KBC Group
Luc Popelier
CFO KBC Group
Havenlaan 2 , 1000 Brussels

20 January 2016

To Mr. Roger Marshall, Acting Chairman of the European Financial Reporting Advisory Group
35 Square de Meeûs , 1000 Brussels

Subject : IASB ED/2015/11 Applying IFRS 9 *Financial instruments* with IFRS 4 *Insurance contracts*

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. In all our core markets we apply a bank-insurance business model by offering clients a total package serving both their banking and insurance needs. Like most financial conglomerates with a mix of banking and insurance activities, we use an integrated distribution model whereby our insurance products are not only provided via tied insurance agents and brokers but also via our banking offices. Moreover, unlike most financial conglomerates, KBC Group is also integrated at a higher level as it acts as one single operating company.

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. Based on regulation, KBC publishes IFRS financial statements on these 3 consolidation levels.

Within KBC Group insurance activities contribute between 20 and 30% of the group's net result and banking activities between 70 and 80 %, implying that nor the banking nor the insurance business is insignificant.

We welcome the opportunity to comment on the EFRAG draft letter to the European Commission providing preliminary views on the two optional approaches of the IASB to apply IFRS 9 together with IFRS 4 Phase 1 for entities that issue insurance contracts.

According to your draft comment letter, the incremental costs related to implementing the temporary exemption from IFRS 9 are acceptable and the overlay approach implies significant additional costs. For KBC Group the opposite is true.

Applying temporary exemption from IFRS 9 for our insurance activities involves significant additional costs and has unreasonable operational consequences and this for an interim solution. We believe this is also confusing for the users of our financial statements and for our management as some assets will be reported under IAS 39 and others under IFRS 9.

On the contrary, the operational consequence and related costs of applying IFRS 9 with the overlay approach are minimal for us.

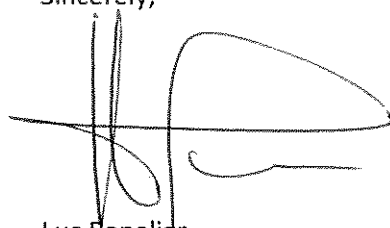
For more details, we refer to the attached presentation on "the implications of the overlay approach for KBC" which was presented on the EFRAG Board meeting of 14 January 2016.

For KBC Group the overlay approach is the solution and thé only solution to cope with the time delay between IFRS 9 and IFRS 4 and this ensures a level playing field with all players in the European insurance market.

We had discussions with Belfius and Argenta, 2 other Belgian financial conglomerates, and they have the intention to apply the overlay approach. We understand that some other financial institutions are also interested in the overlay approach.

We have included in the Appendix A our detailed responses to the questions raised in the Exposure Draft.

Sincerely,



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CFO of KBC Group

If you have any questions regarding our comments, please contact Hilde Leenders (hilde.leenders@verz.kbc.be) or Katrien Verbeke (katrien.verbeke@kbc.be).

Appendix A : Questions to constituents

Question 1 – Addressing the concerns raised

We agree with the assessment of ERAG that the misalignment of the effective dates leads to concerns such as described in the Exposure Draft: it leads to the application of the classification and measurement requirements of IFRS 9 before the effects of IFRS 4 Phase 2 can be fully evaluated; in relation to this, it leads to accounting mismatches and temporary accounting volatility in the financial statements; and it also leads to two sets of major accounting changes in a short period of time complicating investor analysis.

Accordingly, we agree that the IASB Board should provide solutions to address these concerns and that the proposed solutions should only be applicable for a relatively short period of time as a possible postponement of the finalisation of IFRS 4 Phase 2 is not recommended.

The further transition relief measures as foreseen in the Exposure Draft of IFRS 4 Phase 2 will ensure that a level playing field is created with regard to the classification of the financial instruments between entities applying IFRS 9 with the overlay approach and others that make use of the temporary exemption from IFRS 9 until the effective date of the new insurance standard.

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

We fully support the approach taken by the IASB Board to provide both an overlay approach and a temporary exemption from IFRS 9 as a solution for the issues entities, issuing contracts in scope of IFRS 4, are confronted with by adopting IFRS 9 prior to the new insurance standard.

A one size fits all does not provide a solution for all players in the European insurance market. Entities issuing contracts in scope of IFRS 4 are structured in a different way i.e. a pure insurance company, an insurance subsidiary within a financial conglomerate, an integrated bank-insurer and they invest in different types of products. Therefore solutions proposed by the IASB Board should accommodate all entities to adapt their financial statements in an efficient way.

Moreover, to ensure a maximum level playing field both approaches, the temporary exemption from IFRS 9 and the overlay approach, should remain available and maintained in the final amended IFRS 4 Phase 1 standard.

Question 3 – The overlay approach

With regard to the qualification criteria of financial assets eligible for the overlay approach (i.e. wording 'as relating to contracts in scope of IFRS 4'), KBC has taken a limited interpretation being: 'financial assets backing insurance liabilities in scope of IFRS 4'. Other entities could understand these wordings in a broader sense and thus qualify surplus funds as eligible assets for the overlay approach. Different interpretations should be avoided and therefore we would ask the IASB Board to provide detailed examples of qualifying financial assets in the final amended IFRS 4 Phase 1 standard.

KBC intends to apply the overlay approach to specific categories of financial assets of the insurer namely the equity portfolio which meets the eligible conditions of a qualifying financial asset.

