DUFF & PHELPS

European Financial Reporting Advisory Group
Fredré Ferreira (*fredre.ferreira@efrag.org*)
Isabel Batista (*isabel.batista@efrag.org*

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Reference: REQUEST FOR FEEDBACK – QUESTIONNAIRE

EQUITY INSTRUMENTS - RESEARCH ON MEASUREMENT

We are pleased to respond to the EFRAG's *Request for Feedback in connection with Equity Instruments—Research on Measurement Questionnaire*. Duff & Phelps is the premier global valuation and corporate finance advisor with expertise in valuations for financial reporting, transaction, dispute and tax purposes, complex asset valuation, dispute and legal management consulting, M&A, restructuring, and compliance and regulatory consulting. Our valuation advice is sought by hundreds of clients globally as we work with them in developing pragmatic solutions for applying fair value techniques.

In responding to EFRAG's Request for Feedback, we have responded to those questions where we have experience working with a large number of asset managers and ultimate investors. We are happy to discuss in more detail the basis for our views.

Sincerely,

David Larsen, CPA, ABV, CEIV
Managing Director
Portfolio Valuation

david.larsen@duffandphelps.com
T: +1 415 693 5330
F: +1 415 644 5618

Ryan McNelley
Managing Director

ryan.mcnelley@duffandphelps.com
T: +44 (0) 79 79 20 8438

OUR GENERAL OBSERVATIONS

We caution EFRAG and the European from assuming that a measurement basis other than Fair Value, as set forth in IFRS 13 and US GAAP ASC § 820, is the most informative measure of value due to the nature of the equity investment.

Ultimate Investors need Fair Value information for a multitude of reasons, including but not limited to:

- Fair Value is the basis investors use to report periodic (quarterly/yearly) performance to their investors, beneficiaries, boards, etc.
- Fair Value is the best basis to make “like-for-like” asset allocation decisions.
- Fair Value is an important data point in making interim investment decisions on a comparable basis.
- Fair Value is the most objective measure as a basis to evaluate interim performance and make incentive compensation decisions.
- Fair Value is the exit price at which orderly, arm’s-length transactions typically take place between knowledgeable market participants.
- Ultimate Investors need consistent, transparent information to exercise their fiduciary responsibilities. Fair Value provides such information on a comparable basis for monitoring interim performance. Alternative reporting bases such as cost do not allow comparability.
- Most investors are required by relevant GAAP to report their investments on a Fair Value basis.

Furthermore, Investors must exercise their fiduciary duty to their boards and constituencies. Often this means maximizing investment returns while at the same time taking into account factors supporting sustainability. To maximize sustainability impacts, they should be correlated with the fiduciary duty to maximize investment returns. Measuring investments at Fair Value as stipulated by IFRS 13 and ASC 820 allows the interests of investment return and sustainability progress to be objectively considered and provides the best basis to compare investments and evaluate sustainability impacts.

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QUESTIONNAIRE

General information about the respondent

1. Name of the individual/ organization

Ryan McNelley, Managing Director Duff & Phelps

David Larsen, Managing Director Duff & Phelps

Duff & Phelps' role in the financial statement preparation process is unique. As experienced, credentialed, company-engaged third-party valuation specialists, we support investment managers in enhancing internal control processes with respect to estimating fair value, and our fair value analyses serve as an input for consideration by management in preparing its financial statements.

Our comments are derived from decades of experience assisting investment managers around the globe with its fair value estimates both in the context of IFRS 13 and FASB ASC Topic 820, Fair Value Measurements and Disclosures ("ASC 820"). In 2018 alone, we performed more than 12,000 engagements for 5,000 clients, including nearly half of the S&P 500, over 70% of top tier Private Equity firms, 64% of Fortune 100 companies and over 50% of the Euro STOXX 100. Our professionals are deeply involved in industry efforts to enhance valuation consistency and transparency, including participation on boards, such as the International Private Equity and Venture Capital Valuation Board, and the International Valuation Standards Council; on various task forces and working groups of the AICPA and The Appraisal Foundation; and in the Fair Value Quality Initiative.

We have substantial expertise valuing illiquid "long-term" investments held directly or indirectly by investment entities and investors in investment entities.

