STAFF PAPER

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IASB Meeting

Project	**Amendments to IFRS 4: Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts***
Paper topic	Summary of the Board's decisions and staff recommendations

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Introduction

1. This paper:

   (a) sets out, in paragraphs 2-6, the proposals in the Exposure Draft *Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts (Amendments to IFRS 4) (the ED) and the feedback received on those proposals;

   (b) provides an overview, in paragraphs 7-22, of the Board's tentative decisions at its March 2016 meeting and the consequences of the staff recommendations in this month's Agenda Papers.

   This paper is for information only and does not contain any questions for the Board.

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ED proposals

2. The proposals in the ED responded to the following concerns raised by some interested parties about the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard:

   (a) Users of financial statements may find it difficult to understand the additional accounting mismatches and temporary volatility that could arise in profit or loss if IFRS 9 is applied before the forthcoming insurance contracts Standard (ED paragraphs BC10—BC16).

   (b) Some entities that issue contracts within the scope of IFRS 4 could be required to apply the classification and measurement requirements in IFRS 9 before the effects of the forthcoming insurance contracts Standard can be fully evaluated (ED paragraphs BC17—BC18).

   (c) Two sets of major accounting changes in a short period of time could result in significant cost and effort for both preparers and users of financial statements (ED paragraphs BC19—BC21).

3. The ED proposed to address those concerns using two approaches:

   (a) the overlay approach, which would be available to all entities issuing contracts within the scope of IFRS 4. The overlay approach permits entities to reclassify from profit and loss to other comprehensive income the incremental effects of newly measuring some assets at fair value through profit or loss (FVPL) in their entirety when entities stop applying IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) and start to apply IFRS 9; and

   (b) a temporary exemption from applying IFRS 9, sometimes referred to as the deferral approach. The ED proposed that the temporary exemption would be available only to entities whose predominant activity is issuing contracts within the scope of IFRS 4. That proposal would limit the temporary exemption to the entities that are most affected by the different effective dates of the forthcoming insurance contracts Standard and IFRS 9. The ED also proposed that the temporary exemption would expire at the start of annual reporting periods

beginning on or after 1 January 2021 because the Board believes that, even if the forthcoming insurance contracts Standard is not effective by that date, all entities should apply IFRS 9 by that date.

Feedback received on the ED proposals

4. The ED was published in December 2015, with comments requested by 8 February 2016. Ninety-six letters were received from a variety of stakeholders including regulators, preparers of financial statements and their representative bodies, standard setters, the accounting and actuarial professions, and users of financial statements.

5. During the comment letter period the staff also undertook outreach with users of financial statements, which supplemented the outreach with users undertaken while the Board developed the proposals for the ED last year. In total, staff conducted outreach with approximately seventy users from multiple jurisdictions and have also discussed the topic extensively with groups such as the Capital Markets Advisory Committee (CMAC) and the Corporate Reporting Users Forum (CRUF).

6. The Board considered the staff's analysis of the comment letters received and feedback from the user outreach at its March 2016 Board meeting[1]. The high-level summary of that feedback is as follows:

    (a) Most preparers, audit firms, accounting and actuarial professional bodies, national standard-setters and regulators agreed that the Board should address the three concerns described in paragraph 2 above. In contrast, many users of financial statements placed less weight on those concerns and, accordingly, did not think that the proposals in the ED were necessary.

    (b) Most users of financial statements, some preparers that engage in both banking and insurance activities (sometimes termed 'bancassurers') and a few other respondents (eg from South America) preferred the overlay approach to the temporary exemption. In comparison, most preparers

[1] For more detailed analysis please refer to March 2016 Agenda paper 14A *Summary of comment letters and outreach* and March 2016 Agenda paper 14B *Summary of feedback from users of financial statements.*

(especially those from Europe, North America and Asia) thought that the temporary exemption would be the only approach that addresses their concerns about applying IFRS 9 before the forthcoming insurance contracts Standard. The view of preparers was shared by audit firms, accounting bodies and national standard-setters. Finally, some preparers were unconcerned about applying IFRS 9 in 2018. For example, some entities were unconcerned about applying IFRS 9 either because all of their financial assets are measured FVPL today, or because they intend to apply IFRS 9 as they are the subsidiaries of banks.

