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Summary and analysis of the comment letters received

Introduction and Objective

1 The purpose of this paper is to present to EFRAG Board and EFRAG TEG a summary and analysis of the comments received from respondents in response to EFRAG's draft endorsement advice on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4),* hereafter 'the Amendments'.

2 Based on the comments received, the EFRAG Secretariat has developed a revised draft EFRAG final endorsement advice that is presented as agenda paper 02-03 (marked-up version) and 02-04 (clean version).

Structure of the paper

3 This comment letter analysis is structured as follows:

(a) Background;

(b) Summary of respondents' views;

(c) Main positions in EFRAG's draft endorsement advice;

(d) Main positions in EFRAG Secretariat's proposed final endorsement advice;

(e) Appendix 1 - detailed analysis of responses to questions in EFRAG's draft endorsement advice, and EFRAG Secretariat's recommendations; and

(f) Appendix 2 – list of respondents.

Background

4 In order to resolve the problems related to the misalignment of the effective dates of IFRS 9 *Financial Instruments* and the future insurance contracts Standard, the IASB published *Amendments to IFRS 4.* The *Amendments to IFRS 4* provide:

(a) An option that permits entities that issue contracts within the scope of IFRS 4 to reclassify, from profit or loss to other comprehensive income, some or all of the income or expenses arising from designated financial assets as a result of applying IFRS 9 (the overlay approach); and

(b) An optional temporary exemption from IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 (the temporary exemption from IFRS 9).

5 The IASB published *Amendments to IFRS 4* on 12 September 2016. EFRAG subsequently published its draft endorsement advice on 15 November 2016, closing for comment on 13 December 2016.

Summary of respondents' views

6 At the time of writing, 23 comment letters have been received. The letters are summarised below. A list of the respondents is provided in Appendix 2.

Technical criteria for endorsement

7 Eleven respondents agreed that the Amendments fulfilled the technical criteria for endorsement. Twelve respondents did not agree that the technical criteria are met, based on a range of arguments all relating to the availability of the temporary exemption from IFRS being restricted to predominant insurers. Also, one respondent indicated that the ability to apply the overlay approach to only some financial assets raises questions regarding the relevance criterion.

8 The respondents that disagreed with the technical criteria are all either bank-led entities that undertake insurance activities or industry organisations representing such entities.

At or below reporting entity level

9 The comments received on the application of the temporary exemption at or below reporting entity level can be summarised as follows:

(a) Thirteen respondents supported application of the temporary exemption below reporting entity level;

(b) Three respondents explicitly argued against application of the temporary exemption below reporting entity level; and

(c) Seven respondents were silent on the issue.

10 The reasons for or against applying the temporary exemption below reporting entity level are explained in Appendix 1.

European public good

Improvement in financial reporting

11 Eleven respondents agreed that the Amendments lead to an improvement in financial reporting. Some of the respondents that disagreed and who replied to this question did so because the Amendments did not address the situation of insurers that are part of bank-led groups not being able to rely on the temporary exemption from IFRS 9. One regulator noted that applying the temporary exemption from IFRS 9 below reporting entity level would make enforceability more difficult.

Costs and benefits

12 Eight respondents agreed with EFRAG's initial position that the benefits for users and preparers are likely to exceed the costs of applying the Amendments.

13 Ten respondents disagreed that the *Amendments to IFRS 4* provide some form of solution to all insurance entities as they considered that overlay approach is not a viable solution. The overlay approach was considered more costly than the application of the temporary exemption or full IFRS 9 by most (but not all) respondents that commented on this matter.

14 Three respondents questioned the reasoning that implementing IFRS 9 through an entire group is expected to result in synergies for bank-led groups that undertake insurance activities. This is because both activities do not share the same systems to manage financial assets.

Potential competition issues

15 Six respondents agreed with EFRAG's initial position. One respondent indicated that in its jurisdiction, there is no material competition issue that it is aware of.

16 Fourteen respondents advocated a level playing field between insurers, and indicated that this would be achieved by making the temporary exemption from IFRS 9 available to all insurers. Some of these respondents referred to the relative market share of the 20-25% of "non-qualifying" insurers as evidence that the limitation of scope of the temporary exemption gives rise to a material competition

issue. One respondent had the opposite view and noted that when applying the temporary exemption from IFRS 9 below reporting entity level, the level playing field with banks would be affected.

17 The following additional comments were made regarding the existence of a level playing field:

(a) Predominant insurers would have the opportunity to recognise in their income statements unrealised gains related to financial assets currently measured at amortised cost or at fair value through other comprehensive income (FVOCI) until 2021, while these unrealised gains will be frozen in retained earnings from 2018 for non-predominant insurers. As a consequence, the latter insurers might change their investment strategy, in contrast to their business model as long-term investors. This view was opposed by one respondent; and

(b) Predominant insurers would be able to defer the application of the expected credit loss model in IFRS 9, while non-predominant insurers would have to apply it. Two respondents explicitly indicated that not all of their debt-type investments were of investment grade, possibly implying that the impact of expected credit loss accounting could be more significant than indicated in the draft endorsement advice and in EFRAG's endorsement advice on IFRS 9.

