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Berlin, 8 February 2016

Dear Hans,

Re: IASB ED/2015/11 – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB's Exposure Draft ED/2015/11(herein referred to as the 'ED'). We appreciate the opportunity to comment on the ED.

We are supportive of the IASB proposing both, the overlay approach and the temporary exemption from applying IFRS 9, since the benefits of the particular approaches depend on the specific facts and circumenstances of the entity. We also agree with the scope and most of the specific provisions suggested in the ED and would only suggest minor amendments to the proposals. Please find our detailed comments on the questions raised in the ED in the appendix to this letter.

If you would like to discuss our comments further, please do not hesitate to contact Franziska Schmerse or me.

Yours sincerely,

Andreas Barckow
President

Appendix – Answers to the questions of the request for views

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?

We agree that the IASB should seek to address the concerns raised by various parties, including the insurancy industry and the International Association of Insurance Supervisors (IAIS). We believe that all concerns stated above are valid, even though we acknowledge that the weighting of the individual concerns/reasons depends upon the specific situation of each entity under consideration. We think these concerns are sufficient for the IASB to follow up and to address them.

Question 2: Proposing both an overlay approach and a temporary exemptiom 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?

We agree that there should be both an overlay approach and a temporary exemption from applying IFRS 9 as they are intended to address different situations and concerns. Not all insurers around the globe are same: They have varying degrees of carrying out p/c and life insurance business, are structured and organised differently, have different IT systems and infrastructure, underlie different sorts and degrees of regulation, etc. Hence, a solution that might be working better or even perfectly for some might not work for some other. Therefore, it should not come as a surprise that the weighting of the concerns mentioned in question 1 as well as the cost-benefit ratio of either approach differs from one insurer to the next, depending on their specific situation.

As far as our jurisdiction is concerned, we have reached out to the industry and note that no insurer intends to make use of the overlay approach and all are striving for the deferral approach, as only the latter completely addresses their respective situations. Further, we are being told that if entities did not qualify for the deferral approach, the overlay approach would not constitute a fallback solution for them (for the reasons listed in the next paragraph). Rather, those entities would then apply IFRS 9 in full.

We have learned from the industry that there are a number of reasons for not making use of the overlay approach, of which two seem particularly worth mentioning:

- Firstly, whilst the overlay approach does represent a solution in mitigating volatility in the statement of profit or loss –arising on the application of IFRS 9 before the new standard on insurance contracts–, it does not address the other concerns listed in question 1 (most notably the two successive changes in a relatively short period of time and the cost and effort associated with that).
- Secondly, implementation of the overlay approach would be a costly exercise for them as IT systems and infrastructure would have to be changed in order to allow for a simultaneous application of both IFRS 9 and IAS 39. It would be a false assumption to assert that all that would be required for implementing the overlay approach was the introduction of some new accounts and a top-level adjustment. Rather, the chart of accounts would have to be changed across an entire group to allow for the flagging and tracking of items that have been designated (and potentially dedesignated). Further, the changes brought about by the adjustment to be made would have knock-on consequences, e.g. as regards determining policyholder participation and deferred taxes.

For these reasons, insurers in our jurisdiction indicated that they did not intend to make use of the overlay approach but would opt for the deferral approach (provided they qualify).

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?

a)

We agree that the assets described in paragraph 35B should be eligible for the overlay approach as it is that population of financial assets that, when applying IFRS 9, would now have to be measured at fair value through profit or loss, thereby causing the additional accouting mismatch and the temporary volatility that the overlay approach seeks to adress. Thus, these assets should be eligible for the approach. Although the wording of paragraph 35B(a) allows for judgement, we think that the principles-based approach is appropriate.

b)

We do not have strong views on that question as there is no appetite in our jurisdiction for using the overlay approach. Conceptually speaking though, we believe it makes more sense to base the proposals on the existence of an income statement prepared under IFRS 9 and then adjust it (hence: overlay) to arrive at IAS 39 numbers. Our reasoning is based on the idea that this represents the only way to have coherent financial reporting across the financial statements, i.e. a statement of financial position prepared under IFRS 9 and a statement of profit or loss prepared in conformity with that statement of financial position. It would be much harder for users to evaluate and do ratio calculations were the statement of profit or loss based on a different presentation format and adjusted only at the top level. Moreover, we believe that users would most likely be served better if there was a single presentation logic to be followed as this would add to enhancing comparability across entities.

