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Invitation to comment on EFRAG's Request for Feedback "Equity Instruments – Research on Measurement"

Dear Mr. Gauzès,

We appreciate the opportunity to comment on EFRAG's Request for Feedback "Equity Instruments – Research on Measurement". This comment letter summarizes the Allianz Group's position on alternative accounting treatments to the measurement at FVTPL of (long-term) equity instruments in accordance with IFRS 9.

We strongly support EFRAG's efforts to respond to the European Commission's request for technical advice on potential alternative accounting treatments to the measurement at FVTPL for long-term equity and equity-type instruments.

In general, we support fair value measurement of equity and equity-type instruments. Nevertheless, we believe that measuring all equity and equity-type instruments at FVTPL is not appropriate to adequately depict the financial performance of long-term investors such as insurance companies. In this regard, we fully support the FVOCI option for eligible equity instruments, but adhere to the view that OCI recycling should accompany this option. As outlined in detail in our comment letter to EFRAG's Discussion Paper "Equity Instruments – Impairment and Recycling", abolishing the current OCI recycling ban for equity instruments measured at FVOCI would considerably contribute to improving the depiction of the financial performance of long-term investors as well as support the attractiveness of equity instruments from the perspective of long-term investors such as insurance companies.

Besides the abovementioned FVOCI option with OCI recycling, we do not deem other measurement or accounting treatment alternatives – including those presented in the accompanying EFRAG Secretariat Background Paper – superior to the current IFRS 9 requirements. Though we acknowledge the benefits that may be associated with these alternatives, each of them is also subject to a set of more or less severe deficiencies. Further, consistency issues would arise, both with

regard to the accounting treatment of other financial asset classes in accordance with IFRS 9, but also with respect to the measurement approaches applied to other balance sheet positions. Taking these deficiencies and consistency considerations into account, we do not believe that a deviation from fair value measurement and the related accounting treatment would ultimately result in a superior depiction of the financial performance of long-term investors such as insurance companies.


Altogether, our concerns relate less to the measurement of equity and equity-type instruments, but rather to how gains and losses from equity and equity-type instruments held in the long-term are presented in the P&L statement.

As to a potential abolishment of the recycling ban regarding the current FVOCI option in accordance with IFRS 9, we would like to point out that we continue to strongly support a targeted IFRS 9 amendment as issued by the IASB. Notwithstanding this, as a global insurance and asset management group that offers its products and services in over 70 countries, it is of crucial importance to us to maintain worldwide, globally consistent and truly international financial reporting standards. Therefore, we explicitly do not support any solutions at the European level only.

The appendix to this letter sets out our view on the specific questions posed in the Questionnaire.

We hope our feedback is helpful for your further deliberations. Please feel free to contact us to discuss any matters raised in this letter.

Yours sincerely,



Dr. Roman Sauer
Head of Group Accounting and Reporting



Andreas Thiele
Head of Group Accounting Policy Department

General information about the respondent

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

Yes.

How do you define long-term investment business model?

While it is difficult to narrow down this term in a fully distinctive manner, generally, in our understanding, a long-term investment business model refers to a business model with a long-term investment strategy that is based on a long-term investment horizon and aims at generating inflows over several periods. This is true of the insurance business model, as it is long-term-oriented in nature and insurance companies aim to deliver on their forward-looking promises to policyholders and achieve high investment returns for their policyholders' retirement in future periods. Specifically, the long-term nature of insurance liabilities both enables, but also requires insurance companies to pursue a long-term investment strategy. As to investments in equity instruments, we benefit from the equity risk premium throughout a long-term holding strategy. Nonetheless, while we do generally not engage in short-term trading of equity instruments, our business model still foresees future sales of equity instruments in order to realize gains from long-term capital appreciation, which makes their adequate reflection in our financial statements highly relevant. The current IFRS 9 requirements do, however, create disincentives for long-term investors with respect to equity and equity-type instruments as they are not adequate in reflecting their respective investment performance.

Are you currently engaging in investment of sustainable activities?

Yes.

How do you define sustainable activities?

