

STAFF PAPER

March 2016

IASB Meeting

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|--------------------|---|-------------------|---------------------|
| Project | Amendment to IFRS 4: Applying IFRS 9 <i>Financial Instruments</i> with IFRS 4 <i>Insurance Contracts</i> | | |
| Paper topic | Summary of feedback from users of financial statements | | |
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Purpose of this paper

1. This paper summarises feedback from users of financial statements (ie investors and analysts) on the proposals set out in the Exposure Draft *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* (Proposed amendments to IFRS 4) ('the ED').
2. The outreach was conducted by the Board members and staff between November 2015 and March 2016. This outreach supplemented the outreach performed in August and September 2015¹ to develop proposals for the ED and aimed to:
 - (a) check whether views from previous outreach are still valid;
 - (b) obtain views on the detailed proposals set out in the ED; and
 - (c) deepen our understanding of what information would be useful to users of financial statements, and why.

Consequently, we have conducted outreach with a variety of users across different jurisdictions and profiles.

3. This paper is for information only.

¹ Agenda Paper 14A *Feedback from user outreach and submissions* for the September 2015 meeting discusses the results of the outreach conducted in August and September 2015 and is available on the project website page.

Structure of this paper

4. This paper is structured as follows:
 - (a) statistics and demographic analysis of the user outreach (paragraphs 6-13);
 - (b) summary of feedback (paragraphs 14-22);
 - (c) detailed feedback on the following topics:
 - (i) concerns about the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard (paragraphs 23-31);
 - (ii) the overlay approach (paragraphs 32-37);
 - (iii) the temporary exemption from applying IFRS 9 (the deferral approach) (paragraphs 38-47);
 - (iv) whether the proposed approaches should be mandatory or optional (paragraphs 48-49); and
 - (v) whether an expiry date of 1 January 2021 should be set for the deferral approach (paragraph 50).
5. The Appendix includes explanatory materials used by Board members and staff in the outreach.

Statistics and demographic analysis

Previous outreach

6. During August and September 2015, Board members and staff conducted 42 meetings and calls with over 50 users of financial statements to understand their views on the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard and the possible approaches that might address concerns raised by some interested parties.
7. The geographical coverage of interactions with users of financial statements is set out below:

- (a) almost half of all calls and meetings were with European users of financial statements;
 - (b) around 40% were with Australian and Asian users of financial statements (approx. 20% for each), and
 - (c) the remaining 14% were divided between users of financial statements in North and South America.
8. The profile and industry focus for users of financial statements that provided feedback was as follows:
- (a) 74% were sell-side equity analysts. Most of these analysts specialised in the insurance industry and some had a broader focus on financial institutions. The sell-side analysts came from various jurisdictions.
 - (b) The remaining 26% were represented by:
 - (i) various buy-side equity analysts, some of which specialised in the insurance industry and some of which had a broader financial institutions focus. The buy-side analysts mainly came from Europe, but some were from the United States.
 - (ii) credit analysts from rating agencies who focussed on the insurance industry. Credit analysts did not represent a significant portion of our outreach.
9. In addition, the Board also received two written submissions, from Keefe, Bruyette and Woods and from Autonomous Research LLP with the CFA Institute.²

Recent outreach

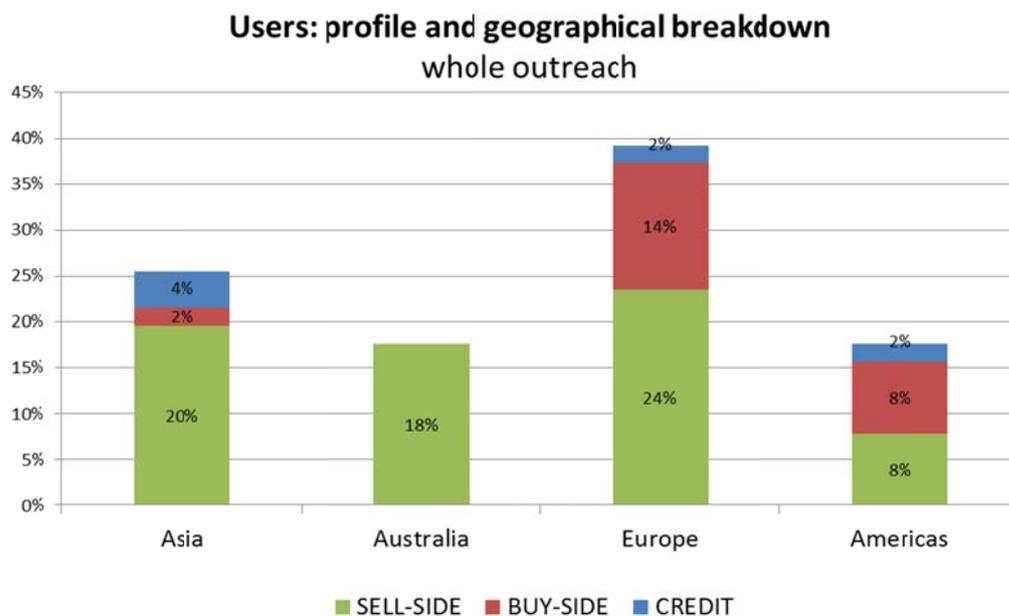
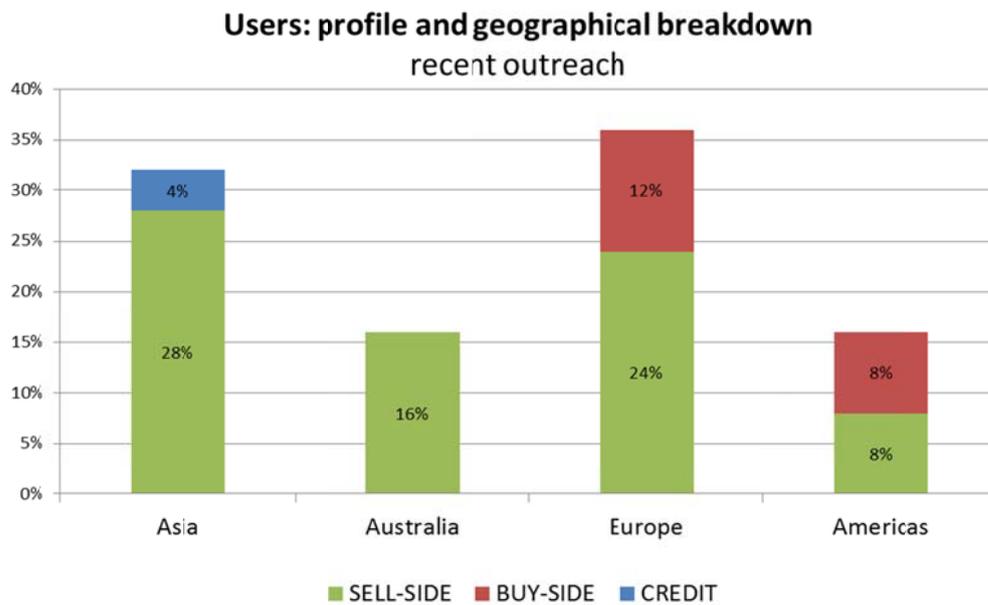
10. Between November 2015 and March 2016, Board members and staff received feedback on the proposals in the ED from 70 users of financial statements in 28 meetings, calls and emails. Among those interactions with users:

