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# EQUITY INSTRUMENTS

## Summary of feedback received

EFRAG TEG 16 September 2019

EFRAG

European Financial Reporting Advisory Group

# OVERVIEW

BACKGROUND

LATEST DEVELOPMENTS

OVERVIEW OF RESPONDENTS

KEY MESSAGES

# BACKGROUND

### EFRAG ENDORSEMENT ADVICE ON IFRS 9 (2015)

EFRAG notes that the use of FVPL and FVOCI without recycling for equity instruments might limit the reporting of performance of some long-term investors but no significant changes in investment strategies expected

### EC REQUEST FOR ADVICE (2017)

The EC sends a request for advice to ask EFRAG to consider the relevance of an impairment model to the reintroduction of recycling for equity instruments

### EFRAG ADVICE TO EC (2018)

EFRAG notes that the reintroduction of recycling would need to be accompanied by a robust impairment model but EFRAG did not have, at the time, sufficient evidence to recommend the reintroduction of recycling

### EC REQUEST FOR ADVICE (2018)

EC publishes its action plan on sustainable finance and requests technical advice on alternative accounting treatments to FVPL for equity and equity-type investments

# LATEST DEVELOPMENTS

## EFRAG PUBLIC CONSULTATION IN 2019

- In May 2019 EFRAG launched a public consultation to gather views on whether alternative accounting treatments to those in IFRS 9 are needed to portray the performance and risks of equity and equity-type instruments held in long-term investment business models

## NEXT STEPS

- The objective is to issue a feedback statement by the end of September and a technical advice to the EC in Q4 2019 together with a summary of the feedback received during EFRAG Public Consultation in 2019

# OVERVIEW OF SURVEY'S RESPONDENTS

- EFRAG received 63 surveys (available on EFRAG's website except for two surveys as these respondents asked to remain anonymous)
- The surveys came from national standard setters, business associations, professional organisations, listed companies and EU authorities
- Majority of the respondents were engaged in a long-term investment business model and/or sustainable activities
- Many (almost half) were from the financial sector
- Approximately 15% of the respondents were users of financial statements, a high rate of response when considering EFRAG's outreaches on other topics

# KEY MESSAGES

## SUSTAINABLE ACTIVIES

- Many respondents noted that there is no formal definition for "sustainable activities" and recognised the challenges of defining it
- Many considered that sustainable activities should not be a distinguishing feature in accounting, even if they supported the aim of encouraging sustainable activities
- Mixed views on whether a change in IFRS 9 would contribute to the objective of the Action Plan on Sustainable Finance.

# KEY MESSAGES

## LONG-TERM INVESTMENT BUSINESS MODEL

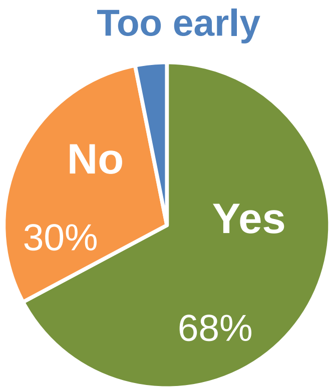
- Many noted that there is no accounting definition for ‘long-term investment business model’ (‘LTIBM’) and recognised the challenges of defining it
- Mixed views on what a LTIBM is. Some referred to the ‘expected holding period' and the use of thresholds. Others provided a definition of LTIBM closer to their business model (e.g. Asset Liability Management)
- Many respondents, particularly from the financial sector, suggested the focus should be on whether an equity instrument is held for (non-)trading purposes (rather than defining LTIBM)
- When replying to which characteristics should be required to identify a LTIBM, many referred to the ‘expecting holding period’ and the ‘characteristics/business model of the investor’

# KEY MESSAGES

## AN ALTERNATIVE ACCOUNTING TREATMENT NEEDED?

- Majority of the respondents, particularly from the financial sector, considered that there is a need for an alternative accounting treatment in IFRS 9 but not all respondents related it to the objective of ‘properly portraying the performance and risks of equity instruments held in a LTIBM’

- Most of the remaining respondents were not convinced that there is a need to identify a long-term investment business model nor an alternative accounting treatment for long-term equity investments in IFRS 9




- Some mentioned that it was too early to conclude whether IFRS 9 (together with IFRS 17) affects any asset allocation decisions to the disadvantage of long-term equity investments

# KEY MESSAGES

## WHY AN ALTERNATIVE ACCOUNTING TREATMENT NEEDED?

- Most respondents justified the need for an alternative accounting treatment in IFRS 9 by highlighting the limitations of accounting for equity instruments either at FVPL or FVOCI without recycling

*FVPL is not appropriate to adequately depict the financial performance of long-term investors as it increases the volatility and generates an asset liability mismatch*

*market-to-market estimates fail to provide a faithful representation of the real strategy underlying long-term equity investments*

*the use of FVOCI without recycling creates the false impression that the cumulative gains and losses at the time of disposal are not economically relevant*

*the ability to identify realised vs. unrealised gains or losses is fundamental and IFRS 9 in its current form creates disincentives for insurers to maintain and increase investments in long-term and/or illiquid assets*

