EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

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04 April 2013
EIOPA/13/136/SH/CM/cla

Response to Exposure Draft ED/2012/4
Classification and Measurement: Limited Amendments to IFRS 9

Dear Mr Hoogervorst,

EIOPA welcomes the opportunity to comment on the IASB's Exposure Draft Classification and Measurement: Limited Amendments to IFRS 9 (ED).

The European Insurance and Occupational Pensions Authority (EIOPA), as part of the European System of Financial Supervisors, was set up to support the stability of the financial system, transparency of markets and financial products as well as the protection of policyholders, pension scheme members and beneficiaries.

We appreciate the opportunity to provide input into the establishment of a global accounting standard for financial instruments, which is particularly relevant for the on-going deliberations on a future IFRS on insurance contracts. We fully support the development of a single, global, high-quality financial reporting and accounting standard for both financial instruments and insurance contracts.

EIOPA notes that one of the drivers for the IASB's decision to consider limited amendments to IFRS 9 is to *"take into account the interaction between the classification and measurement of financial assets and the accounting for insurance contract liabilities"*. From the perspective of European insurance supervision, addressing this issue is the primary focus of this letter. In the attached appendix EIOPA provides its response to the questions raised in the ED which are of particular interest to the insurance industry. Notwithstanding this, the following are general comments on the ED.

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EIOPA is supportive of the IASB's willingness to reopen IFRS 9 to address certain issues that will arise around the classification and measurement of financial assets because of its interaction with IFRS 4. However, as the Board of the IASB has not yet finalised its deliberations on IFRS 4, it is difficult to express a definitive opinion on the full impact of the revisions on issuers of insurance contracts.

As reflected in the response to question 4, EIOPA's view is generally supportive of the proposals in the ED.

If you have any questions or wish to discuss this further with us, please feel free to contact Ms Sandra Hack at Sandra.Hack@eiopa.europa.eu.

With kind regards,

APPENDIX

Question 1

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?

EIOPA broadly welcomes the IASB's proposal to consider the economic relationship of the cash flows when determining whether they are solely payments of principal and interest. EIOPA believes that this assessment is within the principles of IFRS 9. Notwithstanding this, it believes that it is difficult to make a complete assessment of the proposal at this stage because in its view, the ED does not define how new terms should be applied. This is particularly the case for the terms "insignificantly different" and "benchmark cash flows" and therefore, EIOPA calls for extra guidance to be provided on how these terms should be interpreted.

Question 2

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?

EIOPA believes that the ED provides sufficient application guidance in the examples outlined in the paper e.g. the resetting of a monthly variable interest rate to a three month interest rate. However, as IFRS 9 is not currently applied in Europe, EIOPA is not in a position to confirm whether the guidance is comprehensive and therefore would welcome extra field testing by the IASB in this area.

EIOPA further believes that instead of broadening the interpretation of "benchmark cash flows" paragraph B4.1.9B can be read as "the example" as opposed to "an example" and would therefore request the IASB to consider making the example broader/more general.

Question 3

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?

In general, EIOPA agrees that the proposed amendment should help to clarify how the contractual cash flow characteristics test should be assessed when interest rate mismatch features are present.

Question 4

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?

Insurers manage assets using both a "hold to collect" and "sell" basis and therefore EIOPA appreciates the IASB's efforts in trying to address this type of business model in the ED.

EIOPA recognises the benefits of maintaining the two classification criteria, since it retains the simplification achieved in IFRS 9 and reduces judgement. However, EIOPA sees the potential benefit of allowing a classification of fair value through OCI to address the concerns of some companies that:

- have a business model in which assets backing insurance liabilities are managed both in order to collect contractual cash flows and for sale; and
- consider that the recognition in P&L of all changes in fair value of financial assets and current values of insurance liabilities (change in discount rate) may not always reflect the long term nature of their insurance businesses.

EIOPA believes that in the context of the insurance activities, classifying the assets to faithfully reflect the insurer's businesses models is not the whole issue; for the activities being traditionally based on ALM, it is essential that the combination of IFRS 4 and IFRS 9 avoids any artificial accounting mismatches in the financial statements of insurers.

From an insurance contracts perspective, although it is too early to be certain, EIOPA believes that the proposed third classification is insufficient to address all the accounting mismatches arising from IFRS 4 as currently being developed. To overcome this uncertainty, EIOPA has considered a number of potential solutions:

(i) To allow issuers of insurance contracts to use fair value through OCI where assets are used to back insurance contract liabilities which have corresponding changes recognised in OCI (either by providing this option in IFRS 9 or in IFRS 4).
(ii) To broaden the scope of eligible financial assets for the third category.
(iii) To remove the third category and to present all movements in insurance liabilities in the P&L. In order to eliminate or significantly reduce accounting mismatches entities could use the option to designate financial instruments at fair value through profit or loss according to IFRS 9, paragraph 4.1.5.

We acknowledge that there are technical difficulties with each of these approaches e.g. how to define the assets backing the liabilities and the application of an impairment model on other instruments foreseen in the ED.

On balance, EIOPA's view is that the introduction of the third category is a feasible option available to address the accounting mismatches between IFRS 4 and IFRS 9.

Question 5

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?

As mentioned in our response to question 1 above, the ED outlines a number of terms without providing clear direction on how these terms should be applied. EIOPA believes that terms such as "... *infrequent (even if significant) or insignificant both individually and in aggregate (even if frequent)*" can lead to differing interpretations and practices which could reduce consistency and comparability of financial statements.

While EIOPA does not disagree with the relevance of the frequency of sales as a basis of distinction between the three classifications, it wishes to highlight the difficulty in distinguishing between the different categories of frequency. EIOPA also notes that, depending on how those categories are applied, some non-complex financial instruments could fall under any of the three classification categories which again can hamper comparability of financial statements. Therefore, EIOPA can see some merit in providing additional guidance in these areas and for those terms. Alternatively, EIOPA would like to see disclosure requirements on firms outlining how they have applied these terms and the consequential classifications.

Separately, EIOPA proposes that the standard confirms that where assets are managed on a fair value basis e.g. assets of a consolidated mutual fund or assets managed in relation to unit linked contract liabilities, the accounting treatments that value assets at amortised cost or fair value through OCI is not required.

Question 6

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?

EIOPA supports the extension of the fair value option to financial assets which would otherwise be mandatorily measured at fair value through OCI.

Question 7

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?

According to the timelines envisaged by the IASB, insurers would have to support two major changes in their financial statements within a short timeframe. We believe that this situation is not in the interest of either undertakings or users. EIOPA believes that for insurers, the mandatory effective dates of IFRS 4 and IFRS 9 need to be aligned.