STAFF PAPER

September 2015

REG IASB Meeting

Project	**Different effective dates of IFRS 9 and the new insurance contracts Standard**
Paper topic	The Deferral Approach

CONTACT(S)	Yulia Feygina	yfeygina@ifrs.org	+44 (020) 7332 2743

Purpose of the paper

1. In July 2015, the IASB directed the staff to continue to explore several approaches to addressing concerns about different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts Standard, including approaches based on a deferral of the effective date of IFRS 9.

2. Accordingly, this paper discusses deferring the effective date of IFRS 9 for entities that issue contracts in the scope of IFRS 4 *Insurance Contracts* until the new insurance contracts Standard is applied (the Deferral Approach) to address those concerns. Any deferral of the effective date of IFRS 9 (hereinafter 'the deferral') for such entities would apply to all of the requirements for financial instruments in IFRS 9.

Structure of the paper

3. This paper first discusses *how* the Deferral Approach could apply, were the IASB to propose such deferral, and provides staff recommendations. It then discusses whether and why the IASB could consider proposing the Deferral Approach in addition to the Overlay Approach (discussed in Agenda Paper 14B), and transition reliefs on initial application of the new insurance contracts Standard, and asks whether the IASB would like to do so.

4. This paper is structured as follows:

(a) Summary of staff recommendations (paragraph 5)

(b) Considerations for determining the scope of the Deferral Approach (paragraphs 6–14)

(c) Alternatives for the scope of the Deferral Approach (paragraphs 15–85)

(i) Alternative 1—deferral at the reporting entity level (paragraphs 16–39)

(ii) Alternative 2—deferral below the reporting entity level (paragraphs 40–85)

(d) Optional or mandatory deferral (paragraphs 86–95)

(e) Presentation and disclosure (paragraphs 96–104)

(f) Transition (paragraphs 105–113)

(g) Staff assessment of Alternative 1 vs Alternative 2 (paragraphs 114–121)

(h) Why the Deferral Approach should be considered (paragraphs 122–125).

Summary of staff recommendations

5. ***If*** the IASB decides to propose the Deferral Approach, the staff recommend that:

(a) deferral of the effective date of IFRS 9 would be permitted for an entity that issues contracts in the scope of IFRS 4 if that activity is predominant for the reporting entity, and would apply to all financial assets held by that reporting entity;

(b) an entity would be required to initially assess whether insurance activities are predominant for the entity based on the gross liabilities arising from contracts in the scope of IFRS 4 relative to the entity's total liabilities at the date when the entity would otherwise be required to initially apply IFRS 9, ie for annual periods beginning on or after 1 January 2018;

(c) the IASB should not set a quantitative threshold for the assessment of predominance of insurance activities, however, the Basis for Conclusions for the potential amendments to IFRS 4 should include the example discussed in paragraph 24 in order to indicate how high the predominance threshold is intended to be;

(d) an entity is required to reassess whether insurance activities are predominant for the entity at subsequent annual reporting dates if there is a demonstrable change in the corporate structure of the entity (for example, an acquisition or disposal of a business) that could result in a change of the predominant activities of the entity;

(e) if an entity concludes that insurance activities are no longer predominant for the entity as a result of that reassessment, an entity is required to apply IFRS 9 from the beginning of the next annual reporting period and to disclose in the reporting period in which the reassessment took place:

  (i) the fact that it is no longer eligible for deferral;

  (ii) the reason why it is no longer eligible; and

  (iii) the date on which the change in corporate structure took place that resulted in the entity no longer meeting the predominance condition;

(f) an entity that has applied IFRS 9 is not permitted to stop applying IFRS 9 and revert to applying IAS 39;

(g) an entity that applies the deferral should be required to disclose:

  (i) the fact that the entity has chosen to delay application of IFRS 9;

  (ii) explanation of how the entity concluded that it is eligible for the deferral;

  (iii) quantitative information about carrying values and income and expenses in profit or loss and OCI that would have been recognised if an entity were applying IFRS 9 by measurement category of financial assets under IFRS 9 and by type of income and expenses; and

  (iv) those disclosures in IFRS 7 *Financial Instruments: Disclosures* that were added by IFRS 9 and that are necessary to assist users of the financial statements in understanding the IFRS 9 information provided in the notes;

for example, the disclosures that explain the basis for the estimates of expected credit losses and the reasons for changes in those amounts;

(h) quantitative information disclosed in the notes of financial statements should be provided in a way that would enable a user of financial statements to reconcile the amounts reported in accordance with IAS 39 on the face of financial statements with the amounts disclosed in the notes in accordance with IFRS 9;

(i) at the time an entity applies the deferral, it applies IFRS 9 for the purposes of disclosure in the notes to financial statements using the applicable transition provisions in IFRS 9, for example, the requirements for comparative information;

(j) an entity that applies the deferral would be permitted to stop applying the deferral and apply IFRS 9 at the beginning of any annual reporting period before the new insurance contracts Standard is applied and would be required to do so from the beginning of the annual reporting period when that Standard is initially applied; in doing that, the entity follows transition provisions in IFRS 9 in the usual way and stops providing disclosures required under the Deferral Approach.

Considerations for determining the scope of the Deferral Approach

6. There are two basic questions that the IASB needs to answer in determining the scope of the Deferral Approach:

   (a) Which entities would the Deferral Approach apply to, and

   (b) Which financial assets held by those entities would the Deferral Approach apply to.

7. The staff think that the answer to the first question is determined by the objective of the Deferral Approach—to address the concerns discussed in Agenda Paper 14 about different effective dates of IFRS 9 and the new insurance contracts Standard. Accordingly, the Deferral Approach should apply to entities that issue contracts in the scope of IFRS 4. This is because those concerns about different

effective dates arise only for entities that issue such contracts. The staff note that the same logic would apply to any approach that aims to address those concerns.

8. The main question for the IASB to consider is how to identify financial assets to which the Deferral Approach should apply. The staff note that this question arises under all approaches that aim to address the concerns about the interaction of the effective dates of IFRS 9 and the new insurance contracts Standard on the **financial asset side** of that interaction. All approaches being considered by the IASB at this meeting—the Deferral Approach, the Overlay Approach and transition reliefs for classification and measurement of financial assets on initial application of the new insurance contracts Standard—fall into that category.[1]

9. In principle, all these approaches target **financial assets that relate to insurance activities** because it is the interaction between accounting for financial assets and insurance contracts[2] that causes concerns about different effective dates of IFRS 9 and the new insurance contracts Standard. Assets and liabilities that arise directly from the application of IFRS 4 (or the new insurance contracts Standard) are easy to identify, and will be accounted for under the respective Standard. However, there is no direct link between insurance contracts and financial assets held to support insurance activities, except for assets that back direct participating contracts as described under the tentative decisions of the IASB in the *Insurance Contracts* project.

10. Some argue that even absent such a direct link, insurance contracts and financial assets are closely interrelated and the 'business model' of entities that issue insurance contracts is grounded in asset-liability management. Others argue that insurance activities exclude any financial assets, because the determination of the asset strategy is an independent decision process. These financial assets are managed in the same way regardless of whether those assets fund customer deposits or insurance contracts. In their view, accounting for financial assets should be independent from the nature of the entity's liabilities.

---

[1] Approaches that could address those concerns on the insurance contracts side of that interaction based on the existing flexibility in IFRS 4 were discussed by the IASB at the July 2015 meeting (Agenda Paper 2B).

[2] The scopes of both IFRS 4 and the new insurance contracts Standard are broader than just insurance contracts (ie contracts with insurance risk). However, in this paper the staff may refer to contracts in the scope of IFRS 4 as 'insurance contracts' and assets and liabilities that arise under that Standard, as well as those that arise under the new insurance contracts Standard, as 'insurance assets and liabilities' for brevity.

11. The staff think that absent a direct link between financial assets and insurance contracts any approach that aims to address the concerns about the interaction of the effective dates of IFRS 9 and the new insurance contracts Standard on the financial asset side of that interaction would be imprecise in scope. On one hand, it could include financial assets that do not relate to insurance activities and, on the other hand, it could fail to include financial assets that relate to insurance activities—or **both**. The staff think that those consequences are unavoidable and would need to be accepted as a feature of any approach that is designed to capture financial assets related to insurance activities. However, the staff think that it is important for the IASB to strike an appropriate balance between:

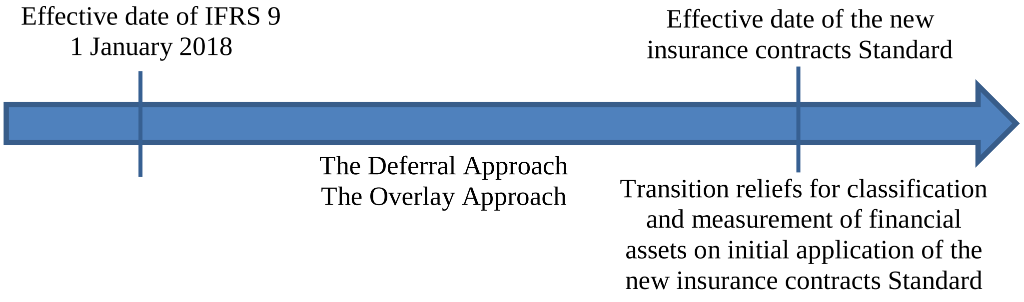
(a) excluding financial assets that do not relate to insurance activities, even if that means that some assets that relate to insurance activities are excluded from the scope, and

(b) including financial assets that relate to insurance activities, even if that means that some assets that do not relate to insurance activities are included in the scope.

12. The staff think that the appropriate balance could be different for different approaches considered by the IASB at this meeting. This is because those approaches:

(a) provide different information to users of financial statements, and

(b) apply at different times (ie during the period when IFRS 9 is applied in conjunction with IFRS 4 or at the time when the new insurance contracts Standard is initially applied) as illustrated on the chart below:



13. The staff think that, on balance, under the Deferral Approach it is more important to ensure that financial assets that *do not relate* to insurance activities are not included in the scope than it is to ensure that all financial assets that *relate* to insurance activities are included. In particular, it is important to ensure that financial assets that relate to banking activities are not included in the scope of the deferral. However, this does not equally apply to other approaches discussed at this meeting. This is because:

    (a) The Deferral Approach, is an on-going relief that applies over an undefined period of time between 1 January 2018 and the date of initial application of the new insurance contracts Standard (unless the IASB decides to place a time cap on that period). In contrast, transition reliefs for classification and measurement of financial assets are point-in-time reliefs that apply on initial applications of the new insurance contracts Standard.

