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

Autorité des Normes Comptables

2. Country of operation

France

3. Job title

4. E-mail address

cedric.tonnerre@anc.gouv.fr

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

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

see Q1.

Please NOTE that, in addition to this questionnaire, a more extensive version of our answer has been provided in form of a Comment letter that is also available on the ANC website (www.anc.gouv.fr)

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

8. How do you define sustainable activities?

see Q1

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
Other

If you have indicated "Other" please provide details

ANC welcomes the EFRAG and EC initiative to address the question of long term investment and accounting. In our view, long term investment contributes to the European objective of achieving a sustainable finance by promoting a favourable political, economic, legal or regulatory environment. IFRS standards however do not aim at "promoting" long term investment per se but rather, as stated in the IAS regulation, should be conducive to the European public good and thus, as specified by Mr Maystadt, should "not endanger" financial stability "nor hinder" the economic development of the European Union.
In its endorsement advice, EFRAG has been questioning certain IFRS 9 requirements that may not reflect the business model of long term investment. In the last years, ANC has been working on two of them: (1) the lack of impairment model applicable to equity instruments that is considered preventing from having a credible alternative measurement to fair-value through P&L (FVPL); and (2) the lack of an alternative accounting treatment to FVPL for shares in investment funds.
ANC is convinced that technical solutions to the current pitfalls in the standard are possible without fundamentally questioning the basics of IFRS 9 or waiting for the Post Implementation Review (PIR).
In general terms, explained in more details in the attached contribution, ANC suggests (i) to introduce recycling, (ii) to define a robust and simple impairment solution for equity or equity type instruments (on a clearly defined and agreed upon basis), (iii) to extend the solutions retained for equity instruments to equity type instruments (defined in accordance with clear criteria via a test) and (iv) to consider if need be some specific situations or business models in respect to the general principles retained.

1.1 Preliminary consideration
ANC fully concurs with EC objectives of ensuring that accounting standards do not hinder long term investment (LTI) that is part of a sustainable finance, even if defining LTI might be challenging because several definitions exist. Besides, we note that the LTI issue has been raised by EFRAG in its endorsement advice on IFRS 9.
Additional developments may be introduced in order to address the accounting issues of specific business models. However, we stress the point that such complementary solutions should not distract from the bigger picture and the urgent need to fix the current pitfalls in IFRS 9 that prove especially critical when applied to LTI.
1.2 Linkage between sustainable finance and accounting issues
In its last year report on sustainable finance, the EU High-Level Expert Group (HLEG) paves the way to the current EC question addressed to EFRAG's constituents by setting the scene regarding sustainable finance and related accounting issues through its cross-cutting recommendations (bold added):
"It advises the EU: to confront short-termism in financial markets so as to reduce its negative impact on long-term corporate investment and development; to consider ways to empower citizens to engage with sustainable finance; to monitor investment plans and delivery through a dedicated EU observatory on sustainable finance; to improve financial market benchmark transparency and guidance; to ensure that EU accounting rules do not unduly discourage long-term investment."
As the HLEG, the long-term investment task force of the Paris Marketplace chaired by Gérard de la Martinière put the emphasis in its report on the urgent need for massive investments in Europe and the limited improvements introduced to date by the "Capital Markets Union" (CMU).
The new IFRS 9 standard, applicable to financial instruments, makes a widespread reference to market value since Fair Value through P&L (FVPL) is (i) the default method for measurement as well as (ii) the only measurement applicable to mutual funds. However, market value measurement creates volatility in the statement of performance and may not fit all situations, especially when financial instruments are not planned to be shortly disposed of or in case of asset-liability management where assets are held for the purpose of meeting specifically identified long term liabilities (eg decommissioning).
1.3 Defining Long Term Investment
In our view, the most relevant characteristics to identifying a long-term investment are not those of the nature of the assets (e.g. "green bonds") but rather those of the business model of the investor.
Measuring financial instruments at FVPL particularly fits a trading/ held for sale business model. Conversely, by definition, LTI is not supposed to be shortly disposed of. As a result it cannot be presumed that FVPL measurement fits LTI. On the whole, there is a consensus among our stakeholders that "trading" corresponds to a defined business model whereas LTI encompasses situations other than trading (reversed definition), i.e. corresponds to the default method for measurement.
In addition to that broad (reversed) definition, specific situations of dedicated business models might be identified and could deserve specific accounting requirements. Such situations are detailed under Question 9.

