

Exposure Draft ED/2015/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed Amendments to IFRS 4)

EFRAG's Feedback Statement

March 2016

Summary of contents

EFRAG’s Feedback Statement.....	1
Introduction	2
Objective of this feedback statement	2
Background to the ED.....	2
EFRAG’s draft comment letter	3
Comments received from constituents	3
EFRAG’s final comment letter.....	4
Detailed analysis of issues, comments received and changes made to EFRAG’s final comment letter	6
Addressing the concerns raised.....	6
Proposing both an overlay approach and a temporary exemption from applying IFRS 9.....	7
The overlay approach – applicability and eligibility.....	8
The overlay approach – Presentation	10
The temporary exemption from applying IFRS 9.....	11
Should the overlay approach and the temporary exemption from applying IFRS 9 be optional?	16
Expiry date.....	17
Applicability for first-time adopters	18
APPENDIX 1: List of constituents.....	19
APPENDIX 2: Summary - constituents by country and by type.....	20

Introduction

Objective of this feedback statement

EFRAG published its draft comment letter on the Exposure Draft ED/2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed Amendments to IFRS 4)* (‘the ED’) on 24 December 2015. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG’s final comment letter.

Background to the ED

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments*. IFRS 9 sets out the requirements for recognising and measuring financial instruments. It replaces IAS 39 *Financial Instruments: Recognition and Measurement* and has an effective date of 1 January 2018 with earlier application permitted.

The IASB is also at an advanced stage in its project to replace IFRS 4 *Insurance Contracts*. However, the IASB is proposing to allow an implementation period of approximately three years after the publication of a new insurance contracts Standard. Hence, the earliest possible mandatory effective date of the new insurance contracts Standard will be after the effective date of IFRS 9.

Some interested parties, in particular insurers and their representative bodies, suggested that the IASB should permit insurers to defer the application of IFRS 9 in order to align the effective date of IFRS 9 with the effective date of the new insurance contracts Standard.

In order to resolve the problems related to the misalignment of the above implementation dates, the IASB tentatively decided upon two alternative solutions: the temporary exemption from applying IFRS 9 and the overlay approach (together the “proposals”). To effect this

decision, on 9 December 2015, the IASB issued the ED. Further details are available on the EFRAG [website](#).

EFRAG's draft comment letter

EFRAG published a [draft comment letter](#) on the proposals on 24 December 2015.

EFRAG assessed both options in the ED – using the temporary exemption from applying IFRS 9 and the overlay approach – as being useful and recommended that they should both be further pursued. Nevertheless, EFRAG noted that the temporary exemption from applying IFRS 9 addressed all concerns related to the misalignment of the implementation dates of IFRS 9 and the new insurance contracts Standard. In contrast, the overlay approach only helped to neutralise the additional accounting mismatches arising from the implementation of IFRS 9 before the effectiveness of the new insurance contracts Standard.

EFRAG further considered that in order to achieve a level playing field among insurers, the temporary exemption from applying IFRS 9 should be made available for all insurers that issue a material amount of insurance contracts within the scope of IFRS 4. In addition, EFRAG considered that the temporary exemption from applying IFRS 9 should not be applied to material banking activities.

As a consequence of the above, EFRAG concluded that the temporary exemption from applying IFRS 9 should be available both at and below the reporting entity level.

In defining the scope, EFRAG considered two possible alternatives (i) a widened predominant activity criterion set at a higher level than proposed by the IASB and (ii) a regulated entity criterion. Based on input from constituents, EFRAG would propose one of the two alternatives to the IASB.

EFRAG agreed with the use of a sunset clause but noted that the overlay approach should not be regarded as a solution to a possible delay in the finalisation of the new insurance contracts Standard.

Finally, EFRAG did not support the proposed consequential amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* that would prohibit all first-time adopters from applying the temporary exemption from IFRS 9.

Comments received from constituents

Twenty comment letters were received from constituents and considered by EFRAG in its discussions. These comment letters are available on the EFRAG [website](#).

The comment letters received came from preparer organisations, preparers, national standard setters, a user organisation, an audit organisation and a regulator.

Temporary exemption from applying IFRS 9

While no constituent opposed the temporary exemption from applying IFRS 9, fourteen constituents agreed that it should be available for all insurance activities in order not to exclude insurance activities within a financial conglomerate or to avoid artificial distinction between insurers that are able to apply the temporary exemption from applying IFRS 9 and those that do not even when the latter ones are generally recognised as insurers by the financial markets, the regulator or the public in general.

Seventeen constituents found the predominance criterion as proposed by the IASB inappropriate or proposed to widen its definition in order to make the temporary exemption from applying IFRS 9 more widely applicable to insurers. Nine of these constituents preferred a principle-based approach without introducing a bright line in defining the scope.

