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LE DÉLÉGUÉ GÉNÉRAL

20 January 2016

EFRAG's comment letter on IASB ED/2105/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contract

Dear Mr Marshall,

This letter is from the Fédération française des Sociétés d'Assurances ("FFSA"), which is the French (re)insurance federation whose members are insurance and reinsurance undertakings, representing 90% of the French insurance market.

FFSA welcomes the opportunity to respond to EFRAG's draft comment letter on the Exposure Draft, ED/2015/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contracts ("ED").

The temporary exemption

FFSA strongly supports a temporary exemption from applying IFRS 9 for all insurance activities. Therefore, FFSA is highly concerned that the scope of the ED's temporary exemption is much too narrow to provide a "level playing field" for all insurance activities.

Indeed:

- The ED's proposal to assess the predominance only at the level of the reporting entity would arbitrarily exclude insurance entities conducted within conglomerates (hereafter bancassureurs). This would entail a negative impact and a disadvantage for the French market where bancassurers represent a significant share of insurance activities. Due to this arbitrary restriction, the performance of bancassurers and the measurement of their financial assets would not be comparable with those of the insurance market players allowed to apply the temporary exemption;
- The ED's proposal to assess the predominance based on the ratio of [liabilities arising from contracts in the scope of IFRS 4 / total liabilities] at the reporting entity level with a suggested threshold of 75% is an arbitrary bright line that does not appropriately capture the predominance of insurance activities.

Mr Roger Marshall
Acting President of the EFRAG Board
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Square de Meeûs 35
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Our members also highlight the risk that this difference of eligibility to the temporary exemption would result in accounting inconsistencies between industry players with some significant impact on their investment strategies. Indeed, the non-eligible players would have to reconsider their investment strategy to reduce the effects of these accounting mismatches, putting them at a disadvantage with their peers eligible to the temporary exemption.

To make the temporary exemption effective for all insurance activities, regardless of their group structure, FFSA proposes to identify insurance activities eligible for the temporary exemption as follows:

(a) Reporting entity level if the group is predominantly involved in insurance activities;

And;

(b) Entity or sub-group predominantly involved in insurance activities that is part of a larger group not predominantly involved in insurance activities. The effect of application of IAS 39 by this entity or sub-group will be maintained ("rolled up") in the consolidated financial statements of the group as a whole (not reversed).

Regarding the assessment of the predominance, FFSA does not believe that the temporary exemption should be based only on one criterion as proposed by EFRAG in its cover letter (e.g. either a "widened predominant activity" criterion or a "regulated entity" criterion). **FFSA considers that the assessment of the predominance of insurance activities should be principles-based reflecting a range of qualitative and quantitative factors, including a quantitative "widened predominance activity" factor and a presumption that a "regulated entity/sub-group" is eligible to the temporary exemption.** This would ensure a "level playing field" for all insurance activities.

In this respect, we note that EFRAG considers that the temporary exemption should not capture "non-insurance activities and in particular banking activities". However, we are of the opinion that a distinction should be made between "non-insurance" activities that are closely linked to insurance activities (for example consolidated funds, service companies or non-regulated intermediate or ultimate holding companies) and banking activities. "Non-insurance" activities that are closely related to insurance activities should be captured by the temporary exemption. Regarding banking activities included in insurance groups, we consider that they should be allowed to apply the temporary exemption only if they are not material to the consolidated financial statements of the reporting entity. We also believe that the amount of IFRS 9 expected credit losses for those banking activities, even if not material, might be of interest for users and as such could be disclosed. Therefore, users will be provided with transparent information about the application of IFRS 9 impairment requirements to those banking activities while the whole group will not have to modify its accounting policies in the period between the application of IFRS 9 and the new insurance contracts Standard.

FFSA considers that a ratio based on "liabilities resulting from insurance activities" as a percentage of total liabilities is an appropriate quantitative factor to capture the predominance of insurance activities. However, the ratio mentioned in paragraph BC.65 of the ED does not achieve this objective as it limits "liabilities resulting from insurance activities" to those arising from contracts within the scope of IFRS 4. The overly restrictive definition of these liabilities would result in a narrow scope of the temporary exemption that would also create inconsistency and absence of comparability within the insurance industry. Furthermore, we believe that a principles-based approach should not include any bright line.

