



Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

28 March 2013

Dear Mr Hoogervorst,

Exposure Draft: Classification and Measurement: Limited Amendments to IFRS 9

We are taking this opportunity to comment on the exposure draft “Classification and Measurement: Limited Amendments to IFRS 9”. This letter has been drafted by the European Insurance CFO Forum, a body representing the views of 20 of Europe’s largest insurance companies and Insurance Europe, representing 95% of the premium income of the European insurance market. Accordingly, it represents the consensus view of a significant element of the European Insurance industry.

As the revised IFRS 4 ED is not yet available, our assessment on IFRS 9 cannot be finalised until such time as we are able to assess both draft standards together. Once the IFRS 4 ED becomes available, we will provide you with any additional feedback we may have.

We welcome the introduction of the FVOCI measurement category in IFRS 9

We see the introduction of the Fair Value through Other Comprehensive Income (“FVOCI”) category as a positive development and believe it represents a significant improvement to existing IFRS 9 – in combination with the use of FVOCI¹ in IFRS 4 – for insurance companies. The FVOCI measurement category is a critical element of accounting for financial instruments by insurance companies as it will facilitate improved performance reporting for certain insurance business models. We appreciate the efforts that the IASB has taken to re-open IFRS 9 and introduce FVOCI (in conjunction with the use of OCI in IFRS 4) and we would like to thank the IASB for taking our considerations into account.

The interaction between IFRS 4 and IFRS 9 is key for insurers

When considering IFRS 9, it is important to understand the asset-liability management of insurance companies. Insurance business is centred around asset-liability management in which insurance liabilities, guarantees and related assets (including derivatives) are managed together. The accounting should reflect this linkage. Accounting requirements that deal with individual components in isolation, separate from the overall asset-liability management (“ALM”) strategy, which result in different measurement and presentation requirements for different components of the ALM strategy, do not adequately reflect the insurance business and the related performance in earnings. As such accounting and performance reporting must reflect ALM and avoid accounting mismatches - changes in insurance liabilities and the associated backing assets should be presented together: either in the income statement or in OCI. If the related changes are reported in different places, performance reporting does not provide useful information. Whilst we acknowledge that current measurement of assets and liabilities in the balance sheet may present useful information to investors, depending on the nature of the insurance products and the related assets, there is a specific need for different measurement categories for the statement of comprehensive income.

As our views have consistently highlighted, the interaction between assets and liabilities is the fundamental core of an insurer’s approach to managing its business and reporting its performance. We think the business model approach outlined in the ED does not reflect the linkage between assets and insurance liabilities.

¹ In this letter references to “FVOCI” in the context of insurance liabilities and IFRS 4 refers to a current value insurance liability in the balance sheet with the impact of changes in the discount rate presented in OCI. References to “FVPL” in the context of insurance liabilities and IFRS 4 refers to a current value insurance liability in the balance sheet with the impact of changes in the discount rate presented in P&L

Consequently, we believe that the interaction between IFRS 4 and IFRS 9 needs further consideration to take account of ALM and avoid accounting mismatches. A comprehensive and consistent approach to FVOCI and Fair value through P&L (“FVPL”) measurement models for both assets and insurance liabilities is needed.

Insurance liabilities and related assets at FVOCI

To adequately reflect insurers’ ALM strategies, we believe that FVOCI measurement should be available for all asset classes that back insurance contract liabilities that are measured at FVOCI.

While insurers do use simple debt instruments in order to match insurance liabilities, the asset strategy is often more complex, for example, involving the use of derivatives in order to diversify credit exposure and manage interest rate risk. Other asset classes may include investments such as equities, investment property, mortgages and other loans. Hence, for FVOCI to be appropriate for all types of insurance business, eligible assets must be extended to cover a wider scope of asset classes without limitation due to cash flow characteristics.

