Grupo Latinoamericano
de Emisores de Normas
de Información Financiera

Group of Latin American
Accounting Standard Setters

February 8, 2016

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Exposure Draft ED/2015/11 – Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* – Proposed amendments to IFRS 4

Dear Board Members,

The "Group of Latin American Accounting Standard Setters" – GLASS[1] welcomes the opportunity to comment on the Exposure Draft ED/2015/11 – Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* – Proposed amendments to IFRS 4 (the "ED")..

Due process

The discussions regarding the ED were held within a specified Technical Working Group (TWG) created in January 2016. All country-members had the opportunity to appoint at least one member to participate in this TWG. Each standard setter represented in the TWG has undertaken different tasks in their respective countries (e.g. surveys, internal working groups). All results were summarized, and this summary was the platform for the TWG discussion process.

The TWG discussed the different points of view included in the summary during several conference calls. In those calls the TWG developed a final document on the basis of the agreed-upon responses and the technical points of view of its members. Finally, the TWG document was submitted to and approved by the GLASS Board.

Overall comments

There are few practitioners in Latin American with experience in applying IFRS for insurance entities, since in most of the countries regulatory accounting is being followed. Therefore, we have a limited viewpoint on the issue, and accordingly our answer is based in analyzing it from a conceptual perspective.

We agree that when insurance entities apply IFRS 9 together with IFRS 4, accounting mismatches may arise as a result of applying the business model approach of IFRS 9 to classify the investments in financial instruments, which in certain cases could be substantial.

However, allowing an interim period in which IFRS 9 would not be fully applied or not applied at all by insurance entities until the effective date of the new insurance contracts standard may be a not appropriate

[1] The overall objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions in respect to all Exposure Drafts issued by the IASB. Therefore, GLASS aims to have a single regional voice before the IASB. GLASS is constituted by: Argentina (Board), Bolivia, Brazil (Vice Chairman), Chile, Colombia (Board), Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico (Chairman), Panama, Paraguay, Peru, Uruguay (Board) and Venezuela (Board).

solution than applying IFRS 9 from its effective date, since during the aforementioned interim period there would be a lack of comparability of the information of insurance entities vis a vis other entities fully applying IFRS 9.

Therefore, we believe that IFRS 9 should be applied as of its effective date. Any accounting mismatches that arise should either be disclosed or the overlay approach should be used to recognize their effect in other comprehensive income (OCI), based on the result that would have been obtained under IAS 39, *Financial Instruments: Recognition and Measurement*. The temporary exemption of not applying IFRS 9 until the new insurance contracts standard is effective should be followed only in those cases in which it would not be possible to determine such effect due to impracticability.

Specific comments

Attached please find our specific responses to the questions presented in the ED.

Contact

If you have any questions about our comments, please contact glenif@glenif.org.

Sincerely yours,

Felipe Pérez Cervantes
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

GLASS' Comment Letter on the IASB Exposure Draft on Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts*

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?

We agree that the IASB should seek to address these concerns.

The lack of alignment of the effective dates of IFRS 9 and the new insurance standard could create accounting mismatches in measuring earnings. In addition, it could be argued that using IFRS 9 could lead to volatility in earnings since measuring investments in equity securities will no longer be recognized through other comprehensive income (OCI). Explaining such volatility to users might prove to be difficult.

It should be mentioned that insurance entities will have to implement IFRS 9 in 2018 and subsequently the new insurance contracts standards in 2021. Notwithstanding, the fact is that they will eventually have to implement both standards, and IFRS 9 has introduced substantial improvements in accounting for financial instruments that are difficult to ignore. Also, initially implementing both new standards with significant changes in 2021 would create a significant hurdle both for preparers and users. Nevertheless, one of our country-members believes that both standards should initially be applied at the same time starting in 2021.

The new insurance standard will be issued shortly, and its effect can start to be gauged by insurance entities to determine its interaction with IFRS 9, so as to reach a proper decision on how to apply IFRS 9 starting in 2018 and during the interim period until the new insurance contracts standard is effective. Also, IFRS 9 permits alternatives for valuing certain investments that could eliminate most of the mismatches. In addition, the business model of insurance entities is readily observable and is unlikely to change as a result of a new standard on insurance contracts. Therefore, these entities have the means to determine how to apply IFRS 9 as of its effective date.

An issue that worries us is if, by permitting a temporary exemption, a precedent is being established so that in the case of future complex standards, such as IFRS 16, *Leases*, some interested parties may ask for a deferral of the effective date of the standard.

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.

We believe that:

1) IFRS 9 should be applied as of its effective date;

2) any accounting mismatches that arise should be disclosed or the overlay approach should be used to recognize their effect in OCI, based on the result that would have been obtained under IAS 39, *Financial Instruments: Recognition and Measurement*; and

3) the temporary exemption of not applying IFRS 9 until the new insurance contracts standard is effective should be followed only in those cases in which it would not be possible to determine such effect due to impracticability.