    (b) The Deferral Approach does not provide improved information about financial assets in accordance with IFRS 9 on the face of financial statements and results in reduced comparability across different industries. Additionally, if delayed application of IFRS 9 is permitted rather than required, it also results in reduced comparability within the insurance industry. In contrast, the Overlay Approach provides IFRS 9 information on the face of financial statements and the overlay adjustment is presented in a transparent manner in the statement of comprehensive income which facilitates comparability both across different industries and within the insurance industry.

14. As a result, the staff think that in order to reduce the risk that financial assets that do not relate to insurance activities are included in the scope of the Deferral Approach, the scope of the Deferral Approach should be more **strictly defined** compared to the scope of other approaches.

Alternatives for the scope of the Deferral Approach

15. The staff identified two main alternatives for the scope the Deferral Approach:

(a) Alternative 1—deferral at the reporting entity level. Under this alternative, a reporting entity that issues contracts within the scope of IFRS 4 would apply the deferral to either all or none of its financial assets. This means that such a reporting entity applies only one Standard for accounting for financial instruments during the deferral period—IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement.*

(b) Alternative 2—deferral below the reporting entity level. Under this alternative, a reporting entity that issues contracts within the scope of IFRS 4 would apply the deferral to some, but not all, of its financial assets. This means that such a reporting entity simultaneously applies two Standards for accounting for financial instruments during the deferral period—IFRS 9 and IAS 39.

Alternative 1—deferral at the reporting entity level

16. Under Alternative 1, a reporting entity that issues contracts in the scope of IFRS 4 would apply the deferral to either all or none of its financial assets. That is, all financial assets held by the reporting entity would be accounted for in accordance with IFRS 9 or under IAS 39. An illustrative example of how Alternative 1 would apply is provided in Appendix A.

17. As discussed in paragraph 13, in the staff's view, under any deferral approach, it is more important to ensure that financial assets that do not relate to insurance activities are excluded from the scope than it is to ensure that all financial assets that relate to insurance activities are included in its scope. The staff therefore think that under Alternative 1 the deferral of the effective date of IFRS 9 should be available only for entities whose **predominant** activity is issuing contracts in the scope of IFRS 4. As a result:

    (a) Entities that issue such contracts but for which this activity is not predominant would not qualify for the deferral under this alternative (and therefore would apply IFRS 9 to all of their financial assets).

    (b) Financial assets that do not relate to insurance activities but are included in the scope of this alternative are kept to a minimum level.

18. In other words, Alternative 1 would apply to what some refer to as 'pure' insurers. It would not apply to entities that also engage in other types of activities to such an extent that insurance activities cannot be considered predominant for those entities.

19. The central question under Alternative 1 is how predominance should be described and assessed. That would determine the scope of Alternative 1. In particular, the IASB would need to consider:

(a) if predominance is described and assessed by reference to a single anchor, then

(i) what that anchor should be (paragraphs 20–22), and

(ii) whether the IASB should specify quantitative thresholds (paragraphs 23–24),

(b) whether the assessment of predominance should focus on a single anchor or be performed in a holistic manner and require consideration of all relevant facts and circumstances (paragraphs 25–28), and

(c) when predominance should be initially assessed and whether, and when, it should be required, or permitted, to be reassessed (paragraphs 29–39).

Single anchor for assessing predominance

Identifying a single anchor

20. If the IASB were to require a single anchor for the assessment of predominance of insurance activities, the staff think that such an anchor would have to be based on assets, liabilities, income or expenses that arise under contracts in the scope of IFRS 4. The staff think that neither the statement of financial position nor the statement of comprehensive income would provide a perfect tool for assessing predominance of insurance activities. This is because of the diversity of accounting policies applied today to insurance activities, and the diversity in the presentation of such activities in financial statements. However, the staff think that if the IASB decided to propose a single anchor for assessing predominance of insurance activities, that anchor should be the level of gross insurance contracts liabilities in the statement of financial position. The staff think that such an

anchor would result in a simple and transparent assessment and would provide more relevant and consistent conclusions. This is because:

(a) It is more difficult to identify income and expenses that relate to insurance activities in the statement of comprehensive income because these are not always separately presented in that statement. However, it is easier to identify liabilities that relate to insurance activities on the statement of financial position because these are generally presented separately.

(b) If the statement of comprehensive income were chosen as a single anchor, the IASB would need to decide whether the assessment of predominance should be based on gross amounts of income and expenses relative to total income and expenses, or whether it should be based on net amounts. The staff think it could be difficult to identify a single most appropriate anchor in the statement of comprehensive income. However, a similar question would not arise if the assessment is based on the statement of financial position. This is because that statement presents gross totals and subtotals.

(c) The staff think that totals and subtotals in the statement of financial position provide a more appropriate common denominator for assessing predominance than those in the statement of comprehensive income (if the IASB were to propose to base the assessment on the net amounts in that statement) because:

(i) presentation of totals and subtotals in the statement of financial position tends to be more consistent across entities that issue insurance contracts than presentation of totals and subtotals in the statement of comprehensive income; and

(ii) totals and subtotals in the statement of financial position tend to be more stable over time than those in the statement of comprehensive income.

21. To describe predominance by reference to gross insurance contracts liabilities, the IASB would need to specify whether the level of those liabilities should be assessed relative to:

(a) total liabilities and shareholders' equity,

(b) total liabilities.

22. The staff do not think that the level of shareholders' equity is relevant to the predominance assessment. This is because the level of shareholders' equity does not reflect the nature of an entity's business activities. In contrast, many of an entity's liabilities directly reflect the nature of an entity's business activities. For example, if an entity engages in banking activities its liabilities will reflect deposits from customers. Accordingly, the staff think that predominance should be assessed by considering gross liabilities that arise under contracts in the scope of IFRS 4 relative to total liabilities of the reporting entity.

Quantitative threshold for a single anchor

23. The staff do not think that the IASB could specify a particular quantitative threshold for when insurance activities are considered predominant. Any such specific quantitative threshold would necessarily be arbitrary.

24. However, the staff note that Alternative 1 is targeted at the entities that some describe as 'pure' insurers. It is not designed to apply to entities that engage in activities other than issuing contracts in the scope of IFRS 4, for example, banking or asset management activities, to such an extent that those entities cannot be considered 'pure' insurers. Accordingly, the staff note that predominance is intended to be a high threshold and the IASB could emphasise that it in the proposals. For example, if two thirds of an entity's liabilities are insurance liabilities and one third is deposits from customers that result from banking activities, that entity in the staff's view would not meet the predominance condition. If the IASB were to propose an assessment of predominance based on insurance liabilities, the staff think this example should be included in the Basis for Conclusions in order to indicate how high that threshold is intended to be.

Single anchor or a holistic assessment of predominance

25. Instead of requiring a single anchor for assessing predominance, the IASB could require a holistic assessment of predominance. Such a holistic assessment could take into account all relevant facts and circumstances with the objective to identify 'pure' insurers, including but not limited to the following:

(a) the level of insurance liabilities relative to other liabilities of the reporting entity,

(b) the composition of other liabilities of the reporting entity, including whether there are any liabilities that do not arise under contracts in the scope of IFRS 4 but are still relevant to insurance activities, for example, liabilities designed specifically to meet regulatory capital requirements for entities that issue insurance contracts,

(c) the level of income and expenses related to insurance activities in the statement of comprehensive income relative to various performance measures, for example:

  (i) operating profit,

  (ii) profit or loss, or

  (iii) total comprehensive income,

(d) whether the legal entity(ies) that comprise the reporting entity are regulated as insurers,

(e) if the entity is listed, whether it falls in the insurance benchmark index of the relevance stock exchanges.

26. The staff note that the advantage of a holistic assessment is that it considers a broad range of facts and circumstances in arriving at the conclusion and could therefore result in an informed and appropriate conclusion. However, the disadvantage of this approach is that is more judgemental and complex than an approach based on a single factor. For example, in a holistic assessment, an entity would need to apply judgement if different facts and circumstances lead to different conclusions—although in this instance, the staff would not expect an entity to come to a conclusions that it is a ‘pure’ insurer. In contrast, an assessment based on a single anchor would point to a single conclusion.

27. The staff think that for ‘pure’ insurers the assessment of whether insurance activities are predominant should be straightforward and a complex holistic approach is not necessary. In addition, the staff note that the Deferral Approach is intended to be short-term and should be kept as simple as possible.

28. Therefore on balance the staff think that the assessment of predominance should be based on a single anchor—the level of gross liabilities arising from contracts within the scope of IFRS 4 relative to the total liabilities of the entity.

When predominance is assessed and reassessed

Initial assessment

29. The staff think that an entity should meet the predominance condition at the point in time when it would otherwise *initially* be required to apply IFRS 9. This is because conditions may change over time.

30. For example, an entity could have been a 'pure' insurer in the past but acquired a banking business before it is required to apply IFRS 9 and as a result its activities are no longer predominantly insurance activities. In that case, in the staff's view, the entity should not be eligible for the deferral under Alternative 1 because that would result in banking activities being accounted under IAS 39.

31. Likewise, an entity could have undertaken banking activities in the past but disposed of those activities before it is required to apply IFRS 9 and as a result its activities are now predominantly insurance activities. In that case, in the staff's view, the entity should be eligible for the deferral under Alternative 1 because the deferral would capture only activities that are predominantly insurance activities.

32. Accordingly, the staff think that an entity should assess whether it is eligible for the deferral under Alternative 1 based on the conditions at the time when the entity would otherwise be required to initially apply IFRS 9, ie the beginning of the first annual reporting period beginning on or after on 1 January 2018).

