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Mr Jean-Paul GAUZES
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EFRAG Discussion Paper – March 2018 – Equity Instruments – Impairment and Recycling

Dear Mr Gauzès,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned EFRAG Discussion Paper regarding Equity Instruments – Impairment and Recycling. As preliminary comment, ANC emphasizes the fact that it considers the IFRS 9 effects on long-term investment could be material. ANC welcomes the European Commission request and supports the EFRAG's approach and the work performed as regards long-term investment.

In providing responses to the questions raised in the Discussion Paper, stakeholders involved in ANC's due process have identified critical issues. This letter presents a summary of these issues and our most structuring answers to the EFRAG Discussion Paper. Our detailed comments are presented in the Appendix.

Preliminary comments on the quantitative study

Pursuant to the Commission request EFRAG has been asked to focus on the accounting treatment under IFRS 9 of equity instruments held for long-term investment in order to assess unintended effects and ensure it serves the long-term investment strategy

ANC considers that to assess the effects of IFRS 9 over long term investment, the quantitative information collected and the impact assessment performed should not have been limited to equity instruments and should have been extended to equity instruments equivalents. In ANC's view, as long-term investments can be held directly or indirectly (such as UCITS¹, and AIF²), the quantitative analysis does not fully assess the impact of IFRS 9 on long term investment.

ANC welcomes the European Commission initiative, but acknowledges the difficulty to currently assess the IFRS 9 requirements' impact on investments in Equity instrument and related long-term investment. The quantitative study has been performed in 2017 before the mandatory application of IFRS 9, this latest starting 1 January 2018. The new requirements will even be deferred for most insurance companies to 2021.

For this reason data provided by this study are not in our view conclusive and should be interpreted very carefully.

Even if it is difficult yet to quantify, ANC is convinced of the potential impact of IFRS 9 on long-term investment. This position is justified by IFRS 9 failure to appropriately represent the genuine nature of the performance of these kinds of investment strategies.

Financial Performance representation and Business Models of Long term Investment

ANC believes that the presentation of performance in financial statements should be further questioned with the aim to identify how to present the performance of long-term investments. We consider that a proper model of performance reporting should take into account the business models and the genuine nature of all different long-term investments.

In practice, different situations may lead entities to hold long-term investments. Long-term investment's models may be very different one from another. For example, pension funds, insurers portfolios, investment portfolios managed by corporates to manage long term non-financial liabilities (such as water pumping of coal mines or nuclear plant decommissioning), or public banks long-term strategic projects' financing may encompass a large range of actual actions and decisions.

Some specific models may require a dedicated approach and standard to capture appropriately their specificity such as entities having legal obligations to constitute assets portfolio matching their long-term nonfinancial liability. In such situations, asset and liability management performance between investments and non-financial liabilities may be easier to reflect in the financial statements if relying on a dedicated standard or ad-hoc provisions outside the current scope of IFRS 9. ANC encourages EFRAG to consider and investigate this alternative approach as it can be a useful, relevant and effective complement to the research performed on IFRS 9.

¹ UCITS – Undertakings for Collective Investments Transferable Securities

² AIF – Authorized Investment Funds

Long term investment shall not be limited to direct Equity holdings

We welcome the European Commission initiative but we consider important to draw the attention of the Commission to the fact that long-term investment do not comprise solely Equity instruments as defined by IAS 32:

- Firstly, investment can be held either directly or indirectly, for example through UCITS, ETFs³ or AIF. From an economic standpoint, the decision to hold equity instruments indirectly can be motivated by various objectives ranging from optimizing risk spreading and diversification, to relying on dedicated experts monitoring the positions or isolating the assets backing some specific underlying liabilities. Excluding these investments, because of their debt classification under IAS 32, leads to a non-comprehensive analysis of the long term investment business model. We note the FICE project may be the opportunity to address the issue but we believe that in any case, it should take into account the impact on long term investment.
- Secondly, we wish to emphasize that long-term investment performance reporting should be assessed at a portfolio level and not instrument-by-instrument, in order to appropriately capture and reflect the benefit of the portfolio's diversification and management.

ANC's overall position on the EFRAG discussion paper

ANC stakeholders consider the current IAS 39 measurement at Fair Value through OCI with a recycling mechanism as being the most appropriate accounting approach to reflect long term investment performance. This accounting treatment provides the users with a comprehensive set of information:

- Fair value of the assets on the balance sheet;
- Cumulative unrealised gains and losses in OCI; and
- Gains and losses realised during the period (including impairments).

