Mr. Jean-Paul Gauzès,
Board President
European Financial Reporting Advisory Group
Square de Meeûs 35
1000 Brussels

January 14, 2022

Dear Mr. Gauzès,

EFRAG's Draft Comment Letter in response to the IASB Request for Information on the Post-Implementation Review of IFRS 9 – Classification and Measurement

This comment letter is written by Assuralia, the association of Belgian insurance companies, representing about 98% of the insurance premiums of Belgian and foreign insurance companies in our market.

Assuralia supports the reintroduction of recycling for equities measured at fair value through other comprehensive income in IFRS 9 since it would significantly improve the presentation of the financial performance of insurance companies. This accounting treatment should also be available for equity-type instruments as defined in our response hereunder.

The prohibition of recycling creates the false impression that cumulative gains and losses at the time of disposal of equity instruments are neither relevant nor economically significant, and therefore not a part of financial performance. In fact, yields from capital gains have been larger historically than dividends and are therefore more relevant. They are also a fundamental reason for investing in equities and such long-term investments are a key element of the insurance business model. The reintroduction of recycling should be accompanied by a well-defined, robust reversible impairment model which would provide clear indicators for impairment. This can be achieved by defining rebuttable default calibrations such as a specific percentage decline in fair value from the acquisition cost or a specific time period over which the fair value has been below the acquisition cost to trigger an impairment.

Our detailed responses to the specific questions to the RFI and our proposal for a robust impairment model are included in the Annex. If you would like any further information on any of these matters or wish to discuss them further with us, we would be pleased to assist.

Yours sincerely,

Paul Windels
Director Risk & Finance

Hein Lannoy
Chief Executive Officer

Assuralia's response to EFRAG DCL on IASB RFI on IFRS 9 'Financial Instruments' Post Implementation Review

Question 3 – Contractual cash flow characteristics (ESG/Green Bonds SPPI Issue)

a) **Is the cash flow characteristics assessment working as the Board intended? Why or why not?**

We observe that there are two types of ESG/Green loans which can be largely divided in two different categories:

(1) Loan proceeds that are used for green purposes, but where the overall ESG performance of the borrower is not linked to the product, and
(2) Loan proceeds where there is no dependency on how the proceeds are used but where the pricing is tied to the borrowers ESG performance.

The first category does not raise any concerns under IFRS 9 because the classification and measurement requirements from IFRS 9 are the same as for any regular financial instrument. However, the second category could cause some concerns because the ESG performance is embedded in the pricing of the loan, which could potentially fail the SPPI-test which is required to classify a loan at Amortised Cost (the typical classification for loans). Therefore, there are concerns that if the default subsequent measurement attribute is FVPL, this measurement might not be reflective of the amount, timing and uncertainty of the cash flows from such instruments. As a result, insurance companies might be indirectly discouraged from investing in this type of lending.

Assuralia consequently considers that the principle underlying the SPPI requirement generally leads to useful information. However, as explained above, the SPPI test guidance requires a re evaluation in the light of specific financial instruments such as financial instruments with ESG features. Assuralia proposes that the IASB remove this issue from the IFRS 9 PIR process and treat it separately as an urgent issue resulting in potential targeted improvements to IFRS 9.

Additional questions raised by EFRAG:

i) **In your view, what is the economic nature of ESG features and what makes it different from other features that result in interest increase and/or decrease?**

There are no legal frameworks for issuing ESG bonds, most of these transactions are based on commonly used market guidelines.

