Amundi
ASSET MANAGEMENT

IFRS

EFRAG recommends a review of the accounting treatment of investments in equities and fund units

After analysing responses to the public consultation launched in May 2019, EFRAG[1] recommends a review of IFRS 9[2] as applied to equities. EFRAG proposes to look at the fact that changes in fair value on disposal previously recorded at FVOCI may not be recycled to income.

EFRAG specifies that if recycling is reintroduced[3], the amendment to IFRS 9 will have to include a robust impairment model and allow for the reversal of impairment losses. It also recommends that equity fund units should receive the same accounting treatment as directly-held shares.

Most respondents to EFRAG's consultation wish to see an accounting treatment allowing the "recycling" of changes in the fair value of equities to income

In its action plan on sustainable finance of June 2018, the European Commission asked EFRAG to explore potential alternative accounting treatments to fair value measurement for long-term investment portfolios of equity instruments. The Commission expressed concerns that if the treatment methods set out in IFRS 9 dissuade long-term investors from holding equity instruments, this could curb financing for sustainable projects.

Of the 63 entities that replied to EFRAG's consultation, nearly 70% would like to see an alternative accounting treatment to that currently available under IFRS 9 to better reflect the financial performance of long-term investments. The 43 entities in question are essentially insurers or associations representing insurers (14 of the 15 responses from insurers or their industry associations), banks and non-financial companies that publish financial statements under IFRS. The entities opposed to such a change are mostly users of financial statements – auditors and European organisations (European Central Bank and ESMA).

Opinions differ according to respondents' country of origin. While French, Belgian, Italian and Austrian respondents support an alternative accounting treatment, German and Spanish respondents are more muted, while British and Danish respondents do not believe that alternative accounting treatment would better reflect the financial performance and risks involved with long-term investments.

Opinions differ as to the definition and features of Long-Term Investments. Some respondents refer to the holding period of securities (though the suggested length of time differs from one respondent to another), while others focus on the business model or asset-liability management, in particular for insurance portfolios which require an investment strategy adapted to the duration of their liabilities.

The definition of Long-Term Investments is a real problem that could ultimately be avoided as 80% of the respondents who support the introduction of an alternative accounting treatment believe that the new provisions should not be limited to Long-Term Investments but instead extended to all equity instruments that are not held for trading.

While the principle of measuring equity instruments at Fair Value is generally approved by entities in favour of introducing an alternative accounting treatment, more than three quarters of them believe that measurement at FVOCI with the recycling of gains and losses on disposal to income would be the most appropriate solution.

For unlisted securities, some respondents recommend measurement at historical cost so as to eliminate the task of determining fair value, which is deemed overly costly.

1. European Financial Reporting Advisory Group.
2. Insurance entities can defer application of IFRS 9 until 1 January 2022, when IFRS 17 on Insurance contracts also takes effect.
3. The recycling of changes in fair value is a principle set forth in the previous standard on financial instruments (IAS 39) for shares classified as "available-for-sale" assets, but when impairmentt has been recognised (provisions for permanent impairment), any subsequent recovery in value may not be taken to income.

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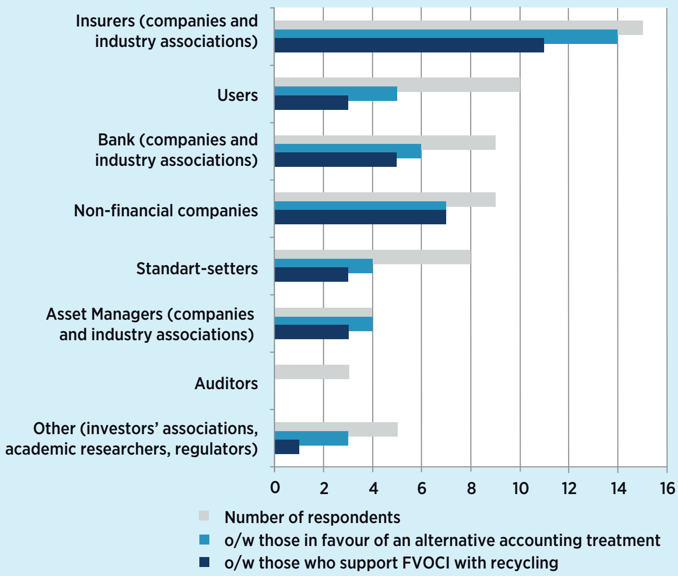