Other factors

18 Eight respondents agreed with EFRAG's initial position that there were no other factors to consider in assessing whether the endorsement of the Amendments is conducive to the European public good. Other respondents raised the following additional items for consideration:

(a) The application of the temporary exemption from IFRS 9 to non-predominant insurers;

(b) The application of the overlay adjustment to selected eligible financial assets; and

(c) The need for using separate operating segments for insurance when separate financial statements are available.

Overall assessment with respect to the European public good

19 Ten respondents agreed that the endorsement of the Amendments would be conducive to the European public good.

20 Eleven respondents expressed the view that the lack of the level playing field in relation to entities undertaking insurance activities that are not predominant insurers has implications for EFRAG's conclusion on European Public Good.

Main positions in EFRAG's *draft* endorsement advice

21 EFRAG's preliminary conclusion was that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship and lead to sufficiently prudent accounting. EFRAG also assessed that the Amendments do not create any distortion in their interaction with other IFRS. EFRAG also concluded that all necessary disclosures are required. Therefore, EFRAG concluded that the Amendments are not contrary to the true and fair view principle.

22 EFRAG's analysis noted that the Amendments address the main concerns of groups whose activities are predominantly related to insurance ("predominant insurers"). EFRAG further noted that predominant insurers are the entities most significantly affected by the issues arising from the misalignment of the effective dates of IFRS 9 and the forthcoming insurance contracts Standard. On that basis, EFRAG assessed that adopting the Amendments would be conducive to the European public good.

23 EFRAG assessed that the Amendments address many of the main concerns raised in its endorsement advice on IFRS 9. In particular, the Amendments provide an optional, temporary exemption from IFRS 9 for predominant insurers. However, this option is not available to entities that are not predominant insurers.

24 The Amendments also provide an alternative approach (the overlay approach) that would be available to all entities undertaking insurance activities and which can substantially mitigate the financial reporting-related concerns arising from the misalignment of effective dates referred to above. The draft endorsement advice noted that the main drawback of the overlay approach is that it would not provide the cost savings for the majority of respondents referred to in EFRAG's endorsement advice on IFRS 9 and would in fact increase costs for entities compared to implementing IFRS 9. Accordingly, EFRAG considered that the Amendments would not result in a completely level playing field among all entities undertaking insurance activities.

25 For these reasons, EFRAG considered that the Amendments addressed many of the concerns in EFRAG's endorsement advice on IFRS 9 but did not address the cost concerns of entities that are not predominant insurers.

Main positions in EFRAG's *proposed final* endorsement advice

26 EFRAG Secretariat considers that the main concern raised by respondents relates to the fact that not all entities undertaking insurance are able to use the temporary exemption from IFRS 9. EFRAG Secretariat notes that while many respondents state that the endorsement criteria are not met, none of them conclude from this that the Amendments should not be endorsed. EFRAG Secretariat notes that non-endorsement of the *Amendments to IFRS 4* would have the effect that *all* insurance entities would have to apply IFRS 9 as from 1 January 2018. Accordingly, EFRAG Secretariat proposes that the initial position in the draft endorsement advice as stated in paragraphs 21 to 25 above is retained.

27 In addition, the comments received confirm the position in the draft endorsement advice, reflected as an emphasis of matter in the overall conclusion on European public good, that the Amendments do not address the cost concerns of entities undertaking insurance activities that are not predominant insurers.

28 Finally, EFRAG Secretariat recommends several changes to the draft endorsement advice addressing the comments received from constituents. These recommendations are clarified in Appendix 1.

Question to EFRAG Board and EFRAG TEG

29 Does EFRAG Board and EFRAG TEG agree with the EFRAG Secretariat's recommendations in Appendix 1 including paragraphs 26 to 28 above?

Appendix 1 - Detailed analysis of responses to questions in EFRAG's draft comment letter, EFRAG Secretariat recommendations and questions to EFRAG TEG

Technical criteria for endorsement

EFRAG's tentative position

30	EFRAG's initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, the Amendments are not contrary to the principle of true and fair view and meets the criteria of relevance, reliability, comparability, understandability and raises no issues regarding prudent accounting.

Summary of respondents' comments

31 Eleven respondents agreed with EFRAG that the Amendments meet the technical criteria for endorsement.

At or below reporting entity level

32 The following respondents did/did not support application of the temporary exemption below reporting entity level or were silent on the issue:

(a) Thirteen respondents supported the application of the temporary exemption below reporting entity level;

(b) Three respondents did not support the application of the temporary exemption below reporting entity level; and

(c) Seven respondents were silent on the issue. However, these respondents either agreed with EFRAG's initial position on the technical criteria and European public good or supported the Amendments as is.

