December 12th 2016

Mr. Jean-Paul Gauzès, President of the European Financial Reporting Advisory Group (EFRAG),

35 Square de Meeûs , 1000 Brussels

Subject: Draft endorsement advice on Applying IFRS 9 *Financial instruments* with IFRS 4 *Insurance contracts*

Dear Mr. Gauzès,

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. In addition, 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 on the endorsement of *Applying IFRS 9 Financial instruments together with IFRS 4 Phase 1 Insurance contracts.*

This comment letter is provided in name of KBC Group together with Belfius , another financial conglomerate operating on the Belgian insurance market.

The Amendments mainly address the concerns of the insurance sector due to the time delay between IFRS 9 and IFRS 17 and provide solutions to mitigate accounting mismatches and P&L volatility in the transition period between adopting IFRS 9 (1/1/2018) and the effective date of IFRS 17 (the IASB has set 1 January 2021 as the mandatory effective date of IFRS 17 recently during their November meeting).

The Amendments meet the technical requirements for EU endorsement and provide a solution for each and every entity taking into account the different way entities are structured and the specific context they are operating in. The solutions offered, i.e. applying IFRS 9 with the overlay or opting for an IFRS 9 deferral when meeting the eligible criteria, are an improvement compared to the situation where no remedies were provided and each entity has to apply mandatory IFRS 9 as of 1/1/2018. Each entity has the possibility to accommodate its financial statements in an efficient way taking into account cost-benefits related to each option (apply IFRS 9 in full, IFRS 9 with the overlay or an IFRS 9 deferral).

Therefore the endorsement of the Amendments is conducive to the European public good and should not be postponed.

To ensure a maximum level playing field both approaches, the temporary exemption from IFRS 9 and the overlay approach, should remain available for players in the European insurance market and should be given a positive advice for EU endorsement.

For KBC Group the overlay approach is the only solution to cope with the time delay between IFRS 9 and IFRS 17. 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 use 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. We understand that some other financial conglomerates are interested in the overlay approach.

We agree with EFRAG's opinion that a temporary exemption should not be available to banking or other businesses unrelated to insurance within a group. An IFRS 9 deferral should maintain a level playing field between banks adopting the IFRS 9 standard as of 1/1/2018 and bank-led entities that undertake to a lesser extent insurance activities. These bank-led groups can mitigate the accounting mismatches and extra P&L volatility as they can opt to apply IFRS 9 with the overlay approach for their insurance activities.

Extending the scope of an IFRS 9 deferral below the entity reporting level distorts the level playing field between banks and bank-led companies with some insurance activities. Moreover, this implies that bank-led companies apply multiple accounting policies i.e. IAS 39 for insurance assets and IFRS 9 for bank assets, in their consolidated financial statements which reduces comparability between financial statements of banks and bank-led financial conglomerates. This impacts KBC Group directly as we are compared by investors and analysts with other European banks and bank-led financial conglomerates.

On the contrary, an IFRS 9 deferral at entity reporting level ensures that bank-led groups with insurance activities cannot postpone the IFRS 9 improvements and guarantees a level playing field between banks having to adopt IFRS 9 as of 1/1/2018 and bank-led groups applying IFRS 9 at the same moment.

We have included in the Appendix A our detailed responses to the questions raised in the *Invitation to Comment on EFRAG's Initial Assessments.*

We appreciate your efforts towards the International Accounting Standards Board (IASB) and support the EFRAG's position which considers that the Amendments are conducive for use by the European good .

In the meantime we support the IASB in its work to finalise IFRS 17 by drafting the final text of the standard, expected to be published March 2017.

We would be pleased to provide any further information you might require.

Yours sincerely,

Luc Popelier, CFO of KBC Group

Johan Vankelecom, CFO of Belfius

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

Appendix A : Questions raised in the Invitation to Comment on EFRAG's Initial Assessments

Question 1 –the Amendments meet the technical criteria for endorsement

- *Relevance – relevant information for users*

The optional solutions offered by the IASB Board accommodate the fact that players in the European insurance market are structured in different ways and are operating in different circumstances. Offering the choice to apply IFRS 9 in full , deferring IFRS 9 (when eligible) or applying IFRS 9 with the overlay, accommodates all entities to adapt their financial statements in an efficient way.

Opting to apply IFRS 9 with the overlay approach provides more relevant information for users of KBC Group's consolidated financial statements. 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, it results in a consistent measurement of both banking and insurance assets throughout the entire group as the balance sheet is fully consistent with IFRS 9 application. The presentation and disclosure requirements related to the overlay approach guarantee transparency to users and facilitate comparisons with other entities opting for an IFRS 9 deferral and with entities applying IFRS 9 in full.

- *Reliability*

The final text of the IFRS 4 Amendments clearly identifies the eligible criteria for the overlay approach and clarifies that surplus assets and assets held for regulatory or capital purposes are in scope of the overlay approach. This ensures a consistent application of the overlay approach and makes it easier to understand for preparers.

