FÉDÉRATION
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Banking supervision
And Accounting issues Unit

The Director

Paris, February 8th 2016

FBF comments on the IASB's Exposure Draft ED/2015/11 « Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* (Proposed amendments to IFRS 4)".

Dear Mr Hoogervorst,

The French Banking Federation welcomes the opportunity to comment on the IASB's Exposure Draft « Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts*"

In general, we are supportive of the initiative of the IASB to address the concerns related to the different effective dates of IFRS 9 and the new insurance contracts standard. In details, we are fully supportive of the temporary exemption. But, we are not convinced that the overlay approach should be retained. While neutralizing the volatility in profit and loss, it will notably imply additional volatility in equity (through OCI). Moreover, the other main issue is the cost and complexity of running two accounting systems –IAS 39 and IFRS 9 – in parallel.

We believe that the temporary exemption would provide a suitable solution to the concerns raised by the misalignment of the effective dates. In substance, it avoids accounting mismatches, supplementary costs due to the parallel run of two accounting systems – IFRS 9 and IAS 39 - and breaches in consistency of financial reporting.

We are convinced that ensuring a level playing field between all entities that have insurance activities is a key element when defining the temporary exemption criterion. Insurance entities should not be treated differently depending on whether the entity is an insurance market player or insurance's entity within a conglomerate. Insurance activities carried within banking conglomerates and their related holdings should, as well, benefit from the optional temporary exemption of applying IFRS 9. Moreover, we share the common concerns raised by the IASB and the EFRAG that material non-insurance activities, particularly banking activities, should not be included in the scope of the temporary exemption criterion.

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Accordingly, we do not believe that the IASB has properly met the key issues. We disagree on how the temporary exemption criterion is designed by the IASB, i.e. applied at the reporting level entity and for entities that have predominant insurance activities. A regulated criterion as proposed by the EFRAG to define insurance activities is the most appropriate as more objective depending on factors independently defined by other competent authorities. However, the definition proposed by the EFRAG should be expanded in order not to exclude entities that are exclusively or mainly related to insurance activities (for example consolidated funds, service companies or non-regulated intermediate or ultimate holding companies). Otherwise, issues would be raised regarding comparability within insurance industry between entities having insurance activities.

For these reasons, we urge the Board of the IASB to reassess the application of the temporary exemption.

Our answers to the exposure draft are detailed in the Appendix to this letter.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely,

Bertrand Lussigny

Appendix.

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 (paragraph BC17–BC18).

(c) Two sets of major accounting changes in a short period of time could result in significant cost and effort for both preparers and users of financial statements (paragraphs BC19–BC21). The proposals in this Exposure Draft are designed to address these concerns.

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

We agree that the IASB should address the concerns that have been raised by both users and preparers and that are related to the different effective dates of IFRS 9 and the new insurance contracts standard.

While remaining favourable towards the endorsement of IFRS 9, we believe that insurance activities, as defined in question 4, should benefit from a temporary exemption from applying IFRS 9 until the new insurance contracts standard is implemented.

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 needed, please explain which and why.

We are fully supportive of a temporary exemption from applying IFRS 9 for insurance activities.

We are not convinced that the overlay approach is the approach to be retained.

For further developments, please refer to questions 3 and 4.

Question 3—The overlay approach

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

(a) Paragraphs 35B and BC35–BC43 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 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?

We believe that the overlay approach will not resolve all the issues raised by the misalignment of dates between IFRS 9 and the future IFRS 4.

While the overlay approach helps to neutralize the volatility in profit or loss from the FVPL classification under IFRS 9 for assets that were previously classified as amortized or available for sale under IAS 39, additional volatility would arise in equity (through the OCI).

It would create confusion as it will imply significant changes in a short period of time. Classification and measurement requirements of IFRS 9 will be implemented twice, once when the insurance entity elects to apply the overlay approach and once when the new insurance contracts will come into force and classification of financial instruments would need to be reassessed.
Besides, as the overlay approach is a matter of classification and measurement of financial assets, it will still require insurance regulated entities to implement the impairment requirements of IFRS 9 creating as such some complexity for users to get extensive understanding of these entities' accounts through additional disclosures.

