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IFRS 9 *Post-implementation Review – Classification and Measurement* – Equity instruments at FVOCI – Project update Issues Paper

Objective

1 To update the EFRAG FR TEG on the latest IASB and EFRAG discussions on equity instruments measured at fair value thought other comprehensive income (FVOCI) in the context of the Post-implementation Review (PIR) of IFRS 9 *Financial Instruments* and to obtain EFRAG FR TEG views on the latest IASB staff recommendations and IASB tentative decisions.

Background of the project

2 In October 2020, the IASB decided to begin the PIR of the IFRS 9 classification and measurement requirements. The Request for Information (RFI) on IFRS 9 was published on 30 September 2021 with comments to be provided by 14 January 2022.

3 In January 2022, EFRAG issued its comment letter in response to the IASB RFI. EFRAG drew attention to the fact that the IASB should expeditiously review the non-recycling treatment of equity instruments within IFRS 9 testing whether the Conceptual Framework would justify the recycling of FVOCI gains and losses on such instruments when realised. EFRAG also drew attention to its advice to the EC in January 2020 on alternative accounting treatments to measurement at fair value through profit or loss for equity and equity-type instruments held in long-term investment business models.

4 In its June 2022 meeting, the IASB had an initial discussion on feedback received on equity instruments and FVOCI presentation election and received the IASB staff preliminary views (reported on the AP 3A). The IASB staff provided the following considerations:

(a) Those who believe the FVOCI presentation election should be available for a wider scope of instruments tend to strongly favour recycling of amounts presented in OCI. For this reason, the reintroducing of recycling is a request for a new classification category for equity instruments;

(b) There is no evidence that the added complexity of a new classification category is justified as there are no significant deficiencies in the information provided to investors.

5 The IASB was not asked for any decisions, but IASB members were overall supportive to the IASB staff preliminary views and welcomed the feedback that in general the option to present FV changes on investments in equity instruments in OCI works as the IASB intended.

6 In October 2022, the IASB was asked to consider the IASB staff's recommendations not to change the requirements in IFRS 9 for equity instruments measured at FVOCI but to add a disclosure requirement on aggregated fair value and changes in fair value recognised in OCI for these instruments (AP 3A).

7 Ten of the 11 IASB members agreed with the IASB staff recommendation.

Description of the issue

8 EFRAG FRB discussed the topic at its meetings on 14 July 2022. In this meeting, EFRAG FRB members questioned the IASB Staff conclusion that the request to reintroduce the recycling implies the need of a new classification category and expressed concern about the need to clarify the scope of the OCI presentation election identified by the IASB Staff. In this context, EFRAG FRB asked the EFRAG Secretariat to proactively work on the development of a possible impairment model, as this could help to address a potential obstacle to the reintroduction of recycling.

9 EFRAG FIWG and IAWG discussed this topic in their meetings on 6 and 8 September 2022 respectively (a summary of discussions can be found in the Appendix 1 to this paper). The issue was also discussed by EFRAG FR TEG-CFSS during the meeting of 14 September 2022 (a summary of discussions is reported below).

10 During these meetings, the discussion focused more on why recycling should provide better information to users than on what a possible impairment model should look like. EFRAG FIWG, EFRAG IAWG and EFRAG FR TEG-CFSS members expressed mixed views on the necessity of reintroduction of recycling for equity instruments at FVOCI and different arguments were highlighted in respect to those indicated in the EFRAG comment letter to the RFI.

11 On one hand, it was unclear whether there was still appetite for reintroduction of recycling by banks and other companies. While on the other hand, it was general agreement that new arguments from insurance companies should be examined. Moreover, a focus on how reintroduction of recycling would improve the representation of an entity's performance could add relevant considerations to the discussion.

12 In the event of the reintroduction of an impairment model, no conceptual preferable model was identified, and preference was expressed for a rule-based impairment model to avoid lengthy discussions.

13 The EFRAG Secretariat had started developing a questionnaire in order to gather evidence from constituents on the prevalence of equity instruments measured at FVOCI, drivers for the use of FVOCI and possible positive effects from a reintroduction of recycling. It was originally planned to discuss the questionnaire at the EFRAG IAWG meeting on 4 October 2022 to get feedback.

14 In the meantime, the EFRAG Secretariat received information indicating that the IASB will most likely not pursue the discussion on the reintroduction of the recycling any further as no sufficient evidence has been provided in that direction. The AP 3A for the IASB October meeting confirms this conclusion (a summary of the IASB staff's recommendations is provided below).

15 Therefore, at its meeting on 4 October 2022, the EFRAG IAWG members discussed how to design examples to clarify the importance of recycling for insurance companies as the reintroduction of recycling is seen by the insurance companies as a major issue.