Since the European Commission's doubts do not relate exclusively to the requirements of IFRS 9, but in particular to the potential negative link between the current IFRS 9 requirements and sustainable investments, we understand that there may be a need to at least narrow down this term; however, with respect to financial reporting purposes, we do not consider such a definition necessary. Therefore, since there is no established definition of sustainable investments by the EU or the IASB to-date and since there currently is a Technical Expert Group working on a (final) classification system for sustainable activities, i.e. an EU taxonomy, we do not make such a distinction. Specifically, our subsequent answers and considerations regarding the questions outlined in this Questionnaire are based more on the above-mentioned considerations with respect to the long-term business model of insurance companies, rather than on a particular understanding of sustainable investments as our concerns with the requirements of IFRS 9 focus on its deficiencies in reflecting the business model of long-term investors such as insurance companies.

Question 1

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?

Other.

If you have indicated "Other" please provide details.

Generally, the categories "The characteristics/business model of the investor" and "The long-term nature of the liabilities that fund the assets" are, from our perspective, most informative to identify the underlying investment horizon of a business. Still, both the overall investment business model and the long-term nature of the matching liabilities are not reflected in each individual investment undertaken and, thus, not sufficient from our perspective to determine the accounting treatment of each individual investment. In terms of equity instruments, even though an entity may generally pursue a long-term investment strategy and/or have long-term liabilities, it might still hold equity instruments for trading purposes for which the classification at FVTPL is appropriate. Thus, we support IFRS 9 insofar as equity instruments held for trading purposes must also be measured at FVTPL. In the insurer case, where the objective of the business model is achieved by both collecting cash flows and selling financial assets (also in the understanding of IFRS 9, see e.g. IFRS 9.B4.1.4C), the business model and long-term nature of the insurance contract liabilities would be indicative and likely in the majority of cases sufficient for the classification of equity instruments. Still, an (additional) instrument-by-instrument analysis that aims at identifying equity instruments held for short-term trading purposes (or, more generally, equity instruments incommensurate with the underlying overall investment business model) and, thus, takes into account the category "The expected holding period" is appropriate to derive the appropriate accounting treatment of the respective equity instruments. While from a procedural perspective, such an approach would be slightly different, given the current option to classify equity instruments that are not held for trading at FVOCI (IFRS 9.4.1.4), the same classification result is currently possible under IFRS 9.

Question 2

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.

Question 3

Explain the reasons for your reply to question 2, including the key operational challenges in developing a different accounting treatment to IFRS 9 requirements.

In terms of measurement, we support that equity instruments be measured at fair value as, from our perspective, generally the fair value provides users of financial statements with relevant information regarding the respective investment performance of these equity instruments. However, measuring all equity instruments at FVTPL is not appropriate to adequately depict the financial performance of long-term investors such as insurance companies. In this regard, our concerns relate less to the measurement of equity instruments, but rather to how gains and losses from equity instruments held in the long-term are presented in the P&L statement. In this context, we support the

FVOCI option for eligible equity instruments included in IFRS 9 as it prevents short-term fair value fluctuations that might generally be compensated over the expected holding period from distorting the P&L statement. However, the requirements of IFRS 9 for equity instruments (except for equity instruments that are held for trading) and, in particular, the recycling ban for FVOCI equity instruments significantly impair the depiction of the financial performance of long-term investors.

In our business model, to fund insurance contract liabilities, we primarily hold equity instruments in the long-term to benefit from the equity risk premium and the expected long-term capital appreciation at the time of sale. Being part of our long-term strategy to generate inflows from equity instruments, these sales are highly relevant to determine our financial performance. The recycling ban prohibits the adequate depiction of our financial performance associated with these equity instruments. The accounting treatment for these equity instruments with respect to the P&L statement is also both inconsistent with as well as disadvantageous compared to debt instruments accounted for at FVOCI and equity instruments accounted for at FVTPL. Also, the interrelation with IFRS 17 needs to be taken into account. Taken together, the current IFRS 9 requirements impair the depiction of the financial performance and make the FVOCI option and – on a broader scale – the equity asset class less attractive for long-term investors such as insurance companies. Therefore, in line with the concerns raised within EFRAG's endorsement advice on IFRS 9 and our concerns raised in the context of our comment letter to EFRAG's Discussion Paper "Equity Instruments – Impairment and Recycling", we continue to strongly support an amendment to IFRS 9 in terms of a re-introduction of recycling for equity instruments measured at FVOCI.