Reasons for calling for application below reporting entity level

33 The following reasons were provided for applying the temporary exemption below reporting entity level:

(a) Ensure a level playing field within the insurance sector. In addition, some respondents noted that 20-25% of the total insurance activity are not able to apply the temporary exemption;

(b) Comparison throughout the insurance market is more meaningful than comparing insurance and non-insurance assets within a financial group;

(c) For bancassurers, application of IFRS 9 will induce a "loss of performance" that is damaging to those companies and to the global insurance market (note that this concern was not further elaborated);

(d) The overlay approach is not an appropriate solution because of its operational complexity and the effort required to run parallel systems for IAS 39 and IFRS 9 would create a costly and complex process;

(e) The overlay approach does not remove from profit or loss the incremental effects of IFRS 9's expected credit loss model;

(f) The overlay approach does not fully address the mismatch (resulting in volatility) as the volatility is transferred from profit or loss to OCI;

(g) The opportunity is open to predominant insurers to recognise, in their profit or loss, unrealised gains related to financial assets currently measured at cost or at fair value through OCI up until transition to IFRS 9 in 2021, while for non-predominant insurers, they will be frozen in retained earnings on transition to IFRS 9 in 2018. This is described as a competitive issue;

(h) Users will not understand the additional accounting mismatches and resulting volatility in profit or loss that cannot be offset by using IFRS 4 *Insurance Contracts*, forecasting earnings based on profit or loss information will become more complex;

(i) As material banking activities will not be included in the scope of the temporary exemption from IFRS 9, no competition issues would arise within the banking sector; and

(j) Analysts working in the insurance sector do their valuations for bank-led groups considering the banking and insurance activities as a whole, without resulting in a separate measurement for each set of activities.

Reasons for not applying below reporting entity level

34 The following reasons were provided for *not* applying the temporary exemption below reporting entity level:

(a) Belgian financial groups are generally not compared to insurance companies by analysts or users; instead comparison is done with other big European banks and other financial groups;

(b) The overlay approach is an alternative that is available for those entities not being able to use the temporary exemption from IFRS 9;

(c) Disclosures related to the overlay approach increase the comparability of insurance companies applying IFRS 9 and those deferring IFRS 9;

(d) Financial statements should be based on consistent accounting policies applied in a uniform way on an international level. Using the temporary exemption below reporting entity level results in mixed consolidated financial statements of bank-led entities. This has negative effects on the understandability of users of financial statements;

(e) If the temporary exemption was to be extended to bank-led financial groups, there would be an unlevel playing field between bank-led groups and pure banks;

(f) Applying the temporary exemption from IFRS 9 involves significant additional costs and has enormous operational consequences even though it is for an interim period. It is confusing for management and users as some assets will be reported under IAS 39 and others under IFRS 9

(g) Incremental costs (related to the double accounting record-keeping for designated financial assets) on top of implementing IFRS 9 with the overlay approach are minimal, as the overlay approach [in their case] would be used for equity instruments only;

(h) The improvements offered by adoption of IFRS 9 are postponed, especially the expected credit loss impairment model as an answer to the financial crisis which revealed that the IAS 39 incurred loss model resulted in recognising losses “too little, too late”;

(i) Enforceability would be difficult when the temporary exemption is applied below reporting entity level;

(j) There is a risk for opportunistic intra-group asset transfers and earnings management and leads to more complex accounting;

(k) Applying the temporary exemption below reporting entity level would be inconsistent with the Resolution of the European Parliament calling for reducing complexity in accounting standards; and

(l) Applying the temporary exemption below reporting entity level would result in the financial statements of bank-led groups carrying out significant insurance business becoming incomparable with those of other bank-led groups and this harms investors' protection and transparency.

Other comments

35 Two respondents concluded that the temporary exemption from IFRS 9 is not contrary to the true and fair view principle of the Accounting Directive but they did not conclude on the overlay approach, which is considered to only partially address the mismatch/volatility issue and to not address the cost issue.

36 Another respondent suggested that the Amendments do not meet the technical criteria for endorsement. They indicated that the Amendments should ensure the alignment of the financial information to the market between the consolidated financial statements of its insurance sub-group (which would qualify for the temporary exemption) and the consolidated financial statements of the ultimate parent entity (which would not qualify).

37 Another respondent noted that the possible reduction of comparability due to the introduction of the two options is acceptable against the background of addressing most of the concerns arising from the misalignment of the effective dates of the two standards. They also believed that the potential negative effects of the temporary exemption on prudence were being mitigated and therefore believed that the Amendments lead to prudent accounting.

38 Another respondent indicated that:

(a) Relevance: not only pure insurers are significantly affected by the different effective dates of IFRS 9 and IFRS 17. Entities undertaking significant insurance activities within bank-led groups are also significantly affected.

(b) Reliability: the introduction of a quantitative test to assess predominance could lead to arbitrary outcomes that could be avoided with a principal-based approach. Additionally, this respondent indicated that the draft endorsement advice did not address the situation of applying the overlay approach to only some eligible financial asset and the resulting loss of information.

