Towards a Draft Endorsement Advice – Temporary exemption from applying IFRS 9 (Amendments to IFRS 4)

Introduction and Objective

1 The objective of this paper is for the EFRAG TEG to agree on the marked-up changes subsequent to the EFRAG TEG written comments. This issues paper is to be incorporated into a draft endorsement advice on the temporary exemption from applying IFRS 9 (Amendments to IFRS 4).

2 This issues paper contains the following:

(a) Appendix 1: Understanding the changes brought by temporary exemption from applying IFRS 9 (Amendments to IFRS 4)

(b) Appendix 2: EFRAG's technical assessment on Temporary exemption from applying IFRS 9 (Amendments to IFRS 4); and

(c) Appendix 3: Assessing whether the Amendments are conducive to the European public good.

3 Regarding a question asked to EFRAG TEG on whether the 'top-up' should be mentioned in the draft endorsement advice. There were mixed views. One member did not want it included as the standard needed to be looked at as it is published for endorsement; another member suggested that it could go in a separate letter to the EC and another member said that it should be mentioned in the DEA. The same question will be asked to the EFRAG Board.

Background

4 In March 2020, the IASB staff, in Paper 2A, recommended to extend the fixed expiry date of the temporary exemption from applying IFRS 9 in IFRS 4 to annual reporting periods beginning on or after 1 January 2023.

5 In addition, in the IASB staff Paper 2B, the IASB staff recommend that the amendment to IFRS 4, reflecting the extension of the fixed expiry date for the temporary exemption from applying IFRS 9, is balloted and published separately from the Amendments to IFRS 17 (including consequential amendments to other IFRS Standards).

6 This is consistent with EFRAG's endorsement plan, which foresees to undertake a fast-track endorsement procedure in 2020 for this separate draft endorsement advice on the IFRS 4 amendments, in order to allow that entities may apply these amendments in time (currently insurance entities are due to start applying IFRS 9 in January 2021).

7 The intention of this draft is not to publish a DEA before the final IFRS4 Amendments are issued, but to have a pre-agreed text of the DEA that can be rapidly issued when the final IFRS 4 amendments will be out.

Question for EFRAG TEG

8 Does the EFRAG TEG have any comments on the marked-up version of this paper? Please explain.

John Berrigan
Director General~~, (acting),~~ Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels

[dd Month] 2020

[This document has been prepared as an anticipation of the intended contents of the EFRAG DEA on the forthcoming Amendments to IFRS 4 and has been prepared on the basis of the IASB Tentative decisions known at the 16 April 2020. Changes to the wording are possible, following the issuance of these Amendments]

Dear Mr Berrigan,

Endorsement of *Temporary exemption from applying IFRS 9 (Amendments to IFRS 4)*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on the *Temporary exemption from applying IFRS 9 (Amendments to IFRS 4)* (the Amendments), which were issued by the IASB on [date]. This resulted subsequent to the IASB re-deliberations on the Exposure Draft *Amendments to IFRS 17*, which was issued in May 2019. EFRAG provided its comment letter on that Exposure Draft on 24 September 2019.

The objective of the Amendments is to extend the expiry date of the temporary exemption from applying IFRS 9 by two years (i.e. from 2021 to 2023) in order to align the effective dates of IFRS 9 *Financial Instruments* with IFRS 17 *Insurance Contracts*. A description is included in Appendix 1 to this letter.

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement, in other words whether the Amendments would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, lead to prudent accounting and are not contrary to the true and fair view principle. We have then assessed whether the Amendments would be conducive to the European public good. We provide our conclusions below.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

EFRAG has concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship and lead to sufficiently prudent accounting. EFRAG has also assessed that the Amendments avoid distortion by not having entities within the scope of the Amendments to mandatorily use IFRS 9 before IFRS 17 and the Amendments do not create any distortion in their interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that the Amendments are not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

EFRAG has assessed that the Amendments would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing the Amendments is conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

In EFRAG's assessment of whether the Amendments would be conducive to the European public good, EFRAG has assessed whether the Amendments would improve financial reporting, would have possible implications for financial stability and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth.

Linking the expiry date of the temporary exemption to the effective date of IFRS 17

EFRAG recommends that in order to avoid any further consecutive amendments to IFRS 4 relating to the expiry date of the temporary exemption from applying IFRS 9, the expiry date should be linked to the effective date of IFRS 17 rather than stating a fixed expiry date. That is, the application of the temporary exemption from applying IFRS 9 would expire as from the effective date of IFRS 17.

