ESAs 2017 26

21 June 2017

ESAs' concerns regarding enlarging the scope of the temporary exemption from applying IFRS 9

Responding to the concerns of the European insurance industry about the different application dates of IFRS 9 *Financial Instruments* and the now published IFRS 17 *Insurance Contracts*, the IASB has issued an amendment that provides for a temporary exemption from applying IFRS 9 until 2021 for insurance companies and groups (the Amendments to IFRS 4 *Insurance Contracts*).

Considering the arguments brought forward by the European insurance industry against the need to apply IFRS 9 in a timely manner and to address the G20's concerns regarding the issue of "too little, too late" accounting for impairment losses, the three ESAs understood the reasons of the IASB to exempt – on an optional basis – insurers from applying IFRS 9 (from 2018) until IFRS 17 becomes applicable (in 2021). This optional exemption is only applicable for predominant insurance groups (i.e. pure insurers as well as insurance groups with insignificant banking activities).

The European Commission proposes to expand the temporary exemption from applying IFRS 9 for the financial instruments held by insurance subsidiaries of all financial conglomerates, regardless of whether these conglomerates qualify as predominant insurance groups. This approach would result in banking groups with insurance activities being able to use the exemption at group level. The expanded exemption would be regulated via a "carve-in", i.e. modified endorsement of the IASB's proposals, effectively leading to European-specific IFRSs.

The ESAs have significant concerns about the endorsement of the approach proposed by the Commission, the main reasons for that being the following:

- **Breach of fundamental accounting principles of consistent accounting policies and adding complexity, affecting a fair presentation, in the consolidated financial statements.**

  This principle is a cornerstone of high quality financial reporting. The Commission's approach would result in a financial conglomerate applying both IFRS 9 to the non-insurance sector and IAS 39 – the predecessor of IFRS 9 – to the insurance sector in one single consolidated financial statement. Non-uniform accounting policies would result in more complex and confusing accounting thus contradicting the recent Resolution of the European Parliament calling for reduced complexity in accounting requirements.

- **Opportunities for accounting arbitrage in the holding of financial instruments.**

  The Commission approach may incentivise opportunistic strategies to elude the application of the stricter rules of IFRS 9 for riskier financial assets. For example, despite the Commission's proposed ban of intra-group transfers, financial conglomerates may decide to acquire riskier securities via their insurance subsidiaries, avoiding the more appropriate rules of IFRS 9, in particular regarding impairment.

- **Un-level playing field in the banking sector.**

  The Commission approach may introduce relevant comparability and competition issues amongst bank-led financial conglomerates and other banking groups. Comparability will also be diminished from the perspective of global capital markets as the Commission approach would result in EU issuers, applying the Commission's proposal, being subject to EU-specific IFRSs.

The ESAs have raised these technical concerns at different stages of the endorsement process and believe that the Commission has not provided sufficient evidence supporting the need for an enlargement of the scope of the temporary exemption from IFRS 9. The Commission should consider the additional costs of implementing such a proposal on the comparability and faithful representation of financial information.

Conclusion

While we fully support the timely endorsement of the IASB's amendments to IFRS 4 *Insurance Contracts*, enabling legal certainty to those entities and groups affected by the disparity between application dates of IFRS 9 and IFRS 17, we would strongly discourage enlarging the scope of the temporary exemption from IFRS 9 on the basis of the above-mentioned concerns and the lack of sufficient evidence of a cost-benefit assessment that justifies a "carve-in".