STAFF PAPER

September 2015

REG IASB Meeting

Project	**Different effective dates of IFRS 9 and the new insurance contracts Standard**		
Paper topic	Feedback from user outreach and submissions		
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Purpose of this paper

1. This paper summarises feedback received by the IASB on the different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts Standard:

   (a) in the outreach with users of financial statements (eg investors and analysts) conducted by the IASB members and staff in August and September 2015, and

   (b) in two written submissions received by the IASB from users of financial statements and their representative organisations.

2. This paper supplements Agenda Papers 14 and 14B-14E for this meeting. This paper is for information only.

Structure of this paper

3. This paper is structured as follows:

   (a) statistics and demographic analysis of participants in the user outreach (paragraphs 5-13);

   (b) our approach to obtaining feedback from users of financial statements (paragraphs 14-18);

(c) summary of feedback from users of financial statements (paragraphs 19-29);

(d) detailed feedback on the following topics discussed in the outreach (paragraphs 30-57):

(i) additional temporary volatility that may arise if IFRS 9 is applied in conjunction with IFRS 4 *Insurance Contracts* (paragraphs 30-34),

(ii) two consecutive major accounting changes for entities that issue insurance contracts (paragraphs 35-40),

(iii) the Deferral Approach (paragraphs 41-48),

(iv) the Overlay Approach (paragraphs 49-53), and

(v) whether those approaches should be mandatory or optional if the IASB decides to propose them (paragraphs 54-57); and

(e) overview of the feedback received by the IASB in two written submissions from users of financial statements and their representative groups (paragraphs 58-61).

4. This paper includes the following appendices:

(a) Appendix A—explanatory materials used by IASB members and staff in the outreach with users of financial statements entitled *Application of the new accounting requirements for financial assets by insurers*

(b) Appendix B—two written submissions from users of financial statements

Statistics and demographic analysis

5. In the outreach on the different effective dates of IFRS 9 and the new insurance contracts Standard IASB members and staff sought views of a diverse group of users of financial statements.

6. Overall, IASB members and staff approached almost 250 users of financial statements in various jurisdictions with a request to provide feedback to the IASB on different effective dates of IFRS 9 and the new insurance contracts Standard.

7. In the period from 3 August to 4 September 2015, IASB members and staff have conducted 42 meetings and calls with over 50 users of financial statements. A few more users have provided their comments by email.

8. In terms of geographical representation, we have conducted twenty calls and meetings with users in Europe, eight calls with users in Asia, eight calls with users in Australia, three calls with users in the United States, two calls with users in Canada and one call with a user from Latin America. Some of the users we have spoken to covered companies in their jurisdiction only and others covered a number of jurisdictions or had a global outlook.

9. In terms of the profile and industry focus, most users we have spoken to were sell-side equity analysts. Most of them specialised in the insurance industry and some had a broader financial institutions focus. Sell-side analysts came from various jurisdictions.

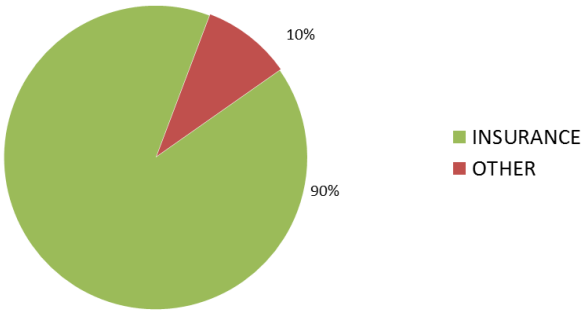
10. Buy-side equity analysts that we have spoken to also represented a significant portion of our outreach. Some of them specialised in the insurance industry and some had a broader financial institutions focus. Buy-side analysts mainly came from Europe, but also from the United States and Asia.

11. Credit analysts we have spoken to were represented by rating agencies specialists who focused on insurance industry and banks. Portfolio managers we have spoken to had diverse industry focus. Credit analysts and portfolio managers did not represent a significant portion of our outreach.

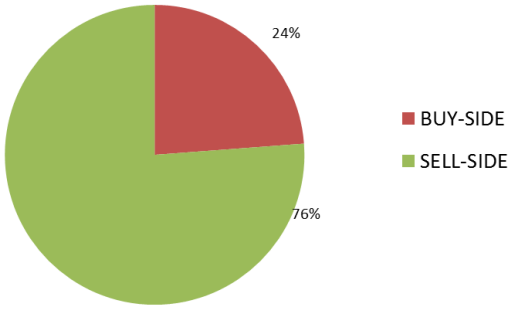
12. Many of the users we have spoken to followed large insurance companies, including those that provided feedback to the IASB on different effective dates of IFRS 9 and the new insurance contracts Standard.

13. The following charts illustrate a demographic analysis of users we have spoken to by jurisdiction, sell-side versus buy-side profile and industry focus.

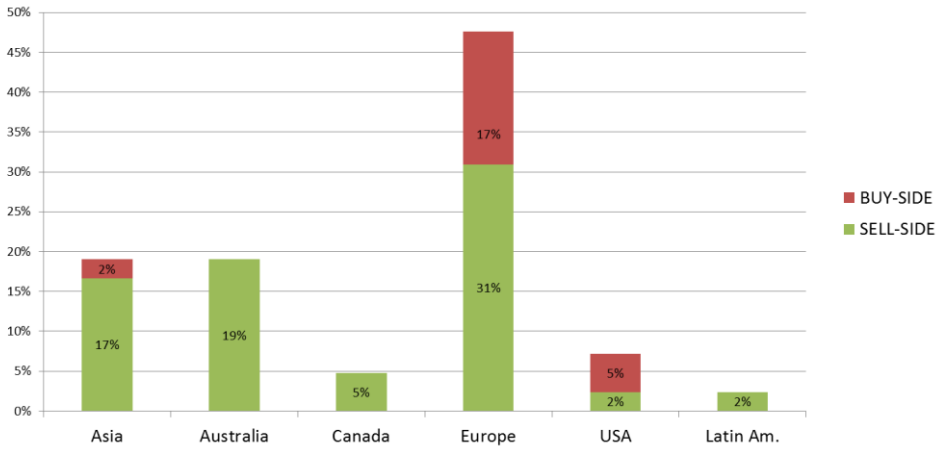
Users: industry focus



Users: profile



Users: profile and geograhical breakdown



Our approach to obtaining feedback from users of financial statements

14. Our discussions with users of financial statements were based on a set of explanatory materials that were distributed in advance of the calls and are included in Appendix A for reference. An IASB member joined almost all calls.

