Mr Hans Hoogervorst
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30 Cannon Street
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United Kingdom

20 January 2016

Comments on IASB Exposure Draft on Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts ("Exposure Draft")

Dear Mr Hoogervorst,

This letter is from the European Insurance CFO Forum ("CFO Forum"), a body representing the views of 21 of Europe's largest insurance companies and Insurance Europe, which is the European (re)insurance federation whose members are the national insurance associations in 34 countries, representing 95% of the premium income of the European insurance market.

We appreciate the IASB's acknowledgement in the current and previous Exposure Drafts of the significant issues faced by insurers due to the misalignment of the effective dates for IFRS 9 and the future standard for insurance contracts ("IFRS 4 Phase 2"). The CFO Forum and Insurance Europe have repeatedly stressed the need to resolve this misalignment for the following reasons:

- Adopting IFRS 9 before IFRS 4 Phase 2 will result in additional accounting mismatches.
- If IFRS 9 were to be implemented before IFRS 4 Phase 2, the classification must be reassessed with IFRS 4 Phase 2, effectively resulting in a dual implementation of IFRS 9. This adds significant costs and confusion without any tangible benefits.
- Both IFRS4 and IFRS9 are significant to insurers. Misalignment in implementing these changes will give rise to volatility in profit or loss and equity without economic substance.

We believe that the proposed Overlay Approach would not resolve all of the key issues related to the misalignment of dates and would result in an approach for which the costs significantly exceed the benefits. None of the CFO Forum members envisage using the Overlay Approach option. Furthermore, Insurance Europe is currently only aware of fewer than 5 other companies who prefer to use the Overlay approach; these companies are conglomerates with predominant banking activities that are based in the Belgian and Finnish jurisdictions.

We believe that a deferral of IFRS 9 for insurers continues to be the only effective method to address all the key issues related to the misalignment of dates. For this reason, the Temporary Exemption from applying IFRS 9 ("Temporary Exemption") must be available to all insurers and not only the subset of insurers that would be eligible under the Exposure Draft. In particular, a level playing field can only be achieved using the Temporary Exemption for insurers with an appropriate scope of application.

The CFO Forum survey that was shared earlier with the IASB (extract included in Appendix B) demonstrates that under the current proposals a significant proportion of the CFO Forum members would be expected not to qualify for the Temporary Exemption when IFRS 9 becomes effective in 2018. As these CFO Forum members represent major insurance companies (in some cases companies designated as Globally Systemically Important Insurers by the Financial Stability Board would not meet the criteria), it would be difficult for users to understand why these insurers could not qualify as an insurance company for this Temporary Exemption. Furthermore, most of the large insurers owned by banks would not qualify for the Temporary Exemption under the Exposure Draft. Therefore the qualifying criteria for the Temporary Exemption must be revised to address these issues.

The Overlay Approach

The Overlay Approach does not address all our key concerns. In particular, it would require insurers to apply IFRS 9 in 2018 in isolation, ahead of implementation of IFRS 4 Phase 2. Therefore, this approach will still result in multiple significant changes in a short period of time and the need to effectively implement IFRS 9 twice (once in 2018 and once when IFRS 4 Phase 2 is implemented). This dual implementation would be confusing to users. Implementing the Overlay Approach would result in significant incremental operational efforts and costs that would outweigh the limited benefits. In addition, the Overlay Approach does not resolve the issue of artificial volatility in shareholders' equity.

We are not opposed to retaining the Overlay Approach as an option in addition to the Temporary Exemption. However, as a result of the serious limitations of the Overlay Approach, our responses to the Exposure Draft are focused on the Temporary Exemption which, if applied appropriately, can address the key issues related to the misalignment of dates for all insurers.

The Temporary Exemption

The primary financial reporting objective of insurers is to provide meaningful and understandable financial information both internally and to the users of our financial statements. We equally believe it is important that there is a level playing field for financial information within the insurance industry. The Temporary Exemption option is the only solution that will provide both meaningful and understandable information while maintaining a level playing field within the insurance industry.

Therefore, we strongly support the Temporary Exemption, provided that its scope is appropriately defined. This is not achieved by the proposals in the Exposure Draft. Whilst we support a principle of "predominant insurance activities" for the scope of the Temporary Exemption, predominance cannot be simplistically defined using only a rigid quantitative test as proposed in the Exposure Draft. Such an approach will lead to inappropriately excluding many insurance entities from the scope of the Temporary Exemption.