Eleven constituents believed that the regulated entity criterion should be the main or at least one of the driver(s) to identify insurance entities eligible for the temporary exemption from applying IFRS 9. This was because, when being regulated, insurers should not be required to provide additional artificial quantitative information to prove that they are insurers. Also the regulated entity criterion was

seen as an alternative for the predominance criterion or as a supplementary indicator.

Fifteen constituents preferred an application either at both reporting entity level and below reporting entity level or below reporting entity level only in order to allow insurers which are part of a financial conglomerate to use the temporary exemption from applying IFRS 9. It was noted that on a segment level, the insurance activities of financial conglomerates were benchmarked against other insurance companies. In addition, the insurance business model which relied on asset and liability management was significantly different from other activities. Applying two different financial reporting standards at consolidated level could be done by rolling up the accounting from the lower levels. Finally, the breach in uniformity of accounting policies was seen as a necessary solution to address exceptional circumstances which needed a practical solution.

Overlay approach

Three constituents were not in favour of the overlay approach or suggested that it should not be retained. This was because the overlay approach was seen as an accounting policy choice for each individual instrument, hence failing to provide comparable financial statements with regards to insurance activities between entities. Entities also would have to provide financial analysts with two types of results which would be difficult to understand. The overlay approach would not remove the need for successive changes to the accounting not did it address the volatility in equity. Lastly, it was considered operationally complex and costly to implement.

Sixteen constituents did not oppose the overlay approach or were in favour of retaining both the overlay approach and the temporary exemption from applying IFRS 9. The reason was that it could be an appropriate solution for some entities. One constituent noted its intention to use the overlay approach.

Sunset clause

Eight constituents agreed with the expiry date of 1 January 2021 because of the expectation of the insurance project being finalised by the IASB as scheduled.

In contrast, seven constituents indicated that the temporary exemption from applying IFRS 9 should be available up until the new insurance contracts Standard is effective. Reasons mentioned were: the fear that the new insurance contracts Standard would not be available in time or that the temporary exemption from applying IFRS 9 was necessary as long as the new insurance contracts Standard was not available.

Nine constituents agreed with the view in the EFRAG draft comment letter that the overlay approach should not be regarded as a solution if the new insurance contracts Standard is delayed.

First-time adopters

The six constituents that commented on this issue agreed with the view in the EFRAG draft comment letter.

EFRAG's final comment letter

Temporary exemption from applying IFRS 9

EFRAG was convinced by the arguments that supported the regulated entity criterion playing a role in determining the eligibility for the temporary exemption from applying IFRS 9 and proposed it as one of the approaches, in addition to the widened predominant activity criterion, in order to have as level a playing field as possible.

The widened predominant activity criterion was re-assessed to have the same numerator as the ED. In addition, the denominator excluded asset management activities accounted for at fair value through profit or loss under both IAS 39 and IFRS 9 and also excluded those liabilities insofar as they are related to the management of insurance and investment contracts.

Overlay approach

EFRAG agreed with the majority of constituents that did not oppose the overlay approach as it could be an appropriate approach for some entities. In EFRAG's final comment letter, conditions were specified according to which entities might decide the overlay approach was a good approach for them.

Sunset clause

EFRAG largely agreed with the constituents' comments but changed its original wording as it could be misread as a plea for an open ended deferral of IFRS 9. Instead, the final comment letter describes the messages better. These messages are that the IASB should finalise the new insurance contracts Standard urgently, and the overlay approach is not to be seen as a backstop in case the Standard is not mandatorily effective by 2021.

More details about the reasons how EFRAG considered the comments received can be found in the answers to the detailed questions below.

First-time adopters

EFRAG retained its proposal on the basis of the support from those constituents that commented.

Detailed analysis of issues, comments received and changes made to EFRAG’s final comment letter

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Addressing the concerns raised

Proposals in the ED

The misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard had raised the following concerns:

- (a) Users may find it difficult to understand the additional accounting mismatches and resulting volatility in profit or loss;
- (b) Having to apply the classification and measurement requirements of IFRS 9 before the new insurance contracts Standard can be fully evaluated may be difficult for preparers; and
- (c) Two sets of major accounting changes in a short period of time could result in significant cost and effort for both users and preparers of financial statements.

EFRAG’s tentative position

EFRAG appreciated that the IASB has considered the difficulties caused by the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard. These difficulties relate to creating accounting mismatches in profit or loss, problems of understanding these by users and the additional costs of implementation. EFRAG also noted that, based on previous outreach, a majority of insurance analysts supported applying the new insurance contracts Standard and IFRS 9 at the same time.

Constituents’ comments on IASB’s questions

Seven constituents agreed with EFRAG’s position. One of these constituents added that group-wide uniform accounting policies are not as important as a level playing field within the insurance industry. Another of these constituents asked for clarity of the decision urgently. Another of these constituents asked for an international solution to address the misalignment.

