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Dear Jean-Paul,

EFRAG DP Equity Instruments – Impairment and Recycling

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the Discussion Paper *Equity Instruments – Impairment and Recycling* (herein referred to as 'DP'). We appreciate the opportunity to respond to the DP.

The issue raised in the DP was widely and intensively discussed at the time IFRS 9 was developed. We concede that the final abolition of recycling for gains and losses on equity instruments classified as FVOCI may have been impacted by existing concerns about earnings management and late recognition of impairments under IAS 39, particularly during the financial crisis. Notwithstanding these concerns, we are open to reconsidering the issue with a fresh and open mind. Having said so, we believe that the issue under discussion has both a technical and a procedural dimension, both of which we feel need to be addressed.

Technically speaking, EFRAG lays out several arguments that we believe are valid and deserve being considered further and more fully (e.g., recognition of impairment losses outside of P/L and the obvious clash with the arguments provided in the recently issued revised Conceptual Framework as regards recycling of gains and losses recognised in AOCI). We acknowledge that EFRAG is responding to a request by the European Commission to analyse the current requirements under IFRS 9 against the predecessor method in IAS 39 and to develop possible alternatives.

In order to limit disruption for those that have just implemented the standard yet being responsive to the needs of others, we suggest engaging with the IASB and discussing with them the potential for pulling forward certain aspects of a Post-implementation Review (PIR) on IFRS 9 – rather than pursuing a stand-alone project at European level. Our suggestion is based on feedback from a survey we carried out amongst the members of the Accounting

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Standards Committee of Germany – mainly companies listed in the DAX 30 segment. There are two key messages that we received from that survey:

- Firstly, the clear majority of the entities in the sample responded that the new treatment under IFRS 9 was not a widespread and urgent issue for them, although some of them flagged that, conceptually, they felt that recycling of AOCI amounts represented a superior approach for amounts initially recognised in OCI and that they were therefore supportive of having a discussion at the appropriate time. Those that strongly supported a consideration at this stage were, understandably, mainly insurance entities that have yet to implement the standard. These entities equally stated that they believed recycling of AOCI amounts to represent the appropriate model for amounts initially recognised in OCI. Additionally, they wanted to ensure that they do not have to change twice within a relatively short period (i.e. the IASB's PiR might start just when they are implementing and/or applying the standard for the first time).
- Secondly, all entities in our survey – including banks and insurance entities – were unanimous in their view that any potential reconsideration of this issue and revision to IFRS 9 should only be done at a global and not a European-only level, possibly as part of the IASB's PiR of the standard.

Our tentative views that are set out in the appendix to this cover letter should be read with keeping the above in mind.

If you would like to discuss our comments further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

Appendix – Tentative views on the key questions raised in the DP

For the reasons set out in our cover letter, our discussion of the DP remained at a general level and did not consider all details of the proposals. Hence, our views relate to only some of the questions – basically questions Q1.1, 2.1, and 4.2 – and are therefore presented below in one piece.

When considering the core question of whether reintroducing recycling (with or without some kind of impairment model) would lead to a better depiction of financial performance, we have not yet formed a final view. As we see it, there is no clear evidence that the current requirements, which prohibit recycling, would negatively impact long-term investments, nor that the reintroduction of recycling would have a positive impact. The proposals are presented by EFRAG based on the assumption that there was a need for re-introducing recycling – which is a view we do not fully share based on the evidence provided so far. We therefore believe that it would be premature to initiate a discussion about changing IFRS 9 without due consideration of the open and unresolved issues. Conceptually speaking, though, we agree that the subject is worth being reconsidered with a fresh and open mind and that such discussion should be commenced on a timely basis.