As the vast majority of our debt instruments fulfills the IFRS 9 SPPI test, financial assets of our insurance activities designated to the overlay approach are likely limited to equity instruments. The equity portfolio is under IAS 39 classified as 'Available For Sale' and will be classified as 'Fair value through P&L' under IFRS 9. There is a direct relationship between this equity portfolio and contracts within the scope of IFRS 17 i.e. 85 % allocated to Life business and 15% allocated to Non-Life business.

- *Comparability*

The current IFRS 4 phase 1 standard contains no measurement model and refers to local GAAP's and local practices. These various accounting practices result in a lack of comparability amongst insurance entities' financial statements.

Acknowledging that comparability will be leveraged as of adoption of IFRS 17 , applying IFRS 9 with the overlay approach results in a better comparability (in comparison with the current situation) with entities applying IFRS 9 in full and facilitates comparison with entities opting for an IFRS 9 deferral.

The same results in P&L are reported by applying IFRS 9 with the overlay approach or by continuing applying IAS 39 for our equity portfolio and, on top, the overlay mitigates the extra P&L volatility related to adoption of IFRS 9. Applying IFRS 9 with the overlay also isolates the impact of the difference between IFRS 9 and IAS 39 in a single line both in profit or loss and OCI having no effect on the reported total comprehensive income.

- *Understandibility*

The additional disclosures relating to how the overlay approach has been applied, make it easy for users to understand the financial statements.

Presenting the overlay adjustment amount on one new line in P&L and also on one separate line in OCI makes the effect and impact of the overlay approach easy to understand by users of insurers' financial statements.

- *Prudence*

Both the IFRS 9 deferral and the overlay approach do not introduce new classification nor new measurement principles.

Applying IFRS 9 with the overlay approach has no effect at the level of total comprehensive income as it reclassifies the extra P&L volatility of designated financial assets from P&L to OCI and thus is to be considered as neutral w.r.t. prudence. Moreover, opting for applying IFRS 9 with the overlay results in additional information in comparison with applying IFRS 9 in full and this for financial assets designated to the overlay approach in the sense that IAS 39 and IFRS 9 information is disclosed.

An IFRS 9 deferral has a negative impact on prudence as the improvements of adopting IFRS 9, especially the forward looking expected loss impairment model, are postponed for some years . This is only partially mitigated by the investment grade of debt-type assets covering the insurance liabilities.

- *True and Fair Value principle*

Taking into account the negative implications of a misalignment between the effective date of IFRS 9 and IFRS 17 , the fact that this is only for a limited period in time, and the long-term business model of an insurer, the options offered by the IASB Board in the IFRS 4 Amendments are according to us relevant, reliable, provide understandable information, lead to a better comparability relative to the current situation and result in prudent accounting.

Opting for the overlay approach fulfills to a greater extent the true and fair value principle as it implements as of 1/1/2018 the IFRS 9 improvements, offers extra information (IAS 39 and IFRS 9) for designated financial assets of the insurer and moreover enhances comparability both with insurance entities deferring IFRS 9 as with banks applying IFRS 9 in full.

The presentation and additional disclosures relating to the overlay approach guarantee that the financial statements provide a complete and reliable view of the entity's balance sheet and total comprehensive income.

Therefore we agree with EFRAG's initial assessment that the IFRS 4 Amendments fulfill the technical requirements set out in the IAS regulation and therefore we give a positive advice for EU endorsement.

Question 2 – Conducive for the European public good : Improvement in financial reporting

In general, the Amendments improve the quality of financial reporting in comparison with the situation where no reliefs are offered by the IASB Board to mitigate the negative effects of accounting mismatches and extra P&L volatility due to the misalignment in effective dates of IFRS 9 and IFRS 17.

Entities issuing contracts in scope of IFRS 4 can be structured in different ways 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.

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 and financial conglomerates.

Question 3 – Conducive for the European public good: Costs and benefits

As a general conclusion both options, an IFRS 9 deferral and IFRS 9 with the overlay approach, imply additional costs for preparers in comparison with implementing IFRS 9 in full. Each entity will choose the appropriate solution that accommodates their financial statements in an efficient way while taking into account cost and benefits related to each option.

- *Cost for preparers*

According to your draft endorsement advice, 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 enormous operational consequences and this for an interim solution. We believe this is also confusing for our management and for the users of our financial statements 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. The incremental costs on top of implementing IFRS 9 related to the double accounting record-keeping for designated financial assets under IAS 39 and IFRS 9 and the related extra controlling is very limited as we intend to apply the overlay approach solely for the equity portfolio.

- *Cost for users*

Users of financial statements will incur some costs in understanding the amount of the overlay adjustment and its impact. It is our aim to limit these costs to a minimal by being as transparent as possible in our disclosures.

