AGENDA PAPER

IFRS Foundation Trustees meeting – Due Process Oversight Committee

BEIJING	13 October 2015	**Agenda ref 3C**
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Different Effective Dates of IFRS 9 *Financial Instruments* and the new Insurance Contracts Standard

Introduction

1. The purpose of this paper is to seek the approval of the Due Process Oversight Committee (DPOC) for a shortened comment period for the forthcoming Exposure Draft (ED) of amendments to IFRS 4 *Insurance Contracts* (IFRS 4). The staff's rationale for recommending a shortened comment period is detailed in Agenda Paper (AP) 3C(i) for this meeting. AP3C(i) will also be discussed at the IASB's October 2015 meeting (as AP 14A for that meeting).

2. The remainder of this paper provides background and contextual information on the forthcoming ED to amend IFRS 4. It discusses:

   (a) the concerns raised on the different effective dates of IFRS 9 and the new insurance contracts Standard in paragraphs 3-12; and

   (b) the IASB's response to those concerns in paragraphs 13-19.

   The question to the DPOC is in paragraph 20.

Background

3. At the IASB's September 2015 meeting:

   (a) the IASB completed the deliberations on the package of proposed temporary measures to address the additional temporary accounting consequences that might arise from applying the new financial instruments Standard, IFRS 9

Financial Instruments (IFRS 9), before the new insurance contracts Standard comes into effect. The package of proposed temporary measures would amend IFRS 4 *Insurance Contracts* (IFRS 4):

(i) to give consolidated groups whose activities is predominantly insurance an optional temporary exemption from applying IFRS 9 until 2021 ('the Deferral Approach'); and

(ii) to give entities issuing insurance contracts that implement IFRS 9 the option to remove from profit or loss some of the accounting mismatches and temporary volatility that could occur before the new insurance contracts Standard is implemented ('the Overlay Approach').

(b) the IASB reviewed the due process steps that the IASB has taken in developing an Exposure Draft (ED) of Amendments to IFRS 4 (AP14E for that meeting, which was circulated to the DPOC under cover of Michelle Sansom's e-mail of 16 September[1]). The IASB confirmed that they are satisfied that the IASB has completed the necessary due process steps on the project to date and therefore instructed the staff to commence the balloting process for the ED. The IASB expects to publish the ED in December 2015.

4. Those proposals, if confirmed, will need to be issued at a time that is reasonably in advance of 1 January 2018, the mandatory effective date for IFRS 9. At the IASB's October meeting, which is the week of 19 October 2015, the IASB will be asked to set the comment period for the forthcoming ED.

5. The forthcoming ED will propose a choice of two options that are intended to address the possible accounting consequences arising from applying the new financial instruments Standard, IFRS 9 *Financial Instruments* (IFRS 9) prior to the forthcoming new insurance contracts Standard. Because those issues arise on first application of IFRS 9, the staff think it is important that the proposals, if confirmed, are published at a time that is reasonably in advance of 1 January 2018, the mandatory effective date for IFRS 9.

[1] AP14E for the IASB's September 2015 meeting can be accessed at: http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/September/AP14E-IFRS%209%20and%20IFRS%204.pdf.

The issue addressed by the ED: Different effective dates of IFRS 9 and the new insurance contracts Standard

