EFRAG

European Financial Reporting Advisory Group

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS ON IFRS 9 *Financial Instruments*

Comments should be sent to commentletters@efrag.org by 30 June 2015

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IFRS 9 *Financial Instruments* ('IFRS 9' or 'the Standard'). In order to do that, EFRAG has been carrying out an assessment of IFRS 9 against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing impact of IFRS 9 on the European public good.

A summary of IFRS 9 is set out in Appendix 1 to the draft endorsement advice letter.

Before finalising its assessments, EFRAG would welcome your views on the issues set out below and any other matters that you wish to raise. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions in Appendices 2 and 3 of the draft endorsement advice.

Your details

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

R+V Versicherung AG

Raiffeisenplatz 1

D-65189 Wiesbaden

Germany

(b) Are you a:

☒ Preparer ☐ User ☐ Other (please specify)

(c) Please provide a short description of your activity:

R+V is a large insurance group located in Wiesbaden, Germany.

The majority of R+V's shares are held by DZ BANK AG, Frankfurt/ Main, Germany.

As a result, DZ BANK and R+V form a bank-led financial conglomerate.

DZ BANK AG's group financial statements are prepared in accordance with IFRS, thus R+V has to prepare IFRS financial statements as well.

Another material part of R+V's shares are held by WGZ Bank AG, Düsseldorf, Germany, resulting in a second financial conglomerate.

In 2014 R+V's consolidated IFRS financial statements show revenues (gross premiums written) of EUR 14,040 Mio. The balance sheet total as of December 31, 2014 is EUR 86,417 Mio. The number of employees is 14,747 as of December 31, 2014.

(d) Country where you are located:

Germany

(e) Contact details including e-mail address:

Ingo Bauer

Rechnungswesen Konzern / Grundsatzfragen

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EFRAG's initial assessment with respect to the technical criteria for endorsement

2 EFRAG's initial assessment of IFRS 9 is that it meets the technical criteria for endorsement. In other words, it is not contrary to the principle of true and fair view and it meets meet the criteria of understandability, relevance, reliability and comparability and leads to prudent accounting. EFRAG's reasoning is set out in Appendix 2, paragraphs 2 to 197 of the draft endorsement advice.

(a) Do you agree with this assessment?

☐ Yes ☒ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

We believe that two amendments are still required:

1. **RECYCLING on FVOCI equities** to avoid distorted performance presentation;
2. **FVOCI option** for debt instruments being otherwise measured at amortised cost: In R+V's financial statements the amortised cost category is of significant importance (ca. 50 % of total financial assets as of 31 December 2014).

Mandatory effective date

Effective dates of IFRS 9 and IFRS 4 Phase II need to be aligned so that insurers are not forced to start adopting IFRS 9 in isolation ahead of the final insurance contracts standard. We believe that significant accounting mismatches are likely to occur if IFRS 9 becomes effective before IFRS 4 Phase II. If IFRS 4 Phase II becomes effective as of 1 January 2020, both 2018 and 2019 will suffer from accounting mismatches.

Insurers should not be obliged to apply IFRS 9 in isolation before the final insurance contracts standard comes into force. We therefore suggest a **deferral of IFRS 9 for insurers**.

We would like to point out that there are several insurers in EU that are part of bank-led **financial conglomerates**. It is important that the deferral of IFRS 9 is **applicable for** those insurers within **financial conglomerates** as well.

R+V fully agrees with EFRAG's view (Appendix 3, #107) that **additional information** of a Group's/ financial conglomerate's financial instruments can be presented per segment in the **notes/ disclosures and/ or MD&A**.

We believe that the information on financial instruments does not become more relevant for the users of financial statements if uniform accounting/ valuation rules within a financial conglomerate are being used. This is because the bank's financial instruments belong to the bank's shareholders whereas the insurer's financial instruments are mainly held for the purpose of the policy holders' interests. Therefore we do not see any necessity why two different businesses / business models within a financial conglomerate would have to apply uniform accounting/ valuation principles.