33. If an entity has already early applied IFRS 9 by that time, the staff think that the entity should not be permitted to stop applying IFRS 9 and start applying IAS 39 because doing so:

    (a) would represent a change from providing improved information about financial instruments under IFRS 9 to providing inferior information about financial instruments under IAS 39, and

    (b) would disrupt trend information multiple times (ie transition to IFRS 9, followed by transition back into IAS 39, followed by repeat transition to IFRS 9 when the entity applies the new insurance contracts Standard is applied).

34. In addition, the staff note that two of the reasons some interested parties have asked the IASB to consider deferring the effective date of IFRS 9 are the additional temporary volatility that could arise in profit or loss for some entities that issue insurance contracts if IFRS 9 is applied in conjunction with IFRS 4, and the cost of first time application of IFRS 9. However, if the entity has already applied IFRS 9, the entity will have explained the effects of application of IFRS 9 to users of financial statements, and would already have incurred the related costs of first-time application.

Reassessment

35. The staff think that typically an entity would only need to assess its eligibility for the deferral once, because the deferral is intended to be a short-term approach. For example, the staff do not think that an entity should be required to perform a reassessment if there is a mere change in the level of insurance liabilities relative to total liabilities at a subsequent annual reporting date. This is because the staff do not think that such a change in itself absent other events would manifest a change in predominant activities of the entity.

36. However, the staff think that an entity that applies the deferral should be required to reassess its eligibility for the deferral under Alternative 1 at subsequent annual reporting dates if there is a demonstrable change to the corporate structure of the entity that results in a change in the predominant activities of the entity.

37. For example, if an entity acquires a bank, it would need to reassess its eligibility for the deferral under Alternative 1. If the predominance condition is no longer met as of the annual reporting date, the staff think that the entity should no longer be eligible for the deferral under Alternative 1 and therefore should be required to apply IFRS 9 from the beginning of the *next* annual reporting period. However, the staff think that an entity should be required to disclose in the reporting period when the reassessment took place:

(a) the fact that it is no longer eligible for deferral,

(b) the reason why it is no longer eligible, and

(c) the date on which the change in corporate structure took place that resulted in the entity no longer meeting the predominance condition.

38. The staff note that the proposed approach could result in some entities that are not eligible for the deferral under Alternative 1 during the entire annual reporting period applying IAS 39 during that entire period. However, as discussed in paragraphs 96–99, the staff recommend that an entity that applies the deferral is required to disclose IFRS 9 information in the notes to financial statements. That would mitigate the consequences of not providing such information on the face of financial statements. In addition, the staff do not expect such changes in the corporate structure of entities that are 'pure' insurers to occur frequently and note that the deferral is intended to be a short-term approach.

39. For the reasons stated in paragraphs 33–34, the staff think that an entity that is *not* eligible for the deferral under Alternative 1 at the effective date of IFRS 9 but becomes eligible at a later date should not be permitted to apply the deferral, ie it cannot stop applying IFRS 9 and revert to applying IAS 39 at that later date. Therefore, if an entity concludes that it is not eligible for deferral at the time when it would otherwise be required to apply IFRS 9, the entity does not need to perform subsequent reassessments.

Question 1 for the IASB—Application of Alternative 1—deferral at the reporting entity level

If the IASB decided to propose Alternative 1 for the Deferral Approach, does the IASB agree with the staff recommendations that:

a) deferral of the effective date of IFRS 9 would be permitted for an entity that issues contracts in the scope of IFRS 4 if that activity is predominant for the reporting entity, and would apply to all financial assets held by the reporting entity;

b) an entity would be required to initially assess whether insurance activities are predominant for the entity based on the level of gross liabilities arising from contracts within the scope of IFRS 4 relative to the entity's total liabilities at the date when the entity would otherwise be required to initially apply IFRS 9, ie for annual periods beginning on or after 1 January 2018;

c) the IASB should not set a quantitative threshold for the assessment of predominance of insurance activities, however, the Basis for Conclusions for the potential amendments to IFRS 4 should include the example discussed in paragraph 24 in order to indicate how high the predominance threshold is intended to be;

d) an entity is required to reassess whether insurance activities are predominant for the entity at subsequent annual reporting dates if there is a demonstrable change in the corporate structure of the entity (for example, an acquisition or disposal of a business) that could result in a change of the predominant activities of the entity;

e) if an entity concludes that insurance activities are no longer predominant for the entity as a result of that reassessment, an entity is required to apply IFRS 9 from the beginning of the next annual reporting period, and to disclose in the reporting period in which the reassessment took place:

    a. the fact that it is no longer eligible for deferral,

    b. the reason why it is no longer eligible, and

    c. the date on which the change in corporate structure took place that resulted in the entity no longer meeting the predominance condition.

f) an entity that has applied IFRS 9 is not permitted to stop applying IFRS 9 and revert to applying IAS 39?

Alternative 2—deferral below the reporting entity level

40. Under Alternative 2, a reporting entity that issues contracts in the scope of IFRS 4 would apply the deferral to some, but not all, of its financial assets. The deferral would apply to financial assets that are considered related to insurance activities in accordance with the eligibility conditions specified under Alternative 2 and would not apply to financial assets that are not considered related to insurance activities in accordance with those conditions. As a result, under Alternative 2, some financial assets in the reporting entity's financial statements will be accounted for under IFRS 9 and other financial assets will be accounted for under

IAS 39. Illustrative examples of how Alternatives 2 would apply are provided in Appendix B.

41. For the reasons discussed in paragraphs 11–14 and similar to Alternative 1, it is important for the IASB to develop robust eligibility conditions to describe financial assets that relate to insurance activities under Alternative 2 rather than, for example, allow entities to freely designate financial assets that relate to insurance activities. For those reasons, the staff think it is also important for the IASB to require consistency in application of the deferral to financial assets that relate to insurance activities under Alternative 2. That is, an entity should be required to apply the deferral to *all financial assets that relate to insurance activities* under the specified eligibility conditions under Alternative 2. An entity should be prohibited to apply the deferral to some, but not all, financial assets that relate to insurance activities under the specified eligibility conditions under Alternative 2.

42. The staff identified the following sub-alternatives for how the IASB could describe financial assets that relate to insurance activities within a reporting entity under Alternative 2:

    (a) Alternative 2.1—based on legal structure and by reference to predominance of insurance activities (paragraphs 45–47),

    (b) Alternative 2.2—based on legal structure and by reference to regulation (paragraphs 48–51), and

    (c) Alternative 2.3—based on segment reporting (paragraphs 52–55).

43. In addition, under Alternative 2, the IASB would need to consider what accounting requirements would provide most useful information about any transfers of financial assets within the reporting entity if, as a result of a transfer:

    (a) the transferred financial assets become related to insurance activities, or

    (b) the transferred financial assets become unrelated to insurance activities.

44. For example, such a change in whether financial assets are considered related to insurance activities would arise if there is a transfer of financial assets between an 'insurance arm' of the reporting entity to which IAS 39 is applied and a 'banking

arm' of the reporting entity to which IFRS 9 is applied. An illustrative example of how such transfers could be accounted for is provided in Appendix C.

Alternative 2.1—deferral below the reporting entity level based on legal structure and by reference to predominance of insurance activities

45. Under Alternative 2.1, financial assets are eligible for the deferral if they are held by a legal entity, and by subsidiaries of that legal entity, provided that those entities issue insurance contracts in the scope of IFRS 4 and insurance activities are predominant for those entities as a group.

46. The eligibility condition under Alternative 2.1 is exactly the same as under Alternative 1, ie an assessment of predominance of insurance activities. However, that condition is applied **below** the reporting entity level rather than **at** the reporting entity level. As a result, if insurance activities are **not** predominant at the reporting entity level but **are** predominant for a subgroup of entities below the reporting entity level, that reporting entity would not be eligible for deferral under Alternative 1 because the predominance threshold is not met for that reporting entity as a whole. However, it would qualify for deferral under Alternative 2.1 because the predominance threshold is met for a subgroup of entities below reporting entity level. As a result, such a reporting entity would not be able to apply the deferral to **all** its financial assets but it would be able to apply the deferral to all financial assets held within the subgroup in the reporting entity for which insurance activities are predominant. This is illustrated in Appendix B, Example 1.

47. The assessment of predominance under Alternative 2.1 is the same as under Alternative 1 and is discussed in paragraphs 20–39.

Alternative 2.2—deferral below the reporting entity level based on legal structure and regulation

48. Under Alternative 2.2, financial assets are eligible for the deferral if they are held by a legal entity that is regulated as an insurance entity, and by subsidiaries of that legal entity, other than those subsidiaries that are regulated as banks. The application of this alternative is illustrated in Appendix B, Example 2.

49. The central question under Alternative 2.2 is how to describe an entity that is regulated as an insurance entity or an entity that is regulated as a bank. The staff have reviewed regulation of insurance and banking activities and have not identified a consistent basis that could be used by the IASB to describe an entity that is regulated as an insurance entity or an entity that is regulated as a bank. The staff noted that generally the following aspects could be subject to regulation:

    (a) Authorisation of an entity to perform regulated activities such as issuing insurance contracts or taking deposits from customers,

    (b) Conduct of an entity that performs regulated activities, or

    (c) Capital requirements for an entity that is regulated.

50. The staff note that the scope of entities that are regulated differs jurisdiction by jurisdiction and is typically driven by legislation in the jurisdiction, and the subject of regulation also differs. Cross-jurisdictional initiatives do exist, for example Solvency II, but even Solvency II applies only in the European Union rather than globally. In addition, even under Solvency II, there may be differences between individual EU jurisdictions in how the requirements of Solvency II are applied in those individual jurisdictions.

51. Accordingly, the staff do not think that the IASB could define or describe an entity that is regulated as an insurance entity or an entity that is regulated as a bank. However, the IASB could still describe the scope of Alternative 2.2 by referring to entities that are regulated as insurance entities and entities that are regulated as banks without discussing regulation in more detail. In that case, entities would need to determine whether they are regulated as insurance entities or regulated as banks under the applicable laws and regulations in their jurisdictions. There could thus be differences in how Alternative 2.2 would be applied by insurance entities in different jurisdictions due to differences in how the scope of regulation might be defined in a particular jurisdiction.

