GDV
DIE DEUTSCHEN VERSICHERER

Mr
Jean-Paul Gauzès
President of the EFRAG Board
European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000 Brussels
Belgien

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EFRAG Discussion Paper "Equity Instruments – Impairment and Recycling" (March 2018)

Dear Mr Gauzès

On behalf of the German Insurance Association (GDV) we welcome the opportunity to comment on EFRAG's Discussion Paper "Equity Instruments – Impairment and Recycling", as issued by EFRAG in March 2018 for public consultation.

We highly appreciate and support the efforts of EFRAG to respond to the underlying Commission's request for technical advice on the accounting treatment of equity instruments under IFRS 9 Financial Instruments from a long-term investment perspective. The German insurance industry continues to have the strong view that the current recycling ban on equities accounted for at fair value through other comprehensive income (FVOCI) should be abolished. We therefore encourage EFRAG to advice the Commission to urge the IASB to undertake a narrow-scoped amendment to IFRS 9 on a timely basis in this regard. It would be most cost efficient for insurance undertakings if the quick fix would be effective at latest at the 1 January 2021, i.e. aligned with the effective date of IFRS 17 Insurance Contracts.

In the recent past IASB responded to the concerns of the banking industry regarding the scope of amortised cost accounting under IFRS 9 with regard to debt instruments with a negative prepayment option in a fast track way. There are no reasons not to follow the same exceptional due procedure and to address the concerns of the insurance industry regarding the existing accounting disadvantage for long-term equity instruments. Finally, EFRAG identified in the Discussion Paper workable and proper impairment models which could accompany accounting of equities at FVOCI with recycling at disposal. In our view both models are superior to the sta-

Gesamtverband der Deutschen Versicherungswirtschaft e. V.

German Insurance Association

Wilhelmstraße 43 / 43 G, D-10117 Berlin
Phone: +49 30 2020-5400
Fax: +49 30 2020-6603
E-Mail: a.wehling@gdv.de

Phone: +49 30 2020-5430
Fax: +49 30 2020-6430
E-Mail: h.saeglitz@gdv.de

51, rue Montoyer
B - 1000 Brussels
Phone: +32 2 28247-30
Fax: +32 2 28247-39

ID-Number 6437280268-55

www.gdv.de

tus quo. Consequently, keeping status quo is absolutely not an adequate approach to respond to the concerns identified already in EFRAG's final endorsement advice on IFRS 9 of 15 September 2015 and also expressed in the European Parliament's resolution of 6 October 2016 on IFRS 9.

You will find our detailed responses to the specific questions in the Discussion Paper in the annex to this letter.

If you would like to discuss our comments further, please do not hesitate to contacts us.

Yours sincerely,

Dr. Axel Wehling
(Member of the Management Board)

Hans-Juergen Saeglitz
(Head of Accounting)

Annex

Question 1 – Recycling gains or losses on disposal
Q1.1 What are your views on the arguments presented in paragraphs 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.

In our view paragraphs 2.3 – 2.10 portray the current stage of the conceptual discussion in a proper manner. Especially, we highlight our strong agreement with the view that the default requirement to measure all equity investments at fair value through profit or loss (FVPL) is not appropriate to reflect the business model of long-term investors (paragraph 2.9). In this regard we fully support the existence of the FVOCI option for eligible equities.

However, we do not believe that the existing requirements of IFRS 9 provide an adequate depiction of the financial performance of long-term investors. In accordance with our previous positions, we consider that the existing ban on recycling for FVOCI equities (i.e. equity instruments accounted for at fair value through other comprehensive income) creates a significant deficiency of IFRS 9. This deficiency causes an accounting disadvantage for related equity investments eligible for the FVOCI option. Consequently, the recycling ban on FVOCI equities should be abolished. In addition, the removal of the recycling ban would create symmetry with the accounting treatment of debt instruments when accounted for at FVOCI.

Furthermore, we also agree with the observation that IASB's revised *Conceptual Framework for Financial Reporting* recommends that gains and losses included in other comprehensive income (OCI) should be generally recycled as the profit or loss is the primary source of information about the entity's financial performance for the period (paragraph 2.1). Finally, we agree that "the period of disposal provides a clear basis to identify the period in which recycling should occur" (paragraph 2.10).

