EFRAG
European Financial Reporting Advisory Group

SUMMARY OF RESPONSES

DISCUSSION PAPER ON EQUITY INSTRUMENTS - IMPAIRMENT AND RECYCLING

August 2018

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European Financial Reporting Advisory Group

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Introduction

In March, EFRAG issued the Discussion Paper *Equity Instruments – Impairment and Recycling* ('DP'). Comments were requested by 25 May.

EFRAG is now issuing a summary of responses which describes the main comments received. This summary of responses should be read in conjunction with the DP which is available on the EFRAG website.

Why was this Discussion Paper written?

The European Commission (EC) has requested a technical advice on the accounting for equity instruments which are carried at FVOCI. The objective of the DP published in March 2018 was to gather constituents' views in relation to the questions raised by the EC.

Responses from constituents

Fifty-three comment letters were received in response to the DP. A list of respondents is in the Appendix I to this summary of responses. All comment letters received are available on the website of the European Financial Reporting Advisory Group (EFRAG), unless respondents asked to remain anonymous.

The EFRAG Secretariat also discussed the contents of the DP with its Working Groups and external organisations. The list of outreaches is presented in Appendix II.

References to EFRAG DP and EFRAG presentation

After the publication of the DP, the IASB commented the DP with the *IFRS 9 and equity investments* published on 24 April.

In March, EFRAG published a literature review by an academic team (*Interaction of IFRS 9 and Long-Term Investment Decisions)* which is available on the EFRAG website

Purpose and use of this summary of reponses

This summary of response has been prepared as a formal record of the responses received. It summarises the messages received from constituents and notes any key themes identified.

The DP's main focus was:

- if the reintroduction of recycling would improve the depiction of the financial performance of long-term investors;
- if from a conceptual standpoint, recycling should be accompanied by some form of impairment model; and

- which impairment model concurs with the general objective and main features of a robust model for equity instruments.

The DP illustrates two models for equity instruments carried at FVOCI:

- a revaluation model, in which all declines in fair value below the acquisition cost would be immediately recognised in profit or loss and changes in fair value above the acquisition cost would be recognised in OCI and recycled on disposal; and
- an impairment model similar to the model of IAS 39 for equity instruments classified as available-for-sale ('AFS'), but with additional guidance to reduce subjectivity.

Summary of the responses received

Overview of the summary of responses

Many of the respondents focused on the main questions in the DP, without replying to all the detailed questions.

Although the DP did not specifically asked questions on the timing or process of the project, more than half of the total respondents suggested that it would be preferable to wait for the IASB's Post Implementation Review (PIR) of IFRS 9 before suggesting changes and/or that any change needs to be agreed with the IASB and not introduced at the European level. For some of these constituents, one or both of these suggestions substantively represented their complete response to the DP.

Nearly three-fourths of the 49 respondents who expressed a view on recycling agreed that its reintroduction would improve the depiction of financial performance of long-term investors. However, some National Standard Setters and users reject this view or would prefer to have fair value changes recognised immediately in profit or loss.

An overwhelming majority of respondents to the question as to whether recycling needed to be accompanied by an impairment model agreed that it did.

Twenty out of the thirty-one respondents who expressed a preference about an impairment model, preferred a model similar to IAS 39, mainly because it attempted to make a distinction between temporary and other declines in fair value, even if some of them remarked that experience had proven that the IAS 39 "significant and prolonged' approach failed to be effective regarding comparability among entities due to the wide range of thresholds retained.

General analysis

Thirty- two respondents provided general comments on the timing of the request and the process lead by the EC instead of the IASB (10 respondents made both comments). The group included approximately half of the preparers, all the regulators and audit/accountant associations, one user organisation and seven National Standard Setters.

Twenty-one respondents noted that entities only just started applying IFRS 9 and therefore it was too early to draw conclusions on the impact of the Standard. Some of them mentioned that there was no clear evidence that the current requirements, which prohibit recycling, would have a negative impact on long-term investments, nor that the reintroduction of recycling would have a positive impact.

Twenty-one respondents noted that, regardless of the outcome of the technical discussion, it was necessary that any change would be discussed with the IASB. No change should be introduced at a European level.

It should be noted that since the DP was not asking for views on these aspects, it is possible that some of the other respondents would also share the same view.

Two National Standard Setters mentioned that the FVOCI option for equity instruments in IFRS 9 should be eliminated. They considered the appropriate measurement criteria for all equity instruments was FVPL as this option allowed greater comparability between entities and they just accept FVOCI because it was introduced by the IASB. A user organisation (the one that had not commented on the timing of the request) also noted that FVPL would be their preferred option to represent investment performance.

Other respondents, mostly preparers (insurance companies) and some National Standard Setters, suggested to amend IFRS 9 to reintroduce recycling. Some of them noted that it would be the only solution to report all the components of the performance of equity instruments in profit and loss. This would also be more consistent with the accounting treatment of debt instruments carried at FVOCI.

