www.allianz.com

Allianz SE, 80790 Munich, Germany

Koeniginstrasse 28
80802 Munich, Germany
Phone +49 89.3800-0

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

Direct dial
Tel. +49 89 3800 14429
+49 89 3800 13103

Our ref., Date
Dr. Roman Sauer
Dr. Nina Fichtl
20.01.2016

Mail roman.sauer@allianz.com
nina.fichtl@allianz.com

Comments on EFRAG's draft letter on the IASB's Exposure Draft ED/2015/11 - Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

Dear Mr Marshall,

We appreciate the opportunity to provide feedback on EFRAG's draft letter on the IASB's Exposure Draft ED/2015/11 - Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts. Allianz Group is a global financial services company operating within the insurance and asset management market segments. As of December 31, 2014, we held financial assets of more than EUR 700bn and the liability side of our balance sheet is dominated by insurance related liabilities. As such, we have a very strong interest in both IFRS 9 and IFRS 4 Phase II and want to avoid the problems arising from a staggered implementation of both standards. These problems include, but are not limited to, additional accounting mismatches and temporary volatility in profit or loss, the necessity to implement IFRS 9 twice, and the costs and efforts that arise for both preparers and users of financial statements from two major standard implementations in a short period of time.

Allianz highly appreciates EFRAG's understanding for the insurance industry's concerns regarding a misalignment of the effective dates of IFRS 9 and IFRS 4 Phase II. We think that the draft comment letter proposed by EFRAG adequately reflects the issues arising from a staggered implementation of the two new accounting standards.

We also share your assessment on the overlay approach. This option would only allow mitigating additional accounting mismatches and temporary volatility arising from a misalignment of the effective dates of IFRS 9 and IFRS 4 Phase II. The other problems cannot be addressed by the overlay approach. In addition, the overlay approach would be costly and burdensome to implement. Hence, the costs of the overlay approach do by far outweigh its benefits. Therefore, Allianz would not even apply the overlay approach if the temporary exemption from applying IFRS 9 (formerly also described as the deferral approach) was not available. However, we share EFRAG's view that the overlay approach should be optional, as under some circumstances the application of the overlay approach might seem attractive for conglomerates.

The temporary exemption from applying IFRS 9, on the other hand, can address all issues arising from the misalignment of the effective dates. Therefore, we are convinced that the temporary exemption is the only efficient solution for the vast majority of insurance companies. We share EFRAG's concern that the scope as being discussed by the IASB is too narrow. Your suggestion to apply a widened "predominant activity" criterion is in our view a reasonable approach. Also the regulated entity criterion as proposed in your draft letter could be a workable solution. However, we would like to clearly emphasize that the assessment both based on the widened predominance criterion and the regulated entity criterion should start by default on a reporting entity level. An assessment on legal entity level as indicated in the discussion of the regulated entity criterion is not an acceptable solution as it would be operationally very burdensome and costly and would also result in consolidated financial statements containing assets measured both under IAS 39 and IFRS 9. An assessment on lower than reporting entity might only be applicable for conglomerates with significant banking activities.

Allianz also fully supports the views expressed in the comment letter of the European Insurance CFO Forum.

For our detailed answers on your questions to constituents we would like to ask you to refer to the appendix.

Please feel free to contact us to discuss any matters raised in this letter.

Yours sincerely,

Dr. Roman Sauer
Head of Group Accounting
Policy Department

Dr. Nina Fichtl
Group Accounting
Policy Department

Appendix – Questions to constituents

Before answering the question raised in your draft comment letter, we would like to highlight that we support the responses as provided to you in a separate comment letter by the European Insurance CFO Forum.

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

Paragraph 19 – In its preliminary outreach, EFRAG has encountered existing, albeit limited, appeal for the overlay approach. Does your company wish to apply the temporary exemption from IFRS 9 or the overlay approach? Please explain the circumstances determining your view.

Allianz Group will be using the temporary exemption from applying IFRS 9. We would not use the overlay approach even if we did not qualify for the temporary exemption.

The rationale for using the temporary exemption instead of the overlay approach is that it addresses all issues arising from the misalignment of the effective dates while the overlay approach only mitigates the additional accounting mismatches and temporary profit or loss volatility. In our opinion, solving the other problems, such as two major standard implementations in a short period of time and a twofold implementation of IFRS 9, are at least as important as reducing the accounting mismatches. In addition, the temporary exemption will cause significantly lower costs than the overlay approach, which will be discussed in detail in our response to the next question. Hence, we come to the conclusion that while for the temporary exemption the benefits by far outweigh the costs, the contrary holds true for the overlay approach. Therefore, the temporary exemption is the only efficient solution.

IASB Question 3 – The overlay approach

Paragraph 38 – Do you agree with the extra costs identified in paragraph 36? If so, do you consider these costs to be significant? Please explain and provide quantifications to the extent possible.