We believe that predominance should be determined based on principles reflecting a range of qualitative and quantitative factors, including the application of regulation to insurers, which would permit insurance entities to be able to apply the Temporary Exemption. Utilising a principles-based predominance criterion would be consistent with the principles-based nature of IFRS and would accommodate the different balance sheets of insurers around the globe. There should be a presumption that a regulated insurance entity/(sub)group is engaged in predominantly insurance activities. This assessment should be done first at a group level. If needed, it could then be performed again at the next level down (sub-group/entity level). Quantitative indicators may be helpful for illustrative purposes, but should not be the key determining factor. Where quantitative examples are used, these should appropriately include all liabilities related to insurance activities, and should not be limited to liabilities in the scope of IFRS 4. Equally it should not include an arbitrary (de facto) bright line.

We support the IASB's proposed application of a predominance assessment at the reporting entity level for insurance groups. However, a specific solution is also needed to ensure that insurers that are part of a conglomerate (e.g. bancassurers) are able to elect to defer IFRS 9 until IFRS 4 Phase 2 is implemented. We believe that comparing "insurer to insurer" is more important and meaningful than comparing assets related to insurance activities with assets relating to non-insurance (e.g. banking) activities within a conglomerate. As such, whether an insurer operates standalone or is part of a conglomerate should not impact the ability to apply the Temporary Exemption. Applying the Temporary Exemption at the level of the insurance operations within the conglomerate and then permitting this Temporary Exemption to roll-up into group reporting will be crucial to address this conglomerate issue.

Conclusion

For the reasons discussed above, we conclude that the Temporary Exemption is the only pragmatic solution that provides meaningful information to users, can be implemented without excessive cost and which avoids accounting mismatches that would create volatility in the income statement and shareholder equity. However, we strongly believe that the proposals in the Exposure Draft must be amended to ensure that the Temporary Exemption is not limited to only a subset of insurers and includes all insurance groups regardless of their group structure.

We have included in Appendix A our detailed responses to the questions raised in the Exposure Draft including our concerns for first-time adopters, who face similar significant issues as entities that already apply IFRS and would not qualify for the Temporary Exemption under the Exposure Draft (see our response to Question 5 for further information). A copy of our letter to EFRAG has been included in Appendix C for your information.

Yours sincerely,

Nic Nicandrou
Chair
European Insurance CFO Forum

Olav Jones
Deputy Director General
Insurance Europe

Appendix A

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?

Joint Response to Question 1:

Yes, we strongly agree that the IASB should address these very significant concerns.

Our previous correspondence with you not only highlighted the above three concerns but also noted others such as:

- Two major accounting changes in a short period of time noted in item (c) above would not only result in the significant costs and effort but could also confuse users of the financial statements and undermine their confidence in the financial statements.
- Applying the more fair value oriented IFRS 9 without the corresponding current value accounting for liabilities under IFRS 4 Phase 2 will result in misleading financial reporting, even if the net P&L impact is reversed (the Overlay Approach would only mitigate some of the net income statement impact but not the impact on equity).

Question 2 – Proposing both an overlay approach and a temporary exemption from 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.

Joint Response to Question 2:

We believe that the Exposure Draft's proposed Overlay Approach would not resolve the key issues related to the misalignment of dates and would result in an approach for which the costs significantly exceed the benefits. None of the CFO Forum members envisage using the Overlay Approach option. Furthermore, Insurance Europe is currently only aware of fewer than 5 other companies who prefer to use the Overlay approach; these companies are conglomerates with predominant banking activities who are based in the Belgian and Finnish jurisdictions.

The Overlay Approach will still result in multiple significant changes in a short period of time and the need to effectively implement IFRS 9 twice (once in 2018 and once when IFRS 4 Phase 2 is implemented). Therefore, it will be confusing to users. Implementing the Overlay Approach would result in significant incremental operational efforts and costs that would outweigh the limited benefits. In addition the Overlay Approach does not resolve the issue of artificial volatility in shareholders' equity.

As a result, we believe that a deferral of IFRS 9 for insurers continues to be the only effective method to address all the key issues related to the misalignment of dates. For this reason, the Temporary Exemption option must be available to all insurers which engage predominantly in insurance activities and not the subset of insurers that would be eligible under the Exposure Draft. In particular, a level playing field can only be achieved using the Temporary Exemption for insurers with an appropriate scope.

As such, we strongly believe that the Temporary Exemption should not be limited to a subset of insurers. However, we are not opposed to retaining the Overlay Approach as an option in addition to the Temporary Exemption.

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?