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	Green bond	Social bond	Sustainability bond	Sustainability-linked bond	SDG bond	Transition bond
Guidelines	ICMA Green Bond Principles	ICMA Social Bond Principles	ICMA Sustainability Bond Guidelines	ICMA Sustainability-Linked Bond Principles	UN Practice Assurance Standards for SDG Bonds	ICMA *Climate Transition Finance Handbook*
General concept	Bonds issued to fund projects with environmental benefits	Bonds issued to fund projects with social benefits	Bonds issued to fund projects with environmental and social benefits	Bonds linked to predefined sustainability metrics	Bonds issued to fund projects with a positive impact related to the UN's SDGs	Provide financing to companies that are "brown" today but have the ambition to become "green" in the future
Use of proceeds (UoP)	Project categories according to ICMA Green Bond Principles	Project categories according to ICMA Social Bond Principles, incl. efforts to address COVID-19	Project categories according to ICMA Green and Social Bond Principles, including efforts to address COVID-19	General corporate purposes	Projects aligned with the UN's SDGs	For industries that currently do not have sufficient green assets to finance but have financing needs and want to reduce GHG emissions

Most of ESG bonds relate to funds specific projects and do not have other specific features. Recently, coupon step-up/down were introduced to incentive lenders to achieve certain KPI related goals. This is usually a 10-25bp difference in coupon and those are not linked to the economic performance of the lender per se. This type of feature is gaining traction in the market but is used only for a fraction of ESG bond at the moment.

ii) Does the inclusion of ESG features have an impact on the price of financial instruments? Please explain

Currently average difference of spread is around 3-10bp for green bonds. Coupons are always tax deductible so the economic cost for the lenders is not different, but they have an interest to do so for reputational reasons and also to attract new funds/new investors.

iii) Is the fulfilment (or non-fulfilment) of ESG lending linked to the internal budgeting? To the ALM of the entity? Please explain

Given the above, maturity and duration are not impacted by ESG features, only the coupon. As such, it should be done by internal budgeting.

iv) How the compliance with ESG features by the borrower is/can be verified by the lender?

Issuers should appoint (an) external review provider(s) to assess, through a pre-issuance external review. An external auditor or other third party be used after issuance to verify the internal tracking and allocation of funds from the green bond 's proceeds to eligible green projects. ESG labels are not permanent features of a bond and might be withdrawn if an issuer fails to comply with the obligations outlined in its framework. Issuers should keep readily available up-to-date information on the use of proceeds. This information is to be renewed annually until full allocation and on a timely basis in the event of material developments.

v) Please explain the reasons why and how amortised cost is able to capture cash flow variability coming from ESG features.

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vi) Does amortised cost allow to make a reliable estimate of the changes in cash flows over time when it includes the variability of ESG features? Please explain.

vii) In case not, could the change in variability be accounted for through catch-up adjustments?

Variability of cash flows due to ESG factors tends to be a fraction of the total coupon. However, as yield and credit spreads tighten, coupon step-up/down can become more material. Even in case of a possible recurring step-up, (interest) cash-flows are perfectly determinable/accruable. However, in that case a recalculation of the carrying amount might be required (discounted at the original effective interest rate) and a modification gain or loss be presented in P/L.

viii) How are ESG features assessed in relation to the credit risk of the issuer/specific issuance at hand?

Issuers should keep readily available up-to-date information on the use of proceeds. This information is to be renewed annually until full allocation and on a timely basis in the event of material developments. Issuers should appoint (an) external review provider(s) to assess, through a pre-issuance external review. Note issuers are constantly improving disclosure in terms of ESG by -amongst others- providing yearly ESG reportings.

ix) Is there a differentiation made between certain types of ESG features? If yes, which ones?

The differentiation in pricing of different ESG bond formats is not significative at the moment. Investors' mandates can be very diverse, some look only at how the proceeds are used, some others at ESG of the issuer only. ESG features constitute an additional incentive to buy these new bonds as compared to previous bonds of the same issuer.

x) Is there a differentiation made between duration or relative size of the issuance? If yes, please provide more details.

If issuance volume is lower than 500mln there should a premium to compensate for illiquidity, if it is higher than 2bn there should a premium as well in order to attract more investors.

xi) **In assessing the issuance risk, do you consider the «ESG quality» of particular underlying assets**

In assessing a new issuance, we include ESG criteria in our credit analysis in addition to relying on assessments of third parties specialized in this field. Note rating agencies (Fitch, S&P Moody's) include ESG parameters in their rating and analysis.

Question 4 – Equity instruments and other comprehensive income

(a) Is the option to present fair value changes on investments in equity instruments in other comprehensive income working as the Board intended? Why or why not?

