INTERNATIONAL ASSOCIATION OF
INSURANCE SUPERVISORS

Ref: 16/9

8th February 2016

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

Dear Mr. Hoogervorst,

The International Association of Insurance Supervisors (IAIS) welcomes the opportunity to comment on the IASB's Exposure Draft *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* (the ED).

The IAIS is supportive of the IASB's work to find suitable measures to address the concerns about the different effective dates of IFRS 9 and the forthcoming insurance contracts standard. In its 21 October 2013 letter to the IASB, the IAIS stated that "If the effective dates of these two standards cannot be aligned, we encourage the IASB to consider introducing an exception for insurers so as to enable implementation of IFRS 9 and IFRS 4 phase II concurrently."

Consequently, the IAIS supports the proposals to provide temporary relief to insurers impacted by the implementation timing issues of IFRS 9 and the new insurance contracts standard. At the same time, for the proposed 'deferral approach', we encourage the IASB to consider possible modifications to make the use of that approach less restrictive, if effective solutions can be identified in the very near term.

The IAIS also supports the offering of the approaches on an optional basis, allowing insurers to apply IFRS 9 if they wish to do so.

Finally, the IAIS welcomes having an expiry date for the temporary exemption from applying IFRS 9. The IAIS supports the near-term finalisation of the insurance contracts project, and believes it is feasible for the IASB to finish the project within the proposed timeframe.

The appendix to this letter provides more detailed responses to the questions set out in the ED. This appendix was prepared on behalf of the IAIS by its Accounting and Auditing Working Group (AAWG). The AAWG`s membership represents a subset of all IAIS members.

If you have questions regarding this letter, please contact Markus Grund, Chair of the IAIS Accounting and Auditing Working Group (telephone: +49 228 4108 3671; email: markus.grund@bafin.de) or Mark Causevic at the IAIS Secretariat (telephone: +41 61 280 8323; email: mark.causevic@bis.org).

Yours sincerely,

Victoria Saporta
Chair, Executive Committee

Michael McRaith
Chair, Technical Committee

Appendix: Questions set out in the IASB's ED/2015/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

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?

The IAIS supports the IASB's work to find suitable measures to address concerns about the different effective dates of IFRS 9 and the forthcoming insurance contracts standard. In its 21 October 2013 letter to the IASB, the IAIS stated that "If the effective dates of these two standards cannot be aligned, we encourage the IASB to consider introducing an exception for insurers so as to enable implementation of IFRS 9 and IFRS 4 phase II concurrently."

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.

The IAIS agrees with the IASB proceeding with both approaches on an optional basis, and expects the usefulness of the two approaches might vary depending on the final outcome of the IASB's deliberations on the insurance contracts standard and the specific circumstances of reporting entities.

Our comments regarding each approach are detailed in our responses 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?

The IAIS is of the view that IFRS 9 is a significant improvement on IAS 39 in the recognition and measurement of financial instruments. The overlay approach has the advantage of allowing users the benefit of IFRS 9 measurement in the statement of financial position whilst at the same time addressing concerns about additional volatility in profit and loss. The use of OCI rather than profit and loss for certain items is well-established in IFRS and has the advantage of transparency, better enabling comparison between those firms that take advantage of the overlay and those that do not.

However, the overlay approach also has some disadvantages:

a) Insurers will need appropriate data-processing systems and internal controls to generate sufficient reliable data under both IFRS 9 and IAS 39;

b) Insurers will need to determine which financial assets relate to contracts within the scope of the current IFRS 4, which in some cases may be unclear; and

c) The choice of the qualifying financial assets potentially allows for earnings management through transfers of determined amounts from profit or loss into OCI and vice versa.

Consequently, depending on specific circumstances, some insurers and financial statement users may not consider the overlay approach as the better proposed solution.

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?

The IAIS supports the temporary exemption from applying IFRS 9 approach described in the ED as it seems to be an efficient solution for resolving the issues from the non-alignment of the mandatory effective dates of IFRS 9 and the forthcoming insurance contracts standard. The IAIS believes that financial reporting for insurance entities should always reflect the economics of both sides of the balance sheet, and their respective impacts on performance reporting.

Nevertheless, if an effective solution can be identified in the near term, we encourage the IASB to consider modifying its "predominant activity" criteria to better capture the population of entities to whom the temporary exemption should apply, which are the insurers significantly affected by the non-alignment of the mandatory effective dates of IFRS 9 and the forthcoming new insurance contracts standard. The IAIS is concerned that the current proposal may be too restrictive, given that large debt financing or similar supporting activities of an insurance entity or group might increase the size of the denominator such that it leads to a failure of the predominance test.

In addition, some IAIS members are concerned that the proposal to have the assessment of eligibility for the temporary exemption from applying IFRS 9 at the reporting entity level will lead to a burdensome set of two-fold financial statements for those insurance entities within a conglomerate that, in contrast to the group's head, are explicitly eligible for the temporary exemption from applying IFRS 9. Consequently, those members would encourage the IASB to further consider workable solutions that could make it more tenable to allow the assessment to be done below the reporting entity level. However, other IAIS members are opposed to the assessment being done at below the reporting entity level on the grounds that the potential reporting of financial instruments under both IAS 39 and IFRS 9 on the consolidated balance sheet would hinder comparability and may confuse users.

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 Standard is applied? Why or why not?

a) The IAIS agrees with the IASB's proposal that both the overlay approach and the temporary exemption from applying IFRS 9 be offered on an optional basis, as it allows insurers to apply IFRS 9 if they wish to do so.

b) The IAIS supports the IASB's proposal to allow reporting entities to stop applying the respective approaches from the beginning of any annual reporting period if there is a demonstrable change in the corporate structure of the entity.

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?

The IAIS welcomes having an expiry date for the temporary exemption from applying IFRS 9. The IAIS supports the near-term finalisation of the insurance contracts project, and believes it is feasible for the IASB to finish the project within the proposed timeframe.