EACB Comments

IASB ED APPLYING IFRS 9 FINANCIAL INSTRUMENTS WITH IFRS 4 INSURANCE CONTRACTS

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Introduction

The members of the EACB welcome the opportunity to comment on the IASB Exposure Draft on applying IFRS 9 financial instruments with IFRS 4 insurance contracts.

Answers to selected questions

Question 1 — Addressing the concerns raised

Paragraphs BC9–BC21 describe the following concerns raised by some interested parties about the different effective dates of IFRS 9 and the new insurance contracts Standard:

(a) Users of financial statements may find it difficult to understand the additional accounting mismatches and temporary volatility that could arise in profit or loss if IFRS 9 is applied before the new insurance contracts Standard (paragraphs BC10–BC16).

(b) Some entities that issue contracts within the scope of IFRS 4 have expressed concerns about having to apply the classification and measurement requirements in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated (paragraph BC17–BC18).

(c) Two sets of major accounting changes in a short period of time could result in significant cost and effort for both preparers and users of financial statements (paragraphs BC19–BC21).

The proposals in this Exposure Draft are designed to address these concerns. Do you agree that the IASB should seek to address these concerns? Why or why not?

Yes, we agree that all these concerns are significant and should be resolved. However, all insurers should be treated equally. IFRS standards should be the same for all entities. The accounting treatment of financial assets should not determine how the insurance business is conducted, i.e. whether in a standalone insurance company or as a part of a financial conglomerate.

Question 2 — Proposing both an overlay approach and a temporary exemption from applying IFRS 9

The IASB proposes to address the concerns described in paragraphs BC9–BC21 by amending IFRS 4:

(a) to permit entities that issue contracts within the scope of IFRS 4 to reclassify from profit or loss to other comprehensive income some of the income or expenses arising from designated financial assets that:

(i) are measured at fair value through profit or loss in their entirety applying IFRS 9 but

(ii) would not have been so measured applying IAS 39 (the 'overlay approach') (see paragraphs BC24–BC25); (b) to provide an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 (the 'temporary exemption from applying IFRS 9') (see paragraphs BC26–BC31).

Do you agree that there should be both an overlay approach and a temporary exemption from applying IFRS 9? Why or why not? If you consider that only one of the proposed amendments is needed, please explain which and why

Ideally, there should be just one approach for all insurers. In our opinion, the temporary exemption would be more suitable, as it resolves the issues related to the misalignment of the different effective dates of IFRS 9 and the new insurance contracts standard and less costly to implement.

Question 3 — The overlay approach

Paragraphs 35A–35F and BC32–BC53 describe the proposed overlay approach.

(a) Paragraphs 35B and BC35–BC43 describe the assets to which the overlay approach can be applied. Do you agree that the assets described (and only those assets) should be eligible for the overlay approach? Why or why not? If not, what do you propose instead and why?

(b) Paragraphs 35C and BC48–BC50 discuss presentation of amounts reclassified from profit or loss to other comprehensive income applying the overlay approach. Do you agree with the proposed approach to presentation? Why or why not? If not, what do you propose instead and why?

(c) Do you have any further comments on the overlay approach?

Our concern with regard to the overlay approach relates to the fact that IFRS 9 will be fully implemented before the effects of the new insurance standard can be fully evaluated. The overlay approach removes the P&L volatility at least to some extent for assets classified to FVPL under IFRS 9. Furthermore, BC18 does not clearly describe the "particular aspects" to reassess the classification that will be included in transition requirements to the new Insurance Contracts Standard. The principles of reclassification should be clarified and the reclassification should be possible especially for equity instruments. Implementing the overlay approach may be too costly as it requires a parallel run of both IAS 39 and IFRS 9 accounting conventions in the IT systems and accounting ledgers.

The temporary exemption from applying IFRS 9 would be more encompassing in resolving the issues related to the misalignment between the effective dates of IFRS 9 and the new insurance contracts Standard. This is because the relevant entities would still be able to apply IAS 39 and IFRS 4 and as a result there would not be additional accounting mismatches in profit or loss, users would not suffer from an unnecessary breach of consistency in financial reporting and any additional cost due to a successive implementation of the two standards would be avoided. In contrast, the overlay approach only provides a solution for the accounting mismatches. The overlay approach does not address the successive implementation (and the related costs) of two accounting standards which for the insurance business are closely related to each other.

Question 4 — The temporary exemption from applying IFRS 9

As described in paragraphs 20A and BC58–BC60 the Exposure Draft proposes that only entities whose predominant activity is issuing contracts within the scope of IFRS 4 can qualify for the temporary exemption from applying IFRS 9.

(a) Do you agree that eligibility for the temporary exemption from applying IFRS 9 should be based on whether the entity's predominant activity is issuing contracts within the scope of IFRS 4? Why or why not? If not, what do you propose instead and why?

As described in paragraphs 20C and BC62–BC66, the Exposure Draft proposes that an entity would determine whether its predominant activity is issuing contracts within the scope of IFRS 4 by comparing the carrying amount of its liabilities arising from contracts within the scope of IFRS 4 with the total carrying amount of its liabilities (including liabilities arising from contracts within the scope of IFRS 4).

(b) Do you agree that an entity should assess its predominant activity in this way? Why or why not? If you believe predominance should be assessed differently, please describe the approach you would propose and why. Paragraphs BC55–BC57 explain the IASB's proposal that an entity would assess the predominant activity of the reporting entity as a whole (ie assessment at the reporting entity level).