Source: EFRAG - Feedback statement - Survey on alternative accounting treatments for long-term equity investments - January 2020 - Amundi

The chart above shows that a large majority of insurers and industry associations that responded to the consultation are in favour of an accounting treatment based on FVOCI with recycling.

Associations of insurance companies specify that it must be possible to apply this treatment to all equity instruments not held for trading, and that it is not appropriate to limit it to a long-term investment business model. They believe that gains or losses on the sale of shares recorded at FVOCI are part of the company's performance and should be included in the net income in the same way as dividends received.

Insurance Europe and the German association GDV[4] insist that IFRS 9 should be amended rapidly to coincide with the application of IFRS 17 on Insurance contracts.

Some respondents, such as the Financial Reporting Council and ESMA raised concerns that allowing measurement at FVOCI with recycling could lead to opportunistic profit-taking for net income management purposes. The ANC[5], which is in favour of an alternative treatment for equities, emphasises that this risk already arises in the treatment of other available-for-sale assets under IFRS (inventories, tangible and intangible assets), and for assets that pass the SPPI (Solely Payments of Principal and Interest) test.

4. Gesamtverband der Deutschen Versicherungswirtschaft.
5. ANC: Autorité des Normes Comptables.
6. IASB: International Accounting Standards Board.

Opinions of national accounting standards bodies on the introduction of an alternative accounting treatment

The Deutsches Rechnungslegungs Standards Committee e. V (DRSC) has mixed views on the need for an alternative accounting treatment. It believes that the IASB's[6] post-implementation review would be the best opportunity to consider introducing a new accounting treatment. It also wants any new accounting treatment to be limited to strategic investments, and to apply a minimum holding period.

The Autorité des Normes Comptables (ANC) believes that there are technical solutions that can improve the current standard without calling into question its fundamental principles or waiting for the post-implementation review. It wishes to see the reintroduction of an FVOCI model with recycling to income and a new impairment model, for all equity instruments.

Like the ANC, the Organismo Italiano di Contabilità (OIC) is in favour of measurement at FVOCI with recycling to income for all equity instruments.

The Instituto de Contabilidad y Auditoria de Cuentas (ICAC) does not support an alternative accounting treatment and, on the contrary, wishes to remove the FVOCI option for equity instruments. However, if the FVOCI option is maintained, it believes that it is necessary to allow recycling and to introduce an impairment model. In its opinion, the current version is the "worst possible solution".

The Austrian Financial Reporting and Auditing Committee (AFRAC) is against measurement at FVOCI without recycling and wants to see an "adjusted cost" measurement model for long-term investments (with the adjustment depending on the percentage holding in the company's earnings).

The Financial Reporting Council (FRC) mentions that there is no compelling evidence that IFRS 9 impacts investment decisions. It emphasises that the IASB had initially introduced the FVOCI option without recycling to measure strategic investments and that there is no need to introduce an alternative accounting treatment for long-term investments.

The Danish Accounting Standards Committee (DASC) is not in favour of an alternative accounting treatment. It recommends enhancing the narrative description.

Opinions of the European authorities on the introduction of an alternative accounting treatment

The European Central Bank emphasises the importance of close cooperation with the IASB and the need for adequate consultation. It also mentions the fact that a new accounting treatment would require the definition of new concepts ("long-term investment business model", "equity-type investments", "impairment of equity investments"), which would complicate matters and raise the risk of inconsistent application.

