

September 2016

IFRS® Project Summary and Feedback Statement

Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* (Amendments to IFRS 4)

Background

Financial assets held by insurers

In July 2014, the International Accounting Standards Board (the Board) issued the completed version of IFRS 9 *Financial Instruments*. IFRS 9 sets out the requirements for recognising and measuring financial assets and financial liabilities. It replaces IAS 39 *Financial Instruments: Recognition and Measurement* and has an effective date of 1 January 2018.

IFRS 9 provides significantly improved information because:

- (a) it introduces a structured approach to the classification and measurement of financial assets that reflects the business model in which they are managed and their cash flow characteristics;
- (b) it provides for more timely recognition of loan losses as it uses a forward-looking expected credit loss model; and
- (c) it has an improved hedge accounting model that better links the economics of risk management with its accounting treatment.

Insurance contracts accounting

The existing requirements for insurance contracts—in IFRS 4 *Insurance Contracts*—apply to all issuers of such contracts. It is therefore applicable to a wider set of companies than just those considered to be ‘insurers’.

IFRS 4, which was issued in 2004, enables existing practices to be maintained or ‘grandfathered’ and was intended as a stopgap measure pending a more fundamental reassessment of the accounting for insurance contracts.

The Board is at an advanced stage in its project to replace IFRS 4 with a new IFRS Standard that sets out comprehensive requirements for insurance contracts. That replacement will be effective after 1 January 2018, the effective date of IFRS 9.

Interaction

Both IFRS 9 and the forthcoming replacement of IFRS 4 are expected to result in major accounting changes for most issuers of insurance contracts.

To address concerns about applying IFRS 9 before the forthcoming insurance contracts Standard, the Board amended IFRS 4 in September 2016 by issuing *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)*.

The issues addressed by the Amendments to IFRS 4

What issues is the Board seeking to address?

The Board is seeking to address concerns that the financial statements of issuers of insurance contracts¹ may be difficult to understand if IFRS 9 is applied before the forthcoming insurance contracts Standard. This is because of additional accounting mismatches and apparent volatility that may arise in profit or loss in the period between the effective dates of IFRS 9 and the forthcoming insurance contracts Standard. This concern is exacerbated because the period is expected to be short.

Insurers were particularly concerned that these mismatches could be difficult to explain to users of their financial statements.

How the Board responded to these issues

The Board responded by amending IFRS 4, introducing the:

- (a) **overlay approach**—an option for all issuers of insurance contracts to adjust profit or loss for eligible financial assets by removing any additional accounting volatility that may arise from applying IFRS 9; and
- (b) **temporary exemption**—an optional temporary exemption from IFRS 9 for companies whose activities are predominantly connected with insurance (ie these companies will be permitted to continue to apply existing financial instrument requirements in IAS 39).

What other solutions are available?

Both the overlay approach and the temporary exemption supplement other measures that a company can use to address the additional accounting mismatches and volatility that may arise in profit or loss as a result of applying IFRS 9, including the:

- (a) flexibility that was already offered by IFRS 4 in choosing an accounting policy for insurance contracts; and
- (b) transition reliefs for companies that apply the forthcoming insurance contracts Standard after they apply IFRS 9.

¹ Insurance contracts are in the scope of IFRS 4 unless otherwise specified. Investment contracts that contain discretionary participation features are also within the scope of IFRS 4. The Amendments to IFRS 4 are also applicable to issuers of investment contracts that contain discretionary participation features.

The overlay approach

—An option for *all* issuers of insurance contracts

The overlay approach is available for all issuers of insurance contracts.

Under this approach, a company will apply IFRS 9 but is permitted to reclassify amounts between profit or loss and other comprehensive income (OCI) for eligible financial assets. As a result, for the eligible financial assets the company selects, they will report the same total profit or loss as if IAS 39 had been applied to those assets.

This enables companies to remove from profit or loss additional volatility that may arise if IFRS 9 is applied with IFRS 4.

How the overlay approach is applied

- (a) IFRS 9 is applied in full, so information provided about financial instruments by issuers of insurance contracts is comparable with the information provided by other companies; and
- (b) in addition, companies may apply IAS 39 to eligible financial assets to calculate a single line item adjustment to profit or loss so that the total effect on profit or loss for the eligible financial assets is the same as if IAS 39 still applied to those assets.

To provide transparent information, the Amendments to IFRS 4 require that companies disclose the effect of the overlay approach to users of financial statements by:

- (a) presenting the adjustment as a separate line item on the face of both profit or loss and OCI; and
- (b) providing additional disclosures about the adjustment.

Illustrative statement of comprehensive income

Statement of Comprehensive Income	
	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Operating result	X
Investment income 'IFRS 9'	X
Interest on insurance liability	(X)
Overlay approach—adjustment	(X)
Investment result	X
Profit or loss	X
Overlay approach—adjustment	X
Effect of discount rate changes on insurance liability	(X)
Other comprehensive income	X
Total comprehensive income	X

Which companies can apply the overlay approach?

