EFRAG

European Financial Reporting Advisory Group

# INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS ON IFRS 9 *Financial Instruments*

**Comments should be sent to commentletters@efrag.org by 30 June 2015**

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IFRS 9 *Financial Instruments* ('IFRS 9' or 'the Standard'). In order to do that, EFRAG has been carrying out an assessment of IFRS 9 against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing impact of IFRS 9 on the European public good.

A summary of IFRS 9 is set out in Appendix 1 to the draft endorsement advice letter.

Before finalising its assessments, EFRAG would welcome your views on the issues set out below and any other matters that you wish to raise. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

**EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions in Appendices 2 and 3 of the draft endorsement advice.**

**Your details**

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

ISDA, International Swaps and Derivatives Association, Inc.

(b) Are you a:

☐ Preparer ☐ User X Other (please specify)

Association

(c) Please provide a short description of your activity:

Since its founding in 1985, the International Swaps and Derivatives Association has worked to make over-the-counter (OTC) derivatives markets safe and efficient.

ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

Today, ISDA has over 800 member institutions from 67 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers.

ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework

(d) Country where you are located:

Global with European offices in London and Brussels

(e) Contact details including e-mail address:

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United Kingdom
Phone: 44 (0) 20 3088 3550
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**EFRAG's initial assessment with respect to the technical criteria for endorsement**

2 EFRAG's initial assessment of IFRS 9 is that it meets the technical criteria for endorsement. In other words, it is not contrary to the principle of true and fair view and it meets meet the criteria of understandability, relevance, reliability and comparability and leads to prudent accounting. EFRAG's reasoning is set out in Appendix 2, paragraphs 2 to 197 of the draft endorsement advice.

(a) Do you agree with this assessment?

X Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

3 EFRAG's initial assessment of IFRS 9 is that it leads to prudent accounting. EFRAG's reasoning is set out in Appendix 2 paragraphs 185 to 191 of the draft endorsement advice.

(a) Do you agree with this assessment?

X Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues relating to prudence that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of IFRS 9? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No, we noted no additional issues that should be mentioned. See also our response to item 5b below.

(c) Are there any other issues that are not mentioned in Appendix 2 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No, we noted no additional issues that should be mentioned. See also our response to item 5b below.

**The European public good**

4 In its assessment of the impact of IFRS 9 on the European public good, EFRAG has considered a number of issues that are addressed in Appendix 3 of the draft endorsement advice.

*IFRS 9 compared to IAS 39*

5 EFRAG's initial assessment of IFRS 9, and particularly with respect to the impairment and hedging requirements, is that it is an improvement over IAS 39 and will lead to higher quality financial reporting. The assessment is reflected in paragraphs 3 to 52 of Appendix 3 of the draft endorsement advice.

(a) Do you agree with this assessment?

X Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues relating to IFRS 9 compared to IAS 39 that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9 when comparing to IAS 39? If there are, what are those issues and why do you believe they are relevant to the evaluation?

Our members generally support the endorsement of IFRS 9 for use in the European Union. We believe that as a whole IFRS 9 represents an improvement of the current IAS 39 standard for the following reasons:

- IFRS 9 reduces a significant amount of complexity in the current standard for financial instrument accounting, by requiring a single impairment model and removing the embedded derivatives rules for financial assets. The use of the business model as a key determinant of classification while still considering the characteristics of the instrument provides a clearer principle for determining when amortised cost/fair value through OCI accounting is appropriate. We also support the IASB's decision to address the important issue of "own credit" and its impact on financial liabilities.
- The impairment rules under IFRS 9 address the issue of 'too little too late', by requiring lifetime expected credit losses on those positions for which there has been a significant increase in credit risk since inception.
- As part of the IASB's due process for all three phases, it has conducted an extensive outreach program on IFRS 9, in which we have actively participated, to ensure that all constituents' concerns and issues were heard and were given due consideration.
- As a result of the due process conducted by the IASB, we believe that the IASB has adequately addressed the concerns we expressed during our discussions with them and in our previous comment letters.

