IFRS

STAFF PAPER

June 2015

REG IASB Meeting

Project	Insurance Contracts
Paper topic	The complexity of deferring the effective date of IFRS 9 *Financial Instruments* for the insurance industry

CONTACT(S) Yulia Feygina yfeygina@ifrs.org +44 207 332 2743

This paper has been prepared for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose of the paper

1. This paper discusses the complexities that would arise if the IASB were to defer the effective date of IFRS 9 *Financial Instruments* for the insurance industry until the effective date of the new insurance contracts Standard to address the feedback discussed in Agenda Paper 2E *Application of IFRS 9* Financial Instruments *before the new insurance contracts Standard*.

2. This paper is for information only. It focusses on the accounting implications and scope considerations of any such deferral. It does not discuss the staff's view on whether the deferral of IFRS 9 for the insurance industry is appropriate. It does not prejudge whether the IASB may consider granting any such deferral and if so, whether it should be mandatory or optional subject to any relevant qualifying conditions.

Structure of the paper

3. This paper:

   (a) Provides an overview of the decisions the IASB would need to make if the effective date of IFRS 9 for the insurance industry were to be deferred (paragraphs 4-10),

   (b) Discusses the following approaches to the deferral, and related issues:

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

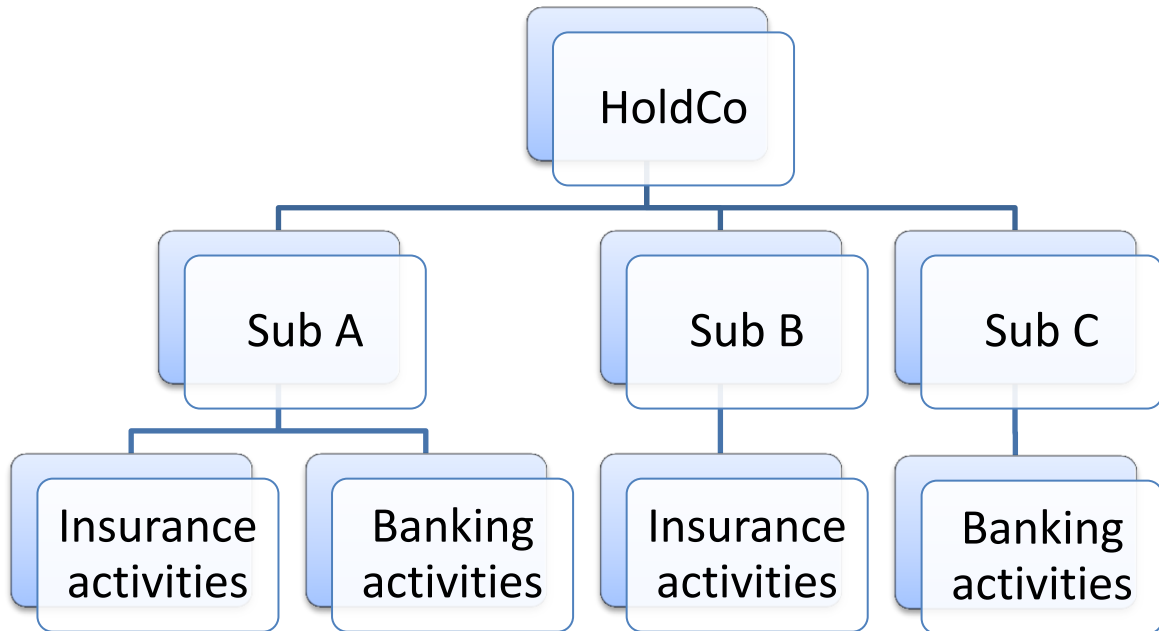
(i) Approach 1—reporting entities (paragraphs 11-22),

(ii) Approach 2—legal entities (paragraphs 23-41), and

(iii) Approach 3—insurance activities (paragraphs 42-46).

Overview

4. Consider the following illustrative group structure[1]:



5. The group is a financial institution that conducts insurance and banking activities. Subsidiary B only conducts insurance activities, Subsidiary C only conducts banking activities and Subsidiary A conducts both insurance and banking activities. Hold Co and Subsidiaries A, B and C all issue financial statements.

6. If the IASB were to defer the effective date of IFRS 9 for the insurance industry, it would need to:

(a) Determine the scope of the deferral, including:

(i) The level in a reporting entity to which the deferral would apply; and

(ii) The qualifying conditions for a deferral.