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

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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

As recommended by the HLEG, the purpose of accounting "is to ensure that EU accounting rules do not unduly discourage long-term investment". In this regard, as mentioned in our previous letter, two main accounting issues in IFRS 9 have been raised by our stakeholders:

- Applying FVOCI to equity investments with OCI not being recycled;
- Equity-type instruments (such as mutual funds or other puttable instruments) treated as "non-SPPI" debt instruments and therefore mandatorily measured at FVPL.

3.1 Reason 1: Address the non-recycling issue

ANC supported IASB's principles (Conceptual framework) and decisions (IFRS 9) to consider the business models in the measurement. Business models have been introduced into the measurement requirements for debt instruments under IFRS 9. Current IFRS 9 provisions on equity instruments rely on a default measurement method being FVPL and a FVOCI alternative option. Choosing either of both measurements does not depend on a conceptual approach or a business model. We see no conceptual reasons for not referring to business models when measuring equity instruments.

Moreover, since OCI cannot be recycled, FVOCI generally does not represent a realistic alternative to FVPL. ANC however strongly believes that "dual measurement" is a valuable alternative to FVPL when applied to business models other than trading.

FVPL may not be appropriate to business models other than trading

For equity instruments other than trading, applying a FVPL measurement will generally not properly reflect the performance in the P&L.

As many users and academics do, ANC considers that the ability to identify realised vs. unrealised gains or losses is fundamental and highly relevant to the users of financial statements since a gain, or a loss, is certain only upon the sale of the underlying instrument.

Moreover, reflecting in the P&L each change in the market value leads to over-represent into the entity's performance its ability to immediately dispose of an asset, compared with other features (risks and performance drivers). This focus is addressed by Jacques de Larosière when he stresses the limits of relying on mere market mechanisms to raise money from the financial markets, since "Financial institution's risks are not market risks, even when their assets are acquired or sold on organised markets. Prudential and accounting standards should rather acknowledge that the long term does not entail greater risk, but simply presents a different risk profile."

In that specific context, historical cost measurement in the P&L may also provide relevant information on non-trading transactions without adding a temporary immediate volatility.

FVOCI without recycling is an incomplete solution.

"Dual measurement" (as referred to in § 6.83-6.86 of the conceptual framework) means that measurements used in the balance sheet and in the P&L differ, the difference between both being put in OCI. The FVOCI option is supposed to address the dual measurement issue of financial instruments measured at fair value in the balance sheet and at historical cost in the P&L. This works well for SPPI debt instruments but not for equity instruments, since OCI is not recycled. In line with the IASB conceptual framework, consistently applying a "dual measurement", ANC considers that recycling OCI (and its corollary, having an impairment mechanism, see § Q 4) is fundamental and highly relevant to the users of financial statements.

Moreover, applying the FVOCI option to equity instruments, the actual performance is difficult to understand as there is no conceptual reason to present differently in the statement of comprehensive income (i) a gain of 15 realised upon a sale and (ii) a gain composed of a dividend of 5 followed by a sale gain of 10. Indeed in both cases the actual realised performance is 15.

3.2 Reason 2: Address the Mutual funds issue

See Question 6.

3.3 Challenges to be addressed: does historical cost allow for earning management?

Some suspect the difference between historical cost and fair value to allow for earning management. We however think that:

- When acknowledging the mixed measurement model in its recent conceptual framework, IASB does not consider that historical cost measurement is conceptually flawed;
- If it were, such a risk of "earning management" should also be considered in the standards dealing with other types of assets that are available for sale (inventories, tangible and intangible assets…) or even debt instruments meeting the SPPI test.

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?