The option to present fair value changes on investments in equity instruments in other comprehensive income without recycling of FVOCI gains and losses on such instruments when realized is not working as intended. According to Assuralia's members, a general improvement of the proposed IFRS 9 accounting treatment of equity instruments classified at FVOCI is needed for the following reasons:

Unfaithful presentation of performance: the prohibition of recycling results in irrelevant information as it does not reflect an entity's business model or fails to convey information about management performance and stewardship. In addition, many users of financial statements are interested in having additional information distinguishing realized from unrealized gains and losses. Recognizing gains and losses of equity instruments measured at FVOCI in the P&L would give users information about the economically motivated disinvestments decisions made by management and would thus put investors in a better position to assess the stewardship of management.

Differential treatment of Fair Value Gains and Dividends: Due to the prohibition of recycling, the cash flows relating to gains on disposal from the sale of equity instruments, which are measured at FVOCI, are not reported in profit and loss anymore (in contrast to IAS 39). As a result, the general principle to show in a transparent way all realised gains and losses in the profit and loss account has been left out under IFRS 9. This creates the false impression that the cumulative gains and losses at the time of disposal of equity instruments are not relevant or economically insignificant, and therefore not a part of the financial performance. In fact, capital gains on average have been larger than dividends and are fundamental to insurer's rationale of investing in equities. On average since 1930, returns on capital have been more significant (5,5%) than from dividends (4.1%). From a company perspective, the lack of recycling can therefore create an unnecessary distortion in the presentation of the financial performance of long-term equity investments using, FVOCI. For insurers the problem can be exacerbated because the equity investments can be backing insurance liabilities. Increases in the liabilities will in some cases need to go through P&L and are economically matched by the combination of dividends and capital gains. Therefore, to avoid accounting mismatch in such cases the ability to recycle equity capital gains through P&L is needed.

Conceptual framework argument: The Conceptual Framework acknowledges that amounts should be recognised in profit or loss when it results in more relevant information. Therefore, all gains and loses should be presented in profit or loss at some point in time as profit or loss is the primary statement of performance under the Conceptual Framework for Financial Reporting. Accounting disadvantage for equities vs debt: entities applying IFRS 9 for debt securities have the option to measure them at FVOCI with recycling, which creates an accounting disadvantage for equity investments which need to either be measured at FVPL or at FVOCI without recycling.

An additional reason why the reintroduction of recycling for FVOCI equities is important for the insurance sector is **the matching with the with the insurance liabilities** that they cover. Typically, investment in equities cover the very long tail of the insurance liabilities and the realized return on the equity investment is part of the financial return used for the profit sharing (more general term to use: ‘investment return’ as ‘profit sharing’ is a more typical Belgian term) to be distributed to the policyholder and thus included in the IFRS 17 fulfilment cash flows. Not taking into account the overall financial return on equities (incl. realized gains and losses) would create mismatches in profit recognition.

Reporting consistently all the components of the performance of equity instruments in profit and loss will provide complete and appropriate information to users about the performance of the related investments. This will also ensure consistency with the accounting treatment of debt instruments accounted for at FVOCI for which interests’ payments as well as gains and losses upon realization are recognized in profit and loss.

Assuralia consequently fully support the reintroduction of recycling to profit and loss unpon disposal of the valuation gains or losses previously recognized through OCI (i.e. recycling) for all equity (and equity-type) instruments which are not held for trading. However, we recognize the need for an **impairment model** if equity instruments were to be accounted for at FVOCI with recycling.

We acknowledge that some of the negative fair value changes can have a permanent nature and that it would be appropriate and in line with the principle of prudence of the Conceptual Framework for Financial Reporting to reflect such fair value changes in profit or loss. A robust impairment model also increases the relevance of the profit or loss statement as primary source of information of a company's performance.

An **improved version of the IAS 39 impairment model** could be used as a way forward. An improvement is needed in order to overcome inconsistencies caused by the **unclear notions of 'prolonged' and 'significant'** and by the excessive notion of **'once impaired always impaired'**.