ESMA does not support alternative accounting treatment. In the absence of proof of the impact of IFRS 9 on investment decisions, it believes it is necessary to wait until the post-implementation review.

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EFRAG supports the introduction of a new impairment model and the possibility of impairment reversals

The IAS 39 impairment model was deemed to be unduly subjective and was not applied consistently. EFRAG therefore recommends the creation of a robust impairment model in which the concept of "a significant or prolonged decline" is clarified.

This is considered a complicated matter and some respondents believe it is too early to give a clear opinion on it.

Many respondents support the application of triggers (maximum percentage decline, maximum period of time) to improve comparability. However, while recognising the validity of triggers, some organisations, such as Insurance Europe and the FFA[7], want it to be possible to rebut them in certain circumstances. Appropriate information on this model would be required. Some respondents prefer a portfolio-based approach rather than an asset by asset approach.

EFRAG also supports a more "symmetrical" solution that allows the recognition in net income of any recovery in value arising subsequent to impairment.

Respondents who support the introduction of measurement at FVOCI with recycling approve this possibility of reversing impairment losses.

Funds invested in equities could benefit from an accounting treatment similar to that applied to directly-held shares

To establish the scope of application of an alternative accounting treatment, EFRAG held a consultation on limiting the scope to long-term investments and on the types of financial instruments that would be eligible.

Out of 41 entities that responded to the question, 36 believe that the alternative accounting treatment should be extended to instruments not considered as equity instruments under IAS 32, in particular investment funds (UCITS, ETFs, AIFs).

IFRS 9 defines equity instruments from the issuer's point of view, based on the criteria set in IAS 32 financial instruments – presentation.

Since units in UCITS do not meet certain criteria of this standard, investments in fund units are not eligible for measurement at FVOCI (not recyclable to income), which is authorised for equities. As fund units do not qualify as SPPI (Solely Payments of Principal and Interest) instruments, changes in their fair value are recognised in profit or loss. In the current form of IFRS 9, investments in equity funds are not eligible for the same accounting treatment as direct equity investments.

In its recommendation to the European Commission, EFRAG accepts that some fund units that behave like equities should be treated in a similar way to equities. It believes that any changes to IFRS 9 regarding fund units would require careful consideration to identify which funds would be concerned.

The ANC suggests introducing an Equity Type Test (ETT) to establish whether a fund is eligible for the same accounting treatment as equity instruments. The fund would have to meet the definition of a "puttable" instrument as defined in paragraphs 16A to 16D of IAS 32 and it would have to hold only equities, ETT funds, cash (according to requirements) and certain hedging instruments (such as currency hedges). If a fund does not pass the test, the fund units would be measured at fair value through profit or loss, as they are at present.

7. FFA: Fédération Française de l'Assurance

Sources:

EFRAG – January 2020: Answer to EC request for technical advice on alternative accounting treatments for Long-term Equity Investments

EFRAG – January 2020: SUPPORTING MATERIAL – Alternative accounting treatments for Long-term Equity Investments

EFRAG – January 2020: FEEDBACK STATEMENT – Survey on alternative accounting treatments for Long-term Equity Investments

Responses to EFRAG's consultation from certain categories of stakeholders:

- Accounting standard-setters: Autorité des Normes comptables (ANC), Deutsches Rechnungslegungs Standards Committee (DRSC), Organismo Italiano di Contabilità (OIC), Instituto de Contabilidad y Auditoria de Cuentas (ICAC), Austrian Financial Reporting and Auditing Committee (AFRAC), Financial Reporting Council (FRC), Danish Accounting Standards Committee (DASC)
- Associations of insurance companies: Insurance Europe, Gesamtverband der Deutschen Versicherungswirtshaft (GDV), Fédération Française de l'Assurance (FFA), ASSURALIA
- European authorities: European Central Bank, ESMA

COMMISSION REGULATION (EU) 2016/2067 of 22 November 2016 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard 9

Amundi – IFRS – July 2019: Will the European Commission instigate new accounting rules for financial assets?

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