ANC is convinced that the OCI-recycling mechanism should be accompanied by an impairment approach. Indeed any IFRS measurement method that leads to an impact in P&L upon de-recognition of an asset (either financial or non-financial) is accompanied by an impairment mechanism and we see no conceptual reason to create an exemption for equity investments.
As regards the impairment model, ANC considers that the prominent characteristics of an impairment model should be relevance and reliability. Relevance can only be achieved by adapting the impairment model to the specific features of equity instruments.
ANC stakeholders believe that the major weakness of the former IAS 39 impairment model was due to the lack of reversibility. The enhanced impairment model should allow reversals under the same conditions as the asset has been impaired.
In a dual measurement approach, the impairment model aims at reflecting in the P&L the performance of an asset measured at historical cost. Accordingly, only changes below historical costs would be subject to impairment. There is a range of possible ways to recognise an impairment, it being understood that there is anyway a FV reference for the assets concerned, i.e. their value for balance sheet purposes.
 The solution suggested by ANC in its 2018 letter was (i) to refer to a "prolonged decline" criterion to set the threshold period and (ii) to consider not waiting for the threshold period when the equity instruments present a fair value below cost and recovery in value above cost before the end of the threshold period is not probable. There are several possible definitions of the "prolonged decline" criterion:
o A simple way would be to set a rules-based definition of "prolonged" that grants comparability and is simple to understand: for instance 12 months;
o A more principles-based solution would be to leave room to the entity to define its own criterion and explain it in the notes. Such judgmental threshold would be capped by anti-abuse rules (such as a one-year threshold, similar to debt instruments);
o A mere principles-based solution i.e. without any cap is not recommended.
 EFRAG's "re-evaluation model" would grant comparability and be simple to understand. That model leads to record (i) in the P&L any change in fair-value below historical costs and (ii) in OCI any change in fair-value above historical costs.
A portfolio approach could also be considered in order to align the impairment with the unit of account used for managing the performance.

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

The limitations in IFRS 9 relate to all situations other than the ones related to the trading 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

ANC welcomes the EFRAG's initiative to extend the scope of the LTI issue to such "equity-type" instruments, as we suggested in our previous comment letter.
Yes, the different accounting treatment should definitely also apply to equity type investment (please refer to our answer to question 7 for more details on this concept).
LTI does not solely comprise Equity instruments as defined by IAS 32. Investment can be held either directly or indirectly, for example through UCITS, ETF (Exchange Traded Funds) or AIF. From an economic standpoint, the decision to hold equity instruments indirectly can be motivated by various objectives such as;
- risk spreading and diversification,
- accessing to a higher level of liquidity,
- relying on dedicated experts monitoring the positions,
- isolating the assets backing some specific underlying liabilities,
- simplifying the operational burden of accounting for each single asset.

Funds are integral to most LTI business models and excluding them from an accounting treatment designed to address LTI would clearly be a significant impediment to the overall approach.
We consider that the driving principle for accounting for equity type investment is both simple and straightforward: we see no conceptual reason to account differently for equity investment depending on whether they are held directly or indirectly.
This principle implies that the management strategy of the fund be analysed to ensure that its business model is not trading, which would require a measurement of the investment at FVPL.
It implies as well to cautiously define the concept of equity-type investment. Please see our answer to the next question for further development on this topic.
Some "Long/short" funds stand for a typical illustration of a trading business model within mutual funds. In our view, the simple fact that a fund is playing a short position against an equity instrument proves that it is not in a long term investment perspective. Indeed, if the entity were to implement such strategy directly, it would be through derivatives instead of equity instruments. Moreover, in some long/short fund, quantitative analysis helps identifying undervalued and overvalued equity securities using an index as a benchmark. The fund takes long positions in stocks it believes to be undervalued and short positions in stocks it believes to be overvalued. Positions constantly adjust depending on market conditions. Basically, the fund is betting on the market's efficiency rather than on an intrinsic long term performance of investments.

10. Question 7

17. If so, which characteristics would you require to define the "equity-type" instruments?

Other

18. If you have indicated "Other" please provide details

Our driving principle is to account for direct and indirect holding of equity instrument in the same way, in aggregate.
To determine whether the unit of a fund qualifies as equity-type instrument, we suggest to introduce an "equity-type test" (ETT) similar to the SPPI test applicable to Contractually Linked Instruments (IFRS 9.B4.1.20-26). The aim of the test is to ensure that an equity fund is not leveraged, and does not provide a structured performance.
The ETT could, for example, rely on the following principles:
(1) The contractual terms of the units meet the definition of a puttable instrument in accordance with IAS 32.16A-16D; and
(2) The underlying pool of assets solely includes:
(a) equity instruments or ETT equity-type instruments (in which case the entity must look through until it can identify the underlying pool of instruments that are creating the cash flows); and
(b) cash or cash equivalent to meet the liquidity constraints of the funds; and potentially
(c) instruments that reduce the cash-flow variability (e.g. hedge of FX risk exposure) and or manage operational issues related to the fund management. [concept similar to the one developed in IFRS 9 B4.1.24 except that the aim is to provide an equity performance instead of a SPPI performance profile].
If the fund satisfies the ETT, then the fund is qualified as equity-type and can be treated as an equity instrument.
If the test is failed (e.g. a fund invested both in debt and equity instruments) or cannot be perform, then the fund shall be measured at FVPL.