15. In introducing the topic to users of financial statements, we adopted the following approach:

    (a) We explained the effect of the different effective dates of IFRS 9 and the new insurance contracts Standard,

    (b) We explained the reasons for and the mechanics of additional temporary volatility that may arise for some entities that issue insurance contracts ('insurers') when IFRS 9 is applied in conjunction with IFRS 4 *Insurance Contracts*, and the potential sources of such volatility on the financial asset side,

    (c) We explained that the IASB could propose the Deferral Approach (discussed in Agenda Paper 14D) to address the concerns about different effective dates of IFRS 9 and the new insurance contracts Standard raised by some interested parties, and explained the challenges of identifying the scope of such an approach, in particular for entities that undertake different activities (eg bancassurers),

    (d) We explained that the deferral of the effective date of IFRS 9 ('the deferral') could be provided at the reporting entity level for entities that predominantly engage in insurance activities, whereby all financial assets held by the reporting entity would be accounted for either under IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement*,

    (e) We explained that the deferral could also be provided at below the reporting entity level based on legal entities with the group whereby IAS 39 and IFRS 9 would simultaneously apply in the consolidated financial statements depending on where within the group financial assets are held, and explained the implications that could arise when

financial assets are transferred between the 'IAS 39' and 'the IFRS 9' parts of the group,

(f) We explained that the IASB could also propose the Overlay Approach (discussed in Agenda Paper 14C) to address the concerns about different effective dates raised by some interested parties, and explained how the Overlay Approach would apply,

(g) We discussed the disclosures that the IASB could propose to accompany either approach, and

(h) We explained that some interested parties requested the deferral of the effective date of IFRS 9 for entities that issue insurance contracts, and that those interested parties thought the deferral should be permitted rather than required for those entities.

16. In conducting our discussions with users of financial statements, we sought to understand:

(a) Whether any increased volatility in profit or loss during the period when IFRS 9 is applied in conjunction with IFRS 4 would make financial statements of insurers less understandable, and why;

(b) Whether it would be preferable for accounting changes for financial assets and insurance contract liabilities to be implemented consecutively or simultaneously, and why;

(c) Which approach, or approaches, would result in useful information for users of financial statements, and why:

(i) the Deferral Approach, or

(ii) the Overlay Approach; and

(d) How those approaches should be applied and what disclosures would result in useful information.

17. We asked users of financial statements whether they thought the Deferral Approach or the Overlay Approach would provide more useful information and be more acceptable, and why. We asked this question even if their preferred approach would be for the IASB not to propose any temporary measures, eg

because they did not have concerns about different effective dates of IFRS 9 and the new insurance contracts Standard.

18. We asked users of financial statements which approach to the deferral, if the IASB were to consider the deferral, would provide more useful information and why—deferral at the reporting entity level or below the reporting entity level. We asked this question even if those users did not support the Deferral Approach and preferred either the Overlay Approach or for the IASB not to propose any temporary measures.

Summary of feedback

19. We heard mixed views on whether the different mandatory effective dates of IFRS 9 and the new insurance contracts Standard would make financial statements of entities that issue insurance contracts less understandable and create disruption for users of financial statements.

20. Many users told us that any additional volatility in profit or loss when IFRS 9 is applied in conjunction with IFRS 4 would not make their analysis more difficult. They said they already see volatility when looking at financial statements of insurance companies and they are able to make necessary adjustments to understand the financial performance of entities in the insurance industry. They also did not think that preliminary numbers (see paragraph 31(c)) indicating additional volatility that have been cited by the insurance industry are significant for their purposes. Some said they do not focus on profit or loss numbers for insurance industry. Others said increased volatility would be unhelpful, in particular for those buy-side analysts who do not perform detailed analysis, and that such increased volatility would make the insurance industry look more uncertain and less attractive for investment.

21. In terms of jurisdictional views, concerns about increased volatility in profit or loss tended to come from Europe and Asia rather than other jurisdictions. However, within those two jurisdictions views were mixed, ie some users in those jurisdictions expressed those concerns and some did not. In terms of user profile, any concerns about increased volatility tended to come from buy-side analysts.

Sell-side analysts expressed mixed views on this topic. We did not observe any trends in views on volatility in terms of industry focus.

22. Some users said that a temporary accounting basis created by two sets of accounting changes would be unhelpful and would make their data series analysis more difficult. Others said that two sets of accounting changes would make their analysis easier because they would be able to fully understand and evaluate the effect of one set of accounting changes before having to understand another set of accounting changes. We did not observe any jurisdictional, user profile or industry focus trends in the views on two sets of accounting changes.

23. We have heard mixed views on whether anything, and if so, what should be done to address any concerns about different effective dates of IFRS 9 and the new insurance contracts Standard. Some users did not think that it is necessary for the IASB to undertake any temporary measures but could still accept the Overlay Approach. Others thought that temporary measures that address the concerns about different effective dates of IFRS 9 and the new insurance contracts Standard would be helpful but expressed mixed preferences as to what those measures should be.

24. We have heard mixed views on the Deferral Approach. Some users supported the Deferral Approach and did not find the Overlay Approach equally attractive. Some users supported the Deferral Approach but also accepted the Overlay Approach. Some users opposed the Deferral Approach. Overall, we did not hear significant support for the Deferral Approach. On jurisdictional basis, mixed views were expressed in Europe and Asia. Users from other jurisdictions we have spoken to did not support the Deferral Approach. Support for the Deferral Approach generally tended to come from sell-side analysts focused on the insurance industry rather than from buy-side analysts or analysts with a broader industry profile. However, views expressed by sell-side insurance analysts were mixed, ie some supported the Deferral Approach and some did not.

25. We have received significant support for the Overlay Approach. Some users preferred the Overlay Approach compared both to the Deferral Approach and to no temporary measures at all. Some users who supported or even preferred the Deferral Approach could also accept the Overlay Approach. Some users who did

not think any temporary measures were necessary could still accept the Overlay Approach even when they would not accept the Deferral Approach. Overall, many users expressed a view that the Overlay Approach is a good compromise and generally no users have told us that the Overlay Approach was unacceptable. We did not observe any jurisdictional, user profile or industry focus trends in the views on the Overlay Approach.

26. We heard mixed views on how the Deferral Approach should apply *if* the IASB were to propose that approach. Most users, especially those coming from Europe, supported the deferral at the reporting entity level, if the IASB were to propose the Deferral Approach. Many users, especially those coming from Asia, expressed concerns about transfers of financial assets and the accounting arbitrage opportunities that might arise from such transfers if the deferral is provided below the reporting entity level. However, some users supported the deferral below the reporting entity level. Some users did not express a view on this topic.

27. Most users across all profiles, industry focus and jurisdictions preferred any approach that the IASB may decide to propose to be mandatory rather than optional. All users stated that comparability within a sector is very important. However, some users could accept an optional approach provided it is accompanied by disclosures. Cross-sector comparability is important for some, but not all, users, mainly buy-side analysts and portfolio managers. However, some sell-side analysts also supported cross-sector comparability. They stated that even though any lack of cross-sector comparability would not affect their analysis, cross sector comparability is important for them in talking to their clients.

