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[DRAFT] Endorsement Criteria Assessment: *Amendments to IFRS 4—Extension of the Temporary Exemption from Applying IFRS 9*

1 Introduction

PURPOSE

1.1 The purpose of this [draft] Endorsement Criteria Assessment (ECA) is to determine whether the UK's statutory requirements for endorsement and adoption of an amended standard are met.

1.2 The International Accounting Standards Board (IASB) first published IFRS 17 *Insurance Contracts* in May 2017 and subsequently published the *Amendments to IFRS I7* in June 2020. This suite of amendments proposed a deferral of the effective date of IFRS 17 until annual periods commencing on or after 1 January 2023. In June 2020 the IASB also published an extension to the temporary exemption from applying IFRS 9 *Financial Instruments;* the exemption is available to insurers under IFRS 4 *Insurance Contracts*.

1.3 This [draft] ECA discusses whether the Amendments to IFRS 4 – *Extension of the Temporary exemption from Applying IFRS 9* ('the Amendments') meet the UK's statutory requirements for endorsement and adoption of an amendment to a standard.

BACKGROUND TO THE AMENDMENTS

1.4 IFRS 9 addresses the accounting for financial instruments and is effective for annual reporting periods beginning on or after 1 January 2018. However, for insurers meeting the eligibility criteria1, IFRS 4 provides a temporary exemption which permits them to continue to apply IAS 39 Financial Instruments: Recognition and Measurement rather than implement IFRS 9. This temporary exemption was applicable to annual periods beginning before 1 January 2021, In June 2020 the IASB published an amendment to IFRS 4 to extend the temporary exemption from applying IFRS 9 until annual periods beginning before 1 January 2023. This amendment maintains the alignment of the effective dates of IFRS 9 and IFRS 17.

[1] An insurer may apply the temporary exemption from IFRS 9 if, and only if: (a) it has not previously applied any version of IFRS 9, other than only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss; and (b) its activities are predominantly connected with insurance (IFRS 4:20B).

2 UK Statutory requirements for endorsement and adoption

2.1 Paragraph 1 of Regulation 7 of the International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019 No. 685[2] ("the Regulations") requires that an international accounting standard[3] only be adopted if:

(a) "the standard is not contrary to either of the following principles—

(i) an undertaking's accounts must give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss;

(ii) consolidated accounts must give a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included in the accounts taken as a whole, so far as concerns members of the undertaking;

(b) the use of the standard is likely to be conducive to the long term public good in the United Kingdom; and

(c) the standard meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management."

2.2 This document assesses the criteria set out in paragraph 2.1 in the following order:

(a) Technical criteria assessment:

(i) Whether the standard meets the criteria of relevance, reliability, comparability and understandability required of the financial information needed for making economic decisions and assessing the stewardship of management (Regulation 7(1)(c)); and

(ii) Whether the standard is not contrary to the principle that an entity's accounts must give a true and fair view (Regulation 7(1)(a)).

(b) Whether use of the standard is likely to be conducive to the long term public good in the UK (Regulation 7(1)(b)).

RELEVANCE, RELIABILITY, COMPARABILITY AND UNDERSTANDABILITY[4]

2.3 Information is **relevant** if it is capable of making a difference in the decision-making of users or in their assessment of the stewardship of management. The information may aid predictions of the future, confirm or change evaluations of the past or both.

2 http://www.legislation.gov.uk/uksi/2019/685/made

3 This is defined in the Companies Act using Article 2 of the IAS Regulation "…'international accounting standards' shall mean International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related Interpretations (SIC-IFRIC interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board (IASB)."

4 These descriptions are based on the qualitative characteristic of financial statements in the *Framework for the Preparation and Presentation of Financial Statements* adopted by the IASB in April 2001. These

2.4 Financial information is **reliable** if, within the bounds of materiality, it:

(a) can be depended on by users to represent faithfully what it either purports to represent or could reasonably be expected to represent;

(b) is complete; and

(c) is free from material error and bias.

2.5 Information is **comparable** if it enables users to identify and understand similarities in, and differences among, items. Information about an entity should be comparable with similar information about other entities and with similar information about the same entity for another period.

2.6 Financial information should be readily **understandable** by users with a reasonable knowledge of business and economic activities and accounting, and a willingness to study the information with reasonable diligence.

3 Rationale for the Amendments

3.1 The IASB introduced a temporary exemption from IFRS 9 for a limited period for entities whose activities are predominantly connected with insurance. During the temporary exemption the insurer would continue to apply IAS 39 when accounting for financial instruments. The IASB concluded that the cost reduction arising from the exemption would outweigh the following disadvantages:

(a) users of the financial statements would not have access to the significantly improved information about financial instruments provided by IFRS 9; and

(b) a reduction in cross-sector comparability.

