KBC Group
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Mr. Roger Marshall

Acting Chairman of the

European Financial Reporting Advisory Group

35 Square de Meeûs , 1000 Brussels

Date : 26 June 2015

Subject : Comments on the EFRAG's draft IFRS 9 endorsement advice

Dear Mr. Marshall,

We are providing you with this comment letter from the perspective of KBC Group. KBC Group is an integrated bank-insurance group, focused on serving retail, private banking, SME and mid-cap clients.

Geographically, we focus on our core markets of Belgium, the Czech Republic, Slovakia, Hungary and Bulgaria. We are also present in Ireland and, to a limited extent, in several other countries to support corporate clients from our core markets. KBC Group employs around 36 000 people and serves approximately 10 million customers.

KBC Group is the stock-listed company which publishes its consolidated financial statements in accordance with IFRS covering all the activities (both bank and insurance) within the group. In addition , the banking activities are reported on KBC Bank consolidated level and the insurance activities on KBC Insurances consolidated level. KBC has the obligation to publish IFRS financial statements on these 3 consolidation levels.

Within KBC Group the income related to the insurance business represents between 30 and 45 % of the total income of the financial conglomerate, implying that nor the banking nor the insurance business is insignificant.

We welcome the opportunity to comment on EFRAG's assessment on IFRS 9 *Financial Instruments*, and in particular on the interaction between IFRS 9 and IFRS 4. In general we support the use of IFRS 9 in Europe as we believe that IFRS 9 stands for an improvement of the accounting of financial instruments compared to the actual requirements in IAS 39.

We agree with the responses given by EBF on the EFRAG's draft IFRS 9 endorsement advice , except for the interaction between IFRS 9 and IFRS 4 phase II. This comment letter therefore only addresses the implications the time delay between IFRS 9 and IFRS 4 phase II has for KBC Group.

We want to inform EFRAG and the IASB that the **proposed solutions** i.e. IFRS 9 deferral for insurers, segmental reporting , and the IASB transition relief measures **do not solve all issues for financial conglomerates.**

Therefore we would ask EFRAG and the IASB to further elaborate the consequences of the non-alignment between IFRS 9 and IFRS 4 phase II for financial conglomerates.

1. **Deferring IFRS 9 for insurers and financial conglomerates.**

The solution proposed by the insurers and shared by EFRAG to defer IFRS 9 for insurance companies until the implementation of IFRS 4 phase II will not solve the non-alignment of IFRS 9 and IFRS 4 phase II for KBC Group. Also expanding the deferral of IFRS 9 to financial conglomerates is for us not an option.

Insurance companies expressed concerns that their financial assets not fulfil the SPPI (solely payment of principal and interest) test and therefore cannot be classified at Fair value through OCI. Their classification at Fair value through P&L will generate a lot of volatility in P&L as insurance liabilities are accounted for at amortised cost although they reflect similar characteristics. Therefore these insurance companies want to defer IFRS 9 until the initial application of IFRS 4 phase II in order to avoid these accounting mismatches. We do not believe that this is an issue for KBC Insurances as currently the majority of our financial assets (> 90 %) are plain vanilla instruments satisfying the SPPI test.

The EFRAG draft endorsement advice does not include an IFRS 9 delay for banking entities. Therefore IFRS 9 has to be applied for the banking activities within KBC Group as of 1 January 2018.

Furthermore, IFRS currently requires to apply uniform valuation rules throughout the group. Standard rules implemented by IFRS should lead to a uniform way of reporting financial information. Consequently KBC Group will need to implement IFRS 9 for all entities, including the insurance entities, as from 1 January 2018.

We are not in favor of asking the IASB nor the EC for a deferral of the effective date of IFRS 9 for insurers nor for financial conglomerates. We believe that this would jeopardize the level playing field between insurers and bank-insurers, as bank-insurers would not have an option but to implement IFRS 9, and therefore have a temporarily **competitive disadvantage.**

By deferring IFRS 9 , pure insurers can continue reporting realized results in P&L when selling AFS classified equity instruments. Under IFRS 9 re-cycling realized results to P&L upon the sale of equity instruments, which are classified at Fair value through OCI , is not permitted. KBC can thus no longer report these results in P&L ; these results remain in equity. On the other hand, if equity instruments would be classified at Fair value through P&L, this would generate P&L volatility due to fair value movements. In addition, although our financial assets , mainly government and corporate bonds, fulfill the SPPI test and are rated 'investment grade' we will have to recognize provisions under the IFRS 9 expected loss model while pure insurers remain reporting impairments under the incurred loss model by applying IAS 39. These competitive disadvantages will disappear at the initial application of IFRS 4 phase II (i.e. when insurance entities would also need to apply IFRS 9).

Pure insurers ,using the option to delay the application of IFRS 9 , are not subjected to a **transition period** (=period between the IFRS 9 initial application and the effective date of the new insurance standard) ,which we **expect** to last for **1 or 2 years**. Furthermore, they are not confronted with the costs and the workload related to a double implementation of IFRS 9.