² These responses were reproduced in Agenda Paper 14A for the September 2015 meeting.

- (a) over 60% were follow-up interactions with users with whom we had previously discussed this project; and
 - (b) almost 40% was interaction with users of financial statements with whom we had not previously spoken.
11. In the current outreach we aimed to achieve a broader representation of users' profiles and jurisdictions:
- (a) In terms of geographical representation, we have increased representation from Asia (from below 20% during previous outreach to 25% overall) and from the Americas (from 14% during previous outreach to 18% for the overall outreach ie current and previous outreach).
 - (b) In terms of profile we have increased the share of users of financial statements that are not insurance specialists from 10% during previous outreach to 25% for the overall outreach. Those users of financial statements focus their analysis mostly on financial conglomerates (17%), banks (2%) or non-financial institutions (6%).
 - (c) We have conducted outreach with groups of users with diverse geographical spread and with wide focus for their analysis, including the Capital Market Advisory Committee (CMAC) at its February 2016 meeting.³ Interactions with groups of different types of users at the same meetings helped in understanding the reasons for different views.
12. In addition, the Board received comment letters from Ascent Partners Limited (comment letter no 1) and the Corporate Reporting Users' Forum (CRUF) (comment letter no 93).

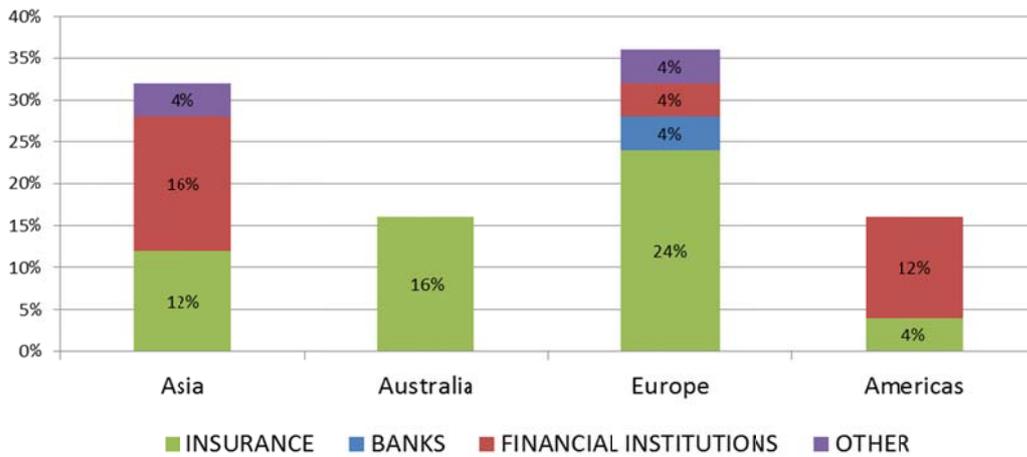
³ CMAC is the advisory body independent of the IASB and the IFRS Foundation, with the specific aim to provide the IASB with regular input from the international community of users of financial statements. The meetings of CMAC are public.

13. The following charts provide a demographic analysis of users we have interactions with by jurisdiction and profile:⁴
- (a) during the recent outreach performed during the period from November 2015 to March 2016; and
 - (b) during the entire outreach, including both previous and recent outreach.