2. Country of operation: Global

3. Job title: Managing Director

4. E-mail address: ryan.mcnelley@duffandphelps.com, david.larsen@duffandphelps.com

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

(X) Yes. We provide wide ranging valuation and other services to Investment Entities with long term investment horizons.

( ) No

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

Those investing with a long-term investment view. “Long-term” can mean different things to different people. We define “long-term” to generally be greater than a year. Many long-term investors such as pension funds, sovereign wealth funds, etc. have extended investment horizons; often decades or longer.

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

( ) Yes

(X) No. We do not invest directly; however, we provide consultative support to investment entities, many of which have either already made such investments or are contemplating sustainable investing.

8. How do you define sustainable activities?

We define sustainable investing broadly as those investments that take into account factors related to environmental, social and governance matters.

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

[ ] The expected holding period

[ ] The actual holding period

[ ] The long-term nature of the liabilities that fund the assets

[X] Other

The question presupposes that an alternative to FVPL or FVOCI is preferable. We caution EFRAG and the EC from assuming that a different basis of accounting is preferable. Ultimate Investors need Fair Value information for a multitude of reasons, including but not limited to:

- Fair Value is the basis investors use to report periodic (quarterly/yearly) performance to their investors, beneficiaries, boards, etc.
- Fair Value is the best basis to make “like-for-like” asset allocation decisions.
- Fair Value is an important data point in making interim investment decisions on a comparable basis.
- Fair Value is the most objective measure as a basis to evaluate interim performance and make incentive compensation decisions.
- Fair Value is the exit price at which orderly, arm’s-length transactions typically take place between knowledgeable market participants.
- Ultimate Investors need consistent, transparent information to exercise their fiduciary responsibilities. Fair Value provides such information on a comparable basis for monitoring interim performance. Alternative reporting bases such as cost do not allow comparability.
- Most investors are required by relevant GAAP to report their investments on a Fair Value basis.

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?

( ) Yes

(X) No

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.

As noted in our response to question 1, ultimate investors need fair value information. If a modification or exemption in IFRS 9 removes the requirement to measure investments at fair value, transparency and usability of investment information would be adversely impacted. Whether changes in fair value are reported as part of profit and loss or through other comprehensive income is of far less importance.

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?

When investments are reported at fair value, an impairment model is not needed, since any impairment is embedded in the fair value estimate.

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

[X] No

14. Please explain your answer

All investments should be reported at fair value for the reasons stated earlier.

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 measure 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.

[ ] Yes

[X] No

16. Please explain your answer

As previously stated, investors need fair value information with respect to investments. The P&L positioning is of limited importance for long-term investors.

Question 7

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

[ ] Units of funds and other instruments that meet the 'puttable exception' in IAS 32

[ ] The nature of the assets invested in

[ ] Mutual funds

[X] Other.

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

The question seems to be leading to an answer. As previously stated, all investments should be measured and reported at fair value.

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.

Not relevant at all [X] [__] Most Relevant [100]

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.

No.

While we have not responded specifically to the questions regarding the 7 illustrative examples of long-term investments, we provide the following observation:

Investors must exercise their fiduciary duty to their boards and constituencies. Often this means maximizing investment returns while at the same time taking into account factors supporting sustainability. Measuring investments at Fair Value as stipulated by IFRS 13 provides the best basis to compare investments and to evaluate sustainability impacts.

For example, if an investor in the equity of a retail business seeks to reduce the carbon footprint of the business, they may seek to rationalize delivery schedules or delivery logistics such that less fuel is consumed delivering goods to various locations. The positive environmental impact also is a positive impact on the investment return by lowering fuel costs. The fair value of the investment increases due to the lower cost (all else being equal). Fair Value principles support and help measure congruent sustainability factors in this example.

Conversely, if the same retailer decided to reduce its carbon footprint by closing its stores on alternate days, the environmental impact may be positive, but the value of the business would decline as sales and profits would be expected to decrease. To maximize sustainability impacts, they should be correlated with the fiduciary duty to maximize investment returns. Measuring such investments at fair value allows the interests of investment return and sustainability progress to be objectively considered.