Most of these respondents which supported an amendment in IFRS 9 encouraged the EFRAG Board to advice the EC to urge the IASB to undertake a narrow-scope amendment to IFRS 9 on a timely basis so to have it in place when IFRS 17 *Insurance Contracts* becomes effective.

Four respondents only commented that the timing of the request was not the appropriate as IFRS 9 came into effect for financial years beginning on or after 1 January 2018 and does not come into effect for insurance companies until 2021 and/or that the most effective method of assessing the impact of the standard is the IASB's own postimplementation review, and therefore do not agree on the EC taking forward this issue.

Detailed analysis

Question 1 – Recycling gain or losses on disposal

In paragraphs 2.3 to 2.10 of Chapter 2 EFRAG presents arguments as to why the recycling of cumulative gains or losses into profit or loss on disposal of equity instruments carried at FVOCI might improve the depiction of the financial performance of long-term investors.

Q1.1 Do you consider that the reintroduction of recycling would improve the depiction of the financial performance of long-term investors? Alternatively, do you consider that the existing requirements of IFRS 9 provide an adequate depiction?

Preparers and organisations of preparers

Some preparers and organisations of preparers from Austria [CL 053], Belgium [CL 015 and CL 024], Greece [CL 035], Poland and Singapore [CL 017] expressed the view that recycling would improve the depiction of the financial performance of long-term investors.

This view was also expressed by some preparers and organisations from Germany [CL 001, CL 002, CL 033 and CL 048], France [CL 007, CL 020, CL 027, CL 029, CL 030, CL 051 and CL 052] and some European or international organisations of preparers [CL 005, CL 016, CL 026, CL 031, CL 034 and CL 046].

The arguments provided in favour of recycling included in these comment letters were that:

- the FVPL category introduced undue volatility and failed to reflect the long-term investments business model as unrealised gains and losses could not be considered as similar to realised gains and losses, for that reason the best accounting method for equity instruments for long-term investors was FVOCI;
- due to the prohibition of recycling, the cash flows relating to gains on disposal were not reported in profit and loss anymore. As a result, the general principle to show in a transparent way all realised gains and losses in the profit and loss account had been lost. This created the false impression that the cumulative gains and losses at the time of disposal of equity instruments were not relevant or economically insignificant, and therefore not a part of the financial performance;
- gains or losses on disposal might not have predictive value but they have confirmative value;
- paragraph 7.16 of the Conceptual Framework established that the statement of profit or loss was the primary source of information about financial performance;
- recycling was also fully consistent with paragraph 7.19 of the Conceptual Framework also included a general presumption that the accumulated gains and losses in OCI into the statement of profit or loss in a future period, when this results in the statement of profit or loss providing more relevant information, or a more faithful representation of the entity's financial performance for that future period and argued that was the case when the investments were sold, and the gains or losses were realised.

A Danish [CL 011] and a German [CL 013] organisation representing financial institutions regarded recycling as a possible approach. They noted that, while recycling could be appropriate to portray the performance of long-term investments, this very complex issue could not be solved by a short-term change.

Two German preparers [CL 003 and CL 013] expressed that recycling had no preferences as it was considered that there were no differences between profit or loss and OCI.

One organisation representing some UK financial institutions was against recycling [CL 038]. It noted that the existing provisions for IFRS 9 provides the appropriate basis for depicting the performance of equity securities.

Three comment letters did not express a clear consensus or no view on the issue [CL 019, CL 028 and CL 044].

National Standard Setters

The standard setters from Austrian [CL 037], France [CL 047], Italy [CL 042] and Japan [CL 006] considered that recycling would be preferable. The arguments provided were:

- there were crucial differences between realised performance that should be recognised in P&L and unrealised performance that should be recognised in OCI;
- it also seemed appropriate to consider changes in value of investments within equity instruments in the financial performance. This certainly included the consideration of final profits or losses at disposal; and
- both dividends receipts (which were included in profit or loss) and gains on disposal from the sale of equity instruments represented a form of realisation of the fair value of the instruments. Therefore, both events should be presented in the same way.

On the other hand, the standard setters from Norway [CL 040], Poland [CL 008], Spain [CL 025] and the United Kingdom [CL 023] were against recycling. The arguments provided were:

- the timing of a sale of an equity instrument was entirely controlled by the entity and did not help reflect the entity's performance in the year;
- any re-measurement gains or losses pertained to holding period and not the period of disposal; and
- recycling could lead to manipulation of profit and loss and obscured the performance of an entity's portfolio.

The Danish standard setter [CL 022] had not seen any convincing evidence that IFRS 9 would affect long-term investors' behaviour concerning the holding of long-term equity instruments. The respondent had "sympathy" for recycling should IFRS 9 be reopened.

The Dutch standard setter [CL 010] thought that it should first be understood what the issue was before a solution could be suggested. The respondent noted that if recycling should be introduced, some form of an impairment model should also be introduced.

The German standard setter [CL 004] had not yet formed a final view on the issue. It saw no clear evidence that the current requirements would negatively impact long-term investments, nor that the reintroduction of recycling would have a positive impact.