All companies that issue insurance contracts can apply the overlay approach to eligible financial assets.

However, a company can choose to apply the overlay approach only when it first applies IFRS 9. A company can apply the overlay approach whenever it begins to apply IFRS 9, including if it chooses to apply IFRS 9 before its effective date, or if it first applies IFRS 9 after previously applying the temporary exemption described in pages 6 and 7.

Which financial assets are eligible for the approach?

A company that applies the overlay approach may choose to apply it to financial assets that are measured at fair value through profit or loss (FVPL) applying IFRS 9 but would not have been measured at FVPL in their entirety applying IAS 39. An example of such a financial asset is one that was bifurcated in accordance with IAS 39.

A company that applies the overlay approach can do so for some or all such assets. However, a company is not permitted to apply the overlay approach to financial assets connected with non-insurance activities, such as banking activities. The selected assets are the 'designated financial assets' for the overlay approach.

What information will companies that apply the overlay approach provide?

A company applying the overlay approach applies IFRS 9, and consequently it will provide:

- (a) significantly improved information, in particular information on credit risk, that will enable enhanced analysis by users of financial statements;
- (b) information about financial instruments that is comparable with the information provided by other companies that apply IFRS 9; and
- (c) additional information that will enable users to understand the effect of applying IFRS 9 to the designated financial assets.

Temporary exemption from IFRS 9

—An option for companies with activities predominantly connected with insurance

The temporary exemption permits companies whose activities are predominantly connected with insurance to defer the application of IFRS 9 until the earlier of:

- (a) the application of the forthcoming insurance contracts Standard; or
- (b) 1 January 2021.

These companies will continue to apply IAS 39 during this period and will be required to make additional disclosures to enable users of financial statements to make comparisons with companies applying IFRS 9.

Which companies can apply the temporary exemption?

Only *some* issuers of insurance contracts can apply the temporary exemption from IFRS 9.

The temporary exemption is only available to companies that, considering their activities as a whole (at the reporting entity level), meet the following qualifying criteria:

- (a) they have not previously applied IFRS 9; and
- (b) they have activities that are predominantly connected with insurance.

Each reporting entity has to assess whether it is eligible for the temporary exemption. So a separate assessment is made for consolidated groups and for individual or separate financial statements. This means a group can be eligible to apply the temporary exemption in the consolidated financial statements, even if one or more of its subsidiaries does not qualify to apply the temporary exemption for its individual or separate financial statements (or vice versa).

When are the company's activities predominantly connected with insurance?

A company's activities are predominantly connected with insurance if, and only if:

- (a) the amount of its insurance liabilities is significant compared with its total amount of liabilities; and
- (b) the percentage of its liabilities connected with insurance relative to its total amount of liabilities is:
 - (i) greater than 90 per cent; or
 - (ii) less than or equal to 90 per cent but greater than 80 per cent, *and* the company does not engage in a significant activity unconnected with insurance.

Liabilities connected with insurance include investment contracts measured at FVPL, and liabilities that arise because the insurer issues, or fulfils obligations arising from, these contracts (such as deferred tax liabilities arising on its insurance contracts).

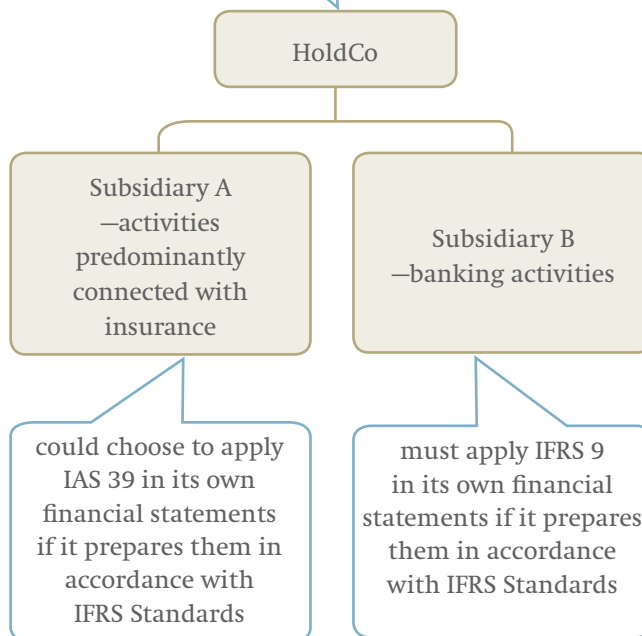
Which financial assets qualify for the temporary exemption?

A company that qualifies for the temporary exemption from IFRS 9 and chooses to use it will apply IAS 39 rather than IFRS 9 to *all*, rather than some, of its financial assets. This means that the company avoids applying both the old and the new financial instruments Standards, IAS 39 and IFRS 9, in one set of financial statements.