(c) Comparability: the Amendments worsen the current lack of comparability of the financial statements of entities undertaking insurance activities. Additionally, this respondent does not share the criticism that using two sets of accounting standards within the same set of financial statements increases complexity. The temporary exemption from IFRS 9 is expected to lead to fewer costs for preparers compared to the overlay approach and those complexities may not be relevant for bank-led groups if there are no significant transfers of financial instruments between the banking and insurance segments.

(d) Understandability: users will find difficulties in understanding financial positions and performances between bank-led groups and pure insurers due to the application of different accounting policies for the same type of financial instruments within the same business model.

(e) Prudence: insurers invest for the majority in investment grade assets but the remaining part may represent the major part of expected losses under IFRS 9.

39 This respondent also commented that the discussion in the draft endorsement advice regarding the fact that more than half of the bank-led groups identified in EFRAG's sample did not identify their insurance business as a reportable segment did not consider certain factors. The respondent considered that there are other valid reasons why insurance might not be a reportable segment, such as:

(a) Similar characteristics of banking and insurance products and how they are managed within a bank-led group; and

(b) Both banking deposits liabilities and insurance technical liabilities are measured on a cost-basis across most jurisdictions.

40 This respondent expected that in the future the majority of bank-led groups would provide separate information about the banking and insurance business.

41 Additionally, this respondent indicated that: (i) they did not agree with the way EFRAG determined the 20-25% non-qualifying proportion and suggested that the proportion should be based instead on profit or loss metrics, (ii) users could look at the insurance subsidiary accounts instead of the consolidated financial information of the bank-led groups to understand the performance of the insurance activities; and (iii) the impact of applying or not applying the temporary exemption from IFRS 9 would be fully visible for users because separate information for each set of activities will be provided to users independently of the application of the temporary exemption from IFRS 9 or not.

42 This respondent indicated also that EFRAG may consider in Appendix 1 that bank-led groups will find difficulties to explain to users:

(a) Which part of the volatility and accounting mismatches arising from the adoption of IFRS 9 will be offset when adopting IFRS 17, and the moment as from when they will be in a position to provide this information. This is because if groups provide their first quantitative impacts of implementing IFRS 9 in its half-year report 2017, IFRS 17 would have been just recently published;

(b) The changes in their business model assessment under IFRS 9 that may be needed to accommodate measurement of insurance liabilities and the financial assets backing them (in 2018 when adopting IFRS 9 and in 2021 when IFRS 17 is expected to be first applied).

43 Regarding the endorsement criteria, another respondent questioned whether 3 of the 4 endorsement criteria were fulfilled: reliability, comparability and understandability. In their understanding, the reduction in comparability is not just "slightly" as described in the draft endorsement advice. They noted the Amendments will increase the accounting mismatches, resulting in volatility in profit and loss, making it difficult for users to understand the financial statements. This respondent also pointed out that not applying the temporary exemption results in the same assets having a different valuation at entity level compared to when they are recorded in the group accounts due to the use of two different standards. They mentioned that similar financial instruments within the same business model may have different accounting policies applied.

44 In the view of this respondent, the reliability and comparability assessment in the draft endorsement advice can be called into question. The draft endorsement advice has not made a complete assessment by not addressing the situation of entities not being able to use the temporary exemption from IFRS 9. This view is shared by another respondent.

45 One respondent accepted EFRAG's understanding that investment grade assets make up a significant portion of insurance entities' holdings in debt-type assets but qualified it by pointing out that the remaining portfolio may represent a significant percentage of the loss on initial application of IFRS 9.

EFRAG Secretariat's recommendations on EFRAG's proposed final position

46 EFRAG Secretariat notes that the endorsement advice has assessed the Amendments *as is*, not as it could have been in another hypothetical scenario. The arguments provided by respondents were discussed by EFRAG TEG and EFRAG Board before release of the draft endorsement advice for comment.

47 EFRAG Secretariat proposes to change the endorsement advice as follows:

(a) Applying the overlay approach only to selected financial assets instead of to all financial assets can be considered to have a negative effect on completeness (an aspect of reliability), albeit mitigated by the fact that the overlay provides additional information;

(b) Insurer-to-insurer comparisons are for some the most important aspect and may be affected by the scope of the temporary exemption, while also noting the existing challenges to such comparisons (comparability). Achieving comparability would require identification of the insurance component in the consolidated financial statements; and

(c) In the discussion on prudence, clarify that the impact of the IFRS 9 expected credit loss model may be material to insurers' financial statements even though it is mitigated by the preponderance of investment-grade assets.

The European public good

Improvement in financial reporting

EFRAG's tentative position

48	EFRAG's initial assessment is that the Amendments are likely to improve the quality of the financial reporting relative to the situation if there were no remedies.

Summary of respondents' comments

49 Eleven respondents agreed with EFRAG's initial position.

50 One respondent noted that adopting the option to apply a temporary exemption would be conducive to the European public good provided that it could be applied by all entities undertaking significant insurance activities regardless whether they are standalone insurance entities or consolidated by financial groups (like bancassurers). They added that the Amendments do not respond to the concerns that have been raised for entities undertaking insurance activities that are not predominant insurers. These insurers should also be eligible to the temporary exemption from IFRS 9.