16 During a closed session of a EFRAG FR TEG meeting, the EFRAG IAWG Chair presented the results of the latest discussions of the EFRAG IAWG. Furthermore, the EFRAG IAWG Chair presented a briefing paper describing the list of the issues

raised by the EFRAG IAWG due to the absence of recycling for equity instruments measured at FVOCI.

17 The key point that emerged from the discussion was that EFRAG has done an extensive work to influence the IASB in reconsidering the reintroduction of the recycling in recent years. Nevertheless, the new IASB PIR criteria for adding items on the standard-setting agenda sets the bar very high and without sufficient evidence that the existing requirements do not work as intended, EFRAG cannot do much from a due process point of view. New evidence could be gathered after the transition by the insurance companies to IFRS 9 and IFRS 17.

18 EFRAG FRB received an update on this topic during a closed session. EFRAG FRB members acknowledged the fact that different sectors have a different propensity for the reintroduction of the recycling for equity instruments measured at FVOCI at this time and that most of concerns are related to a reintroduction of an impairment model. In addition, members agreed with EFRAG FR TEG's comment that EFRAG has done all possible work to influence the IASB on this topic at this stage. Therefore, EFRAG FRB members agreed to keep the topic on the EFRAG agenda and suggested the EFRAG Secretariat to continue monitoring the topic focusing on the transition to IFRS 9 and IFRS 17 by the insurance companies with the aim to obtain new evidence supporting or not supporting the reintroduction of recycling for the equity instruments measured at FVOCI.

Questions for EFRAG FR TEG

19 Does EFRAG FR TEG have any comments on the summary above?

IASB staff's recommendations – IASB October meeting

PIR criteria

20 The IASB staff applied the PIR criteria[1] to the feedback received during the RIF of IFRS 9 *Classification and Measurements* and the results of the academic literature review on the presentation election option for equity instruments measured at FVOCI.

Are there fundamental questions about the clarity and suitability of the core objectives and principles of the requirements?

21 The IASB staff concluded that there is no evidence of fatal flaws since:

(a) stakeholders have strong different views about the role and the importance of the OCI. This longstanding accounting debate is not specific or limited only to IFRS 9 and any revision of the current principles across all IFRS Accounting Standards would extend beyond the scope of the IFRS 9 PIR; and

(b) for the moment there is no evidence that the requirements in IFRS 9 had a negative effect on entities' long-term investments practices or that any unexpected effects were identified. In addition, as many insurers have postponed the application of IFRS 9, there is no evidence yet on how the requirements might impact insurers' investment decisions.

22 The IASB staff reiterated that the reintroduction of recycling would be equivalent to adding a new classification category to IFRS 9 because:

(a) the default classification category in IFRS 9 for financial instruments is FVTPL;

[1] The criteria for determining whether to take action are set out in paragraphs 12 to 15 of AP 8A for the September 2022 IASB meeting.

(b) only if the financial instrument is SPPI it can be measured at amortised cost or FVOCI (in this case mandatory and not on a voluntary basis as for the OCI presentation option); and

(c) the business model for financial assets is based on how an entity expects to release cash flows.

23 In addition, the reintroduction of the recycling for equity instruments measured at FVOCI would require:

(a) defining the business model within which equity investments need to be managed as a condition for such a classification category;

(b) identifying the amounts to be recognised in PL (the distinction between realised and unrealised gains or losses does not exist in the IFRS Accounting Standards); and

(c) development of a new impairment model that resolves the complexities and challenges previously identified with the application of the IAS 39 impairment model (e.g., diversity in practice and losses recognised too late in the PL).

24 Identifying widely accepted requirements for these tasks would be difficult and complex.

25 Furthermore, the IASB staff noted that the current accounting requirements do not create an unfair disadvantage for equity instruments since debt instruments that are not SPPI are measured at FVTPL even if they are managed under a “hold to collect and sell” business model.

Are the benefits to users of financial statements of the information arising from applying the new requirements significantly lower than expected?

26 Feedback from the RFI indicated that the implementation of IFRS 9 was associated with a decrease in the value relevance of earnings and increase in the value relevance of the OCI[2]. Therefore, the IASB staff noted that there is no evidence to indicate that the use of the OCI presentation election has led to a reduction in the usefulness of information provided to the users of the financial statements.

27 Nevertheless, the IASB staff acknowledge that the current disclosure requirements in paragraph 11A[3] of IFRS 7 *Financial Instruments: Disclosures* may not lead to exhaustive information to the users of financial statements. Therefore, the IASB staff recommended adding requirements for disclosure of changes in fair value during the period to improve transparency. In addition, the IASB staff recommended amending paragraph 11A(c) of IFRS 7 to allow an aggregated disclosure of the fair value of equity instruments held at the end of the reporting period.