# KEY MESSAGES

## IMPAIRMENT MODELS SUGGESTED

- Many respondents considered that a robust impairment model can be developed without undue costs by using IAS 39 as a starting point but with additional guidance to reduce subjectivity
  - improve definition and criteria for the notion of ‘significant’ and ‘prolonged’ decline
  - allow the reversals of impairments
  - additional disclosures, including on methodology

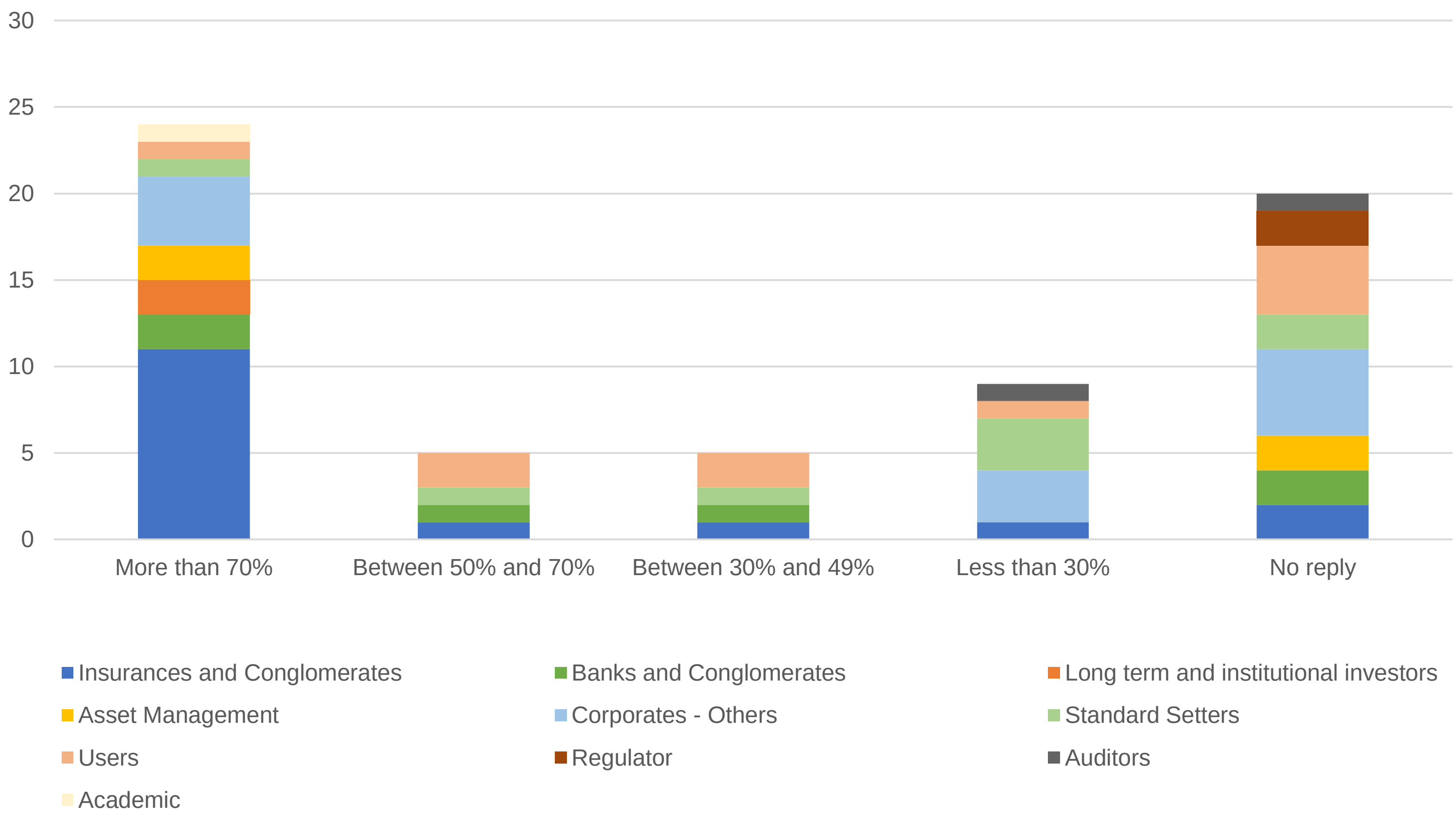
# KEY MESSAGES

## SCOPE OF ALTERNATIVE ACCOUNTING TREATMENT

- Most respondents that called for an alternative accounting treatment considered that it should not be restricted to equity instruments held in a LTIBM but mixed views to which instruments it should be applied and which approaches it should apply
- Most respondents that called for an alternative accounting treatment, considered that it should be extended to "equity-type" instruments
- Most of the remaining respondents did not think that new options were necessary or considered that widening the scope of an alternative accounting treatment would increase complexity

# KEY MESSAGES

## How relevant a different accounting treatment is to the objective of reducing or preventing detrimental effects on LTI?



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

# THANK YOU

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