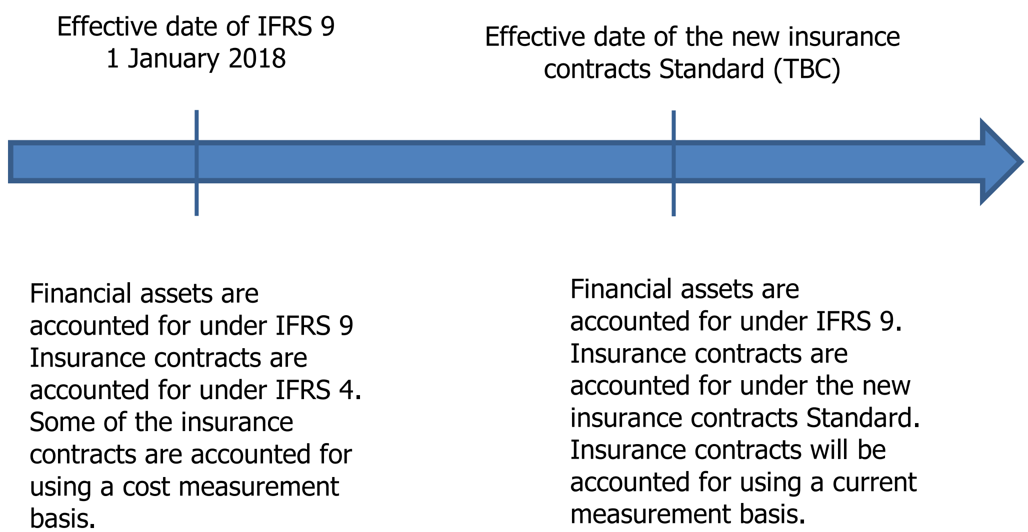
6. The IASB has a project to replace IFRS 4 with requirements for measuring insurance liabilities using a current measurement basis. IFRS 9 sets out the requirements for measuring financial instruments and the majority of assets held by an insurer are likely to be financial assets.

7. The effective date for IFRS 9 is for annual periods beginning on or after 1 January 2018. This means that the earliest possible effective date of the new insurance contracts Standard can no longer be aligned with the effective date of IFRS 9, because the IASB:

   (a) expects to finalise the new insurance contracts Standard no sooner than late 2016, and

   (b) has tentatively decided to allow a period of approximately three years after the issuance of the new insurance contracts Standard for entities to implement that Standard.

8. This is illustrated in the chart below:



9. Some interested parties are concerned that the different effective dates of IFRS 9 and the new insurance contracts Standard would result in the following:

(a) additional temporary volatility in profit or loss, which could confuse users of financial statements. Additional temporary volatility could arise in profit or loss if an entity classifies more financial assets at fair value through profit or loss (FVPL) under IFRS 9 than it did under IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) and when the entity continues to measure the insurance liability using a cost measurement basis in accordance with IFRS 4;

(b) difficulty that some entities will have in applying the classification and measurement requirements in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated. In particular, some state that the classification designations and assessments made on initial application of IFRS 9 might not be the same as those that would have made if they had initially applied the new insurance contracts Standard at the same time; and

(c) additional cost and effort for both preparers and users of financial statements as a result of two consecutive sets of major accounting changes in a short period of time.

10. Those interested parties, in particular insurers and their representative bodies, have suggested that the IASB should permit insurers to delay application of IFRS 9 (and continue to apply IAS 39) and align the effective date of IFRS 9 for insurers with the effective date of the new insurance contracts Standard.

11. A similar view was expressed by the European Financial Reporting Advisory Group (EFRAG) in its September 2015 endorsement advice for the use of IFRS 9 in the European Union (EU). The Endorsement Advice sets out EFRAG’s conclusion that IFRS 9 meets all the technical endorsement criteria of the IAS Regulation. It also sets out EFRAG’s conclusion that, overall, IFRS 9 is conducive to the European public good, except for the impact on the insurance industry of applying IFRS 9 before the finalisation of the new insurance contracts Standard. EFRAG recommends that all entities other than those carrying out insurance activities should be required to apply IFRS 9 in 2018, and that those carrying out insurance activities should be permitted to apply IFRS 9.

12. In contrast, the staff note that many users of financial statements in the extensive outreach conducted by IASB members and staff[2] agreed that ideally they would prefer the effective dates to be aligned. However, many of those users did not think that different effective dates of IFRS 9 and the new insurance contracts Standard justified any delay in the application of IFRS 9. Furthermore, some interested parties other than users are concerned that any measures the IASB might take to address the concerns in paragraph 9 could create:

    (a) disruption for entities that have already started implementing, or have implemented, IFRS 9;

    (b) delay in the application of the improved accounting for financial instruments under IFRS 9 for entities that prefer to apply IFRS 9 from its effective date; and

    (c) additional operational burden.