[1] This example does not purport to represent a typical structure of an entity that conducts insurance activities. It is provided for illustration purposes only.

(b) Assess whether there is a need for particular presentation and disclosure requirements (for example, if Subsidiary A applied IAS 39 and IFRS 9 to its insurance and banking activities respectively, would that result in the need for a particular presentation of those activities in Subsidiary A's financial statements); and

(c) Identify whether there are any accounting consequences of the deferral that need be addressed and develop necessary guidance (for example, if HoldCo applied IAS 39 and IFRS 9 to its insurance and banking subsidiaries respectively and Subsidiary B transferred (sold) financial assets to Subsidiary C, would that trigger a reassessment of classification of the transferred financial assets and how any such reassessment should be applied).

7. The staff have identified three broad approaches to deferring IFRS 9:

(a) Approach 1—deferral at the reporting entity level. Under this approach, each reporting entity would either apply IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement* to all its financial instruments. In our example, suppose Subsidiary B that conducts insurance operations is eligible for the deferral and continues to apply IAS 39 after the effective date of IFRS 9 and Subsidiary C that conducts banking operations is not eligible for the deferral and applies IFRS 9. However, at the group level, HoldCo would need to decide whether the group as a whole qualifies for the deferral and apply either IFRS 9 or IAS 39 to all financial instruments in the consolidated financial statements. Likewise, Subsidiary A that conducts both insurance and banking activities could only apply either IFRS 9 or IAS 39 to all its financial instruments.

(b) Approach 2—deferral at the legal entity level. Under this approach, each legal entity would apply either IFRS 9 or IAS 39 to all its financial instruments. However, a reporting entity that comprises more than one legal entity could simultaneously apply both Standards in its consolidated financial statements. In our example, if Subsidiary B continued to apply IAS 39 after the effective date of IFRS 9 and

Subsidiary C applied IFRS 9, then HoldCo would apply both IFRS 9 and IAS 39 in the consolidated financial statements. However, assuming Subsidiary A comprises one legal entity, it would be required to apply either IAS 39 or IFRS 9 to all its financial instruments.

(c) Approach 3—deferral for insurance activities. This approach is similar to Approach 2 in that both IAS 39 and IFRS 9 could be applied in a single set of financial statements. However, it goes further than Approach 2 in that even a single legal entity could apply both Standards in its financial statements. In our example, not only could HoldCo apply both IAS 39 and IFRS 9 in its consolidated financial statements but Subsidiary A also could apply both Standards in its separate financial statements.

8. Each approach gives rise to different accounting consequences and may require different qualifying conditions for the deferral. As a general observation, the staff think there is a positive relationship between:

   (a) how precisely the deferral captures insurance activities, and

   (b) the complexity of the deferral.

9. A precise deferral that captures most insurance activities, and insurance activities only, would most fully address the feedback discussed in Agenda Paper 2E and at the same time would minimise the scope of the delayed application of the improved accounting for financial instruments under IFRS 9. However, it would lead to significant added accounting and potentially operational complexity and require a substantial amount of time for the IASB to develop and for entities to implement the relevant requirements.

10. A less precise deferral that doesn't capture some insurance activities and / or captures some non-insurance activities would create less complexity and would be easier for the IASB to develop and for entities to implement. However, such a deferral would likely not address all concerns raised by the insurance industry and / or could lead to delayed application of the improved accounting for financial instruments under IFRS 9 for other activities, notably for some banking activities.

Approach 1—reporting entities

11. This is the least complex approach. Under this approach, the IASB would need to consider:

    (a) the qualifying conditions an entity must meet to be eligible for the deferral (paragraphs 15-19), and

    (b) the need for presentation and disclosure requirements for entities that qualify for the deferral (paragraphs 20-22).

12. However, the IASB would not need to address accounting for, and presentation and disclosure of, transfers of financial assets between parts of a reporting entity that apply different Standards to account for financial instruments (see example in paragraph 6(c))—a scenario that is not addressed in the existing Standards (see paragraphs 29-32). It would also result in less added complexity for preparers and users of financial statements.

13. From a conceptual standpoint, this approach would not contradict the existing provisions in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and IFRS 10 *Consolidated Financial Statements* that generally require the application of consistent accounting policies to like transactions and events and specifically the application of uniform accounting policies in consolidated financial statements.

