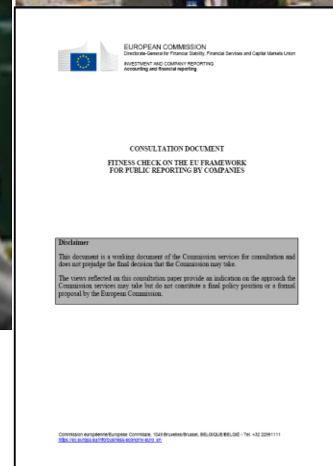
First round discuss with reporting experts in UK 6/28



EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union
INVESTMENT AND COMPANY REPORTING
Accounting and financial reporting

CONSULTATION DOCUMENT

FITNESS CHECK ON THE EU FRAMEWORK
FOR PUBLIC REPORTING BY COMPANIES

Disclaimer

This document is a working document of the Commission services for consultation and does not prejudge the final decision that the Commission may take.

The views reflected on this consultation paper provide an indication on the approach the Commission services may take but do not constitute a final policy position or a formal proposal by the European Commission.

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Second round discussed with UK investor 7/3

Does FV Measurement contradict long-term investment?

Discussion EC consultation Fitness Check

IFRS Digital Reporting Workshop 14th

Date and time：28 June & 3 July 2018, 19:00-21:00 (Tokyo time)

Discussing Fitness check & think about Corporate Report

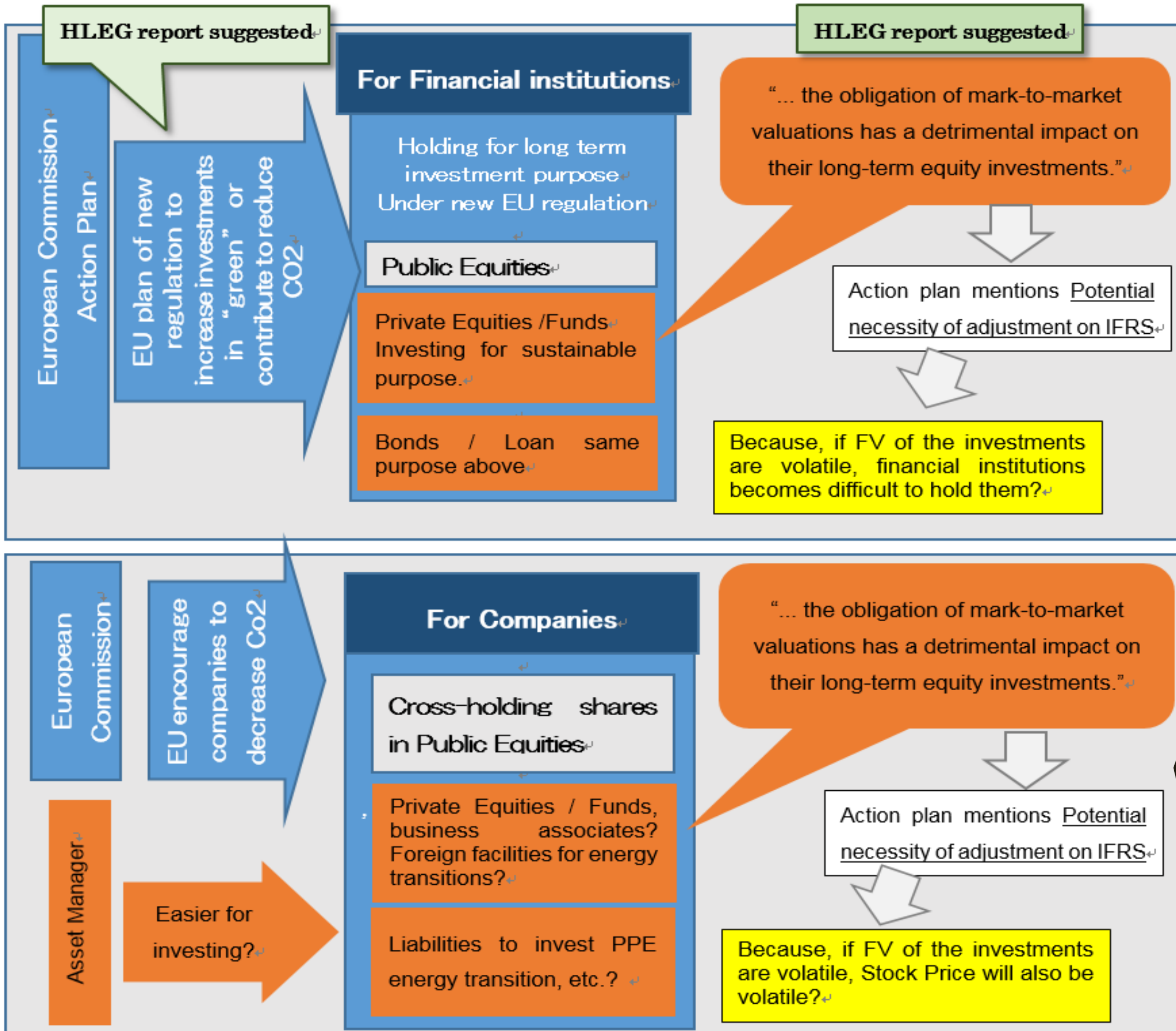
The European Commission(EC) published **”Fitness Check”** asking people with comprehensive view for the fitness of the EU framework on public reporting by companies, under current situations (including non-financial, digital) and several directive and regulations will be applied. Recently EU issued a report which discusses sustainable finance by **"High-level experts group(HLEG)"** and announced its’ action plan. This consultation is one of them.

