

Adjusting the Contractual Service Margin

No comments.

Contracts that Require the Entity to Hold Underlying Items and Specify a Link to Returns on those Underlying Items

No comments.

Presentation of Insurance Contract Revenue and Expense

No comments.

Interest Expense in Profit or Loss

No comments.

Effective Date and Transition

DZ BANK Group appreciates the proposed modified retrospective approach for transition as it allows existing and new business to be treated equally.

We support EFRAG's recommendation that the transition period should comprise at least three years after the final release of the standard. The implementation of the new accounting rules poses extensive operational challenges. Even if the exposure draft provides some simplifications, transition will be complex and costly. Necessary investments include adjustments to existing IT-systems and training of staff. Moreover, users need to learn how to read the adapted financial statements.

Due to the interrelation between insurance liabilities and financial assets DZ BANK Group considers the alignment of the effective dates of IFRS 9 and IFRS 4 to be of crucial importance. We expect the transition to be unnecessarily complex and costly and fear that the information provided in the financial statements is not readily understandable to users if the effective dates are not aligned. Allowing a number of reclassifications/redesignations of financial assets on transition would only partially mitigate these difficulties and would result in other problems. In fact, the insurance industry but also DZ BANK Group would still have to deal with two transition dates. The accounting mismatch would be reduced, but adopting IFRS 9 and IFRS 4 at different points in time would complicate the understandability of DZ BANK Group financial statements. Moreover, if this option is chosen, there needs to be clarity about the categories under IFRS 9.

The Likely Effects of a Standard for Insurance Contracts

Overall, the proposed ED improves the transparency and reduces diversity in the accounting for insurance contracts. However, there are still some aspects which are overly burdensome and do not provide an appropriate benefit.

Especially the transition in general and the disclosure requirements will involve medium to high costs. The costs of presentation aspects depend on the issue raised in our answer concerning clarity of drafting. If this aspect will not be clarified, the costs referring to the presentation of insurance contract revenue and expenses and referring to the presentation of interest expense will both be high.

Clarity of Drafting

DZ BANK Group is particularly concerned about the scope of IFRS 4. The reason for this is the proposal in the ED relating to the separation of components from an insurance contract. These rules could be interpreted as applicable to financial instruments including an insurance component, such as a loan waived on death.

Provided that there are two separate contracts, one dealing with the financial instrument and the other covering the insurance, IFRS 4 would not be applicable to the financial instrument. Both parts will be accounted for separately.

Yet, from a group perspective, such cases could be an issue. Suppose a bank subsidiary issues a loan and an insurance subsidiary underwrites a residual debt insurance on this loan (the insured event includes death, unemployment, divorce etc.). Both agreements are dealt with in one contract. Agenda paper 1C/66C referring to the IASB/FASB meeting on 4 May 2011 states on page 24 that such contracts (termed "loan waived on death") should be accounted for as one insurance contract.

In our opinion, this structure should be separated into a loan (accounted for as a financial instrument at amortised cost or using the fair value option) and an insurance component for the residual debt insurance (accounted for as an insurance contract).

Yet, this accounting treatment cannot be deduced from the ED. Firstly, we examined whether the two components should be combined. In paragraph 8, the ED only considers the combination of insurance contracts. This does not fit our example because there is only one insurance contract. The other component is a loan.

Although paragraph 8 is not applicable, employing the principles of this paragraph in an analogous way, the consideration of the loan and the insurance contract as a combined contract could be justified.

Secondly, we analysed whether the loan component may be separated from the insurance contract.

According to paragraph 9 of the Re-ED, an entity shall separate

- an embedded derivative if the economic characteristic and risks of the embedded derivative and of the insurance contract are not closely related and if the embedded derivative meets the definition of a derivative and is within the scope of IFRS 9,
- an investment component if it is distinct,
- a performance obligation to provide goods or services if that obligation is distinct.

Paragraph B31 states that an investment component is distinct if a contract with equivalent terms could be sold separately – unless the investment component and insurance component are highly interrelated.

According to paragraph B32 these components are highly interrelated if the entity is unable to measure the one without considering the other or if the policyholder is unable to benefit from one component unless the other is also present. This applies to our example because the value of the insurance depends on the amount outstanding of the loan.

Yet, this analysis assumes that the loan meets the definition of an investment component, which is not necessarily the case. Appendix A defines investment component as follows: "The amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur." This definition includes two aspects which do not fit to the situation described above. First of all, the entity (the insurance subsidiary) only repays an amount to the policyholder if the insured event occurs. Secondly, there are cashflows even if the insured event does not occur (interest and amortisation), but those are paid by the policyholder and not by the entity (the insurance subsidiary).

Voluntary unbundling is not permitted (see BCA208).

As the investment component (the loan) and the insurance component (the residual debt insurance) are highly interrelated, it can be concluded that the investment component is not distinct and may not be separated from the insurance contract. The exemplary situation would thus be treated as an insurance contract.

The question arises whether it could be argued that the bank subsidiary is acting as an agent on behalf of the insurance subsidiary as far as the insurance component is concerned. This perception is based on the idea that the bank only passes the insurance contract on to the insurance subsidiary. In this case, the loan and the insurance contract are accounted for separately.

If the Re-ED IFRS 4 should be read as applying to such situations as described in the example, DZ BANK Group does have an issue. The scope of IFRS 4 would then be much broader than expected. Further, it would imply huge efforts to comply with this standard as the insurance contracts are managed separately from the loan agreements. Besides, leasing contracts would be affected as well

because the lease contract (e.g. a vehicle) and the insurance contract (e.g. an automobile insurance) are usually closed in one document.

We do not expect that the board intends to widen the scope of IFRS 4 so extensively. Therefore, we ask for a clarification in terms of explicitly excluding such hybrid contracts from the scope of IFRS 4. It should be mentioned that an insurance contract may not be combined with any other contract besides insurance contracts. Nevertheless, insurance contracts may still include embedded derivatives, investment components and performance obligations.

Additional Comments – Disclosure of Confidence Level

DZ BANK Group supports the considerations of EFRAG's draft comment letter.

In general, the proposed disclosure requirements are too extensive. The requirements are too detailed and too complex. Providing these details will be very burdensome and offers no real benefits for users. The disclosure requirements should be more principle-based.

In particular, the rationale behind the requirement in paragraph 84 is highly questionable. Requiring an entity to translate the result of the risk adjustment into a confidence level if the confidence level technique is not used seems odd. The Board decided to not prescribe a specific technique – which we think is the right decision. The disclosure requirement implies more effort for the entities but provides no real benefit. The expected comparability between companies cannot be achieved by disclosing confidence levels because the circumstances discussed here are entity-specific.

Furthermore, paragraph 88 seems disproportionate. Disclosing information about the effects of each regulatory framework in which the entity operates is not required by other standards. From our point of view, the general requirements listed in IAS 1 are sufficient.