BNP PARIBAS

Chief Financial Officer Paris, May 25, 2018

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Comments on EFRAG's EFRAG Discussion Paper (DP) Equity Instruments – Impairment and Recycling

We are pleased to provide BNP Paribas' comments on the EFRAG's Discussion Paper (DP) Equity Instruments – Impairment and Recycling.

BNP Paribas Group considers being a long term investor in equity instruments notably through the following activities:

- Insurance activities: indeed, the Group is involved in personal insurance in 36 countries, and through its activities, BNP Paribas Cardif holds financial assets including debt instruments but also equity instruments to hedge its commitments towards policyholders.

- Investments activities: the Group manages a portfolio of minority interests in listed and unlisted industrial and commercial investments with a view to supporting clients and extracting value over the medium and long term.
  The Group also provides indirect financing support for the economy through private equity funds.

We welcome the EC request and EFRAG works on the issue of long term investments and would encourage the EC and EFRAG to pursue their work to make sure the treatment of equity instruments is reconsidered before IFRS 17 application date, without waiting for IFRS 9 Post Implementation Review which will not take place before three years.

Financial performance and business models

We are convinced that **the business model should be considered** to determine appropriate classification and measurement principles of equity investments. Furthermore, we think that comparability should not be the main objective pursued to the detriment of relevance and faithful representation which are the main fundamental characteristics of financial information as defined in the revised conceptual framework.

We consider that the most appropriate measurement to faithfully reflect the performance when the business model is to hold the investments for a long period would be the cost measurement, with impairment when the intrinsic value (value in use as defined in IAS36[1]) is lower than cost. The uncertainty inherent to the long term investment business model further justifies prudence and the use of cost that prohibits the recognition of unrealised gains while taking into account potential losses through impairment.

As already highlighted in our comment letter to the first EFRAG consultation on this matter in 2017 (consultation to collect quantitative date on the current holdings of equity instruments), the purpose of investment activities is to hold positions in order to create value in medium and long term, and realised gains and losses is a key indicator of the performance of these activities. Thus, the global performance is assessed not only on dividends received but also on gains or losses realised on sales.

The IFRS 9 category "Fair value through OCI for equities" therefore not faithfully reflects the business model and thus the performance of these activities.

Furthermore, the "Fair value though P&L" category introduces undue volatility and fails to reflect the long term investments business model as unrealised gains and losses cannot be considered as similar to realised gains and losses. Indeed, fair value, does not reflect necessarily only the intrinsic value of an equity instruments as it can be affected by other "short term information/phenomenon".

Thus, we consider that the **reintroduction of recycling** of the changes in Fair value of equities previously recorded in OCI according to IFRS9**, is necessary to appropriately depict the performance of instruments held in a business model which is not a trading business model.** This is all the more important as most stakeholders are more familiar with performance representation through Profit &Loss.

Recycling and Impairment models

We agree with EFRAG that enhancing d**isclosures under the current IFRS 9 model would not address the issue of the appropriate representation of long term investments in the P&L**.

We support the view that from a conceptual standpoint, **recycling should be accompanied by an appropriate impairment model**. An "Impairment and recycling model" for equity investments is consistent with the conceptual framework which states that "*The statement of profit or loss is the primary source of information about an entity's financial performance for the reporting period*". It would also be consistent with the evaluation principles of debt instruments hold in a Hold To Collect business model.

We **do not support the re-evaluation model proposed due to the volatility it will induce,** which would question the relevance of the representation of the performance of those investments not held for trading. Such an approach could be further considered only if the unit of account was defined at a portfolio level aligned with the business model (for example all equity instruments held in the general fund of an insurance company).

We would favour an impairment model which would apply to all investments in equity instruments (directly or indirectly through funds) not held in a trading business model (namely including strategic investments which are today recognised at FVOCI), **similar to that of IAS 39** and with **specific guidance on "significant" and "prolonged" criteria** to make the model more robust and address the criticisms made to the IAS 39 one.

[1] Impairment of assets

We think an impairment should be recognised when there is a prolonged decline in fair value with no expectation of recovery in the future according to the time horizon of holding of the investment and that the model should not be "polluted" by short term mark to market variations which are not representative of the "intrinsic value" of the equity instrument. A way to reduce subjectivity on the impairment model could be to introduce a backstop in the standard (e.g. two consecutive years of decline) which would trigger impairment, whatever the detention horizon is.

Alternatively, the concept of "value in use" (as already applied and defined in IAS 36) could be used to identify an impairment trigger.

Finally, we support a model which would **allow a reversal of impairment in profit and Loss** following recoveries in fair value (on a symmetrical approach as for recognising impairment, e.g. using both symmetric thresholds "significant" and "prolonged)

Should you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely,

Lars Machenil