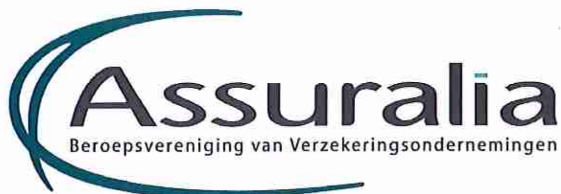

Mr. Roger Marshall
Acting President of the EFRAG Board
European Financial Reporting Advisory Group
Square de Meeûs 35
1000 Brussels

NR 16002

January 20, 2016

Dear Mr. Marshall,

Exposure Draft ED/2015/11
Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

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.

We agree that the new Standard IFRS 9 on Financial Instruments stands for an improvement of the accounting of financial instruments compared to the actual requirements in IAS 39. However, the misalignment of the mandatory effective dates of IFRS 9 Financial Instruments with the new standard on Insurance Contracts ("IFRS 4 phase 2") leads to different concerns for insurance companies. We appreciate the efforts that the IASB has made to address these concerns and welcome the opportunity to comment on the Exposure Draft ED/2015/11 on applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts. Hereunder we highlight our key opinions as well as a number of concerns specifically impacting the Belgian insurance sector.

Assuralia supports the temporary exemption from applying IFRS 9 and welcomes the overlay approach as a useful complementary solution for several Belgian insurance companies.

The temporary exemption from applying IFRS 9 is welcomed since it deals with the concerns related to the misalignment of the effective dates of IFRS 9 and IFRS 4 phase 2. However, the threshold for the use of the temporary exemption from applying IFRS 9 is not defined appropriately because it will exclude companies that are predominantly engaged in insurance activities. The proposed threshold in the Exposure Draft will lead to artificial 'cliff-effects' between companies that are able to use the temporary exemption from applying IFRS 9 and others that are not. This should be avoided in order to maintain a level playing field and a comparable basis for financial reporting in the insurance sector.

The temporary exemption from applying IFRS 9 does not offer a solution for several Belgian insurance companies that are part of a larger financial group which is predominantly engaged in banking activities and for which it is impossible not to apply IFRS 9. These insurance companies represent about 20% of the premiums in the Belgian market. **For these companies the overlay approach provides a useful solution in the period between the mandatory effective date of IFRS 9 and the mandatory effective date of IFRS 4 phase 2.** It permits these companies to apply IFRS 9 as from 2018 without significant costs and efforts and without a significant competitive disadvantage compared to companies opting for the temporary exemption from applying IFRS 9.

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Beroepsvereniging van Verzekeringsondernemingen
Union Professionnelle des Entreprises d'Assurances
Wettig erkende beroepsvereniging
Union professionnelle légalement reconnue

If these companies would not have the possibility to use the overlay approach, the temporary exemption from applying IFRS 9 would not offer a workable alternative solution. The temporary exemption from applying IFRS 9 would be operationally and financially very costly and would likely lead these companies to implement IFRS 9 without any delay. This would not be a solution for the raised problems and would also create an unacceptable un-level playing field with companies that can use the temporary exemption from applying IFRS 9.

Question 1 - *Addressing the concerns raised*

We concur with the assessment of the IASB 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.

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

In response to the concerns raised, the IASB proposes the overlay approach and the temporary exemption from applying IFRS 9. We support both approaches as complementary solutions for different types of financial institutions that issue insurance contracts that fall within the scope of IFRS 4.

For the majority of Belgian insurance companies, the temporary exemption from applying IFRS 9 is the preferred approach for addressing the concerns related to the misalignment of the effective dates of IFRS 9 and IFRS 4 phase 2. However, this approach cannot be applied by all insurance companies in our market. Therefore we welcome the overlay approach as a solution for those companies that are not able to use the temporary exemption from applying IFRS 9. These companies intend to use the overlay approach together with the further transition relief in IFRS 4 phase 2 that permits an entity to reassess its business model for financial assets at the date of initial application of IFRS 4 phase 2. In this way the overlay approach will allow for a level playing field with companies using the temporary exemption from applying IFRS 9.