Users of financial statements have said that avoiding the use of both Standards in one set of financial statements is important to them.

Example—applying the temporary exemption

In its consolidated financial statements HoldCo (conglomerate) could choose to apply IAS 39 to *all* its financial assets if its activities overall are predominantly connected with insurance



Assessment and reassessment of predominant activities

A company is required to assess whether its activities are predominantly connected with insurance at the end of its annual reporting period immediately before 1 April 2016.

After that initial assessment, a company is required to reassess whether its activities are still predominantly connected with insurance if, and only if, there was a change in the company's activities (for example the acquisition or disposal of a business line). If its activities are no longer predominantly connected with insurance, the company is permitted to continue applying IAS 39 only until the end of the annual reporting period that began immediately after that reassessment. However, all companies must apply IFRS 9 in 2021.

A company whose activities are not predominantly connected with insurance on initial assessment is permitted to reassess its eligibility if there is a change in its activities.

Such reassessments are expected to be very infrequent.

Feedback Statement

In developing the Amendments to IFRS 4, the Board considered the feedback on the proposals in the 2015 Exposure Draft *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* (the 2015 Exposure Draft). The Board's response to the feedback is summarised in the table below.

Proposals in the 2015 Exposure Draft	Feedback	The Board's response
Addressing the concerns raised		
<p>The 2015 Exposure Draft proposed two optional approaches to address concerns about applying IFRS 9 before the forthcoming insurance contracts Standard:</p> <p>(a) the overlay approach—allows all companies that issue insurance contracts to recognise in OCI, rather than profit or loss, the volatility that may arise when IFRS 9 is applied for designated financial assets before the forthcoming insurance contracts Standard is issued; and</p> <p>(b) the temporary exemption—an optional temporary exemption from IFRS 9 for companies whose predominant activity is issuing contracts within the scope of IFRS 4.</p>	<p>Most respondents, other than users of financial statements, agreed that the Board should address the concerns and that the approaches should be optional.</p> <p>However, users of financial statements expressed mixed views. Some said that the proposals in the 2015 Exposure Draft were unnecessary. They were concerned about the loss of comparability that might arise as a result of the temporary exemption. Most users of financial statements preferred the overlay approach to the temporary exemption, while most preparers thought that the temporary exemption was the only approach that would address their concerns.</p>	<p>The Board confirmed that it would address concerns about the application of IFRS 9 before the forthcoming insurance contracts Standard by introducing:</p> <p>(a) the overlay approach; and</p> <p>(b) the temporary exemption from IFRS 9.</p> <p>The Board acknowledged the potential disadvantages arising from a loss of comparability because the approaches are optional. However, the Board believes that issuers of insurance contracts should be permitted to apply the improved accounting requirements in IFRS 9 without adjustment in 2018 when other companies will be doing so.</p>
Overlay approach		
<p>The 2015 Exposure Draft required the amount reclassified from profit or loss to OCI to be presented as a separate line item in the statement of profit or loss, OCI or both.</p>	<p>Some respondents expressed concern that the alternative ways of presenting would reduce comparability among companies.</p>	<p>The Board decided to require that a company explain the impact of the overlay approach by presenting its effects as a separate line item both in profit or loss and OCI as well as providing additional explanatory disclosures in the notes.</p>

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Proposals in the 2015 Exposure Draft	Feedback	The Board's response
Temporary exemption from IFRS 9		
–Eligibility		
<p>The Board proposed that the temporary exemption from IFRS 9 be available to companies whose predominant activity is issuing contracts within the scope of IFRS 4.</p> <p>The 2015 Exposure Draft also proposed that the eligibility for the temporary exemption be determined at the reporting entity level (ie by applying the test to the activities of the reporting entity as a whole).</p>	<p>Most respondents agreed that the companies that would qualify for the temporary exemption under the 2015 Exposure Draft proposals would be considered 'insurers'. However, most respondents also noted that some companies would not qualify for the temporary exemption, although they are commonly considered to be 'insurers' and in their view should be eligible.</p> <p>Many agreed that the eligibility assessment for the temporary exemption should be at the reporting entity level so that a company cannot apply both IAS 39 and IFRS 9 in a single set of financial statements. However, some also requested an additional assessment below the reporting entity level for those companies that did not qualify when assessed at the reporting entity level.</p> <p>Most users of financial statements and regulators supported an assessment only at the reporting entity level, whereby the whole group must qualify if the temporary exemption is to be applied in the group's consolidated financial statements. In contrast, most preparers suggested an assessment both at the reporting entity level and below (ie IAS 39 and IFRS 9 would be applicable to different parts of the group).</p>	<p>The Board decided to broaden the qualifying criteria for the temporary exemption so that the financial statements of peers in the insurance sector would be broadly comparable. Specifically, the Board decided that the temporary exemption should be available to companies whose activities are predominantly connected with insurance, which includes a wider set of activities connected with insurance than just issuing contracts within the scope of IFRS 4.</p> <p>The Board also noted that:</p> <ul style="list-style-type: none"> (a) IFRS Standards require a reporting entity to use consistent accounting policies to enable users of financial statements to compare a company with other reporting entities and to reduce the complexity of a single set of financial statements; and (b) a key reason for deferral was to reduce changes in accounting for users of financial statements. Changing from applying IAS 39, to a combination of IAS 39 and IFRS 9, to IFRS 9 in isolation would be inconsistent with that objective. <p>Consequently, the Board decided that companies should be assessed for qualification for the temporary exemption at the reporting entity level because more understandable and useful information would be provided if a reporting entity applied only IFRS 9 or IAS 39.</p>

