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Roger Marshall and Francoise Flores
Acting President and Chair
European Financial Reporting Advisory Group
Square De Meeûs 35, 1000
1000 Ville de Bruxelles
Belgium

Re: Comment Letter on EFRAG Draft Endorsement Advice on Adoption of IFRS 9

Dear Mr. Marshall and Ms. Flores,

The CFA Institute[1], in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment on the European Financial Reporting Advisory Group (EFRAG) draft endorsement advice on adoption of International Financial Reporting Standards Statement 9, *Financial Instruments* (IFRS 9).

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

OVERVIEW

Our comments on EFRAG's on IFRS 9 endorsement advice are confined to the proposed deferral of IFRS 9 for insurance companies. The technical assessment document sets forth the perceived benefits of a deferral including:

- Alleviating the expected incremental volatility for insurers that apply the cost model for their liabilities;
- Incremental costs of a staggered implementation of IFRS 9 and IFRS 4- *Insurance Contracts*; and

[1] With offices in Charlottesville, New York, London, Brussels, Hong Kong, Mumbai, Beijing, CFA Institute is a global, not-for-profit professional association of more than 130,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 150 countries, of whom nearly 123,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 144 member societies in 69 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

- Purported user difficulties in assessing the performance of insurance companies and concerns about the increase in non-GAAP measures.

We are strongly opposed to the deferral of IFRS 9, as we are not persuaded by the significance of the asserted concerns as we explain further below. Instead, we propose the allowance of a one-time reclassification safe harbor once the insurance standard (IFRS 4, *Insurance Contracts*) is completed. We are opposed to deferral for the following reasons:

- Significant uncertainty associated with the timing of completion of IFRS 4;
- Asset classification and measurement improvements are both value-relevant and beneficial for investors on a stand-alone basis; and
- Need to consider investors' ability to discriminate between economic versus accounting mismatches.

We explain our concerns further below.

Significant Uncertainty Associated with the Timing of Completion of IFRS 4

As we understand a key motivation for the proposed deferral is the view that IFRS 9 and IFRS 4 should be adopted at the same date by insurance companies. Stakeholders, including users of financial statements, look forward to the overall update of IFRS standards including the adoption of IFRS 9 and completion of IFRS 4. However, we are not supportive of the proposed alignment in the adoption dates of these two standards for the following reasons:

- *Uncertainty on the timing of completion of IFRS 4*: Our opposition to the deferral is in large part influenced by the significant uncertainty associated with the completion of IFRS 4-, which has been under deliberation for 10+ years. To inextricably link, the adoption of IFRS 9 to the completion of IFRS 4 will not only set a bad precedent, it will also contribute to a potentially highly inefficient standard-setting process and introduce a risk of needing to re-open IFRS 9 due to the emergence of insurance sector specific concerns.

- *Staggered rollout costs are not exceptional to the insurance industry:* All industries are faced with the reality of the need for a staggered roll-out of multiple accounting standards (IFRS 10, IFRS 15, IFRS 9) and the staggered adoption of IFRS 9 and IFRS 4 should not be viewed as exceptional and unusual for the insurance industry.

Asset Measurement Improvements are Value-relevant and Beneficial for Investors on a Stand-alone Basis

Further to the benefits of a deferral of IFRS 9 for insurance companies, the EFRAG assessment document also outlines several drawbacks associated with any such deferral. As users of financial statements, we give more weight to the following drawbacks that were also recognized by the EFRAG assessment document in the articulation of motivation for a deferral of IFRS 9:

- *Delaying the provision of improved financial instruments information*: Stakeholders anticipate that, when compared to current standards, IFRS 9 will result in a more timely reflection of changes in the value of assets - and this will result in an improvement in the existing financial reporting of assets. There are analytical benefits associated with the enhanced reporting of: a) individual income statement line items (i.e. asset re-measurements) and b) insurance company balance sheet assets. For example, the importance of fair value balance sheet items as a valuation input for insurance companies can be inferred from a Columbia University research paper-*Relative Valuation of Insurance Companies,* which shows that relative valuation models (i.e. valuation based on multiples such as Price to Book ratios (P/B)) have higher predictive power when fair value re-measurements of financial assets are reflected on the balance sheet. The study shows that when the book value, which is the denominator of P/B, includes accumulated unrealized other comprehensive gains or losses (i.e. AOCI), it results in higher valuation predictive power, than where the investors strip out AOCI from the book value of equity whilst valuing insurance companies. In other words, the evidence shows that a balance sheet which better reflects updated economic re-measurements of assets is more relevant for valuation purposes than one that does not.