The IASB's response

13. The IASB noted that:

    (a) the concerns about additional accounting mismatches and temporary volatility could be addressed, at least in part, by the existing accounting requirements of IFRS 4;

    (b) the concerns about the difficulty of applying the classification and measurement requirements in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated could be addressed by the transition requirements in the new insurance contracts Standard. The IASB will be considering such requirements in the near future.; and

    (c) users of financial statement have expressed the view that some of the concerns about applying two consecutive sets of accounting changes in a short period of time could be addressed by appropriate disclosures.

[2] Agenda Paper 14A of the IASB's September 2015 meeting describes that outreach and summarises the feedback received, available at: http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/September/AP14A-IFRS%209%20and%20IFRS%204.pdf.

14. However, the IASB acknowledges that the existing accounting requirements in IFRS 4 and the transition requirement in the new insurance contracts Standard are unlikely to address all the concerns expressed by interested parties. Accordingly, the IASB decided to explore ways of addressing the concerns expressed about the different effective dates of IFRS 9 and the new insurance contracts Standards. As a result, in its Exposure Draft, the IASB is proposing:

    (a) the introduction of an option to remove from profit or loss some of the accounting mismatches and temporary volatility that could occur before the new insurance contracts Standard is implemented for all insurers (ie the 'Overlay Approach'), discussed in paragraphs 15-16); and

    (b) a temporary exemption from IFRS 9 for a narrower group of insurers (ie the 'Deferral Approach', discussed in paragraphs 17-19).

The Overlay Approach

15. In July 2015, the IASB decided to propose permitting entities that issue contracts within the scope of IFRS 4 to remove from profit or loss, and recognise in other comprehensive income, the additional volatility that could arise when IFRS 9 is applied in conjunction with IFRS 4 (ie the Overlay Approach). The adjustment would be applied to financial assets that relate to insurance activities, and that are measured at FVPL under IFRS 9 and were not so measured under IAS 39. As a result of the adjustment, overall profit or loss would reflect the result that would have been recognised for such financial assets under IAS 39.

16. Under this approach insurers would provide balance sheet information and disclosures on the profit or loss information in accordance with IFRS 9. Accordingly, doing so preserves comparability with other entities, while removing the additional volatility that results from applying IFRS 9 through a transparent adjustment in the statement of comprehensive income.

The Deferral Approach

17. In September 2015, the IASB decided to propose an optional temporary exemption from applying IFRS 9. The Deferral Approach would be available no later than for annual

periods beginning on or after 1 January 2021. This date was chosen because the IASB believes that the new insurance contracts Standard should be available to apply by that date. However, the IASB considers that, even if the new insurance contracts Standard is delayed, entities should stop applying the temporary exemption by that date. This is because IFRS 9 represents a significant improvement to the accounting requirements for financial instruments and it would not be appropriate that the exemption be given for a longer period. In addition, the IASB notes that, because it will no longer maintain IAS 39, those requirements may become outdated.

18. The temporary exemption is available for the consolidated group financial statements only when the group's predominant activity is insurance. The IASB concluded that, for that limited number of entities whose predominant activity is insurance, a temporary exemption from IFRS 9 would be a simple and effective way of dealing with most of the concerns expressed by interested parties.

19. When the IASB discussed the temporary exemption on 21 September 2015, seven IASB members voted to in favour for the temporary exemption and seven IASB members voted against. On 23 September 2015, the Chairman confirmed his additional casting vote, making the vote 8-7 in favour of the temporary exemption. The IASB was then asked whether any members would dissent to the publication of the ED that would include both the Deferral and Overlay Approaches. One IASB member present indicated they would dissent and another not present had already informed the Chair he was likely to dissent.

Question for the DPOC

20. Does the DPOC give its approval to the proposal for a shortened comment period for the forthcoming ED to amend IFRS 4, as set out in Agenda Paper 3C(i)?