FEEDBACK STATEMENT

IFRS 9 *FINANCIAL INSTRUMENTS*

INDIVIDUAL INSURANCE SPECIALIST USER OUTREACH ON THE POTENTIAL DEFERRAL OF IFRS 9 EFFECTIVE DATE FOR INSURERS

BASED ON A SERIES OF TELEPHONE INTERVIEWS

JULY 2015

This feedback statement has been prepared for the convenience of European constituents by the EFRAG secretariat and has not been subject to review or discussion by the EFRAG Technical Expert Group or the EFRAG Board.

Introduction

EFRAG has issued a Draft Endorsement Advice and an Invitation to Comment on IFRS 9 *Financial Instruments* on 4 May with a deadline for comment of 30 June 2015. EFRAG consulted on both its assessment of IFRS 9 against the technical criteria in the EU and on its assessment of whether IFRS 9 is conducive to the European public good (which includes the costs and benefits associated with implementing IFRS 9).

IFRS 9 becomes effective for annual periods beginning on or after 1 January 2018, with earlier application permitted. As part of the public consultation on its Draft Endorsement Advice, EFRAG wished to gain more insight into the impact on users of non-alignment of the effective dates of IFRS 9 and the future insurance contract standard, and further, on the advantages and drawbacks of a potential deferral of the effective date of IFRS 9 for insurance businesses.

This is because EFRAG received during the consultation process mixed views from user organisations on the potential deferral of IFRS 9 for insurers, ranging from fierce opposition to more balanced views, however without any real support for a deferral of IFRS 9. This was in contrast with the views expressed by a few individual users following the insurance industry who had provided input to EFRAG.

In order to obtain a better understanding of the views held by individual users, EFRAG decided to organise an outreach to users that are following the insurance industry as input for the Final Endorsement Advice on IFRS 9.

Process

An effort was made to find as many analysts and other users that followed the insurance sector as was possible in a short period. The sample is not, and was not intended to be, statistically representative.

The contact information of analysts and other users that follow the insurance industry was obtained by direct contacts (over sixty) with users involved in the EFRAG work and our user activities and outreach events: they provided contact information from colleagues following the insurance industry and referred us to their colleagues (36 contacts) of which 22 accepted the invitation for a telephone interview.

An additional source was the information on the analysts covering insurance companies that could be found on the website of most large insurance companies: Old mutual, Aviva, Prudential, NN(ING), Delta Lloyd, AEGON, AXA, AGEAS, Legal & General, Tryg, Generali, Hannover RE, Munich RE, Vardia Insurance Group. In addition we obtained some contacts directly where companies did not provide the information on their website: Allianz and CNP. This resulted in a further 6 positive responses.

The first two weeks of July turned out to be a period in which many analysts were on holidays given that the half year results are published from the last week of July onwards.

Some analysts, in particular buy-side analysts, did not want to participate in a telephone interview since they felt that implementation of IFRS 9 by the insurance industry was still far away and the insurers did not refer in their communication to analysts the timing of the implementation.

In total 28 users were interviewed in the period from 7 to 20 July. The outreach was carried out in the form of telephone interviews of some 15 to 30 minutes. IASB staff and relevant NSS staff were invited to observe the interviews. The names of users and their respective organisations have been treated on a confidential basis.

The geographical division of the users interviewed is as follows:

Country	Number of users interviewed
UK	14
France	4
Germany	3
Netherlands	2
Belgium	1
Denmark	1
Italy	2
Switzerland	1

The analysis by type of user is as follows

Type of analyst	Number
Rating agency	6
Sell side analyst	15
Buy side analyst	2
Credit analyst	4
Fund asset manager	1

Issues covered

In the invitation users were asked to provide views on:

(a) Do you support or reject a deferral?

  (i) For all stand-alone insurance businesses?

  (ii) For financial conglomerates that include an insurance business (in which case, how would you like to see IAS 39 and/or IFRS 9 applied)?

(b) In case of a deferral should additional disclosures be provided? If so what would you need?

As background information an extract of the IFRS 9 Draft Endorsement Advice, appendix 3 (pages 70 to 73) was provided on the inter-relationships between IFRS 9 and the future insurance contracts standard.

The telephone interview survey started before the public IASB staff papers on the alternative proposals in relation to IFRS 4 were available. In the later interviews analysts were asked their views on the IASB staff recommendation to the Board, based on an oral description.

EFRAG received as part of its public consultation process comment letters from the CFA Institute and the CFA UK FRAC not supporting the deferral (with CFA UK FRAC indicating that their membership was divided). Informal contributions of some CRUF participants argued as well against deferral, which was confirmed in a meeting of the Insurance CRUF. EFFAS expressed itself informally in favour of the deferral, although the views in the EFFAS FAC were divided.

Results of the telephone interviews

Summary

Issue	Supportive	Neutral/No view	Not supportive
IFRS 9 deferral effective date	68%	21%	11%
IFRS 4 phase I alternatives	32%	25%	43%
Additional Disclosures under deferral	46%	11%	43%
European solutions (carve out)	25%	14%	61%

Analysis

The large majority (89%) expressed a preference of having both IFRS 9 and the future insurance contracts standard implemented by the insurance industry at the same time: “big bang” (some wanted to accelerate the implementation of the future insurance contracts standard or were neutral on a deferral of the effective date for the insurance industry). Several analysts said that they may be able to cope themselves with the accounting complexity of different implementation dates but did not believe that their clients, the investors, could understand the volatility and accounting mismatch. They feared that in an environment in which the insurance industry has already lost a lot of trust investors would be even more cautious about investing in the sector.

