EFRAG
European Financial Reporting Advisory Group

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS ON APPLYING IFRS 9 FINANCIAL INSTRUMENTS WITH IFRS 4 INSURANCE CONTRACTS: AMENDMENTS TO IFRS 4

Comments should be submitted by 13 December 2016 by using the 'Express your views' page on EFRAG website or by clicking here

EFRAG has been asked by the European Commission to provide it with advice and supporting material on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4* (the 'Amendments'). In order to do so, EFRAG has been carrying out an assessment of the Amendments against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of the Amendments is set out in Appendix 1 of the accompanying *Draft Letter to the European Commission* regarding endorsement of the Amendments.

Before finalising its assessment, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interests of transparency, EFRAG will wish to discuss the responses it receives in a public meeting, so it is preferable that all responses can be published.

EFRAG's initial assessments, summarised in this questionnaire, will be updated for comments received from constituents when EFRAG is in the process of finalising its *Letter to the European Commission* regarding endorsement of the Amendments.

Your details

1 Please provide the following details:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

Intesa Sanpaolo S.p.A.

(b) Are you a:

☒ Preparer ☐ User ☐ Other (please specify)

Preparer

(c) Please provide a short description of your activity:

Bank-led financial conglomerate with non-predominant insurance activity

(d) Country where you are located:

Italy

(e) Contact details, including e-mail address:

Francesca Passamonti
Head of European Regulatory and Public Affairs
francesca.passamonti@intesasanpaolo.com
Intesa Sanpaolo S.p.A.
Square de Meeûs, 35
1000 Bruxelles
Belgium

EFRAG's initial assessment with respect to the technical criteria for endorsement

2 EFRAG's initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, the Amendments are not contrary to the principle of true and fair view and meets the criteria of understandability, relevance, reliability, comparability and raises no issues regarding prudent accounting. EFRAG's reasoning is set out in Appendix 2 of the accompanying *Draft Letter to the European Commission* regarding endorsement of the Amendments.

(a) Do you agree with this assessment?

☐ Yes ☒ No

If you do not agree, please provide your arguments and what you believe the implications of this could be for EFRAG's endorsement advice.

Intesa Sanpaolo S.p.A. owns directly **Intesa Sanpaolo Vita S.p.A**. and Fideuram Vita S.p.A., and indirectly Intesa Sanpaolo Assicura S.p.A., Intesa Sanpaolo Life L.t.d., Intesa Sanpaolo Smart Care S.r.l.

All the above legal entities, which are Intesa Sanpaolo's insurance subsidiaries based in Italy, report to Intesa Sanpaolo parent company, under Intesa Sanpaolo Group Accounting Principles, to contribute to the Intesa Sanpaolo Consolidated Financial Statements (i.e. second level of financial reporting).

Intesa Sanpaolo Vita S.p.A. directly owns Intesa Sanpaolo Assicura S.p.A., Intesa Sanpaolo Life L.t.d., Intesa Sanpaolo Smart Care S.r.l. and manages for regulatory and IFRS 8 (consolidated operating segments) disclosure purposes Fideuram Vita S.p.A.

Based on the above, Intesa Sanpaolo Vita publishes (i.e. first level of financial reporting):

- a consolidate financial statements for Italian regulatory rules purposes (IVASS) including Fideuram Vita (named IVASS Unified Management);
- a consolidated financial statements for Lux Stock Exchange purposes without including Fideuram Vita (Intesa Sanpaolo Vita issued some subordinated bonds listed on the Lux Stock Exchange).

The amendments to IFRS 4 should ensure the alignment of the financial information to the market between the consolidated financial statements of the Insurance Group and the consolidated financial statements of the Banking Group. Comparability is a value for all the stakeholders, namely Rating

Agencies and financial analysts.

Intesa Sanpaolo S.p.A., as bank-led financial conglomerate (as per second level of financial reporting), does not qualify for the application of the temporary exemption from IFRS 9 (i.e. deferral approach) to its consolidated financial statements.

Intesa Sanpaolo Vita S.p.A. is a company whose activities are predominantly connected with insurance, according to IASB's criteria listed in the amended IFRS 4. Considering the size of the Intesa Sanpaolo Group, Intesa Sanpaolo Vita S.p.A. publishes its own consolidated financial statements, which are directly comparable to those of its peers, which are both insurance companies or insurance-led conglomerates. For the two reasons above, Intesa Sanpaolo Vita S.p.A. qualifies, at first level of financial reporting, for the application of the temporary exemption from IFRS 9.

The amended IFRS 4 aims at ensuring comparability among conglomerates as a whole, but does not ensure comparability among financial statements of insurance subsidiaries. In fact, the Intesa Sanpaolo Vita S.p.A. cannot apply the deferral approach, with the aim of aligning the two reporting levels.

Despite the application of the overlay approach, which is a kind of relief from the direct application of IFRS 9, Intesa Sanpaolo Vita S.p.A. will suffer from a competitive disadvantage not only with its peers but also with associates and joint ventures. In fact, the latters apply IAS 28 in order to have uniform accounting policies when using the equity method, but – according to the amended IFRS 4 – they are allowed to apply a differentiated approach and can choose the temporary exemption[1].

The overlay approach seems to be the only available option that could mitigate the additional accounting mismatches and volatility in profit or loss arising from the full application on IFRS 9. However, the mitigation provided by the overlay approach is not fully effective. In fact, the eligibility criteria do not allow to apply the overlay approach to the impairment accounted for in Profit and Loss, as required by section 5.5 of IFRS 9 (expected credit loss model) and that would not have been accounted for as for IAS 39 (incurred loss model).

Therefore, we conclude that the proposed solution doesn't solve the comparability issue, which is a value for all the stakeholders, namely Rating Agencies and financial analysts.