Recently EC issued a report named "Financing A Sustainable European economy" early this year. The beginning of the report says that "The EU is already leading this shift, with our pledge to reduce CO2 emissions by 40% in all sectors of our economy by 2030" and "But there is still a long way to go. We will need about 180 billion euro in additional yearly investments in sectors such as renovation and energy efficient buildings, renewable energy generation and transmission, and low-carbon transportation, etc. The scale of the investment challenge is well beyond the capacity of the public sector alone.“. “To decisively address the funding shortfall, we are also looking into regulatory changes to mobilize the significant funding capacity of private capital". "That is why, at the end of 2016, the EC appointed the HLEG on Sustainable Finance ".

Attendees	14th workshop First round 28th June	Second round 27th July
Speakers	2 global reporting / accounting experts in UK	Investor (CFA, UK)
Attendees	5 Investors, 5 sell-side analyst/ Information provider/Media/Researcher, 2 CPA, 1 Company side, 1 Academic, 3 Regulator/Accounting setter/Analyst Organization 2 analysts joined from outside Japan by phone	9 investor, 2 sell-side analyst 8 Information provider/Media/Researcher , 2 analyst organization/regulator/stock exchange, 1 CPA, 1 academic, 2 company

Background, environmental activities in EU, HLEG

- HLEG had a mandate to prepare a comprehensive blueprint for reforms along the entire investment chain, on which to build a sustainable finance strategy for the EU. HLEG suggested what measures to take to support Europe in becoming the center of gravity for global investment in the low-carbon, resource-efficient, and circular economy. As one of the topic is accounting. The report mentions some issues with IFRS 9.



"In the context of long-term investments, there is a debate about whether IFRS 9 (Standard for financial instruments) is potentially challenging for such investments, particularly equity instruments"

" There is considerable disagreement on the appropriate accounting treatment for long-term investments, in particular on whether long-term assets on investors' BS should be valued based on the currently prevailing (daily) market prices also known as 'mark-to-market' valuation or 'fair value' accounting. It does not concern financial instruments that financial institutions actively trade for which there is general agreement that (daily) market pricing is appropriate. The debate is mainly around equity, equity-type and listed credit instruments on the BS of long-term investors, such as non-financial corporations, insurance companies and banks."

The consultation is one part of the action plan

- Consultation asking people “why don’t we have ability to alter IFRS, if there are any issues against long-term investment / sustainable finance?”

"Those who raise concerns about mark-to-market valuation of assets for long-term investments, mainly in corporate management, point out that the short-term fluctuations are not very relevant for long-term investors, but **they could trigger volatility**", "In this context, the accounting standard **IFRS 9 is seen by many companies as having a negative impact on long-term finance**“ HLEG final report said.