28. Many users supported additional disclosures under both the Deferral Approach and the Overlay Approach, especially if the IASB decides to propose an optional approach.

29. Many users urged the IASB to complete the Insurance Contracts project as soon as possible. They noted that the main focus for users of financial statements of entities in the insurance industry is insurance contracts liabilities rather than financial assets.

Detailed feedback

Views on increased volatility

30. Users of financial statements expressed mixed views on whether the financial statements of insurers would be less understandable as a result of any increased volatility in profit or loss when IFRS 9 is applied in conjunction with IFRS 4.

31. Some analysts from various jurisdictions, including Europe, did not have concerns about increased volatility:

    (a) Some said that for most investors the main focus with insurance industry is on cash flows and ability to pay dividends rather than profit or loss and any increased volatility in profit or loss would not affect those metrics and decision-making. That feedback largely came from users in Europe, including those with a global outlook.

    (b) Some said that they focus on operating profit in their analysis and therefore any increased volatility from fair value gains and losses on financial assets would not affect their analysis. That feedback was a common theme for Europe.

    (c) Some thought that an estimated increase in volatility in profit or loss of 5-20% for entities that issue insurance contracts in Europe is not significant and should not make a difference to their specialist analysis. That feedback came from users in various jurisdictions, including Europe.

    (d) Some said they focus on embedded value rather than on profit or loss in their analysis of insurance industry, and increased volatility in profit or loss would not impact that analysis. However, they emphasised that the reason they focus on embedded value is because profit or loss is already very volatile and not useful for their analysis. That feedback was common for users from Asia.

    (e) Some said that volatility in profit or loss would not confuse specialist users because any such volatility is usually discussed in the notes to financial statements and through management discussion and analysis.

As a result, analysts are able to make the necessary adjustments. That feedback came from users in various jurisdictions.

(f) Some emphasised that they already see a lot of volatility in profit or loss for both for financial assets and insurance contracts and are able to make necessary adjustments to understand economic performance of insurers. That feedback was common for users from Australia who said that current values are already commonly used for both financial assets and insurance contracts in their jurisdiction.

(g) In contrast, a user from Latin America stated that insurers in their jurisdiction tend to invest in plain vanilla government bonds and therefore he did not expect increased volatility in profit or loss on application of IFRS 9.

32. Other analysts, mainly from Europe and Asia, expressed concerns about increased volatility in profit or loss:

(a) Some stated that increased volatility would make financial statements of insurers even less understandable for buy-side investors and would make the insurance industry less attractive for investment. They pointed out that many non-specialists users would not be interested in digesting the reasons for increased volatility but would see it as an increase in uncertainty and apply a higher valuation discount to insurance stocks.

(b) Some stated that increased volatility in profit or loss would make it more difficult to predict long-term economic performance of insurers and to forecast earnings based on profit or loss information. They stated this would result in an increased focus on alternative performance measures. They said that even the existing level of volatility in equity markets makes it difficult for analysts to understand financial performance of insurers.

33. Regardless of their views on volatility, many users stated that it is important for them to be able to distinguish between economic and accounting volatility and they emphasised the need for disclosure that would explain sources of volatility.

34. Some users, mainly from Canada, expressed a concern as to whether increased volatility would affect the regulatory capital. Some users, mainly from Asia, expressed a concern as to whether the new accounting requirements for financial assets would lead to a behavioural change for entities and affect the composition of their asset portfolios and their product mix.

Views on two consecutive accounting changes

35. As a general proposition, many users thought that it would be easier for them if IFRS 9 and the new insurance contracts Standard are applied at the same time. Therefore it would be ideal for the two Standards to have the same effective date. However, many of those users stated that they will able to understand the effects of those accounting changes even if they are applied at different dates rather than at the same time, and so they did not think that the deferral of the effective date of IFRS 9 would be an appropriate remedy. Instead, they asked the IASB not to delay the effective date of IFRS 9 even if that would mean that they would have to recalibrate their models. Rather, they asked the IASB to complete the *Insurance Contracts* project as soon as possible. Some also expressed a concern that even though the gap between the effective dates of IFRS 9 and the new insurance contracts Standard is expected to be short, there is no guarantee that that would be the case and therefore believed that IFRS 9 should be applied without delay.

36. Some users stated that a temporary accounting basis would be unhelpful and would make it more difficult for both sell-side and buy-side analysts to understand the financial performance of insurers. Some also expressed a concern that buy-side analysts may look to understand nuanced changes in detail and would apply higher valuation discounts as a result of disruption in data series and perceived increased uncertainty. They also stated that frequent changes to valuation models are undesirable. Those users supported the deferral of the effective date of IFRS 9 as an appropriate remedy. This feedback tended to come from Europe, although not all users in Europe shared that view.

37. However, some of the users that supported deferral stated that they would only support a deferral for two or three years. Those users would otherwise require application of IFRS 9. Other users could support deferral of the effective date of

IFRS 9 for an indefinite period. Those users stated they are familiar and comfortable with using IAS 39.

38. Some users did not think that a simultaneous accounting change to IFRS 9 and the new insurance contracts Standard is desirable and that implementing all changes in accounting simultaneously would never be theoretically possible. Many of those users told the IASB that two sets of accounting changes would make it easier for them to understand the separate effects of each change and to adjust their models appropriately. Some users stated that their market lacked resources that would enable them to cope with an extensive simultaneous accounting change. Some users noted that continuous accounting change is inevitable and if the IASB delayed implementation of some Standards in order to align them with implementation of other Standards that affect a particular population of entities in a particular way it would be difficult for the IASB to achieve improved financial reporting over time.

39. Views in Europe on two sets of consecutive accounting changes were particularly mixed. Some users from Europe identified implementation of Solvency II as an additional challenge for their analysis and expressed a concern that a combination of major regulatory and accounting changes over a short period of time makes their analysis more difficult. Some of those users would ideally like to see both accounting and regulatory changes implemented at the same time.

40. Other users stated that because of frequent regulatory and other changes they have learned how to follow dynamic changes in regulation and reporting, and consequently to introduce frequent readjustments to their models. As a result, they support timely implementation of IFRS 9 because they consider it an improvement over IAS 39.

Views on the Deferral Approach

41. Views on the Deferral Approach were mixed. Overall, most users did not support the Deferral Approach. In Europe and Asia, users expressed mixed views. More specifically in Asia, users in Japan tended to support the Deferral Approach and

users elsewhere in Asia tended not to support the Deferral Approach. Other jurisdictions expressed little support for the Deferral Approach.