- *Reduction in comparability across banks and insurance companies:* Cross-industry comparability is important for investors who typically hold cross-industry portfolios. The deferral of IFRS 9 will undermine the desirable cross-industry comparability that is expected from a common adoption date for all companies.

Need to Consider Investors' Ability to Discriminate between Economic versus Accounting Mismatches

The principal argument put forward in favor of the deferral of IFRS 9, largely revolves around expected incremental volatility of net income due to accounting related asset/liability mismatches and the associated perceived difficulties investors will experience in judging the performance of insurance companies. It is presumed that this may then lead to the proliferation of non-GAAP measures. We are not persuaded by these concerns for the following reasons:

- *No demonstration of widespread and significant incremental earnings volatility*: A mismatch in the recognition and measurement of asset and liabilities already exists under the current reporting requirements. There is no widely available empirical evidence substantiating that projected incremental volatility will result from IFRS 9 requirements. Besides, investors already understand that there are differences between the economic asset-liability mismatches under the insurance business model and that these economic mismatches are different from the accounting mismatches reflected under the current reporting requirements. Investors will still be able to discriminate economic versus accounting mismatches under any updates to the accounting standards.

- *Limits to the ability of accounting to fully reflect economic asset/liability management*: The emphasis on reflecting asset/liability management (ALM) in a financial reporting

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context seems misplaced because accounting information cannot reflect the full spectrum of economic ALM mismatches across the insurance company product and liability profile. In addition, there is yet to be established a robust conceptual basis of inextricably linking the measurement of assets and liabilities. That said, the emphasis on minimizing asset/liability accounting mismatches by the insurance industry is understandable and seems to have been accommodated by IFRS 9 requirements that include a fair value through OCI (FVOCI) classification category. We consider that having FVOCI as a classification category under IFRS 9 is as far as the financial instruments accounting standards should go.

- *Investors are sophisticated enough to identify economically relevant income statement line items:* In our opinion, EFRAG's assessment paper overstates the concerns about net income volatility- when such volatility is in fact driven by the inclusion of economically relevant individual line items. The arguments put forward do not seem to give adequate weight to the ability of investors to breakdown the components of the net income sub-total and to determine the individual income statement line items that they consider to be core performance line items and predictive of future cash flows. Besides, we are not aware of any analogous empirical evidence[3] that supports the notion that differing measurement attributes for assets and liabilities held in an ALM context, lowers the predictive value of reported earnings.

- *Non-GAAP measures growth are not driven by investor concerns on accounting mismatches*: The inference made within the articulated benefits for deferral, is that reporting of relevant line items within the income statement can be a root cause for the proliferation of non-GAAP measures. This inference is highly debatable. There is no evidence that non-GAAP measures are investor demand driven whenever reported but rather these measures tend to represent how management wants their performance to be viewed by investors and there are many cases where these measures are actually presented in a biased fashion and with a distortion of a business model's economic reality. We do not disagree that there is need for standard setters to define performance within the conceptual framework and to consider how performance is represented within the financial statements under the financial statement presentation project. However, we anticipate that even such clarity and enhanced financial statement presentation is unlikely to eliminate the reporting of non-GAAP measures. Hence, delaying improved reporting of individual income statement line item due to concerns about non-GAAP measures is likely to be a *red-herring* argument.

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[3] We recognize that robust empirical evidence related to IFRS 9 can only be obtained after its adoption. But analogous evidence is the type that would show that earnings quality (i.e. predictive quality) diminishes whenever fair value recognition through profit and loss for assets and not liabilities occurs and that such differential measurement basis for the assets and liabilities is occurring in the context of an asset/liability managed business model. We are not aware of any such evidence.

Thank you again for the opportunity to comment on the assessment paper. If you or your staff have questions or seek further elaboration of our views, please contact either Vincent Papa, PhD, CFA, by phone at +44.207.330.9521, or by e-mail at vincent.papa@cfainstitute.org.

Sincerely,

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