Equity Instruments - Research on Measurement

Response ID:48 Data

3. General information about the respondent

1. Name of the individual/ organisation

Jed Wrigley

2. Country of operation

Italy

3. Job title

Senior Investment Officer

4. E-mail address

jed.wrigley@fil.com

5. Are you currently engaging in a long-term investment business model?

Yes

6. How do you define long-term investment business model?

We do not attempt to define it. We invest to deliver sustainable returns to multiple generations of our shareholders. Some investments in equities where we cannot equity account are held for over 20 years. We therefore invest for the long term and never invest with a view to holding a security for less than 3 years.

7. Are you currently engaging in investment of sustainable activities?

Yes

8. How do you define sustainable activities?

Any long term investor needs to invest in sustainable activities. Investments include innovative therapies for human disease, low cost medicines for developing countries, wind farms, bee-friendly pesticides and electric vehicles. All can be deemed sustainable. In all cases we need to deliver an appropriate return for the risk taken - because something is sustainable does not mean we can or would invest in uneconomic projects.

4. Question 1

9. IFRS 9 allows an entity to account equity instruments either at FVPL or, if applicable, at fair value through other comprehensive income (FVOCI) without impairment and without reclassification ("recycling") to P&L upon disposal of valuation gains or losses previously recognized through OCI ("IFRS 9 requirements" for equity instruments).
When defining an accounting treatment alternative to IFRS 9 requirements for equity instruments held in a long-term investment business model, which characteristics would you require to identify a *long-term investment business model*?

The characteristics/ business model of the investor
Other

If you have indicated "Other" please provide details

Long term equity investments where a hold might be sold or where the asset has a finite life are best monitored and accounted for using FVPL. FVOCI can materially misrepresent the economics of a long term investment in equities. Therefore IFRS 9 has appropriate options - but the investor / preparer needs to be careful when they use FVOCI as this is rarely appropriate based on the characteristics of that business model.

5. Question 2

10. In your view, is an alternative accounting treatment to IFRS 9 requirements needed to properly portray the performance and risks of equity instruments held in a long-term investment business model?

No

6. Question 3

11. Explain the reasons for your reply to question 2, including the key operational challenges in developing a different accounting treatment to IFRS 9 requirements

FVPL is somewhat costly for the investor as fair value measurement is complex and explanations are needed. However all investors have to monitor fair value if they are to provide appropriate governance over the assets they manage. The data should therefore be available.

7. Question 4

12. With reference to equity instruments held in a long-term investment business model, if you support measurement at FV through other comprehensive income with reclassification to P&L upon disposal of the valuation gains or losses previously recognized through OIC (so called "recycling"), which impairment model would you suggest and how it would work in practice?

I do not support FVOCI with recycling. In my view FVOCI should only be used when the preparer never intends to sell the investment and where the gains and losses in fair value are never deemed relevant to monitor performance. If the investment is sold subsequently it follows that the "one off" gain or loss is not relevant for an investor monitoring the P&L for performance. It also follows that finite life assets would not qualify for FVOCI given the losses in fair value as the end of life approaches will be relevant to monitor performance.

8. Question 5

13. Should the different accounting treatment be restricted to equity instruments held in a long-term investment business model?

For more detail, please refer to paragraphs 4.3 to 4.29 of the Background paper.

Yes

14. Please explain your answer

I do not think new options at necessary - and if they are then I believe use should be limited to a very narrowly defined type of investments.

9. Question 6

15. As per IFRS 9, equity-type of instruments, such as units of investment funds, do not meet the definition of equity instrument of IAS 32 Financial Instruments: Presentation, therefore are not eligible for the option to mesure them at fair value through comprehensive income ("FVOCI"). At the same time, they are not eligible for measurement at amortised cost (as they have contractual cash flows that are not Solely Payments of Principal and Interest, "SPPI" instruments). As such,

IFRS 9 requires to account for them at FVPL; no FVOCI option is granted ("IFRS 9 requirements for equity-type instruments").

Should the different accounting treatment referred to in the previous questions be extended to instruments that are "equity-type"?

For more detail please refer to paragraph 4.30 to 4.39 of the Background paper.

