EFRAG STAFF PAPER FOR PUBLIC MEETING

This paper has been prepared by the staff of EFRAG for discussion at a public meeting of the EFRAG Board. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The papers are made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in EFRAG *Update*. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

Interaction between IFRS 9 and new IFRS 4

Recommending the IASB to allow an option for deferral of the effective date of IFRS 9 for insurance activities

Objective

1 The objective of this note is to determine whether the EFRAG Board wishes to recommend the IASB to consider an option for deferral of the effective date of IFRS 9 for insurance activities.

Background

2 The objective of the insurance business being to invest in assets so as to generate income streams and capital appreciation to cover for insurance liabilities and generate profit for shareholders, the business model of insurance companies/activities is based on asset/liability management. Both IFRS 9 "Financial Instruments" and IFRS 4 "Insurance contracts" play therefore a very significant and interactive role in how the financial position and performance of insurance companies is presented. Changes triggered by the implementation of both standards are pervasive for entities that engage in significant insurance activities.

3 Currently IFRS 4 allows for quite a diversity of accounting treatments for insurance liabilities and there is huge diversity in practice, from current measurement to cost models being applied on the liability side. Insurance businesses have therefore implemented IAS 39, and made use of the flexibility in the standard, to reduce potential accounting mismatches and have as a result reached an equilibrium between IAS 39 and their accounting model for liabilities.

4 In the event IFRS 9 would be implemented before the revised IFRS4, the current equilibrium would be disrupted, and changes introduced in how financial assets are accounted for, with as sole purpose to avoid accounting mismatches. It is doubtful that the change would increase transparency for investors; however it would generate costs for both preparers and investors that everybody agrees would be best avoided.

5 On the basis of the discussions held in EFRAG TEG to date, taking into account that the IAS Regulation is based on the binary choice to adopt or reject, and the decision made by the EFRAG Board in relation to the effective date of IFRS 15, leaving it to Europe to make a decision to defer the effective date of IFRS 9 would not lead to satisfactory outcomes. The same arguments that lead the EFRAG Board to recommend IFRS 15 be endorsed with the effective date as defined by the IASB apply, all the more so that the deferral could last up to three or four years; also, Europe alone could not solve the problem for conglomerates.

6 At the next ASAF meeting in March, the IASB intends to discuss what transition reliefs to grant in IFRS 4 that would allow reclassification of financial assets in IFRS 9 at the time of first application of the revised IFRS 4. In the papers that support the session the IASB explains why it decided not to adopt a deffered effective date for insurance activities:

(a) IFRS 9 improvements, notably the implementation of the new impairment model, should not be delayed;

(b) IFRS 4 deals with insurance contracts, not with insurance companies or insurance activities; it would therefore be difficult to ring-fence the deferral;

(c) Comparability among entities would be impaired.

EFRAG secretariat recommendation

7 On the basis of discussions in EFRAG TEG and EFRAG IAWG (Insurance Accounting Working Group), EFRAG Secretariat believes that the next ASAF meeting should be the opportunity for EFRAG to ask the IASB to reconsider its position.

8 If the EFRAG Board agrees that EFRAG should do so, the EFRAG Board should also request from EFRAG TEG, assisted by EFRAG IAWG and EFRAG staff, to build some recommendations to be proactively brought to the IASB along the following lines:

(a) Deferral of the effective date of IFRS 9 should be limited to classification and measurement provisions, i.e. the new impairment model should be applied from 1st January 2018 at the latest; the IASB would produce application guidance to make the link between the IAS 39 classification requirements and the impairment model in IFRS 9;

(b) The scope of the IFRS 9 impairment model would be as close as feasible to what it would be if IFRS 9 was fully implemented; different scenarios could be envisaged;

(c) The scope of the option to defer the effective date of IFRS 9 classification and measurement requirements would be ring-fenced:

(i) The option would be available only for entities that carry significant insurance activities; proposals would be made on how to identify the significance of such activities; and,

(ii) The option would be valid only if jurisdictions' competent authorities decide to adopt it and available only to entities which are regulated for their insurance activities; the jurisdiction regulatory framework would be the basis for defining the scope of application of the option.

9 The paper would be discussed by the EFRAG Board in its April meeting, provided that EFRAG TEG approves of its content.

Question to EFRAG Board members:

10 Do you agree with the EFRAG Secretariat recommendations? If not, what is the message you wish EFRAG brings at the ASAF table?