28 On equity-like investments, the IASB staff believed that the nature of these instruments is fundamentally different from equity instruments since equity-like investments do not provide the holder with a residual interest in the net assets of the investee and do not meet the definition of an equity instrument in IAS 32. For this reason, the IASB staff recommended not extending the OCI presentation election to equity-like investments.

[2] See paragraph 14(c) of AP 3B for the June 2022 IASB meeting.

[3] Paragraph 11A of IFRS 7 states: “*If an entity has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.7.5 of IFRS 9, it shall disclose:*

a) which investments in equity instruments have been designated to be measured at fair value through other comprehensive income.

b) the reasons for using this presentation alternative.

c) the fair value of each such investment at the end of the reporting period.

d) dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period.

e) *any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers*”.

29 Finally, about the request of reintroduction of the IAS 39 cost exemption for investments in unquoted equity instruments, the IASB staff noted that paragraph B5.2.3 of IFRS 9 already recognises that in some limited circumstances, cost may be an appropriate estimate of fair value for these instruments. In addition, paragraph B5.2.4 of IFRS 9 provides a non-exhaustive list of indicators where cost might not be representative of fair value and paragraph B5.2.5 states that an entity shall use all information available after the date of initial recognition in determining the fair value. Thus, the IASB staff were not in favour of reintroducing the cost exemption for unquoted equity instruments.

Are the costs of consistently applying, auditing and enforcing the application of the requirements significantly higher than expected?

30 Based on the responses to the RFI and academic literature review to date, the IASB staff concluded that there is no evidence of costs of consistently applying, auditing and enforcing the application of the requirements being significantly higher than expected.

IASB staff's recommendations

31 Based on the analysis of feedback against the PIR framework, the IASB staff did not recommend any changes to the requirements in IFRS 9.

32 However, to increase the usefulness and transparency of information provided about the overall performance of equity investments for which the OCI presentation election was made, the IASB staff recommended amending paragraph 11A of IFRS 7 to require disclosure of:

(a) the aggregated fair value of equity investments for which the OCI presentation option is applied at the end of the reporting period; and

(b) changes in fair value recognised in other comprehensive income during the period.

33 The IASB staff proposed to include these amendments in the forthcoming Exposure Draft planned for the *Contractual Cash Flow Characteristics of Financial Assets (Amendments to IFRS 9)* project.

34 In addition, the IASB asked the IASB staff to explore whether an illustrative example such as a reconciliation from the opening balance to the closing balance in OCI could be provided in the proposed amendments.

IASB discussions

35 Ten of the 11 IASB members agreed with the IASB staff recommendation. In general, IASB members agreed that there is no evidence that the OCI presentation election is not working as intended by the IASB when it developed the Standard. IASB members were also supportive of the IASB staff suggestion to amend IFRS 7 to include additional disclosures requirements.

36 The IASB members noted that the concerns heard during the stakeholder discussions are generally outside the scope of the PIR process. In particular, the debate around the OCI presentation election highlighted that most stakeholders and users consider the OCI statement differently from the IASB's intention.

37 Regarding the additional disclosure requirements, some members suggested adding a question in relation to the level of granularity to be provided in the forthcoming Exposure Draft. Furthermore, some members suggested requesting a reconciliation table from opening to closing balance in OCI. As result of the discussion, the IASB staff will explore how to provide an illustrative example in this direction.

EFRAG discussions on IASB's October tentative decisions

EFRAG FIWG – 25 October 2022

38 EFRAG FIWG members noted that the IASB's October tentative decisions were in line with what was expected and welcomed the proposed additional disclosure requirements. Members also noted that the IASB agenda paper for the October meeting comprehensively analysed the feedback received on the use of the OCI presentation election and EFRAG worked and discussed extensively on this topic.

39 One member expressed concern about the IASB decision to add the additional disclosure requirements for equity instruments measured at FVOCI to the next Exposure Draft planned for the *Contractual Cash Flows Characteristics of Financial Assets (Amendments to IFRS 9)* project. The member highlighted the importance of having the proposed clarifications for SPPI requirements as soon as possible since the prevalence and the volume of the ESG linked instruments (especially for large corporate lending) are rapidly increasing. The comments that the IASB will receive on the additional topics could delay the final publication of the amendments to IFRS 9.

EFRAG IAWG – 3 November 2022

40 EFRAG IAWG discussed this topic at its meeting on 3 November 2022. The update from this discussion will be provided to EFRAG FR TEG orally.

Questions for EFRAG FR TEG

41 Does EFRAG FR TEG agree with the IASB staff's recommendation and IASB tentative decisions on equity instruments measured at FVOCI?

Next steps

42 The EFRAG Secretariat will continue to monitor the topic focusing on the transition to IFRS 9 and IFRS 17 by the insurance companies with the aim to obtain new evidence supporting or not supporting the reintroduction of recycling for the equity instruments measured at FVOCI.