February 8, 2016

Mr. Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

<u>Re: Comment letter – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts</u>

Dear Chairman Hoogervorst,

The Canadian Life and Health Insurance Association (CLHIA) greatly appreciates the IASB's efforts to address concerns about the misalignment in the effective dates of implementing the new insurance contracts Standard and IFRS 9. We are pleased to provide responses to the specific questions posed in the IFRS 4 exposure draft on Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts.

The CLHIA is the national trade association for life and health insurers in Canada. Our members account for 99 % of Canada's life and health insurance business and provide a wide range of financial security products such as life insurance, annuities and supplementary health insurance. Canadian life insurers operate in over 20 countries around the world with three of our members among the top 15 global life insurers by market capitalization − over 40 % of gross premiums of Canadian insurers come from their foreign operations.

We agree with and share the concerns the IASB is seeking to address with respect to the different effective dates of the new standards. To achieve the common goal of providing relief to entities where insurance activities are predominant, we believe the proposals as drafted need to be enhanced to capture all the entities that should qualify for the temporary exemption in line with the stated objective. The temporary exemption option must take into account the diverse circumstances of the entities and the impact of the mismatch in effective dates given the differences in current insurance accounting measurement around the world. One size cannot fit all.

CLHIA is of the view that the temporary exemption option is the most effective relief for most insurers, but we agree the overlay approach should continue to be available as an option.

The following are our responses to the questions.

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?

Response: We strongly agree and appreciate the IASB's efforts to address these concerns. While the overlay approach might reduce income volatility from accounting mismatches for some constituents, the temporary exemption from applying IFRS 9 addresses all of the concerns. The IASB should address these concerns to ensure a level playing field for insurers around the world and avoid:

- the confusion and costs to financial statement users of having to understand two sets of major accounting changes in a short period of time;

- additional profit and loss volatility caused by accounting mismatches from the re-classification of invested assets under IFRS 9 while the current IFRS 4 is still effective, making it difficult for users of the financial statements to understand. The extent of the volatility and mismatch will also differ by legal entity versus consolidated reporting and by jurisdiction, making real life asset management difficult and inefficient, and communication with users challenging;

- significant costs and effort for insurers to implement IFRS 9 twice. Classification and measurement of assets under IFRS 9 should be evaluated together with the new insurance contracts Standard. As such, the assessment of the business model and the scope of assets subject to the new impairment model would not be known until the new insurance contracts Standard is effective;

- further operational confusion and complexity to entities and users (including rating agencies, prudential regulators, and taxation authorities) as many jurisdictions use IFRS financial information as the basis of reporting for regulatory and capital market purposes. If IFRS 9 is implemented prior to the new insurance contracts Standard, the operational impact assessment of these changes, along with any corrective action, would need to be done twice. Taxation and other regulatory rules and limits apply at the legal entity level. There are also operational concerns that regulators may have to deal with different reporting bases for similar entities, if the predominance test does not achieve the objective of identifying all entities with predominant insurance activities.

Question 2—Proposing both an overlay approach and a temporary exemption from applying IFRS 9

The IASB proposes to address the concerns described in paragraphs BC9–BC21 by amending IFRS 4:

a) to permit entities that issue contracts within the scope of IFRS 4 to reclassify from profit or loss to other comprehensive income some of the income or expenses arising from designated financial assets that:
   (i) are measured at fair value through profit or loss in their entirety applying IFRS 9 but
   (ii) would not have been so measured applying IAS 39 (the 'overlay approach') (see paragraphs BC24–BC25);

b) to provide an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 (the 'temporary exemption from applying IFRS 9') (see paragraphs BC26–BC31).

Do you agree that there should be both an overlay approach and a temporary exemption from applying IFRS 9? Why or why not?

If you consider that only one of the proposed amendments is needed, please explain which and why.

Response:

We understand that the overlay approach may be useful for certain constituents in some countries. However, the overlay approach does not address many of the concerns of dual implementation of IFRS 9 for Canadian insurers, particularly for the local reporting of their foreign subsidiaries. As such, CLHIA is of the view that the temporary exemption is a more practical and effective option to address the issues caused by the misaligned effective dates for IFRS 9 and the new insurance contracts Standard for the vast majority of Canadian insurers. Therefore, we believe that both approaches should be made available until the new insurance contracts Standard is in place.

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?*

Response: The disclosure requirements of the overlay approach are onerous, essentially requiring both standards (IAS 39 and IFRS 9) to be applied simultaneously, and requiring a double implementation of IFRS 9. So, as proposed, the overlay approach may not be practical for many Canadian insurers. Accordingly, we have not provided detailed comments on this approach.

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?