Besides the abovementioned FVOCI option that allows for recycling cumulative gains and losses at disposal, we do not deem other alternative measurements or accounting treatments – among others, the ones presented in the EFRAG Secretariat Background Paper that accompanies this Request for Feedback – superior to the current IFRS 9 requirements. Specifically, while we acknowledge the benefits of certain alternative accounting treatments, each of these alternative is also subject to a set of more or less severe deficiencies. Further, consistency issues would arise, both with regard to the accounting treatment of other financial asset classes in accordance with IFRS 9, but also with respect to the measurement approaches applied to other balance sheet positions. Taking these deficiencies and consistency considerations into account, we do not believe that a deviation from fair value measurement and the related accounting treatment would ultimately result in a superior depiction of the financial performance of long-term investors such as insurance companies.

As to a potential abolishment of the recycling ban regarding the current FVOCI option in accordance with IFRS 9, we would like to point out that we continue to strongly support a targeted IFRS 9 amendment as issued by the IASB. Notwithstanding this, we explicitly do not support any solutions at the European level only.

Question 4

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 OCI (so called "recycling"), which impairment model would you suggest and how it would work in practice?

We generally acknowledge – also against the background of EFRAG's consultation and technical advice with respect to "Equity Instruments – Impairment and Recycling" – that an amendment to IFRS 9 that would allow the classification of long-term equity instruments at FVOCI including recycling should be accompanied by some form of impairment model that reflects negative fair value changes of permanent nature in the P&L statement. In this context, different impairment models seem feasible and acceptable from our perspective; generally, we support an impairment model

that ensures a high level of consistency and comparability in its application across preparers of financial statements. Also, we would generally support a model that allows for impairment losses on long-term equity instruments to be reversed in subsequent periods as such an approach best reflects economic reality. Overall, however, an in-depth assessment of potential impairment models will become more relevant as it becomes foreseeable whether and to what extent the IFRS 9 requirements for equity instruments will be amended, in which case we are happy to investigate this question further.

Question 5

Should the different accounting treatment be restricted to equity instruments held in a long-term investment business model?

No.

Please explain your answer.

In line with our long-term investment business model, our arguments with respect to the accounting treatment of equity instruments are strongly based on the perspective of long-term investors. Specifically, our concerns with respect to the recycling ban carry a particular weight for long-term investors as for them, the IFRS 9 requirements significantly impair the depiction of their financial performance as well as the attractiveness of the equity asset class. Still, we more generally believe that a FVOCI treatment including recycling best reflects the financial performance of equity instruments that are not held for short-term trading purposes and more suitably distinguishes between realized and unrealized gains and losses. As such and taking comparability and objectivity considerations into account, the same model (both regarding recycling and impairment) should apply to all equity instruments eligible for the FVOCI option. This would also be in line with the IASB not restricting the FVOCI option to strategic investments (IFRS 9.BC5.25(c)).

Question 6

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"?

Yes.

Please explain your answer.

From our perspective, equity instruments that are not held for short-term trading purposes should be subject to equal accounting treatment, irrespective of whether they are held directly or indirectly. As such and in line with our above considerations, we strongly support the re-introduction of recycling for equity instruments eligible for the FVOCI option and suggest that this accounting treatment be applicable to both directly held and indirectly held equity instruments. Accounting for equity-type instruments at FVTPL will significantly increase the volatility in the P&L statement and thereby distort the depiction of financial performance, especially for long-term investors such as insurance companies who primarily invest in equity-type instruments in the long-term. As a consequence, the attractiveness of equity-type investments is likely to decrease. Also, the current different accounting

treatment for financial assets within the equity asset class, i.e. where fair value fluctuations in indirect equity investments are immediately reflected in the P&L statement while fair value fluctuations in direct equity investments for which the FVOCI option is elected are never reflected in the P&L statement, seems counterintuitive and compromises the appropriate depiction of financial performance above and beyond the concerns raised above. Specifically, it adds additional inconsistency within the same asset class.

Question 7

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 & Other.

If you have indicated "Other" please provide details.

In our understanding, equity-like instruments are instruments that put the holder of the instrument in the same economic position as a holder of an equity instrument and thus expose the holder to "equity risk"; this understanding, among others, comprises units of funds and other instruments that meet the "puttable exception" in IAS 32.

Question 9

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.

Apart from the (potential) long-term nature of equity and equity-type instruments, that are particularly, but not only prevalent in the context of the investment business model of long-term investors, we do not see any characteristics that would render an alternative accounting treatment necessary.