Alternative 2.3—deferral below the reporting entity level based on segment reporting

52. Some interested parties suggested that the scope of a deferral of IFRS 9 could be based on segment reporting requirements in accordance with IFRS 8 *Operating*

Segments. Under Alternative 2.3, a reporting entity would apply IAS 39 to financial assets that are allocated to the identified operating segment that engages in insurance activities and would apply IFRS 9 to all other financial assets held in the reporting entity. The IASB could also consider restricting the scope of Alternative 2.3 to financial assets held by *reportable* segments of a reporting entity that engage in insurance activities. Such segments could capture legal entities, similar to Alternatives 2.1 and 2.2, or they could cut across legal entities.

53. However, the staff note that a reporting entity may be identifying its segments on a basis other than by industry or the types of activities conducted. For example, a reporting entity may be identifying its segments on a geographical or market basis. Such entities would not qualify for a deferral under Alternative 2.3.

54. In addition, the staff note that Alternative 2.3, whereas not as permissive as designation of financial assets as related to insurance activities under the Overlay Approach discussed in Agenda Paper 14B, could still provide some flexibility to entities in identifying financial assets that relate to insurance activities. That would be inconsistent with the need to ensure a strict and well-defined scope for the Deferral Approach as discussed in paragraph 14.

Staff recommendation on the eligibility conditions for Alternative 2—deferral below the reporting entity level

55. If the IASB were to pursue deferral of the effective date of IFRS 9 below the reporting entity level, the staff recommend that the IASB should follow Alternative 2.1 that relies on legal structure and predominance of insurance activities. The staff think that Alternative 2.1 would ensure greater consistency around the world in identifying financial assets that relate to insurance activities and greater comparability compared to:

(a) Alternative 2.2 that relies on local laws and regulations in each particular jurisdiction, or

(b) Alternative 2.3 that relies on how a reporting entity identifies its reportable segments.

Question 2 for the IASB—Scope of Alternative 2—deferral below the reporting entity level

If the IASB decided to propose Alternative 2 for the Deferral Approach, does the IASB agree with the staff recommendations that below the reporting entity level financial assets are eligible for the deferral if they are held by a legal entity, and by subsidiaries of that legal entity, provided that those entities issue insurance contracts in the scope of IFRS 4 and that activity is predominant for those entities as a group?

Transfers of financial assets

56. As discussed in paragraph 43–44, under Alternative 2 the IASB would need to set out accounting requirements that would provide useful information to users of financial statements about transfers of financial assets between:

(a) parts of the reporting entity to which the deferral is applied, and

(b) parts of the reporting entity that are not eligible for the deferral.

57. Some interested parties argue that, at present, such transfers of financial assets within a reporting entity are not common in practice. Others note that when such transfers take place, they could be significant. Others, notably users of financial statements, express a concern that such transfers could become more common in the future.

58. The staff think that the IASB should specify accounting requirements for transfers of financial assets irrespective of how common or significant they are. This is because there is no accounting guidance under existing Standards that could be relevant to such transfers (ie normally common accounting policies are applied within a reporting entity). Such requirements would need to ensure that useful information is provided to users of financial statements when such transfers do happen.

59. An illustrative example of such transfers and how they could be accounted for is provided in Appendix C.

60. The staff have identified the following approaches to accounting for transfers of financial assets for the IASB to consider:

(a) Approach A (paragraphs 63–71)—Accounting for financial assets is determined by the origin of the transfer. Changes in classification and measurement of financial assets upon a transfer are prohibited. As a consequence, no gains or losses would arise as a result of a transfer under this Approach A.

(b) Approach B (paragraphs 72–82)—Accounting for financial assets is determined by the destination of the transfer. Changes in classification and measurement of financial assets upon a transfer are required if the transferred financial assets are accounted for differently under IAS 39 and IFRS 9. This approach could give rise to gains and losses in an entity's consolidated financial statements upon an internal transfer and the IASB would need to decide how an entity should account for such gains and losses in order to provide the most useful information to users of financial statements.

61. The staff have also considered the merits of requiring one-way changes in classification, for example:

(a) require a change in classification when a financial asset is transferred out of the 'IAS 39 world' into the 'IFRS 9 world' but prohibit changes in classification for transfers in the opposite direction, or

(b) prohibit a change in classification when a financial asset is transferred out of the FVPL category under one Standard and into a different category under the other Standard, but require a change in classification for all other transfers.

62. However, the staff do not think that one-way changes in classification should be pursued because such approaches would increase complexity and decrease comparability for users of financial statements. In addition, the approach discussed in paragraph 61(b) would be inconsistent with the classification logic in IFRS 9 according to which different classification and measurement categories are more suitable for particular financial assets and business models. Further, that approach would be inconsistent with the reclassification logic in IFRS 9 according to which reclassification of financial assets could occur between all classification

categories in those infrequent cases when the business model for managing financial assets changes.

Approach A—Accounting for financial assets is determined by the origin of the transfer

63. This is a simpler approach of the two approaches considered by the staff. Under Approach A, the IASB would not need to develop requirements on the mechanics for how to account for changes in classification of financial assets upon a transfer and entities would not need to change their accounting when such transfers take place.

64. However, under Approach A, a subset of financial assets held by the part of the reporting entity that is **ineligible** for the deferral would be accounted for under IAS 39 at the reporting entity level as a result of an internal transfer that originated in the part of the reporting entity that is eligible for the deferral. This outcome is inconsistent with the main principle for the scope of the Deferral Approach discussed in paragraph 13. That principle states it is important that financial assets that do not relate to insurance activities are not included in the scope of the Deferral Approach.

65. Likewise, a subset of financial assets held by the part of the reporting entity that is **eligible** for the deferral would be accounted for under IFRS 9 at the reporting entity level as a result of an internal transfer if that transfer originated in the part of the reporting entity that is ineligible for the deferral. This outcome would be inconsistent with the objective of the Deferral Approach that is to target financial assets that relate to insurance activities.

66. In addition, this approach would provide entities with an opportunity to 'choose' the applicable Standard for accounting for financial instruments (ie IAS 39 or IFRS 9) by choosing where in the reporting entity to initially recognise financial assets and then transfer those financial assets to the part of the reporting entity where those financial asserts are intended to be used.

67. To facilitate transparency, the IASB could require separate presentation of transferred financial assets on the face of the statement of financial performance, and disclosures about such transfers in the notes. For example, the IASB could

require entities to separately present financial assets accounted for in accordance with IAS 39 and IFRS 9 held by:

(a) parts of the reporting entity to which the deferral is applied, and

(b) parts of the reporting entity that are not eligible for the deferral.

68. However, that staff think that such a presentation could be confusing.

69. In addition, the IASB could require disclosure of the carrying amounts of the transferred financial assets and gains and losses that would have been recognised if the entity applied the applicable Standard for financial instruments at the destination of the transfer.

70. However, whereas such requirements could achieve transparency about the fact of the transfers taking place, the staff think it would be difficult to provide transparency about the financial impact of those transfers on the *face* of the financial statements because there is no change in classification and measurement as a result of a transfer under Approach A.

71. As noted in paragraph 57, the staff acknowledge that those transfers may not be common in practice today. However, the staff think that an approach that gives entities an opportunity to choose the applicable Standard for financial instruments without presentation of financial impact of those transfers on the face of the financial statements would not provide useful information to users of financial statements if such transfers become more common or are significant. Indeed, many users who participated in the outreach conducted by the IASB members and staff expressed concerns about transfers of financial assets if the IASB were to pursue the deferral below the reporting entity level.

Approach B—Accounting for financial assets is determined by destination of the transfer

72. Under Approach B, the IASB would need to develop requirements on the mechanics for how to account for transfers of financial assets between parts of the reporting entity that are and those that are not eligible for the deferral and entities would need to apply those requirements when such transfers take place. Those requirements would be needed even if the transferred financial assets are in the same classification category under both Standards, except if the financial asset

was measured at FVPL. This because even if the classification category is the same—for example, amortised cost—measurement of financial assets in that category under IAS 39 and IFRS 9 would be different, notably due to different impairment requirements. Accordingly, the staff think that this approach is a more complex approach of the two approaches considered by the staff.

73. Under this approach, the reporting entity would always account for financial assets held by the parts of the reporting entity that are **ineligible** for the deferral in accordance with IFRS 9, even if those financial assets have been internally transferred from the part of the reporting entity that is eligible for the deferral.

74. Likewise, the reporting entity would always account for financial assets held by the parts of the reporting entity that are **eligible** for the deferral in accordance with IAS 39 even if those financial assets have been internally transferred from the part of the reporting entity that is ineligible for the deferral.

75. The staff think that those outcomes are consistent with both the objective and the main principle for the Deferral Approach. That is, financial assets that are considered related to insurance activities under the applicable eligibility condition under Alternative 2 would be accounted for under IAS 39 and financial assets that are not considered related to insurance activities under those conditions, for example, financial assets that relate to banking or asset management activities, would be accounted for under IFRS 9.

76. The staff note that, similar to Approach A, Approach B would also give entities an opportunity to 'choose' the applicable Standard for financial instruments—in this case, by choosing where in the reporting entity to transfer financial assets. However, where that results in a change in classification and measurement of financial assets (ie in all cases except when transferred financial assets are accounted for at FVPL both under IAS 39 and IFRS 9), any resulting gain or loss could be separately presented on the face of the financial statements, and accompanied by disclosure in the notes to financial statements.

77. Accordingly, the staff think that Approach B could provide greater transparency for users of financial statements than Approach A. Indeed, many users of financial statements who participated in the outreach performed by the IASB members and staff emphasised that if the IASB were to proceed with a deferral

below the reporting entity level transparency around such transfers would be very important for them.

78. The staff have identified two ways to account for any gain and losses resulting from changes in classification and measurement upon a transfer of financial assets under Approach B:

(a) Approach B1—Any difference between (i) the carrying value of the financial asset under the applicable Standard for financial instruments at the origin of the transfer and (ii) the initial carrying value of the financial asset under the applicable Standard for financial instruments at the destination of the transfer is recognised and separately presented in profit or loss.

(b) Approach B2— Any difference between (i) the carrying value of the financial asset under the applicable Standard for financial instruments at the origin of the transfer and (ii) the initial carrying value of the financial asset under the applicable Standard for financial instruments at the destination of the transfer is recognised and separately presented in other comprehensive income (OCI).