This equity portfolio is currently under IAS 39 qualified as 'Available For Sale' and will be classified as 'Fair value through P&L ' under IFRS 9. This portfolio is allocated to liabilities in scope of IFRS 4 i.e. 85 % allocated to Life business and 15 % allocated to Non-Life business.

Applying IFRS 9 with the overlay approach or accounting under IAS 39 has the same results in P&L for our equity portfolio and thus mitigates the P&L volatility. This ensures a level playing field with insurance entities that will make us of the deferral approach. Moreover, in the case of KBC this allows internal consistency between banking and insurance activities as all financial assets, both banking and insurance assets, are accounted for under IFRS 9.

The advantages of the overlay approach largely outweigh the supplementary costs for KBC.

- The incremental costs of implementing the overlay approach for the equity portfolio are estimated at less than 1% of the IFRS 9 implementation costs. Identifying and tracking the equity portfolio under IAS 39 and IFRS 9 at the same time implies an operational change that is manageable for us. All information is available: in our current systems and under IFRS 9 acquisition values and fair values w.r.t. our equity portfolio are captured. Therefore the operational change is limited to some new accounting entries and to present in a transparent way the overlay adjustment amount in the disclosures. We agree with the preferred presentation option of EFRAG to have a presentation that is as consistent as feasible with IFRS 9 as the overlay approach requires to apply IFRS 9 in full.

- Applying the overlay approach implies the application of IFRS 9 and thus all improvements compared to IAS 39 are reflected in the financial statements. Moreover, we provide comparable information with information of other entities that apply IFRS 9. This is important for us being benchmarked by financial analysts with other big European banks.

The overlay approach is thé option for KBC as temporary exemption from IFRS 9 is no solution for us. Applying IFRS 9 in full, both for our banking and insurance entities, in combination with the overlay approach for some financial assets of the insurer ensures a level playing field with entities that will make us of an IFRS 9 deferral.

We had discussions with Belfius and Argenta, 2 other Belgian financial conglomerates, and they have the intention to apply the overlay approach. We understand that some other financial institutions are also interested in the overlay approach.

Question 4 – The temporary exemption from applying IFRS 9

Deferring IFRS 9 for our insurance activities is not a solution for KBC as the related costs largely exceed the benefits and these costs have to be made for a temporary solution, valid until the effective date of IFRS 4 Phase 2.

- KBC presents banking and insurance activities in an integrated way on the face of the balance sheet. Segment reporting is based on geographical presence.

- One operational process prepares financial statements over the 3 consolidation levels. Standalone IFRS figures of local bank and insurance entities are uploaded in a central consolidation tool. This tool manages the consolidation scope (which entities are in scope of which consolidation level) and steers reported figures and accounting entries to be integrated in the set of financial statements at group, bank and insurance consolidated level.

- Changing segment reporting to the product view (banking versus insurance activities) implies unbundling the financial statements and the accounting schemes. In addition, some assets are managed in one operational back-office system i.e. bond portfolios. By using the deferral approach, we would have two different impairment models for the same type of bond, the IAS 39 incurred loss model for bonds held by the insurer and the IFRS 9 expected loss model for bonds held by the bank. The lack of consistency between banking and insurance activities will confuse users of our financial statements and management.

- KBC Group is benchmarked by financial analysts with other big European banks and therefore the deferral approach would be confusing for the users of our financial statements and for our management.

Based on the above, the costs related to applying deferral of IFRS 9 for our insurance activities and changing our segment reporting to the product view, largely outweigh the costs related to applying IFRS 9 with the overlay approach (see answer on question 3).

Moreover, the IFRS 9 project at KBC Group is on track and significant investments are made, both in people and IT systems, to be ready for IFRS 9 and this both for the banking and the insurance activities.

We understand that for some entities a temporary exemption from IFRS 9 is the preferred solution to mitigate the time delay between IFRS 9 and IFRS 4. A deferral, however, should maintain the level playing field between banks adopting the IFRS 9 standard.

Question 5 – Should the overlay approach and the temporary exemption from IFRS 9 be optional

We believe that solutions proposed by the IASB Board should accommodate all entities to adapt their financial statements in an efficient way while maintaining a level playing field. Due to the diversity of insurance contracts across the insurance industry, some entities may find it beneficial to apply IFRS 9 in full whereas others consider the best option for them is to apply IFRS 9 with the overlay approach or to make use of the temporary exemption from IFRS 9. Therefore the proposed solutions by the IASB Board should be offered on an optional basis and the understanding by users of an entity's financial statements should by facilitated by means of additional disclosures.

Question 6 – Expiry date for the temporary exemption from applying IFRS 9

The temporary exemption from applying IFRS 9 is proposed as a solution for the concerns related to the misalignment of the effective dates of IFRS 9 and IFRS 4 Phase 2. Once IFRS 4 Phase 2 will be applicable, there are no arguments to continue to apply the temporary exemption from applying IFRS 9 or the overlay approach. Therefore we are of the opinion that the temporary exemption from applying IFRS 9 should be available as long as entities are not required to apply IFRS 4 Phase 2. The overlay approach may not be considered as a fall-back scenario to a possible postponement of the finalisation of IFRS 4 Phase 2. In the meantime we support the IASB in its work to finalise IFRS 4 Phase 2, the new insurance standard.