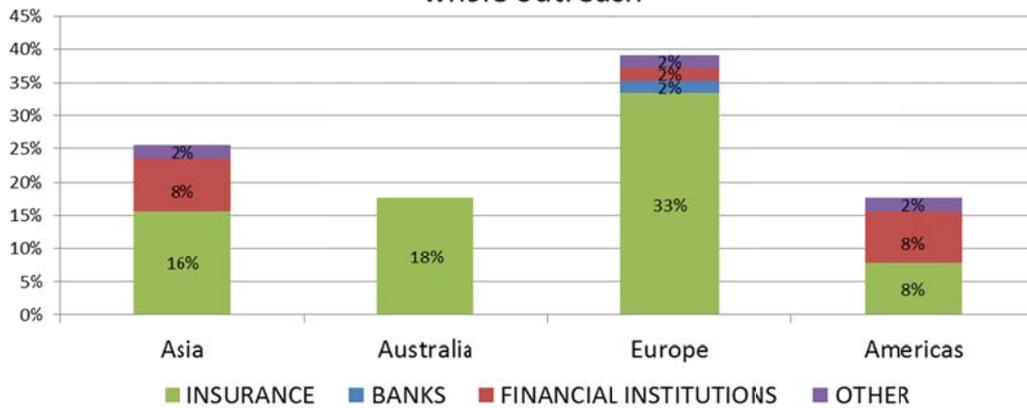


⁴ Please note that the charts do not include discussions with mixed groups of users, explained in paragraph 11c.

Users: industry focus and geographical breakdown
recent outreach



Users: industry focus and geographical breakdown
whole outreach



Summary of feedback

Concerns raised

- 14. Consistently with the feedback received in the previous outreach, we have heard mixed views on whether the different mandatory effective dates of IFRS 9 and the forthcoming insurance contracts Standard would make the financial statements of entities that issue insurance contracts less understandable and create disruption for users of financial statements.

15. Many users of financial statements from different jurisdictions told us that any increased volatility that may arise in profit or loss when IFRS 9 is applied in conjunction with IFRS 4 would not make their analysis more difficult, because:
- (a) they do not focus only on profit or loss but use other metrics to understand the performance of insurance companies; and
 - (b) they note that volatility already exists in profit or loss and they do not expect increased volatility to change their analysis significantly. This view was expressed by CMAC and CRUF, among others.
16. Other users of financial statements said that increased volatility would be unhelpful and would make the insurance industry appear more uncertain and less attractive for investment. This view was heard more from European and Asian users of financial statements that follow the insurance industry. During current outreach the share of insurance specialists was lower compared to the previous outreach; consequently overall we have heard less concern related to the different effective dates.
17. In general, users of financial statements who expressed concerns about potential increased volatility in profit or loss also tended to have concerns about two consecutive changes in accounting in a short period of time.

Approaches proposed

18. Consistently with the feedback in the previous outreach, we have heard mixed views on whether anything should be done, and if so what, to address any concerns about the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard. When expressing their views, users of financial statements weigh concerns about different effective dates against the potential lack of comparability created by the proposed approaches.
- (a) Many users of financial statements, including CRUF and CMAC, did not think that any solution was needed. They noted that IFRS 9 is an improvement over IAS 39 *Financial Instruments: Recognition and Measurement* and therefore should be applied by everyone at the same

time and should not be delayed pending an unspecified completion date of the forthcoming insurance contracts Standard.

(b) Most users of financial statements across all profiles, industry focusses and jurisdictions (irrespective of their views on whether an approach was needed at all and /or their preferred approach) thought that providing two approaches, especially if they are optional, would decrease comparability and would be confusing. Consequently, if an approach was introduced, most users of financial statements preferred only one approach and many preferred that any such approach introduced should be mandatory.

19. Most users of financial statements, including CRUF and CMAC, preferred (or would more readily accept) the overlay approach. They thought that this approach would be a good compromise because it provides comparable information about financial instruments with other entities and removes volatility in a transparent way. Users of financial statements had mixed views on the choice of presentation proposed in the ED but all users of financial statements thought that the disclosures proposed in the ED to accompany the overlay approach would provide useful information.
20. Many users of financial statements did not support any deferral of IFRS 9. They argued that it introduces lack of comparability, creates accounting arbitrage and reduces information content. Those users of financial statements who supported the deferral approach were mainly insurance analysts from Europe, Canada and Asia. Insurance specialists focus their analysis on the insurance sector and consequently are likely to be less concerned about comparability with other sectors. Compared to the previous outreach, the support for the deferral approach during current outreach was lower because we spoke more with users of financial statements that follow financial conglomerates and entities with non-insurance activities.
21. If the Board were to proceed with the deferral approach, most users of financial statements, including CRUF and CMAC, commented on the ED proposals as follows:

- (a) They support deferring IFRS 9 at the reporting level, mainly because it avoids applying two Standards for financial assets in a single set of financial statements including consolidated financial statements.
 - (b) They want comparability within the insurance sector and therefore some users of financial statements suggested specific amendments to the proposed eligibility criteria to capture entities they consider to be within the insurance sector (which would generally increase the eligible population).
 - (c) They agreed that entities should not be able to defer IFRS 9 after 1 January 2021 (even considering that the effective date of the forthcoming insurance contracts Standard is still uncertain). Some strongly emphasised that the deferral approach should be temporary and therefore available only for a short period of time.
22. Some users of financial statements, including CMAC, urged the Board to complete the Insurance Contracts project as soon as possible. They noted that, in regard to entities in the insurance industry, the main source of concerns for users of financial statements is related to the current lack of transparency and comparability of insurance contracts liabilities.

Detailed feedback

Views on increased volatility

23. As stated in paragraph 14, consistently with previous outreach, users of financial statements expressed mixed views on whether financial statements of insurance entities would be less understandable as a result of any increased volatility that may arise in profit or loss when IFRS 9 is applied in conjunction with IFRS 4. We have discussed concerns related to the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard in detail during previous outreach; consequently the discussion on this topic during current outreach was focused on checking whether views from previous outreach are still valid and to consider any additional rationale for the views.

