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28 January 2016 By email: commentletters@hkicpa.org.hk and by post

Ms. Christina Ng
Head of Financial Reporting, Standard Setting
Hong Kong Institute of Certified Public Accountants
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Hong Kong

Dear Ms. Ng

IASB Exposure Draft ED/2015/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

We refer to your letter dated 14 December 2015 inviting the Association's comments on the IASB Exposure Draft ED/2015/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts. Our comments on the specific questions raised in the exposure draft are set out in the enclosed annex.

Should you have any questions, please do not hesitate to contact Ms Emily Ngan of the Secretariat at 2526 6080.

Yours sincerely

Doris Ma
Secretary

Enc.

Chairman Standard Chartered Bank (Hong Kong) Ltd
Vice Chairman Bank of China (Hong Kong) Ltd
The Hongkong and Shanghai Banking Corporation Ltd
Secretary Doris Ma

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根據條例第364章成立

Annex

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?

Question 1

We support the Board's proposal to apply the different effective dates of IFRS 9, as this will avoid any negative implications to be caused by the misalignment of effective dates of IFRS 9 and the new insurance contract 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.

Question 2

We support both the overlay approach and the temporary exemption as they both will address the misalignment of effective dates of IFRS 9 and the new insurance contract Standard.

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?

Question 3 (a)

We agree with the proposal to restrict the application of overlay approach only to the eligible financial assets to avoid any misuse of the overlay approach.

Question 3 (b)

We agree with the proposal to show the reclassification effect in the primary financial statements in order to highlight such to the users of the financial statements.

Question 3 (c)

We would like to recommend that the Board to consider adding eligibility requirements as to determination of qualified financial assets designated as relating to contracts that are within the scope of IFRS 4 in paragraph 35B(a). For example, a financial asset usually does not have one to one relationship to an insurance contract. Also, a value of such financial asset may not be exactly equal to insurance liability. There may be circumstances that the entity may deliberately inflate the value of an asset used to support associated insurance liabilities to qualify for application of the overlay approach.

The Board should also consider adding substantiation requirements where a financial asset is transferred between insurance business segment and non-insurance business segment.

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?

Question 4 (a)

We disagree. The temporary exemption should be available to all entities undertaking insurance business, as the exemption is aim to address the negative implications stemming from the misalignment of effective dates of IFRS 9 and the new insurance contracts Standard. As noted in the 4c below, requiring the predominant insurance activities at the holding entity level would create not level playing field and also it will create an industry specific accounting.

Question 4 (b)

We generally agree. However, BC65 provided an example that three-quarters of an entity's liabilities arising from contracts within the scope of IFRS 4 would not meet the predominance condition, if the remaining one-quarter of liabilities arising from other activities. However, there could be a scenario in which the remaining one-quarter of this entity's business is an agency business that grosses up non-insurance business related assets and liabilities earning minimal returns, even though the insurance business is the core and significant business of the entity.

If the Board's intention is not to provide a quantitative threshold to determine predominant condition, it is suggested to remove the example in BC65 or use of three-quarters. Otherwise, the "three-quarters" or other quantitative threshold should be included in the main content of the Standard.

Question 4 (c)

We disagree. The temporary exemption is aimed to address the concerns for significant costs and efforts for implementation of two sets of major accounting standard changes in a short period of time. However, this temporary exemption will not provide level playing field to banking entities holding insurance subsidiaries, while giving advantages to sole insurers because the insurance subsidiary held by the banking entity parent would have to prepare two sets of financial statements; one for its separate financial statements and the other for its parent consolidated financial statements. It is opposed to the Board's original intention to minimize implementation costs and efforts.

Furthermore, from BC29 (b), the key concern of the Board for not allowing the use of "below the reporting entity level" is earning manipulation on transfer of assets between different Group companies using different accounting standards. However, measures can be taken to avoid this risk. For example, the Board can consider adding requirements for insurer to track histories of assets reclassification among the Group companies. At consolidated financial statements, change in classification and measurement should be prohibited, i.e., the accounting treatment on the transferred asset should not change before and after the transfer within the Group. For the separate financial statements, it should be accounted as if it is purchased from third parties. This issue that the Board was concerned also exists under the current IAS39. For example, subsidiary A can transfer an AFS investment to subsidiary B which would then be recorded as FVTPL at their separate financial statements level. We do not agree that this issue would be the key reason for not allowing the use of "below the reporting entity level".

Another concern of the Board was to maintain the accounting policy consistency in a financial statements (B7). However, in substance, the overlay approach allows insurers to apply IAS 39 and IFRS 9 in its financial statements at the same time in profit and loss perspective, which is contradictory to the concern of the Board. We believe that proper and additional disclosures can address the consistency issue.

Accordingly, we urge the Board to reassess the application of temporary exemption for "below the reporting entity level".

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?

Question 5

We agree that both the overlay approach and the temporary exemption should be optional to address different situations of reporting entities.

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?

Question 6

We disagree. We believe it is unnecessary to determine a specific sunset date to avoid situations where delay in issuance of insurance contract Standard. The Board may not have sufficient time to analyze and address comments to be/have been received for the EDs from the industries if a deadline is set. Instead, the Board should consider indicating the date as three years after the IFRS 4 is issued.