Similarly, the Portuguese standard setter [CL 032] thought that any recommendations should be made after the post-implementation period.

Regulators

The two European regulators responding the to the consultation, were either against recycling [CL 036] or had no clear preference from a conceptual perspective as to whether recycling should be reintroduced [CL 018]. The first respondent noted that the evidence collected by EFRAG did not demonstrate a need to introduce recycling to support long-term investments. On the contrary, it noted that "recycling may introduce in some cases, and especially for financial institutions, short-term accounting incentives to put in place opportunistic profit-taking disposal policies, thus sustaining earnings management practices, which would be contrary to the objective of encouraging long-term investments".

Auditors

An association of auditors from the UK was against recycling [CL 043]. Firstly, the comment letter noted that the FVOCI category was intended for strategic investments only for which changes in fair value were not of primary relevance. Secondly, if FVOCI would also be used for non-strategic investments, recycling in one period would not reflect the investor's periodic performance. Other audit firms or associations of auditors did not have a (consensus) view on the issue [CL 012, CL 014, CL 041, CL 045 and CL 049].

Users

The two groups of users responding to the consultation had the following views:

- one group [CL 021] believed that FVPL was the better approach to depict performance. However, it noted that users focus on the statement of profit or loss to assess an entity's performance, so fair-value fluctuations in OCI were accordingly not regarded as performance. Recycling could therefore be recommendable to gauge the performance of an investor over the entire holding period. The group considers that recycling was more suitable to assess stewardship, particularly when determining how an entity realises capital gains or losses and how successful the entity was in managing its investment portfolio; and
- the other group of users [CL 050] believed that the act of realisation of a gain or a loss does not change the economic reality of the performance of the business. The gain or loss has accrued over the holding period and if management had elected to use OCI, realised gains were not part of the performance of the period. They thought that the election should only be available for strategic investments. Volatility in fair values of long-term investments was "normal" and accordingly, this group of users do not see any need to "smooth earnings". Instead the management should explain the reasons for the movements.

An individual user responding to the consultation [CL 039] was in favour of recycling as he thought realised gains and losses should be reported in profit or loss.

Question 2 – Conceptual relationship between recycling and impairment

In paragraphs 2.11 to 2.17 of Chapter 2 EFRAG discusses the relevance of an impairment model for equity instruments carried at FVOCI.

Q2.1 Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model?

From a conceptual point of view almost all of the respondents, to the questions presented in the DP, supported the proposal that recycling needs to be accompanied by a strong impairment model in order to reach consistent application of the recycling proposal.

Some mentioned that such impairment mechanism currently exists in some of the IFRS measurement methods that lead to an impact in profit and loss upon de-recognition of an asset were accompanied by some kind on impairment mechanism, and also some of those who support the reintroduction of recycling did not find any conceptual reason for creating an exception for equity instruments.

Of the preparers that were in favour of recycling or did not have a view on this, two German preparers responding to the consultation, did not think it was necessary to introduce an impairment model [CL 002 and CL 003]. The other preparers and organisations representation preparers responding to the question in the consultation either supported an impairment model [CL 007, CL 015, CL 016, CL 020,

CL 024, CL 026, CL 027, CL 029, CL 030, CL 031, CL 033, CL 035, CL 044, CL 046 and CL 051] or did not oppose to it [CL 005].

The arguments provided in favour of an impairment model included:

- it would ensure consistency of the accounting treatment of equity instruments at FVOCI under IFRS 9 with the treatment of assets other than those measured at FVPL under IFRS [CL 007, CL 020, CL 026 and CL 030];
- it would enhance the relevance of profit and loss as the primary source of information about an entity's financial performance as all the components of the performance of the investments (dividends, impairment and gains and losses when the asset was sold) will be recognised in the same place [CL 007, CL 024 and CL 026];
- it would be in line with the principle of prudence [CL 016, CL 026, CL 029, CL 030 and CL 031]; and
- impairment enhanced the relevance of profit or loss for stewardship purposes [CL 020 and CL 044].

Some of the preparers or organisations of preparers that supported recycling did not provide an explicit answer such an impairment model should be accompanied by an impairment model [CL 001, CL 009, CL 011, CL 013, CL 017, CL 019, CL 028, CL 034 and CL 048].

The preparer organisation that was against recycling thought that if recycling were reintroduced, an impairment model would be needed, and it should ensure symmetrical treatment for reversals of impairment losses [CL 038].

The standard setters responding to the consultation were either in favour of an impairment model if recycling should be introduced [CL 006, CL 010, CL 022, CL 025, CL 032, CL 037, CL 040, CL 042 and CL 047] or had not formed a view on the issue [CL 004 and CL 008]. However, one of these [CL 008] noted that from a conceptual point of view, testing assets for impairment was a fundamental stand-alone concept irrespective of recycling that, at least theoretically, should apply to any class of assets held.