42. Users who did not have concerns about different effective dates of IFRS 9 and the new insurance contracts Standard did not support a delay in implementing IFRS 9, although they could accept the Overlay Approach. Users who had concerns about different effective dates of the two Standards supported the Deferral Approach, although many of them also supported the Overlay Approach. Some users stated that the deferral of the effective date of IFRS 9 is the only approach that would address their concerns.

43. Views on how the Deferral Approach should apply, if the IASB were to decide to propose it, were also mixed. Users from regions other than Europe tended to prefer the deferral below the reporting entity level. Users in Europe tended to prefer the deferral at the reporting entity level.

44. Those who supported the deferral at the reporting entity level, if the IASB decided to propose the Deferral Approach, did so because they found that approach to be less complex and expected that it would capture entities that they view as insurers for the purposes of their analysis, assuming that there would be an appropriate predominance threshold. Some users, especially many users coming from Europe, stated that there are not many financial conglomerates left and therefore did not see the need for the deferral approach that would apply below the reporting entity level. However, users from some jurisdictions, notably those from Asia stated that financial and non-financial conglomerates are common in their jurisdictions and the legal structure and business activity focus of those conglomerates can change over time.

45. Those who preferred deferral below reporting entity level stated that they look at the insurance activities and banking activities of an entity on a standalone or segmental basis. Therefore, any deferral below reporting entity level would make it easier for them to compare the insurance activities and banking activities of a single entity with standalone banks and insurers.

46. Some users who preferred the deferral below the reporting entity level did so because they thought it would be confusing if the accounting model in an entity's separate financial statements was different from the accounting model applied to

the same entity in its parent's consolidated financial statements. Others did so because they thought that timely implementation of IFRS 9 for banks is of paramount importance. They were concerned that the deferral at the reporting entity level would sweep some banks into the delayed implementation of IFRS 9. They were willing to accept increased accounting complexity of the deferral below the reporting entity level as the 'price' of avoiding that consequence.

47. Most users, including those who preferred the deferral at the reporting entity level and those who preferred the deferral below the reporting entity level, expressed significant concerns about transfers of financial assets between the 'IAS 39' and the 'IFRS 9' world within a reporting entity and the earnings management opportunities that such transfers could present. Those concerns were especially significant for users from Asia. Most users did not express a specific view on whether classification of financial assets should change as a result of the transfer. Rather, they stated that it would be critical for their understanding of an entity's performance to have transparency in presentation and disclosure of those transfers and asked the IASB to keep it as simple as possible. Only a few users did not have concerns about transfers because they thought that such transfers should be constrained by the regulatory requirements.

48. Many users stated that if the IASB were to decide to propose the Deferral Approach they would like to see disclosure of IFRS 9 information in the notes to financial statements, especially if the deferral was permitted rather than required. They stated that such disclosure would help to improve comparability and would also help them to prepare for upcoming application of IFRS 9. Some users stated that even though disclosure of IFRS 9 information would be useful, it may not be looked at frequently because users would focus their attention on profit or loss. Finally, a few users stated that they would like to see disclosure of IAS 39 information for those entities that choose to timely apply IFRS 9.

Views on the Overlay Approach

49. Many users expressed support for the Overlay Approach. Many users preferred this approach to any other approach. Others could accept this approach even if

their preferred approach was the Deferral Approach or for there to be no temporary measures.

50. The reasons many users found the Overlay Approach attractive, or at least acceptable, are because the Overlay Approach:

    (a) provides IFRS 9 information on the face of financial statements,

    (b) addresses the concerns about any increased volatility, and

    (c) would be easy to understand and to explain to investors.

51. Some users also noted that the overlay adjustment that removes any increased volatility is transparent and would increase consistency in presentation of financial statements compared to alternative performance measures that entities may otherwise present or disclose.

52. Some users who supported the Overlay Approach nevertheless noted some of its potential disadvantages:

    (a) Adjustments in other comprehensive income (OCI) are often overlooked by less sophisticated users of financial statements and data providers, whose main focus is on the profit or loss result;

    (b) Another OCI item could encourage the view that OCI is not a meaningful source of information;

    (c) Users would still have to face two sets of accounting changes in a short period of time; and

    (d) Judgement may be required in determining the overlay adjustment.

53. Many users supported disclosures that would provide a breakdown of the overlay adjustment and explanations about sources of volatility.

Optional or mandatory approaches

54. Many, although not all, users that participated in the outreach conducted by the IASB members and staff expressed a strong preference that any approach proposed by the IASB to address the concerns about different effective dates of IFRS 9 and the new insurance contracts Standard should be mandatory rather than optional to ensure comparability at least within the insurance sector even if cross-

sector comparability is not achieved. Some of those users were less concerned about optionality of the Overlay Approach compared to the Deferral Approach due to the different information content and transparency of those approaches.

55. Other users, although a minority, did not object to an optional approach. They stated that the insurance sector is already non-comparable due to the diversity in accounting for insurance contracts and that the added lack of comparability for financial assets would not significantly complicate their analysis. Many users, including those who were opposed to optional deferral, agreed that disclosure of IFRS 9 information in the notes to financial statements would help to address the lack of comparability that would otherwise arise if deferral of IFRS 9 was permitted rather than required.

56. We also asked users a general question whether within and cross-sector comparability is important as well as comparability between jurisdictions if entities in different jurisdictions would commonly apply different approaches depending on the current practice in a particular jurisdiction. Many users, especially sell-side insurance equity analysts and credit ratings analysts told us that cross-sector comparability is not important for them because they either only follow insurance companies or they have different teams following insurance and banks and those teams use different models. Many also told us that they only look at insurers in a particular jurisdiction.

57. Others told us that even if cross-sector comparability may not be important for sell-side analysts in their analysis, such comparability is important for buy-side analysts who often look to invest on a cross-sector basis. They expressed a concern that any additional reduction in comparability in the insurance industry would make the industry less attractive for investment from the buy-side perspective. Some also said that global comparability within and across sectors is important.

Overview of written submissions to the IASB

58. The IASB has received two written submissions from users of financial statements who commented on the issue of the different effective dates of IFRS 9

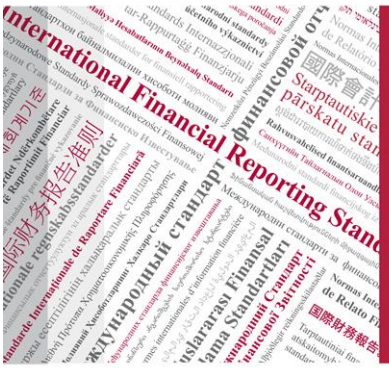
and the new insurance contracts Standard. Those letters form Appendix B of this paper.