14. However, this is also the least precise approach. As discussed in paragraphs 8-10, depending on the qualifying conditions developed by the IASB, this approach could result in some insurance activities not being eligible for the deferral and / or some banking activities being eligible for the deferral.

Qualifying conditions—reporting entities

15. In determining which entities qualify for the deferral under Approach 1, the IASB could consider whether the following conditions are relevant:

    (a) Condition 1—the entity issues contracts in the scope of existing IFRS 4 *Insurance Contracts*;

    (b) Condition 2—those activities are significant to the entity; and / or

(c) Condition 3—the entity is a regulated insurance entity.

16. The IASB would not need to develop any guidance to support Condition 1 because IFRS 4 contains guidance on what contracts are within its scope.

17. The IASB would need to develop guidance on when issuing such contracts is an activity that is ‘significant’ enough for a reporting entity to qualify for the deferral of IFRS 9. In particular, the IASB would need to decide whether:

    (a) significance is assessed in the context of the reporting entity’s financial performance or financial position or both,

    (b) significance is merely a quantitative assessment or there needs to be a qualitative overlay,

    (c) to set out a specific quantitative thresholds or provide general principles and application guidance.

18. The staff note that all other conditions are held constant:

    (a) the higher the significance threshold, the more entities that conduct some insurance activities would not qualify for the deferral, and

    (b) the lower the significance threshold, the more entities that conduct other activities, for example banking activities, would qualify for a deferral.

19. Finally, the IASB would need to consider whether and how the regulatory environment could be part of the qualifying conditions for the deferral and in particular:

    (a) which aspect, or aspects, of regulation are relevant, and why:

        (i) authorisation regulation,

        (ii) conduct regulation; and / or

        (iii) prudential regulation.

    (b) how to reconcile the scope of the deferral under Approach 1 with the scope of regulation, if different (for example, reporting entity as opposed to legal entity and / or different definitions of insurance contracts);

(c) whether, and how, to address the fact that the regulatory environment is different jurisdiction by jurisdiction (for example, a single regulator that regulates both banking and insurance activities as opposed to separate regulators for banking and insurance activities); and

(d) whether, in order to qualify for a deferral, it is sufficient for a reporting entity to demonstrate that it is a regulated insurance entity or whether the deferral of IFRS 9 by the entity should be required to be authorised by the relevant regulatory authority.

Presentation and disclosure—reporting entities

20. The IASB would need to consider whether and what presentation and disclosure requirements are needed to ensure transparency and comparability across entities if there is a deferral of IFRS 9 for reporting entities that meet the qualifying conditions.

21. If the deferral is mandatory, subject to any relevant qualifying conditions, the IASB could consider the need to require the following disclosures for entities that apply the deferral:

    (a) The fact that the entity has applied the deferral,

    (b) How the entity concluded that it is eligible for the deferral, and

    (c) Disclosure of what IFRS 9 carrying amounts would be for some, or all, of the entity's financial assets—that would result in additional burden for preparers but could be necessary to provide comparability for users of financial statements.

22. If the deferral is optional, subject to any relevant qualifying conditions, the IASB could consider the need to require the following disclosures:

    (a) For entities that apply the deferral, in addition to the disclosures discussed in paragraph 21, why the entity chose to apply the deferral; and

    (b) For entities that are eligible for the deferral but choose not to apply it:

(i) The fact that the entity is eligible but has not applied the deferral;

(ii) How the entity has concluded that it is eligible for the deferral; and

(iii) Why the entity chose not to apply the deferral.

Approach 2—legal entities

23. This is a significantly more complex approach for the IASB to develop, for entities to apply and for users of financial statements to understand. Under this approach, the IASB would need to consider the same issues that arise under Approach 1, that is:

    (a) The relevant qualifying conditions for the deferral; and

    (b) Presentation and disclosure requirements about the fact of the deferred application of IFRS 9 by the entity.

24. However, it would also be necessary for the IASB to consider and for entities to apply requirements that address the co-existence of IAS 39 and IFRS 9 in the consolidated financial statements, including:

    (a) Presentation and disclosure requirements to reflect the application of different Standards to account for financial instruments by legal entities within the group;

    (b) Accounting and disclosure requirements for transfers of financial assets between legal entities within the reporting entity that apply different Standards; and

    (c) Requirements for phased transition to IFRS 9 by the reporting entity, ie insurance subsidiaries that apply the deferral would transition to IFRS 9 later than the other parts of the reporting entity.

