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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 present to EFRAG TEG some quantitative data related to the project to help in developing our discussions and future analysis.

Background of the project

Objective of the project

- 2 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 Fair value through other comprehensive income ('FVOCI') with no impairment losses recognised in profit or loss and no reclassification in profit or loss of gains or losses upon derecognition.
- 3 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.
- 4 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.
- 5 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

- 6 During the development of the project, the following topics will be discussed:
 - (a) improvements of the impairment test of AFS equity instruments in IAS 39; and
 - (b) identifying a different impairment model for equity instruments.
- 7 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

- 8 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. It was also suggested to investigate if the impairment model in IAS 36 *Impairment of Assets* could be adapted to apply to strategic investments.
- 9 At its January 2017 meeting, EFRAG TEG discussed possible alternative approaches to the impairment of equity instruments designated at FVOCI under IFRS 9. At this meeting, EFRAG TEG agreed that developing an impairment model would be a pre-requisite to allow recycling of gains or losses on disposal. Moreover, many EFRAG TEG generally supported the development of an approach that would apply to all equity instruments rather than addressing a specific subset. Some EFRAG TEG members favoured a lower of cost or fair value impairment approach for equity instruments.

Past discussions of EFRAG User Panel

- 10 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

- 11 EFRAG FIWG discussed an issues paper at its conference call in November 2016. The objective of that session was to gather 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.

Future steps

- 12 Depending on the discussions made at this meeting, in a future meeting, the EFRAG Secretariat plans to bring to EFRAG TEG an issues paper to develop the ideas supported by EFRAG TEG in previous meetings and potentially some other new ideas for impairment models.

Planned final outcome

- 13 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

- 14 In addition to this cover note, agenda paper 10-02 *Issues paper on Equity Instruments - Impairment and Recycling TEG 17-03-29* 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		