79. The staff note that the IASB could also require that some, or all, of gains and losses that arise on transfers of financial assets are recognised directly in retained earnings. The IASB could also require a change in classification and measurement upon a transfer but prohibit immediate recognition of gains and losses. Instead, the IASB could require that the carrying value of the financial asset under the applicable Standard for financial instruments at the origin of the transfer becomes the initial carrying amount of that asset at the destination of the transfer. Subsequent to the transfer, the financial asset would be accounted under the applicable Standard for financial instruments at the destination of the transfer. However, the staff think that both those approaches lack transparency and the latter approach is also complex and therefore do not consider those approaches further.

80. The staff think that if the IASB were to follow Approach B for accounting for transfers of financial assets, the IASB should pursue Approach B1. This is because, in the staff's view, recognition of gains and losses on such transfers in

profit or loss is a more transparent approach than recognising those gains and losses in OCI. In addition, if the IASB were to pursue Approach B2, the IASB would also need to consider whether the balance accumulated in OCI as a result of those transfers should be reclassified to profit or loss and if so, when and on what basis. That would introduce additional complexity for prepares and users of financial statements.

81. The staff think that the mechanics of Approach B1 would facilitate the transparency around transfers. Under Approach B1, **transfers are reported at fair value**. Subsequent to the transfer, the financial asset is accounted for under the applicable Standard for financial instruments. So for example, if a financial asset is transferred out of the amortised cost category under IAS 39 and into amortised cost category under IFRS 9 the financial asset upon a transfer would be recorded at fair value, followed by recognition of the appropriate allowance for expected credit losses under IFRS 9.

82. Similarly, consistent with the logic whereby transfers of financial assets are treated like outright sales but with maximum transparency and separate presentation of gains and losses in profit or loss, the staff think that if a financial asset is transferred out of the available-for-sale category under IAS 39 or out of the FVOCI category under IFRS 9 any gains and losses accumulated on those financial assets in OCI should be immediately reclassified (recycled) to profit or loss.

Staff recommendation on accounting approach to transfers under Alternative 2—deferral below the reporting entity level

83. The staff think that both Approach A and Approach B to accounting for transfers of financial assets have significant shortcomings in that entities would effectively be in a position to ‘choose’ which Standard to apply to particular financial assets by:

(a) either choosing where in the reporting entity to initially recognise financial assets (Approach A), or

(b) choosing where in the reporting entity to transfer financial assets (Approach B).

84. The staff think that this is an unavoidable consequence of a deferral that is applied below the reporting entity level and therefore it can be mitigated only by presentation and disclosure requirements.

85. However, if the IASB were to pursue the deferral below the reporting entity level, on balance, the staff think that Approach B1 would provide more useful information. This is because Approach B1:

(a) is consistent with both the objective and the main principle for the Deferral Approach; that is, to ensure that financial assets that do not relate to insurance activities are accounted for under IFRS 9 and financial assets that relate to insurance activities are accounted for under IAS 39;

(b) provides transparency about both the fact that a transfer has occurred and the financial impact of transfers of financial assets on the face of profit or loss;

(c) avoids the added complexity for users of financial statements that would arise if financial assets were accounted for both under IAS 39 and IFRS 9 not only within the same reporting entity but also within the same *part* of a reporting entity.

Question 3 for the IASB—Transfers of financial assets under Alternative 2—deferral below the reporting entity level

If the IASB decided to propose Alternative 2 for the Deferral Approach, does the IASB agree with the staff recommendations that:

a) transfers of financial assets between parts of the reporting entity to which the deferral is applied and those that are not eligible for the deferral are accounted for at fair value as of the date of the transfer with any gains and losses arising on those transfers recognised in profit or loss?

b) an entity should be required to separately present any such gains on losses on the face of the statement of profit or loss?

Optional or mandatory deferral

86. As discussed in Agenda Paper 14, interested parties that raised concerns about different effective dates of IFRS 9 and the new insurance contracts Standard, suggested that entities should be permitted, rather than required to delay the application of IFRS 9. This is because those concerns are driven by individual circumstances of reporting entities, notably their existing accounting policies for insurance contracts and the composition of their asset portfolios, and therefore the concerns arise for some, but not all, entities that issue insurance contracts.

87. For the same reason, some interested parties also suggested that entities should be permitted to delay the application of IFRS 9 for some, but not all, financial assets that relate to insurance activities within an entity. This is because different parts of the reporting entity, for example subsidiaries in different jurisdictions, could be applying different accounting policies for insurance contracts liabilities as permitted under IFRS 4.

88. Likewise, as discussed in Agenda Paper 14, interested parties that prefer to apply IFRS 9 on its effective date also requested that any temporary measures proposed by the IASB to address the concerns about different effective dates of IFRS 9 and the new insurance contracts Standard should be optional to avoid disruption and additional operational burden for a broad range of entities.

89. In contrast, many, although not all, users of financial statements that participated in the outreach conducted by the IASB members and staff, expressed a strong preference that any approach proposed by the IASB to address the concerns about different effective dates of IFRS 9 and the new insurance contracts Standard should be mandatory rather than optional to ensure comparability at least within the insurance sector even if cross-sector comparability is not achieved.

90. Other users of financial statements, although a minority, stated that the insurance sector is already non-comparable due to the diversity in accounting for insurance contracts and therefore the added lack of comparability for financial assets would not significantly complicate their analysis.

91. Many users of financial statements, including those who opposed to the optional deferral, agreed that disclosure of IFRS 9 information in the notes to financial

statements would help to address the lack of comparability that would otherwise arise if the IASB permitted rather than required the deferral of IFRS 9.

92. The staff have considered the feedback from different interested parties and recommend that if the IASB were to propose the Deferral Approach, the deferral should be permitted, rather that required, for entities that issue contracts in the scope of IFRS 4. This is because:

(a) IFRS 9 and the accompanying new disclosure requirements represent a significant improvement in accounting for financial instruments that is relevant for all entities. It is important that those changes (particularly in relation to accounting for impairment) are available for application on a timely basis by all entities that have financial instruments.

(b) Concerns about additional temporary volatility in profit or loss when IFRS 9 is applied in conjunction with IFRS 4 arise for those entities that issue contracts in the scope of IFRS 4 and currently account for them at a locked-in discount rate. Therefore, in the staff's view, it would not be appropriate to require entities that apply different accounting policies for contracts in the scope of IFRS 4 and would not experience additional temporary volatility to delay application of IFRS 9.

(c) Some entities have already implemented, or have started implementing, IFRS 9. The staff think it is important not to put those entities at a disadvantage by requiring delayed application of IFRS 9.

(d) The added incomparability between financial statements of entities that issue insurance contracts that would result from permitting, rather than requiring, the deferral of IFRS 9 could be mitigated by disclosure requirements. In addition, such added incomparability is expected to exist for a short period of time.

(e) Permitting, rather than requiring, delayed application of IFRS 9 would be consistent with the IASB's tentative decision in July 2015 to permit, rather than require, the overlay adjustment. It would allow the IASB to propose a package of approaches that would address different circumstances in a way that would provide useful information.

93. However, as discussed in paragraph 41, the staff think that if the IASB were to propose deferral below the reporting entity level (Alternative 2), the deferral once elected should be applied to all financial assets held by all eligible parts of such reporting entities. In other words, in the staff's view, entities should not be permitted to delay the application of IFRS 9 for some, but not all, of their financial assets that are considered related to insurance activities under the proposed eligibility condition under the Deferral Approach.

94. For example, if an entity has Subsidiary A and Subsidiary B that both undertake insurance activities and are eligible for the deferral below reporting entity level, the entity would be required to apply the deferral to both financial assets held by Subsidiary A and Subsidiary B or to neither of them. An entity would be prohibited to apply the deferral to financial assets held by Subsidiary A not to financial assets held by Subsidiary B or vice versa.

95. In addition, for the reasons stated in paragraphs 33-34, the staff think that an entity that is eligible for the deferral, should be required to make the election to apply the deferral on the date when it would otherwise be required to initially apply IFRS 9. An entity that *is* eligible for the deferral at the effective date of IFRS 9 but chooses not to apply the deferral and instead applies IFRS 9 should not be permitted to stop applying IFRS 9 at a subsequent annual reporting date and revert to applying IAS 39, even if it continues to be eligible for the deferral. In other words, once an entity applies IFRS 9, it is not permitted to stop applying IFRS 9 and revert to applying IAS 39.

Question 4 for the IASB—Optional or mandatory deferral
If the IASB decided to propose the Deferral Approach, does the IASB agree with the staff recommendation that an entity should be permitted, rather than required, to apply the Deferral Approach to eligible financial assets?

Presentation and disclosure

96. The staff think that if the IASB decides to permit delayed application of IFRS 9, the IASB should set out presentation and disclosure requirements that would enable users of financial statements to evaluate the effects of IFRS 9 had it been

applied during the reporting period and to ensure comparability both within the insurance sector and across sectors. That is consistent with the feedback from users of financial statements noted in paragraphs 89–91. In addition, some users of financial statements stated that providing IFRS 9 information in the notes to financial statements (in case of a delayed application of IFRS 9) would also allow them to better prepare and to educate themselves about the upcoming effects on the entity of that Standard.

97. The staff think that specific presentation and disclosure requirements would depend of the scope alternative that the IASB decides to propose under the Deferral Approach.

98. The staff think that under either alternative an entity should be required disclose:

(a) the fact that the entity has chosen to delay application of IFRS 9,

(b) an explanation of how the entity concluded that it is eligible for the deferral,

(c) quantitative information about carrying values and income and expenses in profit or loss and OCI that would have been recognised if an entity were applying IFRS 9 by measurement category of financial assets under IFRS 9 and by type of income and expenses,

(d) those disclosures in IFRS 7 *Financial Instruments: Disclosures* that were added by IFRS 9 and are necessary to assist users of the financial statements in understanding the IFRS 9 information provided in the notes, for example, the disclosures that explain the basis for the estimates of expected credit losses and the reasons for changes in those amounts.