The arguments provided in favour of any kind of impairment model were:

- it would result in an outcome closest to the outcome of a fair value through profit or loss approach [CL 022];
- the FVOCI approach reflected a dual measurement approach under which the assets were measured at fair value in the statement of financial position and at cost in the statement of profit or loss. When measuring at cost, it was an established practice to recognise impairment losses through profit or loss when the historical cost was no longer recoverable [CL 006];
- any IFRS measurement method that leaded to an impact on profit or loss upon de-recognition of an asset was accompanied by an impairment mechanism and there was no conceptual reason for creating an exception for equity investments [CL 047]; and
- negative changes in the value should be recognised when they occurred [CL 025].

The Polish standard setter, which was not in favour of recycling (and did not provide a view on impairment) noted that the issues related to impairment was another argument for not introducing recycling [CL 008].

The UK association of auditors that was against recycling noted that a form of impairment model would be a pre-requisite. Otherwise the timing of recognition of losses was entirely within the control of the investing entity [CL 043]. Other auditors and associations of auditors/accountants also shared this position [CL 012, CL 014 and CL 045] or did not provide a view [CL 041 and CL 049].

Both regulators and user organisations supported the need for an impairment model to reduce incentives for earnings management, it was needed for prudence and transparency reasons, [CL 018] as well as to enhance the relevance of profit or loss for stewardship purposes [CL 036] and assess prospects for future cash flows.

Most of respondents acknowledge that some of the negative fair value changes could be of a permanent nature. Most of them also agreed that a robust impairment model increased the relevance of the profit and loss statement as primary source of information of the performance of the company.

Question 3 – Enhancing presentation and disclosure requirements

In Chapter 3 EFRAG discusses whether and how presentation and disclosure requirements could provide better information on performance from a long-term investing perspective, including potential impairments of equity instruments. EFRAG presents arguments as to why enhanced presentation and disclosure requirements might not be an adequate substitute for improving the depiction of performance in profit or loss.

Q3.1 What are your views on the arguments and analysis presented in Chapter 3 of the DP? and Q 3.2: Are there other improvements in presentation and disclosure that you would support?

Almost all the respondents who answer to this question agreed that presentation and disclosure solutions could not adequately replace recognition and measurement in the primary financial statements and referred to IAS 1 *Presentation of Financial Statements*. For that reason, it was generally agreed that information recognised in the financial statements was more valuable that information disclosed in the notes.

Furthermore, for most of those who mentioned that the distinction between realise and unrealised gains and losses was considered useful to users, it would not be sufficient to simply provide a mention in the notes

It was also mentioned that the effect of additional too granular information would be negative as being disproportionate to the current need. It would lead to burdensome reporting for preparers and readers going against the current objectives of disclosure effectiveness, notably given the size of portfolios.

Most of those respondents also did not support additional disclosure requirements, beyond those already in IFRS 7 *Financial Instruments: Disclosure* paragraph 11A and 11B. However; many acknowledged that if recycling with impairment were introduced there would be a need to disclose information on both the impairment policy and impacts. Most of them agreed that any new disclosure requirement should however be kept to the minimum necessary to achieve the objective.

Some respondents also mentioned that it was too early to propose changes to IFRS 9's existing disclosures requirements; to do so would prejudge the results of the PIR. It would be preferable to wait until there was evidence of the actual disclosures made by entities in practice.

Question 4 – Two models

In paragraphs 4.4 to 4.22 of Chapter 4 EFRAG describes two models for equity instruments carried at FVOCI:

- a revaluation model in which all declines in fair value below the acquisition cost would be immediately recognised in profit or loss and changes in fair value above the acquisition cost would be recognised in OCI and recycled on disposal; and
- an impairment model similar to the model of IAS 39 for equity instruments classified as AFS, but with additional guidance to reduce subjectivity

Q4.1 What should be, in your view, the general objective and main features of a robust model for equity instruments (relevance, reliability, comparability…)?

Several constituents agreed that a robust impairment model would need to provide relevant and reliable information and allow conclusions to be made about comparability (which could favour a revaluation model). Some constituents suggested relevance (which could favour an impairment model similar to the previous IAS 39) should take precedence if there was a conflict between features.

The preparer association that was against recycling did not express any preference [CL 038].

The standard setters that did not express a clear view in respect of recycling, did also not favour one of the two models.

The Danish standard setter [CL 022] thought that impairment should be evaluated regardless of the size and duration of the fair value decline (to be as close to the FVPL approach as possible and to be less subjective).

The Dutch standard setter [CL 010] noted that the triggers in any impairment model should be sufficiently clear to avoid unnecessary subjectivity. In addition, any reversal of an impairment should be symmetrical to initial recognition of an impairment.

The UK standard setter [CL 023] thought that a wider debate was needed about when recycling provides more relevant information or a more faithful representation, and what conditions should apply before it could provide a view on impairment.

The UK auditor/accounting association that was against recycling noted that any impairment model would involve complexity and create difficult questions of judgement [CL 043].

Some associations of auditors or accountants did not provide a view on the impairment model [CL 041 and CL 049].