Some users of financial statements are not concerned about increased volatility

24. Some users of financial statements said that increased volatility in profit or loss would not affect their analysis. This is because they do not focus their analysis only on the statement of profit or loss (because it does not provide comprehensive information about the entity's performance), but also on cash flows, ability to pay dividends or non-GAAP measures. For example, Asian users of financial statements noted that they focus on embedded value and European users of financial statements focus on operating or adjusted profit.
25. Some users of financial statements said that volatility in profit or loss would not confuse specialist users of financial statements because volatility currently exists and those users are used to addressing it. For example, users of financial statements from Australia noted that current values are already commonly used for both financial assets and insurance contracts in their jurisdiction so they are used to analysing it.
26. Some users of financial statements from various jurisdictions thought that an increase in volatility in profit or loss for entities that issue insurance contracts would not take place or, if it does, it would not be significant and therefore should not make a difference to their analysis. For example,
- (a) some users of financial statements from Latin America stated that insurance entities in their jurisdiction tend to invest in 'plain vanilla' government bonds. They did not expect the classification of those bonds to change as a result of applying IFRS 9 and therefore they did not expect to see increased volatility in profit or loss on application of IFRS 9.
 - (b) some users of financial statements from Australia and Canada noted that insurance contracts in their jurisdiction are already measured at current value. Consequently, they thought that if additional financial assets are measured at fair value through profit or loss as a result of applying IFRS 9, this might decrease, rather than increase, the volatility in profit or loss.

Some users of financial statements are concerned about increased volatility

27. Some insurance specialists from Europe and those with more general outlook in Asia, expressed concerns about increased volatility in profit or loss, because such volatility:
- (a) would make financial statements of insurance entities even less understandable for investors and in their view would make the insurance industry less attractive for investment. They pointed out that many non-specialist users of financial statements would not be interested in digesting the reasons for increased volatility but would see it as an increase in uncertainty and apply a higher valuation discount to insurance stocks.
 - (b) would make it more difficult to predict long-term economic performance of insurance entities and to forecast earnings based on profit or loss information. They stated that this would result in an increased focus on alternative performance measures. They said that even the existing level of volatility in equity markets makes it difficult for analysts to understand financial performance of insurance entities.
28. Regardless of their view on volatility, a few users of financial statements:
- (a) stated that it is important for them to be able to understand the sources of volatility and to distinguish between economic and accounting volatility.
 - (b) expressed a concern as to whether increased volatility would affect regulatory capital.

Views on two consecutive accounting changes

29. Consistently with the feedback received in the previous outreach, users of financial statements expressed mixed views on whether consecutive changes in two accounting Standards would have any significant impact on their analysis.

Most users of financial statements who were concerned about increased volatility were also concerned about these two consecutive changes.

30. Some users of financial statements said that ideally the effective dates of IFRS 9 and the forthcoming insurance contracts Standard should be aligned.
- (a) However, some did not think that the Board needed to address the existing situation of different effective dates. They thought that similar situations could occur for other changes in Standards, and that if the Board delayed implementation of some Standards in order to align them with implementation of other Standards for only a particular population of entities then it would be difficult to achieve improved financial reporting over time.
 - (b) Other users of financial statements stated that frequent changes to valuation models are undesirable because they might lose trend information that is important in their analysis (some users of financial statements noted that changes are considered frequent only if the time difference between those changes is at most two or three years).
31. Other users of financial statements did not think that a simultaneous accounting change to IFRS 9 and the forthcoming insurance contracts Standard is in fact desirable and / or needed. Those users of financial statements made the following observations:
- (a) Two consecutive sets of accounting changes would make it easier for them to understand the separate effects of each change and to adjust their models appropriately.
 - (b) Continuous accounting change is inevitable (as explained in paragraph 30(a)). In addition, some stated that because of frequent regulatory and other changes they have learned how to follow dynamic changes in regulation and reporting (caused also by changes done by entities in their accounting policies) and recalibrate their models. This view was noted at the CMAC meeting.

Views on the overlay approach*Views on the approach overall*

32. Consistently with the previous outreach, most users of financial statements expressed support for the overlay approach.
- (a) Most users of financial statements preferred this approach over the deferral approach.
 - (b) Others could accept this approach even if they preferred that nothing is done to address the difference in the effective dates or the deferral approach.
33. Many users of financial statements found the overlay approach attractive, or at least acceptable, because they thought that it would provide a good compromise between comparability between all entities and transparency in addressing the concerns about potential increased volatility in profit or loss. Specifically, they noted that the overlay approach would:
- (a) provide IFRS 9 information about financial instruments on the statement of financial position for all entities, which would promote comparability;
 - (b) address the concerns about any increased volatility in profit or loss in a transparent manner by reclassifying any such volatility to other comprehensive income ('OCI') while providing useful information about the effects of applying IFRS 9; and
 - (c) be easy to understand.
34. Some users of financial statements who supported the overlay approach nevertheless noted some of its potential disadvantages:
- (a) income and expenses included in OCI are often overlooked by less sophisticated users of financial statements, whose main focus is on profit or loss; and
 - (b) judgement may be involved in determining the overlay adjustment (see more details in paragraph 35).

Scope

35. Most users of financial statements that commented on this topic supported proposals in the ED on the financial assets that would be eligible for the overlay approach. However, a few Asian users of financial statements expressed a concern that entities may be able to apply the overlay approach to financial assets that have no economic relation to insurance contracts. Those users of financial statements emphasised the importance of disclosures that would explain which financial assets the overlay approach has been applied to and how the entity has designated those financial assets.

Presentation and disclosure

36. Users of financial statements expressed mixed views on the proposed presentation requirements:
- (a) Some users of financial statements did not object to and/or supported the proposed presentation alternatives in the ED. They thought that the presentation format is not important provided that the information about the effect of the overlay adjustment is provided in the financial statements.
 - (b) Some users of financial statements thought that presentation alternatives should not be permitted because they reduce comparability between entities.
 - (i) Some users of financial statements had no preference as to which presentation alternative is preferable provided that all entities present information in the same way.
 - (ii) Some users of financial statements believed that information in profit or loss should be based on IFRS 9 requirements and the adjustment should be presented as a separate line item in profit or loss. This is because such presentation would provide better comparability between all entities. In addition, in their view, such presentation would make the adjustment more transparent and signal to users of

financial statements that some income and expenses are included in OCI.

