Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mr Gauzes
EFRAG Chair
35 square de Meeùs
B-1000 Bruxelles

July 12, 2019

EFRAG CONSULTATION ON EQUITY INSTRUMENTS – RESEARCH ON MEASUREMENT

Dear Mr Gauzes,

We are pleased to take the opportunity to comment on the EFRAG Consultations about equity instruments. Please find below our responses to the questions asked.

Please do not hesitate to contact us if you require any further information about our response.

ACTEO	AFEP	MEDEF
Patrice MARTEAU	François SOULMAGNON	Agnès LEPINAY
Chairman	Director General	Director of economic and financial affairs

Introduction

How do you define long-term investment business model?

Long-term investments encompass many types of instruments corresponding to each specific case and needs of different entities and business models. Characteristics most often identified are:

- Assets held for more than one year (eg : bonds, cash, etc.)
- Assets not intended to be sold for short term profit–
- Investment in companies which are developing activities complementary to the investor's core business or developing new products or services related to the future of the investor's core business
- Strategic investments
- Assets Dedicated to Liabilities (ADL)

It is therefore challenging to find a definition that could fit every kind of investment and situation perfectly. We therefore suggest defining this category by default as those investments which are not trading investments. The definition of the latter is sufficiently explicit, understood and widely used by all entities and does not require further debate.

Need for an alternative accounting treatment to current IFRS 9 requirements

Q1 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?**

We believe that an alternative accounting treatment should exist for:

- All equity instruments and equity-type instruments which are not held for trading (and thus held in a "long-term investment business model")
- Assets Dedicated to Liabilities (ADL)
- Strategic investments

See our specific comments dedicated to each category

Q2/Q3 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.
We believe that the current prohibition of recycling does not permit entities to reflect faithfully the way they manage their resources. It is thus contrary to one of the main objectives of financial reporting. The IASB has recently reaffirmed that net income is the most important performance indicator in the revised conceptual framework. When the gains and losses related to certain items never impact net income, this result cannot be said to reflect performance and stewardship.

While we support EFRAG's initiative on this issue, we wonder, however, about the subsequent stages of the process. We hope that it could lead to a reopening of discussions with the IASB so that the standard setter will be convinced of the need to amend IFRS 9 as a matter of urgency. We would be much more hesitant about a solution that would change the standard only in the European Union and thereby create a parallel accounting framework.

Q4 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?**

We share the view that the accounting model for equity instruments should be consistent with that for other assets and we thus consider that it should include both recycling and some form of impairment recognition. We also agree that impairment enhances the relevance of profit or loss for stewardship purposes.

We would support a model similar to IAS 39's requirements but with less subjectivity. We believe this would improve transparency and rigour in application. In respect of the thresholds for the notion of "significant decline" and "prolonged decline", we believe that the management should be left responsible for specifying their own definition of these terms with transparent disclosures in the notes. However, we understand the need for a more rigorous approach, and we could accept the proposal that the IASB sets rebuttable presumptions in terms of upper limit for both terms.

This presumption may however be rebuttable when the upper limits are judged to be clearly not relevant for specific equity instruments. In such a case, the entity would have to disclose when and why the presumption has been refuted. This could be the case, for example, for strategic investments with very long holding periods or with a very high volatility that could be demonstrated.

We believe that reflecting changes in the adverse effects in the investee's future performance improves the relevance of net income. When the impairment loss is no longer probable, this change should also be translated into net income. Moreover, authorising such reversals to be recognised in net income would probably limit the perceived temptation experienced by entities to defer the recognition of impairment losses in the net result. It will therefore have a beneficial effect on the determination of impairment thresholds.

We are in favour of a reversal model based on the same triggers as those used for impairment since this will lead to a symmetric model and once again will reinforce the reliability of the triggers used for the impairment side, in other words, the impairment model with a limited reversal threshold.

Q5 Should the different accounting treatment **be restricted to equity instruments held in a long-term investment business model?**

We believe that other specific accounting treatments should be provided for other categories of long-term investments such as Strategic investments and Assets Dedicated to Liabilities (ADL)

- Assets Dedicated to Liabilities (ADL)

One type of business model that would benefit from a different accounting treatment is the funding of long-term provisions, such as dismantling provisions, provisions for the treatment of nuclear waste, etc.

A provision for dismantling is set up at the moment the plant is commissioned and then evolves as a function of the unwinding of the discount, changes in the discount rate and changes in the estimated future dismantling cash flows. Under IFRS 9, if an entity invests in (quoted) shares in view of funding such a provision, a choice has to be made between measurement-

- at FV through the P&L, which can generate significant short-term P&L volatility whereas the investment horizon is long term,
- at FV through OCI, whereby any return (other than dividends) on such long term investments is never taken through the P&L, which creates a significant gap in the representation of the entity's total result over the entire time horizon related to the funding of such long term provisions.

In this specific case of dual measurement, it would be useful to allow a specific accounting model for the portfolio of assets identified as funding long-term provisions, no matter what type of investment is used. The principle would be to provide an accounting treatment allowing matching the effects of investments with those of the provision they "hedge" in order to avoid short-term volatility in net income.

- Strategic investment

Fair value of such investments is often difficult to assess. Until the expected technical/business performance proves successful, it is highly judgmental and provides little information. We therefore are of the view that the only approach to the accounting for such investments that would more appropriately reflect that business model would be to allow accounting for them at cost with an impairment test.

Q6 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, and therefore are not eligible for the option to measure 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"?

Q7 17. If so, which characteristics would you require to define the "equity-type" instruments?

Yes, this different accounting treatment should apply to all equity-type instruments except those held in a short-term or trading business model.

A FVOCI accounting model with recycling and impairment should also be opened up to include those instruments which do not qualify under as equity under the current definition, but which qualify for the exception provided by IAS 32.16A-16D on the issuer's side, such as units in investments funds.

Given that the IASB has as its starting point that there should be a symmetry of classification between financial instruments issued and financial instruments held, this symmetry should be respected in its entirety. Even though IAS 32 requires a two-stage process for these puttable, the end result is nonetheless that they are classified as equity for the issuer, both in their presentation and accounting. It therefore does not seem logical to stop at the definition test on the holder's side.

Such accounting treatments will avoid undue P&L volatility without undue cost and effort. In fact, the current restriction can be overcome by investing directly in such funds' underlying rather than in funds themselves (example: investing in all stocks included in a tracker), but this generates huge administrative cost and workload without further added value. We think that allowing a 'FVOCI with recycling' for units of investment funds such as 'trackers' would be very welcome and would allow entities to choose the most adequate investment based on the different investment alternatives' merits rather than based on potentially inadequate accounting impacts.

Q8 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

Not relevant at all [0] ______________________[_**100**]________________Most Relevant [100]