Q4.2 Which, if either, of the two models do you prefer?

Preparers and organisations of preparers

The preparers providing a view on the issue favoured some kind of an IAS 39 model [CL 001, CL 002, CL 005, CL 007, CL 015, CL 016, CL 017, CL 020, CL 024, CL 027, CL 031, CL 044, CL 046 and CL 051]. Some mentioned that they supported modifications that reduced subjectivity.

The argument provided in favour of a model similar to the previous IAS 39 were:

- it would distinguish between permanent declines in the fair value of the underlying equities versus their short-term market-driven fair value changes [CL 002, CL 016 and CL 024];
- it would avoid the unintended volatility in profit or loss, when the current fair value was below the original cost [CL 002, CL 016 and CL 024];
- it would allow the application of an impairment approach for equity instruments that was consistent with the one for debt instruments measured at FVOCI [CL 016 and CL 024];
- entities would be familiar with the model from IAS 39 [CL 013]; and
- it would enhance transparency [CL 020].

Arguments provided against the revaluation model proposed were:

- the approach would result in short-term value decreases being recognised in profit or loss, which would not result in relevant information for users [CL 001, CL 006 and CL 016];
- the information would not be relevant as there would be no assessment of the factors causing the impairment or consideration of the characteristics of the equity portfolios [CL 007, CL 016 and CL 020];
- it would a be source of volatility, in contradiction with their long-term investment strategies [CL 007, CL 020, CL 027, CL 029, CL 030, CL 031, CL 044 and CL 046];
- it would result in an asymmetric treatment [CL 015 and CL 031]; and
- it would not adequately portray the performance of a managed portfolio of equity investments (in which would be expected to show fair value gains and other losses) [CL 044].

Some also provided arguments in favour of the revaluation model:

- it would be simple [CL 001, CL 007 and CL 013]; and
- it would be less discretionary than an IAS 39 approach [CL 013].

National Standard Setters

The standard setter of Germany [CL 004] thought that the models presented by EFRAG were a good starting point for further discussion but not sufficiently developed to enable a judgement of their merits.

The Austrian standard setter [CL 037] thus seemed to consider the IAS 39 model to be better than the revaluation model as the latter would not reflect the business model of long-term investments.

The French standard setter [CL 047] similarly favoured the IAS 39 model but noted that it should include an impairment reversal mechanism.

The Italian standard setter [CL 042] also thought the IAS 39 model should be amended to allow for reversals of impairment losses. In addition, it should provide application guidance on the terms “significant” and “prolonged” to reduce the subjectivity around the interpretation of these terms. Quantitative thresholds might be included in this guidance to reduce subjectivity and enhance comparability among entities.

The standard setter of Japan [CL 006] did not mention it directly, but it seemed to consider that IAS 39 model could be better than then revaluation model although a “significant or prolonged” decline in fair value might not necessarily depict the effects of identifiable adverse changes in the issuer’s economic conditions.

The Norwegian standard setter [CL 040] saw some merits in the revaluation model as it would at least provide information about unrealised loss on an equity instrument with fair value below cost (“lower of cost and market”). The respondent thought that this could provide useful information, the model would increase comparability, reduce complexity (easily understandable), and provide information that would be transparent and less subjective then an “incurred loss” approach.

The Polish standard setter [CL 008] noted that if recycling would be introduced, it would favour the revaluation model as this was objective and result in a more comparable information and it was also principle-based.

The Spanish standard setter [CL 025] preferred the revaluation model as it did not involve the problem of identifying the deterioration milestone.

Auditors

Two auditors or associations of auditors favoured the revaluation model [CL 012 and CL 014]. The arguments provided were:

- it was simpler [CL 012 and CL 014];
- it provided a certain degree of objectivity [CL 012];
- it enhanced comparability [CL 012 and CL 014];
- it enhanced more consistency with the treatment of the impairment of other assets [CL 014]; and
- it provided less scope for earnings management [CL 014].

One audit company [CL 045] favoured an IAS 39 approach but thought that the modifications which included the use of a backstop trigger and introduction of an impairment reversal process might result in the revaluation approach being an interesting alternative as it was simple and offered better comparability across entities.

Regulators

One of the regulators did not think that any of the models proposed would improve financial reporting as they did not strike the right balance between relevance and comparability [CL 018]. For example, the revaluation model could result in comparable information, but as the information would not take the different sources of fair value changes into account the information would not be relevant. The other regulator [CL 036] favoured the revaluation approach, as the IAS 39 approach would not result in timely and comparable recognition of impairment losses.

Users

The organisations of users replying to the consultation [CL 021 and CL 050] did not express any preference about the two impairment models suggested in the consultation document. One of the organisations [CL 021] thought, however, that the concepts of “significant” and “prolonged” should remain as a principle-based approach introducing qualitative guidance and some quantitative thresholds.

Q4.3 Do you have suggestions for a model other than those presented in the DP?

