
Dear Hans,


We consider that, in order to address the concerns expressed by users and preparers, the most optimal solution is a temporary exemption from applying IFRS 9 until the new standard on insurance contracts is effective. However, in order to make such an exemption truly effective, we suggest that it be calculated differently to the way it is done in the ED by:

- Taking out of the denominator the liabilities that are not directly linked to entities’ business activities such as employee- and tax-related liabilities which, in addition, depending on various factors, could actually be unduly discriminating for some entities;
- In order to address the specific issues of financial conglomerates, performing the assessment test in a “descending” way i.e. first at the top reporting entity level and where this fails, at the level immediately below and so on, provided the entity considered is material in respect of the reporting entity. Entities to be considered would be both subsidiaries and entities accounted for using the equity method;
- Requiring the calculation at the date IFRS 9 becomes effective to be performed based on the average of the three last reporting date figures to alleviate any concerns of either earnings management or unfair disqualification due to unfavourable temporary situations.

Whilst we do not oppose the overlay approach, we, concurrently with the IASB, note that it does not address all the concerns put forward by constituents and are unsure of how many entities will actually make use of it. In addition, we think that some clarification should be brought to certain aspects of the method.

We would expect that, were the temporary exemption method to be calibrated as we propose above, there would be even less need for an overlay method.
Finally, we disagree with the sunset clause on the deferral approach because it may fail to address the concern of having to carry out the implementations of two major standards within a short period of time. We expect that the final insurance standard will be made effective not much beyond 2021. We therefore suggest that the expiry date of the period over which the deferral method may be applied is aligned with the effective date of implementation of the new insurance standard (at the latest its effective date). We consider that this will be more effective in focusing the attention of constituents on the finalisation and implementation of the future standard.

Our detailed comments to the questions raised in the ED are set out in the Appendix.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,

Michel Barbet-Massin
Head of Financial Reporting Technical Support
Appendix

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?

Mazars agrees with the three concerns that the IASB is seeking to address.

We note, however, that neither the overlay approach nor the sunset clause on the deferral approach address the last concern expressed regarding the significant cost and effort for preparers and users of implementing two sets of major accounting changes within a short period of time.

Assuming the new insurance contracts standard becomes effective shortly after 1 January 2021, because the proposed sunset clause will have come into effect, the preparers who had applied the temporary deferral would have to implement IFRS 9 for a short period of time (and possibly for just one year) before the new insurance contracts standard is effective, whether or not they choose to apply the overlay approach in the meantime. In our view this cannot be considered a practical way to implement new Standards.
**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.

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We consider that, in order to address the issues listed under Question 1, the most optimal solution is a temporary exemption from applying IFRS 9 until the new standard on insurance contracts is effective. However, as we describe in our answer to Question 4, we suggest that the temporary exemption be calculated differently to the way it is done in the ED.

Whilst we do not oppose the overlay approach, we, concurrently with the IASB, note that it does not address the issue of the cost and effort of applying two sets of major accounting changes in a short period of time and are unsure of how many entities will actually make use of it. For instance, the cost of running two accounting systems (IAS 39-based and IFRS 9-based) in parallel might dissuade many preparers from applying the overlay approach.

In addition, if the temporary exemption method were to be calculated as we propose, we would expect that there will be even less need for an overlay method.
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?

(a) Definition of assets qualifying for the overlay approach

In our opinion, the proposed description of the assets qualifying for the overlay approach is not sufficiently clear and restrictive, and may encourage earnings management.

We note that a clearer description of the assets qualifying according to paragraph 35B(b) for the overlay approach is provided in the document “Mind the Gap” written by IASB Board member, Sue Lloyd.

We are especially concerned with the following phrase in the proposed paragraph 35B(a): “it is designated as relating to contracts that are within the scope of this IFRS” (emphasis added). As the ED provides no definition of what “designated” means and no application examples, different groups might interpret this phrase in different ways ranging from very indirect links to solely very direct links to insurance contracts, in addition to being able to cherry pick the assets upon application of the overlay approach. We consider that this provision would give preparers too much leeway.

We understand that the IASB proposes to address this by enhancing comparability via additional disclosures (§ 37D(b) requiring preparers to disclose the basis for determining the financial assets to which the overlay approach is applied). In our view, these additional disclosures will not outweigh the drawbacks of the definition of qualifying assets being not prescriptive enough.

We would suggest instead that the scope of qualifying assets be clarified by:

- replacing “it is designated as relating to” by “it is managed in relation with” in paragraph 35B(a) and giving examples to illustrate this criterion;
- and bringing forward the examples provided in the publication “Mind the Gap” to the amendment in order to clarify which assets are eligible according to paragraph 35B(b).

(b) Presentation of amounts reclassified under the overlay approach

We do not agree with giving preparers the option of choosing between presenting the reclassification impact as (a) a single line in profit or loss/OCI or (b) in each and every relevant line of P&L and a single line in OCI impacted by such reclassification.

Given the level of optionality in the ED’s proposals, in order to enhance comparability, we suggest that the final standard be more restrictive and only one option be permitted. We support option (a) with further disaggregation in the notes, subject to IAS 1 presentation options in OCI (single line net of tax or two lines (gross and tax)).
(c) Other comments on the overlay approach

Regarding the de-designation for assets that no longer qualify for the overlay approach, we do not see clearly to what situations paragraph 35E(c) refers: if it is only applicable when there is a change in the relationship between a given financial asset and insurance contracts (as in paragraph 35E(b), which would effectively mean that the asset no longer qualifies), we suggest that it be simplified and merged with paragraph 35E(b). We propose the following wording for merged paragraphs 35E(b) and 35E(c):

“shall de-designate a previously recognised financial asset as relating to contracts within the scope of this IFRS only when there is a change in the relationship between that financial asset and the contracts within the scope of this IFRS. Upon such de-designation, an entity shall reclassify to profit or loss any balance accumulated in other comprehensive income relating to a previously designated financial asset.”