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.

100

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.

The default dual measurement models suggested above (FVOCI with recycling and impairment) is probably the preferred way forward since it fits all situations. However, in addition to it, ANC is contemplating suggesting additional measurement alternatives in order to address issues in specific business models.
Current IFRS standards already provide specific accounting solutions to some business models:
- The variable fee approach in IFRS 17 provides a dedicated portfolio measurement to equity investments made in the context of certain insurance commitments;
- IAS 19 also provides for a portfolio approach of assets managed to cover the financial risk of long term pension liabilities;

We suggest adding two additional business models dealing with:
- a dedicated portfolio of assets managed to cover the financial risk of other types of long-term liability, such as decommissioning liabilities (similar to Scenario D in the consultation, see also § 0);
- strategic investments: where an entity acquires a non-controlling interest in a company that secures its current or future business / technology / resources.

Note that the incremental benefits of a specific standard compared to an improved IFRS 9 (i.e. FVOCI with recycling and impairment) would have to be carefully assessed in view of the costs of developing it.
9.1 Assets Dedicated to Liabilities (ADL)
The suggested accounting model is an « allocation based approach » that would apply to situations where:
- the financial performance of a dedicated/ring-fenced portfolio of equity instruments is supposed to service…
- …the financial charge generated by the accretion of a long term liability (e.g. decommissioning).

Under this specific case of dual measurement, the portfolio of assets would be measured at fair value in the balance sheet, with all changes, realised (e.g. dividends received, gains/losses on disposal) as well as unrealised (change in fair value) being recorded in OCI.
That OCI would be recycled into the P&L to the extent that the accretion or financial charge of the underlying (IAS 37) liability is actually affecting the P&L in the period, so that the net P&L effect is nil.
In case the cumulative OCI per portfolio is negative, the cumulative amount is immediately impaired, i.e. is recycled as a loss into the P&L.

9.2 Strategic investment
An investor that cannot direct the activities of an investee (IFRS 10.9) or not even has a significant influence on it (IAS 28.14), applies IFRS 9. It is implicitly assumed, under such circumstances, that holding equity is solely for financial purposes.
We have however been reported situations where financial performance is not the primary goal to be achieved. In fact, a financial purpose might be not achievable (such as in EFRAG's example A, where no dividend or gain can ever be realised) or might not be desirable (such as in EFRAG's example B). In the latter case, the small initial investment is "seed money", a first step towards a future significant influence or even a control, if the investment proves successful. At this preliminary stage of development of a business, dividends are rarely expected and any gain on sale is remote. The investor rather purchases a kind of "option" to participate into the future development of the business.
Such a situation might be similar to "strategic" investments where, for instance, an entity invests non-controlling interests (NCI) in an IT business that is considered strategic because the entity is depending on its service or technology. Another example could be equity investment in a portfolio of R&D projects, some of them being expected to develop the future business or technologies the entity is interested in.
As commented in examples A and B below, a fair value of such investments is difficult to assess. Until the expected technical/business performance proves successful, it is highly judgmental and provides little information. Such a current value would nevertheless be a "value in use" rather than a market value.
Applying current IFRS 9 option to FVOCI without recycling is not appropriate in such a case since it would allow recognising all the risks in OCI whereas any dividend could be recognised as a profit.
We therefore are of the view that a single approach accounting for such investment at cost with an impairment test (or even amortise the assets if no terminal value is reasonably expected) would more appropriately reflect that business model.

13. (untitled)

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.

If yes, please explain why.

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

23. Which accounting treatments do you support?

Other

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.