Some preparers did not express a preference [CL 003, CL 009, CL 011, CL 013, CL 019, CL 026, CL 028, CL 029, CL 030, CL 033, CL 034, CL 035 and CL 048]. Some of these suggested an impairment model based on value in use [e.g. CL 029 and CL 030] or, similarly, an impairment model based on recoverable amount [CL 035]. One constituent suggested a model where the impairment trigger would be a reduction of the dividend pay-out.

The Portuguese standard setter [CL 032] did not favour one of the models, but impairment in accordance with IFRS 9.

The French standard setter [CL 047] proposed a third approach based on the following principles:

- Focus on the “prolonged” criterion as it was a better approximation of what was a “realised” loss than a materiality threshold that could revert over time;
- The prolonged criterion it was proposed to be implemented as follows:
    - any decline in value below cost over a period longer than a defined threshold would trigger immediate impairment; and
    - any major event leading to a significant decline in value would have to be investigated at reporting date to determine whether a recovery above cost is highly probable before the end of the threshold period.
- Reversal of the impairment could be either:
    - authorised based on a symmetric approach encompassing a probationary period (consistent with the “realised vs unrealised” principle, providing less P&L volatility,

conceptually consistent with the use of an impairment trigger threshold, but more complex to implement); or

- automatic for any subsequent increase in value (as a practical expedient for entities having a significant equity instrument portfolio).

The individual replying to the consultation [CL 039] did not favour any of the models and suggested an approach aligned to the expected loss model. The trigger event should be whether there was a dividend cut.

Question 5 – Quantitative impairment triggers

In paragraphs 4.12 to 4.22 of Chapter 4 EFRAG discusses the inclusion of quantitative impairment triggers in its impairment model. Triggers reduce the extent of judgement in assessing whether a decline in fair value below cost represents objective evidence of an impairment, especially if set within the IFRS Standard. This enhances comparability (across entities and over time) but may reduce relevance.

Q5.1 Do you support the inclusion of quantitative impairment triggers in an impairment model? If so, should an IFRS Standard specify the triggers, or should management determine them? and Q5.2 If you do not support quantitative impairment triggers, how would you ensure comparability across entities and over time?

Many of the respondents who answer to that question acknowledged that there were prior practical problems in application of the 'significant' and 'prolonged' criteria used in IAS 39 and believed that more guidance was needed to provide greater comparability.

Of those that supported the use of quantitative impairment triggers or rebuttable presumptions, mostly preparers and two National Standard Setters preferred that entities would set them. The reasons for entity defined triggers included:

- a single bright line approach might not be appropriate in all circumstances or for all entities;
- it would be more principles-based; and
- it allows for consideration of the characteristics of the business model or portfolio and relevance was more important than comparability.

Those in favour of quantitative triggers set in the Standard argued that it was more operational and achieves comparability between entities and over time.

Some of the respondents remarked that any quantitative trigger included should be accompanied by some rebuttable presumption. Some added that a combined approach with the standard defining a maximum threshold would be their second choice, if it was considered necessary to enhance a better comparability among entities.

Those respondents that opposed the use of quantitative triggers argued that:

- specific judgement must be exercised to convey the correct information;
- impairment would become rule-based;
- it would fail to provide relevant information in certain circumstances; and

- management should determine impairment criteria that apply to a dedicated portfolio.

In the absence of quantitative triggers, one respondent suggested that comparability might be improved by the development of illustrative and specific guidance on the meaning of both 'significant' and 'prolonged' in well-defined situations combined with improved disclosure. Another respondent noted that allowing for the reversal of an impairment may improve comparability.

Question 6 – Subsequent recovery in fair value

In paragraphs 5.2 to 5.22 of Chapter 5 EFRAG considers whether subsequent recoveries of fair value should be recognised through profit or loss and illustrates some different reversal mechanisms.

Q6.1 How should subsequent recoveries in fair values be accounted for?

Most respondents who answer that question agreed that recognising subsequent recoveries in profit or loss was appropriate as it would provide more relevant information. The objective of an impairment model would be to capture significant downwards movements in the value of an entity's equity investments. If circumstances changed at a later date and the conditions for an impairment loss would no longer apply, recognising subsequent recoveries in profit and loss would be conceptually acceptable and conceptually consistent with the principles of other IFRS Standards.

Another argument was that reversals help to overcome the perceived reluctance of entities to recognise impairment charges in a timely manner.

Q6.2 If subsequent recoveries in fair values are recognised in profit or loss, which of the approaches in paragraphs 5.2 – 5.10 do you support and why?

One respondent mentioned a preference in retaining the IAS 39 impairment model irreversible approach for impairment losses. However, this respondent also advocated for a relatively high impairment threshold.

The French standard setter [CL 047] considered that it could be useful to develop an approach measuring the impacts based on different units of account whenever it leaded to aligning presented performance with the way it was actually monitored internally. This model would particularly fit the re-evaluation model. Such portfolio should be designed based on the business model of each entity. The characteristics permitting to define portfolios could be diverse but shall be clearly defined, disclosed by the entity, and consistent with actual management practice and organisation and proposed that this approach would be even more relevant if it was extended to all FVOCI investments being part of the actual long-term investment portfolio management.