Response:

Question 4.a): We agree in principle with a predominance test to qualify for the temporary exemption, and the need to capture only those entities where their predominant activity is to issue insurance contracts. However, we are concerned that the predominance test as proposed may preclude many reporting entities that are predominantly engaged in insurance activities, and regulated as such in their local/home jurisdiction, from qualifying for the temporary exemption.

According to our analysis, the predominance test and the related guidance as set out in the ED would exclude many entities whose primary business is the provision of insurance products (as opposed to more diversified financial institutions with some insurance activities). This will result in confusion among financial statement users, since they will not have comparable information for entities which both they and the marketplace more generally, view as both market competitors and predominately engaged in insurance.

For example, a number of Canadian life insurers, and or their foreign subsidiaries, have portfolios of asset management contracts, which are currently accounted for under IAS 39 at FVTPL. Although the measurements of these contracts would not change under IFRS 9, as currently drafted, these liabilities will in many cases contribute to insurance entities failing the predominance test, and also threaten the eligibility of the parent reporting entity. As a result, we do not believe that the stated objectives of the proposals will be met as many insurers who should qualify for the temporary exemption may be inadvertently denied that option at a local and consolidated level, making comparability of financial statements among insurers more confusing, thus defeating the overall objective. It is equally or more important and relevant to ensure comparability among insurers than comparability between insurance and non-insurance (e.g. banking) entities.

We have provided suggestions below on how to improve the application of the predominance test to better capture the entities that should qualify for the temporary exemption in accordance with the stated objective and ensuring a level playing field within the insurance industry.

Question 4.b): CLHIA disagrees with the IASB's rationale in BC 60 to allow temporary exemption on a relatively narrow population of entities on the rationale that entities can still rely on the overlay approach. As noted in the responses to Question 2 and 3 above, the overlay approach does not address many of the concerns of dual implementation of IFRS 9 for Canadian insurers. As the temporary exemption from applying IFRS 9 is the only option that addresses most of the concerns of Canadian insurers, the predominance test should be modified to ensure the financial statements of insurers engaged in significant insurance activities are comparable, so as to avoid confusion among users.

Quantitative Test

The numerator of predominance test appropriately captures the relevant liabilities arising from contracts measured within the scope of IFRS 4. However, to meet the objective of the temporary exemption, the denominator should be modified to include only those liabilities whose measurement depends on assets which may be subject to change in moving from IAS 39 to the IFRS 9 Standard.

We understand that a primary concern of the IASB is that entities with significant lending and similar activities not be allowed to defer the application of IFRS 9 since, in doing so, they would avoid applying the new impairment standards. We note that non-IFRS 4 liabilities of an insurer that reports financial assets at FVTPL, and would continue to report at FVTPL under IFRS 9, would not be affected by the new impairment model.

Accordingly, CLHIA proposes the denominator of predominance test be modified so that it excludes the following types of non-IFRS 4 liabilities:

- liabilities from **derivative positions**, **unit linked accounts and investment contracts** for which the underlying assets are already accounted for at FVTPL. Although insurance entities also engage in certain asset management and hedging activities, the temporary exemption from IFRS 9 would have no effect on the amount of these liabilities or the assets supporting them; and
- **debt to finance insurance activities** as these relate to the capital structure and not to the nature of the business. Whether an insurer is fully equity financed or maximizes its financial and operational leverage (subject to regulatory limits), should have no bearing on the insurer's predominance test/ratio.

In addition, consideration should be given to an adjustment for **other operating liabilities** for which measurement is not affected by the move from IAS 39 to IFRS 9, such as current and deferred taxes and employee benefits. Similar to the point above, the existence and magnitude of these items should not affect the conclusion as to whether the entity’s primary business is insurance.

These principles-based adjustments, are transparent and would be simple to implement, and would better target the deferral to all insurers predominantly engaged in insurance activities, ensuring a level playing field among insures, while excluding entities with significant lending and similar activities.

Qualitative Test
We acknowledge the IASB has considered and rejected qualitative considerations based on legal structure and regulation, due to concerns over jurisdictional differences in insurance and banking regulation. However, the qualitative characteristic of whether an entity is regulated as an insurer would be a strong indicator of significant insurance activities at the entity level. All major jurisdictions around the world have a robust regulatory environment for financial services, including banking and insurance. We recommend that such an objective and impartial evidence (available on an entity by entity basis) of predominant insurance activity be considered in addition to the quantitative assessment, to ensure a more complete and principled based approach to the predominance test.

Linking the temporary exemption to jurisdictional regulation has a further advantage as regulation is robust in most or all jurisdictions where IFRS is followed. An important feature of regulation is the monitoring of financial results and key metrics by the regulators. Adding this qualitative aspect to the predominance test will help ensure that regulated insurance companies in a particular jurisdiction are more likely to report results and key metrics on a consistent basis, which will help facilitate regulation and lead to more comparable information for financial statement users.

