Federation of European Accountants

Mr Hans Hoogervorst
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International Accounting Standards Board
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Sent by email:
Commentletters@ifrs.org

Brussels, 20 January 2016

Subject: FEE comments on the IASB's Exposure Draft "Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed amendments to IFRS 4)" (ED/2015/11)

Dear Mr Hoogervorst,

1. FEE (the Federation of European Accountants, www.fee.be) is pleased to provide you below with its comments on the IASB's Exposure Draft: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: (Proposed amendments to IFRS 4) (ED).

2. The issue relating to the insurance industry continues to be of concern in Europe. We are also aware that similar concerns are expressed in other jurisdictions. Therefore, FEE reiterates its full support for an international solution for this matter and strongly supports the IASB's efforts towards such a solution.

3. FEE also acknowledges that, because of the complexity and urgency of the issue to be solved and because any solution will be of a temporary nature, it cannot be expected to be perfect. FEE recognises that decisions need to be made on the trade-off between different objectives. Overall, FEE considers important that any temporary solution ensures, to the extent possible, implementation at reasonable cost. It is equally important that the degree of complexity of any solution does not become a limiting factor for its implementation, audit, and understanding by the users of financial statements.

4. FEE believes that both the deferral and overlay approach should be optional solutions available in the final standard. We want to stress our support to the Board's decision to introduce an approach for a temporary exemption from applying IFRS 9 (deferral), as we believe that this approach better addresses the concerns raised by a majority of preparers regarding the misalignment of the effective dates of IFRS 9 and IFRS 4.

5. While we support the notion that the assessment for eligibility for temporary exemption from applying IFRS 9 should be based on the predominant activity, we are concerned with the way in which it is proposed in paragraph 20C of the ED. In our view, the objective of the ED should explicitly state that for those financial instruments that do not relate to insurance contracts and for which it is expected to be a significant impact from implementing IFRS 9 are accounted under IFRS 9.

6. Generally we are in favour of simplification, but we believe the conclusion in paragraph BC64, where the IASB proposes a simpler approach to determine whether an entity is eligible to use the temporary exemption from applying IFRS 9, needs to be improved; we therefore propose two adjustments to the way that the predominant test is described in the ED:

    a. Liabilities that are backed by assets that are reported at fair value through profit or loss already under IAS 39 (for which there will be no change under IFRS 9) should be excluded from the calculation;

    b. The denominator should only reflect those liabilities that result from obligation with customers, or in other words to eliminate in the denominator those liabilities that are not directly related to insurance contracts. These include pensions, taxes, deferred taxes, subordinate loans or to some extend derivatives.

7. Our preferred solution would be to adjust the calculation as proposed above and use an even higher threshold than the ED is proposing for an entity to be eligible to use the exemption from applying IFRS 9. Having said that, we would not oppose to another solution that could address this matter, for instance the one suggested by EFRAG.

8. In addition to refining the definition of “predominant”, we would also support an assessment of the eligibility below the reporting entity. We acknowledge the concerns raised by the Board for allowing two standards to be applied for the same transactions and events in the same reporting entity. However, we are aware of different proposals, for instance the “waterfall approach” proposed by EFRAG, which have been shared with the IASB which could prove to be a realistic compromise between the need for assessing the predominance criterion below the reporting entity and establish a robust financial reporting framework. We suggest that the IASB investigates further this.

9. Finally, we strongly agree with the IASB’s conclusion that any exemption from applying IFRS 9 should be a temporary exemption and that it should expire within a reasonable short period of time. Upon finalisation of the new insurance standard, the Board should readjust the availability of both approaches so that it gets aligned with the effective date of the new insurance standard. We note that the IASB is now drafting the final standard on insurance contracts and we urge the Board to devote adequate resources to finalise the standard as soon as possible. This would ensure that any exemption from applying IFRS 9 would be a temporary one.

We hope that our comments are helpful in the process of finalising the amendments to IFRS 4 in this ED.

For further information on this letter, please contact Pantelis Pavlou, Manager, from the FEE Team on +32 2 2 893 33 74 or via e-mail at pantelis.pavlou@fee.be.

