IFRS

STAFF PAPER

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REG IASB Meeting

Project	Different effective dates of IFRS 9 and the new insurance contracts Standard		
Paper topic	Overview		
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Purpose of the paper

1. This paper introduces a series of papers on the different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts Standard.

2. This paper is for information only and does not ask the IASB for decisions. It provides an *overview* of:

   (a) Concerns about the different effective dates of IFRS 9 and the new insurance contracts Standard (paragraphs 6–14);

   (b) Approaches that have been or could be pursued by the IASB in order to address those concerns (paragraphs 15–34), namely:

      (i) Potential amendments to IFRS 4 *Insurance Contracts* that would apply **before initial application** of the new insurance contracts Standard (paragraphs 18–28), including the so-called:

         1. Overlay Approach (paragraphs 23–25); and

         2. Deferral Approach (paragraphs 26–28); and

      (ii) Transition reliefs for classification and measurement of financial assets **on initial application** of the new insurance contracts Standard (paragraphs 29–34);

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(c) Common considerations relating to scope, transfers of financial assets and operational implications of the approaches listed above (paragraphs 35–42); and

(d) Next steps (paragraph 43).

3. Other papers in the series discuss:

(a) Agenda Paper 14A—Feedback received by the IASB from users of financial statements about the different effective dates of IFRS 9 and the new insurance contracts Standard, including their views on the approaches the IASB could consider to address any concerns relating to that difference;

(b) Agenda Paper 14B—The Overlay Approach;

(c) Agenda Paper 14C—The Deferral Approach;

(d) Agenda Paper 14D—Comparative summary of the Overlay Approach and the Deferral Approach; and

(e) Agenda Paper 14E—Due process considerations for the potential amendments to IFRS 4.

4. Agenda Papers 14A and 14D are for information only. Agenda Papers 14B and 14C ask the IASB for decisions.

5. Agenda Papers 14–14D represent a complete package on potential amendments to IFRS 4 that would apply before initial application of the new insurance contracts Standard. Accordingly, Agenda Paper 14E asks IASB members if they are satisfied that the necessary due process steps have been completed for publication of an Exposure Draft, and hence for permission to begin the balloting process.

Concerns about the different effective dates of IFRS 9 and the new insurance contracts Standard

6. In January 2015, the IASB noted that the earliest possible effective date of the new insurance contracts Standard could no longer be aligned with the effective date of IFRS 9. This is because the IASB set the effective date of IFRS 9 for annual periods beginning on or after 1 January 2018 and it also 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.

7. Some interested parties have suggested that the IASB should permit delayed application of IFRS 9 for insurance activities and align the effective date of IFRS 9 for those activities with the effective date of the new insurance contracts Standard. A similar view was included in the draft endorsement advice on the use of IFRS 9 in the European Union (EU) issued by the European Financial Reporting Advisory Group (EFRAG) in May 2015.[1]

8. Those suggesting a deferral of IFRS 9 for insurance activities are concerned about the following:

    (a) The additional temporary volatility in profit or loss that could arise when IFRS 9 is applied in conjunction with IFRS 4, which could confuse users of financial statements;

    (b) The difficulty that some entities that issue contracts within the scope of IFRS 4 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; and

    (c) The cost and effort for both preparers and users of financial statements that will be caused by two consecutive sets of major accounting changes in a short period of time.

9. Preparers that are affected by both IFRS 9 and the new insurance contracts Standard, and their representative bodies have primarily driven that feedback.

10. The staff acknowledge those concerns. However, the staff believe that the effect of these concerns may not be as severe as at first appears because existing requirements of IFRS 4 could reduce the effects of the additional temporary volatility (see paragraph 20), and that the concerns stated in paragraphs 8(a)–(b) can be addressed in ways other than the deferral of IFRS 9. This is discussed in paragraphs 15–34.

[1] The endorsement advice on the use of IFRS 9 in the EU is expected to be finalised in September 2015.

