CaixaBank

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13th December 2016

Dear Andrew,

CaixaBank welcomes the opportunity to comment on EFRAG'S assessments on "*Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contracts: Amendments to IFRS 4*" (the Amendments) as issued on 16 November 2016.

The application of the optional temporary exemption from IFRS 9, which permits an insurer to continue using IAS 39 *Financial Instruments: Recognition and Measurement* until 2021, is targeted in the amendments to predominant insurers only (i.e. groups or entities whose activities are predominantly related to insurance as per the EASB criteria. We wish to stress once again that bank-led groups in various European countries with significant insurance activities such as CaixaBank in Spain are not eligible to apply the temporary exemption in their consolidated financial statements.

Considering the significance of CaixaBank´s insurance activity, and in order to preserve a level playing field among all market players, we should also be allowed to defer the application of

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IFRS 9 *Financial Instruments* to our insurance activities in order to align the effective date of IFRS 9 with the effective date of the new insurance contracts standard (IFRS 17)

An adoption of IFRS 9 on 1st January 2018 based on less complete information may result in a less quality implementation of IFRS 9 along with higher implementation costs, unwanted volatility and accounting mismatches.

This is true even if CaixaBank were to apply the optional overlay approach in the amendments, as we would need to make certain assumptions supporting the business model assessment based on the public available information at that time regarding the IASB's tentative decisions in its insurance contracts project expected for March 2017.

This could jeopardise the conclusion on whether the amendments satisfy the technical criteria set out in the Regulation (EC) No 1606/2002 for the adoption of international accounting standards for this set of entities, given that a less quality implementation of IFRS 9 affects each of the criteria of relevance, reliability, understandability and comparability assessed by EFRAG.

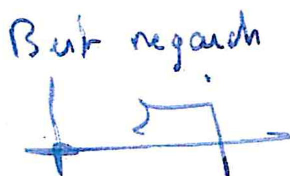
CaixaBank supports a swift finalisation of the EU endorsement process for the Amendments, sufficiently ahead of the effective date of IFRS 9, as all European bank-led groups need clarity on when and how they apply IFRS 9 to their insurance activities.

We are pleased to attach a number of comments which broadly support the endorsement advice albeit stressing that its current scope only deals with predominant insurers.

We also attach for ease of reference, a brief summary of CaixaBank position already shared with you.

On behalf of CaixaBank, I would be happy to discuss our answers and comments provided below with you or other officials of EFRAG, as you may wish.

Yours sincerely,



Jean Naslin
Executive Director

Enc.

CC: Mr. Olivier Guersent- Director General (DG FISMA)
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CaixaBank

CAIXABANK POSITION ON IASB PROPOSALS

INTERACTION BETWEEN IFRS 9 AND IFRS 4 Phase II

Financial conglomerate[1]s should be eligible to apply the IFRS 9 temporary exemption

IFRS 9 is an International Financial Reporting Standard (IFRS) promulgated by the International Accounting Standards Board (IASB) that addresses the **accounting for financial instruments:** classification and measurement, impairment and hedge accounting. The IASB issued the final version of IFRS 9 in July 2014, replacing the earlier IFRS for financial instruments, IAS 39, when it becomes effective the 1st January 2018 (with earlier application permitted). On the other hand, IFRS 4 addresses the **accounting for insurance contracts** and the IASB's project to replace IFRS 4 is expected to be issued in March 2017 with an implementation period of approximately three years (future IFRS 17). As a consequence, **the earliest possible mandatory effective date of the new insurance contracts Standard will be after the effective date of IFRS 9.**

The earlier application of IFRS 9 will **most probably lead to accounting mismatches and volatility in the profit or loss of any financial conglomerate or entity with insurance activities**, as more financial instruments are expected to be measured at FVPL (fair value with changes in value recognized in profit and loss), whereas insurance technical provisions will be still measured under local gaap requirements which are commonly based on a cost basis.

CaixaBank shares the view of the interested parties that suggested **the European Commission should permit insurers and their parents to defer the application of IFRS 9** in order to align the effective date of IFRS 9 with the effective date of the new insurance contracts Standard (IFRS 17).

We note that the solutions issued recently by the IASB do not fully address the concerns around accounting mismatches and volatility in profit in loss arising from the earlier application of IFRS 9: the overlay approach is an extremely costly solution for any type of insurers and their parents, whereas the temporary exemption to apply IFRS 9 requires that liabilities related to insurance activities represent at least 80% of the total liabilities, among other requirements.

