EFRAG
European Financial Reporting Advisory Group

REQUEST FOR FEEDBACK - QUESTIONNAIRE

EQUITY INSTRUMENTS - RESEARCH ON MEASUREMENT

Why is EFRAG consulting?

As part of its Action Plan on Sustainable Finance, the European Commission ("EC") announced it would ask EFRAG to explore potential alternative accounting treatments to ("FV") measurement for long- term investment portfolios of equity and equity-type instruments.

In June 2018, EFRAG received a request for advice from the EC in relation to the accounting requirements for investments in equity instruments.

The request for advice is part of the EC's initiatives to orient capital flows towards investment in sustainable activities.

The request for advice asks EFRAG to consider alternative accounting treatments to measurement at fair value through profit or loss (FVPL) for equity instruments.

According to the request for advice, such possible alternative accounting treatments should serve the following objectives:

- properly portray the performance and risks of long-term investment business models, in particular for those equity and equity-type investments that are much needed for achieving the UN Sustainable Development Goals and the goals of the Paris Agreement on Climate Change;
- 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.

The questionnaire

EFRAG has developed this questionnaire in order to gather views from constituents on alternative accounting treatments to IFRS 9 *Financial Instruments* requirements for equity and equity-type instruments held in a long-term investment business model. Such alternative treatments should serve the objectives mentioned above. Respondents are encouraged to read the EFRAG Secretariat background paper available here.

The EFRAG Secretariat background paper provides background information on the request for advice. It explains how the consultation relates to the EC's initiatives on sustainable growth, illustrates the accounting requirements in IFRS 9 and explores some possible alternative measurement approaches.

The possible alternatives in the background paper are to be considered as examples; respondents may suggest other measurement approaches that they consider appropriate.

Additionally, the background paper provides indications of how the concepts of 'long-term investment business model' and "equity-type instrument" may be considered in the context of the questionnaire.

In addition to submitting replies to the questionnaire, constituents can provide their input on the topic and ask questions about the survey by writing to: Fredré Ferreira (*fredre.ferreira@efrag.org*) or Isabel Batista (*isabel.batista@efrag.org*).

Respondents are encouraged to respond to all questions but are not required to do so. EFRAG will still consider their answers.

EFRAG will disclose the responses, unless a respondent asks for confidentiality.

Please complete this survey by 5 July 2019

General information about the respondent

1. Name of the individual/ organisation*

FSR – Danish Auditors. Responses prepared by its technical accounting arm, Danish Accounting Standards Committee and reflecting discussions with some stakeholders of the financial industry in Denmark which we understand is not asking for amendments to IFRS 9.

2. Country of operation

Denmark

3. Job title

4. E-mail address*

osj@fsr.dk and janlarsen@deloitte.dk

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

( ) Yes

(x) No

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

A long-term investment business model is a model in which an entity keep its investment for a longer time (and not less than one year) for instance to fund a long-term obligation.

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

( ) Yes

(x) No

8. How do you define sustainable activities?

Taking into consideration how the activities, an entity engage in, impact

it's surroundings on a broad scale, being cognizant that profit is not the only purpose

of it's investment.

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*?

[x]The characteristics/ business model of the investor

[ ] The expected holding period

[ ] The actual holding period

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

[x] Other

If you have indicated "Other" please provide details

The entity's past practice of buying/selling.

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.

DASC do not see reasons for an alternative accounting treatment compared to what IFRS 9 currently offers. This view is understood to be shared by the financial industry in Denmark. Our suggestion for relieving concerns would be to strengthen and improve narrative reporting and notes in relation to long-term investments.

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?

While we may have some sympathy for measurement at FV through other comprehensive income with reclassification to P&L upon disposal of the valuation gains or losses previously recognized through OIC we do not see how the issue of impairment be solved in such a model. We therefore support developing better narrative reporting and notes in relation to long-term investments to relieve concerns arising from the measurement options in IFRS 9.

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

[ ] No

14. Please explain your answer

No answer to #13. As mentioned, we do not support a different accounting treatment for equity instruments held in a long-term investment business model.

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

One of the objectives of IFRS 9 was to reduce complexity compared to IAS 39. Creating a new class of instruments that are "equity-type" will increase rather than reduce complexity. Therefore, DASC is not in favor of creating a new class, which will also run into the issue of how to define instruments that are "equity-type". As mentioned, we rather prefer this addressed by developing better narrative reporting and notes in relation to long-term investments to relieve concerns arising from the measurement options in IFRS 9.

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

We do not support creating a new definition as mentioned in Q6.

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 [0]________________________[5-10]______________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.

We currently do not have any examples.

The following pages include 7 illustrative examples of long term investment. For each scenario, you are invited to answer the questions on the page which follows.

Please consider that for Scenario A, B, C and D IFRS 9 requires to either measure the investment at FVTPL or to elect the option for measurement at FV through other comprehensive income, without reclassification to P&L, upon disposal, of the valuation gains or losses previously recognized through OCI, and without impairment.

Illustrative example A - Wind farm with predetermined useful life

Scenario A - Wind farm with predetermined useful life

- Entity A holds a 10% non-controlling equity instrument in Entity B. Entity B does not qualify as an associate and, as a consequence, does not qualify for equity accounting.
- Entity B has been set up to build and operate a wind farm as part of a long-term renewable energy programme. At the end of the economic life of the wind farm (10 years) no residual value is expected, and Entity B could either seek additional financing to build a new asset or be put into liquidation.
- Entity A initially expects Entity B to generate a stable annual profit and distribute it to shareholders. Furthermore, given the business purpose of the equity instrument, the terms and conditions of investing in Entity B prohibit investors

from selling their equity investment during the 10-year period. Entity A is therefore required to hold its investment in Entity B for the full economic 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.

