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:

Joint response from the **European Insurance CFO Forum** and **Insurance Europe**

(b) Are you a:

☐ Preparer ☐ User ☒ Other (please specify)

See response in 1 (c) below.

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

The **European Insurance CFO Forum ("CFO Forum")** is a body representing the views of 21 of Europe's largest insurance companies.

Insurance Europe is the European (re)insurance federation whose members are the national insurance associations in 34 countries, representing 95% of the premium income of the European insurance market.

(d) Country where you are located:

Head office throughout Europe with insurance entities worldwide

(e) Contact details including e-mail address:

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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.

Although we agree in general with EFRAG's assessment that IFRS 9 meets the technical criteria for endorsement, we believe, consistent with EFRAG's assessment in Appendix 3 of in the draft endorsement advice, that requiring an insurer to apply IFRS 9 before the effective date of the future insurance contracts standard ("IFRS 4 Phase II") "has the potential to significantly reduce the quality of information available to users." Thus, the alignment of the effective dates for these standards is critical for the true and fair view (including the criteria of understandability, relevance and comparability) of the financial statements of an insurance company.

To further elaborate on EFRAG's initial assessment, we believe that this alignment of effective dates is critical for insurers because:

- Insurance liabilities and underlying financial instruments are inherently interrelated due to the asset and liability matching nature of our business model. As such, both IFRS 9 and an appropriate IFRS 4 Phase II standard are key to providing meaningful performance reporting and cannot be considered independently. Implementing the changes separately in a short period is inefficient, confusing to users, and will result in the financial statements not reflecting the economic performance of insurers.
- If IFRS 9 were to be implemented before IFRS 4 Phase II, the classification will be reassessed when IFRS 4 Phase II is adopted which effectively results in IFRS 9 being implemented twice. This will create confusion with users and impair the relevance and transparency of the financial statements during this period.
- The application of IFRS 9 accounting for insurers ahead of the IFRS 4 Phase II standard will not reflect the related measurement and performance reporting changes for insurance liabilities under IFRS 4 Phase II, resulting in additional misleading volatility due to accounting mismatches.
- It is currently not possible for an insurer to apply IFRS 9 and early adopt IFRS 4 Phase II as the latter standard has not been completed yet and, once completed, its implementation will take considerable time.

Applying IFRS 9 in isolation, before IFRS 4 Phase II would require the creation of a temporary reporting basis which again will need to be altered once IFRS 4 Phase II is effective. The impact for many users of the financial statements will be negative and costly due to the confusion that will arise. It is also burdensome for preparers to make significant financial reporting changes at different dates, and wasteful where changes have to be made and then reversed.

In our opinion, the European Commission should request the IASB to permit the deferral of the effective date of IFRS 9 for insurance businesses to align it with the effective date of IFRS 4 Phase II. However, if this global solution will be unavailable, the European Commission should enable a deferral in Europe for insurance companies.

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?

No

(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?

While not mentioned in Appendix 2 of the draft endorsement advice, EFRAG does mention in its initial assessment in Appendix 3, paragraphs 100 to 110 of the draft endorsement advice the concerns raised for insurers about the misalignment of effective dates for IFRS 9 and IFRS 4 Phase II. We share EFRAG's concerns about the impact of IFRS 9 on insurers without the alignment with IFRS 4 Phase II.

We have also noted these concerns (see our response to Question 2(a) above) and believe such a misalignment of effective dates will adversely affect the Appendix 2 criteria of understandability, relevance and comparability of the financial statements for insurers.

As IFRS 4 Phase II is not yet finalised, a full analysis of the interaction between IFRS 4 Phase II and IFRS 9 is not yet possible.

Furthermore, we would support EFRAG's proposal that there should be a post-implementation review of IFRS 9 to consider remaining weaknesses in the standard noted.

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.

Although we support EFRAG's assessment that, in general, IFRS 9 is an improvement over IAS 39 and will lead to higher quality financial reporting in certain industries, we believe that specifically for insurers this is only true if the effective dates for IFRS 9 and IFRS 4 Phase II are aligned. For more information, we refer to our response to question 2a.

(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?

No

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.

Whilst we support the development of comprehensive globally converged accounting standards, we concur with EFRAG's assessment in this respect.

(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?

No.

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.

(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?