- (iii) A few users of financial statements thought that it would be more helpful if entities presented information in profit or loss based on the requirements in IAS 39 (ie include the adjustment within individual line items in profit or loss), because that would make it easier to observe trend information until the forthcoming insurance contracts Standard is applied.

37. All users of financial statements thought that disclosures proposed in the ED would provide useful information about the effect of the overlay approach. In addition,

- (a) as stated in paragraph 35, a few Asian users of financial statements emphasised the importance of disclosures that would explain which financial assets the overlay approach was applied to and how the entity designated those financial assets.
- (b) a few Asian users of financial statements noted that they prefer the quantitative rather than qualitative disclosures.

Views on the deferral approach

Views on the approach overall

38. Consistently with the previous outreach, many users of financial statements did not support any deferral of IFRS 9. They stated that:

- (a) IFRS 9 would provide improved information about financial instruments (such as, for example, improved impairment and disclosures) and those improvements should not be deferred for some entities.
- (b) Deferral of IFRS 9 would create a lack of comparability between entities that will apply IFRS 9 immediately and those that will defer the application of IFRS 9. Many believed that this non-comparability is not justified by a difference in effective dates of IFRS 9 and another

accounting Standard. In addition, some users of financial statements felt that creating such an exception for the insurance industry could add to the perception that insurance entities are different and difficult to understand.

39. Those users of financial statements who supported deferring IFRS 9 tended to come from Europe, Canada and Asia and specialise in the insurance industry. They expressed concerns about the different effective dates and they were not concerned about cross-sector comparability because they mainly follow insurance entities.

Below or at the reporting entity level

40. If the Board were to pursue the deferral approach, many users of financial statements from different jurisdictions would prefer the deferral to apply at the reporting entity level. This is because they were concerned about the implications on application of deferring IFRS 9 below the reporting entity level, such as:
- (a) applying both IFRS 9 and IAS 39 to the financial assets in one consolidated financial statement. They believed that such an approach would make financial statements more complex to understand and compare. They prefer the financial statement to provide either continuation of IAS 39 information or improved IFRS 9 information. This concern was raised by some users of financial statements from Asia and Europe and both CMAC and CRUF; and
 - (b) transfers of financial assets between subsidiaries and the accounting arbitrage opportunities that might arise from those transfers. This concern was raised by specialist users of financial statements in different jurisdictions. A few users of financial statements noted that transfers of assets could be quite common but one thought that it might be limited by regulation in some jurisdictions.
41. However, a few users of financial statements from Europe, Asia and Canada would prefer the deferral to apply below the reporting entity level. They stated that:

- (a) they look at the insurance activities and banking activities of an entity on a stand-alone or segmental basis. Consequently, any deferral below the reporting entity level would make it easier for them to compare the insurance activities and banking activities of a single entity with stand-alone banks and insurance entities.
- (b) it could be confusing if the accounting Standard that was applied in an entity's separate financial statements was different from the accounting Standard applied to the same entity in its parent's consolidated financial statements.

Predominant insurance activity

- 42. Many users of financial statements didn't object to the proposed assessment of predominant activity based on the level of insurance liabilities relative to the entity's total liabilities. This is because they considered such an approach to be simple to understand and objective.
- 43. However, a few users of financial statements from Asia expressed a concern that such assessment of predominant activity might not provide comparable results across different jurisdictions. They noted that in the current environment with low interest rates, insurance liabilities measured on a cost basis would have lower carrying values than identical insurance liabilities measured on a current value basis. Consequently, in jurisdictions where insurance liabilities are measured on a cost basis, an entity would need to have more insurance activities in order to qualify for the deferral approach compared to jurisdictions where insurance liabilities are measured on a current value basis.
- 44. Many users of financial statements, including CRUF, emphasised that they would prefer all entities that they considered peers from the insurance sector to be comparable and apply the same accounting basis for financial assets (which would generally increase population for the deferral approach). However, some users of financial statements also noted that in some cases different users of financial statements may take different views on which entities belong to the same sector and should therefore be comparable. Their perspective may depend on the focus

of their analysis (only the insurance sector or including other sectors) and the geographical spread of entities that they analyse.

45. Some users of financial statements made the following observations about the assessment of ‘predominant activity’:

- (a) Some users of financial statements noted that insurance entities undertake many activities that are related to providing insurance service, for example hedging or general business activities such as paying taxes, pensions etc. They argued that an entity should not be disqualified from being considered an insurance entity (and as a consequence from being able to apply the deferral approach) because it has significant liabilities that are not insurance liabilities, but that are related to insurance activities or to general business activities.
- (b) European and Canadian users of financial statements said that insurance entities in their jurisdictions often provide asset management services and such entities are typically compared with pure insurance entities. Consequently, they argued that asset management activity should not cause an entity to be disqualified being able to apply the deferral approach.
- (c) Many users of financial statements stated that they would not like entities with significant banking activity to be able to defer application of IFRS 9. However, many users of financial statements could accept deferral of IFRS 9 even if an entity has some banking activity as long as it is not significant for the reporting entity. For example, users of financial statements from Asia noted that many entities in their jurisdiction are either pure insurance entities or financial conglomerates with banking activity. Users of financial statements had different views on which approach should be applied to such entities:
 - (i) Some users of financial statements stated that such financial conglomerate entities are compared with banks and therefore deferral would not be helpful. Most thought

that the overlay approach would be more appropriate for those entities.