51 Two respondents noted that for bank-led groups with significant insurance activity, the quality of their financial reporting will be impacted if they will not be able to defer the application of IFRS 9 to their insurance activities. Either the application of IFRS 9 or the overlay approach may lead to volatility in OCI and/or profit or loss and they will not be able to explain which part of this volatility will remain when the new insurance requirements are applied which they believed is the more relevant piece of information that users would be interested in.

52 Another respondent noted that enforceability would be difficult if entities would be allowed to apply the temporary exemption from IFRS 9 at a level below the reporting entity. Such an approach would result in more complex accounting and would give rise to possibilities for opportunistic intra-group asset transfers and earnings management. This respondent highlighted that more complex accounting harms transparency of financial information thus reducing the degree of investors' protection. This respondent also noted that this would be inconsistent with the recent Resolution of the European Parliament calling for reducing complexity in accounting standards.

53 In the view of this respondent, the principle of uniform group accounting policies is part of a minimum set of requirements that is in place to safeguard investors' protection, thus improving competition in the financial markets. This respondent concluded that more prominence should be given to the fact that, if the temporary exemption were to be applied below the reporting entity level, the financial statements of bank-led groups carrying out significant, but not predominant,

insurance business would be less comparable with the financial statements of other bank-led groups.

EFRAG Secretariat's recommendations on EFRAG's proposed final position

54 EFRAG Secretariat notes that the draft endorsement advice assessed the Amendments *as is*, not as it could have been in another hypothetical scenario. The arguments provided by respondents have been discussed by EFRAG TEG and EFRAG Board before release of the draft endorsement advice for comment.

55 The changes proposed to the endorsement advice are discussed in the following sections.

Costs and benefits

EFRAG's tentative position

56 Given that the Amendments introduce two options to assist in mitigating the misalignment of the effective dates of IFRS 9 and the forthcoming insurance contracts Standard, EFRAG expects that each entity will select the best option in its specific circumstances for which it is eligible, in particular, each entity will select the option that provides the best cost-benefit trade-off. Overall, EFRAG assesses that the benefits for both users and preparers are likely to exceed the costs of applying the Amendments.

Summary of respondents' comments

57 Eight respondents agreed with EFRAG's initial position.

58 One respondent indicated that they do not have enough evidence to express a definitive opinion regarding the evaluation of the cost and benefits from the Amendments.

59 Ten respondents did not agree with EFRAG's initial position stating that since the temporary exemption from IFRS 9 cannot be applied, the overlay approach would be more costly than applying the temporary exemption or full IFRS 9. Therefore, the preferred approach was the temporary exemption from IFRS 9. Their detailed comments are as follows:

(a) One respondent stated that the German Insurance industry is not focusing on the overlay approach because its cost exceeds the related benefits. They noted that it would require a full parallel run of accounting systems.

(b) Another respondent indicated that the overlay approach only partially reduces the profit or loss volatility because it is not possible to reclassify the impairment on bonds classified at FVOCI from profit or loss to OCI.

(i) They added that considering the volatility range for pre-tax profit and loss in the bond portfolio would be high, from a preliminary impact analysis based on a severe downgrade assumption. Therefore, they could apply the overlay approach only to the equity portfolio and fund which is a minor part of their entire portfolio.

(ii) In order to prevent the volatility effect, they proposed that a financial asset is eligible for designation for the overlay approach if, in conjunction with the condition (b) of paragraph 35E of the Amendments to IFRS 4, the following holds: "it is measured at FVOCI under IFRS 9 and no impairment has been recorded according to IAS 39"

(c) Another respondent indicated that the additional cost of implementing the overlay approach is not justified.

(d) Another respondent noted that it would be expensive for them to define their financial asset allocation twice under IFRS 9 consistent with the required granularity relating to the unit of account (a first time at IFRS 9 transition and a second time at IFRS 17 transition). Stand-alone insurers would only do this once and would benefit from an additional 3-year delay in IFRS 9 implementation which implies lower implementation costs as they would benefit from market experience. They indicated that applying the overlay approach would generate very high implementation costs as it requires maintaining two systems.

(e) Another respondent commented that the overlay approach did not fully address the mismatch issue as it only shifted the volatility from the income statement into equity.

60 One respondent indicated that, in their case, applying a temporary exemption from IFRS 9 for their insurance activities would involve significant additional costs and enormous operational consequences, because they would have to use two different accounting systems for their assets. However, if they apply the overlay approach, their costs would be minimal, since they would apply it only for the equity portfolio.

61 Another respondent indicated that the Amendments do not address the cost concerns of entities undertaking insurance activities that are not predominant insurers and also do not maintain a level playing field.

62 Another respondent noted that entities will find difficulties in explaining to users which part of the volatility would have remained in profit and loss, OCI and/or the contractual service margin if the effective dates of both IFRS 9 and IFRS 17 had been aligned and users would have increased costs to adapt their valuation models for companies depending on the option chosen. They also did not support the statement about cost mitigation indicating that implementing IFRS 9 through the entire group is expected to result in synergies from bank-led groups because banking and insurance activities do not share the same systems to manage financial assets.

