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*

Amundi SA

2. Country of operation

France

3. Job title

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4. E-mail address*

Frederic.bompaire@amundi.com

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

(x) Yes

( ) No

Acting as an asset manager, Amundi engages in different types of strategies and investment models to satisfy its numerous clients. Some are typically LTI strategies.

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

Several definitions exist. Our perception is that long term investment business model results from a series of converging elements among which the most important ones are:

- The identification of a dedicated portfolio expressing the intention to segregate assets run according to a LT model
- The documentation of the investment model of this portfolio with explicit constraints and engagements on the long term
- The existence of liabilities that are long term and need to be properly managed on the asset side with the same long term view
- Alternatively, the existence of dedicated long term capital to finance the long term investment
- The absence of trading and short term arbitrage strategies, though it does not imply that a long term investment cannot be disposed of.

We share the definition in the La Martinière report, stating in French that « *l'investissement de long terme est la stratégie de placement financier déployée par un opérateur quel qu'il soit, disposant de ressources stables qui, à la fois, autorisent et nécessitent une allocation d'actifs susceptible de produire un retour économique dans le temps.* »

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

(x) Yes

( ) No

8. How do you define sustainable activities?

Sustainability aims at preserving our planet and society so that future generations may enjoy and find happiness in their lives. There is an obvious relationship between long term investment and sustainability as there is with responsible investment as defined in the UNO PRI initiative.

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

If you have indicated "Other" please provide details

We want to further comment on our total support with EFRAG’s remark that accounting norm should not come as an obstacle for the development of long term investment (LTI) and we add that it should not either create a discrimination according to the way the same investment is made, directly or indirectly via a fund.
Please, see our comments under the preceding point 6 in the general information part above to better understand the factors we suggest to use to determine LTI. We believe that there is on the one hand a negative definition that would exclude all trading and short term arbitrage strategies. On the other hand, we think that all kinds of investors may start and run a LTI identified in a segregated account and based on the **intention and the financial capability** to serve a better return on the long term.

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?

(x) Yes

( ) No

Undoubtedly accounting treatment in IFRS 9 is not satisfactory.

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.

IFRS 9 creates a negative bias that will prevent investors who have a long term view to develop LTI. The main 3 short comings of IFRS 9 are:

- To introduce artificial volatility in the current yearly profit and loss account;
- Not to allow for recycling and thus making absolutely no difference between potential and effective result;
- To discriminate funds as opposed to direct holding in shares when accounting methodology should be neutral.

As a consequence, accounts are difficult to read, confusing for investors and eventually misleading for the public. We see a very counterproductive impact that the short termism of yearly accounts may have if profits or losses are no longer significant or representative of the activity because they are largely and often excessively masked by financial results not linked to the business of the company.

We recommend that equity LTI benefit from the option to choose either FV/PL or FV/OCI with recycling. And we would recommend companies to opt for the second, except for trading activities where FV/PL is totally justified. The real risk that we do not deny with this accounting option is to avoid mirroring effective depreciation of the assets. Therefore, we want to introduce a strict impairment procedure in IFRS 9.
The next issue is to address the case of equity funds. We see no reason why the same investment made through a fund for practical, notably administrative and risk control, reasons or via a mandate given to the same asset manager. This can be addressed in opening the option to those funds that are not orientated towards short term and arbitrage strategies.

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?

Under IAS 39 the impairment model was not satisfactory. The most important correction to introduce is to allow for reversibility, meaning that de-recognition should not be final and that if conditions return to their initial level accounting should reflect it. We suggest the following accounting of impairment: in OCI as long as the change in FV keeps the price above the historical cost and in P/L if the value goes below it. And the reverse booking should be possible as soon as an opposite move happens.

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

We do not believe that LTI should be considered as the unique business model able to benefit from this accounting treatment (option to select FV/OCI with recycling). We believe it is well suited to all equity investments except for trading activities. Defining trading is an exercise where a global consensus is more easily reached than when defining LTI.

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.