59. In those submissions, the users state that IFRS 9 is an improvement over IAS 39 and should be introduced for everyone at the same time, without any dependence upon an unspecified completion date of the new insurance contracts Standard. They state that insurers should not be allowed to delay implementation of IFRS 9 because the benefits of accounting for financial assets under IFRS 9 will outweigh the costs of its implementation, which applies to all industries.

60. Those users also believe that moving from IAS 39 to IFRS 9 should not have a material impact on the reported shareholders' funds and that there is no widely available empirical evidence that substantiates the projected increased volatility in profit or loss on application of IFRS 9.

61. In addition, one of the submissions notes that the deferral of IFRS 9 would undermine the cross-industry comparability that is expected from a common adoption date for all companies.

International Financial Reporting Standards



Application of the new accounting requirements for financial assets by insurers

Interviews with users of financial statements

August 2015

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Objective

Our objective is to ensure that users of financial statements are provided with useful information about entities that issue insurance contracts. We are therefore looking to better understand investors' views on:

- increased volatility in profit or loss that could arise for some insurers if IFRS 9 *Financial Instruments* is applied before the new insurance contracts Standard
- complexity of understanding two accounting changes rather than one
- potential approaches to address increased volatility in profit or loss
  - defer the effective date of IFRS 9 – option for insurers ('the Deferral Approach')
  - remove the increased volatility from profit or loss – option for insurers ('the Overlay Approach')
- information that would need to be disclosed under each approach

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Background

3

- The IASB is in the process of finalising its insurance contracts Standard which will set out how to measure and report insurance contracts liabilities (on a current basis)
  - the forthcoming changes will likely not be effective before 2020
- Some raised concerns about the interaction between the effective date of IFRS 9 with the forthcoming changes to accounting for insurance contracts liabilities
  - IFRS 9 sets out financial reporting requirements for financial instruments and is effective from 1 January 2018
  - More logical classification with complex assets measured at fair value, better impairment model and more flexible hedge accounting
- Some suggest that the effective date of IFRS 9 should be deferred for insurers and aligned with the effective date of the forthcoming insurance contracts Standard

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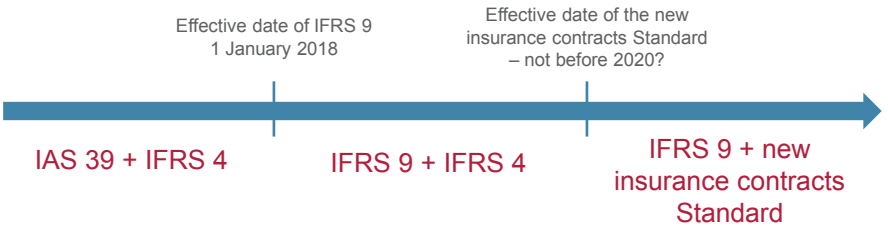
Timeline

4

Flexibility of both IAS 39* and IFRS 4** results in little volatility in profit or loss

Interaction of IFRS 9 and IFRS 4 may result in increased volatility in profit or loss

Interaction of IFRS 9 and the new insurance contracts Standard assists in reducing that volatility in profit or loss



*IAS 39 *Financial Instruments: Recognition and Measurement* is pre-IFRS 9
**IFRS 4 *Insurance Contracts* sets out the current accounting requirements for insurance contracts

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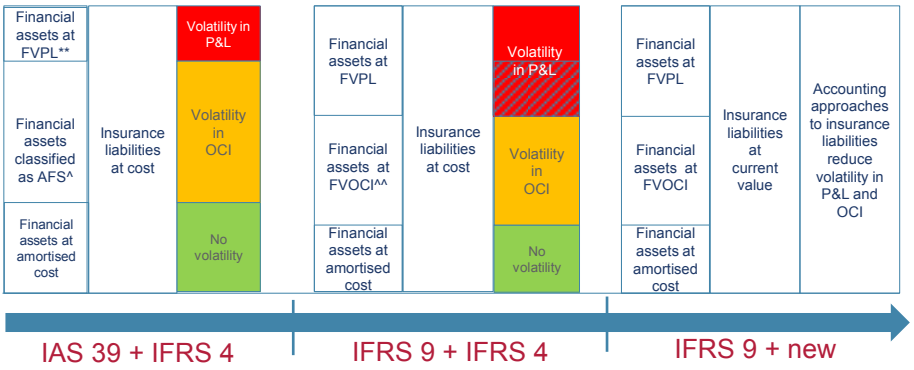
Why volatility in profit or loss may increase: illustration

5

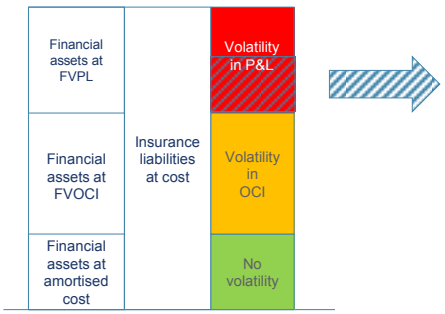
- The charts below illustrate the interaction of accounting for financial assets and insurance liabilities
- Volatility in P&L and OCI* may comprise accounting and economic mismatch between assets and liabilities
- The shaded area on the second chart represents the increased volatility in P&L that could arise for some entities
- *The sizes of boxes do not represent the relative size of different populations; they are used merely for illustration*



*Profit or loss and Other Comprehensive Income
**Fair value through profit or loss
^Available-for-sale
^^Fair value through OCI

Potential sources of increased volatility in profit or loss

6



Examples of financial assets at FVPL under IFRS 9:

- Structured debt
- Convertible debt
- Puttable investments in mutual funds
- Equity investments (if an entity does not select OCI option)

IFRS 9 + IFRS 4

For many assets, classification may not change when IFRS 9 is applied
Insurers use a variety of models to account for insurance contracts

Question 1

7

In your view, does any increased volatility in profit or loss during the period when IFRS 9 is applied in conjunction with IFRS 4 make financial statements of insurers less understandable? Why or why not?

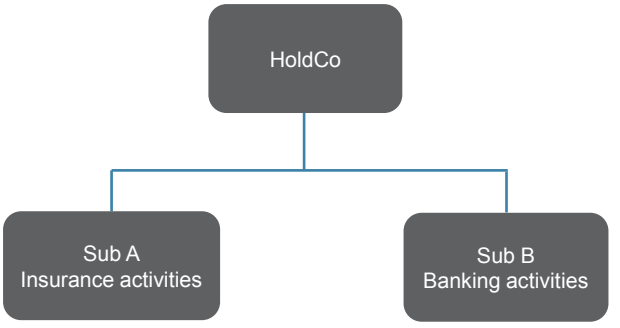
In your view, is it preferable that accounting changes for financial assets and insurance contract liabilities are implemented consecutively or simultaneously? Why?