The main two assumptions made in the example A (no residual value at the end of the economic life of the asset and prohibition from selling) are not common in our jurisdiction.
Applying the current FVOCI, leading to recognise the dividends but not the necessary depletion of the initial value of the instruments would not provide a proper reflection of the performance.
Applying FVPL would require level 3 fair value assessments that would probably create few volatility but also provide costly and not useful information: a change in assumptions regarding future wind capacities or electricity prices would be immediately recognised in the P&L as "performance" whereas there is no possibility to realise that gain because the assets are not tradable.
Accordingly, no actual provisions in IFRS 9 provide a satisfactory treatment.
The economy of the transaction is in fact very similar to holding a share in a tangible asset. Historical cost measurement and amortisation would thus be particularly appropriate and Fair value measurement does not add useful information.
Should however one of the two assumptions be changed, it would allow a possible gain on disposing the asset (either during or at the end the operating life). In such a case, there is some merit in considering a fair value measurement of the asset. Because of the pitfalls of the FVPL mentioned above (§ 59), we then would recommend applying a dual measurement model thanks to a FVOCI with recycling and impairment.

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.

If yes, please explain why.

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

26. 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.

The "incubation" case presented in example B is a much more common situation in our jurisdiction. Whether the assumption that the instruments is unlisted and remains so is however disputable. In fact such start-up investments, after several funding rounds, may intend to go public. Since the measurement method initially applied to equity instruments is irrevocable, that possibility has to be considered originally. We however made the (less realistic) assumption that an IPO is not anticipated.
As in Example A, the economy of the transaction is similar to holding a share in a business (rather than in a financial instrument) that would require level 3 fair value assessments of future cash flows in order to assess a "fair value". We have been reported that in such cases, the main issue is then to assess that fair value rather than reflecting a performance (which is often negative or non-material). FVOCI without recycling is especially not satisfactory where the final gain on disposal is actually the main performance expected to be recognised on such an investment. This is therefore also a case for applying a cost measurement (with impairment test) rather than a fair value one.
Alternatively a dual measurement, FVOCI with recycling and impairment could apply. Impairment is a must to properly reflect the risks incurred on such investments.

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.

If yes, please explain why.

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

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.

Both examples C&D address similar issues where a dedicated portfolio of assets is providing for a financial coverage/mitigation of the costs incurred by long term liabilities (e.g. accretion).
IFRS 17 partially addresses this specific concern thanks to the Variable Fee Approach. VFA contracts indeed allow for adjusting the contractual service margin (CSM) by changes in fair value of the underlying assets. By doing so, the VFA eliminates the equity investment issue and proves adequate as long as assets are recorded at FVPL under IFRS 9. However, if assets are recorded at FVOCI under IFRS 9, VFA eliminates the mismatches only under specific circumstances (if the OCI option is applied).
This conclusion applies to the cash flows directly related to VFA insurance contracts and their underlying items. However, insurance companies are also required to hold equity and reserves attributable but not immediately distributable to shareholders. Such "restricted equity" is necessary for regulatory/solvency purposes for running their insurance activities. For economic reasons (the shareholders expecting higher returns because of such longstanding restrictions) equity-investments (supposed to provide higher returns than debt-instruments) may represent a large part of the assets invested with such restricted shareholders' equity.
Finally, for all approaches except VFA (general model, PAA, reinsurance, investment on its own) the non-recycling of OCI on IFRS 9 equity investments remains an issue.
We note that the LTI Task Force report mentioned previously provides quantitative information on the decrease in equity investment in the last 10 years from 20% to 10% of the assets of European Insurance Companies. Our constituents also mention that the remaining equity investments are made in low-risk assets in order to prevent too high a volatility. Such an investment strategy actually contradicts the possibility offered to such investors to invest in mid-long term investments providing higher returns.

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.

If yes, please explain why.

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

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.

As mentioned above (§ 3.1), current IFRS 9 requirements do not provide an adequate solution since FVPL adds unnecessary volatility and FVOCI without recycling never allows to recognise gains upon disposal.
A consistent dual measurement solution (FVOCI with recycling and impairment) as provided above is the preferred one.
However, an alternative « allocation based approach » might be considered where a servicing linkage can be identified (as described in § 9.1).

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.

If yes, please explain why.

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

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.

Both examples E&F address similar issues since being listed or not is not considered a relevant criterion for differentiating the accounting treatment.
We explain above (Question 6) why we consider that unit funds, i.e. equity-type instruments deserve the same accounting treatments as equity instruments.
The analysis and suggestions to these examples are provided above in Question 7.

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.

If yes, please explain why.

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

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.

Both examples E&F address similar issues since being listed or not is not considered a relevant criterion for differentiating the accounting treatment.
We explain above (Question 6) why we consider that unit funds, i.e. equity-type instruments deserve the same accounting treatments as equity instruments.
The analysis and suggestions to these examples are provided above in Question 7.

20. Thank You!

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