63 Finally, this respondent pointed out that most analysts working in the insurance sector carry out their valuations for bank-led groups considering the banking and insurance activities as a whole, without separate measurement for each set of activities. Accordingly, if bank-led groups with significant insurance activities are not able to apply the deferral option and material volatility and accounting mismatches arise from this situation, users may consider performing separate valuations and incurring additional costs to adapt their valuation models.

64 As for the reason why more than half of the bank-led groups did not identify their insurance business as a separate reporting segment, one respondent pointed out that due to the similarity of many banking and insurance products, it made more sense for the entities not to separate them in their financial statements, as banking deposits and insurance technical liabilities are measured on a cost-basis across most jurisdictions. While the products may be similar, it is also worth noting that this does not mean that the same systems will be used for managing financial assets in the bank-led group and the insurance entity. EFRAG's assertion, therefore, that the application of IFRS 9 across the entire group will lead to synergies is far from certain.

EFRAG Secretariat's recommendations on EFRAG's proposed final position

65 EFRAG Secretariat notes that the endorsement advice has assessed the Amendments *as is*, not as it could have been in another hypothetical scenario. The arguments provided by respondents have been discussed by EFRAG TEG and the EFRAG Board before release of the draft endorsement advice.

66 EFRAG Secretariat proposes to change the endorsement advice to:

(a) explain that many bank-led entities consider the costs of implementing the overlay approach to be too high to make the overlay approach a viable option, particularly in view of the short period during which any necessary investments in systems would be used; and

(b) note that for some highly integrated bank-led entities undertaking insurance activities, incremental costs of the overlay approach are expected to be insignificant.

Potential competition issues within the EU

EFRAG's tentative position

67	EFRAG has assessed a number of other factors that could be considered in assessing whether the endorsement of the Amendments is conducive to the European public good. EFRAG is unable to conclude whether the application of the temporary exemption from IFRS 9 amounts to a material competition issue from an economic perspective. In addition, EFRAG is not aware of any issues where the use of the overlay approach would affect competition between entities.

Summary of respondents' comments

68 Six respondents agreed with EFRAG's initial position. One respondent indicated that for the affected insurers in its jurisdiction, there is no material competition issue that they are aware of.

69 Two respondents preferred to use the overlay approach and indicated that if the temporary exemption was to be extended to bank-led financial groups, there would not be a level playing field among banks and would create competition issues between bank-led groups and pure banks. In addition, applying different accounting policies (e.g. IAS 39 for insurance assets and IFRS 9 for bank assets) would severely restrict the added value of international accounting standards and would create a reduction in comparability and understandability between financial statements of pure banks and bank-led financial groups. Additional comments from these respondents include:

(a) a remark that in their opinion, the non-eligibility for an IFRS 9 deferral does not create a disincentive to invest in equities and does not change the investment strategy towards financial assets with less volatility.

(b) a statement that they did not agree that financial groups that are not eligible for the temporary exemption at consolidated level could be placed at a competitive disadvantage compared to insurance companies that are eligible for the exemption because the financial groups were not compared to insurance companies by analysts or users of the financial statements.

70 Fourteen respondents did not agree with EFRAG's comment that it was not able to conclude on whether there is a material competition issue from an economic perspective. They indicated that either there would be distortions in competition (due to the length of the transition phase to IFRS 9 and/or making reference to 20-25% of European insurance activities not being able to apply the temporary exemption) and as a result there would not be a level playing field in the insurance sector). Their other comments are as follows:

(a) One respondent indicated that since they would be obliged to use the overlay approach, they would suffer from a competitive disadvantage not only with their peers but also with associates and joint ventures. This is because for those applying the overlay approach, there would have to be uniform accounting policies applying IAS 28 while this is not the case when applying the temporary exemption from IFRS 9.

(b) Two respondents noted that in France, the bancassurance business represents 62% of the in-force portfolio of life insurance. The companies that will not benefit from the temporary exemption from IFRS 9 represent 46% of all premiums collected in the French life market in 2015. Furthermore, on the

European market, bancassurance business stands for 22% of the technical reserves of the top 10 life insurers.

(c) One respondent noted that bancassurers would have to limit their policies of diversification of investments due to higher volatility of the IFRS results under IFRS 9 compared to their set maximum volatility levels. Therefore, this would expose them to lower returns in a low interest rate environment. In addition, upon transition, applying FVOCI under IAS 39 for equities and then reclassifying to FVPL upon consolidation would freeze unrealised gains on assets in equity and would lead to significant gaps between the statutory realised gains and the gains realised in IFRS consolidated financial statements compared to predominant insurers who can recognise the unrealised gains in the income statement. Four other respondents concurred with these comments, relating to freezing unrealised gains, in their letters.