We believe that the principles underpinning the classification of assets, supplemented with the improvements in impairment and hedge accounting and the impact on own credit for financial liabilities under a FVO, will provide more relevant information to financial statement users which reflects the specific business models of the institution.

However, we believe that as part as a post implementation review the IASB should assess the impact of those issues that it was not possible to anticipate during the discussion period.

*The lack of convergence with US GAAP*

6 EFRAG's initial assessment is that IFRS 9 will lead to higher quality financial reporting when compared to current US GAAP and proposed changes to impairment requirements. The assessment is reflected in paragraphs 53 to 74 of Appendix 3 of the draft endorsement advice.

(a) Do you agree with this assessment?

☐ Yes X No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

The FASB is still discussing the impairment requirements proposal. Therefore it is still too early to provide a view of the impact of the proposals on entities using U.S. GAAP and IFRS.

On September 2014, the Financial Stability Board (FSB) reiterated the objective of achieving a single set of international high-quality global accounting standards, but there has been very little progress afterwards. We believe that the convergence efforts have lost impetus and should be renewed because U.S. GAAP and IFRS requirements differ in numerous ways.

We believe that the adoption of IFRS in the EU through the IAS Regulation was an important step in establishing IFRS as global accounting standards. Since the implementation of the IAS Regulation, several countries have followed the EU lead, including some large economies which have converted to IFRS or are in the process of doing so. For example, Japan (where voluntary adoption is allowed, but not mandatory transition date has been established), India (where regulatory authorities have made public statements about the intention to adopt from 2016/17), China (which intends to fully converge at some undefined future date) are some of the remaining countries that have initiated the process to require the use of IFRSs for domestic purposes.

The United States has no current plans to change. However, since 2007, the United States has allowed non-US entities to report using IFRS without modifications. There are currently over 450 non-US filers with market capitalisation in the multiple of trillions of US dollars who use IFRS without reconciliation to U.S. GAAP (see PWC publication titled, 'IFRS and US GAAP: similarities and differences, October 2014).

While there is still divergence with US GAAP, the SEC allows foreign companies to report under IFRS thereby eliminating the requirement for dual reporting by EU companies. This resolution represents an effort to reduce the 'convergence gap' and considerable 'cost-savings' for entities in Europe and beyond. Furthermore, investors in the United States are often frequent users of IFRS financial statements for the investment decisions. Recent estimates (see PWC publication titled, 'IFRS and US GAAP: similarities and differences, October 2014) suggest that over $7 trillion of US capital is invested in foreign securities.

(b) Are there any issues related to the impact of the lack of convergence that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9 when comparing with US GAAP? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No, we do not have additional issues to raise over and above those already stated in paragraphs 53 to 74 in Appendix 3, except there is a growing concern among investors and stakeholders (including those of the Basel Committee on Banking Supervision and the Financial Stability Board), about the lack of convergence between U.S. GAAP and IFRS and the impact on comparability, transparency and cost of capital.

*Impact on investor and issuer behaviour*

7 EFRAG's analysis in this area is based on our understanding of both changes in IFRS 9 and current practices of financial institutions and is not a full impact assessment. In its analysis EFRAG has tried to identify potential negative effects only, to contribute to identifying whether there would be any impediment to IFRS 9 being conducive to the European public good. The assessment is reflected in paragraphs 75 to 99 of Appendix 3 of the draft endorsement advice.

(a) Do you agree with this assessment?

X Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

We agree with the assessment in Appendix 3 that IFRS 9 is, on balance, conducive to the public good because it is an overall improvement to financial reporting.

We would suggest that any future impact assessment should cover the interaction between accounting and regulatory changes.

(b) Are there any issues related to the impact of IFRS 9 on investor and issuer behaviour that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No, we do not have additional issues to raise.