- (ii) Some users of financial statements stated that deferral below the reporting entity level would be more appropriate for such entities, because they analyse banking and insurance activity of such entities separately (see more in paragraph 41).
- (d) A few users of financial statements suggested other ways of defining ‘insurance entity’, such as:
 - (i) using known classification metrics to identify insurance entities such as an equity index, for example the MSCI/FTSE classification. However, there was no consensus view on which metric would identify all insurance entities that all users of financial statements would like to compare.
 - (ii) using a more comprehensive approach considering regulatory criteria as a starting point (however they noted that they were concerned that regulation differs between jurisdictions and this could lead to a lack of comparability).

Disclosures

46. Many users of financial statements that commented on this topic thought that disclosures proposed in the ED for entities that defer IFRS 9 should improve comparability with entities that apply IFRS 9. Furthermore, those users of financial statements stated that more disclosures of IFRS 9 information should be required compared to the disclosures proposed in the ED. Out of those users:
- (a) Many users of financial statements did not provide specific examples of such additional disclosures.
 - (b) Some users of financial statements, including CMAC and CRUF, stated that the Board should require more disclosures of information about expected credit losses, including quantitative information. They felt that loss of information about expected credit losses is unjustified as a

side effect of addressing concerns related to the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard. In addition, one user specifically noted that entities that mostly invest in simple bonds may not report any increased volatility as a result of applying IFRS 9 but would still be able to defer the application of IFRS 9 and continue to apply impairment requirements from IAS 39.

- (c) If the Board were to introduce the deferral below the reporting level, some users of financial statements asked for disclosures explaining the effect of the asset transfers between subsidiaries for consolidated financial statement and more information about the effect of applying two accounting Standards in a single financial statement.

47. Other users of financial statements did not object to the disclosures proposed in the ED.

Optional or mandatory approaches

48. Many users of financial statements, including CMAC and CRUF, expressed a preference for any approach to be mandatory rather than optional. Their reason was to promote comparability at least within the insurance sector even if cross-sector comparability is not achieved. Some of those users were less concerned about optionality of the overlay approach compared to the deferral approach, because of the different information content, transparency and lack of comparability caused by those approaches.

49. Some users of financial statements did not object to the approaches being optional. They stated that:

- (a) the insurance sector is already non-comparable because of the diversity in accounting for insurance contracts and that the added lack of comparability for financial assets would not significantly complicate their analysis, especially if the proposals are only temporary measures.
- (b) an entity should always be allowed to use an improved Standard. It is especially important for entities that at present report their liabilities on

the current value basis; application of IFRS 9 might decrease their volatility in the profit or loss statement.

- (c) there is market discipline and similar entities are likely to apply the same approach even if they have a choice between different approaches. One user noted that he expects that some regulators might allow or require only one approach. Thus, in practices, consistency may arise in those jurisdictions.

Expiry date for the deferral of IFRS 9

50. Almost all users of financial statements, including CRUF and CMAC, that commented on the expiry date noted that the proposed expiry date is important and agreed that it should be set at 1 January 2021. They noted that such a date emphasises that the deferral is designed as a temporary measure and can only be accepted as such. They noted that the focus should be placed on finishing the forthcoming insurance contracts Standard as soon as possible. A few users of financial statements provided additional comments, as follows:

- (a) Some were concerned that it might be difficult to uphold the proposed expiry date if the forthcoming insurance contracts Standard is delayed and entities request deferring IFRS 9 for additional period of time.
- (b) One argued that if the forthcoming insurance contracts Standard is postponed by another year, but only one year, the deferral should be extended for this additional period.
- (c) One suggested that the expiry date should also apply to the overlay approach. This is because this approach is also designed to be temporary.

Question

Do the Board members have any questions on the summary of the feedback received?

Appendix: explanatory materials used by Board members and staff in the outreach



Please print the slides in colour, if possible.

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Objective

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- Our objective is to ensure that users of financial statements are provided with useful information about entities that issue insurance contracts. We therefore seek to understand investors' views on the proposals that seek to address concerns about different effective dates of the new accounting requirements for financial instruments and insurance contracts.
- Those proposals:
 - permit *all* insurers to adjust profit or loss to remove any additional volatility (**the Overlay Approach**); and
 - permit *some* insurers to defer the application of the new accounting requirements for financial instruments (**the Deferral Approach**).

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Background

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- The Board expects to finalise a new insurance contracts Standard in 2016
 - The new Standard will introduce consistent accounting for all insurance contracts and require entities to measure insurance contracts on a current basis.
 - The forthcoming changes will likely not be effective before 2020.
- In July 2014, the Board issued IFRS 9 *Financial Instruments*
 - IFRS 9 sets out financial reporting requirements for financial instruments and is effective from 1 January 2018
 - IFRS 9 sets out a more logical classification model with complex financial assets measured at fair value, a better impairment model and more flexible hedge accounting
- Some raised concerns about different effective dates of IFRS 9 and the new insurance contracts Standard
 - the complexity of two consecutive major accounting changes; and
 - additional volatility in profit or loss that could arise when the new accounting requirements for financial instruments are applied in conjunction with the current accounting requirements for insurance contracts
- Some suggested that the effective date of IFRS 9 should be deferred for insurers and aligned with the effective date of the new insurance contracts Standard

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Timeline

4

Flexibility of both IAS 39* and IFRS 4** do not give rise to concerns about accounting volatility in profit or loss

Interaction of IFRS 9 and IFRS 4 may result in increased accounting volatility in profit or loss

Interaction of IFRS 9 and the new insurance contracts Standard assists in reducing accounting volatility in profit or loss