Question 3 - *The overlay approach*

For several Belgian insurance companies, the overlay approach offers a useful solution and the cost-benefit analysis of applying the overlay approach is very favourable. We therefore don't support the comments made by the CFO Forum and Insurance Europe in their joint comment letter with regard to the overlay approach.

Besides 'pure' insurance companies, the Belgian insurance market is characterised by different mixed financial groups that provide predominantly banking activities (so-called bancassurance groups). The insurance companies of these groups represent about 20% of the insurance premiums in the Belgian market. Since both the banking activities and insurance activities are significant in these groups, they will not fulfil the predominance criterion and will not be able to apply the temporary exemption from applying IFRS 9. For these companies the overlay approach is a useful alternative that permits to decrease the temporary accounting volatility in their financial statements in the interim period. As mentioned before, the further transition relief as foreseen under paragraph BC18 of the Exposure Draft will ensure that a level playing field is created between companies using the overlay approach and others that have applied the temporary exemption from applying

IFRS 9 at the time of the initial application of IFRS 4 phase 2 with regard to the classification of their financial instruments.

If these companies would not have the possibility to use the overlay approach, the temporary exemption from applying IFRS 9 would not offer a workable alternative solution. The temporary exemption from applying IFRS 9 would be operationally and financially very costly and would likely lead these companies to implement IFRS 9 without any delay. This would not be a solution for the raised problems: adopting IFRS 9 before IFRS 4 Phase 2 will result in additional accounting mismatches which create additional income statement and equity volatility in the interim period between the mandatory effective dates of IFRS 9 and IFRS 4 phase 2. This would create an unacceptable un-level playing field with companies that can use the temporary exemption from applying IFRS 9.

For some of these companies the introduction of the temporary exemption from applying IFRS 9 would require the introduction of segmental reporting by line of business. Indeed, these companies would implement this new form of segmental reporting only for the interim period between the mandatory effective date of IFRS 9 and the mandatory effective date of IFRS 4 phase 2. The supplementary costs that would be incurred by this change would be much more important than those related to the direct implementation of IFRS 9 or the use of the overlay approach. Also, the application of the temporary exemption from applying IFRS 9 would require maintaining different systems for the valuation and impairment of their financial assets. Because of the strong integration of the banking and insurance activities, the implementation of these significant changes would be operationally very challenging and costly. In this regard it is important to stress that the financial statements of these groups are usually compared with the financial statements of banks and not with those of insurance companies or insurance groups. For these reasons, if the overlay approach would not be available, these companies would be forced to implement IFRS 9 in full without any delay.

We concur with the analysis of the IASB with regard to the financial assets that are eligible for the overlay approach and the fact that not all assets that qualify need to be designated. Based on the analysis made by Belgian insurance companies that have the intention to apply the overlay approach, the overlay approach will be used mainly for quoted equity instruments and participations in investment funds. The identified assets represent the majority of the financial assets leading to accounting mismatches in the profit or loss statement and to temporary accounting volatility. The additional costs for running both IAS 39 and IFRS 9 in parallel for these investment portfolios are considered to be acceptable. In this regard it should be noted that these companies are usually managed based on an integrated approach at group level, for instance, for their asset-liability management. **We therefore concur with paragraph BC25 of the Exposure Draft that the advantages of the overlay approach largely outweigh the supplementary costs and disadvantages related to it.**

The wording "as relating to contracts that are within the scope of IFRS 4" in paragraph 35B can be interpreted in a strict way as the assets that are contractually linked to contracts within the scope of IFRS 4, but can also include the surplus assets that an insurance company holds in the normal course of its business, either to meet regulatory requirements or for its internal capital requirements under Solvency II. We are of the opinion that the overlay approach should also be available for the surplus assets. As described correctly in paragraph BC36 of the Exposure Draft, a narrow scope of the overlay approach would limit this approach to some types of participating contracts only and would severely limit the use of this approach. We agree with paragraph BC36 of the Exposure Draft that a company using the overlay approach should disclose in the notes the basis for identification of financial assets qualifying for the overlay approach. Together with the other disclosure requirements in the Exposure Draft, this will enable companies using the overlay approach to provide clear and transparent information on the use of this approach.