While not in favour of delaying the implementation of IFRS 9, one constituent could agree with a temporary exemption from applying IFRS 9 for insurers.

One constituent noted that an extended use of shadow accounting was not an appropriate solution. In addition, they noted that implementing IFRS 9 and the new insurance contracts Standard consecutively would confuse users.

One constituent noted that users work on historical data and any change in accounting rules implied reclassification of the historical data. Hence they favoured the application of IFRS 9 and the new insurance contracts Standard at the same time.

One constituent remained unconvinced that the difficulties caused by the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard were insurmountable. Nevertheless, that constituent accepted that the IASB needed to provide a temporary solution to address the concerns raised.

EFRAG’s response to constituents’ comments

EFRAG final position

EFRAG considered the comments received and maintained its concerns about the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard.

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

Proposals in the ED

The ED proposed two solutions, an overlay approach and a temporary exemption from applying IFRS 9. The overlay approach would permit entities to adjust pre-tax profit or loss to offset the effect of financial assets that would be measured at fair value through profit or loss under IFRS 9 but would not have been measured this way in accordance with IAS 39. In addition, a temporary exemption from applying IFRS 9 was proposed for those insurers which predominantly issued insurance contracts within the scope of IFRS 4.

EFRAG's tentative position

EFRAG supported both the overlay approach and the temporary exemption from applying IFRS 9 as complementary approaches depending on their circumstances.

Constituents' comments on IASB's questions

Twelve constituents agreed with EFRAG's position. One of these constituents thought that the overlay approach was not a valid alternative for the temporary exemption from applying IFRS 9 approach but did not oppose the overlay approach. Two of these constituents had a strong preference for the temporary exemption from applying IFRS 9 approach.

One constituent supported the temporary exemption from applying IFRS 9 but it did not support the overlay approach. One constituent noted that the overlay approach was their preferred solution and other financial conglomerates in the same jurisdiction also supported the overlay approach. Another constituent noted that both the overlay approach and the temporary exemption from applying IFRS 9 would be applied by insurance entities.

Four constituents noted their intention to use the temporary exemption from applying IFRS 9. If they would not qualify for the temporary exemption from applying IFRS 9, they would not choose to apply the overlay approach as this was considered to be too costly.

One constituent saw the overlay approach and the temporary exemption from applying IFRS 9 as complementary approaches. The former was seen as a suitable solution for financial conglomerates with significant banking activities. In this constituent's view, the latter should only be available to a narrow group of entities for whom the risk of non-application of IFRS 9 was lower (due to not having significant lending activities) and for which the risk of earnings management was low.

Constituents' comments on EFRAG's question

Constituents' comments relating to their intentions to use either the overlay approach or the temporary exemption from applying IFRS 9 have been explained in detail in the sections below.

EFRAG's response to constituents' comments

EFRAG final position

EFRAG considered the comments received. EFRAG continued to support both the overlay approach and the temporary exemption from applying IFRS 9 as complementary approaches because of the existence of diverse situations which required different solutions.

The overlay approach – applicability and eligibility

Proposals in the ED

The ED proposed that:

A reporting entity should be permitted to make an adjustment in respect of financial assets that meet both of the following criteria:

- The financial assets are designated as relating to contracts that are within the scope of IFRS 4; and
- The financial assets are classified as fair value through profit or loss in accordance with IFRS 9 and would not have been classified as fair value through profit or loss in their entirety in accordance with IAS 39.

In making the adjustment, an entity should be permitted to designate any or all financial assets that relate to contracts within the scope of IFRS 4 (and only those financial assets) and disclose their policies for selecting such financial assets.

EFRAG's tentative position

EFRAG considered that the ED correctly identified the financial assets that should be eligible for the overlay approach. However, EFRAG considered that the eligibility criteria for the overlay approach should be enhanced including detailed examples that would assist entities in interpreting the criteria.

Constituents' comments on IASB's questions relating to eligibility

Three constituents indicated their preference for the IASB eligibility criteria with respect to the overlay approach without recommending any enhancement.

Three constituents indicated their preference for the ED being enhanced with detailed examples.

Fourteen constituents did not give an answer to this specific question.

Constituents' comments on IASB's questions relating to applicability

All but three constituents were in favour of the inclusion of the overlay approach in the ED.

Four constituents indicated that they did not intend to use the overlay approach under any circumstances.

One constituent indicated its intention to use the overlay approach.

Five constituents indicated that they were not aware of any entity that intended to use the overlay approach whereas three constituents indicated that they were aware of entities that might use the overlay approach.

Seven constituents did not answer this question.