*IAS 39 *Financial Instruments: Recognition and Measurement* is pre-IFRS 9

**IFRS 4 *Insurance Contracts* sets out the current accounting requirements for insurance contracts

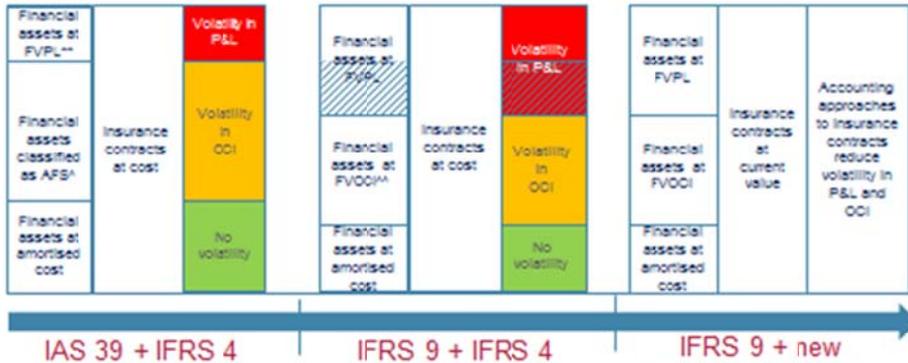
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Why volatility in profit or loss may increase: illustration

5

- The charts below illustrate the interaction of accounting for financial assets and insurance contracts
- Volatility in P&L and OCI* may comprise accounting & economic mismatch between financial assets and insurance contracts
- The shaded area on the second chart represents the increased volatility in P&L that could arise for some entities
- The sizes of boxes do not represent the relative size of different populations; they are used merely for illustration



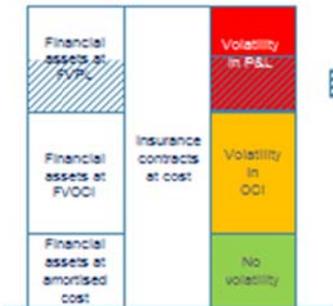
*Profit or loss and Other Comprehensive Income
 **Fair value through profit or loss
 †Available-for-sale
 ‡Fair value through OCI

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Potential sources of increased volatility in profit or loss

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IFRS 9 + IFRS 4

Examples of financial assets measured at FVPL under IFRS 9 that would not be so measured under IAS 39:

- Structured debt
- Convertible debt
- Puttable investments in mutual funds
- Equity investments (if an entity does not select OCI option)

For many assets, classification may not change when IFRS 9 is applied
 Note: Insurers use a variety of models to account for insurance contracts

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Question 1: Different effective dates

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Do you have concerns about different effective dates of IFRS 9 and the new insurance contracts Standard, in particular about:

- A. Any increased volatility in profit or loss that could arise for some insurers?
- B. Two consecutive major accounting changes?

Why or why not? Do you agree that the Board should address those concerns?

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IFRS Standards

The Overlay Approach

An option for *all* entities that issue insurance contracts that applies to *some* of their financial assets

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The Overlay Approach Overview

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- IFRS 9 is applied from 1 January 2018
- All insurers are permitted to adjust P&L and to reclassify to OCI
 - the difference between the amounts recognised under IFRS 9 and the amounts that would have been recognised under IAS 39
 - for financial assets that are designated as related to insurance activities and are measured at FVPL under IFRS 9 and would not be so measured under IAS 39
- Presentation of the overlay adjustment
 - as a separate line item or within the adjusted line items in profit or loss,
 - however, must be a separate line item in OCI if not so presented in profit or loss
- The objective is to remove from profit or loss any increased volatility in a transparent and consistent manner

Statement of Comprehensive Income

| | 20XX |
|-----------------------------------|----------|
| <i>Profit or loss</i> | |
| Insurance contracts revenue | X |
| Incurred claims and expenses | (X) |
| Operating result | X |
| Investment income | X |
| Interest on insurance liability | (X) |
| Investment result | X |
| ... | |
| Profit or loss | X |
| <i>Other comprehensive income</i> | X |
| Overlay adjustment | X |
| Total comprehensive income | X |

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The Overlay Approach Disclosure

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- Enable users of financial statements to understand how the overlay adjustment is calculated and its effect on the financial statements
 - The fact that the entity applied the overlay approach
 - The basis for determining the financial assets to which the overlay approach is applied
 - Carrying amounts and classes of the financial assets to which the reclassified amount relates
 - An explanation of how the amount reclassified from profit or loss was derived and the effect of the reclassification on each line item in profit or loss
 - The information about effects of any changes in designated financial assets in a reporting period

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Question 2: The Overlay Approach

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- A. In your view, does the Overlay Approach represent an acceptable approach to addressing concerns about different effective dates of IFRS 9 and the new insurance contracts Standard? Would that approach provide useful information? Why or why not?
- B. Do you agree that the Overlay Approach should apply to financial assets that are designated as related to insurance activities and are measured at FVPL as a result of applying IFRS 9?
- C. In your view, would the proposed presentation and disclosure requirements enable meaningful comparison between entities that apply the Overlay Approach and those that do not? If not, what other presentation and disclosure requirements would be useful?

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IFRS Standards

The Deferral Approach

An option for *some* entities that issue insurance contracts that applies to *all* of their financial assets

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The Deferral Approach Predominant activity

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- Applied to the entity as a whole and available for 'pure' insurers only
- Insurance activity must be predominant for the entity
- Predominance is assessed based on the entity's liabilities from insurance contracts
- If one quarter of the entity's activities is not insurance (eg banking)
 - the predominance condition would not be met
 - the entity would not be permitted to apply the deferral

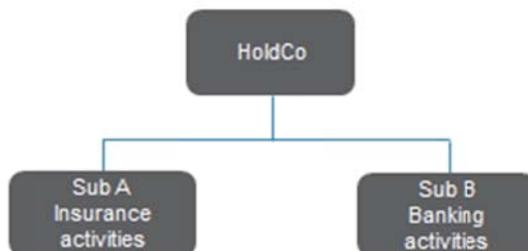
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The Deferral Approach Illustration

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- Consider a financial conglomerate that issues insurance contracts and undertakes banking activities.