- *Benefits for preparers and users*

Applying IFRS 9 provides users with the improvements of IFRS 9 relative to IAS 39 in the financial statements and leads to relevant and transparent information.
When opting for the overlay approach users receive extra disclosed information in order to understand the effects of the overlay adjustment and are not confronted with extra volatility in P&L in the meantime between adoption of IFRS 9 and IFRS 17.

Overall, we agree with EFRAG's assessment that the benefits for both users and preparers exceed the costs of applying the Amendments.

Question 4 – Conducive for the European public good : Potential competition issues within the EU

To ensure a maximum level playing field both approaches, the temporary exemption from IFRS 9 and the overlay approach, should remain available and should be given a positive advice for endorsement by the European Commission.

For KBC Group, the overlay approach is the solution and the only solution to cope with the time delay between IFRS 9 and IFRS 17. 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 use of an IFRS 9 deferral.

Applying IFRS 9 with the overlay approach or accounting under IAS 39 has the same results in P&L for our equity portfolio and ,on top, mitigates the P&L volatility. 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.

Financial conglomerates with insurance activities, not meeting the threshold for making use of the temporary exemption, should apply IFRS 9 as from 1/1/2018 and can opt for either IFRS 9 in full or IFRS with the overlay approach taking into account cost-benefit considerations. Extending an IFRS 9 deferral for bank-led conglomerates which fail the IASB predominance test, creates a non-level playing field.

First of all, the improvements offered by adoption of IFRS 9 are postponed, especially the expected loss impairment model as an answer on the financial crisis which reveals that the IAS 39 incurred loss model was 'too little, too late'. Therefore applying the overlay approach implies the application of IFRS 9 and thus all improvements compared to IAS 39 being reflected in the consolidated financial statements.

Secondly, this results in mixed consolidated financial statements of bank-led entities whereby IAS 39 is used for measuring the insurance assets and IFRS 9 for the banking assets. This has negative effects on the understandibility by users of financial statements. It reduces comparability with European banks, our peers in benchmarking by financial analysts, that have to apply IFRS 9 in full as of 1/1/2018.

On the contrary, requesting bank-led groups to apply IFRS 9 at the same time , will avoid competition issues between bank-led groups and pure banks . In addition, applying IFRS 9 avoids the use of different accounting policies for financial assets within the same group and enhances understandability and comparability.

- *Disincentive to invest in equities*

The IFRS 4 Amendments have a temporary nature while insurers have a long-term business model.

Adoption of Solvency II as of 1/1/2016 has shifted the focus of ALM management from IFRS P&L towards Solvency II required capital when taking decisions w.r.t. invested assets.

The ALM management strives to invest in assets whereby the investment return is higher than the interest guarantees on the liabilities given to the policyholders. Hence, for the investment strategy a higher investment return is more important than the accounting treatment (IFRS 9 does not allow recycling to P&L in case of a FVOCI classification of equities).

Insurance liabilities have a longer duration than the invested assets available on the financial markets. The accounting mismatches ,introduced by adoption of IFRS 9 as of 1/1/2018 ,can be reduced by entities undertaking insurance activities when making re-investments for maturing financial assets.

Based on the above arguments, it is our opinion that non-eligibility for an IFRS 9 deferral does not create a disincentive to invest in equities and does not change the investment strategy towards financial assets with less volatility such as bonds which provide a lower return.

- *Less relevant information on performance*

We agree with EFRAG that a temporary exemption should not be available to banking or other businesses unrelated to insurance within a group. A deferral should maintain the level playing field between banks adopting the IFRS 9 standard.

Entities, not being predominant insurers and thus not eligible for an IFRS 9 deferral, can mitigate the accounting mismatches and volatility that would arise from applying IFRS 9 before the forthcoming insurance contracts standard by using the overlay approach.

- *Cost mitigations available to predominant insurers*

An IFRS 9 deferral postpones the IFRS 9 implementation costs for some years and avoids the costs related to applying the overlay approach as such entities will implement IFRS 9 and IFRS 17 at the same time, presumably at 1/1/2021.

The operational consequence and related costs of applying IFRS 9 with the overlay approach are minimal for KBC Group. For us, the benefits of the overlay approach largely outweigh the costs associated with its implementation.

Bank-led groups that undertake mainly bank activities and on a minor scale insurance activities, need to implement IFRS 9 as of 1/1/2018 resulting in one set of accounting policies i.e. IFRS 9 in their consolidated financial statements. They should not be able to postpone the IFRS 9 implementation and the costs related to this.

Question 5 – Conducive to the European public good : Other factors

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 we welcome the proposed solutions by the IASB Board, offered on an optional basis, and the additional requested disclosures which facilitate the understanding by users of an entity's financial statements.

Question 6 – Overall assessment with respect to the European public good

We fully agree with EFRAG's assessment that adopting the Amendments is conducive to the European public good.

In the meantime we support the IASB in its work to finalise IFRS 17 by drafting the final text of the standard, expected to be published March 2017.