STAFF PAPER

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IASB Meeting

Project	**Amendments to IFRS 4: Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts***
Paper topic	Summary of the Board's decisions

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Introduction

1. This paper:

   (a) sets out, in paragraphs 2–7, the proposals in the Exposure Draft *Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts (Amendments to IFRS 4) (the ED) and the feedback received on those proposals;

   (b) provides an overview, in paragraphs 8–28, of the Board's tentative decisions at its March and April 2016 meetings; and

   (c) describes, in paragraphs 29–32, the consequences of those tentative decisions and this month's staff recommendations.

   This paper is for information only and does not contain any questions for the Board.

ED proposals

2. The proposals in the ED responded to the following concerns raised by some stakeholders about the different effective dates of IFRS 9 *Financial Instruments* (IFRS 9) and the forthcoming insurance contracts Standard:

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(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 forthcoming insurance contracts Standard (ED paragraphs BC10–BC16).

(b) Some entities that issue contracts within the scope of IFRS 4 *Insurance Contracts* (IFRS 4) could be required to apply the classification and measurement requirements in IFRS 9 before the effects of the forthcoming insurance contracts Standard can be fully evaluated (ED paragraphs 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 (ED paragraphs BC19–BC21).

3. The ED proposed to address those concerns using two approaches:

(a) the overlay approach, which would be available to all entities issuing contracts within the scope of IFRS 4. The overlay approach permits entities to reclassify from profit and loss to other comprehensive income the incremental effects of newly measuring some assets at fair value through profit or loss (FVPL) in their entirety when entities stop applying IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) and start to apply IFRS 9; and

(b) a temporary exemption from applying IFRS 9, sometimes referred to as the deferral approach. The ED proposed that the temporary exemption would be available only to entities whose predominant activity is issuing contracts within the scope of IFRS 4. That proposal would limit the temporary exemption to the entities that are most affected by the different effective dates of the forthcoming insurance contracts Standard and IFRS 9. The ED also proposed that the temporary exemption would expire at the start of annual reporting periods beginning on or after 1 January 2021 because the Board believes that, even if the forthcoming insurance contracts Standard is not effective by that date, all entities should apply IFRS 9 by that date.

Feedback received on the ED proposals

4. The ED was published in December 2015, with comments requested by 8 February 2016 (a comment period of 60 days). The Board considered that a comment period shorter than the standard minimum period of 120 days was appropriate because the proposals were narrow in scope and urgent. The shortened comment letter period was consistent with the requirements in the Board's Due Process Handbook and was approved by the Due Process Oversight Committee at its meeting on 13 October 2015.

5. Ninety-six letters were received from a variety of stakeholders including regulators, preparers of financial statements and their representative bodies, standard setters, the accounting and actuarial professions, and users of financial statements. The Board notes that feedback has been received from jurisdictions where insurance is widely purchased and also from jurisdictions where insurance is less commonly purchased.

6. During the comment letter period, the staff also undertook outreach with users of financial statements. This outreach supplemented the outreach with users undertaken while the Board developed the proposals for the ED in 2015. In total, staff conducted outreach with approximately 70 users from multiple jurisdictions. The staff have also discussed the topics extensively with groups, such as the Capital Markets Advisory Committee (CMAC) and the Corporate Reporting Users Forum (CRUF).

7. The Board considered the staff's analysis of the comment letters received and feedback from the user outreach at its March 2016 Board meeting[1]. The high-level summary of that feedback follows:

    (a) Most preparers, audit firms, accounting and actuarial professional bodies, national standard-setters and regulators agreed that the Board should address the concerns described in paragraph 2 above. In contrast, many users of financial statements placed less weight on those concerns and, accordingly, did not think the proposals in the ED were necessary.

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[1] For a more detailed analysis please refer to March 2016 Agenda paper 14A *Summary of comment letters and outreach* and March 2016 Agenda paper 14B *Summary of feedback from users of financial statements.*

(b) Most users of financial statements, some preparers that engage in both banking and insurance activities and a few other respondents (eg from South America) preferred the overlay approach to the temporary exemption. In comparison, most preparers (especially those from Europe, North America and Asia) said the temporary exemption would be the only approach that addresses their concerns about applying IFRS 9 before the forthcoming insurance contracts Standard is issued. Audit firms, accounting bodies and national standard-setters shared the preparers' views. Finally, some preparers were unconcerned about applying IFRS 9 in 2018, either because all of their financial assets are measured at FVPL today, or because they intend to apply IFRS 9 as they are the subsidiaries of banks.