c)

We believe that the wording in paragraphs 35A and 35C regarding ‘reclassification’ and ‘presentation’ of the adjustment can be improved. Per paragraph 35A *“an entity [...] shall reclassify from profit or loss to other comprehensive income an amount [...]”*, which we take to mean that an amount is literally taken out of one statement and added to the other. Hence, both statements are affected. Paragraph 35C then goes on to state: *"The amount reclassified from profit or loss to other comprehensive income <u>shall be presented as a separate line item in the statement of profit or loss, other comprehensive income **or both**</u>"* (emphasis added). If one read the statement in 35A on reclassification to also encompass presentation (i.e., something is being deleted in the statement of profit or loss and added to the statement of other comprehensive income), the wording in 35C sounds confusing given the *'or both'* at the end of the sentence (i.e., we would have expected *'statements of profit or loss **and** other comprehensive income'*). If the emphasis of the text underlined above was on the phrase *'as a separate line item'*, which we believe was the intention, we suggest making clearer that the adjustment booked does *affect both* statements, but a degree of freedom exists as to how the adjustments are being *presented*. The requirement per 35C is to require presentation of the adjustment as a separate line item in at least one of the two statements.

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?

<u>a)</u>

Overall, we 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. We do, however, acknowledge that the condition *'issuing contracts within the scope of IFRS 4'* is not that clear: For example, some entities might have chosen to unbundle investment contracts upon first-time application of IFRS 4, whereas other entities have not. We think that an accounting policy choice made when first applying IFRS 4 phase I in 2004 should not play a role in today's assessment of whether an entity was eligible for using the deferral approach. In any case, investment contracts are an integral part of a 'pure' insurer's business and should therefore be treated the same for all 'pure' insurers doing the test, so the test needs to be accounting policy-neutral.

Conceptually speaking, we are of the opinion that investment contracts should be exluded from both, the numerator and the denominator. For practical reasons though, it might be easier to have them included in both, the numerator and the denominator: We are aware of some contracts that start, and are classified, as investment contracts but turn into insurance contracts in the scope of IFRS 4 over time. Including such contracts in both, the numerator and the denominator would avoid the need of tracking any such changes and, hence, be easier operationally.

b)

We agree with describing predominance by reference to an entity's liabilities and generally support the ratio proposed by the IASB. Whilst we appreciate the IASB's desire to simplify the assessment to the greatest extent possible, we believe that simplification should not take primacy over thoroughness in scoping the right population. From a conceptual angle, we therefore propose amending the computation of the ratio in order to achieve the IASB's goal of faithfully capturing those entities whose predominant activity is issuing contracts within the scope of IFRS 4:

- On the one hand, we think that the numerator should also include other liabilities, as long as they result from, and form an integral part of, insurance activities (such as the investment contracts mentioned above).
- On the other hand, the denominator should exclude those liabilities that have nothing to do with the entity's operating business and are incurred regardless of whether those liabilities are insurance-related or not, such as tax liabilities or pension liabilities. Thus, the denominator should only encompass liabilities that are insurance activities or non-insurance activities (such as banking activities), both resulting from operating activities.

We believe that if adjusted this way, the ratio would adequately reflect the nature of an entity's activities, which is in line with the IASB's intention in BC64.

c)

We agree with the proposal that an entity should assess its predominant activity at the [top/group] reporting entity level, as such concept is easy to apply, understandable and possibly the only way to ensure that any amendment could be finalised quickly. It also ensures that no significant banking business could accidentally qualify and continue to be reported using IAS 39. Nonetheless, we suggest clarifying the phrase *'reporting entity level'* as, according to the recent proposals made in the Exposure Draft on a revised Conceptual Framework, a reporting entity could potentially be anything that prepares a set of accounts (a group, a subgroup, a legal entity, a segment, a business, an operation, etc.; cf. paragraphs 3.11 et seqq. of ED/2015/3). We understand the IASB's proposal to mean that the test should be carried out at the *top level of a group*, and if it was applied at a lower level, the numbers would not be rolled up but would have to be reversed to conform with group level accounting principles. We suggest this be clarified.

