



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via email

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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10 February 2016

Exposure Draft: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed amendments to IFRS 4)

Dear Hans

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the International Accounting Standards Board's (the IASB's) Exposure Draft *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* (the ED).

The Committee has a strong interest in the quality of banks' financial reporting – and therefore the accounting standards applicable to banks – for at least two reasons. Firstly, accounting information provides the basis for the Committee's prudential capital framework and a focus for regulators' surveillance of banks. Secondly, the more transparent financial reporting is, the more effective market discipline can be which the Committee regards as very important. This interest in financial reporting means the Committee supports the timely development of well-designed, consistent accounting standards that are capable of being implemented in a high-quality way. Therefore, the Committee wishes to comment on the ED. We have not commented on the concerns that some insurers have raised about implementing IFRS 9 ahead of IFRS 4 because our comments focus exclusively on the effect of the ED's proposals on the financial reporting of banks and of groups of which banks are a part.

We regard IFRS 9 as fundamentally important to high-quality financial reporting by banks. For that reason, we could not support any proposal that would delay the application of IFRS 9 by internationally active banking groups. The proposals in the ED do not have that effect, but some of the alternatives discussed in the Basis for Conclusions would delay the application of the standard.

Our detailed comments are set out in the annex to this letter but, to summarise:

- An important factor in our considerations has been the relatively short period during which the optionality proposed in the ED will be available. We would be more concerned if it became likely that those periods would be extended. One consequence of this is that we strongly support the proposed sunset clause.

- The ED proposes that the deferral option be available at the reporting entity level only. For example, if a banking subsidiary of a group prepares separate financial statements under IFRS, it would be required to apply IFRS 9 in those separate financial statements. If that group also includes an insurance subsidiary that meets the predominant insurer test, that subsidiary would have the option of applying IAS 39 in its separate financial statements if it is applying IFRS. In the case of a group that includes both a bank subsidiary and an insurance subsidiary, IFRS 9 would be used to account for all the activities, assets and liabilities reported in the group's consolidated financial statements unless the group as a whole meets the predominant insurer test. In that case the group would have the option of applying IAS 39 to all the activities, assets and liabilities in its consolidated financial statements. We strongly support this proposal.
- We would not support the deferral option being available below the reporting entity level (for example, to segments). Such an approach would result in inconsistent accounting in a single set of financial statements, thus creating complexity, comparability and transparency issues. It would also mean banking groups with insurance activities would be allowed to defer the application of IFRS 9 to any insurance activities, assets and liabilities in the group's consolidated financial statements; we wish to see banking groups using only IFRS 9 in their IFRS group consolidated financial statements.
- The ED proposes that the deferral option is available to reporting entities that meet the 'predominantly insurance' test set out in the ED. The supporting material suggests that the IASB has a "more-than-75 percent" threshold in mind when it talks of "predominance". We understand that some insurers are suggesting that the deferral option should be scoped differently and possibly more widely. As long as the option is not available below the reporting entity level, we would not be uncomfortable if the IASB were to conclude during its redeliberations that this quantitative threshold test needs to be re-calibrated to some extent, or maybe even restructured around more qualitative indicators.

These comments have been prepared by the Committee's Accounting Experts Group, chaired by Rene van Wyk, Registrar of Banks, South African Reserve Bank and have been approved by the Committee. The Committee trusts that you will find its comments useful and constructive.

If you have any questions regarding our comments, please contact Mr van Wyk (+27 12 313 3601) or Xavier-Yves Zanota at the Basel Committee Secretariat (+41 61 280 8613).

Yours sincerely



Stefan Ingves

Annex

Detailed comments

The optionality proposed in the ED

- 1 The Committee believes it important that there is a high degree of consistency in accounting practices around the world. The fact that this ED proposes that the measurement and presentation practices it describes should be optional is therefore not ideal because that optionality could affect the transparency of consolidated financial statements of groups of which banks are a part.
- 2 However, we note that the deferral option described in the ED will be available for only a short period of time and that the overlay option is expected to be needed for only a short period of time. Bearing that in mind and bearing in mind the IASB's view that some relief is needed for insurers, we can accept the optionality proposed. We support the proposal that a sunset clause should be applied to the deferral approach, and we would suggest the clause's applicability should be extended to the overlay approach.