Our advice to the European Commission

As explained above, we have concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, lead to sufficiently prudent accounting, and that they are not contrary to the true and fair view principle. We have also concluded that the Amendments are conducive to the European public good. Therefore, we recommend the Amendments for endorsement without further delay.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix 1: Understanding the changes brought by temporary exemption from applying IFRS 9 (Amendments to IFRS 4)

A - Background of the Amendments

1 In 2016, the amendments *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4* were issued. As part of these amendments, there was a (voluntary) temporary exemption from applying IFRS 9 **until** annual reporting periods beginning on or after 1 January 2021 for entities whose activities are predominantly connected with insurance.

2 It is recalled that an insurer's activities are predominantly connected with insurance if, and only if the predominance ratio:

(a) is greater than 90 per cent; or

(b) is less than or equal to 90 per cent but greater than 80 per cent and the entity does not engage in a significant activity that is unconnected with insurance.

3 The IASB is in the process of finalising the amendments to IFRS 17 and intends for them to be issued in June~~the second quarter of~~ 2020. One of the changes being made is the deferral of the effective date of IFRS 17 (incorporating the amendments) to annual reporting periods beginning on or after 1 January 2023. However, the temporary exemption from applying IFRS 9 under IFRS 4 has a fixed expiration date in 2021.

4 Therefore, in order to maintain the alignment of the effective dates of IFRS 17 and IFRS 9 for those entities eligible to apply the temporary exemption from IFRS 9, the IASB will issue Amendments to IFRS 4 (including consequential amendments to other IFRS Standards) ('the Amendments'). Otherwise, if alignment is not maintained, this~~aligned, it~~ could give rise to accounting mismatches and also additional costs for having to first implement IFRS 9 and then IFRS 17.

B - How the issues have been addressed

5 The Amendments ensure that, for entities that apply the temporary exemption from IFRS 9, they will be able to continue to apply this temporary exemption until 2023 in order to align the application of IFRS 9 with IFRS 17 in order to address the concerns explained above.

C - What has changed?

6 The temporary exemption from IFRS 9 will end no later than for annual reporting periods beginning on or after 1 January 2023 (instead of 2021 previously).

Appendix 2: EFRAG's technical assessment on Temporary exemption from applying IFRS 9 (Amendments to IFRS 4)

Does the accounting that results from the application of the Amendments meet the technical criteria for endorsement in the European Union?

1 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words that the Amendments:

(a) are not contrary to the principle of 'true and fair view' set out in Article 4 (3) of Council Directive 2013/34/EU (The Accounting Directive); and

(b) meet the criteria of, relevance, reliability, comparability and understandability required of the financial information needed for making economic decisions and assessing the stewardship of management.

2 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.

3 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive'* (Recital 9 of the IAS Regulation).

4 EFRAG's assessment as to whether the Amendments would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.

5 In its assessment, EFRAG has considered the Amendments from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendments is appropriate both for making decisions and assessing the stewardship of management.

6 EFRAG's assessment on whether the Amendments are not contrary to the true and fair view principle set out in Article 4(3) of Council Directive 2013/34/EU is based on the assessment of whether they meet all other technical criteria and whether they lead to prudent accounting. EFRAG's assessment also includes assessing whether the Amendments do not interact negatively with other IFRS and whether all necessary disclosures are required. Detailed assessments are included in this appendix in the following paragraphs:

(a) relevance: paragraphs 8 - 11;

(b) reliability: paragraphs 12 - 16;

(c) comparability: paragraphs 17 - 22;

(d) understandability: paragraphs 23 - 28;

(e) whether overall it leads to prudent accounting: paragraphs 29 - 32; and

(f) whether it would not be contrary to the true and fair view principle: paragraphs 33 - 37.

7 EFRAG has focused its assessment on those aspects of the Amendments it considered most significant in relation to each of the criteria. EFRAG has accordingly focused on guidance that:

(a) is fundamental to the Amendments;

(b) has been subject to substantial debate (evidenced by the comments EFRAG has received from constituents);

(c) may be problematic to apply; or

(d) relates to the issues raised by the European Commission in its request.

Relevance

8 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.