The IASB's general view, as laid down in the new Conceptual Framework (par. 7.16) and cited in EFRAG's DP, that the statement of profit or loss was the primary source of information about financial performance might be seen as the strongest argument in favour of recycling. Even if the Board's preferred view was to recognise changes in fair value directly in profit or loss, for those items where gains and losses are recognised in OCI, there is a general presumption that the accumulated amounts should be reclassified from other comprehensive income into the statement of profit or loss in a future period when doing so results in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that future period (par. 7.19) – which some would argue is the case when the investments are sold and the gains or losses on them are realised.

On the other hand, some would present the counter-argument that the idea of appropriately allocating gains and losses over the holding period of an equity instrument constitutes no clear support for recycling, as recycling means reclassifying the total gain/loss to profit or loss when the investment is sold and “allocating” the entire holding gain or loss to this period. This is not necessarily an allocation in terms of how that term is generally used in IFRSs, i.e. an allocation of gains or losses to *each* period (which, arguably, would not be different from classifying an instrument as FVPL in the first place; however, some would argue that not allocating *any* gains/losses under the FVOCI model does not appear to be conceptually convincing either). Further, recycling would lead to “allocating” gains/losses to profit or loss only from some instruments (i.e. those “selected” to be sold) and in only one period (i.e. the pe-

riod “selected” for the sale) – while there was no such allocation of gains/losses from value changes of all other equity investments of the same category, as long as they are still being held.

We have also discussed whether recycling should be accompanied by some kind of impairment model. We have not yet reached a final view as to whether or not an impairment model (or any other method of differentiating between into different kinds of value changes) was a necessary precondition for considering reintroducing recycling. From a conceptual point of view, we think that testing assets for impairment is a fundamental stand-alone concept irrespective of recycling that, at least theoretically, should apply to any class of assets held (notwithstanding different measurement attributes, cost-benefit considerations, etc.). Our line of argument is as follows:

- IFRSs foresee that an impairment test generally be carried out for all assets held by an entity (cf. IAS 36 and IFRS 9 for debt instruments); hence, there is no logical argument why this should not equally be appropriate for equity instruments that are measured at FVOCI with recycling of gains/losses from derecognition through P&L;
- If the test leads to the conclusion that an impairment has occurred, per current IFRSs this impairment charge is recognised in the statement of profit or loss. To our knowledge, absent equity instruments measured at FVOCI there is no other asset class for which impairments are recognised outside of profit or loss;
- A recycling of the accumulated gains or losses recognised in AOCI upon derecognition of the equity instrument would ensure that any impairments that had not been recognised over the holding period for whatever reason are at least recognised in the statement of profit or loss upon sale. Whilst we acknowledge that the difference between the carrying amount and the sales price could (and most likely will) encompass different kinds of value changes, it arguably also includes any accumulated impairment charges that have occurred while holding the instrument. Put differently: Recycling would ensure that the aggregate in value changes was finally recognised in profit or loss; it does not constitute an allocation mechanism that would attribute the impairment charges to the periods in which they occurred though;
- We agree with EFRAG that when considering an impairment model that assesses negative value changes on an ongoing basis, known conceptual and practical challenges would have to be addressed while, so far, all attempts to develop a satisfactory solution have failed. Those challenges include, but are not limited to, the following:
 - A decline in value requires assessment of when and to what extent that decline is appropriately considered an “impairment” and recognised accordingly. Such an assessment requires objective criteria for (a) at what point in time and (b) to what extent declines in value are impairments;
 - The same applies to subsequent increases in value that follow an impairment and that are considered a “reversal of an impairment”;



- Any operationalisation by defining thresholds, triggering events or combinations thereof should be assessed by taking cost-benefit considerations into account;
- For equity instruments where there is no active market there is a further challenge of measuring its fair value reliably in the first place, which may impact the cost-benefit consideration referred to above.

We see the models presented by EFRAG as a good starting point for further discussion but do not think that they are developed enough to enable us to judge their merits. We reiterate our position that reservations as to *how* an impairment model might be designed should not preclude the conceptual consideration of *whether* an impairment model should accompany recycling, as the two are separate issues.