In order to achieve a level playing field among insurers and financial conglomerates and to avoid any artificial distinction, CaixaBank believes **the temporary exemption provided by the IASB to 'pure' insurers should be extended to all insurance activities within a financial conglomerate**.

Given that the amendments have already being issued by the IASB and endorsed by EFRAG, **CaixaBank would be supportive of an exceptional modification made at the European Commission level[2].**

[1] CaixaBank is the parent entity of VidaCaixa, the largest insurance company in Spain with a market share of 28,5% as of September 2016.

[2] CaixaBank has always been supportive of allowing any parent entity the roll-forward of the deferral exemption when this exemption is applied at the insurance subsidiary level, as we agree there should be a level playing field between pure insurers, financial conglomerates and insurance groups. If the European Commission were not in favor of this unrestricted scope, CaixaBank would propose that the deferral option is made available at least to all financial conglomerates that are subject to additional supplementary supervision according to Directive 2002/87/EC as this group can easily been identified and would comply with the significance criterion as established in the EU.

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MOD. (W) 001-720.0171-60 (11)

Comments on
EFRAG'S assessments on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contracts: Amendments to IFRS 4*

Appendix 1

Understanding the changes brought by the Amendments

CaixaBank agrees with the concerns detailed in paragraph 1 of Appendix 1 that insurance companies and users have raised about the different effective dates of both IFRS 9 and the new insurance contract standard. In addition, EFRAG may also consider that bank-led groups will find difficulties to explain users:

- Which part of the volatility and accounting mismatches arising from the adoption of IFRS 9 will be offset when adopting the new measurement of insurance liabilities, and when they will be in a position to provide this information. If groups provide their first quantitative impacts of implementing IFRS 9 in its half-year report H12017, the new insurance contract standard would have been just recently published,
- The changes in their business model assessments under IFRS 9 that may be needed to accommodate measurement of insurance liabilities and the financial assets backing them (in 2018 when adopting IFRS 9 and in 2021 when IFRS 17 is expected to be first applied).

Appendix 2
EFRAG's technical assessment on the Amendments

1. *Do you agree with the assessment?*
2. *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?*

Comments on relevance:

We would question the view included in EFRAG cover letter and in paragraph 12 of Appendix 2, that predominant insurers are the insurance entities most significantly affected by the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard, as the temporary exemption should also be the most optimal and desirable solution for entities undertaking significant insurance activities within bank-led groups (please refer to our comments on *Less relevant information – Appendix 3*).

It should be borne in mind that, even if the entities targeted for the temporary exemption were predominant insurers, some of those predominant insurers – insurance subsidiaries within bank-led groups – may not be able to benefit from the use of this option, due to inconsistency reasons between their separate financial statements and the consolidated financial statements of the group in which they are integrated.

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Furthermore, in relation to the requirement to disclose information on the fair value mentioned in paragraph 17 of Appendix 2, we consider that entities should focus, as it is particularly relevant, on providing information on the part of the fair value changes of financial assets that will be recognised in profit or loss, other comprehensive income and/or insurance liabilities.

Comments on reliability:

In the past, EFRAG was of the opinion that the introduction of bright lines generally could lead to arbitrary outcomes which could be avoided if a more principles-based approach was used. In this regard, the use of a quantitative test to assess the predominance ratio seems to be contrary to that approach.

The Amendments do not require entities to apply the overlay approach to all eligible financial assets. We note that the effect on the completeness is not addressed by the endorsement advice (i.e. whether there is loss of information when an entity applies the overlay approach to only some financial assets).

Comments on comparability:

We agree that introducing options generally reduces comparability between entities' financial statements as mentioned in paragraph 46 of Appendix 2. In our opinion, providing the temporary exemption to only predominant insurers and the overlay approach to other entities with significant insurance activities worsen the current lack of comparability of the financial statements of entities undertaking insurance activities. We would contend that a substantiated analysis would be required in paragraph 66 of Appendix 2 to support the conclusion that the Amendments may only *slightly* reduce comparability among entities undertaking insurance activities and between such entities and other entities.

We do not share the criticism that using two sets of accounting standards within the same set of financial statements will increase the complexities, as noted in paragraph 49 of Appendix 2. It is more useful to allow the use of a temporary exemption for different components of the same reporting entity if, by doing this, entities better portray (i) the linkage between their insurance liabilities and the financial assets baking them, and (ii) the performance of their insurance activities.

