BNP PARIBAS

Chief Financial Officer

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EFRAG
35 Square de Meeûs
1000 Brussels
Belgium
commentletters@efrag.org

Comments on EFRAG's assessments on applying IFRS 9 Financial instruments with IFRS 4 insurance contracts: amendments to IFRS 4

We are pleased to provide BNP Paribas' comments on the EFRAG's assessment on applying IFRS 9 Financial instruments with IFRS 4 insurance contracts: amendments to IFRS 4.

In addition to being one of the largest financial institutions in Europe, BNP Paribas has significant insurance activities, particularly in the field of participating life insurance contracts, investment contracts with a discretionary participating feature ("DPF investment contracts"), and creditor insurance contracts.
As a member of the CFO Forum and the Fédération Française de l'Assurance (FFA), we have contributed to their response to EFRAG's assessment on applying IFRS 9 Financial instruments with IFRS 4 insurance contracts. However, we also wish to provide you with the view of the group, as a conglomerate operating both in banking and insurance activities.

We appreciate the IASB and EFRAG's efforts to understand the concerns raised by the Insurance Industry and other interested parties on the misalignment of effective dates for IFRS 9 and IFRS 4 phase II.
With the aim to address these concerns, the IASB has proposed in the amendment "Applying IFRS 9 Financial Instruments with IFRS 4 Insurance contracts" ("IFRS 4/IFRS 9 Amendment") issued in September 2016 two different solutions:

- An optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 ("the deferral approach");
- An option that would permit entities that issue contracts within the scope of IFRS 4 to reclassify from P&L to Other Comprehensive Income temporary additional volatility that could occur before the new insurance contracts Standard is effective (the "overlay approach").

This IFRS 4/ IFRS 9 amendment is similar to the ED which was issued for comments in December 2015 with regards to the two options proposed and their eligibility criteria.

As a conglomerate, we do not meet the requirements of the IASB amendment for applying the temporary exemption. In our Comment letter to the ED addressed to the IASB and EFRAG in January 2016, we advocated that the optional temporary deferral should be made available to all insurers that issue material insurance contracts (i.e. the deferral should be available below reporting entity) to ensure a "level playing field" between all entities involved in insurance activities.

We still do not support the overlay approach as it does not properly address issues raised: it does neither fully address the mismatch issue (merely moving the volatility from the income statement into the equity), nor the cost issue, since it would imply to duplicate systems with potentially supplementary costs. The overlay approach, available to all entities undertaking insurance activities, is not considered as a practicable alternative by pure insurers. If it is not considered as a solution for predominant insurers, the overlay approach cannot be deemed a proper solution for bancassurers. The temporary exemption from applying IFRS 9 is by far the most suitable option for the whole industry.

We welcome EFRAG's in depth analysis on the extent to which the IFRS 4/IFRS 9 Amendment addresses the concerns raised in EFRAG's endorsement advice of IFRS 9 and on whether the IFRS4/IFRS 9 amendment is conducive to the European public good.
We appreciate that EFRAG considers that the Amendment addresses most of the concerns identified in their endorsement advice on IFRS 9 but do not address the cost issue of entities undertaking insurance activities that are not predominant insurers.

We welcome the analysis on "Potential competition issues within the EU" presented in Appendix 3 of the EFRAG's assessment on applying IFRS 9 Financial instruments with IFRS 4 insurance contracts which highlights the weight of bancassurance in Europe within the insurance industry and points out that entities representing approximately 20/25% of the total insurance activity within the sample are not able to use the temporary exemption. It should also be noted that the leader of the French insurance market in 2015 is a bancassurer.

For all these reasons, and as already expressed in our comment letter on the ED/2015/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts, we strongly support the need for a "level playing field" between all entities involved in insurance activities in Europe, as:

- we believe that comparing "insurer to insurer" is more important and meaningful to the users of the financial statements, than comparing assets related to insurance activities with non-insurance (e.g. banking) activities within a conglomerate;
- if insurers within conglomerates were to be required to apply the overlay, they would be at a disadvantage compared to other insurers regarding the cost/benefit ratio of the two approaches, and the difficulty to explain such a restatement to the market;
- the restricted availability of the temporary exemption raises issues regarding the transition period prior to the application of IFRS 9. Insurers may be tempted to manage the assets that have significant unrealized gains as those gains will be frozen in retained earnings upon transition. Non predominant insurers will not benefit from the same time period as predominant insurers.

We therefore still consider that the deferral approach should be made available to all entities undertaking insurance activities that are not predominant insurers, due to the configuration of the insurance industry in Europe and the weight of bancassurers in the European insurance industry.

Should you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely,

Lars Machenil

6. EFRAG has identified a number of other factors that could be considered in assessing whether the endorsement of the Amendments is conducive to the European public good (see Appendix 3, paragraphs 24 to 43). EFRAG is unable to conclude whether the application of the temporary exemption from IFRS 9 amounts to a material competition issue from an economic perspective. In addition, EFRAG is not aware of any issues where the use of the overlay approach would affect competition between entities.
Do you agree with the assessment of these factors?
☐ Yes ☒ No
If you do not agree, please provide your arguments and indicate how this could affect EFRAG's endorsement advice.

Bancassurance operators carry out the same activities as insurance groups and are usually in direct competition with pure-insurers on the life insurance and protection lines of business.

We welcome the analysis on "*Potential competition issues within the EU*" presented in Appendix 3 of the EFRAG's assessment on applying IFRS 9 Financial instruments with IFRS 4 insurance contracts. EFRAG highlights the weight of bank insurance in Europe within the insurance industry and points out that entities representing approximately 20/25% of the total insurance activity within the sample are not able to use the temporary exemption.
Indeed, we would like to stress out that the bancassurance operators carry out the same activities than insurance groups and are usually in direct competition with pure-insurers on the life insurance and protection lines of business.