IFRS

The Deferral Approach

8

Consider a financial conglomerate that issues insurance contracts and also undertakes banking activities



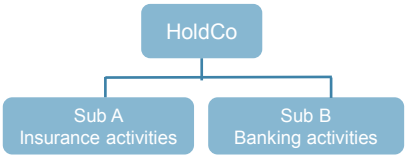
IFRS

Deferral at reporting entity level

9

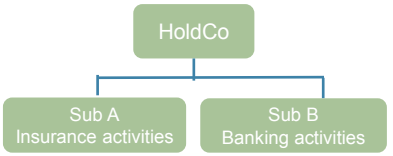
IFRS 9 IAS 39

- If the predominant activity of the conglomerate is insurance business



- The conglomerate could have the option to continue to apply IAS 39 to all financial assets in consolidated financial statements
- However, if Subsidiary B publishes standalone financial statements it must apply IFRS 9

- If the predominant activity of the conglomerate is NOT insurance business

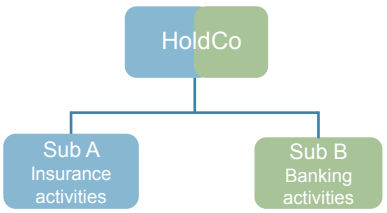


- The conglomerate must apply IFRS 9 to all financial assets in consolidated financial statements
- However, if Subsidiary A publishes standalone financial statements it could have the option to continue to apply IAS 39

Deferral at legal entity level

10

IFRS 9 IAS 39

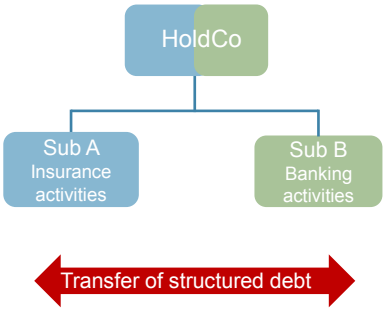


- Subject to qualifying conditions, the conglomerate could have the option to continue to apply IAS 39 in its consolidated financial statements to financial assets that relate to insurance activities
- However, the conglomerate must apply IFRS 9 in its consolidated financial statements to financial assets that do NOT relate to insurance activities
- Subsidiary A could have the option to continue to apply IAS 39 in its standalone financial statements
- Subsidiary B must apply IFRS 9 in its standalone financial statements

Deferral at legal entity level – asset transfers*

11

IFRS 9 IAS 39



*Such transfers may not happen often in practice

- Suppose Sub A that applies IAS 39 sells a structured debt investment to Sub B that applies IFRS 9
- Sub A bifurcated the structured debt under IAS 39. The bifurcated derivative was measured at FVPL and the host was measured at amortised cost
- Subsidiary B already holds identical structured debt investments and measures them at FVPL under IFRS 9
- In the consolidated financial statements of the conglomerate that applies both IAS 39 and IFRS 9:
  - If IAS 39 accounting 'travels' with the transferred investment, identical investments in the banking subsidiary will be accounted for differently;
  - If accounting model changes to IFRS 9 on a transfer of the investment, that could lead to recognition of gains and losses on internal transfers.

IFRS

Question 2

12

In your view, if insurers continue to apply IAS 39 after IFRS 9 becomes effective, would that result in useful information? Why or why not?

Should any such relief apply to all financial assets in consolidated financial statements? Or, should entities simultaneously apply IAS 39 and IFRS 9 in consolidated financial statements?

Should any such relief only be available for a limited period, for example, 2 years after the effective date of IFRS 9?

Should it be optional or mandatory for entities that meet the qualifying conditions?

IFRS

The Overlay Approach

13

- IFRS 9 is applied by all entities, including insurers, from 1 January 2018
- The IASB decided to permit insurers to include in profit or loss an adjustment to remove from profit or loss and recognise in OCI
  - the difference between the amounts recognised under IFRS 9 and the amounts that would have been recognised under IAS 39
  - for financial assets measured at FVPL under IFRS 9 and that were not or would not have been measured at FVPL under IAS 39
- The objective of the adjustment is to remove from profit or loss any increased volatility in a transparent and consistent manner

Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Operating result	**X**
Investment income	X
Interest on insurance liability	(X)
Investment result	**X**
Profit or loss	**X**
IFRS 9 'increased volatility adjustment'	X
Effect of discount rate changes on insurance liability	(X)
Total comprehensive income	**X**

Question 3

14

In your view, would the Overlay Approach represent an acceptable approach to addressing the issue of increased volatility in profit or loss? Would that approach provide useful information?

Disclosures

The Deferral Approach

- Reconciliation between IAS 39 and IFRS 9 eg

Assets at amortised cost under IAS 39			
Carrying value			X
Interest income			X
Impairment (incurred loss)			(X)
Under IFRS 9 would be measured at			
	Amortised cost	FVOCI	FVPL
Carrying value	X	X	X
Interest income	X	X	
Impairment (expected loss)	X	X	
Fair value gain (loss)		X	X

The Overlay Approach

- Breakdown of IFRS 9 adjustment eg

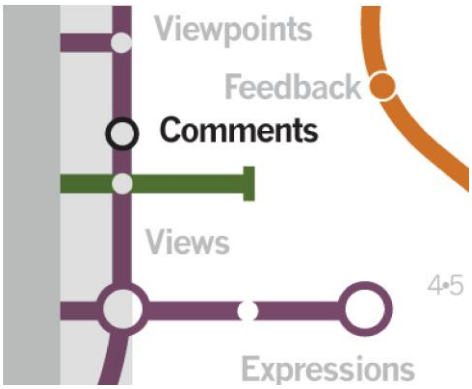
	IFRS 9	IAS 39
Fair value gains (losses)	X	-
Interest income	-	X
Impairment	-	(X)
Total	A	B
IFRS 9 adjustment = A- B		

Question 4

In your view, if the Deferral Approach was used, should entities provide a disclosure of IFRS 9 information (eg a reconciliation of the amounts recognised under IAS 39 with the amounts that would have been recognised under IFRS 9)? If so, what information would be useful and how granular should it be?

In your view, if the Overlay Approach was used, should entities provide a breakdown and explanation of the IFRS 9 'increased volatility adjustment'?

Thank you



We welcome your feedback

The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

IFRS®

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Chairman
International Accounting Standards Board (IASB)
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22 July 2015

Subject: Requiring insurers to adopt IFRS 9 at the same time as all other institutions

Dear Hans,

Autonomous Research LLP ("Autonomous") and Keefe Bruyette & Woods ("KBW") (together "we") are two well-established equities businesses specialising in analysing the shares of financial institutions in Europe and America. Both Autonomous and KBW are authorised and regulated in the UK by the Financial Conduct Authority. We have strong reputations with investors for offering value-added insight, amongst other things, into the European insurance industry.