Qualifying conditions—legal entities

25. In determining which entities qualify for the deferral under Approach 2, the IASB could consider the same qualifying conditions as under Approach 1 discussed in

paragraphs 15-19, and the same detailed issues under those conditions, except that:

(a) The legal entities that issue contracts in the scope of IFRS 4 may not have significant volumes of other types of activities. This may take some pressure off the significance assessment and mitigate the risk that other types of activities, for example banking activities, will be captured by the deferral, and

(b) There may be more consistency between the scope of the deferral and the scope of the relevant regulation (ie legal entities).

Presentation and disclosure—legal entities

26. In addition to presentation and disclosure requirements that could apply under Approach 1 (paragraphs 20-22), the IASB would also need to consider the need for presentation and disclosure requirements that address the following issues, and what those requirements should be:

(a) How the reporting entity applied the deferral to its different legal entities;

(b) The use of two different accounting Standards for financial instruments by legal entities within a single reporting entity,

(c) Transfers of financial assets between those legal entities within the reporting entity (ie between different Standards for financial instruments); and

(d) Phased transition to IFRS 9 by the reporting entity, ie different time of the initial application of IFRS 9 by legal entities within the reporting entity.

Transfers of financial assets between IAS 39 and IFRS 9

27. This is a significant added complexity of Approach 2, that arises as a consequence of co-existence of IAS 39 and IFRS 9 within a single reporting entity. This is because:

(a) Transfers would require the development of new accounting requirements, (paragraphs 29-32); and

(b) Such requirements would likely be highly complex (paragraphs 33-41).

28. Such accounting complexity does not depend on how often transfers occur in practice or what accounting treatment for transfers is pursued.

Why new requirements would be needed

29. The existing Standards require consistent accounting policies for like transactions and events and in particular uniform accounting policies within a group. The simultaneous application by the reporting entity of two different accounting Standards for financial instruments is not envisaged by, and would contradict the existing Standards. Therefore, if the IASB were to consider deferral of IFRS 9 at the legal entity level and hence to allow co-existence of IAS 39 and IFRS 9 at the consolidated level, it would need to develop requirements for transfers of financial assets between legal entities within the group that apply those different Standards.

30. The staff note that the following existing requirements that may at first glance appear relevant are in fact not applicable to an internal transfer between IFRS 9 and IAS 39:

(a) Reclassification requirements in IAS 39 or IFRS 9. This is because those requirements address the reclassification conditions, mechanics, presentation and disclosure **within the same accounting model**, rather than transfers of financial assets between IAS 39 and IFRS 9 accounting models.

(i) For example, if financial assets are reclassified out of amortised cost and into fair value through other comprehensive income under IFRS 9, IFRS 9 specifies how such a reclassification should be accounted for. In this case, IFRS 9 applies both before and after the transfer. However, these requirements do not address a transfer between two different Standards where additional complications are introduced. For example, if financial assets were to be reclassified out of amortised cost under IFRS 9 into available-for-sale under IAS 39 that uses a

different impairment model, there are no existing requirements that address such a scenario.

(ii) In addition, both IAS 39 and IFRS 9 set out restrictions on when reclassification is permitted or required to provide discipline and comparability. For example, IFRS 9 requires reclassification if, and only if, business model changes which is expected to be very infrequent. Those restrictions do not address transfers of financial assets between legal entities with a reporting entity that apply IAS 39 and IFRS 9.

(b) Transition requirements in IFRS 9. This is because those requirements are relevant only when an entity **initially applies** IFRS 9, not when it 'acquires' financial assets via a transfer while already applying IFRS 9. If a financial asset is transferred within the reporting entity from a legal entity that applies IAS 39 to a legal entity that applies IFRS 9, the latter would have already initially applied IFRS 9 and therefore applied the IFRS 9 transition requirements (and thus those requirements would no longer be relevant).

(c) Change in accounting policy requirements in IAS 8. Transferring a financial asset within the reporting entity from a legal entity that applies IAS 39 to a legal entity that applies IFRS 9 does not result in a change in accounting policy. The relevant parts of the entity each apply policies relevant to that part, and those policies do not change as a result of transfers of financial assets between the different parts of the entity.