(c) Most respondents, including users of financial statements, believed that the population of entities that would qualify for the temporary exemption is too narrow, because some entities that they regard as insurers would not qualify. Respondents had mixed views on:

  (i) whether the eligibility assessment for the temporary exemption should be conducted at the reporting entity level only (ie the assessment should be done considering all of the activities of the reporting entity, and the reporting entity applies only one Standard, either IFRS 9 or IAS 39, to all of its financial instruments in its financial statements); or

  (ii) whether an assessment should also be permitted below the reporting entity level (ie the assessment should be done separately on the different activities conducted by differing parts of the reporting entity, and the reporting entity may, within a single set of financial statements, apply both IFRS 9 and IAS 39 to its financial instruments).

Most users and most regulators (both prudential and security regulators) supported an assessment only at the reporting entity level. In contrast, most preparers, audit firms and accounting bodies, and some national standard-setters supported an approach that allowed an assessment below the reporting entity level. An assessment below the reporting entity level would mean that insurance subsidiaries in a group could apply IAS 39 in the consolidated financial statements of the group. In contrast, the non-insurance entities in the group would apply IFRS 9.

(d) Most users of financial statements were concerned that the ED proposed three options—an option to apply the temporary exemption (and continue to apply IAS 39), an option to apply IFRS 9 with the overlay approach, or an option to apply IFRS 9 without the overlay approach. In contrast, all other types of respondents supported these options and some strongly believed that these options are necessary to enable different entities to reflect their differing facts and circumstances.

(e) Respondents had mixed views on whether there should be a fixed expiry date for the temporary exemption. Almost all users of financial statements, most regulators, and some standard-setters and audit firms, support the proposed fixed expiry date of 2021. In particular, most users and regulators support that fixed expiry date, regardless of the effective date of the forthcoming insurance contracts Standard. In contrast, most preparers believe that insurers should be required to apply IFRS 9 only when they apply the forthcoming insurance contract Standard. Accordingly, they do not support a fixed expiry date but instead believe that the temporary exemption should expire on the mandatory effective date of the forthcoming insurance contracts Standard.

Overview of the Board’s key decisions

7. This section summarises the Board’s tentative decisions at its March 2016 meeting in the context of this month’s staff recommendations.

A temporary exemption from applying IFRS 9 for some entities

8. The Board tentatively decided to confirm the proposal in the ED to provide a temporary exemption for some, but not all, entities that issue contracts within the scope of IFRS 4. However, some Board members expressed concerns regarding the criteria for determining the scope of the temporary exemption and the Board noted that the staff intends to bring a paper for Board discussion on the scope. Accordingly, Agenda Paper 14C for April recommends that the Board should modify the criteria in a way that would better preserve peer comparability

between entities that qualified under the ED proposals and their peers within the insurance industry that did not qualify. Nonetheless, we acknowledge that 'perfect' comparability cannot be achieved by changes in the qualifying criteria because 'perfect' comparability is achieved only if all entities apply IFRS 9 when it is effective (or by providing an exemption for all entities, which the Board believes is unacceptable).

9. In confirming the proposal to provide a temporary exemption:

(a) The Board noted that the potential accounting mismatches and volatility that could arise as a result of the different effective dates could be addressed by applying the overlay approach. Nevertheless, the Board acknowledged that there are additional costs from applying the overlay approach compared to applying IFRS 9 without the overlay approach and also compared to continuing to apply IAS 39. However, the Board also noted that there would be costs, in particular for users, associated with not using IFRS 9— the improved information under IFRS 9 would **not** be provided (e.g. the expected credit loss information). While the temporary exemption could address the issue of additional volatility and accounting mismatches in a cost effective way, the Board concluded that due to the costs particularly to users of financial statements of not applying IFRS 9 the temporary exemption should be limited to only some entities that issue contracts within the scope of IFRS 4.

