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Non-recycling of equity instruments at FVOCI

Cover Note

Introduction and Objective

1 The EFRAG Secretariat performed a review of a sample of 2023 annual reports of insurers in order to understand the impact of and communication about equity instruments measured at fair value through other comprehensive income ('FVOCI'). Furthermore, these preliminary results were discussed with EFRAG IAWG and also separately with two EFRAG IAWG users of financial statements.

2 The objective of this session is to provide EFRAG FR TEG members with an overview of, and to discuss, the findings.

3 Questions to EFRAG FR TEG are in Agenda Paper 07-02 (paragraphs 51-52).

What is the issue?

Summary of IFRS 9 and IFRS 17 requirements

4 IFRS 9 *Financial Instruments* generally requires measuring equity instruments at fair value through profit or loss ('FVPL'), however at initial recognition, an entity may make an irrevocable election to present in other comprehensive income ('OCI') subsequent changes in the fair value of an investment in an equity instrument within the scope of IFRS 9 that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 *Business Combinations* applies. Measuring equity instruments at FVPL result in reporting the changes in the fair value in these instruments in profit or loss. However, when the presentation in OCI is elected, the amount in OCI will never be recycled in profit or loss (dividends received are recognised in profit or loss directly). Equity instruments measured at fair value through OCI are not subject to impairment (paragraph B5.7.1 of IFRS 9).

5 Under IFRS 17 *Insurance Contracts*, an entity has an accounting policy choice to either:

(a) include insurance finance income or expenses for the period in profit or loss, or

(b) to disaggregate insurance finance income or expenses for the period to include in profit or loss an amount determined by a systematic allocation of the expected total insurance finance income or expenses over the duration of the group of contracts. The difference between the insurance finance income or expenses measured on this basis and the total insurance finance income or expenses for the period would be recognised in OCI (paragraphs 88 and 90 of IFRS 17).

6 In addition, for insurance contracts with direct participation features and whereby the entity holds the underlying items, an entity also has an accounting policy choice to either:

(a) include insurance finance income or expenses for the period in profit or loss; or

(b) disaggregate insurance finance income or expenses for the period to include in profit or loss an amount that eliminates accounting mismatches with income or expenses included in profit or loss on the underlying items held. The difference between the insurance finance income or expenses measured on this basis and the total insurance finance income or expenses for the period would be recognised in OCI (paragraphs 89 and 90 of IFRS 17).

Description of the issue based on previous EFRAG communications (emphasis added)

7 As per the endorsement advice of IFRS 9 (paragraph 13), "*IFRS 9* ***may result in a less relevant depiction of performance with relation to investments in equity instruments*** *if they are held in a long-term business model. Revaluation through profit or loss may not provide useful information for them. Under the IFRS 9 alternative of revaluing them through other comprehensive income, gains or losses are not recycled into profit or loss and, consequently, any impairment losses are never recognised in profit or loss.* ***This impairs the ability of users to easily assess the performance of the entity's investment activities by relying on profit or loss***."

8 Also, as per the endorsement advice of IFRS 17 (paragraph 88), "*However, when the presentation in OCI is elected, the amount in OCI will never be recycled in profit or loss, apart from dividends received which are recognised in profit or loss directly. In turn, equity instruments measured at fair value through OCI are not subject to impairment. If these instruments back insurance liabilities,* ***an accounting mismatch will arise, as over time the changes in the insurance liabilities will be recognised in profit or loss, whereas the changes to any equity instruments backing those liabilities will never be recycled through profit or loss****. The extent of this accounting mismatch will depend [on] whether the change in the insurance liability relates to financial risks or not and whether the changes in the fulfilment cash flows relate to past [or] future service; also, changes in discretionary cash flows may be reported through the CSM (so, impacting profit or loss during the coverage period)*."

9 In addition, the Exposure Draft on *Amendments to the Classification and Measurement of Financial Instruments (Proposed amendments to IFRS 9 and IFRS 7)* issued in March 2023 (2023 ED), had a question on Disclosures - investments in equity instruments designated at fair value through other comprehensive income (Question 5[1]). In its comment letter to that ED EFRAG:

(i) mentioned that in its comment letter in response to the IFRS 9 post Implementation Review on classification and measurement, EFRAG reported

[1] (a) For investments in equity instruments for which subsequent changes in fair value are presented in other comprehensive income, the Exposure Draft proposed amendments to:

(i) paragraph 11A(c) of IFRS 7 to require disclosure of an aggregate fair value of equity instruments rather than the fair value of each instrument at the end of the reporting period; and

(ii) paragraph 11A(f) of IFRS 7 to require an entity to disclose the changes in fair value presented in other comprehensive income during the period.

that seventy percent (70%) of respondents from its public consultation considered that an **alternative accounting treatment was relevant to meet the objective to reduce or prevent detrimental effects on long-term investments**.

(ii) also indicated that it would be monitoring the implementation of IFRS 9 and IFRS 17 to ascertain the extent of impact resulting from non-recycling of equity instruments measured at FVOCI.

What is the review and why is it being conducted

10 In response to the 2023 ED, EFRAG noted in its comment letter that it would be monitoring the implementation of IFRS 9 and IFRS 17 to ascertain the extent of the impact resulting from non-recycling of equity instruments measured at FVOCI.

11 Therefore, with the agreement from the EFRAG FRB, an initial step of the monitoring process was to review the financial statements of insurers/financial conglomerates in order to understand the impact and communication of these equity instruments measured at FVOCI.

Agenda Papers

12 In addition to this cover note, agenda paper 07-02 – *Overview of financial statement review* – has been provided for the session.