European Securities and Markets Authority

The Chair

Date: 14 December 2016
ESMA/2016/1660

Mr Jean-Paul Gauzès
President of the Board
European Financial Reporting
Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: EFRAG's Draft Letter to the European Commission regarding the endorsement of *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4*

Dear Mr Gauzès,

The European Securities and Markets Authority (ESMA) thanks you for this opportunity to comment on EFRAG's Draft Letter to the European Commission regarding the endorsement of *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4* (hereinafter the 'Amendments to IFRS 4').

On 15 November 2016 EFRAG published its draft letter regarding the endorsement of the Amendments to IFRS 4 which address the effects of the misalignment of the effective dates of IFRS 9 and the forthcoming new insurance contracts Standard, by providing: (i) a temporary exemption from IFRS 9 for insurers that meet specified criteria; and (ii) an option for entities to apply the overlay approach to designated financial assets (hereinafter these options are referred to collectively as the 'temporary solutions').

EFRAG's draft letter considers whether the Amendments to IFRS 4 comply with requirements of Article 3 of the IAS Regulation[1]. In particular, EFRAG concluded that the Amendments to IFRS 4 meet the technical endorsement criteria (understandability, relevance, reliability and comparability) required for financial information in order to make economic decisions and assess the stewardship of management. EFRAG also concluded that the Amendments to IFRS 4 lead to sufficient prudent accounting and are not contrary to the true and fair view principle as defined by Article 4(3) of the Accounting Directive[2]. Furthermore, EFRAG has assessed that the Amendments to IFRS 4 are conducive to the European public good. Nevertheless, EFRAG

[1] Regulation (EC) no 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.
[2] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings.

considered that the Amendments to IFRS 4 do not address the cost concerns of bank-led groups with significant insurance business.

ESMA concurs with EFRAG's conclusion that the Amendments to IFRS 4 meet all the technical endorsement criteria and are not contrary to the true and fair view principle as defined in the Accounting Directive. However, ESMA believes that EFRAG's assessment as to whether the Amendments to IFRS 4 are conducive to the European public good will need further clarity to reflect enforceability and investors' protection considerations, as explained in the following paragraphs.

Firstly, even if the existence of two complementary temporary solutions is not ideal, due to the specific situation, ESMA agrees that the Amendments to IFRS 4 will help improving the quality of financial reporting, compared to a situation where the issue relating to the misalignment of effective dates of IFRS 9 and the forthcoming insurance contracts standard would not be addressed. However, from an enforcement perspective, the acceptability of the temporary solutions and the conclusion that they are conducive to the European public good is inextricably linked to the existence of strict limitations for their eligibility. Particularly, for the temporary exemption to apply IFRS 9, ESMA's view is that enforceability would be particularly difficult if entities would be allowed to apply the exemption at a level below the reporting entity. Such approach would result in more complex accounting and would give rise to possibilities for opportunistic intra-group asset transfers and earnings management. ESMA highlights that more complex accounting harms transparency of financial information thus reducing the degree of investors' protection. ESMA also notes that this would be inconsistent with the recent Resolution [3] of the European Parliament calling for reducing complexity in accounting standards.

Secondly, ESMA notes that the principle of applying uniform accounting policies for all subsidiaries within the same group[4] of entities is complied with only if the temporary exemption from IFRS 9 is applied at the reporting entity level, as provided for in the Amendments to IFRS 4. Uniformity of group accounting policies is a fundamental principle of high quality accounting in the consolidated financial statements. ESMA highlights that, in the context of the IAS Regulation, the objective of applying *'a single set of high quality*' accounting standards is to '*contribute to a better functioning of the internal market'*. High quality accounting standards, when consistently applied and effectively enforced, are the cornerstone of transparent and reliable financial reporting which, in its turn, helps protecting investors and contributes to orderly and competitive markets. Consequently, in ESMA's view the principle of uniform group accounting policies is part of a minimum set of requirements that is in place to safeguard investors' protection, thus improving competition in the financial market.

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[3] European Parliament resolution of 7 June 2016 on International Accounting Standards (IAS) evaluation and the activities of the International Financial Reporting Standards (IFRS) Foundation, the European Financial Reporting Advisory Group (EFRAG) and the Public Interest Oversight Board (PIOB) (2016/2006(INI)).
[4] See IFRS 10 *Consolidated Financial Statements*, paragraph. 19.

Finally, ESMA believes that in assessing the level playing field's implications arising from the Amendments to IFRS 4 for European businesses carrying out significant insurance activities, more prominence should be given to the fact that, if the temporary exemption were to be applied below the reporting entity level, the financial statements of bank-led groups carrying out significant, non-predominant insurance business will become incomparable with those of other bank-led groups. Such lack of comparability, in ESMA's view, would harm investors' protection and transparency thus affecting the overall competitiveness of the European financial services industry far more than excluding insurance divisions of bank-led groups from the scope of the temporary exemption.

To conclude, ESMA concurs with EFRAG's assessment that Amendments to IFRS 4 are conducive to the European public good. ESMA also believes that in EFRAG's assessment of competitiveness aspects relating to enforceability, transparency and investor protection should more appropriately be taken into consideration. In ESMA's view these are decisive factors to conclude that the amendments to IFRS 4 would not impede a level playing field for European businesses carrying out significant insurance activities.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely,

Steven Maijoor

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