Question 4.c):
We understand the IASB position that the predominance assessment should apply at the reporting entity level to ensure only one Standard for accounting for financial instruments is applied. However, given the unique and short-term nature of the ED proposal, we recommend that a conglomerate with diverse businesses be allowed to have a mixed reporting model for financial instruments where the legal entities that qualify for the temporary exemption report under IAS 39 and those that do not qualify report under IFRS 9. This should ensure that all banks and other non-insurance entities within a conglomerate would report under IFRS 9.

This approach would still meet the objective of providing a temporary exemption from applying IFRS 9 to only those entities where their predominant activity is to issue insurance contracts. Any concerns over the mixed reporting of financial instruments can be addressed through relevant and meaningful disclosures.

The mixed reporting model would provide a level playing field for insurance entities since they could qualify for the temporary exemption from IFRS 9 regardless of their parent company's status and corporate structure. Further, it would increase comparability of the performance of insurers within conglomerates with other insurers, benefiting both regulators and financial statement users in their review of financial information of the same industry.

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?*

Response:

Question 5.a): Yes. These approaches should be optional due to the diversity of circumstances facing reporting entities that issue insurance contracts. The consideration of cost and benefits for both insurers and financial statement users will vary by jurisdiction, type of insurance business and the method currently being used to measure insurance contract liabilities.

Question 5.b): Yes. This should similarly be allowed due to the diversity and potentially changing circumstances facing entities that issue insurance contracts.

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.

a) *Do you agree that the temporary exemption should have an expiry date? Why or why not?*

b) *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?*

Response:

Question 6.a): Yes. An expiry date is reasonable since the rationale for the exemption is to deal with the period between the effective dates of IFRS 9 and the new insurance contracts Standard. Also, an expiry date ensures that all entities move to IFRS 9 at some point.

Question 6.b): The temporary exemption should allow an insurer to align the implementation of IFRS 9 and the new insurance contracts Standard.

Other - Disclosure Concerns

Paragraph 37A describes disclosures required if an entity applies the temporary exemption from applying IFRS 9. We understand from BC70-BC72 that the reason for these disclosures is to provide information to enable users to make comparisons between entities that apply the temporary exemption and other entities. We believe that the proposals as drafted are moving more towards a full reconciliation (contrary to intentions in BC72) that may not result in relevant disclosures.

The objective of any disclosure should be to provide relevant information to users of financial information, consistent with the IASB's broader Disclosure Initiative that addressed perceived problems with current 'disclosure overload'. Resulting amendments to IAS 1 *Presentation of Financial Statements* requires more entity-specific relevant information to encourage preparers to focus on the bigger picture. This allows preparers the flexibility to make judgments as to what is relevant and decision useful information to users.

Given the different accounting measurements that insurance entities use around the world, a principles-based approach that provides flexibility to use judgment is important to ensure that the disclosures provide meaningful information in every circumstance. For example, in Canada, given our current method of valuation of insurance contracts, the IASB's goals would be better accomplished if the disclosures of 37A(c) and 37A(d) were required only for assets supporting non-IFRS 4 liabilities, rather than all assets. This would not be true in many other countries, illustrating the need for more principles-based approach to required disclosures.

Notwithstanding the specific example above, we believe a principles-based approach to the proposed disclosure requirements should apply and accordingly, parts (c) and (d) of paragraph 37A should be amended as follows:

Part (c) requires information to be disclosed about financial assets that would fail the contractual cash flows test under IFRS 9 and would therefore need to be measured at FVTPL under that standard, but disregards the fact that many of these assets that would fail SPPI test might already be accounted for under IAS 39 at FVTPL. We believe the proposal should specify that this disclosure is only intended to apply to assets that would fail the SPPI test under IFRS 9 but are not at FVTPL under IAS 39.

Part (d) requires disclosure about credit risk for all financial assets that would pass the SPPI test and would not be reported at FVTPL under IFRS 9. We believe the requirement in part (d) should apply to those assets that would meet the SPPI test under IFRS 9 but are not measured at FVTPL under IAS 39. We also note that IFRS 7.36 already requires information about credit risk for all classes of financial assets, without regard to their measurement. We believe that these disclosures should continue to be sufficient through the temporary exemption period.

We urge the IASB to reconsider the detailed disclosure proposals in 37A(c) and 37(A)(d) and replace them with more principles-based recommendations, keeping in mind the information value and understandability by users. In the event a more principles-based approach is not adopted then disclosure should only be required if there would be a change in measurement base between IAS 39 & IFRS 9.

Yours sincerely,

(original signed by)

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