31. Finally, the staff note that combining some of the above requirements in their current form to address transfers of financial assets between legal entities within the group that apply different Standards for financial instruments would not provide a consistent or meaningful basis for such activities. This is because those requirements were developed to serve different purposes and thus are based on different principles. For example:

(a) Reclassification requirements are generally restrictive and applied prospectively;

(b) Transition requirements generally provide reliefs that are specific to the initial application of a new Standard, are designed to apply at the point of transition only and not over time and are retrospective; and

(c) Changes in accounting policy requirements are retrospective, unless the change in policy results from application of a new Standard or Interpretation, in which case those specific transition requirements apply.

32. Therefore, new requirements for accounting, presentation and disclosure of transfers of financial assets within the reporting entity between legal entities that apply IAS 39 and IFRS 9 (eg insurance and banking subsidiaries) would need to be developed.

Why requirements for transfers would likely be complex

33. In principle, there are three alternatives to address transfers of financial assets:

(a) Alternative 1—require a reassessment and if necessary a change of classification upon a transfer (ie apply the transferee's classification model),

(b) Alternative 2—prohibit a change in classification upon a transfer (ie the transferee would retain the transferor's classification of the financial asset(s)),

(c) Alternative 3—require a reassessment and if necessary a change in classification in some, but not all, circumstances (for example, a reassessment would be required if the asset was transferred from IAS 39 to the improved accounting under IFRS 9 but not in the opposite direction).

34. Under Alternative 1, all financial instruments in the legal entity that applies the deferral would be accounted for under IAS 39 and all financial instruments in the legal entity that does not apply the deferral would be accounted for under IFRS 9. Hence classification would be determined by where the asset is held at the end of the reporting period. It would therefore not be necessary to track where in the reporting entity the financial asset was initially recognised (or held at the time IFRS 9 was initially applied, if later).

35. However, it would be necessary to develop and apply requirements for changes in classification upon a transfer. That would require detailed analysis of the effects of financial assets moving between IAS 39 and IFRS 9 and involve the following complexities:

    (a) Accounting for changes in classification and measurement (for example, if a financial asset is transferred out of amortised cost category under IFRS 9 into available-for-sale category under IAS 39),

    (b) Accounting for changes in the impairment model, even if classification and measurement remain the same upon a transfer (for example, if a financial asset is transferred out of amortised cost category under IFRS 9 and expected loss model into amortised cost category under IAS 39 and incurred loss model),

    (c) Accounting for knock-on effects on hedge accounting (for example, knock-on effects on hedge designation).

36. This would lead to extensive detailed requirements on accounting mechanics of transfers to be included in the deferral guidance.[2] In addition, under this alternative entities would be able to cherry pick which assets to transfer to achieve a particular accounting outcome. That would create the need to extensive disclosure requirements to provide transparency and market discipline.

37. Finally, it would be necessary to develop and apply requirements that address presentation and disclosure related to:

    (a) the use of two different accounting models within a reporting entity, and

    (b) transfers of financial assets between those models and any gains and losses that are recognised as a result of those transfers, unless the recognition of such gains and losses is prohibited.[3]

---

[2] The staff note that even changes in classification of financial assets *within* a single Standard involve significant complexity (eg see paragraphs 5.6.1 – 5.6.7, 5.7.2 IE 104 – IE 114 of IFRS 9). That complexity would be significantly exacerbated in a scenario where assets are transferred *between* IAS 39 and IFRS 9.

[3] The staff note that developing an approach where gains and losses are not recognised on a transfer could be challenging. This is because even if such gains and losses are not recognised immediately upon a

38. Under Alternative 2, a financial asset would maintain its original classification as it is transferred between legal entities within the reporting entity; ie the transferee would not reassess the transferred asset's classification. Arguably, this is the least complex alternative, because it would not require accounting requirements for changes in classification and measurement, impairment and hedge accounting as a result of a transfer.

39. However, compared to Alternative 1, this alternative would:

    (a) require tracking of where the asset was initially recognised (or held at the time when IFRS 9 was initially applied, if later) because this determines classification,

    (b) result in different accounting for assets that are held within the same legal entity (ie a banking subsidiary and an insurance subsidiary could hold both IAS 39 and IFRS 9 financial assets), and require additional presentation and disclosure provisions to address that fact, and

    (c) enable entities to cherry pick where to initially recognise financial assets to achieve a particular accounting outcome (for example, an entity could initially recognise an equity investment in an insurance subsidiary and designate it as available-for-sale and transfer the investment to a banking subsidiary to achieve available-for-sale treatment, with recycling, in the banking subsidiary that is otherwise required to apply IFRS 9 or a bank could obtain its loans via its insurance subsidiary and avoid expected loss accounting),

    (d) likely require extensive disclosure, in particular disclosure of the carrying amount under the transferee applicable Standard, to ensure transparency and provide market discipline.

