International Financial Reporting Standards

Insurance Contracts—Transition relief

This paper is accompanied by ASAF Agenda Paper 6D / January 2015 IASB Agenda Paper 2A: *Initial application of the new insurance contracts Standard after implementation of IFRS 9 Financial Instruments* which provides context to the questions in this paper.

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Objective of this session

We are seeking input from ASAF members on specific issues relating to the transition to the new insurance contracts Standard in the light of the fact that the earliest possible mandatory effective date of the new insurance contracts Standard will be after the mandatory effective date of IFRS 9 *Financial Instruments* (IFRS 9).

Slides 12-17 provide background information relevant to the discussion of applying the new insurance contracts Standard for the first time.

Mandatory effective dates of IFRS 9 and the new insurance contracts Standard

- The earliest possible effective date of the new insurance contracts Standard will be after the mandatory effective date of IFRS 9.
- Considering that fact, some constituents have suggested that the IASB should allow a longer period between the mandatory effective dates of IFRS 9 and the new insurance contracts Standard.
- **Question for ASAF members:** What should be the minimum period of time between the mandatory effective dates of IFRS 9 and the new insurance contracts Standard?

Transition relief: Reassessment of business model

- At its January 2015 meeting, the IASB tentatively decided to consider providing further transition relief on the reassessment of the business model for financial assets at the date of initial application of the new insurance contracts Standard.
- This reassessment would be based on the conditions for assessing the business model in paragraph 4.1.2(a) or 4.1.2A(a) of IFRS 9 and the facts and circumstances that exist at the date of the first application of the new insurance contracts Standard.
  - So an entity would *reassess* the business model of its financial assets using existing evidence at that time. This threshold is lower than the *reclassification* threshold of IFRS 9.
- ASAF Agenda Paper 6D/January 2015 IASB Agenda Paper 2D: *Initial application of the new insurance contracts Standard after implementation of IFRS 9 Financial Instruments* provides the analysis supporting this decision.

Input required on the specifics of the transition relief

The IASB asked the staff to consider further the following four issues:

1. How should the IASB specify the financial assets to which the reassessment of business model would apply and why?
2. Should the reassessment of business model be mandatory or optional?
   Questions 1 and 2 are interdependent.
3. When there is a change in the financial assets' classification as a result of reassessing the business model:
   a) should such a change be applied prospectively or retrospectively?
   b) where should any resulting gains or losses be recognised?
4. What disclosures should be required when there is a change in the financial assets' classification as a result of reassessing the business model?

Accordingly, we are asking ASAF members for their feedback on these specific issues.

1. Which assets should the transition relief apply to?

There are four alternatives:

Alternative (a): The transition relief would apply to all financial assets of a reporting entity. The IASB would need to specify the reporting entities able to apply the transition relief, and to consider how that conclusion would apply in consolidated financial statements. For example, alternative (a) could mean that the transition relief might apply to all entities, all entities that issue insurance contracts, all entities that issue significant levels of insurance contracts or all entities regulated as insurance companies.
Alternative (b): The transition relief would apply only to the financial assets that are contractually linked to insurance contracts. This alternative would affect fewer financial assets of an entity than alternative (a) and potentially alternatives (c) and (d). In particular, with this approach entities that do not have assets contractually linked to insurance liabilities would not need to revisit their assessment of business model. However, it would also exclude financial assets that back insurance contracts without any contractual link to the insurance contracts.

1. Which assets should the transition relief apply to? (continued)

Alternative (c): An entity would need to identify financial assets related to its insurance business and apply the transition relief to the identified assets.
An entity with insurance and non-insurance business would need to identify the financial assets related to its insurance business. If the entity has insurance business only, all of its assets would be deemed to be related to its insurance business. This approach would enable entities to apply the transition relief to a wider range of contracts than alternative (b).

Alternative (d): An entity would make a one-time designation of financial assets related to its insurance business and apply the transition relief to the designated assets.
Under this approach entities that do not have significant insurance business would not be required to revisit their assessment of business model for financial assets. This is because the entity could choose **not** to designate any assets. However, it would enable entities to apply the transition relief to a wider range of contracts than alternative (b).