Moreover, in relation to our suggestion to clarify the scope of qualifying assets under paragraph 35B(a) (as proposed in point (a) above), we recommend that the de-designation criteria in paragraph 35E(b) be modified. We suggest that there be a more direct alignment with the management of insurance contracts, meaning that de-designation would be required for all assets that are no longer managed in relation with insurance contracts. We consider that limiting de-designations to such cases will prevent arbitrary de-designations without sound economic grounding and therefore limit earnings management possibilities.

In addition, we disagree with the requirement in paragraph 37D(d)(ii) to disclose the amount that would have been reclassified from profit or loss to OCI in the reporting period if those financial assets had not been removed from the scope of the overlay approach as we do not see clearly to what extent that information could be useful for the users of financial statements, given that the impact of de-designation is to be provided in accordance with paragraph 37D(d)(iii).

We also think that paragraph 35E(d) should be dealt with in a paragraph separate from paragraph 35E as the situation it addresses is different to that of designating or de-designating individual assets.
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 (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?

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a) Basing the eligibility criterion on predominance of activity in issuing contracts within the scope of IFRS 4

Mazars considers that the temporary exemption from applying IFRS 9 should be granted to entities considered as insurers, i.e. whose activities are predominantly engaged with issuing contracts within the scope of IFRS 4.

We consider that as it is currently proposed, the temporary exemption would fail to capture a number of the entities which are significantly affected by the issue at stake. We therefore propose changes to both the assessment of the predominant activity and to the level at which that assessment is to be made.

b) Assessing predominant activity

We agree with the IASB that the assessment is to be made considering the activities of the entity, i.e. those aspects of an entity’s business which generate revenue. We understand the difficulties of finding the perfect ratio whilst keeping the assessment reasonably simple.

We therefore agree with the focus of the IASB’s proposals being on the liabilities, and more specifically on those arising from contracts within the scope of IFRS 4, in terms of the numerator of the calculation.

We disagree, however, with including liabilities such as employee- and tax-related liabilities in the denominator as these are not directly linked to the business activities of the entities considered. In addition, depending for instance on the significance and location of such liabilities, such amounts could in fact be distorting in that they could unduly disqualify the related entity from being able to apply the exemption.
c) **Level at which predominant activity is to be assessed**

We consider that the entity to be considered is not necessarily the reporting entity as this could exclude significant entities within reporting entities whose activities are solely insurance-related.

We therefore propose a “descending test”, whereby:

1. The predominance assessment is first made at top entity reporting level;
2. Should the test fail at that reporting entity level, the test is to be performed at the level immediately below, and so on, subject to materiality of the entity considered in respect of the reporting entity.

We understand the notion of “entity within the reporting entity” to not only include subsidiaries but also those entities accounted for using the equity method.

We acknowledge that such a test would mean that within a reporting entity both IFRS 9 and IAS 39 could therefore have to be implemented. As supporters of a “business activities” (or business model) approach, we consider that this is not only reasonable but that it is also operational. To alleviate concerns related to earnings management but also to avoid undue disqualification due to a temporary unfavourable situation of the entity (in respect of the predominance test), we suggest that the assessment at the date IFRS 9 becomes effective be performed based on an average of the last three years’ reporting date figures.

We also disagree with the IASB on the rationale of simultaneous application of IFRS 9 and IAS 39 by the same reporting entity being more difficult to understand for users of financial statements (BC56 (a)). We note in this regard that, to some extent, it is precisely what the overlay approach proposes. In addition, paragraph 37A (c) and (d) provides some information that users can make use of if they wish to get a better and closer picture of what full application of IFRS 9 would be.
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?

a) Optionality of the approaches

We agree that applying both the overlay approach and the temporary exemption from applying IFRS 9 should be optional. This will allow insurers that (a) are ready to implement IFRS 9 and consider IFRS 9 implementation to be relevant, and (b) do not wish to bear the costs related to the overlay approach, to apply “full” IFRS 9 starting in 2018 and thus benefit from the improvements of this standard at the same time as other preparers.

b) Voluntary termination of option

We believe that insurers having initially opted for the overlay approach or the temporary exemption should be allowed to apply “full” IFRS 9 even before the new insurance contracts Standard is applied. This will ensure that such preparers may benefit fully from the improvements brought by IFRS 9 as soon as they consider the implementation of IFRS 9 to be relevant.
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?

We do not agree with the IASB’s sunset clause regarding the temporary exemption from applying IFRS 9. In our opinion, the temporary exemption’s expiry date should be aligned with the mandatory effective date of implementation of the new insurance contracts Standard, which we do not expect to be much beyond 2021.

We are concerned that, should the publication of the new insurance contracts Standard be delayed by a short period of time, the same issues as those having led to the publication of this ED will arise again in 2021 (the risk of accounting mismatches and P&L volatility, the high cost of applying two major standards separately over a short period etc.). Therefore, the possibility that, in such an event, the IASB might need to publish a new amendment extending the period of application of this temporary exemption cannot be ruled out. Setting no stated expiry date would therefore save time and effort for interested parties and help them focus on the standard’s finalisation process and/or its implementation.