11. The staff also acknowledge that the different effective dates of IFRS 9 and the new insurance contracts Standard will require implementation of those Standards at different times and will result in two consecutive sets of major accounting changes in a short period of time. However, the staff are not aware of any evidence that implementing the two Standards at different times would lead to significant additional costs compared to implementing them at the same time. In fact, some preparers, as well as users of financial statements, have noted that two consecutive sets of changes may be easier to implement than one major change. In addition, as described in Agenda Paper 14A, the staff note that most users of financial statements in the outreach conducted by IASB members and staff, as well as users of financial statements who submitted letters to the IASB, did not think that different effective dates of IFRS 9 and the new insurance contracts Standard justified any delay in application of IFRS 9, even if they agreed that ideally they would prefer the effective dates to be aligned.

12. Indeed, although some interested parties requested a deferral of IFRS 9 for insurance activities, other interested parties, including many users of financial statements, expressed a view that all entities should apply IFRS 9 without delay, including entities that issue insurance contracts. They also stated that deferral of the effective date of IFRS 9 for entities that issue insurance contracts would not be the only or the most appropriate way to address any of the concerns that had been identified. This view was expressed by interested parties both in Europe and in other jurisdictions.

13. Some interested parties also indicated that any temporary measures (ie any measures that would apply only until initial application of the new insurance contracts Standard) designed to address concerns raised about the different effective date of IFRS 9 should be optional rather than mandatory in order to avoid:

    (a) disruption for entities, including entities that issue contracts within the scope of IFRS 4, 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 a broad range of entities, including

entities that issue contracts within the scope of IFRS 4, that prefer to apply IFRS 9 from its effective date; and

(c) the additional operational burden of any temporary measures on a broad range of entities, including entities that issue contracts within the scope of IFRS 4, that prefer to apply IFRS 9 from its effective date.

14. In contrast, many users stated that comparability is of primary importance and therefore any measures proposed by the IASB should be mandatory for the affected entities rather than optional[2]. In particular, many users opposed providing an *option* for entities that issue contracts within the scope of IFRS 4 to delay the application of IFRS 9. Some users emphasised that doing so would reduce comparability even further within the industry that is already difficult to compare and understand.

Approaches to addressing concerns raised

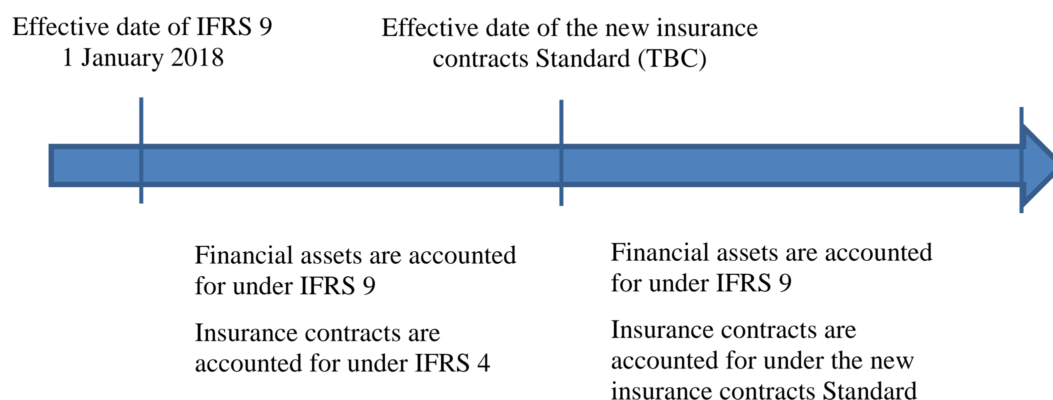
15. The staff note that concerns about the different effective date of IFRS 9 and the new insurance contracts Standard fall into two categories:

(a) Concerns discussed in paragraph 8(a) relate to the temporary effects of applying IFRS 9 in conjunction with IFRS 4, ie before the new insurance contracts Standard is initially applied; and

(b) Concerns discussed in paragraph 8(b) relate to the effects of applying IFRS 9 in conjunction with the new insurance contracts Standard.

16. This is illustrated on the chart below:

[2] Consistent with this view, many users disagree with the IASB permitting early application of any Standard. However IFRS 9 permits early application.