In the Action plan of the HLEG sustainable finance, proposed actions are, for example, **establishing taxonomy for non-financial information (Action 1**: Establishing an EU classification system for sustainable activities), **preparing a report on an EU green bond standard (Action 2**: Creating standards and labels for green financial products), **developing sustainability benchmarks(Action 5)** , mandating **credit rating agencies to explicitly integrate sustainability factors** and considering to issue additional guidelines or measures for them,...etc. Then, its **action 9 is about IFRS 9.**

Action9 mentions about the growing concerns that the current accounting rules are not conducive to sustainable investment decision-making. They debated the potential necessity of adjustment on IFRS. In Action 9, No 1~ No 4 are discussing disclosure of non-financial, sustainable information. But No 5 says "**The Commission will request EFRAG, where appropriate, to assess the impact of new or revised IFRSs on sustainable investments.** The Commission will also ask EFRAG to explore **potential alternative accounting treatments to fair value measurement** for long-term investment portfolios of equity and equity-type instruments. In Q4 2018, the Commission will report, taking into account EFRAG current work, on the impact of IFRS 9 on long-term investments and explore improvements to the standard for the treatment of equity instruments".

Structure of the questions

- S1 Assessing the fitness of the EU public reporting framework overall
  Q1-Q7
- S2 The financial reporting framework applicable to all EU companies
  Q8-Q18
- S3 IFRS Q19-Q24
  Transparency directive
  Q25-Q30
- S4 Banking & insurance accounting
  Q31-39
- S5 Non-financial Reporting directive
  Q40-Q56
- S6 Digital reporting
  Q57-Q66

1. Do you think that the EU public reporting requirements for companies, taken as a whole, have been **effective** in achieving the intended objectives?

	1	2	3	4	5	Don't know
Ensuring stakeholder protection	☐	☐	☐	☐	☐	☐
Developing the internal market	☐	☐	☐	☐	☐	☐
Promoting integrated EU capital markets	☐	☐	☐	☐	☐	☐
Ensuring financial stability	☐	☐	☐	☐	☐	☐
Promoting sustainability	☐	☐	☐	☐	☐	☐

(1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5=totally agree)

16. How do you think that the current EU framework as regards the content of financial reporting is relevant (necessary and appropriate), having regards to the following information:

	1	2	3	4	5	Don't know
A company's or group's strategy, business model, value creation	☐	☐	☐	☐	☐	☐
A company's or group's intangible assets, including goodwill, irrespective of whether these appear on the balance sheet or not						
A company's or group's policies and risks on dividends, including amounts available for distribution						
A company's or group's cash flows						

19. Given the different levels of commitment to require IFRS as issued by the IASB around the globe, is it still appropriate that the IAS Regulation prevents the Commission from modifying the content of IFRS?

- ❍ Yes
- ❍ No, due to the risk of uneven level playing field for EU companies vis-à-vis companies established in third countries that do not require the use of IFRS as issued by the IASB.
- ❍ No, due to the risk that specific EU needs may not properly be addressed during the IASB standard setting process.
- ❍ No, due to other reasons.
- ❍ Don't know

If you answered "No, due to other reasons ", please specify.

40 in the 66 questions are related with accounting issues.

We learned what EU/UK market participants say…

CFA UK

The Importance of Comparability

I think this EU questionnaire (consultation) is important for Japanese investors. Some of you are investing in Europe, and if the commission makes a wrong decision, it becomes negative impact for the whole investors.
The commission intends to change the way to apply IFRS as it is. In my opinion, EU insurance companies and others want to have political leverage to IFRS. It took quite a long time until IFRS has an insurance contract standards. (It finally completed recently) I think that it is a good standard. The current insurance company's reports are made on different standards and is misleading. Therefore, it is difficult to make investing decisions about companies in the insurance industry.
In this consultation, although different issues are gathered together, it asks what the EU should do about IFRS. But EU decided to adopt IFRS many years ago and this has been a driver to make IFRS an international standard. And now it is used around the world. So I think that EU has an important role in IFRS. We, international investors do need, not necessary a single, but high quality standards. When investing around the world, the comparability gives us confidence. I am really worried about this consultation. Single accounting standard brings significant benefits for investors.
The reason why I want Japanese investors to response it, because if once EU started this, this practices of having different accounting standards may spread to rest of the world. I do not say that the current practice is perfect. Enforcement level is also not the same. However, we are discussing together in one foundation.

The Importance of FV

Investor in EU

Long term institutional investors are extremely familiar with the concept of fair value. The income statement would not reflect economic substance if the resulting volatility in equity instruments were to be excluded. We sees no room for special treatment for any entity reporting under IFRS on the topic of equity instruments. Applying the existing fair value treatment of equity instruments contributes to transparency and credibility of financial reporting. We see no need to revise/amend/carve in IFRS 9 to create a different regime for long term investors. Any amendment in such direction will make financial reporting less useful, less transparent further away from economic substance, reduce institutional investors' appetite to invest.