99. The quantitative information in the notes should be disclosed in a way that would enable a user of financial statements to reconcile the amounts reported in accordance with IAS 39 on the face of financial statements with the amounts in accordance with IFRS 9 disclosed in the notes.

100. An entity should also be required to provide disclosures discussed in paragraph 37 if an entity performs a reassessment of predominant activities and concludes that the predominance condition is no longer met at the reporting date.

101. In addition, the staff think that the following should apply if the IASB decides to propose deferral below the reporting entity level:

(a) an entity should be required to separately present on the face of the financial statements the carrying values and income and expenses recognised in profit or loss and other comprehensive income under IAS 39 and IFRS 9,

(b) if an entity has transferred financial assets between parts of the entity that are subject to the deferral and those that are not, an entity should be required to disclose that fact,

(c) if the IASB decides to prohibit changes in classification and measurement of financial assets upon a transfer, entities should be required to disclose the carrying amounts of the transferred financial assets and gains and losses that would have been recognised if the entity had applied the applicable Standard for financial instruments at the destination of the transfer,

(d) if the IASB decides to require changes in classification and measurement upon a transfer, entities should be required to:

(i) separately present on the face of the statement of profit or loss (under Approach B1) or OCI (under Approach B2) gains and losses recognised on a transfer, and

(ii) disclose information about carrying amount, income and expenses that would have been recognised on the transferred financial assets in profit or loss and OCI in accordance with the applicable Standard for financial instruments at the origination of the transfer until financial assets are derecognised.

102. Presentation and disclosure of comparative information on transition in and out of the Deferral Approach are discussed in the transition section (paragraphs 108–109).

103. The staff acknowledge that the proposed presentation and disclosure requirements would create an operational burden on preparers. However, the staff do not think that the Deferral Approach accompanied by the proposed presentation and

disclosure requirements would put preparers at a significant disadvantage compared to applying IFRS 9 at its effective date, except if the IASB decides to propose deferral below the reporting entity level. This is because, in either case, entities will need to implement IFRS 9 and apply it from 1 January 2018, if only for disclosure purposes. Absent application of IFRS 9 by an entity, those disclosures are important in order to facilitate comparison between entities.

104. Indeed, the staff think that concerns about operational burden created by applying IFRS 9 from its effective date for disclosure purposes under the Deferral Approach are outweighed by the need of users of financial statements for comparability, and those needs were clearly stated in the outreach with users of financial statements conducted by the IASB members and staff.

Question 5 for the IASB—Presentation and disclosure
If the IASB decided to propose the Deferral Approach, does the IASB agree with the staff recommendations for presentation and disclosure requirements under the Deferral Approach set out in paragraphs 98–101, including the requirement to provide those disclosures in IFRS 7 that were added by IFRS 9 and are necessary to assist users of the financial statements in understanding the IFRS 9 information provided in the notes?

Transition

105. The staff have identified two sets of questions that relate to transition under the Deferral Approach:

   (a) transition questions that arise during the time when the Deferral Approach would be available (ie during the time when absent the deferral IFRS 9 would be applied in conjunction with IFRS 4) (paragraphs 107–110), and

   (b) transition questions that arise at the time when the new insurance contracts Standard is applied and the Deferral Approach is no longer available (paragraphs 111–113).

106. The staff think that the first set of questions that relate to the period of time **before initial application** of the new insurance contracts Standard form an integral part of potential amendments to IFRS 4 and should be addressed as part of those amendments. In contrast, transition questions that arise **on initial application** of the new insurance contracts Standard relate to the redeliberations of that new Standard. However, they are still covered in this paper for completeness and also because they provide additional considerations about the appropriateness of the Deferral Approach.

Transition in and out of the Deferral Approach before the new insurance contracts Standard is applied

107. As stated in paragraph 95, the staff think an eligible entity should be permitted to start applying the Deferral Approach only at the time when it would otherwise have been required to start applying IFRS 9, ie for annual periods beginning on or after 1 January 2018. If an entity has early applied IFRS 9, in the staff's view, it should not be permitted to stop applying IFRS 9 and revert to applying IAS 39, for the reasons discussed in paragraphs 33–34.

108. When the entity first applies the Deferral Approach, no special transition provisions are needed. An entity just continues to apply IAS 39 and starts providing the additional disclosures required under the Deferral Approach. In applying IFRS 9 for disclosure purposes, an entity follows applicable transition provisions in IFRS 9, for example, the requirements for comparative information. So for example, an entity would not be required, but would be permitted, to provide comparative disclosures of IFRS 9 information, provided that it is possible without the use of hindsight.

109. The staff think that an entity that applies the Deferral Approach should be permitted to stop doing so and to start applying IFRS 9 from the beginning of any annual reporting period before the new insurance contracts Standard is applied (at which time an entity must apply IFRS 9). This is because IFRS 9 represents improved accounting for financial instruments and should be applied as soon as possible. At that point, an entity applies transition requirements in IFRS 9 in the usual way and stops providing the disclosures required under the Deferral Approach. The staff think that the existing transition provisions in IFRS 9 would

be sufficient even if the IASB decides to propose the deferral below reporting entity level. This is because the eligibility condition proposed in this paper for the deferral below the reporting entity level applies to legal entities within a consolidated group. The existing provisions in IFRS 9 are able to be applied at that level.

110. As stated in paragraph 95, for the reasons discussed in paragraph 33–34, the staff recommends that if an entity stops applying the Deferral Approach and starts applying IFRS 9, it should not be permitted to subsequently stop applying IFRS 9 and revert to applying IAS 39.

Transition out of the Deferral Approach at the time the new insurance contracts Standard is applied

111. In paragraph 109, the staff stated that if an entity that applies the deferral *chooses* to stop applying the deferral and applies IFRS 9 **before the initial application** of the new insurance contracts Standard, that entity would:

(a) follow the transition provisions in IFRS 9 in the usual way both in case of deferral at the reporting entity level and below reporting entity level, and

(b) stop applying disclosures required under the Deferral Approach.

112. The staff think that, absent specific transition reliefs in the new insurance contracts Standard, the same would apply to an entity that is *required* to stop applying the deferral and apply IFRS 9 **on initial application** of the new insurance contracts Standard, except in this case an entity would also apply the new insurance contracts Standard at the same time. However, this leads to a question about the interaction between transition provisions of these two Standards, and specifically the presentation of comparative information:

(a) under IFRS 9, entities are not required to restate comparative information but are permitted to do so *if* it is possible without the use of hindsight; in addition, even if comparative information is restated, entities are prohibited from applying IFRS 9 to financial assets that have been derecognised before the date of initial application;

(b) in contrast, under the 2013 Exposure Draft *Insurance Contracts*, entities will restate comparative information (and that new Standard will apply retrospectively to all contracts within its scope).

113. As a result, if restatement of comparative information under IFRS 9 is not possible without the use of hindsight, or an entity chooses not to restate as permitted under IFRS 9, there will be a disconnect in presentation of comparative information ***if*** IFRS 9 and the new insurance contracts Standard are initially applied at the same time (that is, the comparative information would be presented under a combination of IAS 39 and the new insurance contracts Standard). In the staff view, this consideration represents a disadvantage of the Deferral Approach.

Question 6 for the IASB—Transition under the Deferral Approach

If the IASB decided to propose the Deferral Approach, does the IASB agree with the staff recommendation that:

(a) at the time an entity applies the deferral, it applies IFRS 9 for the purposes of disclosure in the notes to financial statements using the applicable transition provisions in IFRS 9, for example, the requirements for comparative information,

(b) an entity that applies the deferral would be permitted to stop applying the deferral and apply IFRS 9 at the beginning of any annual reporting period before the new insurance contracts Standard is applied and would be required to do so from the beginning of the annual reporting period when that Standard is initially applied; in doing that, the entity follows transition provisions in IFRS 9 in the usual way and stops providing disclosures required under the Deferral Approach?

Staff assessment of Alternative 1 vs Alternative 2

114. In the staff's view, the main advantage of Alternative 1 (deferral at a reporting entity level) over Alternative 2 (deferral below the reporting entity level) is that Alternative 1 is a simple alternative both for preparers and users of financial

statements and does not result in simultaneous application of IFRS 9 and IAS 39 in a single reporting entity. One disadvantage of this alternative is that it does not capture financial assets that relate to insurance activities **unless** such activities are predominant. Accordingly, Alternative 1 would only capture a relatively narrow population of entities and would therefore not address all concerns about different effective dates of IFRS 9 and the new insurance contracts Standard, if applied **in isolation** from other approaches that address those concerns. However, the staff note that Alternative 1 could complement the Overlay Approach that would be available to a broader population of entities, including those that would not be eligible for deferral under Alternative 1.

115. Another disadvantage of Alternative 1 is that, even with a high predominance threshold, it could still capture some financial assets that do not relate to insurance activities, including financial assets that relate to banking activities, as long as insurance activities are predominant for the reporting entity. That undesirable effect could to some degree be mitigated by disclosure of IFRS 9 information in the notes to financial statements.

116. Alternative 2 applies at a more granular level within a reporting entity compared to Alternative 1. Accordingly, it would include in its scope more financial assets that relate to insurance activities and fewer financial assets that do not relate to insurance activities. In other words, Alternative 2 would be better suited to meet the objective and the main principle of the Deferral Approach than Alternative 1, if Alternative 1 were applied **in isolation** of other approaches.

117. However, Alternative 2 introduces significant added complexity for both preparers and users of financial statements related to application of two Standards for financial instruments in one set of financial statements. It would also make those financial statements less understandable and result in less useful information. Indeed, many, although not all, users of financial statements who participated in the outreach conducted by the IASB members and staff did not support the deferral below the reporting entity level. In addition, applying different accounting Standards to account for identical financial assets within a single set of financial statements, in the staff's view, is conceptually inappropriate and is inconsistent with IFRS 10 *Consolidated Financial Statements* that requires application of consistent accounting policies in consolidated financial statements.