17. The staff think it is important to consider the concerns in paragraph 15(a) separately from those in paragraph 15(b). This is because addressing concerns related to the interaction between IFRS 9 and IFRS 4 could require amendments to the existing Standards (discussed in paragraphs 18–28). In contrast, any concerns related to the interaction between IFRS 9 and the new insurance contracts Standard could be addressed by transition provisions in that Standard (discussed in paragraphs 29–34) rather than amending existing Standards.

Potential amendments to IFRS 4

18. In June and July 2015, the IASB discussed concerns related to the interaction between IFRS 9 and IFRS 4 in the period between the effective dates of IFRS 9 and the new insurance contracts Standard. The IASB acknowledged that additional 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*.

19. The IASB also acknowledged that some of that additional volatility could be temporary, ie it would exist only until the new insurance contracts Standard is applied, if:

    (a) entities account for contracts within the scope of IFRS 4 at 'cost' (eg using 'locked-in' discount rates) under that Standard and will choose to reflect all changes in the current value of those contracts in profit or loss under the new insurance contracts Standard; or

    (b) volatility relates to the shareholder's interest in financial assets that:

(i) are measured at FVPL; and

(ii) underlie such contracts within the scope of IFRS 4 that would fall in the scope of the variable fee approach that the IASB tentatively decided should apply for contracts with direct participation features under the new insurance contracts Standard.

20. The IASB noted that the concerns about additional temporary volatility in profit or loss could be addressed by changing accounting policies for insurance contracts in accordance with IFRS 4. In particular, on initial application of IFRS 9, IFRS 4 would permit entities to:

(a) measure insurance contracts using current discount rates rather than locked-in rates; or / and

(b) apply an accounting policy that is consistent with the variable fee approach for contracts with direct participation features that is being developed for the new insurance contracts Standard.

21. However, the IASB acknowledged that, although existing IFRS 4 would permit entities to measure contracts within the scope of IFRS 4 using current discount rates rather than locked-in rates, or / and apply an accounting policy that is consistent with the variable fee approach for contracts with direct participation features that is being developed for the new insurance contracts Standard, changing accounting policy for those contracts ahead of the forthcoming application of the new insurance contracts Standard may not be attractive to preparers. This is because such a change would require additional implementation efforts. In addition, those entities could be subject to restrictions imposed by local regulatory, legal or financial reporting requirements.

22. Accordingly, the IASB decided to consider other approaches to address concerns about the temporary effects of applying IFRS 9 in conjunction with IFRS 4. Those approaches would require amendments to IFRS 4.

The Overlay Approach

23. In July 2015, the IASB tentatively decided to propose to amend IFRS 4 to permit entities that issue contracts within the scope of that Standard 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 (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, or would not have been, 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.

24. The main advantage of the Overlay Approach is that it is targeted at the specific concerns about the interaction between IFRS 9 and IFRS 4, ie the concerns about additional volatility in profit or loss for entities that issue contracts within the scope of IFRS 4 (discussed in paragraph 8(a)). This approach cannot capture just *temporary* additional volatility. This is because doing so would effectively require that entities implement the new insurance contracts Standard by the time they apply IFRS 9—otherwise they would not be able to distinguish temporary volatility from volatility that remains when the new insurance contracts Standard is applied. However, this approach captures *additional* volatility that results from applying IFRS 9 and removes that volatility by a transparent adjustment while providing information in accordance with IFRS 9. As a result, this approach facilitates comparability between entities in accounting for financial instruments.

25. Agenda Paper 14B for this meeting discusses detailed aspects of the Overlay Approach, including its scope, mechanics and presentation and disclosure requirements.

The Deferral Approach

26. In July 2015, the IASB directed the staff to also explore deferring the effective date of IFRS 9 as another way to address concerns raised by interested parties. At that time, the IASB also indicated that a package of approaches may be appropriate in order to provide useful information in different circumstances.

27. Agenda Paper 14C for this meeting discusses two alternative approaches for a deferral of the effective date of IFRS 9 for a limited number of entities, as follows:

    (a) Alternative 1—Deferring the effective date of IFRS 9 at the reporting entity level for entities that issue contracts within the scope of IFRS 4 if that activity is predominant for the reporting entity. Under this

alternative, a reporting entity would apply either IAS 39 or IFRS 9 to all its financial assets, rather than applying both IAS 39 and IFRS 9 to different populations of its financial assets.