An article of Analyst in UK

The consultation springs from a recommendations of the EU High-Level Expert Group on Sustainable Finance. The foreword says it all (in the context of reducing CO_2 emissions): "We will need about €180bn" a year, an "investment challenge…well beyond the capacity of the public sector alone". In other words, they want to corral our savings to fulfill the public policy goals that cash-strapped governments cannot afford. Apparently this "requires no less than a transformation of the entire financial system".
It is not that I am a hardened sceptic about environmental, social and governance (ESG) goals. Mainstream fund managers are already acting on the ESG front by adapting their investing and engagement strategies.
What does the Commission really want? The ability to choose and modify IFRS via carve-ins? Even though their own reports have acknowledged that international standards aid the region's capital markets union and help attract overseas investment, reducing European companies' cost of capital?.

What speakers shared with us

Reporting, Accounting should be neutral and informative

IFRS experts in UK

Amongst other things the consultation covers the role of financial statements and IFRS 9. Though the EU has introduced promoting sustainability and financial stability as objectives of corporate reporting I feel the role of reporting should be to provide consistent and transparent information not to promote sustainability of particular types of strategy. For IFRS 9, some feel that this may discourage long-term investment and drive short-termism by focusing on fair value. I do not subscribe to this view, fair value should include expectations of future profits, cash flows or any other benefits to the owner of the asset.

Reporting experts in UK

Over recent years public equity markets seem to have become less attractive to companies. There has been an exodus from public markets while private markets have grown hugely. The burden of reporting and governance is part of this. The consultation does not address the attractiveness of public markets versus private markets in any detail. The possibility of an EU carve-in risks increasing costs further both for companies and investors and exacerbating the situation.

The EU has introduced promoting sustainability and financial stability as purposes of corporate reporting. I agree that these should be facilitated but not that they should be purposes of reporting. Reporting should be neutral and informative not slanted to promote a particular interest. This is like saying the purpose of a thermometer is to cure a fever. Making these a purpose of the financial statements particularly, or blaming them for short-termism, is even stranger, more like blaming the X-ray machine for the patient's fever. Historic efforts to promote particular ends by suppressing problems in the accounts have not ended well. Consider banks' reluctance to write down assets in the financial crisis or the treatment of peripheral European government debt as a risk free asset. My concern is the sheer number of questions in the consultation which may lead to weaker responses.

Japanese investors wondered at the beginning…

It is difficult to identify what is a long-term investment and what is a short-term investment. Evaluation for companies and accounting should be separate. We do not make investment judgment only by accounting. We have to find out how we judge.

Investor Value

I agree with speaker. The stock market is losing attractiveness, indeed. One of the reason is index investment becoming majority. It does not reflect valuation (even if we discuss accounting) using financial statements.

Analyst

It should be good to raise the frequency of asset valuation by mark-to-market under IFRS9. Even though banks and insurers prefer to avoid the risk of capital shortage due to value changes (potentially from ESG investments) in the licensed (regulated) industry, no accounting system should change any management behavior. Allowance for any potential loss and/or guaranteed support by the public is based on regulatory reporting which is separate from accounting.

Analyst

IFRS 9 has been applied earlier in Japan..., is it really a problem?
In Japan, there were companies that sold their cross-holding shares before applying IFRS 9. This was desirable for investors.

Investor Active fund

(I have a client in the EU)
I would be in trouble, if EU requires us to invest only in good companies. I am investing in bad ESG companies and working on engagements to make them better. Also, if everyone invests only in good companies, how do we improve the entire market?

Investor Value

It seems dangerous…

Since EU wants to encourage investment in the private sector, requiring180 billion euros further in the environment, so EU wants to modify IFRS? (HLEG said that IFRS9 has a problem) It seems non-financial way of thinking blaming finance evaluation as the short-termism, rather than the problem of IFRS?

Researcher

After all what does the EU want to do? Do they want to stop FV and turn back to book value? Would they like to adjust FV of high ESG ratings asset as other action plans seem to say…?

Researcher

HLEG seems to say that they want to change IFRS9 because there is volatility. Does it mean that there is a risk?

