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Chairman

PDC N° 08

Paris, the 8h February 2016

Mr Hans HOOGEVORST
Chairman
International Accounting Standard Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Re : ED/2015/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contracts

Dear Mr Hoogevorst,

I am writing on behalf of the Autorité des Normes comptables (ANC) to express our views on the Exposure draft (ED) 2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contracts*, issued by the IASB on 9 December 2015. These views result from ANC's due process which involves meetings with a dedicated working group, followed by an examination by its IFRS Commission and an approval of its Board. ANC welcomes this opportunity to comment on the IASB's proposals.

ANC shares most of the views expressed by EFRAG in its comments letter regarding the IASB proposals to address concerns related to the misalignment of the effective dates of IFRS 9 and the new Insurance Contracts Standard. However, ANC would like to highlight the following points.

ANC appreciates the IASB's efforts in attempting to address some of the major concerns raised by the difference between effective dates of IFRS 9 and the new Insurance Contracts Standard. IASB suggests both an overlay approach and a temporary exemption from applying IFRS 9 approach, on an optional basis. ANC agrees with IASB that both solutions should be pursued and should remain optional, because they are suitable to different situations. However, the temporary exemption from applying IFRS 9 is the preferred approach for ANC since it fully eliminates the temporary mismatch, which is the basic concern, due to the different effective dates of IFRS 9 (2018) and IFRS 4 Phase 2 (to be determined).

ANC believes that the EFRAG's Board recommendation expressed in the endorsement advice to the European Commission on 15 September 2015 that "all businesses other than those carrying out insurance activities are required to account for their financial instruments in compliance with IFRS 9 in 2018 and that businesses carrying out insurance activities are permitted to do so in compliance with IFRS 9 from the same date" is a key recommendation to address the concerns expressed by the insurance sector. Therefore, ANC believes it is fundamental to define an appropriate scope to capture all insurance activities and to guarantee a level playing field between all insurance market players. Such a scope should also prevent banking activities to apply the IFRS 9's temporary exemption, unless they represent an immaterial activity compared to insurance.

The temporary exemption from applying IFRS 9

ANC strongly supports in principle the temporary exemption from applying IFRS 9 approach. However, ANC is very concerned that this approach, as currently envisaged by IASB (predominance criterion), would exclude too many insurance activities. For instance, insurance entities within conglomerates would not be in a position to use it (they represent a major part of the French market). Finally, in ANC's view, there is a risk that the difference of eligibility to the temporary exemption would impair the accounting comparability between the insurance industry's players with some significant impacts on their investment strategies. In addition, there is a risk of still maintaining under IAS 39 certain material banking activities.

This is why ANC believes two solutions should be considered.

The first solution is based upon "insurance regulation". Entities submitted to insurance regulation would, under certain conditions, have access to the temporary exemption, together with non insurance regulated entities directly linked to the insurance activities (asset management vehicles, holding). The key merit of such a criterion is simplicity. On such a basis, the mismatch would be fully eliminated.

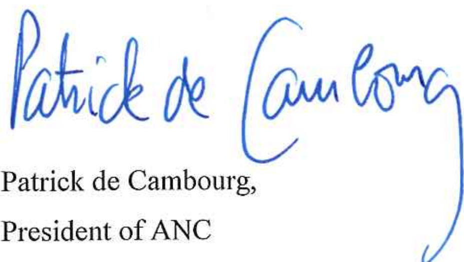
The second solution is based upon "true predominance". For the predominance criterion to be fully effective, the relevant liabilities and assets should be revisited and the criterion should be applicable below group reporting level if need be. The predominance approach, as defined by the IASB, would in effect exclude too many entities conducting insurance activities. As a consequence, ANC supports proposals about the widened "predominant activity" criterion.

The overlay approach

ANC considers the overlay approach may not be an alternative likely to be widely retained, because the operational complexity and efforts required to run IFRS 9 and IAS 39 in parallel would create a cost issue and may deter entities to apply this approach. Moreover, implementing two significant accounting changes in a short period of time may confuse users of financial statements. However ANC does not oppose, considering that this option might be suitable for very specific situations. ANC also expresses a preference for the overlay impact being introduced directly at OCI level.

We appreciate your consideration of our input and remain at your disposal, should you wish to further discuss any of our comments.

Yours sincerely,



Patrick de Cambourg,

President of ANC

APPENDIX 1 – ANC's responses to the questions raised in the ED

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 (paragraphs BC17–BC18).

(c) Two sets of major accounting changes in a short period of time could result in significant costs and effort for both preparers and users of financial statements (BC19–BC21).

The proposals made by the IASB are designed to address these concerns.

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

ANC's response

ANC welcomes the IASB decision to address the misalignment of the different effective dates of IFRS 9 and the new Insurance Contracts Standard.