(c) Most respondents, including some users of financial statements, said the population of entities that would qualify for the temporary exemption is too narrow, because some entities they regard as insurers would not qualify. Respondents had mixed views on:

   (i) whether the eligibility assessment for the temporary exemption should be conducted at the reporting entity level only (ie the assessment should consider all activities of the reporting entity, and the reporting entity would apply only one Standard, either IFRS 9 or IAS 39, to all financial instruments in its financial statements); or

   (ii) whether an assessment should also be permitted below the reporting entity level (ie the assessment should be done separately on the different activities conducted by differing parts of the reporting entity, and the reporting entity may, within a single set of financial statements, apply both IFRS 9 and IAS 39 to its financial instruments). An assessment below the reporting entity level would mean that, in the consolidated financial statements of the group, insurance subsidiaries could apply IAS 39 but non-insurance subsidiaries would apply IFRS 9.

   Most users and most regulators (both prudential and security regulators) supported an assessment only at the reporting entity level. In contrast, most preparers, audit firms and accounting bodies, and some national

standard-setters supported an approach that allowed an assessment below the reporting entity level.

(d) Most users of financial statements were concerned that the ED proposed three options—an option to apply the temporary exemption (and continue to apply IAS 39), an option to apply IFRS 9 with the overlay approach, or an option to apply IFRS 9 without the overlay approach. In contrast, all other types of respondents supported these options and some strongly asserted that these options are necessary to enable different entities to reflect their specific facts and circumstances.

(e) Respondents had mixed views on whether there should be a fixed expiry date for the temporary exemption. Almost all users of financial statements, most regulators, and some standard-setters and audit firms, support the proposed fixed expiry date of 2021. In particular, most users and regulators support that fixed expiry date, regardless of the effective date of the forthcoming insurance contracts Standard. In contrast, most preparers say that the temporary exemption should expire on the mandatory effective date of the forthcoming insurance contracts Standard.

Overview of the Board's key decisions

8. This section summarises the Board's tentative decisions from its March and April 2016 meetings.

A temporary exemption from applying IFRS 9 for some entities

9. The Board tentatively decided to confirm the proposal in the ED to provide a temporary exemption for some, but not all, entities that issue contracts within the scope of IFRS 4. In confirming the proposal to provide a temporary exemption:

(a) The Board noted that the potential accounting mismatches and volatility that could arise as a result of the different effective dates could be addressed by applying either the overlay approach or the temporary exemption. Nevertheless, the Board acknowledged that there are

additional costs from applying the overlay approach compared to applying IFRS 9 without the overlay approach and also compared to continuing to apply IAS 39. The Board also noted that there would be costs, in particular for users, associated with entities delaying the application of IFRS 9, because entities that continue to apply IAS 39 would not provide the improved information required by IFRS 9, such as expected credit-loss information. As a result, the Board concluded that there should be both an overlay approach and a temporary exemption, with the temporary exemption limited to only some entities that issue contracts within the scope of IFRS 4.

(b) The Board was not persuaded by concerns that applying IFRS 9 before the forthcoming insurance contracts Standard is issued would be equivalent to 'applying IFRS 9 twice'. Those concerns often relate to the transition reliefs that the Board has tentatively decided to provide on initial application of the forthcoming insurance contracts Standard for those entities who have previously applied IFRS 9. Those transition reliefs would allow an entity to reassess the business model for some financial assets based on facts and circumstances that exist on the date of transition to the forthcoming insurance contracts Standard, and to designate or de-designate financial assets under the fair value option at that date. The Board believes that the incremental costs of first applying the insurance contracts Standard after applying IFRS 9 would be limited because:

(i) the transition reliefs would apply to some, but not all, financial assets. Even in those cases, the transition reliefs would not require a full reapplication of the requirements of IFRS 9 (because, for example, contractual cash flow characteristics are not reassessed);

(ii) the entity is expected to continue to use any expected credit loss systems put in place when it initially applied IFRS 9 (unless the entity intends to measure all financial assets at FVPL, which the Board understands is unlikely); and

(iii) the application of the transition reliefs is optional.

(c) The Board noted that feedback differed on whether there would be significant incremental costs arising from applying two accounting changes consecutively, rather than simultaneously. Further, the Board noted that all entities will have to apply IFRS 9 eventually and incur the costs necessary to do so. Accordingly, the Board placed less weight on the costs that some state may arise in applying IFRS 9 before the forthcoming insurance contracts Standard than on other considerations such as the potential for additional accounting mismatches that may be temporary.