Constituents' comments on EFRAG's questions relating to applicability and eligibility

EFRAG asked questions to constituents relating to the costs associated with the application of the overlay approach. The constituents' feedback was as follows:

Six constituents responded that they agreed with the description of the extra costs identified in paragraph 36 of EFRAG's draft comment letter.

Seven constituents responded that there were other reasons why an insurer would not elect to apply the overlay approach. The main reasons presented were the complexity of running two systems in parallel, the additional volatility in equity that the overlay approach would bring, the difficulty to explain to users and the lack of comparability.

Two constituents responded that they did not consider such extra costs to be so significant. One of those constituents agreed with some of the extra costs but for them the advantages of the overlay approach largely outweighed those supplementary costs. They did not consider that these extra costs would limit the applicability of the

overlay approach. They estimated the extra costs to increase the total IFRS 9 implementation costs by less than 1%.

The other constituent indicated that the additional costs for running both systems in parallel were considered to be acceptable. This constituent indicated that they concurred with paragraph BC25 of the ED that indicates that the advantages of the overlay approach outweighed the supplementary costs and disadvantages related to it.

EFRAG's response to constituents' comments

EFRAG final position on eligibility

EFRAG considered the comments received and maintained its initial position supporting the eligibility criteria for the overlay approach. That draft position already suggested the inclusion of detailed examples to achieve a better understanding of the overlay approach.

EFRAG final position on applicability

EFRAG considered the comments received that only few companies intended to use the overlay approach. Yet one constituent explained in detail the reasons why the overlay approach was a good approach for them and more broadly for banking conglomerates. EFRAG accepted this reasoning and reflected this in the final comment letter. Considering that a majority of constituents were not opposed to having both the overlay approach and the temporary exemption from applying IFRS 9 as optional approaches, EFRAG confirmed its support for the overlay approach.

Also based on the input mentioned above, EFRAG recommended that paragraph 35 of its draft comment letter be amended to note that, for some banking conglomerates, the costs of the overlay approach were relatively minor compared to the costs of implementing IFRS 9 and the costs were outweighed by the improved information for users of financial statements.

EFRAG also considered the arguments of constituents that did not support the overlay approach and that largely agreed with the costs

related to it, which were listed in EFRAG's draft comment letter. As a result, EFRAG retained its original position.

The overlay approach – Presentation

Proposals in the ED

The ED proposed that entities that apply the overlay approach should present the amount reclassified from profit or loss to other comprehensive income ('OCI') as a separate line item in the statement of profit or loss, OCI or both.

EFRAG's tentative position

Based on the ED, EFRAG understood that an entity that elects to apply the overlay approach would have a number of presentation alternatives including:

- Alternative A where the revenues and expenses related to the eligible financial assets would first be determined in accordance with the measurement criteria of IFRS 9; and
- Alternative B where the revenues and expenses related to the eligible financial assets would first be determined in accordance with the measurement criteria of IAS 39.

EFRAG proposed that all revenues and expenses should be determined in accordance with the measurement criteria in IFRS 9 and an adjustment to eliminate some or all of the volatility arising from eligible assets be transferred from profit or loss to OCI as a one-line adjustment (Alternative A).

Constituents' comments on IASB's questions

Three constituents indicated their preference for the IASB approach, i.e. optionality in presenting the overlay adjustment. One of them suggested not to require a limitation of the presentation alternatives of the overlay approach because it understood that the IASB had already discussed the different alternatives for presentation of the overlay approach. As this approach would be a temporary solution for the misalignment of the effective dates, they would find any of the different alternative presentations as suggested in the ED

acceptable, since comparability is achieved through the required disclosures.

Three constituents indicated their preference for EFRAG's approach. One constituent indicated its preference for reducing flexibility but without showing preferences for Alternative A or B as presented in EFRAG's draft comment letter.

Thirteen constituents did not give an answer to this specific question.

Constituents' comments on EFRAG's questions

EFRAG did not receive additional comments on this question other than the comments detailed above.

EFRAG's response to constituents' comments

EFRAG final position

Although the overlay approach is temporary, EFRAG noted that the overlay approach implies the application of IFRS 9 in full. Taking into consideration this fact, a presentation that was consistent with IFRS 9 was considered preferable. Alternative A aligned the presentation of the statement of profit or loss with the statement of financial position and facilitated cross-industry comparability, therefore EFRAG retained its initial position. Additionally, there were no strong views expressed by constituents against any reduction of flexibility in presentation, especially given the number of constituents who did not answer the question.

The temporary exemption from applying IFRS 9

Proposals in the ED

The ED proposed that only entities whose predominant activity is issuing contracts within the scope of IFRS 4 can qualify for the temporary exemption.

In addition, an entity would determine if it qualifies for the temporary exemption from applying IFRS 9 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).

Furthermore, an entity would assess its predominant activity at the reporting entity level.