No

16. Please explain your answer

FVPL is the best way to describe performance of these investments as they would not meet my preferred criteria for a FVOCI election (recognising IFRS 9 is not as restrictive).

10. Question 7

17. If so, which characteristics would you require to define the "equity-type" instruments?

The nature of the assets invested in

18. If you have indicated "Other" please provide details

11. Question 8

19. With reference to equity and equity-type instruments held in a long term investment business model, please rate how relevant a different accounting treatment is to the objective of reducing or preventing detrimental effects on investment in sustainable activities in Europe.

12. Question 9

20. Are there other characteristics that would justify an accounting treatment different than IFRS 9 requirements for equity instruments and equity-type instruments held in a long-term investment business model? Please provide examples.

Equity investments in finite life assets are problematic if they use FVOCI whilst IFRS 9 does not restrict this option. In such situations then FVPL should be mandatory.

14. Illustrative example A - Wind farm with predetermined useful life

21. For scenario A - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

No

If yes, please explain why.

22. Which element in the scenario is more relevant for your reply?

1. The investor's inability to dispose of the shares
2. The definite useful life of the investee's operation

23. Which accounting treatments do you support?

Other

In case you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have selected "Other", please illustrate the accounting treatment you would support and why.

FVPL is the best accounting - recognising the reporting will need to include communication about the reasons for the fair value movements - changes in discount rate and power price assumptions are equally relevant to a user of the accounts and should have similar focus in the P&L. This is met by existing requirements but FVOCI is also possible in IFRS 9. FVOCI would materially misrepresent the above fact patter - B presumably distributes almost all FCF as dividends if it is a single asset business - using FVOCI the dividends pass through P&L but the FV movement goes to OCI despite the losses being a true economic cost in a period as the asset approaches the end of life.

15. Illustrative example B - Unlisted single equity instrument

24. For scenario B - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

No

If yes, please explain why.

25. Which element in the scenario is more relevant for your reply?

1. The fact that the shares are unlisted
2. The fact that the investor does not have a put option
3. The sustainable nature of the investee's operation

26. Which accounting treatments do you support?

Other

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

FVPL is the right option here and so existing requirements are appropriate. The FVOCI election is not appropriate as there is an intent to sell and each year performance in FV will be a function of business execution and observable market conditions (multiples, cost of capital etc.). All should flow through P&L and be explained.

16. Illustrative Example C - Open portfolio of equity instruments held with a view to service a long-term insurance liability

27. For scenario C - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments,

as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

No

If yes, please explain why.

28. Which element in the scenario is more relevant for your reply?

1. The fact that the entity holds a portfolio of equity instruments
2. The fact that the shares are unlisted
3. The link to a long-term obligation (insurance contracts)

29. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

17. Illustrative Example D - Open portfolio of equity instruments held with a view to service a long-term liability

30. For scenario D - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

No

If yes, please explain why.

31. Which element in the scenario is more relevant for your reply?

1. The fact that the entity holds a portfolio of equity instruments
2. The fact that the shares are unlisted
3. The link to a long-term obligation

32. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

18. Illustrative example E - Long-term investment held indirectly through a unit fund - listed

33. For scenario E - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

No

If yes, please explain why.

34. Which element in the scenario is more relevant for your reply?

1. The investor's ability to redeem or sell
2. The listed feature of the fund
3. The investor's assessment of the long-term nature of its investment

35. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.

19. Illustrative example F - Long-term investment held indirectly through a unit fund – non listed

36. For scenario F - In your view, is a different accounting treatment needed in order to meet the following two objectives? (i) properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change; and (ii) preferably enhance investors' insight in the long-term performance of investments, as opposed to recognising point-in-time market-based value changes in reported profit or loss during the duration of the equity investment.

No

If yes, please explain why.

37. Which element in the scenario is more relevant for your reply?

1. The investor's ability to redeem or sell
2. The unlisted feature of the fund
3. The investor's assessment of the long-term nature of its investment

38. Which accounting treatments do you support?

Existing requirements are appropriate

If you would support an Accounting treatment other than the examples explored in the EFRAG Secretariat Background paper and/or you have indicated "other", please illustrate the accounting treatment you would support and why.