[x] Yes
[ ] No

16. Please explain your answer.

Amundi strongly supports an homogenous accounting treatment of equity portfolios, be they direct or indirect investments through a fund. We cannot see accounting methodologies diverging for the same economic exposure. It would tend to distort decisions by investors based on external criteria and eventually reduce the efficiency of investment management. Investors tend to use funds because it provides them with positive services such as:

- A simplification of the administrative burden at their level,
- An access to a diversified portfolio through one single line,
- A regular (and frequently daily) valuation of their investment, immediately readable,
- The certainty to have constant risk management and monitoring of their assets,
- The recognised professional skills and expertise that asset managers have on different market segments,
- An extra layer of liquidity resulting from the potential compensation between subscriptions and redemptions and, in the case of ETFs, due to the activity of market makers quoting the fund,
- An opportunity to ring-fence a dedicated portfolio with a view to cover some specific liabilities…

The conceptual approach of funds as non-equity instruments lacks strong economic basis in our opinion and lies on a fragile analysis. The fund manager commits to pay redemptions when they come according to the rules of the funds, but the comparison with the contractual repayment of

a bond at maturity is not convincing. The investor does not know at which price its redemptions will be paid. He does not know whether the asset manager will decide to trigger a gating mechanism in case of excessive redemptions. The asset manager may even suspend redemption. These features are far more comparable to the existing liquidity for equities where the supply and demand may move the price and sometimes trigger circuit breakers.
We do insist that funds investing in equity be considered as equity or equity –type products. In our opinion this should apply for all funds which have a position in equity or equity like instruments. However, we agree that there is rationality in considering the investment universe and the investment strategy of the fund. It is a representation of its business model.

Question 7

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

[x] Units of funds and other instruments that meet the 'puttable exception' in IAS 32
[ ] The nature of the assets invested in
[ ] Mutual funds
[ ] Other

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

If we put aside our reservations (see above) about the IAS 32 so called 'puttable exception' that applies to funds, how can we identify funds qualifying as equity type instruments? The overarching principle is to have the same accounting treatment for direct and indirect holding of the same assets. Investors have the option to subscribe a fund or give a mandate to the asset manager they have chosen. The choice between these two possibilities should not be dependent on accounting rules.
A fund investing in equity and equity type instruments will keep liquidity (short-term bonds and notes, CPs, MMFs, reverse Repo or deposits…) to face redemptions and it will also manage risk and exposures to different segments of the market. This risk management may involve using derivatives in relationship with the authorised underlying investment universe. The advantage of a funds is to clearly disclose its investment strategy and the limits and constraints that will apply. Therefore, we think that the reference to the prospectus is the key to identify those funds that can or cannot benefit from the FV/OCI with recycling option.
A fund will qualify if its prospectus evidences that:

- Its main exposure and performance engine are equity and equity type investments
- There is a strict investment process with a clear definition of the use of derivatives as a way to manage risk without introducing leverage above a risk exposure of 100%; typically, ETFs that use derivatives for the replication of their index should be eligible exactly as those that use physical replication; the criterion is that derivatives should be conceived as means to adjust volatility and performance;
- It does not develop strategies or use instruments and techniques that would justify disqualification as explained below.

A fund will not qualify if it uses:

- Leverage defined as a net commitment that exceeds 100% of the NAV; this should not prevent a fund to lend or Repo securities for the benefit of the investors provided that use of proceeds is kept with non-risky short term assets;
- Strategies that are not consistent with a long term view; we can think of arbitrage (specially automated robot arbitrage through algos with a very short term horizon), long/ short or momentum based strategies…

- Non-equity instruments to a large extent; typically, as long as the major risk exposure and the main contributor to the expected performance is equity, the fund should qualify, even if at a given time its market exposure is largely reduced.

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] ______________________[_100_]________________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.

Amundi thinks that the suggested FV/OCI with recycling option (associated with an impairment procedure) should apply for all equity portfolios, including funds. It seems well calibrated to suit most long term investment business models. There are, however, 2 other issues that could be tackled with the introduction of a specific methodology.
First, the LTI model that relies on the adjustment to specific liabilities may benefit from a stronger linkage between assets and liabilities. Only major distortions should be considered in the impairment test. This means that some minimum duration of the misalignment and some quantitative threshold should be introduced typically for LTI related to decommissioning liabilities as well as life insurance businesses.
Second, many LTI business models are not limited to equity but include diversified investment classes in a common portfolio. The extension of the suggested accounting methodology to these diversified portfolios that include a reasonable percentage of equities should be considered to properly fit the reality of LTI. We think again of decommissioning portfolios, but also of life insurance companies or corporates investing in a pool of start-ups with a view to accompany them and help one or several to emerge as future leaders. This may imply support via capital but also a credit line or financing through bonds, notes or convertibles which should not be converted except if a trigger is reached.

X x X

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.

We did not analyse these examples in details and will limit our feedback to the following comments:

- We see that a FV/OCI with recycling and impairment would be more appropriate than the current IFRS 9 in all cases and probably the most appropriate solution in a majority of them;

- Examples C and D should not differ in their accounting treatment as they have the same business model of LTI servicing LT Liabilities;
- Examples E and F should not differ in their accounting treatment, since listing of the funds units does not change the nature of the investment nor the business model. Listing will provide for another external source when it comes to valuation.

X x X