In the same manner we consider that a "regulated criterion" is an appropriate qualitative factor to capture the predominance of insurance activities. In this respect, we believe that a presumption should be established that a regulated entity/ (sub) group predominantly involved in insurance activities is eligible to the temporary exemption. Indeed, applying only a "regulated criterion" at the (legal) entity level would result in a rigid approach that would also exclude from the temporary exemption entities that are closely linked to insurance activities (for example consolidated funds, service companies or non-regulated intermediate or ultimate holding companies).

In addition, a principles-based approach reflecting a range of qualitative and quantitative factors would have the benefit of addressing the concern of the date of the assessment of the predominance. If the predominance were only based on a quantitative ratio, there is a risk that some insurance activities that would have been eligible may not meet this threshold as at January 2018 simply as a result of changes in the value of their liabilities related to insurance activities compared to the total of their liabilities.

The overlay approach

FFSA considers that the deferral approach is the most effective approach. The overlay does not address all the concerns raised about the different effective dates of IFRS 9 and the new insurance contracts Standard. The operational complexity, costs and efforts required to run IFRS 9 and IAS 39 in parallel may also deter entities to apply this option. In this respect, FFSA notes that paragraph 18 of EFRAG's draft comment letter states that "the overlay approach is a suitable solution for some banks which carry out insurance activities". FFSA understands that EFRAG's assessment is that a very limited number of entities, with very specific characteristics may be considering applying the overlay approach. With regard to the French market, FFSA is not aware of any significant French insurer and bancassureur that might consider the overlay approach as a suitable solution.

We have included in the Appendix our detailed responses to the questions raised in your draft comment letter. We appreciate your consideration of our input and remain at your disposal should you wish to further discuss any of our comments.

Yours sincerely,

Pierre Michel

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 (paragraphs BC17–BC18).

(c) Two sets of major accounting changes in a short period of time could result in significant costs and effort for both preparers and users of financial statements (BC19–BC21).

The proposals made by the IASB are designed to address these concerns.

Do you agree that the IASB should seek to address these concerns? Why or why not?

FFSA has been a long-time supporter of the IFRS 9 deferral to address these concerns. We also concur with the IASB that the existing accounting requirements in IFRS 4 and the transition requirements in the new insurance contracts Standard do not address the key concerns raised about the different effective dates of IFRS 9 and the new insurance contracts Standard.

Therefore, FFSA strongly agrees with the decision of the IASB to seek to address these concerns. Regarding the concern expressed in (c), FFSA also believes that two sets of major accounting changes in a short period of time will make financial statements less understandable reducing their decision-usefulness for users.

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 required, please explain which and why.

Question to constituents

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.

FFSA considers that the deferral approach is the most effective approach. Indeed, the overlay does not address all the concerns raised about the different effective dates of IFRS 9 and the new insurance contracts Standard. As stated by EFRAG in paragraph 17 of its draft comment letter "the overlay approach does not address the successive implementation (and the related costs) of the two accounting standards....Furthermore, it generates supplementary costs of its own, due to the necessary dual bookkeeping for the eligible assets under IAS 39 and IFRS 9 that is required at financial asset level and the related supplementary internal controls".

In addition, although the overlay approach would remove from the income statement some of the volatility arising from IFRS 9 for certain financial assets, it would necessitate a dual reassessment of the designation of the financial assets in 2018 and 2021 (expected implementation date of the future insurance contracts Standard). These two significant accounting changes in a short period of time would confuse users of financial statements. The operational complexity, costs and efforts required to run IFRS 9 and IAS 39 in parallel may also deter entities to apply this approach.