In view of maintaining a level playing field between insurance companies applying the overlay approach and others applying the temporary exemption from applying IFRS 9, we support the proposal under paragraph 41K of the Exposure Draft for a retrospective application of the overlay approach. Under a retrospective application of the overlay approach, any accumulated amounts in OCI related to qualifying assets would be transferred into retained earnings at the moment of initial application of IFRS 4 phase 2. This is in line with the temporary exemption from applying IFRS 9, where any accumulated amounts in OCI under IAS 39 will be transferred to retained earnings at the moment of initial application of IFRS 4 phase 2.

Question 4 - *The temporary exemption from applying IFRS 9*

The majority of Belgian insurance companies will opt for the temporary exemption from applying IFRS 9 as it helps to mitigate all the identified concerns related to the misalignment of the effective dates of IFRS 9 and IFRS 4 phase 2. In this regard we support the comments with regard to the temporary exemption from applying IFRS 9 made by Insurance Europe and the CFO Forum in their joint comment letter.

An important comment on the Exposure Draft relates to the proposed determination whether an entity's predominant activity is issuing contracts within the scope of IFRS 4:

- The predominance test as described in the Exposure Draft excludes several liability balances that are clearly related to insurance activities or normal business activities of an insurance company, such as derivative liabilities (hedging insurance related risks), non-controlling interest in consolidated investment funds (classified under IFRS as liabilities), funding liabilities, other insurance related liabilities like payables arising from (re-) insurance operations and policyholder payables, deferred tax and pensions. The liabilities related to investment contracts carried at fair value through profit and loss should be included in the predominance assessment since there will be no significant classification and measurement impact for financial assets backing investment contracts: these assets will be accounted for at fair value through profit or loss under IFRS 9 just as under IAS 39;
- The use of an artificially high predominance criterion of 75% could imply that insurance companies that currently fulfil the predominance criterion may not fulfil this criterion anymore on the first of January 2018. For instance, new regulatory requirements and the ongoing low interest rate environment could invoke changes in companies' business model during the coming years. Such an evolution may result in important changes in the companies' balance sheet structure which could negatively affect the result of the predominance test. Moreover, the threshold of 75% is a high threshold that is currently not reached by several insurance companies with predominant insurance activities;
- It is therefore likely that the proposed threshold will lead to artificial 'cliff-effects' between companies that are able to use the temporary exemption from applying IFRS 9 and others that are not. This should be avoided in order to ensure a level playing field and a comparable basis for financial reporting. It is therefore proposed to set the threshold of the predominance test at a more reasonable level, or to broaden the criteria for eligibility for the temporary exemption from applying IFRS 9.

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

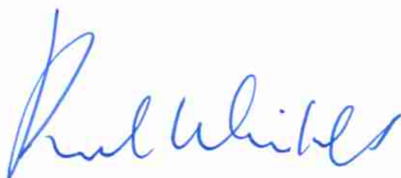
We agree with the position of the IASB that both the overlay approach and the temporary exemption from applying IFRS 9 should be optional. Depending on its structure and portfolio of insurance contracts, each company should determine which approach is most appropriate to provide a true and fair view of its financial statements. In this regard each company should be allowed to stop applying the overlay approach or the temporary exemption from applying

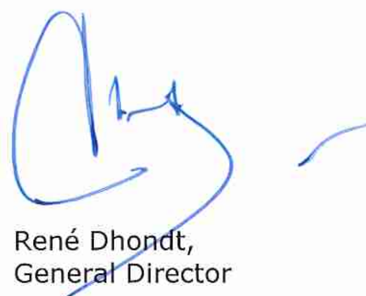
IFRS 9 before the mandatory effective date of IFRS 4 phase 2 if this would increase the quality of its financial reporting. In case the overlay approach would not be available, an alternative solution for the temporary exemption from applying IFRS 9 should be available that is operationally and financially acceptable for all insurance companies.

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 companies 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.

Yours faithfully,





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