IFRS 9 should explicitly include such a statement to make clear that the application of both IAS 39 and IFRS 9 in one set of consolidated financial statements is acceptable, at least for the time lag resulting from the effective dates of IFRS 4 Phase II and IFRS 9. The use of IAS 39 and IFRS 9 at the same time for different segments in one set of consolidated IFRS F/S should be optional.

3 EFRAG's initial assessment of IFRS 9 is that it leads to prudent accounting. EFRAG's reasoning is set out in Appendix 2 paragraphs 185 to 191 of the draft endorsement advice.

(a) Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues relating to prudence that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of IFRS 9? If there are, what are those issues and why do you believe they are relevant to the evaluation?

(c) Are there any other issues that are not mentioned in Appendix 2 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9? If there are, what are those issues and why do you believe they are relevant to the evaluation?

The European public good

4 In its assessment of the impact of IFRS 9 on the European public good, EFRAG has considered a number of issues that are addressed in Appendix 3 of the draft endorsement advice.

IFRS 9 compared to IAS 39

5 EFRAG's initial assessment of IFRS 9, and particularly with respect to the impairment and hedging requirements, is that it is an improvement over IAS 39 and will lead to higher quality financial reporting. The assessment is reflected in paragraphs 3 to 52 of Appendix 3 of the draft endorsement advice.

(a) Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues relating to IFRS 9 compared to IAS 39 that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9 when comparing to IAS 39? If there are, what are those issues and why do you believe they are relevant to the evaluation?

The lack of convergence with US GAAP

6 EFRAG's initial assessment is that IFRS 9 will lead to higher quality financial reporting when compared to current US GAAP and proposed changes to impairment requirements. The assessment is reflected in paragraphs 53 to 74 of Appendix 3 of the draft endorsement advice.

(a) Do you agree with this assessment?

☐ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues related to the impact of the lack of convergence that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9 when comparing with US GAAP? If there are, what are those issues and why do you believe they are relevant to the evaluation?

Impact on investor and issuer behaviour

7 EFRAG's analysis in this area is based on our understanding of both changes in IFRS 9 and current practices of financial institutions and is not a full impact assessment. In its analysis EFRAG has tried to identify potential negative effects only, to contribute to identifying whether there would be any impediment to IFRS 9 being conducive to the European public good. The assessment is reflected in paragraphs 75 to 99 of Appendix 3 of the draft endorsement advice.

(a) Do you agree with this assessment?

☐ Yes ☒ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

We would like to bring the following issues and peculiarities of financial conglomerates to your attention:

Due to the application of CRR/ CRD IV in the banking industry, our parent banking company is focusing on equity ratios. Banks are from a regulatory perspective required to increase their equity ratios over the next couple of years gradually.

Applying IFRS 9 before the new insurance standards comes into effect leads –as already discussed– to accounting mismatches and makes it difficult if not impossible to reliably forecast equity developments and P&L results for the insurance segment of the conglomerate.

Introducing IFRS 9 before IFRS 4 Phase II in financial conglomerates might jeopardize a conglomerate's capital strategies.

(b) Are there any issues related to the impact of IFRS 9 on investor and issuer behaviour that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9? If there are, what are those issues and why do you believe they are relevant to the evaluation?

Inter-relationship of IFRS 9 with the future insurance contracts standard

8 EFRAG has initially concluded that the mismatch in timing of the future insurance contracts standard and IFRS 9 will create disruptions in the financial reporting of insurance activities which may not be beneficial to investors and other primary users (see Appendix 3, paragraphs 100 to 110 of the draft endorsement advice). Hence EFRAG proposes to advise the European Commission to ask the IASB to defer the effective date of IFRS 9 for insurers and align it with the effective date of the future insurance contracts standard.

