European Securities and Markets Authority

The Chair

19 November 2015
ESMA/2015/1749

Mr Roger Marshall
European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: Draft Letter from EFRAG to the European Commission supplementing its endorsement advice on adoption of IFRS 9 *Financial Instruments*

Dear Mr Marshall,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to EFRAG's due process related to the draft letter supplementing the endorsement advice on adoption of IFRS 9 *Financial Instruments* ('draft letter').

On 15 September 2015, EFRAG submitted to the European Commission its endorsement advice on IFRS 9. In this advice, EFRAG concluded that IFRS 9 meets the qualitative endorsement criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management and is not contrary to the true and fair view principle. EFRAG also concluded that except for the impact on the insurance industry, IFRS 9 is conducive to the European Public Good.

On 10 November 2015, EFRAG published for public consultation the draft letter in which it concluded that it is not in a position to amend its recommendation from September 2015, despite the fact that the International Accounting Standards Board (IASB) is developing options to address the issues facing the insurance industry.

ESMA continues to emphasise the importance of fully implementing IFRS 9 and notably of applying the expected loss model to financial assets in a timely manner, as the introduction of the expected loss model responds to an important G20 request following the financial crisis.

ESMA highlights that the IASB responded quickly and adequately to EFRAG's concerns about the different application dates of IFRS 9 and the future standard for accounting for insurance contracts (IFRS 4 Revised). The IASB took the decision to propose amendments to IFRS 4 *Insurance Contracts*, which implies that IFRS 9 as published in July 2014 is not subject to any changes and thus allows a stable version of the standard to be available for endorsement. This proposal is expected to be published for public consultation in December 2015 and would result in amendments to IFRS 4 by mid-2016.

ESMA reiterates its position[1] that a European carve-out is not a feasible solution for insurance activities in light of their global nature. Furthermore, ESMA highlights the need of extensive additional guidance for any deferral (i.e. additional presentation and disclosure requirements) that is not possible to be added to a standard according to the existing European legal framework. ESMA notes that during the due process on the Draft Endorsement Advice on IFRS 9, EFRAG received strong messages that a specific European solution should not be pursued. ESMA regrets that this conclusion is not explicitly taken into account in the draft letter as we believe that this important point should be communicated prominently to the European Commission.

In the context of the draft letter, ESMA notes that proper implementation of IFRS 9 requires significant resources as well as an adequate timeframe and results in significant changes in IT systems. ESMA fears that the uncertainty about the mandatory application date of IFRS 9 might delay these implementation activities and endanger consistent implementation of IFRS 9 in the EU for all entities. Consequently, in light of the solution for the insurance industry being developed by the IASB, ESMA is of the view that EFRAG should enable endorsement of IFRS 9 in the EU as soon as possible.

While EFRAG notes that at this moment a lot of uncertainty exists as to whether the IASB will provide an appropriate solution, ESMA has concerns that the preliminary conclusions in the draft letter, reached without considering the IASB's final proposals, might be prejudicial to the final assessment EFRAG shall make. As the IASB Exposure Draft proposing amendments to IFRS 4 is not available yet and thus sufficient analysis of the impact of the proposals could not be performed, ESMA considers that at this stage it is premature to draw the preliminary conclusion that '*IFRS 4 amendments, if finalised on the basis of current IASB tentative decisions, would not allow EFRAG to lift the reservations included in its endorsement advice of IFRS 9.*' ESMA suggests that the EFRAG letter only presents the pros and cons of the different approaches in a balanced manner.

While the IASB's tentative decisions on the overlay and deferral approaches have not been finalised, we would like to provide the following comments to the EFRAG's preliminary assessment in the draft letter:

- ESMA acknowledges that EFRAG appropriately highlights the importance of the introduction of the expected loss model for financial assets for banking activities. However, in our view, the importance of providing information about expected losses for financial assets held by insurance activities is not sufficiently considered in assessing the deferral and overlay approaches. ESMA believes that proper and robust implementation of the expected loss model in order to provide information about expected losses for all financial assets measured at amortised cost in an objectively verifiable way, irrespective whether expected losses are recognised

[1] Letter, Ref: EFRAG Draft endorsement advice on Adoption of IFRS 9 *Financial Instruments*, ESMA, June 2015, 2015/1056

directly in the primary financial statements (by applying the overlay approach) or disclosed in the notes (when applying the deferral approach), is indispensable to respond to the G20 request. In this context ESMA is concerned that the EFRAG draft letter does not sufficiently reflect the need for all entities, including insurance companies, to adopt and implement the expected loss model in order to be able to comply with IFRS 9 requirements or additional disclosure requirements stemming from the tentative decisions leading to IFRS 4 amendments.

- While EFRAG suggests that 'scope of insurance regulation may have a helpful role to play in identifying "insurers" for the deferral approach', EFRAG does not assess the drawbacks of this option. In particular, as the regulatory and accounting treatment differ, entities that are in scope of insurance regulation may not include the same entities as entities issuing insurance contracts within the meaning of IFRS 4. This is because IFRS 4 deals with accounting for insurance contracts rather than accounting for insurance companies.
- EFRAG's analysis seems to be mainly based on the representations received from the insurance industry and the current short public consultation might not allow engaging with a broad range of stakeholders. ESMA encourages EFRAG to undertake further work, in order to objectively assess both quantitative and qualitative evidence supporting the assertions in the draft letter.

Please do not hesitate to contact us should you wish to discuss all or any of the issues we have raised in this letter.

Yours sincerely,

Steven Maijoor

cc: Erik Nooteboom, Head of Unit B3 FISMA, European Commission