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Comments on Exposure Draft Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts - Proposed amendments to IFRS 4

Dear Mr Hoogervorst,

The European Insurance and Occupational Pensions Authority (EIOPA) welcomes the opportunity to comment on the IASB's Exposure Draft Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts Proposed amendments to IFRS 4.

EIOPA supports the IASB's efforts to find efficient and effective solutions for the effects of different application dates of IFRS 9 *Financial Instruments* and of a future IFRS *Insurance Contracts*.

EIOPA believes that IFRS 9 introduces important amendments in comparison to IAS 39 *Financial Instruments* being, first and foremost, an expected loss model to assess the impairment of financial assets - as well as the consequential changes to the classification and impairment of financial assets measured at fair value through other comprehensive income and those measured at amortised costs. In our opinion, IFRS 9 is a significant improvement for the accounting of financial instruments that is relevant for insurance and reinsurance undertakings.

EIOPA has been engaged in dialogues with European insurance and reinsurance undertakings, industry bodies and audit firms to better understand the significance of the individual and aggregate effects on insurers' performance reporting in case IFRS 9 would be applied before a future IFRS on insurance contracts becomes applicable. Assessing the overall effects, we conclude that those mainly depend on the volume of financial assets that are required to be reclassified, the measurement of the liabilities and, in particular, on the extent to which participating contracts are linked to those assets.

EIOPA has been of the view, also in its comment letter on the ED Insurance Contracts, that aligned application dates of IFRS 9 and a future IFRS on insurance contracts would have been strongly desirable to limit the costs of introducing changes in the accounting systems and to allow for a holistic approach to the application of new accounting standards for both assets and liabilities of insurance and reinsurance undertakings. In that sense, EIOPA believes that any other solution is sub-optimal.

A departure from full application of IFRS 9 for insurance and reinsurance undertakings, in particular if granted on an optional basis, would come at the price of increased complexity, lack of comparability and perceived lack of transparency of the insurance sector. On the other hand, if IFRS 9 is applied by insurance and reinsurance undertakings before the new insurance contracts standard is applied this may result in additional costs and efforts for both preparers and users of financial statements and could lead to a temporary increase in accounting mismatches for European insurers and volatility in the profit and loss statement.

EIOPA is generally of the opinion that the IASB's proposed amendments to IFRS 4 can be considered as adequate solutions for those financial statements that could be temporarily affected by the different effective dates of the two standards. Further views on the individual questions can be found in the annex.

Most importantly, EIOPA strongly urges the IASB to give priority to the finalisation of the future IFRS for insurance contracts in order to ensure that both assets and liabilities of insurance and reinsurance undertakings are comprehensively portrayed, accounting mismatches are eliminated and insurance business activities are better reflected.

If you have any questions or wish to discuss this further with EIOPA, please feel free to contact Ms Sandra Hack at Sandra.Hack@eiopa.europa.eu.

Yours sincerely,

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?

EIOPA's response:

EIOPA agrees that the IASB should investigate efficient solutions to address those concerns. As indicated in previous EIOPA communication, EIOPA understands that financial statements of some insurers and reinsurers are affected by the diverging application dates of IFRS 9 and the future IFRS on insurance contracts, as outlined in the IASB's considerations to develop its proposals.

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.

EIOPA's response:

In line with EIOPA's previous communication on this issue, EIOPA fully understands the objective to amend the current IFRS 4.

EIOPA is aware that both options have benefits and costs and different scopes. As mentioned in previous communication, EIOPA can envisage both methods to resolve the issues raised: by applying a presentation solution along the lines of the overlay approach or by deferring the application date for insurers affected by the impacts of diverging application dates.

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?

EIOPA's response:

EIOPA understands that the overlay approach would enable insurers and reinsurers to apply IFRS 9 immediately, choosing (within the regulated limits) the appropriate category in light of minimising accounting mismatches with their insurance liabilities whilst eliminating the volatility in the profit and loss statement. In light of EIOPA's positive assessment of IFRS 9 that approach definitely has its merits.

The technical criteria to define assets to which the overlay approach can be applied could be further clarified in order to clearly identify the relevant assets and to foster consistent application.

However, EIOPA follows the reasoning as outlined in the BC 39 and would stress the importance of the proposed disclosures.

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?

EIOPA's response:

In line with EIOPA's previous communication, EIOPA agrees that it may be a solution to defer the application date of IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4.

Based on the line of argumentation that accounting mismatches and volatility in profit or loss due to divergent application dates of IFRS 9 and the future IFRS on insurance contracts should be addressed, it is reasonable to define the scope of application of the deferral approach in relation to the current use of IFRS 4, which supposedly is the root of the problem.

Therefore, EIOPA agrees with a predominance criterion that links the scope of the deferral approach with the use of IFRS 4. Insurance contracts subject to IFRS 4 should be the primary business activity to be eligible for the deferral approach.

EIOPA notes that the introduction, as suggested in BC 65, of the example of the 75% predominance test may be viewed as a bright line, which may be considered as sub-optimal in a principle based framework like IFRS.

EIOPA understands the reasons for the IASB to consider the deferral approach at reporting entity level.

EIOPA supports the line of reasoning that consistent accounting policies within consolidated financial statements should be weighed as more important compared to applying the deferral only to those business activities subject to IFRS 4 within a reporting entity.

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?

EIOPA's response:

In terms of improving the understandability and comparability of insurance and reinsurance undertakings' financial statements, both on an individual entity basis and from period to period, it is not desirable to allow for different, optional solutions. Arguably, the perceived need for an improved IFRS on insurance contracts is the high degree of complexity and lack of comparability of insurers' financial statements currently.

However, again weighting the arguments, EIOPA can support optional, differing solutions in light of the near finalisation of the IASB's proposals for a future IFRS on insurance contracts, which will render these proposals irrelevant in the very near future. EIOPA stresses the importance of meaningful and sufficient corresponding disclosures to facilitate a satisfying degree of comparability and understandability of insurance and reinsurance undertakings' financial statements.

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?

EIOPA's response:

EIOPA supports a strict expiry date of the temporary exemption. EIOPA considers that by that date the future IFRS on insurance contracts should be applicable. A strict deadline helps insurance and reinsurance undertakings to have certainty on the actual application of the exemption, which again caters for, and supports, proper preparation and basis for applying IFRS 9 in the future.