Consequently, we encourage EFRAG to advice the Commission to urge the IASB to undertake a narrow-scoped amendment to IFRS 9 on a timely basis in this regard. It would be most cost efficient for insurance undertakings if the quick fix would be effective at latest at the 1 January 2021, i.e. aligned with the effective date of IFRS 17 Insurance Contracts.

In the recent past IASB responded to the concerns of the banking industry regarding the scope of amortised cost accounting under IFRS 9 with regard to debt instruments with a negative prepayment option in a fast track way. There are no reasons not to follow the same exceptional due procedure and to address the concerns of the insurance industry regarding the existing accounting disadvantage for long-term equity instruments.

Question 2 – Conceptual relationship between recycling and impairment
Q2.1 What are your views on the arguments presented in paragraphs 2.11 – 2.17? Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.

Paragraphs 2.11 – 2.17 describe the need for some form of impairment model if equity instruments were to be accounted for at FVOCI with recycling.

We continue to have the view that it is conceptually not indispensable to accompany the abolishment of the recycling ban for FVOCI equities with the introduction of an impairment model for these instruments. In such a case both gains and losses would be recognised in profit or loss upon disposal and any unrealised market driven fair value changes would be transparently reflected in OCI, in accordance with the current OCI presentation for equites (without recycling).

However, we acknowledge that some of the negative fair value changes might have a permanent nature and it would be more appropriate and in line with the principle of prudence of the revised Conceptual Framework for Financial Reporting to reflect such fair value changes in profit or loss. Finally, IAS 39 also required recognising impairment losses on equity instruments under certain preconditions.

Consequently, we do not oppose the tentative EFRAG's conclusion that recycling should be accompanied by some form of impairment model, if this is the IASB's fundamental precondition for quick fixing the recycling issue, though we refer to the conceptual and operational simplicity of the recycling model without impairment recognition.

Question 3 – Enhancing presentation and disclosure requirements
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?

Q3.1

We support the perspective taken in paragraph 3.7. However, we have strong reservations regarding the approach of Chapter 3 in large. In addition, it is not in line with the core presumption of the IASB that presentation and disclosure solutions cannot replace the proper recognition and measurement in the primary financial statements (IAS 1.18 and paragraph 3.24).

Furthermore, we disagree with the implicit recommendation that all equity instruments might be accounted for at FVPL (third scenario). As reinforced in our response to **Question 1** we fully support the FVOCI option in IFRS 9 for the eligible instruments.

Q3.2

In our view no additional disclosure requirements should be introduced, beyond those already existent in IFRS 7.11A and IFRS 7.11B, if the recycling ban on FVOCI equities would not be abolished (first, second and third scenario and paragraph 3.24).

Obviously there would be a need to disclose an explanation of the aggregated impairment amounts for the reporting period, if the introduction of recycling would be accompanied by an impairment approach. Any new disclosure requirements should be however kept to the minimum absolutely necessary to achieve the objective, i.e. to provide transparency about the impairment losses recognised in the particular reporting period by the reporting entity on its equity investments.

Question 4 – Two models
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 your 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.

Q4.1

As a matter of principle the impairment approach is not indispensable to allow for recycling for gains or losses at disposal (**Question 2**). However, assuming that impairment model would accompany the recycling requirement we have the following views.

- A robust impairment model should lead to relevant information being provided to users of entity's financial statements. Hence, it should be capable of distinguishing between permanent declines in the fair value of the underlying equities versus their short-term market-driven fair value changes.

- A robust impairment model should also be understandable and its design should ensure that reliable information are provided to users of entity's financial statements.

- A robust impairment model should allow for conclusions regarding the level of comparability of the information provided by reporting entities.

- If the relevance condition is met, it would capture the need for prudent information in the case of financial instruments.

Q4.2

We appreciate that EFRAG identified in the Discussion Paper workable impairment models for equity instruments which could accompany accounting at FVOCI with recycling at disposal. In our view both model are superior to the status quo. Hence, keeping status quo is absolutely not an adequate approach to respond to the concerns identified already in the final endorsement advice on IFRS 9 of 15 September 2015 and expressed in the European Parliament's resolution of 6 October 2016 on IFRS 9.