Eligibility for the temporary exemption should be determined at the reporting entity level

10. The Board tentatively decided to confirm the ED proposal that eligibility for the temporary exemption should be determined only at the reporting entity level[2]. The Board noted that many respondents suggested that eligibility for the temporary exemption should also be determined below the reporting entity level.

11. Consistent with the feedback from many users of financial statements and regulators, the Board said it is more useful for a reporting entity to apply only one Standard, either IFRS 9 or IAS 39, to all its financial instruments than to have financial statements with inconsistent accounting policies —applying IFRS 9 to some financial instruments and IAS 39 to others. The Board agreed with those users that note:

    (a) that IFRS Standards require reporting entities to use consistent accounting policies because this enables the reporting entity to be compared with other reporting entities, and allows for a common understanding of all the reporting entity's assets and liabilities. Consistent accounting policies also reduce the accounting complexities arising from intra group transactions.

[2] Agenda Paper 14D *Relief for investors in associates and joint ventures* for May 2016 considers whether an exemption should be provided from requiring the entity's financial statements to be prepared using uniform accounting policies for financial instruments on application of the equity method when accounting for investments in associates and joint ventures under IAS 28 *Investments in Associates and Joint Ventures*.

(b) that financial statements that provide only IAS 39 information are acceptable because they provide a continuation of previous information and do not change accounting. Similarly, financial statements that provide only IFRS 9 information are acceptable because users view IFRS 9 as providing better information than that provided applying IAS 39. In contrast, financial statements that contain a mix of both IFRS 9 and IAS 39 information prompt additional changes that users of financial statements need to analyse, because they provide information that will be used for the first time and only for a temporary period; they provide no continuation of previous information; and they do not provide the information that will ultimately be required when applying the forthcoming insurance contract Standard.

(c) that although users analyse disaggregated information of a reporting entity, they nevertheless also rely on the information in the consolidated financial statements.

(d) that a change from reporting under IAS 39 to partial reporting under IFRS 9, followed by a later change to full reporting under IFRS 9 constitutes two major changes to accounting in a relatively short period of time, which undermines one significant reason for supporting the temporary exemption.

12. Accordingly, the Board notes that determining eligibility for the temporary exemption below the reporting entity level would not address concerns about the different effective dates of the forthcoming insurance contracts Standard and IFRS 9 without an unacceptable loss of comparability and understanding, and would also have the consequence of two accounting changes within a short period of time.

Qualifying criteria

13. The Board tentatively decided to modify the qualifying criteria for the temporary exemption to better preserve peer comparability between entities in the insurance industry. The Board acknowledged that 'perfect' comparability cannot be achieved through changes in the qualifying criteria, because 'perfect' comparability is achieved only if all entities apply IFRS 9 when it is effective or

by providing an exemption for all entities, which the Board believes would be a disproportionate response to the issues raised. Nonetheless, because many insurers issue investment contracts, the Board tentatively decided that, when an entity issues investment contracts measured at FVPL applying IAS 39, this should be considered to be an activity related to insurance (subject to the condition that an entity issues sufficient contracts within the scope of IFRS 4).

14. The Board noted that IFRS Standards do not include guidance related to specifically identifying investment contracts issued by insurers. However, regarding the issuing of investment contracts as an activity related to insurance, if they are accounted for at FVPL applying IAS 39, is a practical way to identify such investment contracts while excluding financial liabilities that are unrelated to insurance. The Board noted that entities generally measure at cost most non-derivative financial liabilities associated with activities unrelated to insurance. Furthermore, an entity that issues a substantial amount of investment contracts measured at cost would normally account for the assets linked to such contracts at amortised cost or available for sale applying IAS 39. Applying IFRS 9 would result in a significant improvement to the information reported for such assets.

15. The Board also tentatively decided that eligibility for the temporary exemption would be based on a quantitative ratio. The Board noted that the temporary exemption is intended to be in place for a short period. The Board thinks the scope for the exemption should be clearly described so it can be easily understood and consistently applied, and that using a quantitative test assists in achieving this.

16. Therefore, the Board tentatively decided that:

    (a) a qualifying entity must have as its predominant activities, activities that relate to insurance (the predominance criteria). Activities that relate to insurance are:

        (i) issuing contracts within the scope of IFRS 4; and

        (ii) issuing investment contracts accounted for at FVPL applying IAS 39.

    (b) an entity's activities are deemed to be predominantly related to insurance only if:

        (i) the predominance ratio is greater than 90 per cent; or

(ii) the predominance ratio is less than or equal to 90 per cent but greater than 80 per cent and the entity can provide evidence that it does not have a significant activity unrelated to insurance.