In terms of complexity, we further note that the use of the temporary exemption is expected to lead to fewer costs for preparers compared to the application of the overlay approach and that complexities may not be relevant for bank-led groups if there are not significant transfers of financial instruments between the banking and insurance segments. Nevertheless, if the provision of separate information for these two segments, whose financial assets would be reported under IAS 39 and IFRS 9, is considered relevant by users, there could specific disclosures requirements (for example, to identify each one as a reportable segment).

It should also be borne in mind the loss of comparability to which this situation may lead with regards to the accounting treatment of financial assets connected with contracts that are within the scope of IFRS 4.

Paradoxically same financial assets of the same entity could be classified and measured under IAS 39 in its separate financial statements (i.e. if the entity is considered as a predominant insurer on a standalone basis), but classified and measured under IFRS 9 in the consolidated financial statements (i.e. if the entity is part of a bank-led group with significant insurance activities but not eligible for the temporary exemption).

Comments on understandability:

In our view, understandability will also be reduced. Users will find difficulties in understanding the financial performance and position of an entity within a bank-lead group compared to the financial position and performance of a predominant insurer, due to the application of different accounting policies for same type of financial instruments within the same business models.

We note the IASB received feedback from some interested parties subsequent to IFRS 9 being issued in 2009 stressing that this standard should contain a third measurement category: fair value through other comprehensive income (FV-OCI). In that feedback, mostly insurance entities were concerned about the potential accounting mismatch that may arise because of the interaction between the classification and measurement of financial assets under IFRS 9 and the proposed accounting for insurance contract liabilities under the IASB's insurance contracts project.

In response to that feedback and mainly to address the insurance sector concerns, the IASB introduced into IFRS 9 a FV-OCI measurement category for particular financial assets.

We believe that when the IASB introduced this category, their assumption was that both effective dates of IFRS 9 and the new insurance contracts standard would have been aligned and that insurance entities would be able to offset in OCI a significant part of measurement changes of insurance liabilities and the financial assets backing them.

When this FV-OCI measurement category was introduced, the IASB did not limit its use to a particular sector or type of insurance entity. Accordingly, we believe that the optional deferral exemption should also not be limited to predominant insurers.

In this sense, we would suggest that EFRAG should further considers whether described situation affects the understandability of financial reporting by predominant insurers as well as bank-led groups.

Comments on prudence:

We agree with EFRAG analysis in paragraph 80 of Appendix 2 that insurance entities' holdings in debt-type assets are typically concentrated in assets of investment grade. However, the remaining portfolio may represent a significant percentage of the expected losses on initial application of IFRS 9. Based on first estimations, circa 10% of the debt portfolio may represent 90% of the expected losses to be booked under IFRS 9.

Appendix 3
The European public good

1. *Improvement in financial reporting.*

   We agree that predominant insurers will be able to minimise the adverse impact of the misalignment between the effective dates of IFRS 9 and the forthcoming insurance contract standard.

   However, for bank-led groups with significant insurance activity the quality of their financial reporting will be impacted by the fact that they will not be able to defer the application of IFRS 9 to their insurance activities. Either the application of IFRS 9 or the overlay approach may lead to volatility in OCI and/or PL and will not be able to explain which part of this volatility will remain when the new insurance requirements are applied, which we believe is the more relevant piece of information that users will be interested in.

   Up to date, entities undertaking insurance activities within a bank-led group have been involved in the IFRS 9 implementation projects at a consolidated level. Although the classification of financial instruments in IFRS 9 is no longer based on management intent, it is still difficult to conclude on the assessment of the business model for all the instruments that meet the SPPI criterion (and therefore measured either at cost or at FVOCI), due to:

   - There is not a unique public document which contains the latest IASB proposals in relation to the forthcoming insurance contracts standard,
   - There is uncertainty in terms of the interest rate used for the recognition in profit or loss of the expense related to insurance liabilities, and
   - There is uncertainty in terms of the volatility that will be recognised in other comprehensive income and/or the contractual service margin.
   - There is uncertainty about the level of aggregation of insurance liabilities (unit of account) for their measurement.

   Given that the Amendments are recognised to be a unique and short-term solution, we would agree with extending the deferral option to bank-led groups with significant insurance activity.

