Canadian Institute of Actuaries / Institut canadien des actuaires

February 8, 2016

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

The Canadian Institute of Actuaries (CIA) is the national voice of the actuarial profession in Canada. With more than 5,000 members, the Institute puts the public interest ahead of its own, and is dedicated to providing actuarial services and advice of the highest quality.

The CIA establishes the Rules of Professional Conduct, guiding principles, and monitoring and discipline processes for qualified actuaries. The CIA also establishes guidance to support standards developed by the Actuarial Standards Board, which are applicable to actuaries working in Canada.

On behalf of the CIA, we are writing to comment on the Exposure Draft, ED/2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*, issued by the International Accounting Standards Board (IASB) on December 9, 2015 ("the exposure draft"). The CIA has been active in transitioning Canadian actuarial standards of practice in the direction of IASB developments, including significant changes to standards for valuation of insurance contracts. The CIA appreciates the efforts of the IASB to address the concerns that the misalignment of effective dates of IFRS 9 and the new Insurance Contracts Standard has brought, and appreciates the opportunity to provide our comments to the exposure draft, which we hope are useful in your final deliberations.

The CIA supports the IASB's efforts to develop high-quality, globally adopted financial reporting standards for financial instruments and insurance contracts. Symptomatic of the complexity of accounting for insurance contracts and the interaction with the accounting for financial instruments, the transition periods for these financial reporting changes are complex, resource intensive, and challenging to explain to the user community.

This upcoming transition is even more complex. Recognizing the global diversity of existing insurance contracts standards and corporate structures, it is our view that comparability during the transition period to the new Insurance Contract Standard will be highly challenging, if not impossible, even within countries, including Canada, let alone across them.

Furthermore, the most effective approach to transition depends on the existing local insurance contract standards and corporate structures. We found a number of places where the exposure draft requirements did not line up with the stated objectives in the context of current Canadian insurance contracts standards (examples are given in the body of this response).

1740-360 Albert, Ottawa, ON K1R 7X7 ☎ 613-236-8196 🖷 613-233-4552
head.office@cia-ica.ca / siege.social@cia-ica.ca **cia-ica.ca**

We recognize that the IASB is not in a position to consider all of the different situations around the world. Therefore, we recommend the IASB place more emphasis on the objectives rather than the specific application, and allow for more local judgement in the application of the various transition approaches (IFRS9 without overlay, IFRS9 with overlay, temporary exemption). This, accompanied by disclosure of the approach being taken and the underlying rationale, will improve the usefulness of the financial statements in the context of current local standards and the corporate structures to which they are being applied.

We offer our additional comments to your specific questions below. Thank you again for your consideration.

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 (paragraphs 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?

The CIA agrees that the IASB should address these concerns. We are especially concerned about the first issue, namely, the potential for significant confusion to users of the financial statements that would be caused by the two different effective dates, even with additional efforts by preparers to explain inconsistencies.

Question 2: Proposing both an overlay approach and a temporary exemption approach:

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.

The CIA agrees that both options should be available, as we recognize that there are a variety of circumstances that entities face, and that there is no single solution that would address all situations. However, as noted in our response to questions 3 and 4, we propose some revisions to the temporary exemption and the overlay approach that we believe would better achieve the objectives of these approaches.

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?***

The CIA agrees with the objectives that the overlay approach is attempting to address as expressed in BC24. In particular, we note the objective of BC24 (d) which is to reduce accounting mismatches for participating and non-participating contracts and to eliminate the additional volatility in pre-tax profit or loss that may arise from applying IFRS 9.

However, the assets described in 35B do not achieve this objective in all jurisdictions. In Canada in particular, the valuation of insurance contract liabilities under the current insurance contracts standard is directly linked to the statement value of assets that support those liabilities, which inherently eliminates accounting mismatches. Assets that support liabilities and that are currently non FVTPL under IAS39 but become designated as FVTPL under IFRS 9, will not result in additional accounting mismatch in Canada, because there would be an offset in the liability value. Under the overlay approach as currently worded, the reclassifying changes in fair value from profit and loss (P&L) to other comprehensive income (OCI) would actually **create** a mismatch, because the change in liabilities will continue to be linked to the fair value of the assets and flow through P&L, while the change in fair value of the asset will be transferred to OCI.