Question 1 (a)

Unlike what is indicated in paragraph BC14 of the Basis for Conclusions of the ED, using the existing accounting possibilities offered by IFRS 4 such as shadow accounting, use of current market interest rates or changes in accounting policy, could not address the concerns.

Shadow accounting is a specific feature in the current IFRS 4 to mitigate accounting mismatches. It permits that the measurement of certain insurance liabilities is adjusted for gains and losses on the assets backing certain types of insurance contracts. The current IFRS 4 has various restrictions on shadow accounting – it only allows a shadow liability (shadow assets are limited) when, and to the extent that, realized investment results directly impact policyholders. Extension of shadow accounting is not the right solution to the misalignment of date between IFRS 9 and the new Insurance Contracts Standard.

Question 1 (c)

Both IFRS 4 and IFRS 9 are significant to insurers – implementing these significant changes in a short period after each other would be inefficient and confusing to users. If IFRS 9 were to be implemented before IFRS 4 phase II, the classification should be reassessed with IFRS 4 phase II, effectively resulting in a two-step implementation of IFRS 9. This will create confusion with users.

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 required, please explain which and why.

ANC's response

ANC strongly supports the temporary exemption from applying IFRS 9 to all insurance entities. However, the overlay approach could also be a solution in addressing the misalignment of effective dates between IFRS 9 and the new Insurance Contracts Standard for some entities.

Questions 2(a) and 2(b)

ANC expresses a strong preference for the temporary exemption from IFRS 9. This is because:

i. It should avoid an entity having to implement IFRS 9 twice (once in 2018 and again when the New Insurance Contracts Standard is adopted).

ii. It does not result in further accounting mismatches in the periods between 2018 and when the new Insurance Contracts Standard is adopted.

iii. The financial statements would be simple to understand for users and confusion created by two important successive accounting changes in a short period of time would be avoided.

However ANC considers that there are still some major concerns and that some improvements are needed for the exemption to be workable.

ANC considers that the overlay approach is an alternative unlikely to be widely retained. Indeed, the overlay approach is difficult and costly to apply in practice:

i. It would require an entity to run multiple IT processes in parallel (IAS 39 and IFRS 9) ;

ii. It would be necessary to reconcile these two systems, which run in parallel, so as to ensure that they both run in a meaningful and auditable manner ;

iii. It would introduce an operational complexity, i.e. additional accounting schemes to be implemented;

iv. The presentation of the overlay adjustments, as well as two significant accounting changes in a short period, may confuse users of financial statements.

With regard to the French market, ANC is not aware of any major French insurer or bank insurer that might consider the overlay approach as a suitable solution.

Question 3 – The overlay approach

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

(a) Paragraphs 35B and BC35–BC40 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 in 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?

ANC's response

The overlay approach does not address the aforementioned key topics and, as a result, is not the preferred approach for ANC.

Question 3(b)

ANC points out that paragraphs 35A-35C of the ED are not clear about the presentation of the overlay adjustment. While paragraph 35A of the ED states that there should be a reclassification of the overlay adjustment from profit and loss to other comprehensive income (OCI), paragraph 35 C of the ED seems to allow several presentation alternatives.

In order to be consistent with the objective of and the rationale for the overlay approach and facilitate insurance-industry comparability, ANC supports the following option: the revenues and expenses related to the eligible financial assets would be determined in accordance with the measurement criteria of IAS 39 before the overlay adjustment is made in OCI by entering an amount based upon the difference between IAS 39 and IFRS 9.

ANC recommends the IASB to clarify this possible inconsistency in wording between paragraphs 35A and 35C of the ED and, if a presentation option is offered, expresses its preference for a presentation that does not affect profit and loss.

Question 3(c)

ANC agrees with paragraph BC53 of the Basis for Conclusions of the ED which states that applying the overlay approach would be more costly than applying only IFRS 9. Indeed, in itself, it is very costly to implement IFRS 9, especially when the implementation must be done twice. The overlay approach would be even more costly, as insurers would face the cost of implementing IFRS 9, while incurring the cost and operational difficulties of still having to maintain their existing IAS 39 systems. In addition, the overlay approach will result in multiple significant changes in a short period and, therefore, would be confusing to users.

Question 4 – The temporary exemption from applying IFRS 9

As described in paragraphs 20A and BC58–BC60 the ED 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 ED 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 (i.e. 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?

ANC's response

As the temporary exemption from applying IFRS 9 helps mitigate all negative effects of the misalignment of the effective date of IFRS 9 and the new insurance contracts standard, ANC strongly supports this approach. In this respect, ANC supports the principle of predominance for the scope of the temporary exemption approach. However, predominance cannot be simplistically defined using only a rigid quantitative test of "IFRS 4 insurance liabilities as a percentage of total liabilities".