FFSA also notes that paragraph 18 of the EFRAG's draft comment letter states that "the overlay approach is a suitable solution for some banks which carry out insurance activities". FFSA understands that EFRAG's assessment is that a very limited number of entities, with very specific characteristics may be considering applying the overlay approach. With regard to the French market, FFSA is not aware of any significant French insurer and bancassureur that might consider the overlay approach as a suitable solution.

Question 3 – The overlay approach

Paragraphs 35A–35F and BC32–BC53 describe the proposed overlay approach.

(a) Paragraphs 35B and BC35–BC40 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 in 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?

Question to constituents

Please respond to these questions in light of the preamble to this draft comment letter highlighting that EFRAG is seeking facts and evidence as assistance in helping finalise its assessments and proposals.

Application of the overlay approach

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.

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?

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

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

Presentation

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

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?

FFSA agrees with the qualitative assessment of the extra costs made by EFRAG in paragraph 36 of its draft comment letter. These extra costs coupled with the operational complexity of an approach that does not solve the key concerns raised by the different effective dates of the two standards are the reasons why the overlay approach is not considered to be the most effective approach by our members.

As the benefits of the overlay approach were not convincing in comparison to its operational complexity, most of our members have not considered in more detail the quantification of these extra costs.

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?

EFRAG Questions to constituents

Please respond to these questions in light of the preamble to this draft comment letter highlighting that EFRAG is seeking for facts and evidence helping finalise its assessments and proposals.

Widened predominance criterion

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

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?

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

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.

The "regulated entity" criterion

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.

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

General

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.

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?

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?

IASB Question 4 (a), (c) and EFRAG Question 78

FFSA strongly supports a temporary exemption from applying IFRS 9 for all insurance activities regardless of the structure of the group in which insurance activities are conducted. We believe that a temporary exemption should capture insurance activities that are affected by the different effective dates of IFRS 9 and the new insurance contracts Standard independently of whether they are operated on a standalone basis or as part of a conglomerate.

Therefore, FFSA is highly concerned that the scope of the ED's proposed temporary exemption is much too narrow to provide a "level playing field" for all insurance activities.

Indeed:

- The ED's proposal to assess the predominance only at the level of the reporting entity would arbitrarily exclude insurance entities conducted within conglomerates (hereafter bancassureurs). This would entail a negative impact and a disadvantage for the French market where bancassurers represent a significant share of insurance activities. Due to this arbitrary restriction, the performance of bancassurers and the measurement of their financial assets would not be comparable with those of the insurance market players allowed to apply the temporary exemption;
- The ED's proposal to assess the predominance based on the ratio of [liabilities arising from contracts in the scope of IFRS 4 / total liabilities] at the reporting entity level with a suggested threshold of 75% is an arbitrary bright line that does not appropriately capture the predominance of insurance activities.

Our members also highlight the risk that this difference of eligibility to the temporary exemption would result in accounting inconsistencies between industry players with some significant impact on their investment strategies. Indeed, the non-eligible players would have to reconsider their investment strategy to reduce the effects of these accounting mismatches, putting them at a disadvantage with their peers eligible to the temporary exemption.

To make the temporary exemption effective for all insurance activities, regardless of their group structure, FFSA proposes to identify insurance activities eligible for the temporary exemption as follows:

(a) Reporting entity level if the group is predominantly involved in insurance activities;

And;

(b) Entity or sub-group predominantly involved in insurance activities that is part of a larger group not predominantly involved in insurance activities. The effect of application of IAS 39 by this entity or sub-group will be maintained ("rolled up") in the consolidated financial statements of the group as a whole (not reversed).

FFSA understands that the IASB is concerned that as a result of (b) IAS 39 and IFRS 9 would be simultaneously applied for the accounting of financial instruments in the group as a whole. However, FFSA believes that this concern can be addressed by introducing appropriate disclosures ensuring that useful information is provided to users of financial statements for example by presenting the amount of financial assets measured under IAS 39 and those measured under IFRS 9 separately on the face of the consolidated balance sheet.

IASB Question 4 (b) and EFRAG Questions 70-77

Regarding the assessment of the predominance, FFSA does not believe that the temporary exemption should be based only on one criterion as proposed by EFRAG in its cover letter (e.g. either a "widened predominant activity" criterion or a "regulated entity" criterion).