9 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

Extending the expiry date to 2023

10 EFRAG considers that the extension of the expiry date to 2023 for the temporary exemption from IFRS 9, in order to align with the effective date of IFRS 17, provides relevant information for the following reasons:

(a) The business model of entities undertaking insurance activities is based on asset/liability management, with the objective of investing in assets in order to generate income and capital appreciation to cover insurance liabilities and provide profit for shareholders;

(b) Predominant insurers will be in a position to implement IFRS 9 with more complete information, if doing so in conjunction with IFRS 17 and thereby would achieve a high-quality implementation and information. Also, this would avoid accounting mismatches across the implementation periods. This then provides relevant information for users of the financial statements;

(c) The disclosures required for those that apply the temporary exemption from IFRS 9 will continue to provide relevant information for users:

(i) An entity is required to disclose fair value information for (i) financial assets that give rise to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding (excluding any financial assets that meet the definition of held for trading in IFRS 9, or that are managed and whose performance is evaluated on a fair value basis); and (ii) all other financial assets. This will provide relevant information such as an indication of expected credit losses under IFRS 9; and

(ii) An entity is required also to disclose information about credit risk exposure for financial assets that meet the SPPI test. EFRAG considers that this disclosure requirement provides relevant information because of the different impairment requirements under IFRS 9 and IAS 39.

11 EFRAG's overall assessment is that the changes brought by the Amendments are conducive to the provision of relevant information.

Reliability

12 EFRAG considered the reliability of the information that will be provided by using the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

13 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

Extending the expiry date to 2023

14 Extending the expiry date of the temporary exemption from IFRS 9 by two years will enable entities to provide a full implementation of IFRS 9 considering, in parallel, the whole IFRS 17 Standard which includes the amendments. This will, thereby, provide complete information and will faithfully represent the entity's business model of asset/liability management.

15 Furthermore, the level of experience of IFRS 9 implementation available in the market (including consultants and experienced personnel) is expected to increase significantly from the time that IFRS 9 was issued in 2014 to the time that an entity ceases to be eligible for the temporary exemption of applying IFRS 9.

16 Based on the above reasons, EFRAG's overall assessment is that extending the expiry date of the temporary exemption would not prevent the provision of reliable information.

Comparability

17 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

18 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

Existence of three options~~Extending the expiry date to 2023~~

19 Consistently with the current version of the standard *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4*, the temporary exemption and the overlay approach are optional. While options, in general, reduce comparability among entities, the application of IFRS 9 in full is not prohibited.

20 An entity that previously elected to apply the temporary exemption from applying IFRS 9 may at the beginning of any subsequent annual reporting period choose to apply IFRS 9 rather than IAS 39. An entity that chooses or is required to stop applying the temporary exemption from applying IFRS 9 shall, on initial application of IFRS 9, use the relevant transition requirements in that IFRS.

~~19 Entities can apply IFRS 9. Also, the other approach provided in the Amendments to IFRS 4 that was issued in 2016 was the Overlay approach. This Overlay approach reclassifies from profit or loss to other comprehensive income, an overlay adjustment equal to the difference between:~~

~~(a) the amount reported in profit or loss by applying IFRS 9; and~~

~~(b) the amount that would have been reported in profit or loss by applying IAS 39.~~

~~20~~21 Therefore, there are three possible approaches applied by entities. However, the arguments in the endorsement advice on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4* which was issued in January 2017, still hold, i.e.

46 … EFRAG generally considers that options may reduce comparability between entities' financial statements. However, in this case EFRAG observes that the particular options are designed to mitigate the disruptive effects of the misalignment of effective dates of IFRS 9 and the forthcoming insurance contracts Standard. These disruptive effects would affect different entities in different ways and could therefore have a negative effect on comparability.

48 EFRAG expects that entities will select an option that provides the most relevant information given the circumstances of that entity, taking into account cost and benefit considerations. EFRAG also notes that: (i) entities applying the overlay approach will also use IFRS 9; and (ii) the required disclosures result in the provision of information that will enable users to compare entities applying the temporary exemption and entities applying IFRS 9 (with or without the overlay approach).

~~21~~22 In addition, IAS 39 will continue to be applied, therefore, the financial statements will be accounted for in a consistent way over time. The arguments in the endorsement advice on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4* continue to hold*:*

Effect of the application of the temporary exemption

55 Entities that are eligible for the temporary exemption from IFRS 9 and elect this option will continue to apply IAS 39. As a result, no changes will be needed for comparative information. Therefore, the financial statements would be accounted for in a consistent way through time.