Also, initial application for the temporary exemption from applying IFRS 9 should be the beginning of the first annual reporting period beginning on or after 1 January 2018. After initial application of the temporary exemption, an entity should reassess whether insurance activities are predominant if there is a demonstrable change to the entity's corporate structure.

EFRAG's tentative position

EFRAG considered that the temporary exemption from applying IFRS 9 should be available to all entities undertaking insurance activities, in order to avoid breaching the level playing field in the insurance sector. In addition, material banking activities should not be within the scope of the temporary exemption from applying IFRS 9.

To achieve the above objectives, EFRAG considered two alternative approaches, one of which would be finalised and proposed to the IASB (i) a widened predominant activity criterion set at a higher level than proposed by the IASB and (ii) a regulated entity criterion. EFRAG considered that the issuance of material contracts within the

scope of IFRS 4 was a necessary condition for the application of the temporary exemption from applying IFRS 9 for both approaches.

Both of the above approaches could be applied either at or below reporting entity level, i.e. the entity would have the choice to elect the appropriate level.

Also, EFRAG supported the IASB proposals relating to reassessing eligibility for the temporary exemption from applying IFRS 9 if there is a demonstrable change to the entity's corporate structure.

Constituents' comments on IASB's questions

General comments

Fourteen constituents agreed that the temporary exemption from applying IFRS 9 should be available to all insurance entities/activities in order to ensure a level playing.

Furthermore, six constituents agreed that material banking activities should not benefit from the temporary exemption from applying IFRS 9 while the other constituents did not respond to this.

How to apply the temporary exemption from applying IFRS 9

Seventeen constituents did not support the predominance assessment as proposed by the IASB because they indicated that it was too restrictive and the IASB should also address the issues relating to financial conglomerates.

There were mixed views, regarding how to apply the temporary exemption from applying IFRS 9, i.e., whether there should be a widened predominant activity criterion and/or the regulated entity criterion as follows:

- Five constituents supported widening the predominance test only because the IASB's proposals were restrictive and did not include in the numerator of the ratio liabilities that related to insurance activities;

- Two constituents supported the regulated entity criterion only because it was more objective compared to the widened predominant activity criterion which might lead to interpretation;
- Nine constituents supported a principle-based approach or supported applying both criteria to be consistent with the principle-based nature of IFRS and ensure a level playing field in the insurance sector; and
- One constituent supported regulation being supplementary to the IASB's proposal because insurers should not be obliged to provide any artificial quantitative proof if they were insurers in scope of the insurance supervision.

Assessment and application of the temporary exemption from applying IFRS 9 at or below reporting entity level

Eleven constituents indicated that both levels, i.e., at both reporting entity level and below the reporting entity level were necessary to assess predominance. This was because it was necessary to address the issues relating to both pure insurers and financial conglomerates.

Four constituents preferred that the temporary exemption from applying IFRS 9 should be below the reporting entity level because the issues relating to financial conglomerates needed to be addressed so that they could also be eligible for the temporary exemption from applying IFRS 9.

Six constituents preferred to apply the temporary exemption from applying IFRS 9 at reporting entity level. However, four of them could accept below the reporting entity especially for financial conglomerates.

Two constituents supported the temporary exemption from applying IFRS 9 to be at the reporting entity level because this would avoid opportunities for abuse and accounting arbitrage. Also, it would be less costly and complex compared to below the reporting entity level.

Furthermore, application at reporting entity level was seen as a starting point for further consideration or would lead to the parallel use of IFRS 9 and IAS 39 in the consolidated financial reporting.

Reassessment of the temporary exemption from applying IFRS 9

Six constituents did not support the IASB's proposals relating to reassessment as described in the ED because if an entity failed the predominance test, it would not have sufficient time to appropriately implement IFRS 9.

Constituents' comments on EFRAG's questions

The following relate to additional responses from constituents to EFRAG's questions other than what has been stated above. Ten constituents specifically responded to EFRAG's questions relating to the temporary exemption from applying IFRS 9.

The "widened predominant" activity criterion

Two constituents agreed with EFRAG that the threshold should be higher than 75%. In contrast, six constituents did not agree with EFRAG and indicated that the threshold should not be a bright line because they preferred a principle-based approach rather than a rules-based approach.

Four constituents responded that the widened predominant activity criterion was practical, auditable and comparable.

The "regulated entity" criterion

Two constituents indicated that there were differences between the regulatory consolidation scope and the IFRS consolidation scope. Eighteen constituents did not answer this specific question.

Eleven constituents agreed with the regulated entity criterion but not all of them supported it as defined by EFRAG in its draft comment letter. More specifically, from those eleven, three constituents supported EFRAG's position on this and eight constituents were proposing changes to the wording or to the principle, for example,

changes that would allow holding companies and special purpose vehicles or investment funds to be within the scope of the regulated entity criterion.