FFSA considers that the assessment of the predominance of insurance activities should be principles-based reflecting a range of qualitative and quantitative factors, including a quantitative "widened predominance activity" factor and a presumption that a "regulated entity/sub-group" is eligible to the temporary exemption. This would ensure a "level playing field" for all insurance activities.

In this respect, we note that EFRAG considers that the temporary exemption should not capture "non-insurance activities and in particular banking activities". However, we are of the opinion that a distinction should be made between "non-insurance" activities that are closely linked to insurance activities (for example consolidated funds, service companies or non-regulated intermediate or ultimate holding companies) and banking activities. "Non-insurance" activities that are closely related to insurance activities should be captured by the temporary exemption. Regarding banking activities included in insurance groups, we consider that they should be allowed to apply the temporary exemption only if they are not material to the consolidated financial statements of the reporting entity. We also believe that the amount of IFRS 9 expected credit losses for those banking activities, even if not material, might be of interest for users and as such could be disclosed. Therefore, users will be provided with transparent information about the application of IFRS 9 impairment requirements to those banking activities while the whole group will not have to modify its accounting policies in the period between the application of IFRS 9 and the new insurance contracts Standard.

FFSA considers that a ratio based on "liabilities resulting from insurance activities" as a percentage of total liabilities is an appropriate quantitative factor to capture the predominance of insurance activities. However, the ratio mentioned in paragraph BC.65 of the ED does not achieve this objective as it limits "liabilities resulting from insurance activities" to those arising from contracts within the scope of IFRS 4. As such, it does not capture all the liabilities resulting from the day to day insurance activities. "Liabilities resulting from insurance activities" should also include derivatives liabilities (used to hedge insurance activities), non-controlling interest in consolidated funds (which are classified as liabilities), contracts accounted for at fair value through profit and loss and other insurance liabilities (for example payables arising from insurance/reinsurance operations, policyholders payables, tax / employees payables related to insurance activities). In addition, insurance activities should be eligible to the temporary exemption independently of the manner in which they raise funds (debt versus equity), therefore related debt should also be part of the "liabilities resulting from insurance activities". The overly restrictive definition of these liabilities would result in a narrow scope of the temporary exemption that would also create inconsistency and absence of comparability within the insurance industry. Furthermore, we believe that a principles-based approach should not include any bright line.

In the same manner we consider that a "regulated criterion" is an appropriate qualitative factor to capture the predominance of insurance activities. In this respect, we believe that a presumption should be established that a regulated entity/ (sub) group predominantly involved in insurance activities is eligible to the temporary exemption. Indeed, applying only a "regulated criterion" at the (legal) entity level would result in a rigid approach that would also exclude from the temporary exemption entities that are closely linked to insurance activities (for example consolidated funds, service companies or non-regulated intermediate or ultimate holding companies).

In addition, a principles-based approach reflecting a range of qualitative and quantitative factors would have the benefit of addressing the concern of the date of the assessment of the predominance. If the predominance were only based on a quantitative ratio, there is a risk that some insurance activities that would have been eligible may not meet this threshold as at January 2018 simply as a result of changes in the value of their liabilities related to insurance activities compared to the total of their liabilities.

Furthermore, we consider that a re-assessment of the predominance is not appropriate considering the short duration of the exemption.

Questions to constituents

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.

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.

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.

91 Which alternative for the accounting of transfers as stated in paragraph 82 to 87 above would be most appropriate for the temporary exemption from applying IFRS 9 below reporting entity level? Please explain why.

For questions 88 to 90, please refer to our response to Question 4 and our proposal to make the temporary exemption effective for all insurance activities.

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?

We do not have any particular comments on this question.

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?

We are not opposed to the proposed expiry date for the temporary exemption. We believe that even there remains significant concerns regarding the outcome of the future insurance contracts Standard - such as the treatment of participating contracts - there is still a possibility of achieving a 2021 effective date for the future insurance contracts Standards, including a three year time implementation delay.