We propose the introduction of **quantitative triggers** to define what is a significant or prolonged decline in fair value. This could be done by defining a specific percentage decline from the acquisition cost and a specific time period over which the fair value has been below acquisition cost. However, these quantitative triggers should be **rebuttable** to take into consideration certain exceptional facts and circumstances. These **exceptional facts and circumstances shouldn’t let place to interpretation and should be based on measurable (market) indexes to prevent any ‘cherry picking’.** Concerning the excessive notion of 'once impaired always impaired', we suggest including in the standard an **option to book reversal of impairments using symmetric quantitative rebuttable thresholds.**

A simple impairment rule could be:

An equity position is written down to its current market value and the loss recognized in P&L if either:

a) Its (current) price at closing is more than 25 % below acquisition price; or
b) Its (current) price has remained below acquisition price for more than 6 consecutives months

The ability to reverse such impairments (using the same triggers) would increase the relevance of the profit and loss account as a primary source of information of a company's performance.

Such a rule could avoid that short term market movements and prices dips force an impairment and avoid the need to reverse impairments too often while addressing concerns by ensuring consistency and that significant and/or prolonged falls in value will be reflected in P&L.

(b) For what equity instruments do entities elect to present fair value changes in other comprehensive income?

Equity and Equity-type instruments should be eligible to FVOCI with recycling instead of FVPL

The issue of non-recyclability of equity instruments is not limited to equity instruments only, but also to equity-type instruments. **The proposal for measuring equity-like instruments at FVOCI with recycling should also include funds that principally (so not exclusively) invest in equity securities and shareholder loans, necessary cash and derivatives holdings**. Next to the typical equity funds, also funds in **real estate or infrastructure** should be considered. As a definition for 'equity-type', the presence of the following characteristic is required: **equity-type instruments could encompass any form of financial instrument that entitles the holder to a return based on the net assets of the fund**.

Insurers do not invest only directly in equities instruments; they also invest in **equities indirectly**, for example through **investment funds.** It is important not to create competitive disadvantage because the same assets are held through different mechanisms. Therefore, to provide relevant information for the performance of long-term investors, we believe that the **accounting treatment of equity-like instruments such as UCITS should also be eligible to the FVOCI category under IFRS 9.** It also reflects the fact that the investor is fully exposed to the equity risk; e.g. the underlying investment in ETF (exchange traded funds) is equity and therefore the accounting treatment should be identical to equities.

In the Belgian market, there is a typical type of UCITS called 'BEVEK'/'SICAV' which is a fund with variable capital which increases or decreases its capital based on investors stepping in or out of the funds. The funds generally invest in equity instruments, but because of the puttable feature, the investor would need to classify its investment in this UCITS as a debt instrument at FVPL, since it fails the SPPI-test. This creates a competitive disadvantage of the funds compared to directly investing in shares.

We believe that classifying **puttable instruments** as debt from the perspective of the issuer also depicts a misleading view because the **put option has no intrinsic value** as the put option is merely there to provide liquidity to the investor. The put will be exercised at the pro rata amount of the NAV of the equity funds, which would generally be **the same price** as the market price for the pro rata number of shares in the funds (which are mostly tradable on the market). If we would classify these instruments as debt instruments purely because of the puttable feature, this would not represent the economic substance as the investor is fully exposed to equity risk at any time. It has no protection against a decrease in share price unlike often debt instruments which do propose a capital and/or return guarantee.

Furthermore, a lot of those UCITS appear to have put options which are **not genuine** (unlike the BEVEK/SICAV). Instruments such as ETFs may perhaps be puttable according to the prospectus, but they are never putted directly to the issuer in reality. Accounting for those funds as debt instruments would also not properly depict the economic substance of those instruments.

c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in other comprehensive income? How significant are these effects?

At this stage Assuralia is not aware about any unexpected effects arising from the option to present fair value changes on investments on equity instruments in other comprehensive income, in addition to those described in the question 4 a) & b) above. This is partly due to the fact that IFRS 9 is substantially still not applied by the insurance sector.

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