That is the reason why ANC stakeholders underline that the key element to be considered in this comments letter is the need to reintroduce recycling. Considering the significance in France of long-term investments and of IFRS 9 impacts, ANC believes that developing a recycling and impairment model is essential to better reflect the performance of long-term investments.

In practice, the following proposals in the EFRAG's discussion paper could improve the presentation in the financial statements:

- As many users and academics do, ANC considers that recycling would be a major benefit to the relevance of financial reporting as the ability to identify realised vs. unrealised gains or losses is fundamental and highly relevant to the users of financial statements. This is for several reasons :
 - A gain, or a loss, is certain only upon the sale of the underlying instrument.
 - Realised gains or losses are an information of major importance as this may interact with other local requirements (tax, collective remunerations, corporate laws, reserves available for dividend distributions etc.).
 - Finally, despite the "exit price" approach of IFRS 13 on Fair Value Measurement the actual sell price of an equity instrument may be significantly different from its fair value ("control premium", unit of account, liquidity issue, impact of sale on the current market price etc.)

³ ETF – Exchange Traded Funds

- As the EFRAG Academic literature review shows, users are more familiar with the presentation of performance in the profit or loss. Furthermore when opting for the Fair Value through OCI option, the current IFRS 9 requirements lead to situations where the actual performance is difficult to understand as we see no conceptual reason to present differently in the statement of comprehensive income a gain of 15 realised upon a sale, of 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.

For all these reasons, ANC considers that presenting the fair value of an equity investment on the face of the balance sheet, the status of its unrealised gains or losses in the OCI, and the amount of gains and losses realised in the period in the P&L is the best way to provide the users of financial statements with all relevant information.

We note that some may consider recycling as a source of complexity. ANC disagrees with this assumption and considers it is a well understood mechanism as it has been applied to equity investments for the last 15 years (Available for Sales category under IAS 39).

- ANC is convinced that this 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 approach to each specific impairment model.
 - ANC stakeholders believe that the pre-existing IAS 39 standard impairment requirements could be re-used and enhanced by introducing the possibility to reverse impairment, developing specific guidance to define how impairment tests should be performed based on the actual business model of the entity. In ANC's view, applying this approach would provide more reliable information. Additionally, new required specific disclosures on the impairment methodology would be an effective mean to provide users with relevant information.
 - ANC considers that the re-evaluation model grants comparability and is simple to understand. ANC stakeholders would nevertheless favour an actual impairment model to this asymmetric re-evaluation model (unrealised cumulative gain in OCI vs unrealised cumulative loss in P&L). The relevance of this model would be clearly enhanced if it was performed on a portfolio basis consistently with the entity's business model. ANC stakeholders would therefore recommend working on the unit of account issue.

ANC considers that another approach could be developed focusing on the “prolonged decline in value” trigger. In ANC's view, a prolonged decline in value is a better indicator of a realised vs unrealised loss than the “significant criteria” as it better takes into account the specificities of long term investment. The following impairment approach could be developed:

- Main principle: at each reporting date, any equity instrument presenting a decline in value below cost over a period above a specified threshold would have to be impaired.
- In addition, entities would book an impairment without waiting for the end of the threshold period when the equity instruments present a fair value below cost and a recovery in value above cost before the end of the threshold period is not probable.

Ultimately, ANC believes that the scope of such an amendment to IFRS 9 should be investigated further in order to determine if amendments (recycling and impairment model) could apply to all equity instruments (whether long term or short term investments) and to all types of business.

Yours sincerely,

Patrick de CAMBOURG

Patrick de Cambourg,

Appendix – EFRAG’s questions to constituents

Q1.1. What are your view on the arguments presented in paragraph 2.3.-2.10? 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? Please explain.

ANC considers that the reintroduction of recycling would enhance financial performance depiction. It must be bore in mind that such investment portfolios are often used to cover underlying liabilities, long term projects, or funded by financial liabilities. Therefore, the management stewardship can only be assessed by presenting the realised income in P&L as it is the case for the cost of the related liability.

We have identified three major benefits:

- (i) There are crucial differences between realised performance that shall be recognised in P&L and unrealised performance that should be recognised in OCI:
- A gain is certain only when it is realised. Despite IFRS 13 requirements to provide as much information as possible to help users understand how the most probable exit price was determined, it remains only an estimation that may change over time in the future. Therefore an unrealised gain, even determined on the basis of an IFRS 13 valuation, is uncertain. This is a crucial difference with an actual gain.
 - Realised and unrealised gains and losses are not dealt with in the same way for various tax (income tax), legal (basis of dividend distributions) and social (collective remuneration) requirements.