Using only a formula to make this assessment will lead to unintended consequences excluding potentially many relevant insurance entities from the scope of the temporary exemption. Moreover, the IASB's proposed application of predominance assessment at the reporting entity level for insurance groups would exclude insurance entities within conglomerates e.g. bank insurer (they represent a major part of the French market). Furthermore, ANC considers that banking activities should not be allowed to apply the IFRS 9's temporary exemption, unless they represent an immaterial activity compared to insurance.

As a consequence, ANC believes it is fundamental to define an appropriate scope to capture all insurance activities and to guarantee a level playing field between all the insurance market players. Hence, ANC proposes to identify insurance activities eligible for the temporary exemption applying a simple criterion based on insurance regulation. In ANC's view, the scope of insurance regulated entities, subject to a few additional provisions, is the one that coincides best with the scope of insurance activities in all significant jurisdictions. The predominance criterion might also be a workable solution if relevant liabilities and assets are revisited and if it can be applied below reporting level if need be.

ANC firmly considers that any approach that will succeed in meeting the objective of (1) making the temporary exemption from applying IFRS 9 available to all insurance activities ; (2) avoiding applying the temporary exemption from applying IFRS 9 to material banking activities, is one that :

- will focus on identifying "insurers" more broadly rather than focussing on contracts within the scope of IFRS 4 alone;
- can be applied below reporting entity level.

ANC expresses the view that material banking activities should not apply the temporary exemption from applying IFRS 9. Only immaterial banking activities compared to insurance activities should be allowed to apply the IFRS 9's temporary exemption.

ANC has investigated two approaches, as is explained below, that characterise "insurers" in a manner as close as possible to how they can or are identified in practice.

In doing so, ANC has considered two different criteria:

(a) A qualitative criterion based on insurance regulation, the preferred approach for ANC ; and
(b) A quantitative predominance widened criterion.

Based on these two criteria, ANC's answers to Questions 4(a), 4(b) and 4(c) are as follows.

Question 4 (a)

As is explained in our response to the following question, the focus of the IASB on this criterion alone results in a scope that is so limited that it does not meet the objectives which have been highlighted in our general comments above.

Question 4 (b)

As explained above, ANC does not agree that an entity should assess its predominant activity with the IASB's quantitative criterion proposal. ANC believes that a successful approach in scoping the temporary exemption from applying IFRS 9 is one that will capture all insurance activities, and only insurance activities. ANC has therefore investigated the two following criteria.

<u>Approach 1: a qualitative criterion based on insurance regulation</u>

In defining insurers, ANC proposes to rely on the following definitions derived from the insurance regulation:

(a) An 'insurance undertaking' is defined as 'a direct life or non-life insurance undertaking which has received authorisation from the supervisory authorities' and is supervised by them; and
(b) A 'reinsurance undertaking' is defined as 'an undertaking which has received authorisation from the supervisory authorities to pursue reinsurance activities' and is supervised by them; and
(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 insurance or reinsurance undertakings " .

A combination of the above defined entities may constitute an insurance (sub) group, which would therefore be composed of one or more of the following entities: (i) an insurance or a reinsurance undertaking and (ii) an insurance holding company and (iii) any entity directly or indirectly held by an insurance or a reinsurance undertaking or an insurance holding company, closely related to the insurance business (additional provision 1).

In order to avoid integrated entities that do not perform insurance activities, the above would in addition be applied considering the general materiality threshold, i.e., the issuance of material IFRS 4 insurance contracts (additional provision 2).

Entities belonging to the insurance (sub) group such as defined in the above paragraph could then apply the temporary exemption from applying IFRS 9 that enables them not to apply this standard in the following situations: (i) when preparing their individual financial statements, (ii) when reporting their financial statements to the reporting entity preparing the consolidated financial statements, i.e. the accounting would be rolled-up into the consolidated financial statements. In addition, when another reporting entity, which may not itself apply the temporary exemption from IFRS 9, accounts for a reporting entity that apply the temporary exemption under the equity method, in order to avoid an unnecessary restatement, the financial statements of the entity accounted for under the equity method should be used as the basis for this accounting treatment with appropriate disclosures. As a consequence of above, entities not belonging to the insurance sector included in the consolidated financial statements of an insurance reporting entity would not be allowed to apply the temporary exemption from IFRS 9, unless they represent an immaterial activity compared to insurance.

With the two additional provisions mentioned above, ANC believes the regulatory criterion is a workable solution that is simple, understandable and free from bias.

<u>Approach 2: a widened quantitative criterion</u>

ANC considers that the "predominance criterion" based on a ratio of total liabilities may be a way of identifying "insurers", however the definition of the ratio would need to be revisited so as to encompass virtually all liabilities that an "insurer" might carry on its balance sheet

ANC observes that the activities of insurers are not limited to issuing insurance contracts within the scope of IFRS 4. Insurers also provide asset management services, provide for premium rebates (amounts to be paid back to the policyholder), undertake hedging activities, issue debt to finance insurance activities, may have written put options over non-controlling interest and have operating

liabilities such as deferred tax and employee benefit liabilities. ANC notes that these liabilities are not included in the IASB'S proposed threshold when assessing predominance.