(b) Alternative 2—Deferring the effective date of IFRS 9 at a level below the reporting entity level. This alternative would also apply to entities that issue contracts within the scope of IFRS 4. Under this alternative, a reporting entity would apply both IAS 39 and IFRS 9 in its financial statements depending on whether the financial assets relate to insurance activities or not.

28. Agenda Paper 14C discusses detailed aspects of those alternatives, including their scope, mechanics and presentation and disclosure requirements. In that paper, the staff ask whether the IASB would like to proceed with the Deferral Approach and if so, the staff recommend Alternative 1—deferring the effective date of IFRS 9 at the reporting entity level. The staff think that, *if* the IASB decides to proceed with deferring the effective date of IFRS 9 for entities that issue contracts within the scope of IFRS 4, Alternative 1 in combination with the Overlay Approach would provide more useful information than Alternative 2 either in isolation or in combination with the Overlay Approach.

Transition reliefs for financial assets on initial application of the new insurance contracts Standard

29. As stated in paragraph 8(b), some entities that issue contracts within the scope of IFRS 4 expressed concerns about having to apply the classification and measurement requirements in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated. In particular, they stated that the classification designations and assessments made on initial application of IFRS 9 might not be the same as those that they would have made if they had initially applied the new insurance contracts Standard at the same time.

30. The IASB has acknowledged those concerns. In January 2015, the IASB discussed the initial application of the new insurance contracts Standard subsequent to the initial application of IFRS 9 and tentatively decided:

(a) to confirm reliefs proposed in the 2013 Exposure Draft *Insurance Contracts* related to the classification and measurement of financial assets on transition to the new insurance contracts Standard, notably:

(i) an entity is permitted to newly designate financial assets under the fair value option (FVO) as measured at FVPL to eliminate (or significantly reduce) an accounting mismatch;

(ii) an entity is required to revoke previous FVO designations for financial assets if the accounting mismatch that led to the previous designation no longer exists; and

(iii) an entity is permitted to newly designate an investment in an equity instrument as measured at fair value through other comprehensive income (FVOCI) and is permitted to revoke previous designations; and

(b) to consider providing further transition relief to permit or require an entity to reassess the business model for managing financial assets at the date of initial application of the new insurance contracts Standard.

31. If the IASB were to confirm the further transition relief in paragraph 30(b), the combined effect of transition reliefs available on initial application of the new insurance contracts Standard would be to eliminate the uncertainty that could otherwise arise for entities that apply IFRS 9 prior to that Standard. It would provide those entities an opportunity to fully evaluate how insurance contracts are accounted for both under existing IFRS 4 and the new insurance contracts Standard when making classification assessments for financial assets under IFRS 9.

32. The staff note that some interested parties expressed concerns about the transition relief for the reassessment of business model for managing financial assets. In particular, some interested parties are concerned that this transition relief would effectively require preparers to implement IFRS 9 twice. However, the staff do not agree with this assessment. This is because implementation of IFRS 9 has a much broader scope than the assessment of business model for managing financial assets. For example, application of IFRS 9 also involves assessment of contractual cash flows characteristics of financial assets that will not be reassessed on subsequent initial application of the new insurance contracts Standard.

33. Some interested parties also state that it is not clear whether the transition relief for the reassessment of business model for managing financial assets would achieve the desired effect of providing insurers with an opportunity to classify financial assets on initial application of the new insurance contracts Standard in a way that is aligned with accounting for contracts within the scope of that Standard. However, the staff note that the transition relief for the reassessment of business model for financial assets, if confirmed by the IASB, would put preparers in the same position they would have been if they were initially applying IFRS 9 and the new insurance contracts Standard at the same time. That is, in reassessing business model for managing financial assets on initial application of the new insurance contracts Standard, preparers would be able to consider all facts and circumstances *as of that date* as opposed to having to meet the requirements for a *change* in business model under IFRS 9 which is only allowed in infrequent cases.