The previous respondent proposed that a cost formula should be developed in the standard, and shall it be amended, in order to specify how to account for an impairments / gains or losses when equity instruments were acquired in multiple steps

Less than one-third of the respondents who expressed a view on that topic mentioned a preference on the method of an impairment reversal. Most of the respondents that did express a preference preferred a limited reversal approach[1] because it was symmetrical with the underlying impairment model and limited undue volatility.

Question 7 – Other considerations

EFRAG discusses a number of other relevant considerations, including:

- whether an IFRS Standard should introduce specific requirements for particular sub-sets of equity instruments and, if so, how these sub-sets should be defined (In paragraphs 4.23 to 4.29 of Chapter 4). EFRAG has not developed this approach further;
- the use of rebuttable presumptions for recognising impairment losses instead of automatic triggers (In paragraphs 5.11 to 5.13 of Chapter 5);
- the unit of account in applying the models (In paragraphs 5.14 to 5.24 of Chapter 5); and
- other application issues (In paragraphs 5.25 to 5.40 of Chapter 5).

Q7.1 Do you consider that the same model should apply to all equity instruments carried under the FVOCI election? If not, why not and how would you objectively identify different portfolios?

A clear majority of respondents to the question mentioned that for reasons of comparability and objectivity, the same model should apply to all equity instruments carried at FVOCI. A few of the respondents suggested there should be different impairment models. The suggested exceptions included:

- level 3 instruments, as the market information to conduct the impairment test was not reliable;
- equity instruments held by insurers; and
- strategic investments.

One respondent mention that an alternative approach that could be considered would be to identify accounting models based on the holding objectives of equity instruments. For example, for those investments that are held for purposes of funding liabilities, a model similar to IAS 19 (with potential adjustments) would achieve a better performance presentation of the asset and liability management performed by entities.

This same respondent also mentioned that might also be considered introducing an accounting based on the IFRS 13 fair value hierarchy, as this approach would allow to address the earnings management concern associated with the recycling of OCI.

Other respondent considered that as far as the equity financial asset could be acquire in multiple steps, it was proposed that in the case of amending IFRS 9 for equity instruments, it would also be necessary to develop a cost formula and to specify how to account for impairment gain and losses.

[1] A limited reversal approach would allow recognition of a reversal only from the moment when the fair value recovers over the initial cost or the impairment threshold. In an impairment model with a 'significant' threshold this would introduce a degree of symmetry – moving across the threshold would trigger both the recognition of downward changes and recoveries in profit or loss.

Q7.2 Do you have comments on these other considerations? and Q7.3 Are there other aspects that EFRAG should consider?

Respondents generally agreed that the unit of account for the measurement of financial instruments was the individual instrument. However, two respondents had opposing views. One respondent a portfolio approach should be allowed for linked asset/liabilities. Another respondent believed the unit of account should be the portfolio or business model of equity instruments.

Respondents commenting on individual investments acquired in multiple tranches generally did not support to specify a cost formula (FIFO or weighted average cost).

One respondent asked to explicitly clarify the consequences of any changes to the requirements in interim periods, for instance in relation to the ongoing reversal approach.

Question 8 – Other aspects of IFRS 9's requirements on holdings of equity instruments

In paragraphs 1.15 to 1.16 of Chapter 1 EFRAG explains that the scope of EFRAG's project is based on the specific questions in the EC's request for advice and that other aspects of IFRS 9's requirements on accounting for holdings of equity instruments have not been explored.

Q8.1 Are there other aspects of IFRS 9's requirements on accounting for holdings of equity instruments, in addition to those considered in the DP, which in your view are relevant to the depiction of the financial performance of long-term investors?

Several respondents suggested that the FVOCI election should be allowed for indirect investments in equity instruments, such as Undertakings for Collective Investments Transferable Securities (UCITS), Exchange Traded Funds (ETF) or Authorized Investments Funds (AIF).

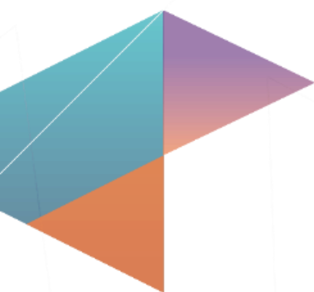
Some of the respondents mentioned above also mentioned that under IAS 39, investments through an investment fund were usually accounted for as equity instruments (such as UCITs) classified as Available for Sale (AFS), with recognition of changes in fair value in OCI. However, under IFRS 9, those investments were considered to be debt instruments and had to be accounted for at FVPL since these would normally not meet the "solely payments of principal and interest" (SPPI) –criteria.

This significant change in accounting treatment could create volatility in the statement of profit and loss that was not consistent with the long-term investment perspective of these instruments. It would also create accounting mismatches if the corresponding liabilities were not accounted for at FVPL under IFRS 17.