56 EFRAG assesses that users of financial statements may avoid the difficulties in predicting long-term economic performance of insurance entities and forecasting earnings based on profit or loss information if a predominant insurer applies the temporary exemption from IFRS 9 instead of applying IFRS 9 before the forthcoming insurance contracts Standard. This results from the insurance entity continuing relevant trends until IFRS 9 is applied at the same time as the forthcoming insurance contracts Standard.

57 In addition, the valuation models for users of financial statements would not need to be changed twice in a short period of time, i.e. between the effective date of IFRS 9 in 2018 and the subsequent effective date of the forthcoming insurance contracts Standard. Therefore, as a result of avoiding two significant consecutive changes, users of the financial statements of these entities would continue to have trend information that is important for their analysis.

Comparability among entities with insurance activities

23 EFRAG recalls that, in order to apply the optional temporary exemption, an insurer's activities are predominantly connected with insurance if, and only if the predominance ratio:

(a) is greater than 90 per cent; or

(b) is less than or equal to 90 per cent but greater than 80 per cent and the entity does not engage in a significant activity that is unconnected with insurance.

24 Therefore, entities with insurance activities that do not meet this predominance ratio would not be able to apply this temporary exemption, thereby impacting comparability between predominant insurers and non-predominant insurers. In this context, the arguments in the endorsement advice on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4* continue to hold*:*

49 EFRAG considers that the availability of the temporary exemption from IFRS 9 only to entities that are predominant insurers at reporting entity level could affect the ability of users to make meaningful comparisons between the financial statements of predominant insurers and the insurance components of other entities undertaking insurance activities that are not predominant insurers. EFRAG understands that the ability to make "insurer-to-insurer" comparisons is for some users more important than broader comparability issues ...

Conclusion on comparability

~~22~~25 ~~Based on the above,~~ EFRAG's overall assessment is that comparability may be impacted between predominant insurers and non-predominant insurers. In addition, even though there are three options that exist, entities would choose the option that provides the most relevant information given the circumstances of that entity, taking into account costs and benefits. Therefore, on balance, based on the above, EFRAG considers that the~~this slight~~ reduction in comparability is acceptable.

Understandability

~~23~~26 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.

~~24~~27 Although there are a number of aspects related to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

~~25~~28 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.

~~26~~29 It is recalled that, in its endorsement advice relating to IFRS 9, EFRAG assessed that the information resulting from IFRS 9 was not unduly complex as the requirements in that Standard are generally built upon clear principles.

Extending the expiry date to 2023

~~27~~30 The users of financial statements have been assessing entities that apply the temporary exemption since 1 January 2018 when the IFRS 4 Amendments *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* (that were initially issued in 2016) became effective. There would be a risk of confusion if users of financial statements receive information provided by IFRS 17 at different times compared to IFRS 9.

Conclusion on understandability

~~28~~31 Therefore, based on the above, EFRAG's overall assessment is that the changes brought by the Amendments are conducive to the provision of understandable information.

Prudence

~~29~~32 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated and liabilities or expenses are not understated.

~~30~~33 The Amendments introduce no new recognition and measurement requirements. Instead, the Amendments rely on the recognition and measurement requirements of IAS 39 and IFRS 9.

~~31~~34 The extension of the expiry date by two years also means that these predominant insurers, who choose the temporary exemption, will not apply the expected credit loss model for measuring loan loss provisions in IFRS 9 during this time. However, the arguments in the endorsement advice on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4*, which was issued in January 2017, continue to hold. The extract of this is below.

Temporary exemption from IFRS 9

Eligibility criteria

82 The most important area is the more forward-looking expected credit loss model for measuring loan loss provisions in IFRS 9, in comparison to the incurred loss model in IAS 39. In allowing predominant insurers to delay the application of this more prudent accounting, the temporary exemption is not conducive to prudence. However, in our endorsement advice on IFRS 9 we noted that insurance entities' holdings in debt-type assets are typically concentrated in assets of investment grade. This factor helps to mitigate any negative effects on prudence, although we understand that the effect of the expected credit loss model could be material to the financial statements of at least some entities undertaking insurance activities.