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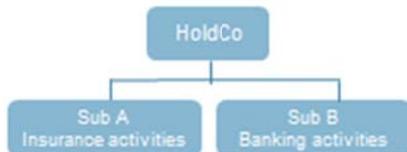


The Deferral Approach Reporting entity level

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IFRS 9 IAS 39

- If the predominant activity of the conglomerate is insurance business
- If the predominant activity of the conglomerate is NOT insurance business



- The conglomerate is permitted continue to apply IAS 39 to **all** financial assets in consolidated financial statements
- Note: if Sub B publishes standalone financial statements it must apply IFRS 9 to **all** financial assets

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- The conglomerate must apply IFRS 9 to **all** financial assets in consolidated financial statements
- Note: if Sub A publishes standalone financial statements it is permitted continue to apply IAS 39 to **all** financial assets



The Deferral Approach Disclosure and expiry date

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- Disclosure
 - The fact that the entity applied the Deferral Approach and how it is concluded it is eligible
 - Selected IFRS 9 information:
 - Fair value of financial assets that are not considered 'simple' under IFRS 9 (ie cash flows are not solely payments of principle and interest)
 - Information about credit risk exposure for financial assets that are considered simple and are subject to impairment under IFRS 9, and their gross carrying amounts by credit risk rating grades
 - Information about changes in predominant activity of the entity in the reporting period
- Expiry date
 - The Deferral Approach can only be applied until 1 January 2021 – all entities must apply IFRS 9 from that date

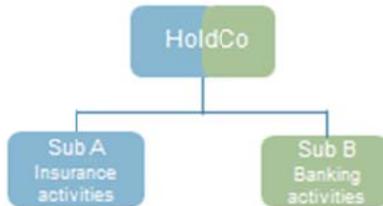
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Alternative approaches considered Deferral **below** reporting entity level

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IFRS 9 IAS 39



- In its consolidated financial statements, the conglomerate
 - could continue to apply IAS 39 to financial assets that relate to insurance activities
 - would be required to apply IFRS 9 to financial assets that do NOT relate to insurance activities
- In the standalone financial statements
 - Subsidiary A could continue to apply IAS 39
 - Subsidiary B would be required to apply IFRS 9
- Challenges
 - Financial assets that relate to insurance activities
 - Legal structure and predominant activity
 - Legal structure and regulation
 - Segment reporting
 - Different requirements for identical financial assets
 - Transfers of financial assets (Slide 18)

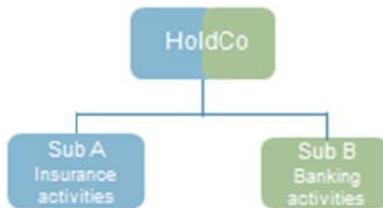
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Deferral **below** reporting entity level Asset transfers*

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IFRS 9 IAS 39



*Such transfers may not happen often in practice

- Suppose Sub A that applies IAS 39 sells a structured debt investment to Sub B that applies IFRS 9
- Sub A bifurcated the structured debt under IAS 39. The bifurcated derivative was measured at FVPL and the host was measured at amortised cost
- Subsidiary B already holds identical structured debt investments and measures them at FVPL under IFRS 9
- In the consolidated financial statements of the conglomerate that applies both IAS 39 and IFRS 9:
 - If IAS 39 accounting travels with the transferred investment, identical investments in the banking subsidiary will be accounted for differently;
 - If accounting model changes to IFRS 9 on a transfer of the investment, that could lead to recognition of gains and losses on internal transfers.

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The Deferral Approach Basis for the proposals

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- Feedback received by the Board in its outreach with investors in developing the proposals
- Complexity and confusion and arbitrage opportunities as a result of applying different accounting requirements (ie both IAS 39 and IFRS 9) in one set of financial statements
- Improved accounting for financial instruments required for most entities
- Overlay Approach available to all entities that issue insurance contracts

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Question 3: The Deferral Approach

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- A. In your view, would the Deferral Approach for entities whose predominant activity is insurance provide useful information? Why or why not? If not, what would you propose instead?
- B. Do you agree that predominant activity is assessed based on the level of liabilities under insurance contracts? If not, what do you propose instead?
- C. Do you agree that the Board should seek to avoid simultaneous application of IFRS 9 and IAS 39 in one set of financial statements?
- D. In your view, would the proposed disclosures enable meaningful comparison between entities that apply the Deferral Approach and those that do not? If not, what other disclosures would be useful?
- E. Do you agree that the Deferral Approach should only be available for a short period of time after IFRS 9 becomes effective, specifically until 1 January 2021? If not, why?

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All proposals

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Question 4

In your view, should entities be permitted or required to apply the Overlay Approach and the Deferral Approach? Why?

Question 5

In your view, should both the Overlay Approach and the Deferral Approach be permitted? Alternatively, do you think that only one approach should be permitted and if so, which one? Why?

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Next steps

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- ED published on 8 December 2015
- Comment period ends 8 February 2016
- Re-deliberation and publication of final amendments to IFRS 4 in 2016

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Thank you

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We welcome your feedback

The views expressed in this presentation are those of the presenter. Official positions of the Board on accounting matters are determined only after extensive due process and deliberation.