For these reasons, in determining the numerator of the predominance criterion ANC considers that all of the liabilities an insurer is expected to carry should be captured, including those mentioned above. ANC considers that, when comparing the widened predominant activity criterion to the proposal in the ED, this widened criterion better reflects the set of activities that an insurer routinely performs, rather than the proposal in the ED that bases the predominance criteria on a relevant, however restrictive, subset of insurance activities.

Another option would be to exclude certain liabilities from the denominator. As a matter of fact, a percentage of total liabilities approach to determine the insurance nature of the business would overstate the denominator for items that are not representative of the nature of the underlying business operations or would include items that will be backed by assets already held at fair value and, therefore, that have no impact on the adoption of IFRS 9. For example:

- Debt financing is only providing information about the capital structure and not about the nature of the business, and
- Items such as unit linked accounts, investment contracts and derivative liabilities are already fully fair valued and in compliance with IFRS 9.
- Tax liability and other payables related to insurance and reinsurance operations will distort the ratio unless those related to insurance business are included in the numerator.

Based on the paragraph # 20D of the ED, initial assessment of the predominance test on or after 1st January 2018 is inappropriate. Indeed, given the time needed for the IFRS 9 implementation, entities would be required in practice to develop and maintain two sets of systems, processes and resources to ensure accounting can be switched at the beginning of the first annual reporting period. The test of the criterion shall be passed by preparers as of 1st January 2018 but it is anticipated that three years are necessary to implement IFRS 9. A test designed on bright lines or overly simplistic ratio could explain that a preparer passes the test as of today and not at the beginning of 2018. Moreover, reassessment of the predominance test would result in excessive operational burdens and complexities that would be inappropriate for such a short time period. In this regard, ANC supports an overall assessment of the predominance principle which application can be anticipated, for example as of publication of IFRS 4's amendments.

Question 4 (c)

Under the quantitative predominance activity approach, if the redefined predominance criterion is only tested at reporting entity level, the "bank insurers" topic is not addressed. Then the redefined predominance criterion could operate at below reporting entity level. It is crucial that the IASB predominance criterion does address the legitimate concerns of significant insurance activities of insurance entities within conglomerates; therefore it is important to apply this approach at below reporting entity level.

Avoiding a breach in uniformity of accounting policies

In the BC56 of the ED, the situation where a reporting entity would simultaneously apply two standards for accounting for financial instruments is assessed as harder for users to understand.
We note that there have been precedents in applying two successive standards (such as IFRS3 and IFRS3 revised), which have been solved by adequate disclosures. In the current situation, IAS 39 and IFRS 9 do address the same scope of items with the same measurement basis, so that differences or additional features (such as expected loss model) may adequately be disclosed. ANC is therefore convinced that this situation should not be eliminated since it is not conceptually prohibited nor would necessarily obscure the presentation. Additional disclosures required in this regard should however be considered by preparers in their cost-benefits assessment of opting for the temporary exemption.

Transfers

In paragraph BC57 (b), IASB considers that the application of the temporary exemption from IFRS 9 below the reporting entity level has raised concerns of earnings management. ANC proposes that when transfers of financial assets occur, the transferred assets should follow the origination accounting in order to avoid earnings management.

Question 5 – Should the overlay approach and the temporary exemption from applying IFRS 9 be optional?

As explained in paragraphs BC78–BC81, the ED proposes that both the overlay approach and the temporary exemption from applying IFRS 9 should 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?

ANC's response

ANC agrees that both the overlay approach and the temporary exemption from applying IFRS 9 should be optional due to the diversity of circumstances encountered in reporting entities that issue insurance contracts. ANC also agrees to permit entities to stop applying the overlay approach or the temporary exemption from applying IFRS 9 before the effective date of the new insurance contracts Standard because no entity should be prevented from benefiting from the improvements brought by IFRS 9 when its circumstances permit them to do so.

Question 6 – Expiry date

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 from applying IFRS 9 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 dates would you propose and why?

ANC's response

ANC agrees that the temporary exemption from applying IFRS 9 should have an expiry date as this constitutes a strong incentive for all parties involved in as quick a finalisation of the insurance contracts Standard as feasible. ANC also agrees that the expiry date should be reporting periods beginning on or after 1 January 2021 or earlier because ANC expects that the effective date of the new insurance contracts Standard will be no later than 1 January 2021. ANC however disagrees with the IASB that the overlay approach may be a remedy to a possible postponement to the finalisation of the new insurance contracts Standard.