3.2 As a mitigation against these disadvantages, the IASB amended IFRS 4 to require additional disclosures, to enhance users' ability to compare financial statements of different entities.

3.3 Insurers applying the temporary exemption from IFRS 9 must disclose the fair value at the end of a reporting period, and the amount of change in the fair value during that period, for the following two groups of assets:

(a) financial assets with contractual terms that give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding, excluding financial assets which meet the definition of held for trading in IFRS 9 or whose performance is evaluated on a fair value basis; and

(b) all other financial assets.

3.4 In addition, insurers must disclose information about their credit risk exposure, including significant credit risk concentrations, from a specific population of financial assets that is similar

qualitative characteristics became part of the criteria for endorsement and adoption of IFRS in the EU's IAS Regulation (1606/2002), and, subsequently, in SI 2019/685.

to the population to which the IFRS 9 credit loss requirements would apply (those referred to in paragraph 3.3(a) above).

3.5 In June 2020 the IASB deferred the effective date of IFRS 17 by two years, to annual periods beginning on or after 1 January 2023, and considered whether to extend the expiry date of the temporary exemption from IFRS 9. Extending the temporary exemption beyond 1 January 2021 would result in insurers applying IFRS 9 up to five years after other entities. The IASB was of the view that a delay may have a material impact because some insurers have significant holdings of financial assets.

3.6 However, the IASB concluded that the arguments for the original temporary exemption – the exemption was applicable for only a limited population of entities and the relief it provided outweighed any disadvantages – were still applicable. It therefore decided, on balance, that extending the temporary exemption by two years so that the effective dates for IFRS 9 and IFRS 17 would be aligned for insurers in scope outweighed the disadvantages of the additional delay to the application of IFRS 9.

4 Assessment against technical criteria

RELEVANCE

4.1 The matching of assets with the insurance contract liabilities they support is central to the business model of insurers; many insurers are therefore managing the transitions to IFRS 9 and IFRS 17 as a single integrated project. If IFRS 9 had to be applied before IFRS 17 that would be detrimental to the ability of insurers to make optimal accounting policy decisions about financial asset classification in the context of IFRS 17 accounting for insurance liabilities. The risk of accounting mismatches, and hence volatility in profit or loss that does not reflect economic substance, would increase. The Amendments will avoid this risk and therefore enhance the relevance of financial information prepared by insurers.

4.2 It might be argued that the Amendments will delay the provision of more useful information about financial instruments held by insurers for two further reporting periods. IFRS 9's requirements improve information particularly in respect of the classification and measurement of financial assets, including the provision of fair value information, and in respect of credit risk and impairment (in particular through its more forward-looking expected credit loss model). Therefore, users of financial statements will experience a delay in accessing information which may influence their decision making.

4.3 However, feedback from stakeholders highlights that UK insurers hold most of their financial assets at fair value through profit or loss, or fair value through other comprehensive income. Information currently disclosed by insurers will therefore still be useful for users as these assets are held at fair value. Fair value measurement incorporates information on credit risk and indicators of impairment, providing relevant information. Furthermore, the additional disclosures required from entities taking advantage of the temporary exemption (set out in paragraphs 3.3 and 3.4 above) will help ensure additional useful information is provided. Therefore, a further delay in the implementation of IFRS 9 will not result in a significant loss of useful information.

RELIABILITY

4.4 By simply deferring the use of IFRS 9, the Amendments do not alter the recognition and measurement requirements for financial instruments, either as currently applied by insurers in accordance with IAS 39 or as set out in IFRS 9. Therefore, the Amendments will not directly impact the reliability of financial information presented by insurers.

COMPARABILITY

4.5 IFRS 9 became effective for most entities for reporting periods starting on or after 1 January 2018. The temporary exemption from applying IFRS 9 for eligible insurers decreases comparability with non-insurers and ineligible insurers. Extending the exemption as proposed in the Amendments will extend that reduced comparability for a further two years.

4.6 However, as noted above, for UK insurers any negative impact on comparability is reduced by the existing predominant use of fair value measurement for investment assets. Furthermore, the additional disclosures required by IFRS 4 will minimise the loss of useful information arising from the deferral of the application of IFRS 9. As a result, the disclosures will limit any loss of comparability between insurers and non-insurers.

