individual investee, rather than just changes in market prices. Reliability and comparability are important, but not to the extent that short term fluctuations in general market fair values cause impairment to be recorded.

*Q4.2 Which, if either, of the two models do you prefer? Please explain.*

Our members strongly do not support the revaluation model:

- i) it gives undue prominence to short term negative fluctuations in fair value (which are not reflective of the long term investment intention); and
- ii) it does not adequately portray the performance of a managed portfolio of equity investments (in which some will be expected to show fair value gains and others losses).

Those members who support FVOCI with recycling would therefore prefer an impairment model that is closer to IAS 39 (see our response to Question 4.3). The challenge is to find a model that is sufficiently relevant and reliable while allowing greater comparability.

*Q4.3 Do you have suggestions for a model other than those presented in the DP? If so, please describe it and explain why it would meet characteristics such as relevance, reliability and comparability.*

A significant part of the problem with the IAS 39 impairment model was that it did not allow impairment recorded on equity holdings to be reversed (see our response to Question 6).

Beyond that, those of our members who would support a FVOCI with recycling model would prefer not to link it solely to quantitative triggers but also to take into account qualitative indicators. The aim should first be to develop a principle as to what impairment is designed to achieve. Our members believe that impairment should reflect the expected ability of the individual investment to generate cash flows, rather than general changes in market fair values. Hence impairment should be recorded (by recycling fair value losses to profit or loss) when there has been a significant reduction in the expected future cash flows of the investee.

It is recognised that this test would be even more subjective than the IAS 39 criteria and so it is suggested that it would be underpinned by a rebuttable presumption that a holding is impaired if it has suffered a decline in fair value compared to the general market that is significant, or that it has suffered a significant decline in fair values that is significant and prolonged. This would differ from the IAS 39 'significant or prolonged', so as to help avoid recognition, as impairment, of short term changes in fair value that have little to do with long term expectations of performance. However, if there has been a significant deterioration in expected future cash flows, this principle would require impairment to be recorded without having to wait for a decline in fair value to be prolonged.

#### QUESTION 5 - QUANTITATIVE IMPAIRMENT TRIGGERS

*Q5.1 Do you support the inclusion of quantitative impairment triggers in an impairment model? If so, should an IFRS Standard specify the triggers, or should management determine them?*

Our members who favour a FVOCI with recycling model would be supportive of the Board setting quantitative parameters for what is 'significant' and 'prolonged', but note that it has always been reluctant to set bright lines.

Our members are not supportive of the portfolio approach suggested in paragraphs 5.14 to 5.19, since this will fail to recognise, as losses, any significant deterioration in the expected cash flows to be generated by an investee.

#### QUESTION 6 - SUBSEQUENT RECOVERY IN FAIR VALUES

*Q6.1 How should subsequent recoveries in fair values be accounted for? Please explain.*

As already mentioned, our members agree that any impairment model should be symmetrical, so that impairment can be reversed. One of the concerns with the IAS 39 AFS impairment model was the irreversibility. If reversals of impairment were permitted, then that would also help avoid the interim/final reporting issue discussed in paragraphs 5.37 to 5.40 of the DP.

*Q6.2 If subsequent recoveries in fair values are recognised in profit or loss, which of the approaches in paragraphs 5.2 – 5.10 do you support and why?*

Our members believe that the impairment model should be symmetrical. Hence if there is no longer a significant decline in expected cash flows, or (if impairment was recorded because of the rebuttable presumption) the fair value is no longer significantly below general market fair values, or there has been a prolonged period of time over which the fair values has not been significantly below cost, the impairment should be reversed.

#### QUESTION 7 - OTHER CONSIDERATIONS

*Q7.1 Do you consider that the same model should apply to all equity instruments carried under the FVOCI election? If not, why not and how would you objectively identify different portfolios?*

Our members do not believe that there is a need for more than one model. As already stated, they either do not consider the current model requires change or would chose a single FVOCI model with recycling and impairment.

*Q7.2 Do you have comments on these other considerations?*

No

*Q7.3 Are there other aspects that EFRAG should consider?*

No

QUESTION 8 - OTHER ASPECTS OF IFRS 9'S REQUIREMENTS ON HOLDINGS OF EQUITY INSTRUMENTS

*Q8.1 Are there other aspects of IFRS 9's requirements on accounting for holdings of equity instruments, in addition to those considered in the DP, which in your view are relevant to the depiction of the financial performance of long-term investors? Please explain*

See our response to Question 5.