We have recently discussed the timing of the implementation of IFRS 9 and IFRS 4 Phase 2 for insurance companies, in the context of the likelihood that IFRS 9 will be ready at least two years before IFRS 4 Phase 2. We think the introduction of both standards at the same time would in theory be preferable. However, faced with the fact that IFRS 9 will be implemented sooner, we do not think European insurers should be allowed special dispensation to delay their implementation until IFRS 4 Phase 2 is ready. We set out our arguments below.

Fundamental. Companies frequently tell us that they do not measure value-creation using IFRS. So there should be no fundamental concern to their businesses from implementing IFRS 9 earlier than IFRS 4 Phase 2. The current treatment of assets and liabilities for insurance companies between IAS 39 and current IFRS 4 is already inconsistent and economically inappropriate so moving from one combination of this to another should not matter.

From a European perspective, Solvency 2 goes live in January 2016. There is roughly two years between this start date and IFRS 9. The ability to pay dividends should be independent of IFRS accounting and Solvency 2 should underpin this. The assessment of free cash generation, at least

in Europe, should offer some stability to the financial perception of the industry while the accounting standards are changing.

If insurers continue to use IAS 39 while banks adopt IFRS 9 there is the risk that arbitrage opportunities are generated between the industries. This risk should be mitigated by compliance controls and if the window of inconsistency is relatively brief but there remains the real danger of unintended economic consequences of two major components of the capital markets accounting for financial contracts differently.

Presentation. European insurance businesses already publish operating profits to provide analysts with their view of sustainable earnings before market or accounting noise. We would expect this to continue and offer stability to perceived financial performance.

Many companies seem to be concerned about how simple headline financials will be presented in the press, with a view that excessive volatility could undermine their cost of capital. We believe this under-estimates the competence of the capital markets and their ability to read beyond the front page of a newspaper or the first page of an annual report.

Extent of change. Most insurance companies carry the vast majority of their investments at fair value on the balance sheet already. So moving from IAS 39 to IFRS 9 should not materially change the reported shareholders' funds. The introduction of a "fair value through OCI" amendment to the IFRS 9 treatment of debt instruments means that from an insurer's point of view the new standard looks much more like IAS 39 and its "available for sale" category. This means that earnings volatility should be dramatically lower than it would have been in the early draft of IFRS 9. The obligation to reclassify some bond investments may even offer more insight into the structure of companies' bond portfolios.

Understanding. There is a view that introducing IFRS 9 and IFRS 4 Phase 2 at the same time will mean that analysts can be educated about the change in accounting in the round. That is true and in an ideal world would be preferable. But if two major standards are changed there is equally an argument that a gap between the two allows analysts more time to understand each separately and bring their knowledge of one to help their understanding of the other. Too much change all at once can actually lead to more confusion, not less, versus evolution.

Modelling confusion. In practice, most insurance companies restate their numbers almost annually already to reflect changes in corporate structure as well as changes in accounting policy. Dealing with change can be frustrating but is already part of an analyst's day job. One further restatement will just be dealt with pragmatically.

Timing. The enforced introduction of IFRS 9 should act as a final catalyst towards the introduction of IFRS 4 phase 2. Insurers that are concerned about volatility already have the option to early adopt fair value accounting for their liabilities. The incentive to complete the update of the insurance contracts standard should improve once the treatment of investments is clarified and enforced. Conversely, allowing a delay of IFRS 9 could also permit the glacial momentum behind IFRS 4 Phase 2 to slow yet again. If the IASB wants to complete the IFRS 4

Phase 2 project, deferring IFRS 9 implementation would be a marginal step in the wrong direction, we feel.

In conclusion, generally speaking analysts do not like to change their models and especially not for changes in accounting standards. Making as few changes as possible, preferably as far away as possible typically makes our lives feel easier. In an ideal world, IFRS 9 and IFRS 4 Phase 2 would be introduced concurrently. However, if we are faced with the fact that IFRS 9 has an earlier implementation date than IFRS 4 Phase 2, we at Autonomous and KBW believe the arguments above overwhelmingly support the case that the insurers should cease to be treated as special cases and should be told to get on with implementation like everybody else.

Whilst we are of the view that IFRS 9 should be introduced for everybody at the same time, we can see that there may be an argument for working with insurers to provide supplemental disclosure that could offer some continuity. We do not have a concrete list currently but a case could be made for brief reporting of legacy figures in the notes to the accounts, for example. There has also been discussion about a simple one-line adjustment at the bottom of the income statement to restore the IAS 39 impact on earnings. We do not feel this would be necessary but can understand it might be a useful disclosure compromise.

Thank you for your consideration.

Yours sincerely,

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Managing Partner – Insurance
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August 8, 2015

Hans Hoogervorst
Chair
International Accounting Standards Board
30 Canon Street
London EC4M 6XH
United Kingdom

Re: Comment Letter on EFRAG Draft Endorsement Advice on Adoption of IFRS 9

Dear Mr. Hoogervorst,

The CFA Institute[1], in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment on the European Financial Reporting Advisory Group (EFRAG) draft endorsement advice on adoption of International Financial Reporting Standards Statement 9, *Financial Instruments* (IFRS 9).

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures provided to investors and other end users is of high quality.

OVERVIEW

Our comments on EFRAG's on IFRS 9 endorsement advice are confined to the proposed deferral of IFRS 9 for insurance companies. The technical assessment document sets forth the perceived benefits of a deferral including:

- Alleviating the expected incremental volatility for insurers that apply the cost model for their liabilities;
- Incremental costs of a staggered implementation of IFRS 9 and IFRS 4- *Insurance Contracts*; and

[1] With offices in Charlottesville, New York, London, Brussels, Hong Kong, Mumbai, Beijing, CFA Institute is a global, not-for-profit professional association of more than 130,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 150 countries, of whom nearly 123,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 144 member societies in 69 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

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- Purported user difficulties in assessing the performance of insurance companies and concerns about the increase in non-GAAP measures.

We are strongly opposed to the deferral of IFRS 9, as we are not persuaded by the significance of the asserted concerns as we explain further below. Instead, we propose the allowance of a one-time reclassification safe harbor once the insurance standard (IFRS 4, *Insurance Contracts*) is completed. We are opposed to deferral for the following reasons:

- Significant uncertainty associated with the timing of completion of IFRS 4;
- Asset classification and measurement improvements are both value-relevant and beneficial for investors on a stand-alone basis; and
- Need to consider investors' ability to discriminate between economic versus accounting mismatches.

We explain our concerns further below.