Widening the scope of assets at FVOCI would be consistent with presenting the effect of changes in the discount rate in OCI. When the current proposals in IFRS 4 and IFRS 9 are taken together, IFRS 4 will allow the effect of changes in discount rates to be presented in OCI whilst IFRS 9 permits FVOCI only for simple debt instruments and would not allow FVOCI for other debt instruments and assets in a ‘held to collect’ business model or those assets that would be required to be at FVPL. This will create unnecessary accounting mismatches because assets relating to the same liabilities will be split across three categories in IFRS 9.

The contractual cash flow characteristics test is too narrow to identify all debt instruments that should be eligible for amortised cost or FVOCI measurement. The current test proposed will result in mandatory FVPL measurement for some debt instruments for which amortised cost or FVOCI is a more appropriate measurement basis. Thus, we believe debt instruments which are not significantly different from simple debt instruments, should not be mandatorily classified as FVPL.

For assets held under a ‘held to collect’ model, a FVOCI option is necessary to reduce or eliminate accounting mismatches. We note that IFRS 9 requires assets in a ‘held to collect’ business model to be measured at amortised cost. This would result in an accounting mismatch if IFRS 4 Phase II, as currently proposed, requires interest rate movements on liabilities to be reported in OCI. As such, the interest rate movements would be reported in OCI for the liability and the assets would be reported at amortised cost.

Although IFRS 9 has a FVOCI category for equity instruments, the restriction on recycling means that this approach is not consistent with the nature of the insurance liability. This is particularly so for participating contracts, where the investment returns (including gains and losses) are ultimately passed to the policyholder.

Insurance liabilities and related assets at FVPL

As we have continuously expressed in the context of the discussions on accounting for insurance contracts, there are circumstances where FVPL best reflects the management and performance measurement of certain insurance portfolios. Therefore we continue to believe that the proposals for IFRS 4 should not mandate the use of OCI in all circumstances. Similar to the current option in IFRS 4 (“Phase 1”), it must include the ability to measure insurance liabilities at FVPL.

For such circumstances, we welcome the introduction of the FVPL option in the IFRS 9 ED for assets that would otherwise be classified as FVOCI. Taken together with the need for FVPL in IFRS 4, this FVPL option should provide the ability to classify both assets and insurance liabilities at FVPL in those circumstances where FVPL provides better information to users. However, the combined effect of the current proposals in IFRS 9 and the tentative decisions for IFRS 4 does not achieve this result.

Until we are able to assess the inter-linkage of the IASB’s accounting alternatives for assets and liabilities in both IFRS 9 and IFRS 4 we are unable to conclude our comments on the amendments to IFRS 9.

The mandatory effective date of IFRS 9 must be aligned with IFRS 4 for insurers

As we highlighted in our December 2012 and February 2013 letters, insurers should not be required (but be permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise it may put into question

the usefulness of financial reporting for users in the period between IFRS 9 and IFRS 4 adoption, as users will experience two major changes in an insurer's financial statements in short succession.

There will be situations, such as when an insurer is part of a conglomerate, where the insurer may elect to early adopt IFRS 9 in advance of IFRS 4. In these situations, it is critical that sufficient provisions are included in IFRS 4 to permit insurers to fully reclassify their assets when adopting IFRS 4. Whilst IFRS 9 contains some provisions to allow re-designation when an entity's business model changes, we are concerned this provision is insufficient to capture all scenarios where re-designation may be necessary upon adoption of IFRS 4.

We also note that the current IFRS 9 standard has an effective date of 2015. We believe this effective date is unrealistic given the overall status of the Financial Instruments Project and we would like the IASB to clarify as soon as possible that this effective date is no longer applicable.

We would like to thank the IASB for the efforts it has taken in developing the limited amendments to IFRS 9 and for this opportunity to comment on the exposure draft. The appendix to this letter sets out our views on the detailed questions posed in the exposure draft. Please feel free to contact us to discuss any matters raised in this letter.

Yours sincerely



Gerald Harlin
Chair, European Insurance CFO Forum



Olav Jones
Deputy Director General
Director Economics & Finance, Insurance Europe

APPENDIX 1

Contractual cash flow characteristics assessment

Question 1 – Modified economic relationship

Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest?

Do you agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?