UNDERSTANDABILITY

4.7 Extending the temporary exemption by two years to 1 January 2023 will increase understandability for users of financial statements. Although for many UK insurers IFRS 9 is not expected to lead to material changes in asset valuation, the standard may nevertheless lead to significant changes in presentation (for example the way assets are classified) and disclosure. The Amendments will align the effective dates of IFRS 9 and IFRS 17 for insurers and prevent the implementation of two major accounting standard changes in quick succession. Stakeholder feedback indicates that two significant changes in accounting standards in two years would be viewed negatively by investors due to the impact on trend information that is important for their analyses.

4.8 Furthermore, as noted in paragraph 4.1 above, if IFRS 9 is applied before IFRS 17 it may result in accounting mismatches, and hence volatility in profit or loss that does not reflect economic substance. This will reduce understandability and can be avoided if the two standards are implemented at the same time.

4.9 The Amendments do not alter the recognition and measurement requirements for financial instruments. Furthermore, insurers adopting the temporary exemption from applying IFRS 9 are required to make additional disclosures. These disclosures provide information to users and investors to help them understand the impact IFRS 9 will have on their financial statements and thereby enhance understandability. The Amendments do not change the additional information required and therefore do not negatively impact understandability.

CONCLUSION

4.10 Overall, we conclude that the Amendments meet the criterion of relevance, reliability, comparability and understandability required of the financial information needed for making economic decisions and assessing the stewardship of management, as required by SI 2019/685 (see paragraph 2.1(c) above).

5 True and fair view

5.1 This section considers whether the Amendments are not contrary to the principle that an entity's accounts must give a true and fair view.

5.2 A true and fair view is an overarching concept, to be applied to an entity's financial statements as a whole. Accounting standards provide for recognition, measurement, presentation and disclosure for transactions and events so that the financial statements fairly reflect the economic substance of those underlying transactions and events, hence providing a true and fair view.

5.3 The Amendments are only able to be implemented by entities if, and only if: (a) they have not previously applied any version of IFRS 9, other than only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss; and (b) their activities are predominantly connected with insurance (IFRS 4:20B). The Amendments are therefore appliable to only a limited number of entities.

5.4 Furthermore, entities that adopt the temporary exemption from applying IFRS 9 are required to disclose additional information. These additional disclosures help users to understand the nature and extent of the expected impact of IFRS 9 implementation, providing useful information to users of financial statements about the risks relating to entities' financial assets.

5.5 Overall, the current position, whereby eligible insurers account for financial instruments in accordance with IAS 39 until they apply IFRS 17, combined with the required additional disclosures, is not considered contrary to the true and fair view principle. Extending this current position for a further two years for the limited number of eligible entities is also not considered contrary to the true and fair principle.

CONCLUSION

5.6 Overall, we conclude that application of the Amendments is not contrary to the principle that an entity's accounts/consolidated accounts must give a true and fair view as required by SI 2019/685 (see paragraph 2.1(a))[5].

6 UK public good

6.1 This section considers whether the Amendments are likely to be conducive to the long term public good in the UK. Regulation 7(2) of SI 2019/685 includes specific areas to consider for this assessment. They are:

(a) whether the use of the standard is likely to improve the quality of financial reporting;

(b) the costs and benefits that are likely to result from the use of the standard; and

(c) whether the use of the standard is likely to have an adverse effect on the economy of the UK, including on economic growth.

IMPROVE THE QUALITY OF FINANCIAL REPORTING

6.2 The objective of the Amendments is to align the implementation of IFRS 9 and IFRS 17 for insurers. Alignment of the implementation dates will improve the quality of financial reporting

5 This requirement is separate from the requirement in section 393 of the Companies Act 2006, that the "directors of a company must not approve accounts for the purposes of this Chapter unless they are satisfied that they give a true and fair view…"

because it will reduce the risk of accounting mismatches and hence prevent volatility in profit or loss that does not reflect economic substance.

6.3 Implementing IFRS 9 and IFRS 17 on the same date would avoid two major accounting changes in two years, thus ensuring that insurers in scope provide clearer financial information for investors. Frequent changes in financial reporting impair the ability of users of financial statements to assess the performance of entities because it reduces the availability of consistent trend information.

6.4 It might be argued that deferring the effective date of IFRS 9 for insurers by another two years will reduce the quality of financial reporting, because it will delay the provision of improved information on financial instruments. However, this risk is considered low due to UK insurers' current accounting practices (see paragraph 4.3 above). The risk is further mitigated by the additional disclosures which are required during the temporary exemption.

Conclusion

6.5 On balance we conclude that the Amendments will improve the quality of financial reporting by avoiding the detrimental impact of accounting mismatches and providing more consistent information for investors.