(b) Are there any issues that are not mentioned in Appendix 2 of the accompanying *Draft Letter to the European Commission* regarding endorsement of the Amendments that you believe EFRAG should take into account in its technical evaluation of the Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

[1] See pag.8 par. 20O of IASB Amendments to IFRS 4.

The European public good

3 In its assessment of the impact of the Amendments on the European public good, EFRAG has considered a number of issues that are addressed in Appendix 3 of the accompanying *Draft Letter to the European Commission* regarding endorsement of the Amendments.

Improvement in financial reporting

4 EFRAG has identified that in assessing whether the endorsement of the Amendments is conducive to the European public good it should consider whether the Amendments are an improvement over current requirements (see paragraphs 3 and 4 of Appendix 3 of the accompanying *Draft Letter to the European Commission*). To summarise, EFRAG's initial assessment is that the Amendments are likely to improve the quality of financial reporting relative to the situation if there were no remedies.

Do you agree with the assessment?

☒ Yes ☐ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Costs and benefits

5 Given that the Amendments introduce two options to assist in mitigating the misalignment of the effective dates of IFRS 9 and the forthcoming insurance contracts Standard, EFRAG expects that each entity will select the best option in its specific circumstances for which it is eligible, in particular, each entity will select the option that provides the best cost-benefit trade-off. Overall, EFRAG assesses that the benefits for both users and preparers are likely to exceed the costs of applying the Amendments for the reasons stated in paragraphs 5 – 23 of Appendix 3.

Do you agree with this assessment?

☐ Yes ☒ No

If you do not, please explain why you do not agree and explain broadly what you believe the costs and associated benefits will be?

The overlay approach would be the identified way for the Intesa Sanpaolo Group to reduce the volatility and accounting mismatch (first level) and to have an alignment between the insurance consolidated financial statements and the Intesa Sanpaolo consolidated financial statements (second level).

However, the overlay approach, as amended, only partially reduces the Intesa Sanpaolo Vita Group portfolio Profit and Loss volatility, because, according to the prevailing interpretation of the IFRS 4 amendments, it is not possible to reclassify the impairment on bonds classified at FVOCI from the Profit and Loss to the Other Comprehensive Income (Net Equity). Considering the bond portfolio of Intesa Sanpaolo Insurance Group, from a preliminary impact analysis based on a severe downgrade assumption, the volatility range for pre-tax Profit and Loss is high. Intesa Sanpaolo Vita Insurance Group could apply the overlay approach only to Equity portfolio and fund, that represents a minor part of the entire portfolio of the Insurance Division.

Despite the overlay approach application, as defined up to now, profit and loss volatility for the Insurance Division remains higher compared to the competitors allowed to apply the deferral approach. Therefore, the overlay approach in this case is deviating from IASB's initial objective.

In order to prevent the volatility effect described above, the Intesa Sanpaolo Group proposes the following integration of the IFRS 4 amendment paragraph 35 E:

"*A financial asset is eligible for designation for the overlay approach if, the following criteria are met:*

(a) it is measured at fair value through profit or loss applying IFRS 9, but would not have been measured at fair value through profit or loss in its entirety applying IAS 39;

(b) […]"

Alternatively, a financial asset is eligible for designation for the overlay approach if, in conjunction with the condition *(b)* of 35E, the following holds:

(c) "it is measured at FVOCI under IFRS 9 and no impairment has been recorded according to IAS 39"

The proposed integrations not only permit to reclassify from profit and loss to OCI, but also the impact of the impairment is recognized using an expected loss basis, reducing the volatility of profit and loss driven by the IFRS 9 for insurers, without the need to enlarge the perimeter of application for the deferral approach and ensuring a level playing field in the insurance market.

Potential competition issues within the EU

6 EFRAG has identified a number of other factors that could be considered in assessing whether the endorsement of the Amendments is conducive to the European public good (see Appendix 3, paragraphs 24 to 43). EFRAG is unable to conclude whether the application of the temporary exemption from IFRS 9 amounts to a material competition issue from an economic perspective. In addition, EFRAG is not aware of any issues where the use of the overlay approach would affect competition between entities.

Do you agree with the assessment of these factors?

☐ Yes ☒ No

If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

In Italy the majority of insurance companies are not part of a conglomerate financial institution in which non-insurance activity is predominant. Therefore, a large part of the insurance market is eligible for the application of the deferral approach and it would not suffer of the impacts of income statements volatility arising from i) the classification and measurement of financial instruments and ii) the definition of impairment due to the application of IFRS 9. Therefore, as stated above in the comment to par. 2(a), the application of the overlay approach represents a disadvantage for Intesa Sanpaolo Vita S.p.A., which is potentially eligible for the deferral approach, compared to its direct competitors (as per first level of financial reporting). The level playing field of the Italian insurance market is not preserved according to the proposed solutions.

Other factors

7 Do you agree that there are no other factors to consider in assessing whether the endorsement of the Amendments is conducive to the European public good?

☐ Yes ☐ No

If you do not agree, please identify the factors, provide your views on these factors and indicate how this could affect EFRAG's endorsement advice.

Overall assessment with respect to the European public good

8 EFRAG has initially concluded that endorsement of the Amendments would be conducive to the European public good (see paragraphs 44 to 47 of Appendix 3 of the accompanying *Draft Letter to the European Commission*).

Do you agree with this conclusion?

☐ Yes ☒ No

If you do not agree, please explain your reasons.

We believe that some adjustments are needed, according to the proposal above, in order to ensure full comparability in the European insurance market, without creating discriminations according to the configuration of the insurance market among Member States, leaving some countries in a competitive disadvantage.