(d) Four respondents advocated for the deferral approach to be applied below reporting entity level. They found it contradictory that EFRAG mentioned that there is no material evidence of competition issues when the draft endorsement advice stated that 20%-25% of insurance companies will not be eligible for the temporary exemption. They also noted that users of financial statements would find it difficult to understand the additional accounting mismatches and resulting volatility in profit or loss that cannot be offset by using existing options under IFRS 4 to address temporary volatility. One of these respondents pointed out that insurers may have an incentive to manage their assets that have accumulated unrealised gains in order to recognise such gains in the income statement prior to the transition to IFRS°9. Finally, this respondent did not agree with EFRAG's view on avoiding competition issues between banks as material non-insurance activities are not within the scope of the temporary exemption from IFRS 9.

(e) One respondent noted that entities predominantly connected with insurance which are controlled by a group would be put at a disadvantage compared to stand-alone insurers that apply the temporary exemption from IFRS 9 at a minimum with regards to the costs to be incurred. Applying the overlay approach does not address the cost concerns of these insurers that represented about 20-25% of the total insurance activities.

(f) Another respondent indicated that allowing insurers that are part of a financial group to apply the temporary exemption from IFRS 9 at the consolidated group level until IFRS 17 is implemented would be welcomed.

(g) Although another respondent concluded that entities not eligible for the deferral approach would be at a competitive disadvantage, they mentioned that other important factors might influence investments decisions as well.

71 Another respondent disagreed with the statement that "requiring bank-led entities that undertake insurance activities to apply IFRS 9 at the same time as other bank-led entities will avoid competition issues between bank-led groups and pure banks". As material non-insurance activities, i.e. banking activities, will not be included in the scope of the temporary exemption, IFRS 9 will apply to all entities undertaking banking activities and, therefore, no competition issues would arise within the banking sector."

EFRAG Secretariat's recommendations on EFRAG's proposed final position

72 EFRAG Secretariat notes that the draft endorsement advice assessed the Amendments *as is*, not as it could have been in another hypothetical scenario. The arguments provided by respondents have been discussed by EFRAG TEG and the EFRAG Board before release of the endorsement advice.

73 EFRAG Secretariat notes that the 20-25% figure does not provide compelling evidence that the scope of the temporary exemption leads to a <u>material</u> competition issue <u>from an economic perspective</u>. In order to decide if there is a material competition issue from an economic perspective we need evidence of the amount by which the 20-25% would be disadvantaged along with a basis to assess if this amounted to a material impairment in the ability of these entities to compete with predominant insurers. We already acknowledge that the playing field is not level.

74 EFRAG Secretariat proposes to change the endorsement advice to:

(a) Include the concern about "freezing" unrealised gains on transition to IFRS 9 in the list of competition concerns, also noting that the overlay approach can be used to address this concern.

(b) Clarify that the comment in the draft endorsement advice regarding competition issues between bank-led groups and pure banks relates to possible structuring opportunities and should therefore be combined with the draft endorsement advice's existing reference to structuring (ie this is the same point and should be made once not twice)

(c) Note that predominant insurers will be able to defer the application of the expected credit loss model (ECL) in IFRS 9, while non-predominant insurers will not be able to do so. This may lead to a larger potential large impact for insurers than we had previously understood (according to two respondents) but should not be seen as a disadvantage of the overlay in view of the widely-held view that the ECL model is a major improvement over IAS 39.

(d) Note that the overlay approach does not fully address additional volatility in OCI. This volatility may arise for SPPI assets measured at FVOCI under IFRS 9 managed in a 'hold to collect and sell' business model, but measured at amortised cost under IAS 39 (the overlay approach does not apply to FVOCI assets). Also, for equities measured at cost under IAS 39 (due to an inability to reliably estimate fair value, which should be rare) but FVPL under IFRS 9 the overlay shifts 'new' volatility from profit or loss to OCI. Our previous work indicates that the profit or loss volatility is however the major concern. In addition, the evidence provided to the European Commission by the French Banking Federation indicates that only a very small proportion of financial assets held by the bancassurers that contributed to that exercise are measured at cost/amortised cost under IAS 39. This suggests that the concern over the overlay approach merely "shifting volatility into OCI" is not compelling, as this volatility is already presented in OCI under IAS 39.

Other factors

EFRAG's tentative position

75	EFRAG has not identified any other factor that would made the Amendments not conducive to the public good.

Summary of respondents' comments

76 Eight respondents agreed there were no other factors to consider in assessing whether the endorsement of the Amendments is conducive to the European public good.

77 One respondent noted that bancassurance operators carry out the same activities as insurance groups and are usually in direct competition with pure-insurers. They believed that comparing insurer to insurer is more important and meaningful to users than comparing assets relating to insurance activities with non-insurance activities within a financial groups. Also, if insurers within financial groups were to be required to apply the overlay approach, they would be at a disadvantage compared to other

insurers regarding the cost/benefit ratio of the two approaches and the difficulty to explain such a restatement to the market.

78 Another respondent indicated that they would suggest that EFRAG clearly differentiates its conclusions for predominant insurers from the conclusions for other entities (such as European bank-led groups) with significant insurance activities on each of the endorsement criteria.