Joint Response to Question 3:

The Overlay Approach does not address all our key concerns. This approach will still result in multiple significant changes in a short period of time and the need to effectively implement IFRS 9 twice (once in 2018 and once when IFRS 4 Phase 2 is implemented). This dual implementation would be confusing to users. Implementing the Overlay Approach would result in significant incremental operational efforts and costs that would outweigh the limited benefits. In addition the Overlay Approach does not resolve the issue of artificial volatility in shareholders' equity.

None of the CFO Forum members envisage using the Overlay Approach option. Furthermore, Insurance Europe is currently only aware of fewer than 5 other companies who prefer to use the Overlay approach; these companies are conglomerates with predominant banking activities who are based in the Belgian and Finnish jurisdictions.
As the Overlay Approach does not address all our key concerns, we have not commented on the details of this approach.

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 (i.e. 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?**

Joint Response to Question 4:

(a) We believe the eligibility for the Temporary Exemption should be revised. Whilst we support a principle of "predominant insurance activities" for the scope of the Temporary Exemption, predominance cannot be simplistically defined solely based on insurance contract liabilities within the scope of IFRS 4. Such an approach will lead to excluding many insurance entities from the scope of the Temporary Exemption.

The CFO Forum survey that was shared earlier with the IASB demonstrates that under the current proposals a significant proportion of the CFO Forum members would not qualify for the Temporary Exemption when IFRS 9 becomes effective in 2018 (see Appendix B). As these CFO Forum members represent major insurance companies (in some cases companies designated as Globally Systemically Important Insurers by the Financial Stability Board would not meet the criteria), it would be difficult for users to understand why these insurers could not qualify as an insurance company for this Temporary Exemption. Therefore, in order to create a meaningful scope, the qualifying criteria for the Temporary Exemption must be revised.

(b) No, we disagree. We believe that predominance should be determined based on principles reflecting a range of qualitative and quantitative factors. There should be a presumption that a regulated insurance entity/(sub)group is engaged in predominantly insurance activities. This assessment should be done first at a group level. If needed, it could then be performed again at a lower level(s) (sub-group/entity level).

Utilising a principles-based predominance criterion would be consistent with the principles-based nature of IFRS and would accommodate the different balance sheets of insurers around the globe.

While we support the principle of predominant insurance activities, we are very concerned with the limited and arbitrary fashion in which the Exposure Draft proposes to apply the predominance principle. Predominance cannot be simplistically defined using only a rigid quantitative test of "IFRS 4 insurance liabilities as a percentage of total liabilities". Using only a formula to make this assessment will lead to excluding many insurance entities from the scope of the Temporary Exemption.

A predominance test based on IFRS 4 insurance liabilities as a percentage of total liabilities excludes several liability balances even if these are clearly related to insurance activities, such as derivative liabilities (which hedge insurance activities), non-controlling interest in consolidated investment

funds (which are classified under IFRS as liabilities), funding liabilities, investment contract liabilities (e.g. unit linked contracts) carried at fair value through profit and loss and other insurance related liabilities (for example payables arising from insurance/reinsurance operations and policyholder payables). Specifically for investment contracts which are accounted for at fair value through profit or loss and derivatives at fair value through profit or loss, the accounting under IFRS 9 would not be different from IAS 39; therefore, these items should not impact the outcome of the predominance test. Any examples used to illustrate the predominance principle should adequately reflect these liability components. On top of this, the IFRS 4 insurance liabilities may not be a good indicator of the size of insurance activities. For example, P&C and certain life-protection business may have relatively small insurance liabilities but represent a much larger portion of the entity's activities. The above illustrates the significant shortcomings of a simplistic formula and the limitations of an arbitrary (de facto) bright line.

In addition, using such a principles-based approach may also help to deal with some application issues such as the timing of the assessment and which entities within the group would qualify for the Temporary Exemption. If the assessment is to be performed on 1 January 2018 only then an entity that may currently meet the quantitative Temporary Exemption requirements as defined in the Exposure Draft may find that it does not meet those requirements on 1 January 2018 due to normal fluctuations in its business/market conditions. If that entity would then not be allowed to utilise the Temporary Exemption, it would not have sufficient time to appropriately implement IFRS 9 before its annual or even interim reporting is due. Therefore, any requirement to implement IFRS 9 must be known years in advance of when an entity must report under IFRS 9.

Given the temporary nature of the Temporary Exemption, we believe that reassessments are unnecessary or should only occur under exceptional circumstances.

(c) We support the IASB's proposed application of a predominance assessment at the reporting entity level for insurance groups. However, a specific solution is also needed to ensure that insurers that are part of a conglomerate (e.g. bancassurers) are able to elect to defer IFRS 9 until IFRS 4 Phase 2 is implemented.