(c) Do you agree with the proposal that an entity would assess its predominant activity at the reporting entity level? Why or why not? If not, what do you propose instead and why?

With regard to point (a), we think that the temporary exemption could be concluded by using multiple predominance criteria.

With regard to point (b), we do not agree how the principle of predominant activity is determined by dividing insurance liabilities by total liabilities (including all business lines). IFRS standards are principles based in nature. This temporary exemption and the predominance criteria should also be built on quantitative and qualitative principles. As regards the quantitative criterion to assess the predominance of insurance activities, we consider that it should be based on a widened "predominant activity" criterion, including all liabilities related to insurance activities and not only liabilities resulting from contracts in the scope of IFRS 4 (e.g. debts arising from insurance or reinsurance operations, derivative instrument liabilities, liabilities towards holders of units in consolidated mutual funds, …). As for the qualitative criterion to assess the predominance of insurance activities, we think that, for example, the "regulated entity" criterion as proposed by the EFRAG is relevant, provided that the "regulated entity" encompasses all entities that are exclusively or mainly related to insurance activities, including "insurance holding companies", consolidated funds and servicing entities that are exclusively or mainly related to insurance or reinsurance undertakings.

With regard to point (c), we do not agree. In order to achieve a "level playing field" among insurers, the predominant activity should be assessed below the reporting entity level. We are convinced that insurance activities eligible for the temporary exemption should be identified as follows:

1) Reporting entity level if the group is predominantly involved in insurance activities;

2) Entity or sub-group predominantly involved in insurance activities that is part of a larger group not predominantly involved in insurance activities (e.g. financial conglomerates).

We urge the IASB to extend to groups not predominantly involved in insurance activities (e.g. financial conglomerate) the exemption that is applicable at the entity or sub group level predominantly involved in insurance activities.

In our opinion, the requirement to apply the temporary exemption to all parts of the reporting entity would prohibit possible earnings management. Furthermore, the views presented in Appendix B.B7-B9 do not justify prohibition of the temporary exemption from all insurers. IAS 39 restricts the circumstances to reclassify the financial assets which in our opinion, effectively reduces the concern that transfers of financial instruments between parts of the reporting entity would result in gains and losses from changes in classification and measurement. In addition, insurance business and banking business in a financial conglomerate are generally managed in separate segments, and transfers of financial assets between the business segments/legal entities are very rare. Additionally, any internal gains and losses are eliminated in consolidation.

Question 5 — Should the overlay approach and the temporary exemption from applying IFRS 9 be optional?

As explained in paragraphs BC78–BC81, the Exposure Draft proposes that both the overlay approach and the temporary exemption from applying IFRS 9 would be optional for entities that qualify. Consistently with this approach, paragraphs BC45 and BC76

explain that an entity would be permitted to stop applying those approaches before the new insurance contracts Standard is applied.

(a) Do you agree with the proposal that the overlay approach and the temporary exemption from applying IFRS 9 should be optional? Why or why not?

(b) Do you agree with the proposal to allow entities to stop applying the overlay approach or the temporary exemption from applying IFRS 9 from the beginning of any annual reporting period before the new insurance contracts Standards is applied? Why or why not?

Yes, we agree that both of the approaches should be optional.

Question 6—Expiry date for the temporary exemption from applying IFRS 9

Paragraphs 20A and BC77 propose that the temporary exemption from applying IFRS 9 should expire at the start of annual reporting periods beginning on or after 1 January 2021. Do you agree that the temporary exemption should have an expiry date? Why or why not?

Do you agree with the proposed expiry date of annual reporting periods beginning on or after 1 January 2021? If not, what expiry date would you propose and why?

We do not agree that the temporary exemption should expire at the start of annual reporting periods beginning on or after 1 January 2021. Moreover, we disagree with the IASB that the overlay approach be a remedy in case the new insurance contracts standard would not be finalised on time. As already explained implementing the overlay approach generates additional costs and does not resolve all the issues related the misalignment of the effective date of IFRS 9 and the new insurance contracts standard.

We strongly believe that the temporary exemption should be available until the start of the effective date of the new insurance contracts standard.

Investment in associates and joint ventures (IAS 28)

It seems from the ED that insurance company may continue to apply IAS 39 for IFRS-reporting e.g. in 2018. This could create difficulties for a bank which has significant influence in an Insurance Company that would not apply IFRS 9 as of 1 January 2018.

In fact, in order to fulfil the requirements of IAS 28 the bank holding such participation in an Insurance Company under the current framework of IAS 28 would have to require from his equity investee that they provide IFRS 9 figures for the purpose of "at-equity" accounting, regardless of the fact that such an insurance company for their own IFRS-reporting may have decided to continue with IAS 39 application.

In this case, as a consequence the respective Insurance company would have to report under both IAS 39 for its own Financial Statements and IFRS 9 for its investor's purpose. Similarly to what indicated above this would generate undue complications additional costs and would not resolve all the issues related to the misalignment of the effective date of IFRS 9 and the new insurance contracts standard.

Such additional workload could be avoided if an exemption on equity investments in insurance companies is provided accordingly within IAS 28. This could be done in a way that the already prepared IAS 39-figures of the insurance company may be taken for the purpose of 'at-equity-accounting' in the IFRS 9-based-financial statement of the holder of such the participation, as long as foreseen in the exemption rule.