Question 2 – Application guidance on modified economic relationships

Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?

Question 3 – Objective of amendment

Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features?

Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?

Contractual cash flow characteristics assessment

As outlined in the main body of this letter, we believe the FVOCI category must be available for a wider scope of assets beyond simple debt instruments. In this context we believe the contractual cash flow characteristics test is too narrow to identify all instruments that should be eligible for FVOCI and/or amortised cost measurement. Our response to questions 1 – 3 is given in this context.

Modified economic relationship & objective of amendment

We agree that a financial asset with a modified economic relationship, where the cash flows are insignificantly different from the cash flows in a benchmark instrument, should be eligible for amortised cost and FVOCI measurement.

We believe the proposed amendment will help clarify the application of the contractual cash flow characteristics assessment to financial assets which contain interest rate mismatch features and result in identification of more financial assets which should be eligible for amortised cost or FVOCI measurement. However, as noted above we do not believe the amendment will identify all debt instruments which are suitable for amortised cost or FVOCI measurement.

There are other relevant features in debt instruments which should also not restrict the asset from using amortised cost or FVOCI measurement under the contractual cash flow characteristics assessment. Other features in debt instruments which make the instrument “not significantly different” to a benchmark instrument include for example, contingent cash flows which are immaterial to the overall instrument. The standard does not address these features and as a result under the revised principles the debt instruments would be required to be measured at FVPL. We believe that based on a particular portfolio business model, amortised cost or FVOCI measurement would provide more relevant information in that circumstance.

Other examples of features in debt instruments which we believe make the instrument “insignificantly different” to a benchmark instrument and for which amortised cost or FVOCI would be a suitable measurement basis include the following. We believe these features are also worthy of being taken into consideration in terms of further developing the contractual cash flow characteristics test.

- Perpetual debt instruments with no stated maturity with interest payments based on a referenced index or where interest payments may be suspended following certain triggering events
- Debt instruments with a prepayment option not meeting the prepayment provisions in paragraph B4.1.10

(for example a prepayment option relating to future performance or a future event) for which the prepayment is very remote and hence has an “insignificant” impact of the cash flows

- Debt instruments with ‘insignificant’ equity features (e.g. deep out of the money convertible bonds and insignificant equity distribution rights)
- Debt instruments where ‘insignificant’ parts of the coupon and / or principal relates to the performance of the issuer (e.g. revenues, EBITDA, NI)
- Debt instruments with immaterial contingent cash flows (e.g. punitive interest rate step up if public offering does not occur)

Application guidance

We believe the application guidance that has been included in the standard for the proposed amendment on the modified economic relationship appears to be acceptable, and that preparers and auditors will be able to exercise appropriate judgement to ensure the principles are implemented adequately. As noted above, if the contractual cash flow characteristic assessment is further developed to take account of the additional debt instrument features we have identified, additional application guidance would then be needed to also address those features.

Business model assessment: the fair value through OCI measurement category

Question 4 – Fair value through OCI measurement

Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that:

(a) interest revenue, credit impairment and any gain or loss on derecognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and

(b) all other gains and losses are recognised in OCI?

If not, why? What do you propose instead and why?

Question 5 – Application guidance on the three business models

Do you believe that the Exposure Draft proposes sufficient, operational application guidance on how to distinguish between the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the guidance provided to describe those business models? If not, why? What additional guidance would you propose and why?

Question 6 – Fair value option

Do you agree that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI? If not, why and what would you propose instead?

Fair value through OCI measurement

As set out in the main body of this letter, we support the introduction of the FVOCI category in IFRS 9.

We see the introduction of the FVOCI category as a positive development and believe it represents an improvement to existing IFRS 9 for insurance companies when taken together with the intended introduction of the OCI model in IFRS 4. The FVOCI measurement category is a critical element of accounting for financial instruments by insurance companies as it will facilitate improved performance reporting for certain insurance business models. However, as it will depend on the insurance business model, the FVOCI measurement category should not be mandatory.