Kind regards,

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FEE President	FEE Chief Executive

Encl. Appendix: FEE comments to the IASB ED/2015/11: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed amendments to IFRS 4)

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?

1. We observe that the issue relating to the insurance industry continues to be of a major concern in Europe. FEE agrees with EFRAG's final endorsement advice[1] where EFRAG explains the issue and the reasons why it should be addressed. FEE reiterates its full support for an international solution for this matter; therefore we strongly support the IASB's efforts towards a solution into this direction.

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

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

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

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

(ii) would not have been so measured applying IAS 39 (the 'overlay approach') (see paragraphs BC24–BC25);

(b) to provide an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 (the 'temporary exemption from applying IFRS 9') (see paragraphs BC26–BC31).

Do you agree that there should be both an overlay approach and a temporary exemption from applying IFRS 9? Why or why not?

If you consider that only one of the proposed amendments is needed, please explain which and why.

2. FEE acknowledges that, because of the complexity of the issue to be solved and because any solution will be of a temporary nature, it cannot be perfect. FEE recognises that decisions will need to be made for a trade-off between different objectives. Overall, FEE considers important that any solution needs to ensure, to the extent possible, implementation at reasonable cost. It is equally important that the degree of complexity of any solution does not become a limiting factor for its implementation, audit, and understanding by the users of financial statements.

[1] http://www.efrag.org/files/IFRS%209%20endorsement/IFRS_9_Final_endorsement_advice.pdf

3. To this end, we believe that both approaches should be available in the final standard. Even though both approaches have significant drawbacks, we understand that both together can be a compromise until the new insurance contracts standard is published.

4. We understand that the deferral approach is preferable for the insurance industry as it is simpler and less costly, but equally we believe that for some companies, especially banking conglomerates, the overlay approach is equally important.

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?

5. While we note that some constituents (but not all) have reservations on the costs related to the overlay approach, as stated above, we believe that this should not be ruled out as an option, as some preparers expressed the view that they prefer the overlay approach. We understand that the cost of the overlay approach depends on the extent to which insurance activities are integrated with banking activities. The further they are integrated the lesser the costs might be.

6. We would also support the IASB's decision not to elaborate further the overlay approach at this stage. We believe that the main principle is sufficiently well explained and adequate at this stage, bearing in mind the limited period of time for its use, the urgency of the issue, the risk for unintended consequences of amendments due to different circumstances in different jurisdictions, and the expected limited use of this approach by preparers.

Question 3 (a)

7. The scope definition has been deliberately left broad, as the IASB has decided not to include a reference to the contractual link between the assets and the insurance liabilities. FEE agrees with this approach as we understand that in different jurisdictions insurance undertakings use different practices to manage their insurance liabilities, and some of the assets are not contractually linked to the insurance liabilities.

Question 3 (b)

8. We understand that the IASB has already discussed the different presentation alternatives of the overlay approach. As this approach would be a temporary solution for the misalignment of the effective dates, we agree with the different alternative presentations as suggested in the ED since, in our view, comparability is possible through disclosures required.

Question 4—The temporary exemption from applying IFRS 9

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

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

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

(b) Do you agree that an entity should assess its predominant activity in this way? Why or why not? If you believe predominance should be assessed differently, please describe the approach you would propose and why.

Paragraphs BC55–BC57 explain the IASB's proposal that an entity would assess the predominant activity of the reporting entity as a whole (ie assessment at the reporting entity level).

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

9. We support the temporary nature of the exemption from applying IFRS 9.

10. As a general remark on the deferral approach regarding the disclosure requirements for the temporary exemption from applying IFRS 9, we are not convinced about the usefulness of paragraph 37A (c) of the ED, regarding the requirement to disclose separately the fair value of those financial assets that do not meet the classification criteria for "solely payment of principal and interest" as described in paragraphs 4.1.2(b) and 4.1.2A(b) of IFRS 9. By using the temporary exemption an entity should not need to make the classification assessment under IFRS 9, since that may not be relevant, as this might change, depending on the application of IFRS 9 once the final insurance standard is applied. We would therefore suggest deleting this requirement, or as an alternative, the IASB may consider the mentioned disclosures for instruments that an insurer expects to classify as fair value through profit or loss once IFRS 9 applies. This is also in line with paragraph BC9 (b) and paragraphs BC17 and BC18 of the ED.

