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EFRAG Equity Instruments – Research on Measurement

Cover Note

Objective of the session

- 1 Following a new request for technical advice from the European Commission, EFRAG has started a project to explore possible alternatives to the use of fair value measurement for equity and equity-like instruments.
- 2 The objective of the session is to ask the EFRAG TEG members their input about possible alternatives to fair value measurement bases for equity instruments. EFRAG plans to issue a consultation document on the issue in early 2019.

Background of the project

- 3 In May 2017, the European Commission sent a first request for technical advice to EFRAG. The request had two distinct phases: an assessment phase and a possible solutions phase. In the assessment phase, the EC asked EFRAG to collect quantitative information about current holdings of equity instruments and their accounting treatment. The EC also requested EFRAG to obtain information of the entities' expectations in relation to:
 - (a) the extent to which they plan to use the FVOCI election and the factors that will influence their choices; and
 - (b) the anticipated effects of the new requirements in IFRS 9 on their decisions to invest in equity instruments or other categories of financial assets and their holding periods (including quantification where possible).
- 4 In the possible solutions phase, the EC asked EFRAG to assess, from a conceptual perspective, the significance of an impairment model to the re-introduction of recycling. If EFRAG concluded that an impairment model is a precondition to re-introduce recycling, then EFRAG was to consider how the existing impairment model under IAS 39 for equity instruments could be improved or propose other impairment approaches.
- 5 EFRAG was also asked to consider if, in the absence of a robust impairment model, alternative presentation or disclosure requirements could be used to provide users with the necessary information to make the adjustments deemed necessary to the reported profit or loss.
- 6 During the work on the first request, EFRAG assumed that no change would be made in relation to the following requirements in IFRS 9:
 - (a) Equity instruments are carried at fair value in the statement of financial position;
 - (b) Entities are allowed (but not required) to designate equity instruments to be carried at FVOCI, unless the instruments are held for trading;

- (c) The election is available on an instrument-by-instrument basis and is irrevocable.
- 7 EFRAG also did not address the definition of equity instruments and what instruments qualify as such. During the consultation, some constituents noted that the differentiation of the requirements for direct and indirect equity holdings in IFRS 9 is unjustified (unit of investment funds are not eligible for the FVOCI election).
- 8 EFRAG published a consultation document in March to solicit views from European constituents.

Current status of the project

- 9 EFRAG discussed the feedback from its consultation paper over the summer. Views were significantly split among constituents on different aspects:
 - (a) Whether there is a case for immediate change to the IFRS 9 requirements, based on the available evidence – some of the respondents claimed that it is too early to draw conclusions on the impact of the new requirements, while others supported immediate action to amend the Standard;
 - (b) The conceptual relevance of recycling in depicting financial performance of investors – some of the respondents consider that neither FVPL nor FVOCI with no recycling provide a proper depiction of the financial performance especially of long-term investors, while others argue that recycling at disposal does not depict the performance of the period;
 - (c) How to develop a robust impairment model for equity instruments – the majority of respondents agreed that the reintroduction should be accompanied by an impairment model. However, views were split on whether an impairment model should rely substantially on the investors' assessment (which would be more conducive to relevant information) or be more prescriptive (which would promote consistency and comparability).
- 10 Similarly, mixed views were expressed both in EFRAG TEG and at the EFRAG Board. EFRAG TEG finally expressed the view that at this stage, they would not recommend changed to be introduced in IFRS 9.

New request for technical advice

- 11 In June 2018 EFRAG received a new request for technical advice from the European Commission in relation to the accounting treatment of to consider alternatives to fair value as the measurement basis for equity long-term investment portfolios of equity and equity-like instruments.
- 12 In the words of the request, the alternative treatments should properly portray the performance and long-term risks of long-term investment business models, in particular for those equity and equity-type investments needed to sustain the United Nations Sustainable Development Goals and the goals of the Paris Agreement on climate change.
- 13 While the request refers to *equity-like instruments* and *long-term investments*, the European Commission will not be providing a working definition. When referring to equity-like instruments, EFRAG understands that the Commission has in mind units in investment funds such as (but not limited to) the European Long-Term Investment Funds (ELTIF) established under Regulation 2015/760 of April 2015.
- 14 The initial technical discussion with EFRAG TEG members in September 2018 has been on whether EFRAG should try to define long-term investments or long-term investing activities, The majority of EFRAG TEG members was not supportive. Concerns were raised both on the conceptual merit of differentiating the accounting treatment for long-term investments in equity and on the operational difficulties of developing a definition.

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- 15 The next step will be an initial discussion on the definition of equity-like instruments at the December EFRAG TEG meeting.

Agenda papers

- 16 In addition to this cover note, the following papers have been provided for the session:
- (a) **Paper 06-02** – Issues Paper on the EFRAG Research project - Alternative approaches; and
 - (b) **Paper 06-03**– Issues Paper on the EFRAG Research project - Measurement of Equity Instruments in some local GAAP.