Though this issue may be unique to Canada, we would nonetheless encourage a more general description of assets that are eligible for the overlay approach that focuses on whether additional volatility is being created by IFRS 9, rather than a specific prescription.

We would suggest an amendment to paragraph 35B (b) as follows:

"if the asset measurement basis changes from IAS39 to IFRS 9 and volatility would have been increased as a result".

(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?***

We agree with the IASB for recognizing that discretion has a role in the application of the overlay approach. For example, paragraphs BC39 and BC40 support the notion that it would be appropriate to allow for flexibility in deciding which assets can be used in the overlay approach. We agree that this type of discretion has an important role to play in this transitional exposure draft.

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?***

The CIA agrees that the temporary exemption should be available for entities whose predominant activities are issuing insurance contracts within the scope of IFRS 4. However, as noted in our response to 4(b) below, we propose an alternative measurement of predominance.

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.***

The CIA acknowledges that the carrying amount of liabilities is a simple metric to obtain and to explain, but is concerned that it is not necessarily a suitable indicator of the extent of an entity's insurance activities. The carrying amount of liabilities under IFRS 4 depends on the financial reporting standards and regulations in each jurisdiction, which vary widely. It is possible for similar entities in different jurisdictions to be assessed differently, based solely on different financial reporting standards in effect. Furthermore, the carrying amount of liabilities can be small, or even negative, for some types of insurance contracts even when there is significant insurance risk (e.g., term life insurance). In Canada, there are many specialty, niche, or single-line companies that operate extensive insurance businesses but have minimal liabilities measured on IFRS 4. Such companies might not qualify for the temporary exemption, even if their only business is insurance.

However, we also acknowledge that other metrics, such as premium- or risk-based capital would have other challenges associated with them, and could create the same situation where a company that is clearly in the insurance business does not qualify for the temporary exemption.

To that end, we propose that the IASB consider making the criteria for electing to use the temporary exemption more general, and allow for consideration of qualitative factors in making the decision. Together with disclosure of the approach being taken and the underlying rationale, we believe the usefulness of the financial statements during the transition period will be improved given the diversity of current local standards and corporate structures.

Alternatively, we offer four suggestions to improve the temporary exemption:

1) The temporary exemption could apply to all assets that would otherwise qualify for the overlay approach. This would mean that the temporary exemption could be applied below the reporting entity level. However, the advantage of doing this is that there would be greater consistency between the temporary exemption and the overlay approach across entities. This solution would also address the concerns around additional costs that would arise from the different implementation dates.
2) The measure of predominance could be based on the ratio of the carrying value of IFRS 4 liabilities to the total carrying value of liabilities **that are measured under IFRS 4 or that are not supported by assets already measured at FVTPL**. That is, the total carrying value of liabilities would be adjusted for the businesses that would not be affected by IFRS 9 in any case.
3) The measure of predominance could be based on the ratio of the carrying value of liabilities of all insurance businesses to the total carrying value of liabilities. This takes into account jurisdictions where not all insurance business is currently measured under IFRS 4.
4) The measure of predominance could include, among other things, consideration of the ratio of any local risk based capital requirements associated with the insurance business to the total risk based capital requirements of the company. Where available, this would be a more objective indicator of predominance.

Paragraphs BC55–BC57 explain the IASB's proposal that an entity would assess the predominant activity of the reporting entity as a whole (i.e., 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?

As noted above, we would prefer that the temporary exemption be available to those assets that would otherwise qualify for the overlay approach, which is necessarily below the reporting entity level.

Furthermore, if a corporation consists of different reporting entities some of which use the temporary exemption and others that don't, we believe that the corporation should be allowed

to report using the sum of the individual reporting entities. In our view, the advantages of such a mixed measurement model outweigh the disadvantages.

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?

Considering the wide range of situations faced by entities in different jurisdictions, the CIA agrees that the overlay approach and the temporary exemption should be optional.

(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?