Two constituents did not agree with the regulated entity criterion mainly because (i) it was being tailored for a specific industry, (ii) it could allow regulated insurance entities, which did not issue a material number of contracts within the scope of IFRS 4, to apply the temporary exemption from applying IFRS 9, (iii) relying on the regulated entity criterion would provide a solution wider than the difficulties caused by the different implementation dates of IFRS 9 and the new insurance contracts Standard, (iv) insurance companies provide activities that are indistinguishable from activities from banks or asset management companies and the temporary exemption from applying IFRS 9 should not apply to these bank activities, (v) insurance regulation was different between jurisdictions which would limit comparability and (vi) the assessment of regulation could only be made on the legal entity level rather than the reporting entity level.

Seven constituents did not provide comments on the regulated entity criterion.

Other comments

Two constituents agreed with EFRAG's proposal in paragraph 85 of its draft comment letter relating to the accounting for transfers.

EFRAG's response to constituents' comments

EFRAG final position

General comments

EFRAG considered the support from the constituents regarding EFRAG's objectives. Given the very different ways in which insurers operate, EFRAG acknowledged that a simple principle-based approach may not lead to a perfect level playing field for insurers. Therefore, as a result of this, EFRAG, in its final comment letter, considered that a playing field within the insurance sector should be maintained as much as possible, whilst acknowledging that a perfect

level playing field will not and cannot be obtained even with EFRAG's proposals.

EFRAG refined the wording to focus on the temporary exemption from applying IFRS 9 to be made available to entities that are significantly impacted by the interaction between IFRS 9 and IFRS 4. This is because EFRAG considered that the link to the concerns raised in the ED should be made more explicit.

With the same concern in mind, EFRAG increased and clarified the threshold to the issuance of a significant amount of insurance contracts within the scope of IFRS 4 instead of the issuance of material insurance contracts within the scope of IFRS 4. This was because EFRAG was of the view that the term material was too low a threshold. Therefore it was increased in order to ensure that the temporary exemption from applying IFRS 9 was only applicable to those entities that are significantly impacted by the misalignment of the effective dates of IFRS 9 and the future insurance contracts Standard.

EFRAG enhanced the wording to clarify that banking activities that are material at the reporting entity level should not be in the scope of the temporary exemption. EFRAG continued to support this objective because IFRS 9 brings significant improvements in financial reporting particularly in the banking sector. Therefore, EFRAG maintained its initial position that material banking activities should not be eligible for the temporary exemption from applying IFRS 9.

In order to achieve a playing field as level as possible within the insurance industry, EFRAG changed its original view to define eligibility for the temporary exemption from applying IFRS 9 on either the widened predominant activity criterion or the regulated entity criterion. In its final comment letter, EFRAG supported both approaches whereby an entity could select either one of them. The reasons for supporting both are indicated below.

In summary, when an insurer issues a significant amount of insurance contracts within IFRS 4, it can subsequently choose to apply either

the widened predominant activity criterion or the regulated entity criterion, which is a two-step approach. EFRAG noted that the exclusion of banking activities that are material at the reporting entity level are implicitly considered in applying the two-step approach described above. As a result, EFRAG considers that once these objectives are met, the insurer would be able to apply the temporary exemption from applying IFRS 9.

Widened predominant activity criterion

EFRAG confirmed its position in favour of a widened predominance test but changed its calculation. In its final letter, EFRAG defined the numerator as liabilities arising from insurance contracts within the scope of IFRS 4. The denominator was defined as total liabilities minus:

- (a) Those asset management activities and hedging instruments accounted for at fair value through profit or loss both under IAS 39 and IFRS 9 because these would not be affected by the change in accounting standards; and
- (b) Liabilities related to the management of insurance and investment contracts.

EFRAG noted that subtraction from the total liabilities instead of addition ensured that material banking activities were taken into account when determining the predominance ratio. Also, it allowed to focus the predominance ratio on the issue at hand – insurance contracts within the scope of IFRS 4 – instead of trying to achieve a particular outcome by adding activities.

Regulated entity criterion

Based on the feedback received from those constituents, EFRAG considered that the regulated entity criterion may provide an approach for those entities that are significantly affected by the interaction of IFRS 9 and IFRS 4 but for which the widened predominant activity criterion was not an appropriate indicator. In addition, entities may find it simpler to apply the regulated entity

criterion instead of the widened predominant activity criterion. Therefore, to ensure a level playing field as much as possible, EFRAG decided to maintain the regulated entity criterion.

EFRAG modified this regulated entity criterion in order to capture relevant components of an insurance group, e.g., holding companies or special purpose vehicles, which are not within the scope of the insurance regulated scope and are essential for the performance of the insurance business. This is because EFRAG considered that the corporate structure in itself does not change the nature of the insurance activities and therefore these entities could apply the temporary exemption from applying IFRS 9.