( ) Yes

(x) No

If yes, please explain why.

We prefer developing better narrative reporting and notes in relation to long-term investments to relieve concerns arising from the measurement options in IFRS 9 explaining the set up and the entity's objectives in a way that will help users understand the impact of investment on the numbers.

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

________The sustainable nature of the investee's operation

________The definite useful life of the investee's operation

X_______The investor's inability to dispose of the shares

23. Which accounting treatments do you support?

( ) Historical cost

( ) Average fair value

( ) Adjusted cost

( ) Adjusted fair value

( ) Allocation-based approaches

(x)Existing requirements are appropriate

( ) 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.

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Illustrative example B - Unlisted single equity instrument

Scenario B - Unlisted single equity instrument

- Entity A buys a 10% equity instrument in Entity B from Entity C for CU 1000. Entity B is an unlisted start-up company manufacturing electronic scooters to be used in the e-scooter sharing industry. Entity B does not qualify as an associate and, as a consequence, does not qualify for equity Accounting.
- Entity A intends to hold the equity instrument in Entity B for the purpose of creating value in the long term by generating a capital gain after a period of time during which Entity B is likely to have gone through a significant transformation.
- Entity A does not have a put option and there are no observable recurring transactions in the equity of Entity B. Due to these conditions, Entity A does not expect to dispose of its interest in Entity B in the near future.

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.

( ) Yes

(x) No

If yes, please explain why.

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

________The fact that the shares are unlisted

________The fact that the investor does not have a put option

_x_______The sustainable nature of the investee's operation

26. Which accounting treatments do you support?

( ) Historical cost

( ) Average fair value

( ) Adjusted cost

( ) Adjusted fair value

( ) Allocation-based approaches

(x)Existing requirements are appropriate

( ) 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.

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

Scenario C

- Entity A holds a portfolio of various financial instruments, including equity instruments that do not qualify as subsidiaries nor as associates, therefore do not quality for consolidation nor for equity accounting. The objective of entity A is to use the proceeds from the portfolio to serve the cash flows from a long-term obligation of issued insurance contracts.
- Entity A sets up a dedicated "asset base" to serve the long-term obligation which is expected to be settled over the next 30 years. The portfolio includes a significant portion of shares in unlisted corporates, although there is no legal constraint on the composition of the portfolio.
- Entity A regularly monitors the value changes in the portfolio and may occasionally sell part of it and reinvest the proceeds, with a view to achieve its target returns.

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.

( ) Yes

(x) No

If yes, please explain why.

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

________The link to a long-term obligation (insurance contracts)

x________The fact that the entity holds a portfolio of equity instruments

________The fact that the shares are unlisted

29. Which accounting treatments do you support?

( ) Historical cost

( ) Average fair value

( ) Adjusted cost

( ) Adjusted fair value

( ) Allocation-based approaches

(x)Existing requirements are appropriate

( ) 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.

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

Scenario D

- Same fact pattern as Scenario C but the liability is an obligation or financial liability other than insurance contracts, for example a decommissioning liability per IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

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.

( ) Yes

(x) No

If yes, please explain why.

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

________The link to a long-term obligation

_x_______The fact that the entity holds a portfolio of equity instruments

________The fact that the shares are unlisted

32. Which accounting treatments do you support?

( ) Historical cost

( ) Average fair value

( ) Adjusted cost

( ) Adjusted fair value

( ) Allocation-based approaches

(x)Existing requirements are appropriate

( ) 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.

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

Scenario E

- Entity A acquires units in Exchange Traded Funds (ETF) as part of a larger investment portfolio.
- Each ETF invests in a diversified portfolio of financial and non-financial assets. Entity A does not have control over the investment decisions of the funds, which are managed independently.
- Entity A's past practice indicates that, on average, it will hold these units for approximately six months although the holding period varies considerably from one investment to another. When the units are redeemed or sold, Entity A expects to acquire another investment or investments.
- In its management report and other public statements, Entity A presents itself as a long-term investor whose strategy is to allocate assets so as to generate an economic return over time.
- Under IFRS 9, Entity A will be required to classify the investment as FVPL. Refer to Equity-type instruments in Chapter 4 of the Secretariat background paper for more information.

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.

( ) Yes

(x) No

If yes, please explain why.

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

_________The investor's assessment of the long-term nature of its investment

_________The listed feature of the fund

x_______The investor's ability to redeem or sell

35. Which accounting treatments do you support?

( ) Historical cost

( ) Average fair value

( ) Adjusted cost

( ) Adjusted fair value

( ) Allocation-based approaches

(x)Existing requirements are appropriate

( ) 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.

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

Same fact pattern as Scenario E above, except that the fund is unlisted.

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.

( ) Yes

(x) No

If yes, please explain why.

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

________The investor's assessment of the long-term nature of its investment

________The unlisted feature of the fund

x_______The investor's ability to redeem or sell

38. Which accounting treatments do you support?

( ) Historical cost

( ) Average fair value

( ) Adjusted cost

( ) Adjusted fair value

( ) Allocation-based approaches

(x)Existing requirements are appropriate

( ) 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.

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Thank You!

Thank you for taking our survey. Your response is very important to us.
