17 April 2015

**European Insurance CFO Forum and Insurance Europe supplementary comments on "Views on IFRS 9 endorsement in the EU"**

On 6 March 2015 the European Insurance CFO Forum and Insurance Europe wrote to Mr Roger Marshall, the Acting President of the European Financial Reporting Advisory Group ("EFRAG") to express their "Views on IFRS 9 endorsement in the EU". For ease of reference, a copy of this letter is attached. The letter included opinions of the two organisations that it is important that:

- the accounting requirements for financial instruments and insurance liabilities are considered and applied together;
- there is a global solution to align the effective dates for IFRS 4 phase II and IFRS 9 for insurers, reflecting how financial assets and insurance liabilities for insurers are managed together;
- it is of paramount importance that insurers are not required to apply significant changes in accounting requirements to assets and liabilities at separate times.

This paper provides supplementary information to EFRAG to augment the opinions expressed in that letter and, in particular, the adverse effects of IFRS 9 being applied ahead of the IFRS 4 phase II insurance standard.

For most European insurers the vast majority of investment assets are accounted for at either amortised cost or on an available-for-sale basis with, under the current IFRS 4 basis, insurance liabilities measured on a cost-type basis using locked-in discount rates. Thus, under the current accounting framework, these liabilities are largely not re-measured for the impact of movements in short-term market conditions.

Our key concern is that under IFRS 9 many assets, in particular equity securities held for investment, certain non-consolidated investment funds and certain types of more complex debt securities which will not meet the so-called Solely Payments of Principal and Interest ("SPPI") criteria will be required to be measured at fair value through P&L. Until such time as the IFRS 4 phase II insurance standard is adopted this altered measurement and presentation of fair value movements under IFRS 9 will give rise to fundamental accounting mismatches in the income statement.

Whilst the full impact of IFRS 9 on the insurance industry is yet to be determined, an initial review of the balance sheets of some of the largest and most affected continental European insurers suggests that between 8% and 20% of the assets currently accounted for at amortised cost or on an available-for-sale basis, with a value of more than Euro 250

billion, will be required to be accounted for at fair value through profit and loss. Fair value movements on these assets would be recognised in the income statement. With the measurement methodology for insurance liabilities remaining unaltered until the IFRS 4 phase II standard is implemented this will give rise to significant volatility in reported net income. For example, based on analysis by some of the larger continental European insurers for the years 2011 to 2014 there would have been volatility of up to 20 per cent from this accounting mismatch.

This very significant level of volatility arises despite the fact that the new impairment rules under IFRS 9 are currently not expected to give rise to a significant financial impact. This is because the vast majority of European insurers' investment portfolios have a relatively low risk of default. Our organisations do however have other concerns with IFRS 9 for the new impairment rules being applied before the application of the phase II standard. This is because new systems would have to be developed and implemented for a significant amount of assets, which will partly only be required for a short, temporary period, depending on the final outcome of the IFRS 4 Phase II standard. Insurers expect that the operational impact and cost thereof is significant.

End of note