(b) The Board was not persuaded by the concerns that applying IFRS 9 before the forthcoming insurance contracts Standard would be equivalent to 'applying IFRS 9 twice'. Those concerns often relate to the transition reliefs provided by the Board on first application of the forthcoming insurance contracts Standard for those who have previously applied IFRS 9. Those transition reliefs would allow an entity to reassess the business model for some financial instruments based on facts and circumstances that exist on transition to the forthcoming insurance contracts Standard, and to designate or de-designate financial assets under the fair value option at that date. Accordingly, the Board believes that the incremental costs of first

applying the insurance contracts Standard after applying IFRS 9 would be limited because:

(i) the transition reliefs would apply to some, but not all, financial assets. Even in those cases, the transition reliefs would not require a full reapplication of the requirements of IFRS 9 (because, for example, contractual cash flow characteristics are not reassessed);

(ii) the entity is expected to continue to use any expected credit loss systems put in place when it initially applied IFRS 9 (unless the entity intends to measure all financial assets at FVPL, which the Board understands is unlikely); and

(iii) the application of the transition reliefs is optional.

(c) The Board noted that there was differing feedback as to whether there would be significant incremental costs arising from applying two accounting changes consecutively, rather than simultaneously. Further, the Board noted that all entities will have to apply IFRS 9 eventually and incur the costs necessary to do so. Accordingly, the Board placed less weight on the costs that some state may arise in applying IFRS 9 before the forthcoming insurance contracts Standard than on other considerations such as the potential for additional accounting mismatches that may be temporary.

Expiry Date

10. Consistent with the feedback received from regulators and users of financial statements, the Board thinks that a temporary exemption can be considered only if it is in place for a short period of time. Accordingly, the Board tentatively decided to confirm that there would be a fixed expiry date for the temporary exemption. The Staff intend to bring a paper to the Board that will discuss the actual expiry date (ie 2021 or another date) at the May 2016 meeting.

Eligibility for the temporary exemption should be determined at the reporting entity level

11. The Board tentatively decided to confirm the ED proposal that eligibility for the temporary exemption should be determined only at the reporting entity level. The

Board noted that many respondents suggested that eligibility for the temporary exemption should also be determined below the reporting entity level.

12. Consistent with the feedback from many users of financial statements and regulators, the Board believes it is more useful for a reporting entity to have consistent accounting policies within its financial statements (ie applying only one Standard, either IFRS 9 or IAS 39, to all its financial instruments) than to have financial statements with inconsistent accounting policies (ie applying IFRS 9 to some financial instruments and IAS 39 to others). The Board agrees with those users that note:

    (a) IFRS Standards require reporting entities to use consistent accounting policies because this enables the reporting entity (the group producing the consolidated financial statements) as a whole to be compared with other reporting entities, and allows for a common understanding of all the reporting entity's assets and liabilities. Consistent accounting policies also reduce the accounting complexities arising from intra group transactions.

    (b) Financial statements that provide only IAS 39 information are acceptable because they provide a continuation of previous information and do not change accounting. Similarly, financial statements that provide only IFRS 9 information are acceptable because users view IFRS 9 as providing better information than that provided under IAS 39. In contrast, financial statements that contain a mix of both IFRS 9 and IAS 39 information cause additional changes that need to be analysed by users of financial statements – they do not provide a continuation of previous information and they do not provide the information that will ultimately be provided; they provide a different set of information that will be used only for a temporary period.

    (c) Although users analyse disaggregated information of a reporting entity, they nevertheless also rely on the information in the consolidated financial statements.

    (d) A change from reporting under IAS 39 to partial reporting under IFRS 9, followed by a later change to full reporting under IFRS 9 constitutes

two major changes to accounting in a relatively short period of time, which undermines one significant reason for supporting the temporary exemption.

13. Accordingly, the Board notes that determining eligibility for the temporary exemption below the reporting entity level would not address the concerns about the different effective dates of the forthcoming insurance contracts Standard and IFRS 9 without an unacceptable loss of comparability and understanding, and would also have the consequence of two accounting changes within a short period of time.