118. Moreover, Alternative 2 also introduces additional complexity related to transfers of financial assets and provides an opportunity for accounting arbitrage. Many users of financial statements who participated in the outreach conducted by the IASB members and staff raised significant concerns about transfers of financial assets and earnings management opportunities that such transfers could present. As discussed in paragraph 76, those consequences could be mitigated by separate presentation of the financial impact of those transfers on the face of profit or loss, and accompanying disclosures. However, the staff think that those consequences still represent a major drawback of Alternative 2, even if transparent presentation and disclosure of the effects of such transfers is required.

119. From the operational viewpoint, the staff think that Alternative 2 would present greater challenges than Alternative 1. Both alternatives would require maintaining IAS 39 systems and implementing IFRS 9 systems. However, Alternative 2 presents an additional complexity related to the need to present both IAS 39 and IFRS 9 information on the face of financial statements.

120. The staff have considered:

(a) advantages and disadvantages of Alternative1 and Alternative 2,

(b) how these advantages and disadvantages could be mitigated,

(c) feedback from users of financial statements, and

(d) operational implications for preparers.

121. Based on the above considerations, the staff think that Alternative 1 would result both in more useful information for users of financial statements and lesser operational challenge for preparers. This is because it is a simple alternative that does not provide an opportunity for accounting arbitrage and captures entities that are 'pure' insurers and therefore are most impacted by the interaction of accounting for financial assets and insurance contracts. The disadvantages of this alternative could be mitigated by disclosure of IFRS 9 information and by complementing Alternative 1 with other approaches, such as the Overlay Approach.

Question 7 for the IASB—Which alternative for the Deferral Approach is more appropriate
If the IASB decided to propose the Deferral Approach, does the IASB agree with the staff recommendation that deferral at a reporting entity level (Alternative 1) would provide more useful information to users of financial statements?

Why the Deferral Approach should be considered

122. As discussed in Agenda Paper 14, there are several approaches that could address any concerns about different effective dates of IFRS 9 and the new insurance contracts Standard. For example:

(a) the Overlay Approach discussed in Agenda Paper 14B would address the additional volatility in profit or loss that may arise for some entities that issue insurance contracts when IFRS 9 is applied in conjunction with IFRS 4 (ie during the period when IFRS 9 is applied **before the initial application** of the new insurance contracts Standard), and

(b) transition reliefs for classification and measurement of financial assets **on initial application** of the new insurance contracts Standard, notably the transition relief for the reassessment of business model for managing financial assets discussed by the IASB in January 2015, if confirmed, would address the uncertainty that would otherwise arise for entities that issue insurance contracts and apply IFRS 9 prior to the new insurance contracts Standard.

123. Accordingly, the staff think that the Deferral Approach is not necessary in order to address any concerns about different effective dates of IFRS 9 and the new insurance contracts Standard. In addition, the staff note that some users of financial statements that participated in the outreach conducted by IASB members and staff did not think that the Deferral Approach was necessary or that it would provide the most useful information. Some users of financial statements had concerns about different effective dates of IFRS 9 and the new insurance contracts

Standard but preferred the Overlay Approach, others did not have such concerns but could still accept the Overlay Approach.

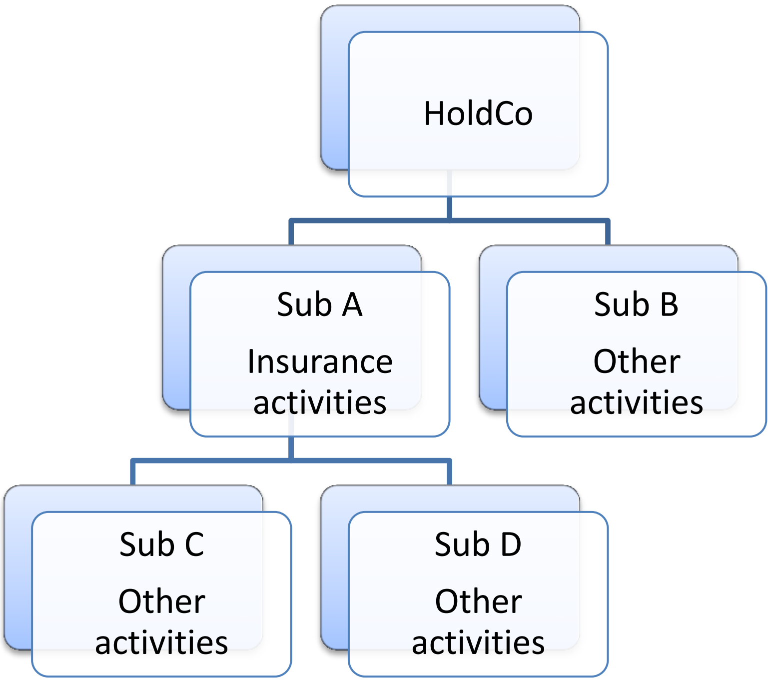
124. However, the staff note that the Deferral Approach could still be attractive for some interested parties because it addresses both the concerns related to application of IFRS 9 in conjunction with IFRS 4 and the concerns related to initial application of the new insurance contracts Standard subsequent to initial application of IFRS 9. In addition, the staff note that there were also many users of financial statements who supported or even preferred the Deferral Approach.

125. The staff acknowledge that the Deferral Approach could address both issues stated in paragraph 122. At the same time, as discussed in previous section, the staff think that the Deferral Approach could only provide useful information for a small population of entities that issue contracts in the scope of IFRS 4, ie those entities for which insurance activity is predominant. Therefore, the staff do not think that the IASB should propose the Deferral Approach **instead of** the combination of the Overlay Approach and transition reliefs for classification and measurement of financial assets on initial application of the new insurance contracts Standard. However, the staff think that the Deferral Approach could be proposed **in addition to** those approaches. In this case, the Deferral Approach could be applied to entities that issue contracts in the scope of IFRS 4 and for which insurance activities are predominant. Entities that would not be eligible for the Deferral Approach would be able to apply the Overlay Approach and transition reliefs for classification and measurement of financial assets on initial application of the new insurance contracts Standard.

Question 8 for the IASB—Proposing the Deferral Approach
Would the IASB like to propose the Deferral Approach in order to address concerns about different effective dates of IFRS 9 and the new insurance contracts Standard?

Appendix A Alternative 1—Deferral at the reporting entity level

A1. Consider the following group structure (the same group structure is used for illustration in all examples):



A2. If insurance activities are predominant for the group as a whole, HoldCo would be eligible for the deferral under Alternative 1 and would apply IAS 39 to all financial assets in its consolidated financial statements. However, that would not impact the accounting in the separate financial statements of Subsidiaries A, B, C and D.

A3. For example, if Subsidiary B engages in activities other than insurance activities (for example, banking activities) and issues separate financial statements, it would be required to apply IFRS 9 in its separate financial statements. However, on consolidation, HoldCo would have to reverse the effect of application of IFRS 9 by Subsidiary B for inclusion in Holdco consolidated financial statements.

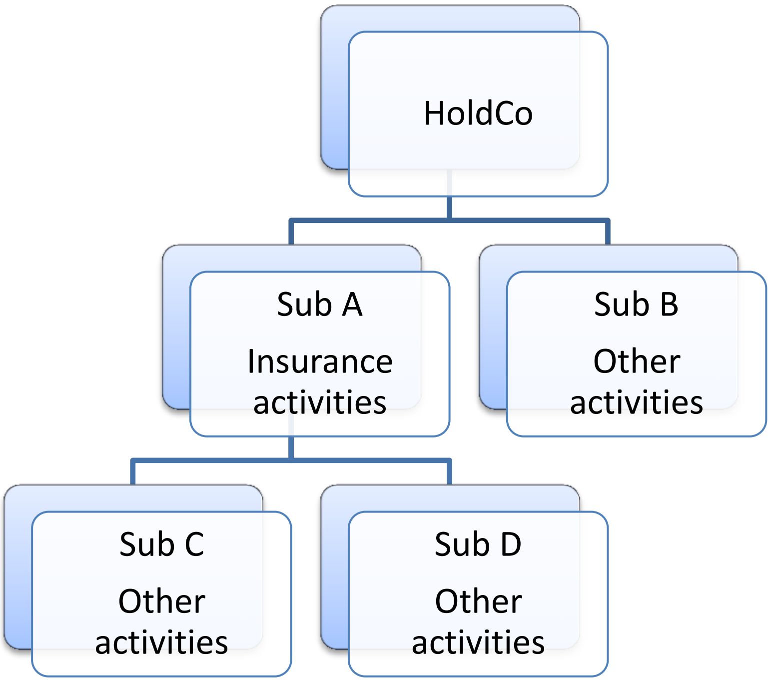
A4. If insurance activities are not predominant for the group as a whole, HoldCo would not be eligible for the deferral under Alternative 1 and would apply IFRS 9 to all financial assets in its consolidated financial statements. However, that would not impact the accounting in the separate financial statements of Subsidiaries A, B and C.

A5. For example, if Subsidiary A issues its own separate or consolidated (ie consolidating Subs C and D) financial statements and insurance activities are predominant at that level, Subsidiary A would be eligible for the deferral under Alternative 1 in those financial statements. However, if Subsidiary A applies the deferral, on consolidation, HoldCo would have to reverse the effect of application of IAS 39 by Subsidiary A for inclusion in Holdco consolidated financial statements.