One of our country-members believes that the overlay approach is the only one that should be permitted, since that approach provides information on the differences between using the prior valuation methodology of IAS 39, thus providing valuable information to users of the financial statements.

The temporary exemption approach would create problems due to the resulting lack of comparability. If the financial statements of an insurance entity using this approach are consolidated in a financial group that includes also a bank, the accounting principles applied would not be uniform, which is contrary to the principle stated in paragraph 19 of IFRS 10, C*onsolidated Financial Statements*, which requires using uniform accounting policies when preparing consolidated financial statements.

Therefore, such country-member concludes that the temporary exemption approach should only be used if it is impracticable to fully apply IFRS 9 or the overlay approach, clearly disclosing why it is impracticable.

Another country-member believes that the application of IFRS 9 has so many challenges that its application should be deferred for all industries.

An issue that is not considered in the proposed modification is how to deal with the application of IFRS 9 by insurance entities that will adopt IFRS in 2018 or thereafter, as requested by their regulators, since there is no precedent of applying IAS 39.

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?

We believe that the application of IFRS 9 would only affect those assets that in accordance with IFRS 9 should be measured at fair value through profit and loss, for example because the business model indicates that the equity financial instruments are held for trading, thereby creating a mismatch with liabilities that reflect deferred income. If such financial instruments were measured in accordance with IAS 39 at fair value through OCI, applying the overlay approach would enable the entity to disclose the effect of not measuring the financial instruments through profit and loss, thereby avoiding earnings volatility. In such cases, an analysis should be made to determine if the measurement fairly reflects the performance of the business.

Something that is not mentioned regarding the overlay approach is how to deal with the accumulated effect in OCI when the new standard on insurance contracts becomes effective in 2021. If such standard will require a retrospective approach, we assume the effect will be adjusted at the beginning of the initial period of application, which would be 2020. Since the IASB has concluded its debate on the new standard and is now reviewing its due process, there is a basis to indicate the accounting for the OCI in the modification to IFRS 4.

One country-member believes that using OCI creates additional costs and will unduly expand the notes to the financial statements. It will also be difficult to explain the OCI effects to analysts and other users. That country-member also maintains that the use of OCI is well defined in the proposed revised Conceptual Framework for Financial Reporting and is well understood by users. Using OCI to reconcile a lack of alignment of the effective dates of two standards has no technical support.

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?

As previously indicated, we believe the temporary exemption should be applied only when it is not possible to determine the effect (i.e. it is impracticable) of the accounting mismatches generated by IFRS 9, which would not exist if IAS 39 were applied.

The temporary exemption could be appropriate only for entities whose predominant activity is issuing insurance contracts, since these entities will have to analyze the new standard on insurance contracts that will be issued soon and evaluate its effects, which will be a significant effort that will require a long time to be properly completed.

Some commented that the term "predominant activity" is not sufficiently precise in the ED, since such activity can either be measured based on:

1) the importance of the insurance premiums that are earned (and the earning process varies from one type of insurance to another);
2) the relative weight of the liabilities for the deferred earnings of insurance premiums vis a vis other liabilities; or
3) the rules of the local insurance regulator.

We believe that the evaluation should be made taking into consideration all of these factors.

There is also a problem with evaluating the predominant activity at the level of the reporting entity. It may be easier to make such evaluation if the entity's only activity is related to insurance. However, frequently such entities are part of a financial group that carries out banking activities. In such cases there will be a problem in consolidation. If paragraph 19 of IFRS 10, *Consolidated Financial Statements*, which requires uniform accounting policies for like transactions and other events in similar circumstances, is applied, the figures of the insurance entity would have to be adjusted to apply IFRS 9 or, alternatively, use the overlay approach.

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?

As previously indicated, IFRS 9 should first be applied and, if necessary, the overlay approach would be applied recognizing the effects of the accounting mismatches based on IAS 39 in OCI. Only in those cases in which the accounting mismatches cannot be determined, because it is impracticable to do so, would the temporary exemption of not applying IFRS 9 until the new insurance contracts standard is effective be applied.

Allowing an entity to elect the option to be followed would not be the best approach, since an entity could opt for the approach that is more advantageous and not necessarily the one that provides the best information.

Also, one country-member believes that a deferral of the implementation of IFRS 9 should be considered for all industrial sectors, since there are other activities that are impacted by IFRS 9, such as real estate.

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?

There is a consensus that the exemption from applying IFRS 9 should expire when the new standard on insurance contracts goes into effect. The length of time available to evaluate the effects of such standard and to define the entity's business model to manage the investments in financial instruments would be sufficient.