Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

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Berlin, 28 June 2019

Dear Jean-Paul,

Re: EFRAG questionnaire on Equity instruments – Resesarch on measurement

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to answer the questionnaire as well as to provide additional comments by way of a cover letter to our answers on the questionnaire.

Apart from our answers on the questions, we would like to submit some general comments on the purpose and context of this consultation.

- Firstly, and apart from the fact that the European Commission's request deserves being duly answered, we are not convinced of the usefulness of the current consultation. During the consultation on the Commission's first request EFRAG gathered sufficiently robust evidence that *"the majority of respondents do not expect to modify their holding period for equities following the introduction of IFRS 9"*, *"asset allocation decisions of long-term investors are driven by a plurality of factors"* and *"it is difficult to assess the relative importance of accounting requirements"* (all references quoted from EFRAG's answer to the Commission on the "assessment phase", dated 17 January 2018).
- Secondly, we believe that any consideration of potential alternatives for accounting treatments, i.e. measurement bases, for (equity and equity-like) instruments with a long-term investment focus should preferably be done by the IASB and not at a national or regional level. We believe that the PiR is the right tool for such a reconsideration, as said in our answer on the previous consultation.

- Thirdly, if one were to consider long-term investments, we are not convinced that it should be restricted to equity instruments, as debt instruments may equally serve long-term investment purposes.
- Fourthly and lastly, if considering means that (could) support or strengthen long-term financing in the EU, we firmly believe that areas and vehicles other than accounting requirements should be in the focus (e.g. subsidies, tax reliefs, etc.). We are convinced that accounting requirements are, and should remain, a means to enable user making investment decisions, but not to influence their decision-making.

Please find attached to this cover letter our answers on the main questions in the questionnaire (but not on the examples, Appendix A).

If you would like to discuss our answers and views further, please do not hesitate to contact me.

Yours sincerely,

Andreas Barckow
President

Appendix A – Answers to the questions in the questionnaire

General information about the respondent

1) Name of the individual/organisation

Accounting Standards Committee of Germany (ASCG)

2) Country of operation

Germany

3) Job title

President

4) E-mail address

barckow@drsc.de

5) Are you currently engaging in a long-term investment business model?

( ) Yes

(X) No

6) How do you define long-term investment business model?

n/a

7) Are you currently engaging in investment of sustainable activities?

( ) Yes

(X) No

8) How do you define sustainable activities?

n/a

Question 1

9. 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 recognised 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?

[ ] The characteristics/ business model of the investor

[X] The expected holding period

[ ] The actual holding period

[ ] The long-term nature of the liabilities that fund the assets

[ ] Other

If you have indicated "Other" please provide details.

Question 2

10. 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

[ ] No

Question 3

11. Explain the reasons for your reply to question 2, including the key operational challenges in developing a different accounting treatment to IFRS 9 requirements

We have mixed views in this respect, therefore our answer is Yes AND No.

We disagree with a view that an accounting alternative to IFRS 9 is ***needed*** to properly portray performance and risks of equity instruments – as well as equity-like instruments – held in a long-term business model. (As the long-term nature might depend on something else than the business model, see our answer on Q1, we suggest a notion of long-term ***investment focus***). Some deem the fair value still to be a relevant and, under certain circumstances, even the most relevant measurement base for equity instruments with a long-term focus. Hence, from this point of view, any further debate could be narrowed down to the question of when fair value changes should be recognised and where they should be presented.

However, we acknowledge that under certain circumstances equity instruments with a long-term focus could deserve an accounting treatment different from current IFRS 9. This is particularly the case for equity instruments that are not “marketable” – i.e. instruments that have no (active) primary or, if any, secondary market. Having said so, it is not straightforward whether an “alternative accounting treatment” for those equity instruments should comprise a ***presentation alternative*** (e.g. fair value changes in OCI instead of P&L, or recycling upon derecognition, along with or without impairment) or a ***measurement alternative*** (e.g. cost instead of fair value).

Question 4

12. 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 OCI (so called “recycling”), which impairment model would you suggest and how it would work in practice?

We believe that the question raised contains an implicit assumption as to what constitutes performance. We would like to point out that there is no uniform view as to what performance encompasses, even though most constituents in our jurisdiction believe that performance was depicted by a residual in the income statement (i.e. net income or a subtotal). Those holding such view base their line of argument on a realisation notion and the understanding that (A)OCI is a holding tank for gains and losses that will be recycled upon sale of the instrument.

If one followed that line of argument, classifying equity instruments with a long-term investment focus at FV-OCI and accompanying such measurement by recycling upon derecognition and by an impairment model is an alternative accounting treatment that we believe warrants further research. If, on the other hand, performance was defined holistically as comprehensive income comprising both net income and OCI, neither recycling nor an impairment model would be necessarily needed.

As to the specific question raised which impairment model would be appropriate, we have not yet considered, let alone identified, any specific model (or specific features). We particularly agree with the IASB’s findings that the IAS 39 impairment model clearly demonstrated significant drawbacks in terms of consistent application and rigour, as was evidenced, inter alia, by ESMA and others. We therefore believe that simply reinstating the old impairment model is not an appropriate solution under any future accounting alternative.

Question 5

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

[X] Yes

[ ] No

14. Please explain your answer.

We favour considering different accounting treatments for equity instruments (as well as “equity-like” instruments, see answer on Q6) only with a long-term focus, i.e. not a short-term focus. By long-term focus we refer to instruments that are strategic in nature. This means that the focus does not relate to the business model of the entity, but rather to the holdig period of the particular instrument (see also answer on Q1).

Question 6

15. 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, therefore are not eligible for the option to mesure them at fair value through other 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"?

[X] Yes

[ ] No

16. Please explain your answer

This answer depends on the definition of ”equity-like” instruments. Our answer “Yes” on Q6 is based on a specific understanding of “equity-like”, which we explain in the answer on Q7.

Question 7

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

[X] Units of funds and other instruments that meet the 'puttable exception' in IAS 32

[ ] The nature of the assets invested in

[ ] Mutual funds

[X] Other

18. If you have indicated "Other" please provide details.

In our view, equity-like instruments are any instruments that put the investor or holder in the same economic (not “legal”) position as a holder of a share in the entity. Hence, we would view all instruments that comprise an “equity risk” constituting “equity-like instruments”. Puttable instruments as per IAS 32 therefore would form part of this understanding of “equity-like”.

Question 8

19. 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.

[**0**] 100

Question 9

20. Are there other characteristics that would justify an accounting treatment different than IFRS 9 requirements for equity instruments and equity-type instruments held in a long-term investment business model? Please provide examples.

No, we are not of the opinion there are other characteristics that justify an accounting treatment deviating from that under IFRS 9. As said in our answer on Q8, we disagree with the view that the "sustainability" purpose of an instrument or investment could or should affect, or be relevant for determining, its accounting treatment – or vice versa.