COSTS AND BENEFITS FROM USING THE AMENDMENTS

Introduction

6.6 This section considers the costs and benefits that are likely to result from the use of the Amendments. The work undertaken to make this assessment is proportionate to the nature and scale of the Amendments and to the population of entities that are affected by them.

6.7 The Amendments are limited in scope because they apply to only a limited population of entities (eligible insurers applying IFRS). In addition, the Amendments alter the timing of when insurers are required to implement IFRS 9, but they do not change the accounting and reporting requirements of that standard or of IFRS 17.

Costs for preparers

6.8 We consider that the costs of implementing the Amendments are minimal. The Amendments delay the implementation date of IFRS 9 by two years. Preparers will need to incur costs to implement IFRS 9, however this Amendment only changes when these costs will be incurred.

6.9 Costs for delaying the implementation are anticipated to be minimal and concern the preparation of additional disclosures as required by IFRS 4. Entities have been making these disclosures since the effective date of IFRS 9, annual periods commencing on 1 January 2018. As a result, no additional costs relating to familiarity or development of systems and procedures are necessary.

Benefits for preparers

6.10 We consider that a principal benefit of adopting the Amendments is the alignment of implementation dates for IFRS 9 and IFRS 17. Implementing both standards at the same time will reduce the risk of accounting mismatches and of accounting-led volatility in profit or loss; this may have required additional disclosures to help explain financial performance to users of the financial statements.

6.11 Extending the temporary exemption from applying IFRS 9 may reduce costs for preparers due to the wider availability of IFRS 9 expertise. In addition, insurers will have more time to develop their own expertise in the standard and more examples of good practice will be publicly available. This will help insurers in scope to prepare higher quality disclosures.

6.12 Avoiding two major accounting standard changes in quick succession will enable insurers to explain their financial performance more clearly and avoid additional costs preparing supplementary disclosures to explain the changes.

6.13 If the Amendments are not adopted for use in the UK then UK insurers may have to accelerate their current IFRS 9 implementation projects, potentially disrupting IFRS 17 implementation work and leading to increased competition for resources and higher costs.

Costs for users

6.14 The Amendments will create a cost to users of financial statements because it will delay the provision of improved information on financial instruments under IFRS 9. However, UK insurers' current accounting practices (see paragraph 4.2 above) and the additional disclosures required during the temporary exemption period will mitigate any loss of information for users.

6.15 Extending the temporary exemption from IFRS 9 by two years may also increase costs for users because it will maintain the existing reduction in cross-sector comparability. However, this cost will be limited given the small number of investors specialising in insurance. Such investors will already be accustomed to this situation and to the additional disclosures provided by insurers since 2018.

Benefits for users

6.16 The Amendments will prevent two major accounting changes being implemented in quick succession. This will make it easier for users of the financial statements to interpret the results. Information on trends will be more observable because results will not be distorted by two major changes, instead there will only be one step change to analyse. Furthermore, the avoidance of accounting mismatches will result in more relevant and understandable information for users of accounts.

Conclusion

6.17 We conclude that the incremental costs of the Amendments are minimal for both preparers and users. On balance, the benefits of extending the temporary exemption from IFRS 9 outweigh any additional costs because doing so will reduce the risk of accounting mismatches, promote higher quality implementation of IFRS 9, reduce disruption for both users and preparers, and provide clearer information on the financial performance of insurers.

LIKELY EFFECT ON THE ECONOMY OF THE UK

6.18 This section addresses whether the use of the Amendments is likely to have an adverse effect on the UK economy, including on economic growth.

6.19 As explained above, the Amendments are applicable to only a limited number of entities and are expected to have only a minimal impact on the costs of insurers and users of financial statements. Overall, the benefits of the Amendments are considered to outweigh any additional costs.

6.20 The Amendments will avoid further disruption in the reporting of financial information for eligible insurers at a time of particular economic uncertainty and change due to the coronavirus pandemic and the end of the UK's Transition Period on 31 December 2020.

Conclusion

6.21 We conclude that the Amendments are **not** likely to have an adverse effect on the economy of the UK, including on economic growth.

OVERALL CONCLUSION ON UK PUBLIC GOOD

6.22 In paragraphs 6.2–6.21 we conclude that the Amendments:

(a) will generally improve financial reporting when compared to the unamended requirements of IFRS 4;

(b) will lead to benefits that exceed the costs; and

(c) are **not** likely to have an adverse effect on the economy of the UK, including on economic growth.

6.23 Overall, therefore, we conclude that the Amendments are likely to be conducive to the long term public good in the UK as required by SI 2019/685.