Investor Governance

Encouraging environmental investment: it may be possible to increase investment in infrastructure or energy generation facilities. HLEG claims that "financial market movements can trigger volatility even though there is no impairment in the underlying fundamentals", however the judgment of impairment is not easy, and volatility is more likely to increase when transparency decreases. So this way of thinking is dangerous.

Analyst

If you make the risk less visible, someday the same thing happens as in the financial crisis.

Investor

In EU, is the idea that fair value accounting inhibits financial stability or activates short-termism, relatively strong?

Strategist

We agree that IFRS9 has some difficulties

As a financial institution, IFRS 9 is a classification of financial instruments, so we need to test cash flow test, business model, and make recognition and measurement. However, ESG assets are long-term and complicated, it must be classified and measured with considerably advanced judgment. And this operational burden should be heavier in EU.

Bank

I feel that this is IFRS 9's problem. If EU is aiming to change the evaluation of those assets that contribute to the environment which matches their policy, this is also a problem of whether it is good or not. In Japan, policy holding shares are treated as other option(FVtOCI). So, there might be a problem in IFRS9's framework trying to measure everything at fair value.

Investor

The impairment test is very unclear, and it becomes OK if the auditor says OK. That is a problem. However, if the ESG factor is further incorporated into that state, it becomes even more difficult to understand with carbon pricing and subsidies from the government.

Investor

(EU attempt) seems to make things as black boxed, so I think that it is not desirable for investors.

Company Accounting Dpt.

Although I can understand accounting principles, I realized that the market value evaluation in long-term investment makes difficult to holding such financial instruments.

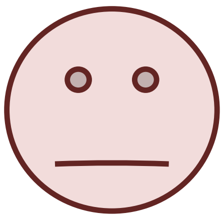
Bank

What investor responsible for…

Reporting/ Financial statements should be neutral from policy so that investor could be confident to invest

If the EU adopts an amended version of IFRS within the EU, even investors who are investing in EU companies or investing with EU asset owners’ money from outside of EU will lose a chance to share opinions to improve corporate report of financial statements

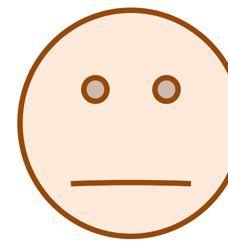
Information provider



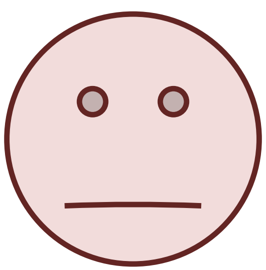
Analyst

If there is a possibility that some of the financial assets may have an uncertain risk, which couldn't be known by investors, Europe companies might be avoided by the foreign investors.

Traditionally, non-financial information has been requested to be increased as factors to judge the possibility of long-term corporate value creation. But recently, tendency to seek value for the ESG factor itself became remarkable. HLEG put environment issues as top priority, I felt that the tendency is strong. It is as same as a strong tendency to emphasize other stakeholders, and investors, but the responsibility of fiduciary-duty is solved?



Research analyst



Almost of us

If EU thinks that there are problems with IFRS 9, please do not try to change it only in the EU, we would like to ask them to share the discussion with IASB, and us.

Why don't we continue to discuss together?

For the energy sector, the difficulty can arise, for example, when companies have to make large provisions related to the winding down of nuclear operations as part of the energy transition, which is something the regulator can call for. From a business perspective, this may involve long-term investments in equity instruments that would be preferable over debt, given the favourable long-term risk-return profile of equities. The problem is that mark-to-market requirements create short-term fluctuations and a reporting maturity mismatch. The European electricity industry, for example, which comprises about 3,500 companies and is a critical sector towards achieving carbon neutrality by 2050, has confirmed in the stakeholder consultation that the obligation of mark-to-market valuations has a detrimental impact on their long-term equity investments.

P57 of this report

"For the energy sector, the difficulty can arise, for example, when companies have to make large provisions related to the winding down of **nuclear operations** as part of the energy transition, which is something the regulator can call for", "this may involve long-term investments in equity instruments",

Will investors believe the values of "long-term" quoted equity investments to funding provisions if fair values are not applied?

The EU is not the only place this would be an issue..

Please respond to this consultation ….

https://ec.europa.eu/info/consultations/finance-2018-companies-public-reporting_en#contributions

The Deadline is July 21st 2018

Even if you missed the deadline, the issue is universal,

Let's **Continue to discuss it, together!!**