40. Alternative 3 would arguably ensure the most discipline as only particular changes in classification upon a transfer would be allowed. It could also ensure the most comparability, for example, if only transfers into IFRS 9 were allowed entities would account for more assets under IFRS 9. However, this would be the most

---

transfer, if assets moved to fair value – based measurement (for example), gains could be recognised on 'day 2' when those assets are remeasured to fair value.

complex alternative as it would require determining which assets should be reassessed and combine the complexities that arise both under Alternative 1 and Alternative 2, notably:

(a) The need for an accounting model that addresses changes in classification, impairment and hedge accounting;

(b) The need to track where the financial asset was initially recognised (or held at the time IFRS 9 was initially applied, if later); and

(c) Additional presentation and disclosure provisions to reflect the fact that same legal entities within the reporting entity may be applying both IFRS 9 and IAS 39.

41. The staff note that the significant complexity of requirements for transfers of financial assets may not be justified:

(a) If such transfers are rare in practice; and

(b) Because those requirements would potentially only apply for a short period of time, ie after IFRS 9 is initially applied and before the new insurance contracts Standard is applied.

Phased transition to IFRS 9

42. Application of IFRS 9 at different times by legal entities within a reporting entity effectively constitutes phased transition to IFRS 9 by that reporting entity. The staff note that requirements for phased transition to IFRS 9 that were needed because IFRS 9 was developed in stages involved significant accounting complexity. However, the requirements for phased transition to IFRS 9 developed by the IASB in the past addressed initial application of *different chapters* of IFRS 9 and would not apply to initial application of IFRS 9 as a whole at different times by *different parts* of the reporting entity. That would require a new set of phased transition requirements, including supporting disclosures, to be developed.

Approach 3—insurance activities

43. This is the most precise, but the most complex approach. It may not require a significance assessment as part of the qualifying conditions for the deferral because it purports to capture just insurance activities. However, in addition to all of the complexities discussed under Approach 2, this approach would also require the IASB to determine how to capture insurance activities below the level of a legal entity and which particular financial assets belong to those activities.

44. Similar to the discussion above on transfers (ie where there are no existing requirements in current IFRSs that are on-point), the staff do not think that any of the existing requirements in Standards would provide a meaningful basis for determining the scope of this alternative; ie how to assess or identify the insurance activities within a legal entity that could qualify for the deferral. This is because the existing requirements were developed for a different purpose.

45. The closest analogy the staff are aware of is segment identification, and reporting requirements under IFRS 8 *Operating Segments*. However, an entity may be identifying its segments on a basis other than industry or the types of activities conducted. Rather, an entity may be identifying its segments on a geographical or market basis.

46. Hence the staff think new requirements would need to be developed and applied to identify activities within a legal entity that qualify for the deferral and those requirements could be complex.

To conclude

47. The staff note that all approaches to deferring the effective date of IFRS 9 for the insurance industry discussed in this paper have different *relative* advantages and disadvantages. However, they would all introduce additional complexity, lead to delayed application of improved accounting for financial instruments and reduce comparability (discussed in Agenda Paper 2E). Arguably, that reduction in comparability would be further exacerbated if any deferral were optional rather than mandatory—although a mandatory deferral would arguably have even more significant drawbacks (discussed in Agenda Paper 2E).

48. In particular, Approach 2 and Approach 3—deferral for only legal entities or only insurance activities, respectively—would involve significant accounting complexity and reduction in comparability. They would require significant amount of time to develop and would not lend themselves to an expedited due process because of significant accounting complexity and overarching effects on the markets. Implementing those approaches would likely require system changes and make financial statements of entities that issue insurance contracts more difficult to understand.

49. The staff think that these consequences must be carefully weighed against the benefits of any deferral and against approaches that are already available to mitigate the concerns about applying IFRS 9 prior to applying the new insurance contracts Standard (discussed in Agenda Paper 2F). This is particularly important given that the accounting issues created by applying IFRS 9 prior to applying the new insurance contracts Standard (discussed in Agenda Paper 2E) will only exist for a limited period of time.