Appendix B Alternative 2—Deferral below the reporting entity level

Example 1 Alternative 2.1—Deferral below the reporting entity level based on legal structure and by reference to predominance of insurance activities

A1. Consider the following group structure (the same group structure is used for illustration in all examples):



A2. As discussed in Appendix A, if insurance activities are predominant for the reporting entity as a whole, the reporting entity would be eligible for the deferral under Alternative 1. That is, all financial assets in consolidated financial statements of HoldCo would be eligible for the deferral. If insurance activities are not predominant for the reporting entity as a whole, it would not be eligible for the deferral under Alternative 1. However, the reporting entity would be eligible for the deferral under Alternative 2.1 if insurance activities are predominant for **Subsidiary A and its subsidiaries**. In that case, in its consolidated financial statements, HoldCo would apply:

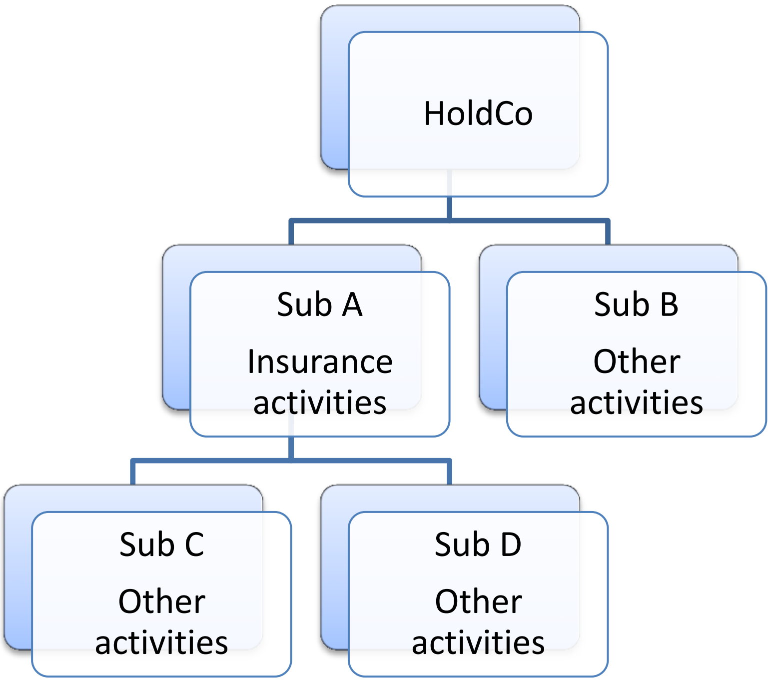
a. IAS 39 to all of the financial assets held by Subsidiary A and its subsidiaries, and

b. IFRS 9 to all its other financial assets (ie those held by Subsidiary B).

A3. If Subsidiary A issues its own separate or consolidated (ie consolidating Subs C and D) financial statements, it would also be eligible for the deferral under Alternative 2.1 in its own financial statements and would apply IAS 39 to all its financial assets. Accordingly, financial assets held by Subsidiary A and its subsidiaries would be consistently accounted for under IAS 39 both by Subsidiary A in its own financial statements and by HoldCo in its consolidated financial statements.

Example 2 Alternative 2.2—Deferral below the reporting entity level based on the legal structure and by reference to regulation

A4. Consider the following group structure (the same group structure is used for illustration in all examples):



A5. If Subsidiary A is regulated as an insurance entity, then Subsidiaries A, C and D would be eligible for the deferral under Alternative 2.2 as long as Subsidiaries C and D are not regulated as banks. In that case, in its consolidated financial statements, HoldCo would apply:

a. IAS 39 to all of the financial assets held by Subsidiary A and its subsidiaries, and

b. IFRS 9 to all its other financial assets (ie those held by Subsidiary B).

A6. If Subsidiary A issues its own separate or consolidated (ie consolidating Subs C and D) financial statements, it would also be eligible for the deferral under Alternative 2.2 in its own financial statements and would apply IAS 39 to all its financial assets as long as Subsidiaries C and D are not regulated as banks. Accordingly, financial assets held by Subsidiary A and its subsidiaries would be consistently accounted for under IAS 39 both by Subsidiary A in its own financial statements and by HoldCo in its consolidated financial statements.

A7. If, however, Subsidiary C is regulated as a bank, only Subsidiaries A and D would be eligible for the deferral under Alternative 2.2. In that case, in its consolidated financial statements, HoldCo would apply:

a. IAS 39 to all of the financial assets held by Subsidiaries A and D, and

b. IFRS 9 to all its other financial assets (ie those held by Subsidiaries B and C).

A8. In this case, if Subsidiary A issues its own separate or consolidated (ie consolidating Subs C and D) financial statements, it would also be eligible for the deferral under Alternative 2.2 in its own financial statements. In its consolidated financial statements, Subsidiary A would apply:

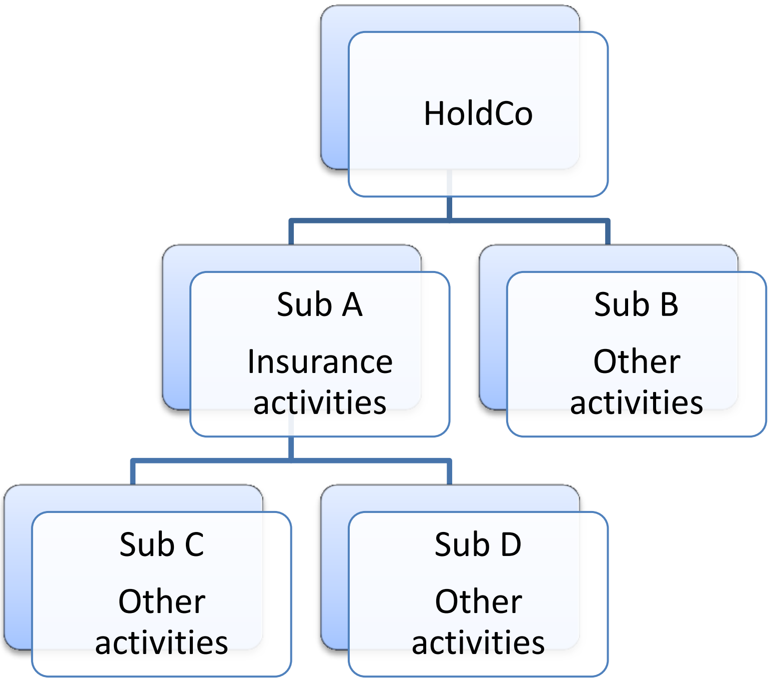
a. IAS 39 to all of the financial assets held by Subsidiaries A and D, and

b. IFRS 9 to financial assets held by Subsidiary C.

A9. Accordingly, financial assets held by Subsidiary A and its subsidiaries would be consistently accounted for under IAS 39 both by Subsidiary A in its own financial statements and by HoldCo in its consolidated financial statements.

Example 3 Alternative 2.3—Deferral below the reporting entity level based on segment reporting

A10. Consider the following group structure (the same group structure is used for illustration in all examples):



A11. If HoldCo identifies and reports its operating segments based on the types of activities, it could identify Subsidiary A as a reportable segment which would qualify for the deferral under Alternative 2.3 and apply:

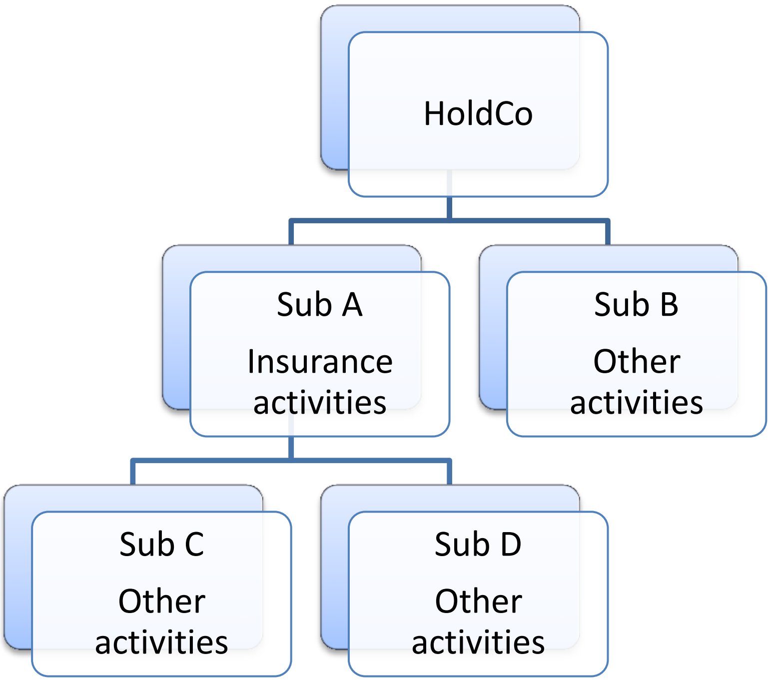
a. IAS 39 to financial assets held by Subsidiary A, and

b. IFRS 9 to all its other financial assets (held by Subsidiaries B, C and D).

A12. However, if HoldCo identifies and reports its operating segments based on geography and, for example, reports Subsidiaries A and B as one segment and Subsidiaries B and D as a different segment, HoldCo would not be able to apply the deferral under Alternative 2.3.

Appendix C Transfers of financial assets under Alternative 2—Deferral below the reporting entity level

A1. Consider the following group structure (the same group structure is used for illustration in all examples):



A2. Suppose Subsidiaries A, C and D are eligible for the deferral and Subsidiary B undertakes banking activities and is not eligible for the deferral. Accordingly, financial assets held by Subsidiary A (and its subsidiaries) are accounted for under IAS 39 in the consolidated financial statements of HoldCo and financial assets held by Subsidiary B are accounted for under IFRS 9 in those financial statements. Suppose Subsidiary A transfers a portfolio of structured debt investments to Subsidiary B. Those investments are bifurcated under IAS 39 and are accounted at FVPL in their entirety under IFRS 9.

A3. The staff identified two approaches for how to account for such a transfer in the consolidated financial statements of HoldCo.

Approach A—Accounting for financial assets is determined by the origin of the transfer

A4. Under Approach A, changes in classification and measurement of financial assets upon a transfer are prohibited.

A5. In our example, that would mean that the financial assets transferred to Subsidiary B would continue to be accounted for under IAS 39 even though other financial assets held by Subsidiary B are accounted for under IFRS 9 in the consolidated financial statements of HoldCo. As a result, no gains or losses would arise as a result of a transfer under this Approach A.

Approach B—Accounting for financial assets is determined by the destination of the transfer

A6. Under Approach B, changes in classification and measurement of financial assets upon a transfer are required if the transferred financial assets are accounted for differently under IAS 39 and IFRS 9 (because of different impairment models, this would always be the case other than for financial assets that are measured at fair value through profit or loss (FVPL) under both Standards).

A7. In our example, that would mean that transferred financial assets that used to be accounted for under IAS 39 and were bifurcated in the consolidated financial statements of HoldCo while they were held by Subsidiary A would need to be accounted for at FVPL in the consolidated financial statements of HoldCo as a result of the transfers. That approach could give rise to gains and losses in an entity’s consolidated financial statements upon an internal transfer.