Finally, it would result in costs significantly exceeding the benefits notably. It will require to perform a parallel run of two accounting systems for financial instruments - IFRS 9 and IAS 39 - during the transition period. It implies to maintain two systems, to develop new data-processing systems and new internal controls in order to reconcile data coming from these two set up.

Moreover, we have not been informed that any of our members envisage to apply the overlay approach.

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?

We believe that the temporary exemption would provide a suitable solution to the concerns raised by the misalignment of the effective dates. Indeed, the temporary exemption avoids accounting mismatches, supplementary costs due to the parallel run of two accounting systems and breaches in consistency of financial reporting.

However, we disagree on how it is designed by the IASB, i.e. applied at the reporting level entity and for entities that have predominant insurance activities using a ratio threshold. It should not "only capture a relatively narrow population of entities" (§ BC60) as proposed by the IASB.

The EFRAG proposes two approaches in order to capture all insurance activities and only insurance activities that could benefit from the temporary exemption from applying IFRS 9.

When considering the two approaches proposed by the EFRAG to identify insurance activities, the "regulated entity" criterion appears to be the most appropriate.
We believe that a "regulated entity" criterion depends on factors independently defined by other competent authorities and, thus, is more objective. Indeed, in most jurisdictions, insurance activities are undertaken within regulated entities and have received authorisation from the supervisory authorities.

However we believe that the regulated criterion as proposed by the EFRAG would be too restrictive and would exclude from the temporary exemption entities that are exclusively or mainly related to insurance activities (for example consolidated funds, service companies or non-regulated intermediate or ultimate holding companies). Accordingly we would suggest to complete the proposed definition in the EFRAG's comment letter with the followings:

(c) An 'insurance holding company' is defined as 'a parent undertaking the main business of which is to acquire and hold participations in subsidiary undertakings, where those subsidiaries undertakings are exclusively or mainly related to insurance or reinsurance undertakings "

Using such a criterion will meet the common concern raised by the IASB but also by the EFRAG that the exemption should not be extended to material non-insurance activities, particularly banking activities. It will also ensure that the level playing field within insurers that issue material amount of insurance contracts within IFRS 4 would not be distorted. Insurance entities would not be treated differently depending on whether the entity is an insurance market player or insurance's entity within a conglomerate. Insurance activities carried within banking conglomerates and their related regulated holdings could, thus, benefit from the optional temporary exemption of applying IFRS 9.

Moreover, we have noticed that the IASB has concerns regarding transfers of assets between banking entities and insurance entities, i.e. between an IAS 39 environment and an IFRS 9 environment that could lead to earnings accounting. We believe that, in order to avoid such concerns, the transferred assets should be valued under IFRS 9 requirements, either should they cease to appear on the balance sheet of the banking entity or should they enter into the balance sheet of the banking entity.

Another issue relates to the different accounting standards – IAS 39 and IFRS 9- that are applicable in one set of consolidated financial statements, i.e. where an insurance entity is a subsidiary of a bank and part of the bank's consolidated IFRS financial statements. We believe that maintaining the two standards would not introduce more disparity within financial conglomerates as, currently and until the forthcoming insurance contracts standard is implemented, insurance liabilities can be measured under local GAAPs.

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 agree that the approach to apply the deferral of IFRS 9 should be optional for the entities that qualify. .

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 agree that the temporary exemption should have an expiry date.

We believe that the expiry date should be defined so that the temporary exemption from applying IFRS 9 should be available as long as the new insurance contracts standard will not be applicable. Therefore, the expiry date should be reassessed when the future insurance contracts standard is finalised.

Finally we share the EFRAG's view that "the overlay approach" should not be regarded as a solution to a possible delay in the finalisation of the new insurance contracts Standard.