Paragraph 39 – Do you consider that the application of the overlay approach will imply that such extra costs as stated in paragraph 36 above will limit its applicability? If so, could you identify and quantify, if possible, which extra costs (on top of implementing IFRS 9) are the most significant?

Paragraph 40 – Other than costs, are there any other reasons why an insurer would not elect to apply the overlay approach?

Paragraph 41 – If you elect to apply the overlay approach, would you change the way the eligible financial assets are being reported internally?

Paragraph 42 – Do you agree that the optionality in presentation should be limited to Alternative A as stated in paragraph 28 above?

Paragraph 43 – Referring to paragraph 34 above, do you consider that the amendments to IFRS 4 which may arise due to the ED should include further explanation about the presentation of the overlay adjustment in OCI?

EFRAG states that the main costs related to the overlay approach will arise because it requires a parallel run of IAS 39 and IFRS 9, which will require costly changes in data-processing systems and the set-up of new internal controls for a limited period of time. We generally agree with EFRAG that these are very significant cost components.

More specifically, it is the very nature of the overlay approach to require a parallel run of both IAS 39 and IFRS 9, as the difference between the two amounts can otherwise not be determined. This is driven both by the different measurement models and the second order effects like deferred taxes and shadow accounting, which is relevant for life insurers that have a strong relationship between the asset and liability side of the balance sheet. This parallel run means that an insurer will be required to collect IAS 39 and IFRS 9 information of its financial instruments on an instrument by instrument basis. Hence, it is a misconception to assume that the overlay approach would only be consisting of a simple adjustment on account level in the consolidated financial statements based on already available data.

The parallel run would require two charts of accounts for investments. A parallel run would also be a significant challenge to the closing process and reporting systems as the information would need to be processed in parallel to stay within the tight closing deadlines. However, that cannot be achieved with the current capacity of the reporting systems. Please consider that information and data needed for IFRS reporting of financial instruments is generated and processed through multiple back office systems, data-warehouses and general ledgers up to the group consolidation systems and group investment data warehouse. In a group with the size of Allianz this is a large and highly complex system landscape where many restrictions exist with regard to data volume and data fields etc.

Hence, the costs of the overlay approach clearly outweigh its benefits. However, even if not considering the additional costs, we do not think the overlay approach is an efficient solution. Of all the issues arising from a staggered implementation of IFRS 9 and IFRS 4 Phase II it would only mitigate accounting mismatches and temporary profit or loss volatility. It would not avoid having two major standard implementations/restatements in a short period of time and would require implementing IFRS 9 twice. In addition, we think that the overlay adjustment would be rather confusing for investors.

As we will not apply the overlay approach, we do not comment on the details of the approach. However, we are not opposed to provide insurers with the option to apply the overlay approach as an alternative to the temporary exemption.

IASB Question 4 – The temporary exemption from applying IFRS 9

Paragraph 70 - How restrictive is the assessment of predominance as proposed by the IASB? Please provide quantitative evidence.

Paragraph 71 – Would the proposal in paragraphs 57 – 64 above achieve the objectives highlighted by EFRAG (i.e. avoid a breach in level playing field in the insurance sector and inclusion of banking activities)? If not, what formula would you recommend for the assessment of predominance, and why?

Paragraph 72 – Do you think that the proposal above leads to a predominance criterion that is practical, auditable and comparable? Please explain.

Paragraph 73 - Taking into account the widening of the predominance criterion, do you agree that the quantitative threshold should be at a level that is substantially higher than three quarters of an entity's total liabilities? Please explain.

Paragraph 74 – Do you agree with the arguments in paragraphs 65– 69 above? If you do not and still believe that the regulated criterion has a role to play, please explain why and how it would work.

Paragraph 75 – Is the regulatory consolidation scope always identical to the IFRS consolidation scope? If not, please explain the difference(s).

Paragraph 76 – EFRAG currently considers that eligibility for the temporary exemption of IFRS 9 requires that entities/activities issue material insurance contracts within the scope of IFRS 4. Do you agree with this materiality threshold? If not, what do you suggest instead? Please explain.

Paragraph 77 – Is this condition necessary when relying on the "regulated entity" criterion? What are the circumstances in which an entity would be supervised by an insurance regulator and not issue insurance contracts within the scope of IFRS 4? What are the effects of changing from IAS 39 to IFRS 9 to those entities?

Paragraph 78 – If you consider that eligibility for the temporary exemption from applying IFRS 9 should not be based on predominance or on regulation, what principle(s) should be applied, and how would you test these principles?

We generally think that the IASB's predominance criterion is too restrictive. While Allianz would pass the quantitative predominance test as proposed by the IASB with a ratio of 82%, a very significant number of European Insurance CFO Forum members would not pass the "de-facto" threshold set by the IASB.