We agree with the measurement approach for FVOCI outlined in Question 4 (a) and (b) above. However, as described earlier in this letter, we believe further work is needed to make sure the proposals for the classification and measurement of financial instruments better reflect the asset-liability management of insurance companies. We believe the FVOCI category must be available for a wider scope of assets beyond

simple debt instruments. Limiting this measurement category to only simple debt instruments which meet the contractual cash flow characteristics assessment will result in mandatory FVPL measurement for some debt instruments for which FVOCI is a more appropriate measurement basis.

While insurers do use simple debt instruments in order to match insurance liabilities, the asset strategy is often more complex, for example, involving the use of derivatives in order to diversify credit exposure and manage interest rate risk. Other asset classes may include investments such as equities, real estate, mortgages and other loans. Hence, for FVOCI to be appropriate for all types of insurance business, eligible assets must be extended to cover a wider scope of asset classes without limitation due to cash flow characteristics.

Application guidance on the three business models as proposed in the ED (considering assets in isolation)

We believe the additional application guidance that has been included in the standard on the three business models is useful. We have however concerns that the dividing line between 'held to collect', 'held to collect and for sale' and 'held for sale' business models is not clear enough to adequately distinguish between amortised cost, FVOCI and FVPL. It could result in misleading outcomes when applied to an insurer's ALM strategies as the guidance oversimplifies the insurance business model. However, instead of providing additional application guidance we think the business model should be more defined to asset-liability management strategies and how insurers report performance as noted above.

Insurance liabilities and related assets at FVPL

As we have continuously expressed in the context of the discussions on accounting for insurance contracts, there are circumstances where FVPL best reflects the management and performance measurement of certain insurance portfolios. Therefore we continue to believe that the proposals for IFRS 4 should not mandate the use of OCI in all circumstances. Similar to the current option in IFRS 4 ("Phase 1"), it must include the ability to measure insurance liabilities at FVPL.

For such circumstances, we welcome the introduction of the FVPL option in the IFRS 9 ED for assets that would otherwise be classified as FVOCI. Taken together with the need for FVPL in IFRS 4, this FVPL option should provide the ability to classify both assets and insurance liabilities at FVPL in those circumstances where FVPL provides better information to users. However, the combined effect of the current proposals in IFRS 9 and the tentative decisions for IFRS 4 does not achieve this result.

Until we are able to assess the inter-linkage of the IASB's accounting alternatives for assets and liabilities in both IFRS 9 and IFRS 4 we are unable to conclude our comments on the amendments to IFRS 9.

As outlined in the main body of this letter, we believe that the possibility to classify both assets and insurance liabilities either at FVOCI or FVPL must always be available to reflect how the insurer manages asset and liability portfolios and presents its performance.

Early application

Question 7 – Application of complete version of IFRS 9

Do you agree that an entity that chooses to early apply IFRS 9 after the completed version of IFRS 9 is issued should be required to apply the completed version of IFRS 9 (i.e. including all chapters)? If not, why? Do you believe that the proposed six-month period between the issuance of the completed version of IFRS 9 and when the prohibition on newly applying previous versions of IFRS 9 becomes effective is sufficient? If not, what would be an appropriate period and why?

Yes, we agree that once issued, IFRS 9 should be adopted in its entirety. However, as noted earlier, we believe that it is critical that insurers should not be required to adopt IFRS 9 before the mandatory effective date of IFRS 4. We note in this respect that the current IFRS 9 standard has an effective date of 2015. We believe this effective date is unrealistic given the overall status of the Financial Instruments Project and we would like the IASB to clarify as soon as possible that this effective date is no longer applicable.

Question 8 – Early adoption of 'own credit' provisions

Do you agree that entities should be permitted to choose to early apply only the 'own credit' provisions in IFRS 9 once the completed version of IFRS 9 is issued? If not, why and what do you propose instead?

Yes, we agree that entities should be permitted to early adopt the 'own credit' provisions in IFRS 9. Given the delay in the completion of IFRS 9 in its entirety, it may be beneficial to look to another approach to allow entities to adopt these provisions as soon as possible.