83 In addition, this negative effect on prudence should be balanced against the fact that, by applying the temporary exemption, predominant insurers can avoid accounting mismatches in their financial statements that would arise from applying IFRS 9 before the forthcoming insurance contracts Standard. The scope of the temporary exemption is intended to ensure that only entities that are significantly affected by accounting mismatches and resulting volatility will be able to use it. EFRAG assesses that this limitation in scope further serves to restrict the negative effects on prudence.

~~32~~35 Based on the above, which still holds, EFRAG's overall assessment is that the Amendments would continue to postpone certain improvements on prudence. However, this is ~~mitigated by~~ (i) mitigated by the fact that insurance entities' holdings in debt-type assets are typically concentrated in assets of investment grade (and to a lesser extent in non-investment grade assets); and (ii) balanced against other considerations such as the cost and understanding of having two consecutive changes shortly after each other. EFRAG, therefore, considers that the Amendments lead to sufficiently prudent accounting.

True and Fair View Principle

~~33~~36 A Standard or Amendment will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS, it:

(a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and

(b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.

~~34~~37 EFRAG assesses that the Amendments provide relevant, reliable, understandable information, reduce~~lead to a slight reduction in~~ comparability but this is acceptable and lead to sufficiently prudent accounting, taking into account the circumstances that gave rise to them (i.e. the misalignment of the effective dates of two Standards both of which have a very significant impact on a particular sector).

~~35~~38 EFRAG assesses that the Amendments do not create any negative interactions with other IFRS Standards and are specifically designed to complement IFRS 4 and IFRS 9. The Amendments avoid distortion by not having entities within the scope of the Amendments to mandatorily use IFRS 9 before IFRS 17. Accordingly, EFRAG assesses that the Amendments do not lead to unavoidable distortions or significant omissions and therefore do not impede financial statements from providing a true and fair view.

~~36~~39 EFRAG also concludes that the disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss are required.

~~37~~40 As a result, EFRAG concludes that the application of the Amendments would not lead to information that would be contrary to the true and fair view principle.

Conclusion

~~38~~41 For the reasons set out above, EFRAG's assessment is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

1 EFRAG considered whether it would be conducive to the European public good to adopt the *Temporary exemption from applying IFRS 9* ("the Amendments"). In addition to its assessment included in Appendix 2, EFRAG has carried out an impact analysis that considers a number of issues in order to identify any potential negative effects for Europe on the application of the Amendments. In doing this, EFRAG considered:

(a) whether the Amendments are likely to improve financial reporting. This requires a comparison of the Amendments with the existing requirements and how they fit into IFRS as a whole; and

(b) the costs and benefits associated with the Amendments.

2 These assessments allow EFRAG to draw a conclusion as to whether the Amendments are likely to be conducive to the European public good. If the assessment concludes there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

Possible implications for financial stability

3 EFRAG acknowledges that, in the past, the optional deferral of the temporary exemption was justified due to its nature as a 'short-term' solution, however there is a prolongation. In this context, the concerns of users in relation to the fact that insurance entities are de facto exempted from applying IFRS 9 is a matter of growing concern to them as well as for regulators.

~~3~~4 Some users have expressed a concern on further postponing the first-time application of IFRS 9 in a period of low interest rates and consequent search for yield that provides an incentive to invest in more risky assets. According to them, users need to have access to IFRS 9 compliant information, in particular, with reference to the effective credit loss.

~~4~~5 EFRAG observes that there are disclosures under IFRS 4 to help ~~the users~~, i.e.

(a) An entity is required to disclose fair value information for (i) financial assets that give rise to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding (excluding any financial assets that meet the definition of held for trading in IFRS 9, or that are managed and whose performance is evaluated on a fair value basis); and (ii) all other financial assets. This will provide information such as an indication of expected credit losses under IFRS 9; and

(b) An entity is required also to disclose information about credit risk exposure for financial assets that meet the SPPI test. EFRAG considers that this disclosure requirement provides information because of the different impairment requirements under IFRS 9 and IAS 39.

6 Furthermore, thanks to the additional time due to the extension of the IFRS 9 expiry date, insurance entities will have the possibility to help users in the transition to the combination of IFRS 9 and IFRS 17 in order to avoid cliff effects of the transition.