IFRS9.BC25.a states that many respondents, including many users, were sharing the view that recycling would be an appropriate method and that realised and unrealised gains or losses are of different nature. The Academic Litterature Review published by EFRAG and realised by Elisabetta Barone and Benita Gullkvist also points out that some studies have evidenced the value-relevance of recycling:

- *“Dong et al (2014), investigating gains or losses on AFS securities held by US commercial banks, found that realised gains or losses, which are being recycled from accumulated OCI to profit or loss, provide incremental information to the market, i.e. are value-relevant. Thus, they argue that the recycling of AFS gains and losses from accumulated OCI into profit or loss contributes to better predictive ability of future bank performance.”*
- It must also be noted that this study states that *“In addition, their findings indicate a difference between realised and unrealised gains or losses from the users’ point of view”*.

In the EFRAG review of literature, it is understood that scholars underline the positive effects of recycling and investors of financial firms regard recycling disclosure value relevant and useful for improving their investment decision making process. This conclusion is aligned with ANC’s stakeholders view considering that financial communication will need to be enhanced providing users with more detailed information (split between realised and unrealised amounts in OCI) in order for them to assess the performance.

- (ii) ANC considers that communicating on the performance of an entity is easier if all realised profits and losses are booked in a single location. Most users expect realised performance to be presented in the profit or loss statement. If not available in the profit and loss statement, it is probable that this information will need to be separately disclosed to provide users with a split between realised and unrealised items booked in OCI.
- (iii) Long-term investments' performance encompasses both dividends and gains/losses on disposal that need to be jointly analysed. The accounting asymmetry between dividends (booked in P&L) and profits or losses on disposals (booked at FVOCI with no recycling) leads to the impossibility to have such representation of performance. Moreover, as dividends depend upon the type of underlying business (for instance the real estate sector currently distributes high dividends) the content of long term portfolio may change in order to maintain the balance of P&L. Therefore, it is probable that IFRS 9 impact will depend upon the nature of the underlying sector. The only way to avoid creating such bias would be to adopt the same representation of performance for the different types of profits.

We note that some may consider recycling as a source of complexity. ANC disagrees with this assumption and considers it is a well understood mechanism as it has been applied to equity investments for the last 15 years (Available for Sales category under IAS 39).

Q2.1. What are your views on the arguments presented in paragraph 2.11-2.17? Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.

From a conceptual point of view ANC supports the proposal that recycling needs to be accompanied by a strong impairment model in order to reach a consistent application of this amendment. Any IFRS measurement method that leads to an impact in P&L upon de-recognition of an asset is accompanied by an impairment mechanism, and we see no conceptual reason for creating an exception for equity investments.

Q3.1. What are your views on the arguments and analysis presented in Chapter 3 of the DP?

Q3.2. Are there other improvements in presentation and disclosure that you would support?

ANC believes that providing additional information on equity instruments held at reporting date and with an OCI debit balance could be useful to users (to compare the fair value to the original cost for instance).

However, concurring with EFRAG, ANC believes that under the current model, enhancing existing disclosures is not sufficient to provide adequate information to users and that gains and losses have to be accounted for in the primary financial statements.

It must also be noted that given the size of the portfolios, providing such detailed disclosures would go against the objective of streamlining financial statements and limiting the reporting overload. ANC prefers a model that would book in the primary financial statements the recycling effects of the variations on equity instruments rather than merely mentioning them in disclosures.

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

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

Q4.3. Do you have suggestions for a model other than those presented in the DP? if so, please describe it and explain why it would meet characteristics such as relevance, reliability and comparability.

ANC believes that a robust model would be a model permitting to represent the genuine performance of an entity. It means that performance should reflect the activities and objectives of long-term investments and take into consideration the underlying business model. Therefore, relevance and reliability are the most critical features of a robust impairment model.

There has been little support amongst ANC's stakeholders of the re-evaluation model, mostly due to the fact that this model favours comparability to relevance. It means that with this model, two entities investing at the same time, on the same equity instruments and at the same price would recognise the same impact in their Comprehensive Income as this model leaves no room for judgment. In addition, even though proposing a pragmatic approach, this model may generate immediate P&L volatility caused by changes in value that may not evidence realised losses. ANC nevertheless considers that these drawbacks can be mitigated if the unit of account were to be modified and were defined based on the underlying business model (portfolio basis). This change of unit of account would have to be supported by actual evidence of business management (internal control and procedure, internal performance reporting, relevant segregation of considered assets etc...). A re-evaluation model based on a portfolio basis, consistently with the actual management of the entity, rather than on an asset by asset basis would provide much more relevant information to users and would therefore be more acceptable.