IFRS 4 Phase II is expected to help address some of the potential negative effects noted in EFRAG's IFRS 9 analysis which further supports the need to align the effective date for IFRS 4 Phase II and IFRS 9 as set out in our response to Question 2(a) above. We agree with EFRAG's analysis including that "measuring equity instruments at fair value through profit or loss may result in fluctuations in profit or loss that may not reflect the economics of their business".

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.

(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.

(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?

Consistent with the conclusion reached in Appendix 3 of your Draft Endorsement Advice, for insurance businesses, a global solution is required to align the effective dates of IFRS 4 Phase II and IFRS 9. In our opinion, the European Commission should request the IASB to permit the deferral of the effective date of IFRS 9 for insurance businesses to align it with the effective date of IFRS 4 Phase II. However, if this global solution will be unavailable, the European Commission should enable a deferral in Europe for insurance companies.

In addition to our response to Question 2(a) above, we believe that any concerns regarding a temporary deferral of IFRS 9 for insurance business can be addressed. The identification of an insurance business is manageable, for example by reference to regulated insurers. The application of a deferral for insurers within a conglomerate can be addressed through segmental reporting and additional disclosures, with business model-based accounting policies for financial instruments. Furthermore, provisions to prevent accounting arbitrage could be envisaged for intra-group transactions within conglomerates.

We do not believe that existing features in the current IFRS 4 (such as shadow accounting and the option to apply current market interest rates) or potential extensions to these features (such as an extended scope for shadow accounting) could be considered as adequate alternatives for the deferral of IFRS 9. Such features or extensions, if at all workable in an acceptable manner to all stakeholders, would be complicated and time consuming to achieve and would still result in multiple accounting changes for insurers in a short period of time. Given the analysis and process required, we strongly believe that the time that would be necessary for amending the current IFRS 4 and implementing the resulting changes by insurers, even if achievable, are not compatible with an effective date of 1 January 1, 2018. We believe that this time would be better utilised in finalising IFRS 4 Phase II.

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?

No

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 EFRAG's assessment that the implementation of IFRS 9 would result in significant costs for preparers related to implementation of and ongoing costs of complying with the standard. We do not agree with EFRAG's assessment that IFRS 9 is not likely to result in significant costs for users after the transition if the effective dates of IFRS 9 and IFRS 4 Phase II remain unaligned. Applying IFRS 9 in isolation, before IFRS 4 Phase II would require the creation of a temporary reporting basis which again will need to be altered once IFRS 4 Phase II is effective. The impact on many users of the financial statements will be negative and costly due to the confusion that will arise. It is also burdensome for preparers to make significant financial reporting changes at different dates, and wasteful where changes have to be made and then reversed.

(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.

Although we agree in general with EFRAG's assessment of the benefits of IFRS 9, we do not believe that this is the case for insurers if IFRS 9 is implemented independently from IFRS 4 Phase II.

As set out in the issues noted in the response to Question 2(a) above, if IFRS 9 were to be implemented before IFRS 4 Phase II, it will result in multiple significant accounting changes and the classification must be reassessed when IFRS 4 Phase II is adopted, which effectively results in IFRS 9 being implemented twice. This will create confusion with users and impair the relevance and transparency of the financial statements during this period.

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.

Although EFRAG's assessment may be accurate for most companies, for insurers, the benefits may only outweigh the cost involved if the effective date for IFRS 9 is aligned with the effective date for IFRS 4 Phase II. We refer to the response to Question 2(a) above.

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.

Although we agree with EFRAG's initial conclusion that the endorsement of IFRS 9 would be conducive to the public good in general, we believe that this would only be true if the effective date for IFRS 9 is aligned with the effective date for IFRS 4 Phase II for insurers. This is consistent with EFRAG's recommendation noted in Appendix 3 of the draft endorsement advice, paragraph 110 which notes "that a deferral of IFRS 9 for insurers would be conducive to the European public good."

As such, we strongly agree with EFRAG's proposals that the IASB should temporarily defer IFRS 9 for insurers until IFRS 4 Phase II is implemented.

A second but less attractive alternative would be an EU-only solution. This would however not address the issue for entities operating on a global basis and/or insurers that are listed on stock exchanges outside Europe (including the US).

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.

We refer to the additional documents sent to EFRAG containing additional explanations to EFRAG questions as well as quantitative data which was shared on a confidential basis.

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.

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.