*Inter-relationship of IFRS 9 with the future insurance contracts standard*

8 EFRAG has initially concluded that the mismatch in timing of the future insurance contracts standard and IFRS 9 will create disruptions in the financial reporting of insurance activities which may not be beneficial to investors and other primary users (see Appendix 3, paragraphs 100 to 110 of the draft endorsement advice). Hence EFRAG proposes to advise the European Commission to ask the IASB to

defer the effective date of IFRS 9 for insurers and align it with the effective date of the future insurance contracts standard.

9 In reaching this preliminary position, EFRAG has relied on quantitative assessments prepared by the European insurance industry and released shortly before EFRAG concluded on its tentative advice to the European Commission. EFRAG intends to deepen its understanding of the effect on the reporting by insurance businesses by implementing IFRS 9 in advance of the forthcoming IFRS 4. EFRAG invites all quantitative evidence that can supplement the impact assessment received from the European insurance industry, including evidence gathered by those who oppose the deferral.

(a) Do you agree with this assessment and the subsequent advice to the European Commission?

☐ Yes X No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

ISDA members recognise that there is a split view on this issue. We understand the difficulties that insurance companies may face due to the different time frame for completion of the insurance project. However, for banks with insurance liabilities, a deferral will mean additional costs to the IFRS 9 implementation costs that are already significant.

Some ISDA members believe that there are important reasons not to defer the effective date of IFRS 9 are as follows:

- The IASB has publicly confirmed they will afford entities the ability to refresh the IFRS 9 fair value options when IFRS 4 becomes effective. So the issue will exist only for a relatively short period of time (the expectation is that there will be only one 'gap' year between the effective dates of the standard).
- Even so, in the period between the effective dates of IFRS 9 and the new insurance standard, we believe that any mismatches in financial reporting can be adequately addressed via additional disclosure for that gap period.
- Were the IASB to decide not to grant such deferral for insurers but Europe creates a carve out, such that only European insurers can defer IFRS 9, this would be highly detrimental for IFRS as a global accounting standard. Any carve outs significantly reduce the benefits of global accounting standards and dilute investor confidence in financial reporting in Europe.
- Finally, it is also unclear what the exact scope for such a deferral would be - how would 'insurers' be defined for this purpose - and therefore unclear how this could be operationalised. In particular there are many large financial institutions that hold insurance activities / contracts. A deferral for insurance activities / contracts would also create a difficulty trying to define the different scenarios when such an exemption would apply.

However, some of our members which are financial conglomerates consider that the scope of the deferral should be applied to insurance "regulated entities" (as they are in most jurisdictions) instead of insurance "business" as specified by EFRAG. Those members are aware of the operational

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| constraints of such a deferral but they consider that the benefit of providing more meaningful information to users on their insurance operating segment would outweigh such concerns. |

(b) Do you think that EFRAG should recommend the EC to grant to insurance businesses a deferred mandatory date of application for the endorsed IFRS 9 if the IASB were not to defer the effective date of IFRS 9?

☐ Yes X No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

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| See our comments above in 9a |

(c) Are there any issues related to the inter-relationship of IFRS 9 with the future insurance contracts standard that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9 when assessing the inter-relationship between IFRS 9 and the future insurance contracts standard? If there are, what are those issues and why do you believe they are relevant to the evaluation?

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| See our comments above in 9a |

*European carve-out*

10 EFRAG has initially concluded that the endorsement of IFRS 9 would not affect the ability of entities to rely on the European carve-out (see Appendix 3, paragraphs 111 to 117 of the draft endorsement advice).

(a) Do you agree with this assessment?

X Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

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| Please note that only a small number of our members make use of the European carve out. Our understanding is that the European carve-out remains applicable and that this will be the case until the completion of a suitable macro-hedge accounting standard. |

(b) Are there any issues related to the European carve-out that are not mentioned in Appendix 3 of the draft endorsement advice that you believe EFRAG should take into account in its technical evaluation of IFRS 9 when assessing the EU carve out? If there are, what are those issues and why do you believe they are relevant to the evaluation?