2. *Costs and benefits*

   Preparers

   As noted in previous comments, EFRAG cover note does not make any reference to the fact that the Amendments will not avoid the need forbank-led groups with significant insurance activities recognising the volatility in OCI and/or PL and accounting mismatches that are expected to result from applying IFRS 9 before the forthcoming insurance contracts standard.

   While explaining the benefits of the temporary exemption in terms of certain cost mitigations, we would welcome EFRAG acknowledgement of the competitive disadvantage by insurance companies that are part of banking groups against insurance groups (i.e. predominant insurers).

   We believe that the above referred issues should be better explained in the cost and benefits section, as these bank-led groups will incur in relevant costs to explain users (in particular analysts, and supervisors) the impacts of applying IFRS 9 and the overlay approach, the latter if applicable. We are concerned that entities will find difficulties in explaining which part of this volatility would

have remained in profit and loss, OCI and/or the contractual service margin if both effective dates of IFRS 9 and the new insurance contract standard had been aligned.

For example ESMA expects that, for most issuers, the impacts of the application of IFRS 9 in the period of initial application will be known or reasonably estimable at the time of preparation of their 2017 interim financial statements. Considering that the current IASB work plan for IFRS standards considers the tentative publication of the new insurance contracts requirements by March 2017, it will be very difficult to provide transparent and useful information about the approach to the implementation of IFRS 9 and the expected final impacts of the new insurance contracts standard. As noted by EFRAG in paragraph 47 of Appendix 2, for entities undertaking insurance activities, the measurement of financial assets and presentation of related gains and losses is at least partially linked to the accounting for financial liabilities.

Users

We note that users of financial statements will have difficulties, and incur in additional costs, in predicting long-term economic performance of bank-led groups with significant insurance activities, given that (i) forecasting earnings based on profit or loss information will become more complex regardless of whether these groups apply IFRS 9 or the overlay approach, and (ii) historical relevant trends will be discontinued when IFRS 9 is first applied.

We expect that users will have to change their internal valuation models so that different sets of valuations are developed depending on the option that companies may choose. In this regard, we bring to the attention that a specific valuation model for entities applying the deferral approach may be needed; therefore, the incremental costs of allowing bank-led groups with significant insurance activities to defer IFRS 9 are negligible.

Up to date most analysts working in the insurance sector carry out their valuations for bank-led groups considering the banking and insurance activities as a whole, without resulting a separate measurement for each set of activities. Accordingly, if bank-led groups with significant insurance activities are not able to apply the deferral option and material volatility and accounting mismatches arise from this situation, users may consider performing separate valuations and incurring in additional costs to adapt their valuation models.

3. *Potential competition issues within the EU*

We agree with EFRAG that the Amendments would not result in a completely level playing field among all entities undertaking insurance activities.

The temporary exemption is expected to lead to (i) full implementation of IFRS 9 at a later date with more complete information, (ii) less volatility and accounting mismatches in PL/OCI of predominant insurers in the interim period before the new insurance contract standard is implemented, and (iii) certain cost mitigations compared to implementing IFRS 9 on its normal effective date and implementing the forthcoming insurance contracts Standard at a later date.

It may be seen as contradictory that EFRAG mentions that there is no material evidence of competitive issues as only the predominant insurers will be able to benefit from the temporary exemption. Based on the conclusions of the analysis detailed in Appendix 3, entities representing approximately 20% - 25% of the total insurance activity will not be eligible for temporary exemption from IFRS 9. These entities include bank-led groups with significant insurance activities in their consolidated financial statements.

Therefore, we consider that the Amendments in the current formulation would not result in a completely level playing field among all entities undertaking insurance activities, particularly not addressing the volatility, accounting mismatches and cost concerns of entities undertaking insurance activities that are not predominant insurers.

We provide below some additional comments regarding EFRAG's assessment of (i) less relevant information on performance and (ii) cost mitigations available to predominant insurers.

Less relevant information

EFRAG notes that in the case of the 30 bank-led groups in their sample, more than half did not identify their insurance business as a reportable segment in accordance with IFRS 8 *Operating Segments*. Furthermore, EFRAG states that the extent to which these entities would elect to apply the temporary exemption if it were available[3] to them is unclear.