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Proposals in the 2015 Exposure Draft	Feedback	The Board's response
Temporary exemption from IFRS 9		
—Disclosure		
<p>The 2015 Exposure Draft proposed disclosure requirements so that companies deferring the application of IFRS 9 would provide some information that could be compared alongside those that apply IFRS 9.</p> <p>The Board did not propose that a company be required to provide quantitative information about expected credit losses in accordance with the new model in IFRS 9.</p>	<p>Some preparers stated that the proposed disclosures would be unduly burdensome. However, most regulators and users of financial statements welcomed the proposed disclosures and suggested additional disclosures to assist in cross-sector comparisons and in understanding the credit risk of financial assets held by companies applying the temporary exemption.</p>	<p>The Board concluded that the objective of the disclosure requirements is to allow users of financial statements to compare companies applying the temporary exemption with companies applying IFRS 9, without adding excessive costs for preparers.</p> <p>The Board modified the scope for fair value disclosures proposed in the 2015 Exposure Draft to better meet that objective and to provide additional cost relief for preparers. Also, the Board observed that companies would need to produce credit risk information (ie disclosing the credit risk ratings of relevant financial assets) for some and not all financial assets, and would not be required to apply the new expected credit loss requirements in IFRS 9.</p>
—Fixed expiry date		
<p>The 2015 Exposure Draft proposed that an eligible company would be permitted, but not required, to apply IAS 39 rather than IFRS 9 for annual reporting periods beginning before 1 January 2021.</p>	<p>Many preparers recommended that insurers should be required to apply IFRS 9 only when they apply the forthcoming insurance contracts Standard. In contrast, users of financial statements and regulators supported the fixed expiry date.</p>	<p>The Board confirmed that an eligible company would be permitted, but not required, to apply IAS 39 rather than IFRS 9 for annual reporting periods beginning before 1 January 2021.</p> <p>The Board concluded that the temporary exemption would only be acceptable for a short period of time as those applying the temporary exemption would not be providing the significantly improved financial information available for companies applying IFRS 9, and there would be reduced comparability for users of financial statements.</p>

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Proposals in the 2015 Exposure Draft	Feedback	The Board's response
Temporary exemption from specific requirements in IAS 28		
The 2015 Exposure Draft did not propose any relief from the requirement to use uniform accounting policies when applying the equity method of accounting for investments in associates or joint ventures.	A few respondents asked the Board to consider providing relief so that a company could retain the financial instruments accounting applied by an investee that is an associate or joint venture when applying the equity method to its investment in the associate or joint venture. For example, if that investee applies the temporary exemption and the investor does not, respondents asked that the investor not be required to adjust the investee's financial information to reflect IFRS 9.	The Board decided to provide relief to reduce the costs of applying the equity method. As such, a company is permitted not to apply uniform accounting policies when the investee applies IAS 39 and the investor applies IFRS 9, or vice versa, when applying the equity method of accounting. The Board noted that the impact of not applying uniform accounting policies was limited under the equity method, and decided to provide such relief due to the practical difficulty of changing this accounting in an investee that is not controlled.
First-time adopter		
The 2015 Exposure Draft proposed that first-time adopters be prohibited from applying the overlay approach and the temporary exemption.	Some respondents expressed the view that the concerns raised about the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard could also be applicable to some first-time adopters.	The Board decided to permit eligible first-time adopters to apply the overlay approach or the temporary exemption, just as existing IFRS preparers can do, using consistent qualifying criteria.

Important information

This Project Summary and Feedback Statement have been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views within this document are those of the staff who prepared this document and are not the views or the opinions of the Board and should not be considered authoritative in any way. The content of this Project Summary and Feedback Statement does not constitute any advice.

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Further information

The Basis for Conclusions on the *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)* analyses the considerations of the Board when developing these amendments including comprehensive analysis of the feedback received on the proposals that preceded the Standard and how the Board responded to that feedback.

Notes

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