The widened predominance criterion as defined in the EFRAG draft comment letter seems from our perspective to be a workable solution. It would represent a fair balance between the objectives of avoiding a breach of the level playing field for insurers and the inclusion of banking activities. However, one might also consider a more principles-based approach as proposed by the CFO Forum to achieve this result.

We also support EFRAG's proposal that the predominance test should first be performed on a reporting entity level. An assessment on a lower level would be problematic. Even a pure insurer like Allianz holds entities like special investment funds, service companies, and very small banks that would not qualify on a legal entity level for the temporary exemption. Accordingly, an assessment on a lower level would require a parallel reporting of IAS 39 and IFRS 9 information in the consolidated financial statements. This would come at high costs. On the other hand, the costs arising from a few entities like banks preparing their separate financial statements in accordance with IFRS 9, but reporting to the Group based on IAS 39 would by far be lower. Hence, only if the test is not passed at reporting entity level, the test should be repeated on a lower level and rolled-up in the consolidated financial statements.

We would like to highlight that we do not agree with EFRAG's view on the reassessment. Changes in group structure can in practice sometimes not be anticipated over a long period of time. Given the temporary nature of the exemption and the fact that an implementation of IFRS 9 within a short period of time, i.e. for the next annual reporting period following the change in corporate structure, is not possible, insurers should not be required to reassess their eligibility for the temporary exemption.

The predominance criterion as proposed by EFRAG seems to be practical, auditable, and comparable.

A threshold set a significantly higher level than 75% would, however, not be appropriate. We even doubt whether one should set any bright line. That is also supported by the IASB, which states in para. BC65 of the ED that "specifying a particular quantitative threshold for when insurance activities would be considered predominant would be arbitrary". While the IASB is then providing an example of a conglomerate having 75% insurance liabilities and 25% banking liabilities, we think that this should not be interpreted as a threshold.[1] Just testing for 75% insurance liabilities misses the important point that the 25% are only considered to be problematic if they are related to banking business.

As an alternative to the predominance test, EFRAG has developed a regulation criterion. Overall, we think that such an approach could be workable. However, we rather think in line with the CFO Forum that the regulation criterion could play a part in a principles-based assessment of the eligibility of an entity for the temporary exemption. Nevertheless, Allianz wants to highlight that an application of the regulated insurance entity criterion should be applied, like the quantitative predominance criterion, on a reporting entity level.

Summarizing, we think that EFRAG's proposal for a widened predominance criterion represents a good solution. However, setting a bright line for a predominance threshold would be in our opinion arbitrary. Insurance regulation, which is proposed by EFRAG as a second criterion could be work-

[1] We are perfectly aware that this example will be interpreted by audit companies as a de-facto bright line. However, we think that this was not intended by the IASB.

able, but should not be seen as an alternative, but rather as another factor in a principles-based assessment. The default level for the assessment of the eligibility needs always to be the reporting entity level.

Paragraph 88 – Should an entity assess its predominant activity at the reporting entity level or below the reporting entity level or both? Please explain your view.

Paragraph 89 – In your view, how can the temporary exemption from applying IFRS 9 below the reporting entity level be determined in a way that ensures the eligibility of relevant entities and allows for comparability between entities? Please explain your view.

Paragraph 90 – What are the expected costs involved in the implementation of the temporary exemption from applying IFRS 9 at reporting entity level or below reporting entity level (including disclosures)? Please provide evidence, including quantitative evidence to the extent feasible.

Paragraph 91 – Which alternative for the accounting of transfers as stated in paragraph 82 to 87 above would be most appropriate for the temporary

Allianz is, as highlighted before, clearly in favour of assessing the eligibility on a reporting entity level. Only for conglomerates that do not meet the predominance test on a reporting entity level, a test on a lower level should be considered. The result of the lower level would then be rolled up in the consolidated financial statements.

We estimate that the cost for the implementation of the deferral approach on reporting entity level would be in a low single digit million Euro range due to the development of an SPPI tool in order to satisfy the additional disclosure requirements. If an insurer would however be required to apply the deferral on a lower level than the reporting entity level, the costs would increase significantly. In this case an insurer would need to run both standards in parallel, i.e. in the consolidated financial statements asset measurement would be based on IAS 39 and IFRS 9. This would require additional accounts, a restructuring of the components of financial statements like balance sheet and statement of comprehensive income, and there would also be additional disclosure requirements. Hence, financial statements would be more costly to prepare and the accounting information would be more difficult to understand for users.

Paragraph 105-107 – Other issues – Applicability for first time adopters

We clearly share EFRAG's concern on the IASB's proposal to exclude first-time adopters from using the temporary exemption and the overlay approach. This issue is problematic for insurance groups whose subsidiaries might be obliged to start applying IFRS on or after January 2018. This could result in an application of IAS 39 for consolidated financial statements, but of IFRS 9 for the separate financial statements. This would create significant operational challenges and costs to the insurers without a convincing conceptual argument that clearly speaks against allowing a temporary exemption for first-time adopters.