We would like to draw EFRAG's attention to certain factors that may have influenced the decision on not identifying the insurance business in a bank-led group as a reportable segment:

(i) Banking and insurance products (in particular, long-term life insurance contracts) have similar economic characteristics, bearing in mind their inherent risks and how they are management within a bank-led group,

(ii) It may have sense to report the above within the same segment as both banking deposits liabilities and insurance technical liabilities are measured on a cost-basis across most jurisdictions (their carrying amount is not updated because of changes in market and actuarial assumptions),

If these groups are not able to elect the deferral option, we would expect all of them to provide separate information for the insurance segment at first application of IFRS 9[4] (either as a reportable segment in accordance with IFRS 8 or as sub-segment information) in order to provide relevant information about their performance during the reporting period. Having more financial assets measured at FV-OCI or FV-PL may distort the PL and OCI presented by the bank-led group when they relate to the insurance business.

Accordingly, we do not agree with paragraphs 32-35 of Appendix 3. In particular we note that:

(i) EFRAG measures the significance of insurance activities based on entity's total liabilities, without considering the contribution of insurance activities to bank-led groups' revenues, operating income and RoTE, which can be significant.

(ii) The impact of applying or not applying the temporary exemption from IFRS 9 should be visible and transparent to market analysts and other stakeholders, i.e. we do not expect the impact to be subsumed within the reportable segment that relates to both insurance and non-insurance activities when it is material. As noted before, separate information for each set of activities will be provided to users of financial statements.

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[3] As discussed in EFRAG's letter, bank-led groups with significant insurance activities in their consolidated financial statements will not be able to apply the deferral option in the Amendments.

[4] We note that it is expected that the majority of these bank-led groups will provide separate information about the banking and insurance business when IFRS 9 and the forthcoming insurance contracts Standard apply:

- the measurement of the insurance liability measurement will differ and it will not make sense to include them within a reported segment balance with deposits at amortised cost
- accounting mismatches related to the insurance business will be shown separately from the banking business.

(iii) EFRAG does not consider the current situation where two sets of public accounts are already available: (1) the bank-led group accounts, which may consider the banking and insurance activities as a single IFRS 8 reportable segment, and (ii) the insurance subsidiary accounts. In this case, reviewing only the bank-led group consolidated accounts could incorrectly lead to concluding that insurance activities are not relevant.

Cost mitigations available to predominant insurers

EFRAG notes in paragraph 40 of Appendix 3 that implementing IFRS 9 through the entire group is expected to result in synergies fro bank-led groups that undertake insurance activities that will serve to mitigate the costs of implementing IFRS 9 within the insurance sub-group.

We do not fully support this statement considering that not necessarily the banking and insurance activities have to share the same systems to manage financial assets. For example, CaixaBank' insurance activities currently use a separate system that has been tailored to their needs in terms of accounting and reporting criteria.

EFRAG is concerned in paragraph 41 about using a different set of accounting policies within the same group for financial assets and consequential structuring opportunities.

Although it is not the objective of this letter to discuss the eligibility criteria of the deferral option, we note EFRAG's analysis does not touch upon bank-led groups that are financial conglomerates subject to supplementary supervision according to Directive 2002/87/EC. These are financial conglomerates that are required to have in place, at the level of the financial conglomerate, adequate risk management processes and internal control mechanisms, including sound administrative and accounting procedures, which we believe mitigate the structuring opportunities.

Finally, we believe that the focus should be on the requests to address accounting mismatches that may arise from the application of different measurement models to insurance liabilities and the financial assets backing them and to distinguish short-term volatility from performance of the insurance activities instead of whether there are temporarily two different set of accounting policies within the same group until IFRS 17 is implemented.

4. *Overall assessment with respect to the European public good*

We support the positive endorsement advice based on the comments provided in the previous sections. However, this endorsement's scope should be limited to predominant insurers, excluding other entities with significant insurance activities.

Considering that the European Commission recitals[5] refers to the insurance sector as a whole, we would suggest that EFRAG clearly differentiates its conclusions for predominant insurers from the conclusions for other entities (such as European bank-led groups such as CaixaBank in Spain) with significant insurance activities on each of the endorsement criteria.

[5] The adoption of international accounting standards by the Commission has to be done in a timely manner so as not to undermine investor understanding and confidence. Nevertheless, while endorsing IFRS 9, the need for an optional deferral of its application for the insurance sector is recognised. The IASB has undertaken an initiative to address this issue and is expected to submit a proposal in order to secure a single internationally recognised solution. However, in the case that the provisions adopted by the IASB by 31 July 2016 are not considered satisfactory, the Commission intends to give an option to the insurance sector not to apply IFRS 9 for a limited period of time.