2. Should the transition relief be mandatory or optional?

- The transition relief for reassessing business model may mean that entities need to revisit assessments made when implementing IFRS 9.
- For some entities, the costs of the ‘relief’ may outweigh the benefits. This would be particularly the case for reporting entities that conduct non-insurance business or issue non-traditional insurance contracts (eg fixed fee contracts).
- Requiring the reassessment of the business model would:
  - increase comparability and consistent application; and
  - be consistent with the transition approach proposed for the new insurance contracts Standard, and with IFRS generally because it reduces options
- However, making reassessment optional would allow the entity to decide whether the costs applying the relief would outweigh the benefits. This becomes more important the greater the number of financial assets that are eligible for the transition relief (ie it depends on the scope that is selected).

Questions for ASAF members:

1. How should the IASB specify the financial assets to which the reassessment of business model would apply and why?
2. Should the reassessment of business model be mandatory or optional?

3. Accounting for change in classification of financial assets

Question for ASAF members: When there is a change in the classification of financial assets as a result of reassessing the business model:

a) Should such a change be applied:
   - **prospectively** from the date of the first application of the new insurance contracts Standard (consistent with the reclassification requirements paragraphs 5.6.1-5.6.2 of IFRS 9); or
   - **retrospectively** (consistent with the transition requirements of IFRS 9 and the new insurance contracts Standard)?

b) how should any resulting gains or losses be treated:
   - **in profit or loss** (consistent with the reclassification requirements on a change in a business model in IFRS 9); or
   - **in retained earnings** (consistent with the transition requirements of IFRS 9 and the new insurance contracts Standard)?

4. Disclosures

- **Question for ASAF members:**
- What should be disclosed to allow users of financial statements to assess the effect of reassessing the business model on transition to the new insurance contracts Standard?

Background

Deferral of IFRS 9 for insurance entities

The IASB decided **not** to consider deferring the mandatory effective date of IFRS 9 for entities that issue insurance contracts because:

a) IFRS 9 is a significant improvement, particularly in impairment accounting and, therefore, all entities should be required to apply those new requirements at the same time and as soon as possible

b) The new Standard applies to insurance contracts, not insurance entities, and IASB members thought it would be difficult to define an insurance entity in a robust way that could be applied consistently from country to country. (See slide 15 for further information).

c) It would impair comparability of the financial statements of entities that issue insurance contracts with entities that do not.

Difficulties in defining an insurance entity

- As noted in slide 13, IASB members thought it would be difficult to define those entities that would be significantly affected by the new insurance contracts Standard.
- The new insurance contracts Standard applies to contracts that meet the definition of an insurance contract, and not to insurance entities. Consequently, an entity issuing a single insurance contract would be required to apply the new Standard.

Difficulties in defining an insurance entity (continued)

- Assuming that only entities subject to insurance regulation would be significantly affected by the new insurance contracts Standard is problematic because:
  - there may be differences between jurisdictions in the contracts to which insurance regulations apply.
  - contracts in scope may not be subject to insurance regulation. For example, fixed fee service contracts within the scope of IFRS 4 might not be regulated as insurance contracts.
  - in some jurisdictions, regulated insurance entities issue contracts without insurance risks (eg investment type products).
  - in some jurisdictions, there may be no specific regulation to identify insurance entities or businesses.
- It is increasingly common for a group to have either a parent or a subsidiary that issues insurance contracts. Unless the delayed application of IFRS 9 is accepted for the whole group, the group's financial statements may combine IAS 39 and IFRS 9 and be less understandable

Background: Transition relief in the 2013 Exposure Draft *Insurance Contracts*

The IASB tentatively confirmed the transition relief proposals in the 2013 Exposure Draft. On initial application of the new insurance contracts Standard:

a) an entity is permitted to newly designate financial assets under the fair value option as measured at fair value through profit or loss to eliminate (or significantly reduce) an accounting mismatch in accordance with paragraph 4.1.5 of IFRS 9;

b) an entity is required to revoke previous fair value option designations for financial assets if the accounting mismatch that led to the previous designation in accordance with paragraph 4.1.5 of IFRS 9 no longer exists; and

c) an entity is permitted to newly designate an investment in an equity instrument as measured at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9 and is permitted to revoke previous designations.

Feedback on the 2013 Exposure Draft *Insurance Contracts*

- Feedback on the 2013 ED was that the original transition proposals are insufficient and requested that the IASB consider further reliefs.
- The application of the new insurance contracts Standard may cause an entity to reconsider/change its objectives for its business model for some of its assets.
- Such modifications are unlikely to meet the threshold for reclassifying financial assets in accordance with the requirements in IFRS 9 (see paragraphs 4.4.1, B4.4.1-B4.4.3).