We prefer the model which allows differentiating between permanent declines in fair value and short-term fair value changes. Therefore we prefer the model similar to IAS 39 for financial instruments classified as AFS (available for sale) with less subjectivity (paragraphs 4.12 – 4.18). We fully acknowledge that the “revaluation model” would be less judgmental (paragraph 4.9) and simpler in technical terms (paragraph 4.7). However, an impairment model similar to IAS 39 has two conceptual advantages:

- it would distinguish between permanent declines in the fair value of the underlying equities versus their short-term market-driven fair value changes (paragraph 4.19); and
- it would avoid the unintended volatility in profit or loss, when the current fair value is below the original cost (paragraph 4.11).

However, if the simplicity is the major objective, than we would also support the revaluation model to accompany accounting of equites at FVOCI with recycling at disposal. In this regard we agree with the by-side-observations in paragraph 4.6.

Q4.3

No, we do not have any further specific suggestions.

Question 5 – Quantitative impairment triggers
Q5.1 Do you support the inclusion of quantitative impairment 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?

Q5.1

We do not oppose the inclusion of quantitative impairment triggers in an impairment model. However, it should be up to the reporting entity to specify them (paragraph 4.18 b)). As the second best alternative we would recommend the combined approach, described in paragraph 4.18 c).

Such an approach would balance the need for both considerations, i.e. the need for a reduced scope for discretion and the need for an entity's specific determination of impairment triggering events. The former would address the concerns of ESMA (paragraphs 4.16 - 4.17) and the latter would be more in line with the principle-based nature of IFRS. Consequently, we don't support that IFRS 9 should specifically define quantitative thresholds (paragraph 4.18 a)).

Q5.2

n/a

Question 6 – Subsequent recovery in fair values
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?

Q6.1

We believe that recognising subsequent recoveries in profit or loss is necessary as it would provide relevant information. It would be also generally in line with reversal of impairments in other cases in IFRS, beyond goodwill (paragraph 5.3).

Q6.2

We recommend the ongoing reversal approach as operationally the simplest and the best understandable one (paragraph 5.7).

Regarding the need for further analysis in paragraph 5.10 we like to note that in case of recovery in fair value followed by a new decline in fair value in another period that it should be considered automatically as impairment. Any other treatment of such decline in fair value would not fit to the preferred ongoing reversal approach. Only a decline in fair value after full recovery would be subject to new assessment.

Question 7 – Other considerations
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?

Q7.1

We do not think that it would be appropriate to define different classes of equity investments under the FVOCI category (paragraphs 4.23 – 4.29). Hence, any impairment approach should apply to all equity instruments for eligible for the irrevocable FVOCI option in IFRS 9, in line with the original IASB's decision not to determine what constitutes a "strategic investment" for this purpose.

Q7.2

We support the idea to include a rebuttable presumption into the impairment model with (entity-specific) quantitative thresholds as it would still properly reflect the acknowledgment that some equity instruments are more volatile than others (paragraph 5.11).

We agree with the observation that the unit of account for the measurement of financial instruments is the individual instrument (paragraph 5.14).

However we do not believe that impairment model should specify a particular cost formula for an individual investment when is has been acquired in multiple traches (paragraphs 5.20 – 5.22). Reporting entities continue to be able to develop and apply such accounting policies, considering for example tax treatments (paragraphs 5.23 – 5.24).

Q7.3

We underline the need to explicitly clarify the consequences of any changes to accounting for equity instruments in IFRS 9 for interim financial reporting. We believe that in the case of impairment model with the preferred ongoing reversal approach no issues would arise in that respect.

Question 8 – Other aspects of IFRS 9's requirements on holdings of equity instruments
Q8.1 Are there other aspects of IFRS 9'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.

We believe that EFRAG should amend its considerations and also assess if long-term investments in equity instruments are treated consistently under IFRS 9, irrespective if they are held directly or indirectly. It would than better cover the European Parliament's resolution of 6 October 2016 on IFRS 9. The Discussion Paper deals solely with direct equity investments eligible for FVOCI accounting under IFRS 9.