We note that carrying out the test at the group level does mean that conglomerates cannot qualify for the deferral approach. Whilst there are only few examples of such conglomerates in our jurisdiction, they nonetheless do exist. We understand that the IASB has looked at the issue and has come to the conclusion that it will not deal with it for basically two reasons (BC29): (a) it would require new accounting guidance that could be complex and create operational challenges and confusion; and (b) it could create a risk of earnings management. We understand these points and, based on the situation existing in our constituency, acknowledge the IASB's decisions. However, if the IASB received significant pushback from other jurisdictions in the world that the conglomerate issue was too big to be neglected, we would be open to the IASB investigating solutions.

In such case, a variant of the 'reporting entity level' concept might play a role in scoping the 'reporting entity' that would be eligible for using the deferral approach: The predominance test could be revised such that the assessment would start at the top reporting entity level (as the IASB envisages). However, if the group does not pass the threshold, one would go down level by level until the largest reporting entity that would pass the test is identified. We acknowledge that this approach would build on the control principle in IFRS 10 and assume that the 'reporting entity issuing predominantly insurance contracts in the scope of IFRS 4' could always be identified by looking at (a group of) legal entities controlled – which could help bringing insurance subgroups into the scope that are part of a banking or industry conglomerate. However, it would not help insurance groups with significant banking activities, as the approach would only work top-down and under a control notion.

Other issues regarding the temporary exemption but not targeted in the ED

Notwithstanding our general support for the predominance criterion, we disagree with the requirement for reassessment in paragraph 20D. We understand the IASB's logic for requiring a reassessment justifying the exception. Our counter-argument would be that, as it is generally acknowledged that entities need approximately three years to adopt IFRS 9, we simply have difficulty in seeing how an entity should and would implement the Standard within a few months, and at what cost, which could be the case if the reassessment led to no longer applying the temporary exemption (e.g., due to a merger with a non-insurance entity). Especially, we raise significant doubts as to the quality and reliability of such data. Since the temporary exemption is intented to apply only for a limited period (three years at most), we strongly suggest the IASB reconsider this requirement and require that entities make the assessment once.

We fully acknowledge the IASB's move of requiring specific disclosures in order to enhance comparability between entities that intend to make use of the temporary exemption from applying IFRS 9 and those that intend to apply IFRS 9 in 2018 already. We also note that the ED does not require a reconciliation of the information provided in the financial statements with the information that would have been provided if the entity had instead applied IFRS 9 (cf. BC72). In other words, it is our understanding that a simplified assessment of the IFRS 9 requirements is deemed adequate for disclosure purposes. In that regard, we completely understand and support the disclosure requirement in paragraph 37A(d) about the credit risk exposure, as it provides sufficient information that compensates for the information resulting from the IFRS 9 impairment model. However, we have difficulty in seeing the benefit of the disclosure requirement in paragraph 37A(c). If the driver for such disclosure was to provide users with an estimate of the amount of financial assets that would henceforth be measured at fair value through profit or loss rather than through OCI or at amortised cost, we would be concerned about the conclusions drawn from such disclosure. As we see it, such disclosure comprise only a subset of assets and, therefore, neither allows for an “as-if classification” to be seen once IFRS 9 was implemented, nor does it allow for a reconciliation from IAS 39 to IFRS 9. Rather, the figures presented would only show a part of total story, as the complete picture will only be known once IFRS 4 phase II is complete and all accounting policy options are reconsidered.

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?

a)

We agree with the proposal that the overlay approach and the temporary exemption from applying IFRS 9 should be optional for the reasons stated in paragraphs BC78-BC81.

b)

We agree with the proposal to allow entities to stop applying the overlay approach or the temporary exemption from applying IFRS 9 from the beginning of any annual reporting period before the new insurance contracts standard is applied. If the entity no longer benefits from applying one of the approaches, it should be allowed to adopt IFRS 9 in full.

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?

We acknowledge and support the IASB's intention when proposing an expiry date for the deferral approach and encourage the IASB to continue its work on finalising IFRS 4 phase II as quickly as possible. Thus, we agree with the proposed expiry date considering that the new insurance contracts Standard will be finalised sufficiently before that point in time.

Other issues not targeted in the ED

We do not agree with the IASB's proposal in BC82 that first-time adopters of IFRSs should be prohibited from applying the overlay approach and the temporary exemption from applying IFRS 9. We believe that the concerns raised can equally apply to entities that apply IFRSs for the first time. Especially in situations where a subgroup that has to apply IFRSs for the first time but is part of a group that already applies IFRSs, the IASB's prohibition for first-time adopters would lead to challenges. We therefore recommend the IASB make these temporary approaches applicable for first-time adopters, too.