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EUROSYSTEM

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Frankfurt am Main, 5 July 2019
LdG/2019/189

EFRAG's consultation "Equity instruments – research on measurement"

Dear Mr Gauzès,

In May 2019 EFRAG published a public consultation on alternative accounting treatments to IFRS 9 requirements for equity and equity-type instruments held in a long-term investment business model. The ECB has a keen interest in high quality financial reporting standards which are a major prerequisite for efficient capital allocation and effective prudential supervision. The ECB therefore welcomes the opportunity to provide input to this consultation.

In our view the consultation raises an important question: Is fair value the most appropriate measurement approach for long-term equity investments?

From our side two aspects would need to be considered if accounting standard setters were to pursue this project further: 1) Timing of the project and due process and 2) Implications for financial reporting.

Timing of the project and due process

Public financial reporting plays a major role in market discipline. Adoption of the alternative measurement concepts that are discussed in the background paper to this consultation would constitute a fundamental change to some of the key principles in IFRS 9 only shortly after IFRS 9 became effective (1 January 2018). This being the case, we would support a full consultation

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process once any more concrete proposals for change have been formulated. A proper consultation is essential to assess the benefits of any new accounting approach against the need to avoid confusion among preparers and users. Finally, it would be important to ensure close collaboration with the IASB in order to help promote a single set of high quality global accounting standards as mandated by the G20.

Implications for financial reporting

Transparency in financial reporting is essential for efficient capital allocation. The ECB maintains its preference for a "mixed model approach"¹, that is, the co-existence of "amortised cost" and "fair value" in the accounting for financial instruments. Indeed, fair value is an appropriate measurement for certain financial instruments, notably those that are held for trading and for which reliable market prices are readily available, as well as for derivatives.

We understand that some constituents are concerned about "artificial volatility" arising from short-term fluctuations in the fair value of equity instruments held in a long-term business model. At the same time, it may in practice be challenging to reliably distinguish "artificial volatility" from "economic volatility" (for example, volatility due to changes in the perception of the issuer's viability). Therefore, any change to the existing requirements in IFRS 9 should in our view not allow or facilitate undue earnings management and regulatory arbitrage, for example through opportunistic selling of equity investments to manage profit or loss. For the same reason, and as already stated in our response to the previous EFRAG Discussion Paper Equity Instruments – Impairment and Recycling², we believe that the introduction of a sound and operational impairment model would be an indispensable prerequisite for any changes to the existing requirements for equity instruments.

More generally, the ECB notes that certain aspects that are discussed in the questionnaire would, if taken further, result in new definitions or classifications, for example, "long-term investment", "equity-type investment" and "impairment of equity investments". These new concepts may increase complexity of financial reporting and require considerable judgement. Therefore it is important to ensure that any new definitions are clear, and the principles behind them well-understood, in order to avoid inconsistency in practice or confusion among users. If you have any questions regarding our comments please feel free to contact us.

Yours sincerely,



¹ For example, the ECB advocated a "mixed model approach" already at a conference in Paris on 27 April 2010: https://www.ecb.europa.eu/press/key/date/2010/html/sp100427_2.en.html.

² Cf. ECB (2018): <https://www.efrag.org/Activities/1606201553344223/EFrag-Research-Project-Equity-Instruments-Impairment-and-Recycling>

Cc:

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