79 Another respondent expressed a similar opinion and proposed two alternatives to EFRAG:

(a) Including a scope limitation in its endorsement advice opinion: providing an endorsement advice supporting a positive endorsement advice for predominant insurers (excluding other entities, such as bank-led groups with significant insurance activities); or

(b) Clearly differentiating for each of the endorsement criteria its conclusions for predominant insurers from the conclusions for other entities (such as bank-led groups with significant insurance activities).

EFRAG Secretariat's recommendations on EFRAG's proposed final position

80 EFRAG Secretariat notes that the draft endorsement advice has assessed the Amendments *as is*, not as it could have been in another hypothetical scenario. The arguments provided by respondents have been discussed by EFRAG TEG and EFRAG Board before release of the endorsement advice.

81 EFRAG Secretariat observes that meeting the European public good criterion does not require that all of EFRAG's or others' concerns are met. The European public good is by its very nature an overall assessment: it cannot therefore be subdivided into particular constituencies. The European public good assessment considers whether the Amendments, taken as a whole, deliver an improvement (i.e. add value) and do not endanger growth, stability, EU competitiveness.

Overall assessment with respect to the European public good

EFRAG's tentative position

82	EFRAG has initially concluded that endorsement of the Amendments would be conducive to the European public good.

Summary of respondents' comments

83 Ten respondents agreed with EFRAG's initial position.

84 One respondent supported an unqualified endorsement advice to the European Commission to allow for a swift finalisation of the European endorsement procedure.

85 Two respondents did not agree with EFRAG's initial position and provided the following comments:

(a) One respondent indicated that some adjustments were needed in order to ensure full comparability in the European insurance market, without creating discriminations and leaving some countries in a competitive disadvantage.

(b) The other respondent noted that the weight of bancassurance in Europe within the insurance industry is significant. Bancassurers will have to reconsider their financial investment policy and allocation strategy which may expose them to lower financial performance. The limitation in their policies of diversification of investments will expose them to lower returns in a low interest rate environment. Therefore the deferral approach should be made available to all entities undertaking insurance activities that are not predominant insurers.

86 Four respondents specifically indicated that EFRAG's initial position is met only for predominant insurers but the temporary exemption from IFRS 9 should also be available to entities undertaking insurance activities that are not predominant insurers.

87 In addition to the above respondents in paragraphs 85 and 86, five respondents indicated that the lack of level playing field needed to be addressed and/or a preferred solution was for the temporary exemption to be extended to incorporate entities undertaking insurance activities that are not predominant insurers.

EFRAG Secretariat's recommendations on EFRAG's proposed final position

88 EFRAG Secretariat notes that the endorsement advice has assessed the Amendments *as is*, not as it could have been in another hypothetical scenario. The arguments provided by respondents have been discussed by EFRAG TEG and the EFRAG Board before release of the endorsement advice.

89 EFRAG is not requested by the European Commission to express an opinion of whether there should or should not be any additional action at EU-level in addition to endorsement or non-endorsement of the Amendments.

90 No changes have been made to the overall conclusion.

Appendix 2 – List of respondents

1 Below is a list of the respondents to EFRAG's draft endorsement advice on *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4).*

Name of respondent	***Country***	***Type/Category***
The Institute of Chartered Accountants in England and Wales (ICAEW)	UK	Professional Accounting organisation
Instituto de Contabilidad y Auditoria de Cuentas (ICAC)	Spain	National Standard Setter
Organismo Italiano di Contabilita (OIC)	Italy	National Standard Setter
Accounting Standards Committee of Germany (ASCG)	Germany	National Standard Setter
Fédération Française de l'Assurance (FFA)	France	Preparer organisation
Assuralia	Belgium	Preparer
Institute des Actuaires	France	Preparer organisation
Accountancy Europe-FEE[1]	Europe	Professional Accounting organisation
Intesa Sanpaolo S.p.A.	Italy	Preparer
KBC/Belfius Group	Belgium	Preparer
CFO Forum/Insurance Europe	Europe	Preparer organisation
Société Générale	France	Preparer
Financial Reporting Council (FRC)	UK	National Standard Setter
ESBG - European Savings and Retail Banking Group	Europe	Preparer organisation
Groupement Française des Bancassureurs (GFBA)	France	Preparer organisation
Allianz	Germany	Preparer
BNP Paribas	France	Preparer
Pan-european conglomerate Club (PCSG)	Europe	Preparer organisation
Caixa Bank	Spain	Preparer
FBF	France	Preparer organisation
Autorité des Normes Comptables (ANC)	France	National Standard Setter
German Insurance Association (GDV)	Germany	Preparer organisation
ESMA	Europe	Regulator

[1] Note that FEE has changed its name to Accountancy Europe.

2 Below is a summary of the number of respondents by country and by type of respondent.

Country	Number of respondents
Belgium	2
Europe	5
Germany	3
France	7
Italy	2
Spain	2
UK	2
Total	**23**

Type of respondent	Number of respondents
National Standard Setters	5
Preparers and preparer organisations	15
Professional Accounting organisation	2
Regulator	1
Total	**23**