(c) the predominance ratio will be calculated as follows:

(i) the numerator: all liabilities arising from contracts related to insurance activities, including the other liabilities that are connected to those activities, such as tax and derivatives; and

(ii) the denominator: the total liabilities of the entity.

17. In addition, the Board confirmed that its objective is to provide the temporary exemption only to those entities that are appreciably affected by the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard. That is only the case if the entity issues contracts within the scope of IFRS 4 and has not previously applied IFRS 9. Accordingly, to qualify for the temporary exemption:

(a) the carrying amount of the entity’s liabilities arising from contracts within the scope of IFRS 4 is significant compared to the total carrying amount of its liabilities; and

(b) the entity must not have applied IFRS 9 previously (other than the own credit requirements in isolation).

The date of assessing eligibility for the temporary exemption

18. The Board tentatively decided to require an entity to compute the predominance ratio using the carrying amount of the liabilities reported on the entity’s balance sheet at its annual reporting date between 1 April 2015 and 31 March 2016 (the assessment date). The Board think that setting an assessment date earlier than 2018 will reduce the uncertainty of whether an entity would be required to implement IFRS 9 in 2018 and provide time for implementation.

19. Agenda Paper 14B *Reassessment of eligibility for the temporary exemption from applying IFRS 9* for May 2016 addresses whether the Board should require an entity to reassess if it still qualifies for the temporary exemption in particular circumstances (as proposed in the ED).

Expiry Date

20. The Board agrees with the feedback received from regulators and users of financial statements that a temporary exemption should be considered only if it is in place for a short period of time. Accordingly, the Board tentatively decided to confirm that there would be a fixed expiry date for the temporary exemption. The Board will discuss the actual expiry date (ie 2021 or another date) at the May 2016 meeting in Agenda Paper 14C *Fixed expiry dates and other aspects of the temporary exemption and the overlay approach* (14C).

Disclosures

21. The Board tentatively decided to:
    (a) confirm the disclosures for entities that apply the temporary exemption as proposed in the ED; and
    (b) add additional disclosures to provide further information. In adding additional disclosures, the Board sought to balance the potential costs to preparers against requests from users of financial statements and some regulators for more quantitative credit-risk information. Thus, the Board tentatively decided that for assets that do not have low credit risk (as described in IFRS 9) an entity should disclose fair value information along with the gross carrying amount of those assets applying IAS 39.

The overlay approach

22. The Board tentatively decided to confirm the ED proposal to provide an overlay approach. In the overlay approach, an entity applies IFRS 9 and then adjusts profit or loss to provide IAS 39 information for assets newly measured at FVPL in their entirety as result of applying IFRS 9. The Board noted that the overlay approach would:
    (a) address the issue of accounting mismatches and volatility in profit or loss through presentation, while resulting in the application of the IFRS 9 requirements that are a significant improvement over the existing IAS 39 requirements.

(b) be available for those entities that do not qualify for the temporary exemption, for example, because of their significant banking activities.

(c) be the preferred alternative of a few preparers that would have been eligible for the temporary exemption (applying the ED proposals), and most users of financial statements. Those users preferred the overlay approach to the temporary exemption because the overlay approach would provide additional information that could assist them in understanding the effect of changing from IAS 39 to IFRS 9.

23. The Board confirmed most of the aspects of the ED's proposals on the overlay approach but modified the presentation requirements by restricting the flexibility proposed in the ED. In particular, the Board tentatively decided to:

(a) specify that the presentation in profit or loss for financial assets to which the overlay approach is applied must reflect the application of IFRS 9, with a single, separate line item for the overlay adjustment; and

(b) require an entity to present in other comprehensive income (OCI), the overlay adjustment separate from other components of OCI, consistently with IAS 1 *Presentation of Financial Statements*.

The Board noted that doing so would increase comparability between the entities applying the overlay approach.

24. The Board noted that it would be difficult to provide further guidance on the eligibility of the qualifying assets and observed that the presentation and disclosure requirements provide transparency on how the entity has designated the assets subject to the overlay adjustment and the effects of doing so.

Expiry Date

25. Agenda Paper 14C for May 2016 will consider whether there should be a fixed expiry date for the overlay approach.

Should the temporary exemption and the overlay approach be optional?