9 In reaching this preliminary position, EFRAG has relied on quantitative assessments prepared by the European insurance industry and released shortly before EFRAG concluded on its tentative advice to the European Commission. EFRAG intends to deepen its understanding of the effect on the reporting by insurance businesses by implementing IFRS 9 in advance of the forthcoming IFRS 4. EFRAG invites all quantitative evidence that can supplement the impact assessment received from the European insurance industry, including evidence gathered by those who oppose the deferral.

(a) Do you agree with this assessment and the subsequent advice to the European Commission?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

R+V agrees with the EFRAG's tentative assessment and supports the suggested advice to the European Commission.

The **preferred solution** from R+V's point of view is to **allow the application of both IFRS 9 and IAS 39 (for insurers) in the consolidated financial statements of a financial conglomerate**. Given additional information in the segmental reporting, in notes/ disclosures and/ or MD&A we believe that this would result in relevant investor information.

The **second best solution** from R+V's perspective would be to have an explicit option at group level (in case groups are not be allowed to use both IAS 39 and IFRS 9 at the same time in their consolidated financial statements) for a reassessment with regard to classification of financial instruments including reassessment of business model as recently discussed when the insurance contracts standard becomes effective.

(b) Do you think that EFRAG should recommend the EC to grant to insurance businesses a deferred mandatory date of application for the endorsed IFRS 9 if the IASB were not to defer the effective date of IFRS 9?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

Based on the answers already given above we believe that it is absolutely necessary to defer the mandatory effective date for insurers.

Without repeating the points already made, we want to highlight once again that a **deferral solution must be able to cover the peculiarities of insurers within financial conglomerates** as well.

A solution for pure insurers only is not sufficient.

(c) Are there any issues related to the inter-relationship of IFRS 9 with the future insurance contracts standard that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9 when assessing the inter-relationship between IFRS 9 and the future insurance contracts standard? If there are, what are those issues and why do you believe they are relevant to the evaluation?

If IFRS 9 is to become effective (also) for insurers as of 1 January 2018, insurers would have to test and implement a software solution for IFRS 9 purposes in near future.

As long as there is no final IFRS 4 Phase II standard available it is not possible to identify and take into account the technical requirements resulting from the insurance contracts standard and their effect on the IFRS 9 software solution. This is because especially the accounting for participating contracts, i.e. the link between assets and insurance liabilities, has not been finalized.

Therefore it is not possible for insurers to start implementing IFRS 9 before the final standard for insurance contracts, especially participating business, has been finalized.

In any other case insurers are forced to invest in an IFRS 9 software solution today to be IFRS9 compliant in 2018, while there is a significant risk that the selected software solution may not be able to interact with the upcoming IFRS 4 standard in the future to properly reflect the asset dependency of the insurance liabilities.

Implementing IFRS 9 twice, i.e. as of 1 January 2018 and again when IFRS 4 Phase II becomes effective, would lead to tremendous costs with questionable benefits for the users of financial statements.

We believe that it is not appropriate to make the policy holders bear these risks and/ or to carry these costs.

Last but not least, these (unnecessary) costs lower the insurer's profitability and distort competition in the market between IFRS and local GAAP

preparers.

European carve-out

10 EFRAG has initially concluded that the endorsement of IFRS 9 would not affect the ability of entities to rely on the European carve-out (see Appendix 3, paragraphs 111 to 117 of the draft endorsement advice).

(a) Do you agree with this assessment?

☐ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues related to the European carve-out that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9 when assessing the EU carve out? If there are, what are those issues and why do you believe they are relevant to the evaluation?

Costs and benefits of IFRS 9

11 EFRAG is assessing the costs that are likely to arise for preparers and for users on implementation of IFRS 9 in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

12 The results of the initial assessment of costs are set out in paragraphs 120 to 155 of Appendix 3 of the draft endorsement advice. To summarise, EFRAG's initial assessment is that overall, IFRS 9 is likely to result in significant costs for preparers related to implementation of and ongoing costs of complying with the standard. However, IFRS 9 is not likely to result in significant costs for users after the transition. At transition costs will be incurred in understanding the new financial reporting.

(a) Do you agree with this assessment?