Whether the Amendments are likely to improve the quality of financial reporting

~~5~~7 EFRAG notes that the Amendments have been developed in order to align the effective dates of IFRS 9 and IFRS 17. This alignment leads to improved information given the inherent linkage between the two Standards and avoids the potential for accounting mismatches across their implementation periods.

~~6~~8 EFRAG assesses that, without any remedy, the misalignment of effective dates would impact the quality of financial reporting by affected entities to varying degrees depending on their circumstances. Accordingly, the Amendments will serve to improve the quality of financial reporting relative to the situation without any remedies enabling insurers to reduce the impact of the misalignment.

Costs and benefits of the Amendments

~~7~~9 EFRAG has considered whether, and if so to what extent, implementing the Amendments in the EU might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from its adoption.

Costs for preparers

Extending the expiry date to 2023

~~8~~10 Extending the effective date of the temporary exemption by two years will add to the costs of running the implementation projects. However, EFRAG considers that if the expiry date was not extended to align with the effective date of IFRS 17, preparers (affected by the temporary exemption from IFRS 9) would incur even more significant costs due to two significant sets of accounting changes in a short period of time. However, with the alignment of the two standards, the preparers would avoid these significant costs.

~~9~~11 Also, preparers may even continue to benefit from synergies from this dual implementation at the same time, thus reducing costs.

Conclusion – cost for preparers

~~10~~12 Overall, based on the above reasons, EFRAG's assessment is that the extension of the temporary exemption expiry date may add costs for preparers. However, not as significant compared to if the two standards were effective at different dates.

Costs for users

Extending the expiry date to 2023

~~11~~13 EFRAG does not consider that users will incur significant costs due to the Amendments. This is because the relevant entities would still use IAS 39 and users, in particular,~~especially~~ specialist users, are accustomed to these requirements and the temporary exemption has been in place since 2018. Also, due to the alignment between the two standards, the valuation models for users of financial statements would not need to be changed twice in a short period of time.

Conclusion – cost for users

~~12~~14 Overall, based on the above reasons, EFRAG's assessment is that users will not incur significant costs arising from these Amendments.

Benefits for preparers and users

Temporary exemption from IFRS 9

~~13~~15 The benefits in the endorsement advice on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4*, which was issued in

January 2017, continue to hold for both preparers and users. The extract of this is below.

Temporary exemption from IFRS 9

18 EFRAG assesses that the temporary exemption will allow preparers to avoid recognising the volatility in profit or loss and accounting mismatches that would result from applying IFRS 9 before the forthcoming insurance contracts Standard. As noted above, preparers will also avoid the costs relating to a consecutive implementation of two related accounting standards.

19 Users will benefit from the temporary exemption because they can continue using their existing models until IFRS 9 and the forthcoming insurance contracts Standard are applied. EFRAG expects that the IASB will continue to make its best endeavours to issue the forthcoming insurance contracts Standard in sufficient time that the two standards can be applied at the same time by entities electing to apply the temporary exemption from IFRS 9.

Conclusion – benefits for preparers and users

~~14~~16 In EFRAG's endorsement advice on IFRS 9, EFRAG assessed: "*that the mismatch in timing of the future insurance contracts Standard and IFRS 9 would create disruptions in the financial reporting by many entities undertaking insurance activities during the period until the forthcoming insurance contracts Standard is applied, which will make financial reporting less understandable for users while increasing costs for preparers*".

~~15~~17 Overall, based on the above reasons, EFRAG assesses that the benefits for both users and preparers are likely to exceed the costs of applying the Amendments.

Linking the expiry date of the temporary exemption to the effective date of IFRS 17

18 In 2016, the amendments *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4* were issued. Within these amendments, the optional temporary exemption from applying IFRS 9 has a fixed expiry date of 1 January 2021. This temporary exemption expiry date is being extended until 1 January 2023.

19 EFRAG continues to consider that applying IFRS 9 and IFRS 17 together, at the same time, provides useful information. Therefore, EFRAG recommends that in order to avoid any further consecutive amendments to IFRS 4 relating to the expiry date of the temporary exemption from applying IFRS 9, the expiry date should be linked to the effective date of IFRS 17 rather than stating a fixed expiry date. In other words, the application of the temporary exemption from applying IFRS 9 would expire as from the effective date of IFRS 17.

Conclusion on European public good

~~16~~20 Having considered all relevant aspects, including costs and benefits of implementing the Amendments, EFRAG assesses that endorsing the Amendments is conducive to the European public good.