Many analysts mentioned that the current insurance accounting is complex and difficult to understand. . Moreover analysts need to cover more and more companies and have less time to understand all the accounting differences. It is difficult to compare companies within the sector because of the variety of accounting treatments used. Insurance companies publish extensive non-GAAP information tailored for their company, not allowing for comparison with peers in the sector. Concern was expressed about the current frequent changes to earnings: some referred to it as “almost yearly changes”. Some analysts indicated that the insurance companies were already undervalued because of the accounting complexity and current lack of comparability.

Several analysts called on the IASB to finalise the future insurance contracts standard as soon as possible. Some fear that the deferral of the effective date of IFRS 9 for insurers will delay the finalisation of the future insurance contracts standard whereas others believe that it will extend the implementation period of the future insurance contracts standard once the standard is issued.

Several analysts referred to Solvency II implementation as per 1 January 2016 as a huge change for the insurance industry. There will be a step change in capital and cash disclosure from 2016 which some analysts would rather allow to bed down before changing the IFRS disclosures. Several analysts were concerned about the understanding of further major implementations of accounting standards whereas others saw this as a support for the changes and implementation of IFRS 9 since the market would require this market consistent information anyway.

IFRS 9 Deferral

A two-thirds majority was supportive of a deferral of IFRS 9 effective date for insurers with only 11% being against. The reasons cited were diverse (avoiding accounting mismatch, avoiding artificial volatility, IFRS 9 will not bring that many improvements for the insurance industry, accounting should match the business model, comparability within the sector; adjusting forecasting models only once; difficult of explaining volatility to investors, implementation of Solvency II; avoiding the development of additional non-GAAP measures; multiple changes make it even more difficult to understand underlying economic trends; it would not be helpful for investors to have more noise in the P& L that needs to be explained).

Some analysts made their support for a deferral conditional upon an interim period during which the deferral being applied not being too long. The dividing line seemed to be around 3 to 4 years.

Those analysts expressing themselves against deferral mentioned for example that there was no need for a special treatment of the insurance sector in particular since IFRS 9 was a better standard.

IFRS 4 phase I alternatives

Following an oral description one third of the analysts would be open to, or favour, a different solution (opening up IFRS 4 phase I and widening the shadow accounting) if it could deal with the accounting mismatch and artificial volatility. It would also allow analysts to become familiar with IFRS 9. However most analysts remained concerned since it would still mean two different implementation dates for IFRS 9 and the future insurance contracts standard.

In the later interviews analysts were also asked about one of the alternative models the IASB staff presented to the IASB Board on 20 July. The IASB staff proposed (whilst applying IFRS 9 by the effective date of 1 January 2018) an amendment to IFRS 4 phase I to permit an entity to exclude from profit or loss and recognise in OCI the difference between the amounts that would be recognised in profit or loss in accordance with IFRS 9 and the amount recognised in profit or loss in accordance with IAS 39 (IASB Public Board paper 2B, July 2015). The on-the-spot reaction of most analysts was to state that this would not cope with their main concern, i.e. having two standards implemented at different times and having to understand major changes twice. They nevertheless were sensitive to the elimination of accounting mismatches in profit or loss. Notwithstanding these immediate reactions, analysts indicated that they had to see and reflect on further details before having a firm view.

Disclosures

Mixed views were held on the usefulness of additional disclosures in case of a deferral of IFRS 9 effective date. Some welcomed additional disclosures in general but others, in particular sell-side analysts, warned that given the very short time they have to develop their opinion they may miss important information in the overload of disclosures and therefore would consider additional disclosures not helpful. It should be noted that over half of the analysts interviewed were sell-side analysts who may have different objectives than investors. Generally the sell-side analysts are under a certain amount of pressure, implicit or explicit, to get their clients to trade to generate revenue for their respective banks/employers. This tends to make their views far more short term than the actual investors.

About half of the analysts would welcome disclosure of the impact of IFRS 9 on both the balance sheet and the profit or loss account. It was also observed that investors in general do not look at disclosures. Some suggested that additional disclosure of the impact of the new standards ahead of time would also be helpful to aid a smooth introduction as/when/if it happens

Financial Conglomerates

Almost all persons interviewed indicated that there were hardly any financial conglomerates left and that they would not have real concerns for a bank with an insurance activity or an insurance company with banking activity when two different standards (IFRS 9 and IAS 39) were applied. The analysts we spoke to look at the legal entities or segments and not at a conglomerate as a whole. Investors usually do not take a holistic view.

Most analysts would only compare within the insurance and banking sectors separately and not across sectors. Some mentioned in particular the comparability over time for a specific entity being important.

The issue of transfers creating profits only being accounting transactions (at conglomerate level the situation would be unchanged) was not of concern. It there were such transactions they should be disclosed and the auditors and regulators should ensure that they resulted from the business model.

European Solution

In case the IASB would not propose a global solution almost two thirds would be against a European solution since this was said to create additional complexity. Several analysts expressed themselves against a carve-out from a principle point of view.