See our response to 10a above.

*Costs and benefits of IFRS 9*

11 EFRAG is assessing the costs that are likely to arise for preparers and for users on implementation of IFRS 9 in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

12 The results of the initial assessment of costs are set out in paragraphs 120 to 155 of Appendix 3 of the draft endorsement advice. To summarise, EFRAG's initial assessment is that overall, IFRS 9 is likely to result in significant costs for preparers related to implementation of and ongoing costs of complying with the standard. However, IFRS 9 is not likely to result in significant costs for users after the transition. At transition costs will be incurred in understanding the new financial reporting.

(a) Do you agree with this assessment?

X Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be.

(b) In addition, EFRAG is assessing the benefits that are likely to be derived from the application of IFRS 9. The results of the initial assessment of benefits are set out in paragraphs 156 to 170 of Appendix 3. To summarise, EFRAG's initial assessment is that overall, users and preparers are both likely to benefit from IFRS 9, as the information resulting from it will be relevant and transparent and therefore will enhance the analysis of users.

Do you agree with this assessment?

X Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice.

13 EFRAG's initial assessment is that the benefits to be derived from implementing IFRS 9 in the EU as described in paragraph 12 (b) above are likely to outweigh the costs involved as described in paragraph 12 (a) above.

Do you agree with this assessment?

X Yes ☐ No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice.

*Overall assessment with respect to the European public good*

14 EFRAG has initially concluded that endorsement of IFRS 9 would be conducive to the European public good (see Appendix 3, paragraphs 174 to 176 of the draft endorsement advice).

Do you agree with the assessment of these factors?

X Yes ☐ No

If you do not agree, please explain your reasons.

We agree with the assessment in Appendix 3 that IFRS 9 is, on balance, conducive to the public good because it is an overall improvement to financial reporting as discussed in our response to comment 5b.

**Other issues for consideration**

*Request to provide quantitative data on a confidential basis*

15 EFRAG continues its search for quantitative data in the fields of impairment and the inter-relationship between IFRS 9 and the future insurance contracts standard. EFRAG calls upon constituents who have quantitative data available in these fields, to provide it to EFRAG on a confidential basis during the consultation period of the draft endorsement advice. Data provided will be used in finalising the endorsement advice but will not be made public.

The collection of these data is subject to EFRAG's field-work policy which is available on the EFRAG website.

ISDA is not in a position to provide quantitative data.

However, it is critical that the Commission and other European authorities be in a position to monitor the interaction of the new impairment model with other regulatory requirements (e.g.: uncertainty on the future treatment of Basel expected loss shortfalls/excess), in order to avoid any detrimental effect on European economic interest.

*Should endorsement be halted until quantitative data are available?*

16 Based on the results of our questionnaire follow up to the field-tests, it can take up to 2017 to have quantitative impacts of the implementation of IFRS 9 available. It has been argued by some that the quantitative impacts of IFRS 9 should be known before endorsement of the standard is decided upon. EFRAG does not agree with this view and believes that the improvements brought to financial reporting by IFRS 9 should not be withheld from European companies for a period that long.

Do you agree with this assessment?

X Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

We agree that the endorsement of IFRS 9 should not be delayed until a date that precise quantitative impacts are known.

A delayed endorsement process until 2017 creates uncertainty in implementation projects and may compromise high quality implementation of the accounting and disclosure requirements. Therefore we do not believe that not having precise quantitative impacts should preclude endorsing the use of IFRS 9 in Europe.

Please also refer to question 15 above.

*Should early application of IFRS 9 be prohibited?*

17 It has been argued by some that early application of IFRS 9 should not be allowed for specific regulated industries. EFRAG does not agree with this and is of the opinion that entities should be able to apply IFRS 9 early (see Appendix 2, paragraphs 192 to 195 of the draft endorsement advice).

Do you agree with this assessment?

X Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.