Significant Uncertainty Associated with the Timing of Completion of IFRS 4

As we understand a key motivation for the proposed deferral is the view that IFRS 9 and IFRS 4 should be adopted at the same date by insurance companies. Stakeholders, including users of financial statements, look forward to the overall update of IFRS standards including the adoption of IFRS 9 and completion of IFRS 4. However, we are not supportive of the proposed alignment in the adoption dates of these two standards for the following reasons:

- *Uncertainty on the timing of completion of IFRS 4*: Our opposition to the deferral is in large part influenced by the significant uncertainty associated with the completion of IFRS 4-, which has been under deliberation for 10+ years. To inextricably link, the adoption of IFRS 9 to the completion of IFRS 4 will not only set a bad precedent, it will also contribute to a potentially highly inefficient standard-setting process and introduce a risk of needing to re-open IFRS 9 due to the emergence of insurance sector specific concerns.

- *Staggered rollout costs are not exceptional to the insurance industry:* All industries are faced with the reality of the need for a staggered roll-out of multiple accounting standards (IFRS 10, IFRS 15, IFRS 9) and the staggered adoption of IFRS 9 and IFRS 4 should not be viewed as exceptional and unusual for the insurance industry.

Asset Measurement Improvements are Value-relevant and Beneficial for Investors on a Stand-alone Basis

Further to the benefits of a deferral of IFRS 9 for insurance companies, the EFRAG assessment document also outlines several drawbacks associated with any such deferral. As users of financial statements, we give more weight to the following drawbacks that were also recognized by the EFRAG assessment document in the articulation of motivation for a deferral of IFRS 9:

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- *Delaying the provision of improved financial instruments information*: Stakeholders anticipate that, when compared to current standards, IFRS 9 will result in a more timely reflection of changes in the value of assets - and this will result in an improvement in the existing financial reporting of assets. There are analytical benefits associated with the enhanced reporting of: a) individual income statement line items (i.e. asset re-measurements) and b) insurance company balance sheet assets. For example, the importance of fair value balance sheet items as a valuation input for insurance companies can be inferred from a Columbia University research paper-*Relative Valuation of Insurance Companies,* which shows that relative valuation models (i.e. valuation based on multiples such as Price to Book ratios (P/B)) have higher predictive power when fair value re-measurements of financial assets are reflected on the balance sheet. The study shows that when the book value, which is the denominator of P/B, includes accumulated unrealized other comprehensive gains or losses (i.e. AOCI), it results in higher valuation predictive power, than where the investors strip out AOCI from the book value of equity whilst valuing insurance companies. In other words, the evidence shows that a balance sheet which better reflects updated economic re-measurements of assets is more relevant for valuation purposes than one that does not.

- *Reduction in comparability across banks and insurance companies:* Cross-industry comparability is important for investors who typically hold cross-industry portfolios. The deferral of IFRS 9 will undermine the desirable cross-industry comparability that is expected from a common adoption date for all companies.

Need to Consider Investors' Ability to Discriminate between Economic versus Accounting Mismatches

The principal argument put forward in favor of the deferral of IFRS 9, largely revolves around expected incremental volatility of net income due to accounting related asset/liability mismatches and the associated perceived difficulties investors will experience in judging the performance of insurance companies. It is presumed that this may then lead to the proliferation of non-GAAP measures. We are not persuaded by these concerns for the following reasons:

- *No demonstration of widespread and significant incremental earnings volatility*: A mismatch in the recognition and measurement of asset and liabilities already exists under the current reporting requirements. There is no widely available empirical evidence substantiating that projected incremental volatility will result from IFRS 9 requirements. Besides, investors already understand that there are differences between the economic asset-liability mismatches under the insurance business model and that these economic mismatches are different from the accounting mismatches reflected under the current reporting requirements. Investors will still be able to discriminate economic versus accounting mismatches under any updates to the accounting standards.

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- *Limits to the ability of accounting to fully reflect economic asset/liability management*: The emphasis on reflecting asset/liability management (ALM) in a financial reporting context seems misplaced because accounting information cannot reflect the full spectrum of economic ALM mismatches across the insurance company product and liability profile. In addition, there is yet to be established a robust conceptual basis of inextricably linking the measurement of assets and liabilities. That said, the emphasis on minimizing asset/liability accounting mismatches by the insurance industry is understandable and seems to have been accommodated by IFRS 9 requirements that include a fair value through OCI (FVOCI) classification category. We consider that having FVOCI as a classification category under IFRS 9 is as far as the financial instruments accounting standards should go.

- *Investors are sophisticated enough to identify economically relevant income statement line items:* In our opinion, EFRAG's assessment paper overstates the concerns about net income volatility- when such volatility is in fact driven by the inclusion of economically relevant individual line items. The arguments put forward do not seem to give adequate weight to the ability of investors to breakdown the components of the net income sub-total and to determine the individual income statement line items that they consider to be core performance line items and predictive of future cash flows. Besides, we are not aware of any analogous empirical evidence[3] that supports the notion that differing measurement attributes for assets and liabilities held in an ALM context, lowers the predictive value of reported earnings.

- *Non-GAAP measures growth are not driven by investor concerns on accounting mismatches*: The inference made within the articulated benefits for deferral, is that reporting of relevant line items within the income statement can be a root cause for the proliferation of non-GAAP measures. This inference is highly debatable. There is no evidence that non-GAAP measures are investor demand driven whenever reported but rather these measures tend to represent how management wants their performance to be viewed by investors and there are many cases where these measures are actually presented in a biased fashion and with a distortion of a business model's economic reality. We do not disagree that there is need for standard setters to define performance within the conceptual framework and to consider how performance is represented within the financial statements under the financial statement presentation project. However, we anticipate that even such clarity and enhanced financial statement presentation is unlikely to eliminate the reporting of non-GAAP measures. Hence, delaying improved reporting of individual income statement line item due to concerns about non-GAAP measures is likely to be a *red-herring* argument.

[3] We recognize that robust empirical evidence related to IFRS 9 can only be obtained after its adoption. But analogous evidence is the type that would show that earnings quality (i.e. predictive quality) diminishes whenever fair value recognition through profit and loss for assets and not liabilities occurs and that such differential measurement basis for the assets and liabilities is occurring in the context of an asset/liability managed business model. We are not aware of any such evidence.

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Thank you again for the opportunity to comment on the assessment paper. If you or your staff have questions or seek further elaboration of our views, please contact either Vincent Papa, PhD, CFA, by phone at +44.207.330.9521, or by e-mail at vincent.papa@cfainstitute.org.

Sincerely,

/s/ Vincent Papa

Vincent Papa, CFA
Director, Financial Reporting Policy
Standards & Financial Markets Integrity Division
CFA Institute

/s/ Ashwinpaul C. Sondhi

Ashwinpaul C. Sondhi
Chair
Corporate Disclosure Policy Council

cc: Sandra Peters, CPA, CFA; Head, Financial Reporting Policy
cc: Corporate Disclosure Policy Council