One respondent did not see a need for a discretionary option as contained in IFRS 9 to designate an equity instrument at FVOCI, and instead, believed it should be mandatory depending on the business model. However, another respondent also commented on the option and suggested should be eliminated altogether resulting in all equity instruments at FVPL. It should be noted that several respondents to earlier questions in the DP also expressed support that all equity instruments should be at FVPL.

Some respondents mentioned that the DP excluded a discussion on the use of fair value as the measurement basis for all equity instruments. They questioned the reliability of the measurement for certain instruments. One respondent suggested that on-going initiatives related to the accounting for these instruments were coordinated.

One respondent favoured using cost for less significant long-term investments, with impairment charges and reversal mechanism similar to IAS 36 *Impairment of Assets*, and the recognition of gain and losses on disposal or retirement in profit or loss. This would be simple and consistent with other non-current assets while avoiding irrelevant volatility and the need to fair-value investments often not listed.

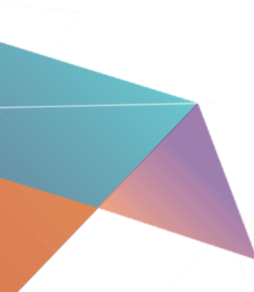


APPENDIX I – List of respondents

Respondent	Country	Type
ACCA – Association of Chartered Certified Accountants	International	Auditing Association
Accountancy Europe	Europe	Business Association
ACTEO – Association pour la participation des entreprises françaises à l'harmonisation comptable internationale		
AFEP – Association française des entreprises privées	France	Business Association
MEDEF – Mouvement des entreprises de France		
Af2i – Association Française des Investisseurs Institutionnels	France	Business Association
AFG – Association Française de la Gestion Financière	France	Business Association
AFME – Association for Financial Markets in Europe	Europe	Business Association
AFRAC – Austrian Financial Reporting and Auditing Committee	Austria	National Standard Setter
Allianz	Germany	Preparer
ANC – Autorité des Normes Comptables	France	National Standard Setter
ASBJ – Accounting Standards Board of Japan	Japan	National Standard Setter
ASCG – Accounting Standards Committee of Germany	Germany	National Standard Setter
Assuralia	Belgium	Business Association
BNP Paribas	France	Preparer
BusinessEurope	Europe	Business Association
CFO Forum – European Insurance CFO Forum	Europe	Business Association
CNC – Comissao de Normalizacao Contabilistica	Portugal	National Standard Setter
CRUF – The Corporate Reporting Users Forum	International	Professional Organisation of Users

Commerzbank	Germany	Preparer
DASB – Dutch Accounting Standards Board	Netherlands	National Standard Setter
DASC – Danish Accounting Standards Committee	Denmark	National Standard Setter
Deloitte	International	Auditing
Deutsche Telekom AG	Germany	Preparer
Dr. Carsten Zielke	Germany	Individual
ECB – European Central Bank	Europe	Regulator
EFAMA – European Fund and Asset Management Association	Europe	Business Association
EFFAS – European Federation of Financial Analysts Societies	Europe	Professional Organisation of Users
ESBG – European Savings and Retail Banking Group	Europe	Business Association
ESMA - European Securities and Markets Authority	Europe	Regulator
Evonik Industries AG	Germany	Preparer
FBF – French Banking Federation	France	Business Association
FFA – Fédération Française de l'Assurance	France	Business Association
Finance Denmark	Denmark	Business Association
FRC – Financial Reporting Council	UK	National Standard Setter
GBIC – German Banking Industry Committee	German	Business Association
GDV – German Insurance Association	Germany	Business Association
HBA – Hellenic Bank Association	Greece	Business Association
ICAC – Instituto de Contabilidad y Auditoría de Cuentas	Spain	National Standard Setter
ICAEW – Institute of Chartered Accountants in England and Wales	UK	Auditing Association
ICAS – Institute of Chartered Accountants of Scotland	UK	Auditing Association

Insurance Europe	Europe	Business Association
Invest Europe	Europe	Business Association
ISDA – International Swaps and Derivatives Association	International	Business Association
KBC	Belgium	Preparer
Mazars	International	Auditing
NASB – Norwegian Accounting Standards	Norway	National Standard Setter
OIC – Organismo Italiano di Contabilita	Italy	National Standard Setter
PASC – Polish Accounting Standards Committee	Poland	National Standard Setter
ProSiebenSat.1 Media SE	Germany	Preparer
Siemens AG	Germany	Preparer
Société Générale	France	Preparer
Temasek Holdings	Singapore	Preparer
UK Finance	UK	Business Association
Anonymous	Austria	Preparer



APPENDIX II – List of presentations

Date	*Presentation*
9 April	Accountancy Europe IFRS 9 Task force
13 April	International Forum of Accounting Standard Setters
2 May	EFFAS Financial Accounting Commission
3 May	EFRAG Financial Instruments Working Group
3 May	Euro Corporate Reporting User Forum
14 May	International Group Organismo Italiano di Contabilitá
15 May	EFRAG User Panel
24 May	BusinessEurope Sounding Board
6 June	KBC Bank