

## **EFRAG Research project Equity Instruments – Impairment and Recycling**

### **Update and next steps**

#### **Objective of the paper**

- 1 This paper:
  - (a) seeks input from the EFRAG Board's on the finalisation of the reply to the first request for technical advice from the European Commission; and
  - (b) provides an update on the EFRAG Research project on Equity Instruments – Research on Measurement.

#### **Background**

- 2 In May 2017 EFRAG received a request for technical advice from the European Commission in relation to the accounting treatment of equity instruments carried at fair value through OCI under IFRS 9 *Financial Instruments* ('first request').
- 3 The original deadline to submit the EFRAG's advice was the end of the second quarter 2018. EFRAG has agreed with the EC a further extension of the deadline until the end of March 2019.
- 4 In June 2018 EFRAG received another request for technical advice from the EC ('second request'). The second request asks EFRAG to consider alternative measurement bases for equity and equity-type instruments especially in the context of a long-term investment model.
- 5 At its 5 July meeting, EFRAG TEG voted on the advice in response to the first request. EFRAG TEG (by a vote of 10 votes in favour, 5 against and one abstention) not to recommend an immediate reintroduction of recycling for equity instruments designated in accordance with IFRS 9's FVOCI election. EFRAG TEG's draft technical advice also noted (among other things) that EFRAG will carry on investigating the accounting for long-term equity and equity-type investments in responding to the second request and that further experience with IFRS 9 and the IASB's Post-implementation Review will provide further insights and evidence
- 6 Considering that mixed views were expressed both by EFRAG TEG members and respondents to the Discussion Paper, it was agreed that the draft technical advice from TEG would:
  - (a) reflect also the concerns and arguments of those recommending an immediate reintroduction of recycling; and
  - (b) address the questions in the first request concerning the relevance of an impairment solution for the reintroduction of recycling and what characteristics an acceptable impairment solution would have.
- 7 In relation to (b) above, EFRAG TEG at its 25 July meeting decided that it would not express a preference on the impairment solution. Therefore, the draft technical advice described two solutions presented in the EFRAG DP and the comments from respondents but did include an EFRAG TEG recommendation.
- 8 At its 21-22 August meeting, the EFRAG Board considered the draft technical advice but took no decisions as to its finalisation. The EFRAG Board asked the EFRAG Secretariat to meet with the Commission and:

- (a) Clarify the scope of the second request and
  - (b) Discuss the possibility to combine the two requests and provide a single reply.
- 9 In relation to the timing of EFRAG's response to the first request, the EC noted that they are committed to report back on their action plan on financing sustainable growth by March 2019. They also noted that there is a clear interaction between this piece of advice and EFRAG's ongoing analysis of the interrelation between IFRS 9 and IFRS 17. Therefore, the EC asked EFRAG to provide a separate reply to the first request for technical advice not later than March 2019.

## **Next steps**

### *Finalising EFRAG's response to the first request*

- 10 The extension granted by the EC will enable EFRAG to take into consideration any additional insights and evidence obtained from the ongoing endorsement assessment of IFRS 17 and the work in developing a response to the second request (see below).
- 11 The extension granted by the EC will however not allow EFRAG to collect data from the 2018 financial statements. While it would be possible to perform some analysis on the 2018 interim financial statements of European entities, EFRAG Secretariat doubts that this would prove significantly helpful to the EFRAG Board.
- 12 The EFRAG Secretariat suggests that there are two possible approaches to the finalisation of this advice, the selection of which depends in part of the EFRAG Board's orientation as to the overall advice:
- 13 The EFRAG Board may decide to finalise the overall technical advice either in accordance with EFRAG TEG's recommendation, or in another way, without amending the rest of the content. This would not require any further input from EFRAG TEG. The final advice would then:
- (i) Provide a recommendation against an immediate reintroduction of recycling (as per EFRAG TEG's advice) or provide a different recommendation to be determined;
  - (ii) Regardless of the overall recommendation on recycling, recommend that if recycling were to be required entities should also assess impairment;
  - (iii) Refer to the impairment solutions described in the EFRAG Discussion Paper without expressing a preference;
  - (iv) Recommend that the impairment solution should also allow for reversal of impairment losses;
  - (v) Not address whether the changes should apply to all investment in equity instruments or only to some sub-set.
- 14 Based on the preliminary discussion at the September EFRAG Board meeting, the EFRAG Secretariat has drafted a new version of the technical advice that follows the suggestion advanced by the EFRAG Board President.
- 15 Alternatively (and presumably only if the EFRAG Board decides to depart from EFRAG TEG's advice and recommend reintroduction of recycling), the EFRAG Board might decide to ask EFRAG TEG to provide more specific advice on an impairment solution. In that case, EFRAG TEG would be asked to:
- (i) Express a clear preference between an IAS 39-based approach and the revaluation approach described in the draft technical advice;

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- (ii) If applicable, provide more specific advice on the features of an IAS 39-based approach.
- 16 In this case, EFRAG TEG could also be asked to:
- (i) Deliberate a possible definition of a long-term investment, or a long-term investing business model, and consider whether the recommended solution should be limited to investments meeting that definition/held within that business model;
  - (ii) Consider some alternative impairment solution not previously included in the Discussion Paper (although EFRAG Secretariat questions the achievability of this).
- 17 EFRAG Secretariat notes that a discussion on the possible definition of a long-term investment will in all cases be part of the deliberations on the second request.

**Question for the EFRAG Board**

- 18 Do you support the alternative in paragraph 14 above? If so, do you have comments on the revised draft of the technical advice?
- 19 If you do not support the alternative in paragraph 14, which specific topics should EFRAG TEG be asked to reconsider?

*Update on the Research project Equity Instruments – Research on Measurement*

- 20 Since the last EFRAG Board meeting, the EFRAG Secretariat discussed the new Research topic with the following Working Groups:
- (a) On 25 September, the User Panel discussed a paper on long-term investing activities and possible ways to define them;
  - (b) On 27 September, EFRAG TEG discussed a paper about possible definitions of *long-term investment and long-term investor*;
  - (c) On 10 October, the Academic Panel was asked to provide input on data and literature that could be helpful for the project, as well as views on alternative measurement bases.
- 21 The User Panel and most of the TEG members who intervened during the discussion did not support that EFRAG tries to come up with its own definition of long-term investment as a basis to develop specific accounting requirements. Some claimed that more information is needed on the nature and type of investment that the European Commission wants EFRAG to investigate.
- 22 The EFRAG Secretariat plans to continue work as follows:
- (a) On 19 November, there will be a session with the Financial Instruments Working Group to ask for input on alternative measurement basis;
  - (b) At the November EFRAG TEG meeting, we will bring papers on:
    - (i) Initial ideas for alternative measurement basis, including a linked measurement approach when investment in equity instruments are economically linked to long-term liabilities; and
    - (ii) A summary of accounting requirements for equity instruments under national GAAP.
  - (c) At the December joint EFRAG Board- EFRAG TEG meeting there will be a session to discuss the status of the project and its timetable.