European Association of Public Banks

– European Association of Public Banks and Funding Agencies AISBL –

commentletters@efrag.org

24 June 2013

EAPB comments on the EFRAG consultation on the need for Specific financial reporting for long-term investing activities business models

The EAPB welcomes the opportunity to provide some comments on the EFRAG consultation on the need for specific financial reporting for long-term investing business models. In the Green Paper the European Commission rightly highlights the important role of public development banks and public long-term investors in countering negative economic cycles and in the stimulation of private financing as they are committed to the public interest. The EAPB believes that accounting standards should allow for an appropriate treatment for such business models focused on long-term financing.

The general objectives of public banks and public long-term investors are defined by public law. This includes financing SMEs, infrastructure, environmental or social projects as well as municipalities. While EAPB members perform their activities in line with sound business management there main aim cannot be to maximise profit. The specific business models designed to meet public-interest objectives may differ from Member State to Member State, but many public financing tools have in common that they aim at correcting the private sector's short-sightedness which may to some extent be encouraged by current regulation. Achieving public-interest objectives may be done with a mix of instruments combining public guarantees, principles of non-profit maximisation, public-private risk-sharing (e.g. indirect financing mechanisms via commercial banks) and sound and efficient business management.

For many public developments banks and long-term investors IFRS have important short-comings and do not sufficiently take into consideration the business model of an entity. EAPB considers that the valuation of financial instruments at fair value may lead to short-term valuation advantages and which for example may be reported as profits. This could affect a long-term financial orientation of entities. In this context the right categorization of financial instruments in terms of accounting is crucial. Mark-to-market valuation should be one of the options for accounting, but not the "default" one as far as long-term investment is concerned. In particular IFRS 9 should be adapted to take into account the specific characteristics of long-term investments. Therefore the EAPB fully supports a reflection process on alternatives in order to make IFRS more suitable.

Assets cannot be classified as "long-term" per se. That is why applying measurement rules based on management intent rather than the category of financial instrument is relevant in

Avenue de la Joyeuse Entrée 1 - 5, B-1040 Brussels ● Phone :+32 /2 / 286 90 62 ● Fax : +32 /2 / 231 03 47

Website : www.eapb.eu

this matter. It is important to define long-term investing as a "business model": stable assets, multi-annual objectives and constraints, a long-term strategic asset allocation set accordingly. As the OECD puts it in its high level principles of long-term investment financing by institutional investors, such investors are set with "patient, productive and engaged capital".

When a financial instrument has been purchased for trading purposes, its market developments will be correctly and transparently reflected by a fair-value based valuation. However, it is very important for public financial institutions that long-term oriented financing activities are mainly valuated at amortised cost. IFRS only considers this to a limited extent. The classification model should continue to clearly provide for the two categories of financial instruments:

- Amortised cost for financial instruments allocated to the banking book

- Fair value for financial instruments allocated to the trading book

But in addition to fair value through profit and loss and amortized cost, a third accounting portfolio should be considered that would be dedicated to long-term investments, which are managed on the basis of a business model that does not involve either the realization of short-term capital gains or the collection of cash flows, i.e. financial instruments that are held as investments in a medium or long term perspective or that do not meet the definition of either the amortized cost category or the fair value through P&L category. Financial instruments included in the last category could be measured at the lowest between the "acquisition cost" and "value in use"[1]. Reversal of impairment through profit and loss should be allowed. The definition of "value in use" could be extended to financial assets when the business model applied is to hold these assets for a long period (a minimum commitment of 2 years of holding period for instance could be required).

Please do not hesitate to contact us should you have any questions.

The European Association of Public Banks (EAPB) represents the interests of 40 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions. The latter have a combined balance sheet total of about EUR 3,500 billion and represent about 190,000 employees, i.e. covering a European market share of approximately 15%.

[1] The concept of "value in use" is already defined by IAS 36 - §6: "value in use is the present value of the future cash flows expected to be derived from an asset"

Avenue de la Joyeuse Entrée 1 – 5, B-1040 Brussels ● Phone :+32 /2 / 286 90 62 ● Fax : +32 /2 / 231 03 47

Website : www.eapb.eu