ANC considers that these essential features are easier to achieve with the pre-existing IAS 39 model, supplemented with additional guidance on how to assess impairments in order to enhance reliability and comparability, rather than the re-evaluation model. ANC draws the attention of EFRAG to the fact that this IAS 39 model should not be retained without an impairment reversal mechanism. ANC stakeholders are convinced that the non-reversal feature of the former IAS 39 equity impairment model is the main reason of some misapplication of this impairment model. Indeed, preparers would probably have calibrated their impairment triggers differently (i.e. at an earlier stage of unrealised loss) had the reversal of the impairment been possible.

Finally, one other option EFRAG could investigate is a third approach based on the following principles:

- Focus on the “prolonged” criterion as it is a better approximation of what is a “realised” loss than a materiality threshold that can revert over time;
- The prolonged criterion could be implemented as follows:
 - Any decline in value below cost over a period longer than a defined threshold would trigger immediate impairment
 - 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).
 - Automatic for any subsequent increase in value (as a practical expedient for entities having a significant equity instruments portfolio)

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

ANC Stakeholders consider that a robust impairment model should prioritise relevance and reliability features. Any systematic impairment trigger would favour comparability instead of relevance as such trigger would not be able to take into account the specificities of each business model and the characteristics of related equity instruments.

For these reasons we would rather favour an approach allowing each entity to specify its own impairment triggers based on its own business model and investment portfolio.

Conversely, ANC would support defining principles-based triggers. ANC stakeholders believe that the diversity observed by IASB on Equity impairment triggers were merely caused by the prohibition of impairments reversal. It could be envisaged to provide a rebuttable presumption according to which above a predetermined threshold an impairment would be required.

Nevertheless, ANC stakeholders consider that the benefits of the recycling mechanism overcome the drawbacks of any impairment model. Therefore ANC would favour a recycling approach combined with quantitative impairment thresholds to the current non recycling model.

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

1. Subsequent recoveries in fair value

At this stage, ANC stakeholders haven't reached a consensus on the most appropriate model for recovery.

The different views of ANC stakeholders are as follows:

- Recoveries' recognition should follow a symmetrical approach to the impairment model (taking into consideration a prolonged recovery for instance)
- Recovery recognition applies to any subsequent increase in value of the equity instrument.

2. Rebuttable presumption to bright line approach

A rebuttable presumption would in ANC view better reflect the specificities of each instrument / portfolio characteristics and business model and avoid having an over-rigid model. The main advantage of this approach is that it can be adapted to all types of instruments (listed or unlisted equity instruments).

3. Unit of Account – Individual investment or portfolio

ANC considers that it could be useful to develop an approach measuring the impacts based on different units of account whenever it leads to aligning presented performance with the way it is actually monitored internally.

In ANC's view, this model would particularly fit the re-evaluation model. ANC believes that 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 (internal control, risks and performance reporting, asset segregation etc).

Beyond the issue of Equity portfolios, this approach would be even more relevant if it is extended to all FVOCI investments being part of the actual long term investment portfolio management (debt and equity instruments).

4. Unit of Account – Cost formula

ANC agrees that a cost formula should be developed in the standard, shall it be amended, in order to specify how to account for an impairments / gains & losses when equity instruments are acquired in multiple steps.

5. Others application issues (*Interactions with hedging requirements, Interactions with changes in Foreign exchange rates, Timing of impairment tests & interaction with interim reporting*)

ANC considers that the additional questions raised in the EFRAG research paper are key and should be further analysed once the underlying accounting model is agreed on. In ANC's view, it is still too early to propose an accounting treatment as that the conceptual accounting model has not been decided yet.

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?

Q7.2. Do you have comments on these other considerations?

Q7.3. Are there other aspects that EFRAG should consider?

ANC would favour having one single approach for impairment. However, the diversity of long-term investments may trigger the necessity to adapt some features of the model, such as thresholds, to the nature of each investment strategy. This area of customisation would have to be carefully explained by guidance as it would increase the relevance of the impairment model but impair its comparability.

Q8.1. Are there other aspects of IFRS9'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? Please explain.

In ANC's view the representation of long-term investments' financial performance should be further questioned. ANC considers that these issues should be discussed in the light of other IASB's projects such as FICE and Primary Financial Statement projects.

In addition, ANC believes that instruments equivalent to equity instruments (such as indirectly held instruments – UCITs or AIF...) should also be considered in the study as they are commonly a significant part of long term investments' portfolio.