34. At a future meeting, the staff expect to ask the IASB to confirm transition relief that would permit or require an entity to reassess the business model for managing financial assets at the date of initial application of the new insurance contracts Standard, and to consider the following:

    (a) the scope and mechanics of reassessing the business model for managing financial assets;

    (b) whether transition reliefs for classification and measurement of financial assets should apply prospectively or retrospectively; and

    (c) whether restatement of comparative information for financial instruments that changed classification should be required.

Common considerations relating to scope, transfers of financial assets and operational implications of approaches discussed

35. The staff note that there are common questions that arise for different approaches, for example, how to identify the entities that should be eligible for each approach, and which financial assets held by the eligible entities should qualify for the approach. Similar issues also arise in determining how to account for transfers of

financial assets between parts of a reporting entity that are subject to different accounting for financial assets.

36. However, even though the questions that arise under the Deferral Approach, the Overlay Approach and the transition relief for the reassessment of the business model are the same, the appropriate answer to those questions can be different for those approaches and can involve different level of complexity. This is because the different approaches provide different information content and also differ in the period of time for which they apply, ie apply over time or only on transition to the new insurance contracts Standard.

37. For example, as discussed in Agenda Paper 14C*,* the scope of the Deferral Approach must be more strictly defined than the scope of the Overlay Approach or the reassessment of the business model because the Deferral Approach applies over time and only provides IFRS 9 information in the notes. In addition, if the Deferral Approach is applied below the reporting entity level, financial assets held by a reporting entity would be measured under both IAS 39 and IFRS 9 on the statement of financial position. This 'mixed model' means that the determination of scope of this approach is considerably more important than under the other approaches.

38. Likewise, even though transfers of financial assets must be considered by the IASB under both the Overlay Approach and the Deferral Approach, those transfers lead to different consequences and involve different considerations. This is because under the Overlay Approach all financial assets are accounted for in the same way on the statement of financial position. In contrast, as stated in paragraph 27(b), the Deferral Approach, if applied below the reporting entity level, would result in financial assets measured under both IAS 39 and IFRS 9 on the statement of financial position. As a result, under the Deferral Approach below the reporting entity level, the IASB would need to consider whether to require a change in classification and measurement of transferred financial assets on the statement of financial position and if so, how to account for such a change. That added complexity does not exist under the Overlay Approach.

39. There are also operational implications that arise under different approaches to addressing the concerns about different effective date of IFRS 9 and the new

insurance contracts Standard and that need to be considered in evaluating those approaches.

40. For example, the staff note that some interested parties are concerned that the Overlay Approach would require that an entity maintain its IAS 39 systems, including the IAS 39 impairment systems, in addition to implementing IFRS 9. However, the staff note:

    (a) the IAS 39 systems would be required only for a *subset* of financial assets that are designated as related to contracts within the scope of IFRS 4 and that are measured at fair value through profit or loss (FVPL) under IFRS 9 and were not, or would not have been so measured, under IAS 39.

    (b) there will be no need to run two impairment systems for the same financial assets because financial assets measured at FVPL are not subject to impairment requirements. While an entity would need to run an impairment system for assets that are measured at FVOCI or amortised cost under IFRS 9, that system would be needed in any event.

41. The staff emphasise that in evaluating the operational implications of each approach, the IASB should consider the operational implications of the disclosures that would be needed under each approach. In particular, the staff think that the Deferral Approach would require disclosure of IFRS 9 information. The staff note that most users of financial statements that participated in the outreach conducted by the IASB members and staff have indicated that IFRS 9 disclosures should be required for comparative purposes between those entities that apply the deferral, and those that do not, especially if delayed application of IFRS 9 is permitted, rather than required. Entities that would apply any such deferral would therefore potentially be running two systems in parallel for all their financial assets, in order to generate the required information for presentation and disclosure purposes.

42. Common questions that arise under each approach are considered in further detail in Agenda Paper 14B and Agenda Paper 14C.

Next steps

43. The staff plan to discuss the comment period for the potential amendments to IFRS 4 in October 2015 and to proceed with drafting and balloting those amendments in an expeditious manner assuming that the IASB:

    (a) tentatively decides which approach, or approaches, it would like to propose and how that approach, or approaches, should be applied (Agenda Papers 14B and 14C); and

    (b) is satisfied that the due process steps for the potential amendments to IFRS 4 are met (Agenda Paper 14E).