☐ Yes ☒ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be.

We agree with the assessment that IFRS 9 causes tremendous expenses, both for implementation and for subsequent years.

Taking a closer look at the insurance industry we are afraid that IFRS 9 in combination with IFRS 4 Phase II might further more lead to significant cost on the user side as well.

This is especially true if the users are faced with several first time adoptions of new standards or double first applications within a short period of time.

We therefore strongly urge EFRAG to offer a solution to synchronously implement IFRS 9 and IFRS 4 Phase II for insurers, including those within financial conglomerates.

(b) In addition, EFRAG is assessing the benefits that are likely to be derived from the application of IFRS 9. The results of the initial assessment of benefits are set out in paragraphs 156 to 170 of Appendix 3. To summarise, EFRAG's initial assessment is that overall, users and preparers are both likely to benefit from IFRS 9, as the information resulting from it will be relevant and transparent and therefore will enhance the analysis of users.

Do you agree with this assessment?

☐ Yes ☒ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice.

.. R+V is not in a position to make this assessment until the IFRS 4 Phase II standard has been finalized, especially as far as the accounting for participating contracts is concerned.

13 EFRAG's initial assessment is that the benefits to be derived from implementing IFRS 9 in the EU as described in paragraph 12 (b) above are likely to outweigh the costs involved as described in paragraph 12 (a) above.

Do you agree with this assessment?

☐ Yes ☒ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice.

R+V's assessment is that the benefits to be expected do not outweigh the cost of implementing IFRS 9. From a regulatory standpoint insurers' investments in high-risk assets are rather limited. Calculating expected losses is therefore rather questionable given the background of a highly regulated insurance industry.

Overall assessment with respect to the European public good

14 EFRAG has initially concluded that endorsement of IFRS 9 would be conducive to the European public good (see Appendix 3, paragraphs 174 to 176 of the draft endorsement advice).

Do you agree with the assessment of these factors?

☐ Yes ☒ No

If you do not agree, please explain your reasons.

Overall and based on our answers given above we cannot share this opinion at the moment.

Other issues for consideration

Request to provide quantitative data on a confidential basis

15 EFRAG continues its search for quantitative data in the fields of impairment and the inter-relationship between IFRS 9 and the future insurance contracts standard. EFRAG calls upon constituents who have quantitative data available in these fields, to provide it to EFRAG on a confidential basis during the consultation period of the draft endorsement advice. Data provided will be used in finalising the endorsement advice but will not be made public.

The collection of these data is subject to EFRAG's field-work policy which is available on the EFRAG website.

.. R+V is not in a position to make this assessment until the IFRS 4 Phase II standard has been finalized, especially as far as the accounting for participating contracts is concerned.

Should endorsement be halted until quantitative data are available?

16 Based on the results of our questionnaire follow up to the field-tests, it can take up to 2017 to have quantitative impacts of the implementation of IFRS 9 available. It has been argued by some that the quantitative impacts of IFRS 9 should be known before endorsement of the standard is decided upon. EFRAG does not agree with this view and believes that the improvements brought to financial reporting by IFRS 9 should not be withheld from European companies for a period that long.

Do you agree with this assessment?

☐ Yes ☒ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

.. For the insurance industry the new IFRS 9 standard is a very important one. In R+V's consolidated IFRS F/S approx. 83% of all assets are subject to the rules of IAS 39/ IFRS 9, respectively. We feel that such a crucial standard should not be adopted before sufficient

evidence from field testing has been derived.

Furthermore, such a crucial standard should not become effective before the interdependencies with other crucial standards, i.e. IFRS 4 Phase II which will cover the majority of the liability side of the balance sheet, have been duly assessed.

Should early application of IFRS 9 be prohibited?

17 It has been argued by some that early application of IFRS 9 should not be allowed for specific regulated industries. EFRAG does not agree with this and is of the opinion that entities should be able to apply IFRS 9 early (see Appendix 2, paragraphs 192 to 195 of the draft endorsement advice).

Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.