



Project	Agenda decision
Topic	IFRS 4 Insurance Contracts / IAS 32 Financial Instruments: Presentation – Scope issue for investments in REITs

Introduction

1. In November 2009, the IFRIC published a tentative agenda decision not to add to its agenda a request asking for guidance on the liability / equity classification of financial instruments with specific features issued by Real Estate Investment Trusts (REITs).
2. This issue was discussed at the November 2009 IFRIC meeting; it was set out in agenda paper reference 10 that can be found on the public website¹.

Background

3. In some jurisdictions, a Real Estate Investment Trust (REIT) is a tax designation used for an entity investing in real estate that meets certain criteria to attain preferential income tax status. In some of these cases, the contractual terms of the ownership units of such REITs require it to distribute 90% of the Total Distributable Income (TDI) to the investors. The remaining 10% of TDI may be distributed at the discretion of management. The IFRIC received a request to provide guidance on whether the discretion to distribute the remaining 10% of TDI met the definition of a Discretionary Participation Feature (DPF) as defined in IFRS 4. If the DPF definition is met, IFRS 4 permits the ownership units to be

¹ <http://www.iasb.org/NR/ronlyres/6D9C7ED5-EE7C-48C8-9667-7BDC460CDF88/0/0911ap10obsIFRS4IAS32ClassificationFinancialInstruments.pdf>

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRIC.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRIC or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

Decisions made by the IFRIC are reported in *IFRIC Update*.

Interpretations are published only after the IFRIC and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in *IASB Update*.

classified as a liability rather than classified into debt and equity components in accordance with IAS 32.

4. As published in the November 2009 IFRIC Update:

The IFRIC noted that the objective of IFRS 4 is to specify the financial reporting for insurance contracts. The IFRIC noted that the definition of DPF in Appendix A of IFRS 4 requires, amongst other things, that the instrument provides the holder with guaranteed benefits and that the DPF benefits are additional to those guaranteed benefits. Further, the IFRIC noted that there must be guaranteed benefits to the holder for the definition to be met and that such guaranteed benefits referred to are typically those present in insurance activities.

The IFRIC noted that providing guidance on this issue would be in the nature of application guidance, rather than interpretative guidance. Therefore, the IFRIC [decided] not to add the issue to its agenda.

Comment letters analysis

5. The two comment letters that were received both agree with the tentative agenda decision not to take the issue on to the IFRIC agenda, though with comments that are analysed in the paragraphs below.

Scope of the decision

6. One respondent² points out that the tentative agenda decision assumes that guaranteed benefits may typically be found in insurance activities.
7. However, they note that paragraph 2 of IFRS 4 *Insurance contracts* explicitly states that the standard applies to financial instruments that it issues with a Discretionary Participation Feature (DPF).
8. As a result they are concerned that the tentative agenda decision is overly restrictive. They suggest that a reference to financial instruments be included in the agenda decision.

² EY CL 1

9. The staff acknowledges that the objective of IFRS 4 may seem slightly inconsistent with its scope section. The intent of the Board when bringing financial instruments with DPF into the scope of IFRS 4 was to reduce diversity in practice and have a consistent accounting treatment for similar transactions. The Board observed then that DPFs are found not only in insurance contracts but also in some financial liabilities that do not transfer significant insurance risk - also called investment contracts.

Extent of the decision

10. The other respondent³ highlights that the tentative agenda decision is not conclusive on the specific subject of Real Estate Investment Trusts (REITs). They would appreciate that the final agenda decision reflects the conclusion that investments in REITs are exclusively in the scope of IAS 32 *Financial Instruments: Presentation*. In their view such conclusion would prevent diversity in practice.
11. In response to this comment, the staff notes that the tentative agenda decision not to take this issue on to the IFRIC agenda reflects the assessment against the agenda criteria. The staff does not agree that the agenda decision should go further than this in describing the acceptable accounting treatment.
12. After considering the above, the staff does not recommend amending the agenda decision. The staff believes the current wording of the tentative agenda decision:
- (a) reflects the consensus of the IFRIC members reached at the IFRIC meeting in November;
 - (b) reflects current practice that contracts with DPF are mainly found in insurance activities; and

³ DTT CL 2

- (c) does not preclude investment contracts that do not transfer insurance risk to follow paragraph 35 of IFRS 4 as long as all the relevant criteria and definitions are met.

Staff recommendation

13. Based on the two comment letters received, the staff recommends that the tentative agenda decision be finalised with no change from the Tentative Agenda Decision published in the November 2009 IFRIC Update.

Questions to the IFRIC

Questions – Finalisation of IFRIC Agenda Decision

Question 1 – The staff recommends that the IFRIC finalise its Tentative Agenda Decision not to add this issue to its agenda. Does the IFRIC agree with the staff's recommendation?

Question 2 – Appendix A includes the staff's proposed wording for the final Agenda Decision. Does the IFRIC agree with the proposed final Agenda Decision wording?

Appendix A – IFRIC Final Agenda Decision DRAFTING

A1. The staff proposes the following wording for the **final** agenda decision.

(Deleted text is struck through.)

**IFRS 4 *Insurance Contracts* and IAS 32 *Financial Instruments: Presentation*
- Scope issue for investments in REITs**

In some jurisdictions, a Real Estate Investment Trust (REIT) is a tax designation used for an entity investing in real estate that meets certain criteria to attain preferential income tax status. In some of these cases, the contractual terms of the ownership units of such REITs require it to distribute 90% of the Total Distributable Income (TDI) to the investors. The remaining 10% of TDI may be distributed at the discretion of management. The IFRIC received a request to provide guidance on whether the discretion to distribute the remaining 10% of TDI met the definition of a Discretionary Participation Feature (DPF) as defined in IFRS 4. If the DPF definition is met, IFRS 4 permits the ownership units to be classified as a liability rather than classified into debt and equity components in accordance with IAS 32.

The IFRIC noted that the objective of IFRS 4 is to specify the financial reporting for insurance contracts. The IFRIC noted that the definition of DPF in Appendix A of IFRS 4 requires, amongst other things, that the instrument provides the holder with guaranteed benefits and that the DPF benefits are additional to those guaranteed benefits. Further, the IFRIC noted that there must be guaranteed benefits to the holder for the definition to be met and that such guaranteed benefits referred to are typically those present in insurance activities.

The IFRIC noted that providing guidance on this issue would be in the nature of application guidance, rather than interpretative guidance. Therefore, the IFRIC {decided} not to add the issue to its agenda.