26. The Board tentatively decided to confirm the ED proposal that both the temporary exemption and the overlay approach should be optional. While options, in general, reduce comparability between entities, the Board said that the significant

improvement of IFRS 9 compared to IAS 39 makes it inappropriate to prohibit a reporting entity from applying IFRS 9 in full by requiring the entity to apply the temporary exemption if it is eligible or by requiring it to apply the overlay approach. The Board also noted that some preparers do not have concerns arising from potential accounting mismatches (because, for example, they already measure their financial assets at FVPL) or do not wish to defer application of IFRS 9 (with or without applying the overlay approach).

27. However, the Board considered ways to alleviate users' concerns about the lack of comparability that might arise as a result of these options. The tentative decisions relating to additional disclosures under the temporary exemption assist in improving comparability among entities that elect the temporary exemption, and thus continue to apply IAS 39, and entities that apply IFRS 9 (see paragraph 21).

28. In addition, based on the feedback received, the Board said that some concerns about the lack of comparability could be alleviated in practice because entities in a particular jurisdiction that qualify for the temporary exemption are highly likely to make the same choice, for example, to apply IFRS 9 with or without the overlay approach, or continue to apply IAS 39. This could, for example, be due to similar drivers, for example, whether the entities' assets are already measured at FVPL, or due to the requirements imposed by regulators who may limit options in their jurisdiction.

Consequences of the Board's tentative decisions to date

29. Overall, the consequences of the Board's tentative decisions to date are as follows:

    (a) The overlay approach would be an option available to address any accounting mismatches and additional volatility that may arise if IFRS 9 is applied before the forthcoming insurance contracts Standard is issued. The Board expects that the overlay approach would be applied by entities that do not qualify for the temporary exemption and by entities for which applying IFRS 9 with an overlay adjustment is the most cost-effective choice.

(b) The temporary exemption would be an option available for many reporting entities most affected by the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard. Amendments to the qualifying criteria are intended to better capture the appropriate entities—those that many consider as 'insurers'— and would result in a larger population of qualifying entities than under the ED's proposals.

(c) The temporary exemption would have a fixed expiry date. This means that all entities would need to apply IFRS 9 after the fixed expiry date, even if the forthcoming insurance contracts Standard is not yet effective. However, the staff expects that in setting this fixed expiry date, the Board will consider the likely effective date of the forthcoming insurance contracts Standard.

30. The consequences of the Board's tentative decisions are that the temporary exemption would not be available to some reporting entities with insurance activities (see paragraph 31). The changes that the Board has tentatively decided to make to the qualifying criteria should increase comparability within the insurance sector compared to the ED proposals, while at the same time ensuring that any reporting entities with significant non-insurance related activities, such as banking, would continue not to qualify for the temporary exemption.

31. An example of a reporting entity that will not qualify for the temporary exemption is a conglomerate with insurance activities and significant activities unrelated to insurance. The Board notes that for such entities:

(a) the entity would be required to apply IFRS 9 to all financial instruments reported in its consolidated financial statements. The overlay approach would be available to address any additional volatility and accounting mismatches in the entity's insurance activities arising from the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard.

(b) The entity could choose to produce segmental information in accordance with IFRS 8 *Operating Segments* for its insurance activities using IAS 39, if such information is used in internal management reports, to facilitate comparison with other insurers applying IAS 39. If

the entity did not produce such information in internal management reports, the entity could still choose to disclose additional information for its insurance activities using IAS 39.

(c) In addition, if an individual reporting entity, such as a subsidiary, undertakes insurance activities, and prepares individual financial statements, the temporary exemption could be applied in those individual financial statements. Accordingly, that insurance subsidiary could choose to apply IAS 39 to all the financial instruments reported in its individual financial statements when it qualifies for the temporary exemption. However, the subsidiary would still need to produce IFRS 9 information for the consolidated financial statements. In some cases, an entity may decide that the cost of applying the temporary exemption (ie IAS 39) in its individual financial statements and preparing IFRS 9 information for consolidation purposes is justified.

32. The Board said the outcome described in paragraph 31 is appropriate because evidence gathered in outreach during the comment period showed that entities, such as bancassurers[3], are typically compared with other bancassurers and with banks, and not with insurers.

[3] The Longman Business English Dictionary defines 'bancassurance' as the combining of banking and insurance activities in one organization (accessed on 4 May 2016 at http://lexicon.ft.com/). The Oxford Dictionary defines 'bancassurance' as the selling of life assurance and other insurance products and services by banking institutions (accessed on 4 May 2016 at http://www.oxforddictionaries.com/).

Appendix: Qualification for the temporary exemption

A1. This flow chart illustrates the process for determining if an entity qualifies for the temporary exemption.