Question 4 (a) (c)

11. We agree that the main principle on the eligibility for the temporary exemption from applying IFRS 9 is based on whether the entity's predominant activity is issuing contracts within the scope of IFRS 4. However we believe that the ED should also take into the impact of applying IFRS 9. To reflect this we suggest amending the objective of the ED to ensure that those financial instruments that do not relate to insurance contracts and for which it is expected to be a significant impact from implementing IFRS 9 are accounted under IFRS 9. Paragraph B9 of the ED does not reflect the later part and therefore we suggest that the IASB adds the reference to "significant impact from implementing IFRS 9".

12. In the case that the predominance criteria is widened (see our comment below of Q4 (b)) there might be a risk that significant other activities, and especially banking activities, are captured in the scope of the deferral of IFRS 9. We would be concerned by this outcome. In order to avoid this risk, we would agree with a tougher predominance test, but which could also be assessed below the reporting entity level if the predominance test is not passed at the reporting entity level.

13. Even though we can understand the IASB's concerns related to applying the temporary exemption from applying IFRS 9 as explained in Appendix B, we believe that as long as the main principles are in place, the benefits for ensuring that any banking activities are reported under IFRS 9 would outweigh the risks associated with applying two different accounting standards in the same reporting entity.

14. One possible approach could be the approach proposed by EFRAG and already shared with the IASB.

Question 4 (b)

15. While we support the concept of determining the scope of any temporary exemption by way of a predominance test, we believe that the test as proposed by the IASB should be refined.

16. In our view the calculation should be narrower in a way that captures the pure insurance activities. Insurance companies usually assume other liabilities in order to be able to operate as separate entities, for instance pensions, taxes, deferred taxes, subordinate loans or derivatives. We do not support that those liabilities should be part of the calculation when making the assessment for the predominant activity and we propose to adjust the denominator by excluding those liabilities. Therefore we disagree with the conclusion in paragraph BC64 where the IASB proposes to use a simpler approach for the assessment of the predominant activity.

17. In particular we propose the following adjustments to the predominance criterion calculation:

    a. Liabilities that are backed by assets that are reported at fair value through profit or loss already under IAS 39 (for which there will be no change under IFRS 9) should be excluded from the calculation.

    b. The denominator should only reflect those liabilities that result from obligation with customers, or in other words to eliminate in the denominator those liabilities that are not directly related to insurance contracts. These include pensions, taxes, deferred taxes, subordinate loans or to some extend derivatives.

18. Our preferred solution would be to adjust the calculation as proposed above and use an even higher threshold than the ED is proposing for an entity to be eligible to use the exemption from applying IFRS 9. Having said that, we would not oppose to another solution that could address this matter, for instance the as suggested by EFRAG.

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?

19. Yes, we strongly support that both approaches are optional.

20. FEE strongly believes that IFRS 9 in principle improves financial reporting for financial instruments and therefore, if an entity assesses that the benefits for full application of IFRS 9 outweigh the costs for the misalignment of the effective dates of IFRS 9 and IFRS 4, such entity should have the option to apply IFRS 9 as from 1 January 2018.

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?

21. We strongly believe that any temporary exemption from applying IFRS 9 should expire within a reasonable short period of time. We understand that the IASB is working on the completion of the final standard on the insurance contracts. In line with our comments on the IASB's Agenda Consultation[2], we urge the IASB to devote adequate resources to finalise the standard as soon as possible. Upon finalisation of the new insurance standard, the Board should readjust the availability of both approaches so that it gets aligned with the effective date of the new insurance standard. This would ensure that any exemption from applying IFRS 9 would be temporary.

[2] http://www.fee.be/library/list/50-corporate-reporting/1556-fee-comments-on-priorities-for-iasb-in-2015-agenda-consultation.html