Equity Instruments - Research on Measurement

1. 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.

2. 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:
Fredre 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

3. General information about the respondent

1. Name of the individual/ organisation

ENGIE

2. Country of operation

Worldwide, based in France

3. Job title

Director Accounting Principles

4. E-mail address

wathelet.lepour@engie.com

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

Yes

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

A business model where the entity invests in
• Physical assets (owned, leased or under concession),
that the entity intends to operate (as owner or lessee or concession holder) or to lease (as lessor) over a number of years (longer than one year and up to several decades), or
• Participations in
o Joint ventures (accounted for by the equity method), or
o Participations with a significant influence (accounted for by the equity method), or
o Participations without a significant influence (and hence not consolidated)
or loans to such entities,
and that the entity intends to hold during a number of years and that have a strategic interest for the entity.

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

Yes

8. How do you define sustainable activities?

Engie aims to create sustainable value for all its stakeholders, shareholders, clients and employees and engages in renewable energy, energy efficiency and related services, with the ambition to evolve towards zero carbon emission.

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
The expected holding period

If you have indicated "Other" please provide details

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?

Yes

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

One type of business model that would benefit from a different accounting treatment, is the funding of long term provisions, such as dismantling provisions, provisions for the treatment of nuclear waste, etc.
A provision for dismantling is set up at the moment the plant is commissioned, and evolves from then onwards in function of the effect of unwinding the discount, changes in discount rate and changes in the estimated future dismantling cash flows.
Under IFRS 9, if an entity invests in (quoted) shares in view of funding such provision, a choice has to be made between measurement
• at FV through P&L, which can generate significant short term P&L volatility whereas the investment horizon is long term,
• at FV through OCI, whereby any return (other than dividends) on such long term investments is never taken through P&L, which creates a significant gap in the representation of the entity's total result over the entire time horizon related to the funding of such long term provisions.
It would be useful to allow recycling of OCI upon sale of the equity instrument, once the gain or loss is final. This accounting treatment would allow to avoid short term P&L volatility, while still taking the final gain or loss through P&L and reflecting in P&L over time the full impact of the funding, no matter the type of investment used and the way it is monetized to externalize the returns (through dividends or sale)

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?

Ideas for an impairment model for equity instruments at FV/OCI with recycling :
Triggers (no impairment without trigger) :
o significant deterioration of the credit quality of the issuer
o for quoted stock : decrease of the stock price that is strong and permanent.

Impairment measurement :
o difference between historical investment price (adjusted for reimbursed capital, dividends, etc. if pertinent) and fair value (quoted stock price if available) : no impairment recognised before aggregated OCI amounts become negative

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.

No

14. Please explain your answer

We think that for all equity instruments, under the FV/OCI option, the 'FV/OCI with recycling' accounting treatment should replace the current 'FV/OCI without recycling' accounting treatment, and that it is not useful to restrict such accounting treatment to equity instruments held in a long-term investment business model.

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.

Yes

16. Please explain your answer

We think that the different accounting treatment, in casu 'FV/OCI with recycling', should be extended to 'equity-type' investments, such as units of investment funds. However, we think that such extension should only apply to investment funds that purely invest in equity instruments (consider the funds in function of the nature of their underlying).
We refer to the arguments developed under question 3 : for the funding of long term provisions, an entity will try to spread its risk, including by investing in different types of instruments. Some entities currently avoid the funding by investing in units of investment funds in order to avoid the short term P&L volatility that results from a straightforward FV/P&L measurement. This restrictive impact on the investment possibilities is seen as a significant handicap. It can be overcome by investing directly in such funds' underlyings rather than in funds themselves (example : investing in all stocks included in a tracker), but this generates huge administrative cost and workload without further added value.
We think that allowing a 'FV/OCI with recycling' for units of investment funds such as 'trackers' would be very welcome and would allow entities to choose the most adequate investment based on the different investment alternatives' merits rather than based on potentially inadequate accounting impacts.

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.

80

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.

No

13.

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.

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?

23. Which accounting treatments do you support?

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.

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?

26. Which accounting treatments do you support?

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.

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.

Yes

If yes, please explain why.

For the equity instruments that do not qualify as subsidiaries nor as associates, and that are included in the portfolio of entity A, the current accounting treatment is either FV/P&L or FV/OCI without recycling.
Investors' insight in the performance of such investments, especially in a context of a business model with long-term investments such as the funding of a long-term obligation of issued insurance contracts and alike, would be enhanced if recycling of OCI upon sale of the equity instrument would be allowed. This accounting treatment would make it possible to avoid short term P&L volatility, while still taking the final gain or loss through P&L and reflecting in P&L over time the full impact of the funding, no matter the type of investment used.

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

1. The link to a long-term obligation (insurance contracts)

29. 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.

We propose to allow entities to opt for a measurement at FV/OCI with recycling, for equity instruments and also for units of funds that purely invest in equity instruments.
This accounting treatment would allow to avoid short term P&L volatility, while still taking the final gain or loss through P&L and reflecting in P&L over time the full impact of the funding, no matter the type of investment used.

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.

Yes

If yes, please explain why.

In our view, for scenario D the same arguments are valid as for scenario C.

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

1. The link to a long-term obligation

32. 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.

In our view, for scenario D the same accounting treatment should be retained as for scenario C.

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.

Yes

If yes, please explain why.

For ETFs (or other comparable funds, regardless of whether they are listed or not), we think that distinction should be made between funds that purely invest in equity instruments and other funds (consider the funds in function of the nature of their underlying), and that the accounting treatment should be aligned on the accounting treatment that would have been applicable if the entity had directly invested in the underlying. For funds that purely invest in debt instruments, or funds that have a mixed portfolio with debt instruments as well as equity instruments, we would suggest to apply FV/PL. But for funds that purely invest in equity instruments, we suggest to consider them 'in substance' as equivalent to equity instruments and apply the same accounting treatment as for equity instruments.

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

1. The investor's assessment of the long-term nature of its investment

35. 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.

We propose to allow entities to opt for a measurement at FV/OCI with recycling, for units of funds that purely invest in equity instruments.
This accounting treatment would allow to avoid short term P&L volatility, while still taking the final gain or loss through P&L and reflecting in P&L over time the full impact of the funding, no matter the type of investment used.
It would allow entities to invest in such funds, rather than having to invest directly in the underlying equity instruments if they want to avoid P&L volatility as is the case today under IFRS 9.

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.

Yes

If yes, please explain why.

We don't think it is necessary to make a distinction between listed and unlisted funds, and therefore refer to our arguments of scenario E.

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

1. The investor's assessment of the long-term nature of its investment

38. 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.

We don't think it is necessary to make a distinction between listed and unlisted funds, and therefore refer to our proposal for scenario E.

20. Thank You!

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