In particular, under EFRAG's proposals (i) application of the temporary exemption from applying IFRS 9 was subject to issuing a significant amount of insurance contracts within the scope of IFRS 4, (ii) it was recognised that asset management activities were part of an insurance business, (iii) banking activities that were material at reporting entity level were excluded from the temporary exemption from applying IFRS 9, (iv) it was noted that in all material jurisdictions, insurance activities were based on core principles shared by insurance regulators and (v) in identifying the entity within a mixed-group that would apply the temporary exemption from applying IFRS 9, that entity would have to be a reporting entity itself, but including subsidiaries, associates or joint arrangements.

At or below reporting entity level

EFRAG considered the feedback from constituents who supported the temporary exemption from applying IFRS 9 being assessed at the reporting entity level only. However, EFRAG considered that:

- a majority of users contacted during the outreach that EFRAG conducted noted that insurers (and insurer segments within financial conglomerates) were compared with their peers and not across industries. Consequently, the application of two different reporting standards for financial instruments in the consolidated

accounts of mixed groups would not increase the complexity for users in understanding their financial statements;

- opportunities for abuse could be discouraged if the transferred assets followed the origination accounting and if the transferred assets were separately presented in the statements of financial position and comprehensive income; and
- given the temporary nature of the exemption from applying IFRS 9, the breach in the consistent application of accounting principles could be dealt with adequate presentation and disclosures.

Therefore, EFRAG continued to support the temporary exemption from applying IFRS 9 to be applied either at or below reporting entity level as this was aligned with EFRAG's objectives. In particular, in the case of mixed groups, when neither the widened predominance criterion nor the regulated entity criterion were met at the mixed group reporting entity level, the test should be performed below the mixed group reporting entity level. This was done by analysing entities within the mixed group reporting entity starting from the top and moving down to the point when the criterion that has been selected was met by an entity that met the reporting entity definition in accordance with the *Conceptual Framework for Financial Reporting ED*, in a waterfall approach

Reassessment of the temporary exemption from applying IFRS 9

EFRAG was considerate of the concerns from the constituents regarding reassessment as described in the ED because EFRAG acknowledged that implementation of IFRS 9 required more than one year of preparation; a rushed implementation would affect the quality of the resulting accounting data and above-all, the temporary exemption from applying IFRS 9 was a practical expedient and should remain practical as it was a short-term solution.

Therefore, EFRAG changed its initial position and did not support reassessing the eligibility for the temporary exemption from applying

IFRS 9 when there is a demonstrable change to the entity's corporate structure.

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

Proposals in the ED

The ED proposes that the use of both the overlay approach and the temporary exemption from applying IFRS 9 should be permitted but not required for entities that issue contracts within the scope of IFRS 4.

In addition, the ED proposed that an entity can stop using the overlay approach and the temporary exemption from applying IFRS 9 at the beginning of any annual reporting period.

EFRAG's tentative position

EFRAG agreed that both the overlay approach and the temporary exemption from applying IFRS 9 should be optional due to the diversity of circumstances encountered in reporting entities that issue insurance contracts.

EFRAG also agreed that entities should be permitted to stop applying the overlay approach or the temporary exemption from applying IFRS 9 before the effective date of the new insurance contracts Standard because no entity should be prevented from benefiting from the improvements brought by IFRS 9 when its circumstances permit them to do so.

Constituents' comments on IASB's questions

Sixteen constituents indicated that both the overlay approach and the temporary exemption from applying IFRS 9 should be optional.

Two constituents did not support the optionality because it introduced an element of flexibility that would make comparability very difficult.

Two constituents did not respond to the question on optionality.

Nine constituents indicated that they were in favour of permitting entities to stop applying both the overlay approach and the temporary

exemption from applying IFRS 9 at the beginning of any annual reporting period.

Eleven constituents did not give an answer the question on whether entities should be permitted to stop applying the overlay approach or the temporary exemption from applying IFRS 9.

EFRAG's response to constituents' comments

EFRAG final position

EFRAG considered the comments received and decided not to change its initial position due to the diversity of circumstances encountered in reporting entities that issue insurance contracts.

Expiry date

Proposals in the ED

The ED proposes that the temporary exemption from applying IFRS 9 should expire at the start of annual reporting periods beginning on or after 1 January 2021.

EFRAG's tentative position

EFRAG agreed with the expiry date proposed by the IASB or an earlier date because EFRAG expects that the effective date of the new insurance contracts Standard will be no later than 1 January 2021. However, EFRAG disagreed with the IASB that the overlay approach could be used if there would be a possible postponement of the new insurance contracts Standard.