2. Segmental reporting for financial conglomerates

A dual model i.e. **segmental reporting** where the insurance part of the group applies IAS 39 to their financial instruments while the remaining part of the group applies IFRS 9 is technically very difficult to justify under IFRS. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and IFRS 10 *Consolidated Financial Statements* generally require the application of consistent accounting policies to similar transactions or events and specially the application of uniform accounting policies in consolidated financial statements. Furthermore, it will require additional guidance on how to align presentation and disclosure between IFRS 9 and IAS 39 and will only be relevant for a limited period of time. Applying different standards to the same types of transactions within an entity is not desirable, let alone transactions between our bank and insurance entities, which from an operational point of view would not be manageable.

KBC prepares and publishes IFRS consolidated accounts at three levels : KBC Group, KBC Bank and KBC Insurances. Preparation of financial statements within KBC is done in a uniform way over the 3 consolidation levels. Financial analysts will benchmark us (as a bank- insurance company) towards the other big European banks, especially in relation to IFRS 9 phase II. As from the moment other big European banks will start publishing their financial statements under IFRS 9, the analysts will want to know the impact on the impairment levels in KBC. Financial markets will not accept that we report impairments for the insurance activities under an incurred loss model and for the other activities within our financial conglomerate based on an expected loss model.

The operational complexity and extra costs for our insurance entities to apply in the transition period both IAS 39 to report at KBC Insurances consolidated level and at the same time IFRS 9 to report at KBC Group consolidated level substantially outweigh the benefits.

We do not support the use of segmental reporting because it would lead to unnecessary operational difficulties for the preparers of the financial statements. It would also lead to unnecessary complexity for the users of the financial statements.

Given the short period of transition, which we expect to last for 1 or 2 years, we do not consider an investment in segmental reporting.

3. The IASB transition relief measures

We welcome the IASB Board tentatively confirmed transition relief measures. These transition measures allow at the initial application of the new insurance contracts standard to **re-classify the financial assets** e.g. use the fair value option to avoid accounting mismatches. However, the current transition measures include some **restrictions ,** mainly reclassifications between Amortised Cost and

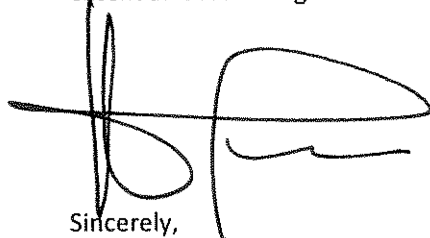
Fair value through OCI are not possible. To keep a maximum level of flexibility ,as IFRS 4 phase II is still under discussion and mainly the accounting for participating contracts is uncertain, ideally an **unrestricted reclassification of financial instruments under IFRS 9 at the date of implementation of IFRS 4 phase II should be allowed.**

The IASB decided to provide further transition relief to permit or require an entity to **reassess the business model for financial assets** taking into account the facts and circumstances that exist at the date of the first application of IFRS 4 phase II and which may be different compared to the initial application date of IFRS 9. Being a financial conglomerate we welcome the re-assessment of the business models as such an approach would entail benefits. This allows to cope with accounting mismatches related to the non-alignment of the application date of IFRS 9 and IFRS 4 phase II.

We understand that a broad interpretation of this re-assessment of the business models is allowed so that financial conglomerates can use this transition relief measure at the initial application of IFRS 4 phase II.

Also according to us ,in view of the business models, the interaction between IFRS 9 *Financial Instruments* and IFRS 4 *Insurance Contracts* is very important to insurance undertakings. Therefore, re-assessing the business models will be a workable solution in case the new accounting of insurance liabilities under IFRS 4 phase II can be taken into account for the business model assessment and not only the financial assets. An insurer manages assets and liabilities together and economically matches the risks in the insurance liabilities and the financial assets ('ALM'). In order to reflect the ALM of an insurer, accounting requirements for assets and liabilities should therefore be considered together.

We are in favor of asking the IASB to explicitly state in the wording of the final IFRS 4 phase II standard that at the initial application of IFRS 4 phase II a re-assessment of the business models can be done considering accounting requirements for assets and liabilities together, thus guaranteeing that insurance companies have full flexibility in re- defining the business model. Our main concern is avoiding accounting mismatches in order to obtain an acceptable level of volatility. Measuring insurance contracts at fulfilment value will lead to volatility if no mitigating actions are taken. However, this volatility in P&L or OCI can be partly mitigated by measuring the financial assets at a value that compensates the valuation of the insurance contracts, hence eliminating to a certain extent an accounting mismatch.



Sincerely,

Luc Popelier

CFO of KBC Group

If you have any questions regarding our comments, please contact Hilde Leenders (hilde.leenders@verz.kbc.be) or send a mail to the IFRS box (IFRS@kbc.be).