In France, the bancassurance business represents 62% of the in-force portfolio of life insurance, equivalent to € 761 Bn of technical and policyholders' participation reserves. The companies that will not benefit from the IFRS 9 deferral option represent 46% of all premiums collected in the French life market in 2015.
Furthermore it should be noted that the leader of the French insurance market in 2015 is a bancassurer.
On the European market, bancassurance stand for 22% of the technical reserves of the top 10 life insurance players. The exclusion of such a significant part of the insurance market from the scope of the IFRS 9 deferral is a material breach of competition.

Financial performance and return of insurance contracts

Bancassurers might have to adjust their investment strategies as explained which will reduce the comparability and quality of financial information. Please refer to question 8.

IFRS 9 implementation

The banking and insurance entities within a financial conglomerate usually do not share the same investment management systems, given the specificities of the insurance activities. Insurance subsidiaries of banking groups will only have several months to implement new parameters in their information systems and integrate their investment portfolios and the new framework.
Furthermore, an additional exercise of financial assets allocation will be performed before 2021 to comply with the requirements of IFRS 4 Phase II, notably regarding the granularity of insurance contracts (unit of account).

On the contrary, stand-alone insurers will benefit from an additional 3-year delay to prepare

IFRS 9 implementation and longer delay implies lower implementation costs as they would benefit from the market experience. In addition, a single exercise to define financial assets allocation under IFRS 9, consistent with the required granularity (unit of account) of insurance contracts specified in IFRS 4 Phase II, is less expensive than having to reallocate the assets twice (a first time at IFRS 9 transition and a second time at IFRS 4 Phase II transition).
In addition, it should be kept in mind that the issues faced by the banking and the insurance business are different and the implementation of the expected credit loss for a portfolio of bonds of the insurance could not benefit from a complete mutualisation with the implementation of an expected loss model for a portfolio of loans in the bank due to different IT systems and different issues from a modelling perspective.

Applying the Overlay Approach

Applying the overlay approach is very complex as it requires defining a greater granularity within the investment portfolios. There is no systematic rule to switch from one framework to the other (IAS 39 / IFRS9). This approach requires maintaining two systems with specific settlement, impairment and valuation rules for the IFRS reporting, in addition to numerous other frameworks: local GAAP, Solvency II and Tax.

Managing interactions between two IFRS frameworks is very demanding and even impossible to implement in a fast closing process of ten days, as experienced by significant Groups. As such, it could generate operational risks. The implementation of overlay approach within a few months before end 2017 would be complex and would induce very high implementation costs for a use limited to 3 years.

The overlay approach, available to all entities undertaking insurance activities, is not considered to be a practicable alternative by pure insurers. If it is not considered as a solution for predominant insurers, the overlay approach cannot be deemed a proper solution for bancassurers. The temporary exemption from applying IFRS 9 is by far the most suitable option for the whole industry.

For all these reasons, and as already expressed in our comment letter on the ED/2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*, we strongly support the need for a "level playing field" between all entities involved in insurance activities in Europe, as:
- we believe that comparing "insurer to insurer" is more important and meaningful to the users of the financial statements, than comparing assets related to insurance activities with non-insurance (e.g. banking) activities within a conglomerate;
- if insurers within conglomerates were to be required to apply the overlay, they would be at a disadvantage compared to other insurers regarding the cost/benefit ratio of the two approaches, and the difficulty to explain such a restatement to the market.

We therefore consider that the deferral approach should be made available to all entities undertaking insurance activities that are not predominant insurers, due to the configuration of the insurance industry in Europe and the weight of bancassurers in the European insurance industry.

8. EFRAG has initially concluded that endorsement of the Amendments would be conducive to the European public good (see paragraphs 44 to 47 of Appendix 3 of the accompanying *Draft Letter to the European Commission*).
Do you agree with this conclusion?
☐ Yes ☒ No
If you do not agree, please explain your reasons.

As highlighted above in question 8, the weight of bancassurance in Europe within the insurance industry is significant.

Bancassurers will have to reconsider their financial investment policy and allocation strategy which may expose them to lower financial performance. The limitation in their policies of diversification of investments will expose them to lower returns in a low rate environment.

The portion of financial assets accounted for at fair value through P&L is higher under IFRS 9 than under IAS 39. In order to preserve insurance contracts' performance, bank insurance operators have to diversify their investments (equities, UCITS) which might result in a higher volatility of their IFRS results under IFRS9.

In the meantime, the risk appetite of insurance companies, in accordance with the Solvency 2 principles, is defined in relation to a number of indicators, including indicators of accounting profit based on IFRS. Insurance companies therefore set maximum volatility levels for IFRS profit and adjust their investment portfolios in light of this indicator. As a consequence, all other things being equal, bancassurers will have to reduce the exposure of their financial portfolio to assets accounted for at fair value through P&L, and be deprived of additional return.

In addition, the freezing in equity of the unrealized gains on assets previously recorded at Fair Value through OCI under IAS 39 and that will be reclassified to Fair Value Through P&L under IFRS 9 will lead to significant gaps between the statutory realised gains and the gains realised in IFRS consolidated financial statements. Bancassurers will be penalised compared to pure insurers that will benefit from a longer period of time (until 2021) to manage the reserves of unrealised gains and their recycling through their P&L.

We therefore consider that the deferral approach should be made available to all entities undertaking insurance activities that are not predominant insurers, due to the configuration of the insurance industry in Europe and the weight of bank insurers in the European insurance industry.