The CIA agrees with this proposal. In principle, entities should not be prevented from complying with approved accounting standards.

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?

The CIA views both the temporary exemption and the overlay approach as different solutions to the same problem (i.e., the inconsistencies in financial statements and associated increased costs of disclosure and preparation as well as the decline in comparability of financial statements that results from the different effective dates of the two standards). These issues will disappear once both standards are in effect and there will no longer be a need for either solution. As such, we agree that both the temporary exemption and the overlay approach should have an expiry date, which is the effective date of the new Insurance Contracts Standard.

We do not agree that the temporary exemption should expire on January 1, 2021 if that is sooner than the effective date of the new Insurance Contracts Standard. The temporary exemption addresses all of the concerns that have been raised, whereas the overlay approach addresses only some of them. If the new Insurance Contracts Standard is not in effect by January 1, 2021, then companies who have elected to use the temporary exemption would have to undergo yet another transition to the overlay approach, which would result in

additional preparation costs and confusion to users of the financial statements. We believe the additional cost and confusion would outweigh any perceived benefit of moving to IFRS 9. Given that the new Insurance Contracts Standard is widely expected to be in effect by January 1, 2021, or within a very short period thereafter, we see more harm than good in forcing another transition in 2021.

Other comments on paragraph 37A (Disclosure)

Paragraph 37A discusses disclosures that are required for entities that apply the temporary exemption from IFRS 9. Paragraphs BC70–BC72 indicate the objective of these disclosures is to provide information to enable users to make comparisons between entities that apply the temporary exemption and those that do not. However, the specific disclosures required in 37A(c) and 37A(d) do not achieve these objectives in Canada because of our current insurance contracts standards, which link the value of liabilities to the statement value of supporting assets. We acknowledge that this issue is unique to Canada, but would nonetheless encourage a more general description of required disclosures that focuses on the objectives of the disclosure rather than specific prescription.

In particular,

> 37A(c) requires disclosure of the fair value and change in fair value for assets that would be measured at fair value under IFRS 9 because they do not meet the test that they are solely payments of principal and interest (SPPI). This disclosure would be useful to users of financial statements where equity and income would be different under IFRS 9 than under IAS 39. However, in Canada (under the current IFRS 4), the value of liabilities is equal to the statement value of assets supporting liabilities, so whether the assets supporting insurance contract liabilities are measured at fair value or at some other value has no bearing on the equity or income of the entity. Therefore, the disclosure in 37A(c) is not meaningful, and could be misleading, for assets backing IFRS 4 liabilities. Therefore in Canada, this disclosure should be provided only for assets that do not support liabilities measured under IFRS 4.
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> Similarly, 37A(d) requires disclosure of information about the credit risk exposure of assets that meet the SPPI test but would not be measured or managed on a fair value basis under IFRS 9. This disclosure would be useful to users of financial statements in identifying assets to which IFRS 9 impairment provisions would apply. However, in Canada (under IFRS 4), the value of liabilities already makes explicit provision for the credit risk exposure of assets supporting liabilities. Therefore, the disclosure in 37A(d) is not meaningful, and could be misleading, for assets backing IFRS 4 liabilities, and should be provided only for assets that do not support liabilities measured under IFRS 4. Alternately, credit risk exposure on all assets could provide more meaningful disclosure to users of the financial statements.

Finally, we would like to point out two other issues associated with paragraph 37A that are not unique to Canada:

- The disclosures in paragraph 37A(c) should be limited to assets that are not designated as FVTPL under IAS 39. We understand this to be the intent of the paragraph, as such

disclosures would provide information to users about what might change under IFRS 9. However, it would be useful to clarify this explicitly.

- The disclosures in paragraph 37A(d) should cover only SPPI assets that are not FVTPL under IAS 39 (as opposed to IFRS 9). Otherwise, insurers would be required to apply the business model of IFRS 9 to determine which assets are covered, which defeats the purpose of the exemption and the objective stated in BC71.

On behalf of the Canadian Institute of Actuaries, we would like to thank you again for your consideration of our comments on this exposure draft and hope that you find them useful.

Sincerely,

Robert H. Stapleford, FCIA
CIA President