Constituents' comments on IASB's questions

Eight constituents agreed with the expiry date of 1 January 2021 because of the expectation of the insurance project being finalised by the IASB as scheduled.

In contrast, seven constituents indicated that the temporary exemption from applying IFRS 9 should be available up until the new insurance contracts Standard is effective because the misalignment issue between IFRS 9 and the new insurance contracts Standard would be resolved when the new insurance contracts Standard would be effective.

Nine constituents agreed that, the overlay approach should not be regarded as a solution if the new insurance contracts Standard was delayed because it did not address all the concerns arising from applying IFRS 9 with IFRS 4.

EFRAG's response to constituents' comments

EFRAG final position

EFRAG considered the positive feedback from the constituents. EFRAG maintained its initial position because it continued to expect a rapid finalisation of the new insurance contracts Standard. Therefore, EFRAG continued to support the expiry date of 1 January 2021 at the latest.

EFRAG noted that the original wording of its draft comment letter where it stated "*EFRAG disagrees with the IASB that the overlay approach would constitute a possible alternative to the temporary exemption from applying IFRS 9 in case the new insurance contracts Standard would not be finalised in time*" could be misread as a plea for an open ended deferral of IFRS 9. Instead, EFRAG clarified that the new insurance contracts Standard should be finalised urgently and that the existence of the overlay approach should not be regarded as a backstop in case of a possible delay in the finalisation of the new insurance contracts Standard.

Applicability for first-time adopters

Proposals in the ED

This issue was not explicitly addressed, but the ED proposed a consequential amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* that would prohibit first-time adopters of IFRS from applying either the temporary exemption from applying IFRS 9 or the overlay approach.

EFRAG's tentative position

EFRAG did not support this proposal because it would exclude entities that (i) join a group that was applying the temporary exemption from applying IFRS 9 or the overlay approach and where the entity would be required providing a reporting package based on IFRS to the group level; or (ii) was part of a group that adopted the temporary exemption from applying IFRS 9 or the overlay approach but, at the time of adopting the temporary exemption, was a first-time adopter in its own right. EFRAG assessed that such an exemption would lead to subsidiaries within a group being required to apply both IFRS 9 and IAS 39, leading to excessive costs and hence recommended that IFRS 1 permit a first-time adopter to adopt the temporary exemption from applying IFRS 9 or the overlay approach if they were prepared a reporting package in accordance with IFRS for consolidation purposes without preparing a complete set of financial statements (paragraph 3 (c) of IFRS 1). EFRAG agreed that the temporary exemption from applying IFRS 9 or the overlay approach should not be available to other first-time adopters of IFRS.

Constituents comments

Six constituents agreed with EFRAG's comments relating to first-time adoption. Fourteen constituents did not provide any comments to this issue.

EFRAG's response to constituents' comments

EFRAG final position

EFRAG considered the comments from constituents and maintained its initial position.

APPENDIX 1: List of constituents

Table 1: List of constituents

Name of constituent¹	Country	Type / Category
R+V Versicherung AG (R+V)	Germany	Preparer
Danish Insurance Association (DIA)	Denmark	Preparer Organisation
Gesamtverband der Deutschen Versicherungswirtschaft (GDV)	Germany	Preparer Organisation
Swedish Bankers' Association (SBA)	Sweden	Preparer Organisation
Federation of European Accountants (FEE)	Europe	Audit Organisation
European Savings and Retail Banking Group (ESBG)	Europe	Preparer Organisation
KBC	Belgium	Preparer
Assuralia	Belgium	Preparer Organisation
CNP Assurances (CNP)	France	Preparer
Autorité des Normes comptables (ANC)	France	National Standard Setter
Allianz	Germany	Preparer
CFO FORUM and Insurance Europe (CFO FORUM/IE)	Europe	Preparer Organisation
Fédération Française des Sociétés d'Assurances (FFSA)	France	Preparer Organisation
BNP Paribas	France	Preparer
Organismo Italiano di Contabilità (OIC)	Italy	National Standard Setter
AMICE	Europe	Preparer Organisation
Fédération Bancaire Française (FBF)	France	Preparer Organisation
European Federation of Financial Analysts Societies (EFFAS)	Europe	User Organisation
Dutch Accounting Standards Board (DASB)	The Netherlands	National Standard Setter
ESMA	Europe	Regulator

¹ Respondents whose comment letters were considered by the EFRAG Board before finalisation of EFRAG's comment letter.

APPENDIX 2: Summary - constituents by country and by type

Table 2: Total constituents by country and by type

Constituent by country:		Constituent by type:	
Germany	3	National Standard Setter	3
Denmark	1	Audit Organisation	1
Sweden	1	Preparer Organisations	9
Belgium	2	Preparers	5
France	5	User Organisation	1
Italy	1	Regulator	1
The Netherlands	1		
European organisations	6		
	20		20