We believe that comparing "insurer to insurer" is more important and meaningful than comparing assets related to insurance activities with assets relating to non-insurance (e.g. banking) activities within a conglomerate. As such, whether an insurer operates standalone or is part of a conglomerate should not impact the ability to apply the Temporary Exemption. Applying the Temporary Exemption at the level of the insurance operations within the conglomerate and then permitting this Temporary Exemption to roll-up into group reporting will be crucial to address this conglomerate issue.

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?

Joint Response to Question 5:

(a) We agree that the Overlay Approach and the Temporary Exemption from applying IFRS 9 should be optional. We believe that the Exposure Draft's proposed Overlay Approach would not resolve the key issues related to the misalignment of dates and would result in an approach for which the costs significantly exceed the benefits. None of the CFO Forum members envisage using the Overlay Approach option. Furthermore, Insurance Europe is currently only aware of fewer than 5 other companies who prefer to use the Overlay approach; these companies are conglomerates with predominant banking activities who are based in the Belgian and Finnish jurisdictions.
While we agree with the optional nature of applying the Temporary Exemption, we are concerned that first time adopters of IFRS will not be permitted to apply the Temporary Exemption. We believe that a first-time adopter such as described in paragraph 3(c) of IFRS 1 (prepared a reporting package in accordance with IFRSs for consolidation purposes without preparing a complete set of financial statements as defined in IFRS 1) should be able to elect to apply either the Temporary Exemption or the Overlay Approach. We do not see any principles that would support excluding first-time adopters from applying the Temporary Exemption. Even if those entities do not publish their financial statements in accordance with IFRS, they may already have IFRS reporting systems in place (for example, a subsidiary that reports externally on local GAAP, but internally on IFRS to its parent). Therefore, we believe that the Temporary Exemption should be extended to first-time adopters to ensure a principles-based approach and prevent additional costs and duplication of procedures.

(b) We agree with the proposal to allow entities to stop applying the Overlay or Temporary Exemption from the beginning of any annual reporting period before the new insurance contracts Standards is applied.

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?

Joint Response to Question 6:

We appreciate the IASB's acknowledgement of the significant issues faced by insurers due to the misalignment of the effective dates for IFRS 9 and IFRS 4 Phase 2. As such, we believe that when this misalignment issue is resolved with the effective date for IFRS 4 Phase 2 then the Temporary Exemption from applying IFRS 9 should be terminated.

Appendix B –CFO Forum Survey Results[1]

In percentage of total liabilities	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Amount of insurance contract liabilities	75%	72%	73%	83%	56%	81%	65%	88%	49%	19%	75%	39%	41%	81%	84%	14%	69%	60%	84%	50%
Amount of investment contract with DPF liabilities accounted for under IFRS 4	7%	6%	11%	0%	14%	0%	15%	0%	42%	8%	7%	33%	25%	0%	0%	2%	2%	21%	0%	10%
Amount of investment contract liabilities accounted for under IAS 39 at FVPL	5%	5%	6%	0%	9%	2%	1%	0%	2%	44%	2%	16%	18%	0%	0%	73%	17%	3%	0%	19%
Funding liabilities	1%	1%	1%	1%	4%	6%	1%	4%	1%	1%	2%	5%	3%	7%	2%	1%	3%	3%	3%	21%
Insurance related derivatives liabilities	1%	0%	1%	0%	6%	2%	0%	0%	2%	0%	0%	0%	1%	0%	0%	1%	0%	0%	0%	0%
Non-controlling interest in consolidated funds classified as liabilities, not equity	0%	1%	2%	0%	1%	0%	0%	0%	0%	8%	0%	0%	3%	2%	0%	4%	0%	0%	0%	0%
Sum of above	89%	85%	94%	84%	89%	91%	83%	92%	95%	80%	86%	93%	92%	91%	86%	96%	91%	87%	87%	99%
All other liability balances not included above	11%	15%	6%	16%	11%	9%	17%	8%	5%	20%	14%	7%	8%	9%	14%	4%	9%	13%	13%	1%
Total liabilities per 2014 annual report	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

[1] Insurance operations of CFO Forum members reporting under IFRS. For conglomerates, these insurance operation figures have been extracted from their consolidated conglomerate figures. For these conglomerates, their insurance operations meet the proposed Exposure Draft predominance threshold but not at the conglomerate level.

Appendix C – Joint CFO Forum Insurance Europe letter to EFRAG