The overlay approach

- 3 As we believe the overlay approach will not have a significant impact on transparency of financial reporting, we do not object to its availability as an interim measure to address the wider concerns of the insurance community.

The deferral approach

- 4 There is no doubt that IFRS 9 results in better accounting for banking activities, assets and liabilities. For that reason, we are keen to ensure that, if some form of deferral is to be available for insurance activities, its implications for banking activities are minimised and in particular that the result will not be that the application of IFRS 9 by banks (in their separate financial statements) and banking groups (in their consolidated financial statements) is delayed.
- 5 In an ideal world, that would mean that deferral would not be available for banking activities. However, that would mean that in a group that has an insurance subsidiary, a banking subsidiary and maybe other subsidiaries, either IFRS 9 alone would always be used in the group's consolidated financial statements – regardless of how significant the insurer is – or inconsistent accounting policies would be used (with IFRS 9 being used for the banking activities and IAS 39 for the insurance activities). We do not regard either of these options as tenable.
 - (a) If it is accepted that implementing IFRS 9 ahead of IFRS 4 results in sub-optimal financial reporting by insurers, we do not believe it

reasonable to expect IFRS 9 rather than IAS 39 to be used in an insurance group's consolidated financial statements just because the group includes a bank, however small. Such an expectation seems to imply that banks are in some way more important than insurers.

- (b) It is a fundamental principle of financial reporting that consistent accounting policies should be adopted in a set of financial statements. We know that this principle is currently not always applied in the financial statements of insurers with activities in different jurisdictions but we believe that exception should not be extended; inconsistent accounting policies can create transparency issues and transparency issues can raise the cost of capital. We would not wish to see the financial reporting practices of groups that include banks degraded in a way that makes it more difficult for them to raise capital.
- (c) We do not wish to see any delay in the application of IFRS 9 by internationally active banking groups, a wish that would not be consistent with banking groups being allowed to defer the application of IFRS 9 to insurance activities, assets and liabilities dealt with in their group consolidated financial statements.

- 6 It follows from the above that we would not support the deferral option being available below the reporting entity level but we are prepared to accept that there will be some predominantly insurance groups that will be permitted to prepare their consolidated financial statements using IAS 39 rather than IFRS 9 even though the group might contain a bank. We would prefer this not to be the case, but we regard it as the least worst option.
- 7 If the deferral option is not available below the reporting entity level, it is necessary to develop criteria for deciding whether the reporting entity as a whole should be allowed to defer application of IFRS 9. The ED proposes that this should be done by asking whether the reporting entity is predominantly an insurer. The supporting material to the ED suggests that predominance should be determined by assessing whether more than 75 percent of the reporting entity's liabilities are IFRS 4 insurance contract liabilities. We understand the IASB's desire to focus its criteria on the source of the accounting mismatches that are giving rise to the concern the IASB is seeking to address by making a deferral option available. We also recognise that the IASB is seeking to keep the availability of the deferral option as restricted as possible. Nevertheless, we can see the challenge in a test based on a quantitative threshold test that relies on guidance that is in the supporting material rather than the standard itself and is based on an arbitrary threshold, particularly as some assets and liabilities are the source of greater margins and volatility in profit or loss than others. For that reason, we are open to alternative tests, particularly if a way could be found to incorporate some qualitative factors and thereby reduce the dependence on a quantitative test. We recognise that a result might be that more predominantly insurance groups with banks will be able to prepare their group consolidated financial statements using IAS 39 rather than IFRS 9. It is absolutely essential though that banking groups are required to use IFRS 9 in preparing their consolidated financial statements, and that the deferral approach continues to be applied just at the reporting entity level.

- 8 If the IASB is seeking to address only the concerns that have been raised about the potential for accounting mismatches, we think there might be merit in exploring the possibility of limiting the deferral option to the classification and measurement parts of IFRS 9. One of our concerns about the deferral option is that it will result in some increasingly large loans and receivables portfolios not being subject to expected credit loss impairment provisioning from 2018, so limiting the deferral option in this way would address that concern.