



Comments on EFRAG letter on the Exposure Draft ED/2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*

We are pleased to provide BNP Paribas' comments on the EFRAG Draft comment letter on the IASB Exposure Draft Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts ("ED").

In addition to being one of the largest financial institutions in Europe, BNP Paribas has significant insurance activities, particularly in the field of participating life insurance contracts, investment contracts with a discretionary participating feature ("DPF investment contracts"), and creditor insurance contracts.

As a member of the CFO Forum and the Fédération Française des Sociétés d'Assurance (FFSA), we have contributed to their response to EFRAG's Draft comment letter on the ED. However, we also wish to provide you with the view of the group, as a conglomerate operating both in banking and insurance activities.

We appreciate the IASB and EFRAG's efforts to understand the concerns raised by Insurance Industry and other interested parties on the misalignment of effective dates for IFRS 9 and IFRS 4 phase II.

With the aim to address these concerns, the IASB proposes in the ED two different solutions:

- An optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 ("the **deferral approach**");
- An option that would permit entities that issue contracts within the scope of IFRS 4 to reclassify from P&L to Other Comprehensive Income temporary additional volatility that could occur before the new insurance contracts Standard is effective (the "**overlay approach**").

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We welcome EFRAG's in depth analysis regarding the consequences of both the Overlay, and Temporary exemption from applying IFRS 9 approaches.

We broadly agree with EFRAG's comments on these two approaches proposed in the ED. In particular, we strongly support the need for a "level playing field" between all entities involved in insurance activities, because:

- we believe that comparing "insurer to insurer" is important and is more meaningful to the users of the financial statements, than comparing assets related to insurance activities with non-insurance (e.g. banking) activities within a conglomerate;
- if insurers within conglomerates were to be required to apply the overlay, they would be disadvantaged compared to other insurers regarding the cost/benefit ratio of the two approaches as it is highlighted in EFRAG's draft response.

Deferral approach

To identify entities eligible for the deferral, EFRAG has identified two criteria:

- 1/ A widened "predominant activity" criterion
- 2/ The "regulated criterion".

We consider the 'level playing field' is the key argument justifying that the eligibility criterion should not be restricted at the reporting entity level, as currently proposed in the IASB ED. We welcome the fact that EFRAG is proposing to assess the eligibility of insurance activity not only at reporting entity level, but below the reporting entity level if necessary. As a conglomerate, the assessment below the reporting entity level is a necessary condition for allowing our insurance subgroup to be eligible for the deferral approach.

As a step further to the EFRAG's proposal, we believe that the "regulated entity" criterion should be the main criterion to identify insurance entities eligible to the deferral. This criterion is deemed objective, less judgmental and simple as a means to identify eligible entities. More specifically, because the European supervision authorities acknowledge the notion of insurance groups or subgroups, we believe that the "regulated entity" approach considered by the EFRAG should be applied at the highest level (i.e. group or subgroup) under the supervision by an insurance supervisory authority.

In the situations where the regulated criterion could not apply (e.g.: in jurisdictions where insurance activities are not subject to specific regulations), the "predominant activity criterion" should be applied.

We have noted that the EFRAG has analysed the pros and cons of the proposed IASB criterion to determine the predominance of insurance activity (e.g. when the ratio "liabilities arising from contracts in the scope of IFRS 4 compared to total liabilities" exceeds 75%). We share the EFRAG's view that this ratio does not capture all the liabilities related to insurance activity, and thus should be extended.

We therefore agree with the EFRAG's proposal to widen the predominant activity criterion for two reasons:

- when considering only liabilities arising from contracts in the scope of IFRS 4, several liabilities related to insurance activities (as hedging activities linked to insurance contracts, asset management activities or debt issued to finance insurance activities among others ...) are excluded;



- in some cases, the quantitative criterion based on liabilities under IFRS 4 could be irrelevant because the amount of recognised insurance liabilities could be low by nature, depending on the characteristics of the insurance products offered. This is the case for instance, in P&C contracts, when insurance claims are rapidly paid and settled (leading to low claim reserves), and for life contracts with regular premiums, for which the mathematical reserves are calculated as a net amount (the insurer's expected commitment to pay the possible claim, less the policyholder's expected commitment to pay the futures premiums).

Overlay approach

EFRAG acknowledges that the overlay approach does not address all the concerns arising from the misalignment of the effective dates of the two standards and generates supplementary costs. However EFRAG thinks that this approach should be pursued, as it could be suitable for limited population of banks carrying insurance contracts.

BNP Paribas does not support the overlay approach and does not consider this approach as a workable solution in most cases, and in particular in our own case, for the following reasons:

- Providing the financial analysts with two financial results (one under IFRS 9 and one under a combination of IFRS 9 and IAS39), which are moreover presented in the same statement of comprehensive income, will be difficult to understand, and thus of limited use;
- The overlay approach will still result in several significant changes in a short period of time and to the need to implement twice IFRS 9 classification (in 2018 and when the new insurance contract standard will become effective). Indeed, performance ratios are taken into account for asset and liability management and consequently, the investment strategy is likely to be revised and adjusted to address the consequences of the new insurance contract standard.
- The overlay approach does not address the entire volatility generated by IFRS 9. Indeed, for assets previously held at cost under IAS 39 and that would be reclassified to FVPL under IFRS 9, the IFRS 9 induced volatility is merely moved from P&L to OCI whereas the equity stability is fundamental for prudential capital purposes;
- It is operationally complex and costly to have both accounting standards implemented in financial systems and this proposal cannot be seen as a simple parallel run (for the French entities an increase of almost 50% in the costs could be incurred). It should be noted that the overlay approach requires both implementing IFRS 9 Expected Credit Loss model and maintaining IAS 39 Incurred Loss Model.

Should you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely,

Lars Machenil