The overlay approach

14. The Board tentatively decided to confirm the ED proposal to provide an overlay approach. In the overlay approach, an entity applies IFRS 9 and then adjusts profit or loss to provide IAS 39 information for particular assets that are newly measured at FVPL in their entirety as result of applying IFRS 9. The Board noted that the overlay approach would address the issue of accounting mismatches and volatility in profit or loss through presentation, while resulting in the application of the IFRS 9 requirements that are a significant improvement over the existing IAS 39 requirements. In addition, the Board notes that the overlay approach:

    (a) would be available for those entities that do not qualify for the temporary exemption, for example because of their significant banking activities.

    (b) is the preferred alternative of a few preparers that would have been eligible for the temporary exemption (applying the ED proposals), and most users of financial statements. Those users preferred the overlay approach to the temporary exemption because the overlay approach would provide additional information that could assist them in understanding the effect of changing from IAS 39 to IFRS 9.

15. For this meeting in Agenda Paper 14B *The overlay approach*, the staff considers whether particular aspects of the ED's proposals on the overlay approach should be amended. The staff recommend that the Board confirms most of those aspects

but modify the presentation requirements by restricting the choices proposed in the ED.

Should the temporary exemption and the overlay approach be optional?

16. The Board tentatively decided to confirm the ED proposal that both the temporary exemption and the overlay approach should be optional. While options, in general, reduce comparability between entities, the Board thinks that the significant improvement of IFRS 9 compared to IAS 39 make it inappropriate to prohibit a reporting entity from applying IFRS 9 in full (ie by requiring the entity to apply the temporary exemption if it is eligible or by requiring it to apply the overlay approach). The Board also noted that some preparers do not have concerns arising from potential accounting mismatches (because, for example, they already measure their financial assets at FVPL) or do not wish to defer application of IFRS 9 (with or without applying the overlay approach).

17. However, in Agenda Paper 14C *Temporary exemption from IFRS 9—Qualifying criteria* and Agenda Paper 14D *Temporary exemption from IFRS 9—Disclosures*, the Board will consider ways to alleviate the concerns raised by users of financial statements about the lack of comparability that might arise as a result of these options. Agenda Paper 14D considers whether additional disclosures are necessary to improve the comparability between entities that elect the temporary exemption (and thus continue to apply IAS 39) and those entities that apply IFRS 9.

18. In addition, based on the feedback received, the Board thinks that entities in a particular jurisdiction that qualify for the temporary exemption are highly likely to make the same choice (ie apply IFRS 9 (with and without the overlay approach), or continue to apply IAS 39). This could, for example, be due to similar drivers (eg if the entities' assets are already measured at FVPL) or to the requirements imposed by regulators who may act to limit choices in their particular jurisdiction. In Agenda Paper 14C, the changes recommended to the scope of entities eligible for the temporary exemption are contemplated to better preserve peer comparability within the insurance industry and thus, some concerns on the lack

of comparability could be alleviated if similar choices are made available to entities that are commonly considered to be peers.

Consequences of the Board's tentative decisions and this month's staff recommendations

19. Overall, the consequences of the staff recommendations for this meeting and the Board's tentative decisions from March are as follows:

    (a) The overlay approach would be an option available to address any accounting mismatches and additional volatility that may arise if IFRS 9 is applied before the forthcoming insurance contracts Standard. The Board expects that the overlay approach would be applied by entities that do not qualify for the temporary exemption, and by entities for which applying IFRS 9 with an overlay adjustment is the most cost-effective choice.

    (b) The temporary exemption would be an option available for many reporting entities that are the most affected by the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard. The recommendations in Agenda Paper 14B, intended to better capture the appropriate entities (ie those that many consider as 'insurers'), would result in a larger population of qualifying entities than under the ED's proposals.

    (c) The temporary exemption would be optional and would have a fixed expiry date. This would mean that all entities would need to apply IFRS 9 after the fixed expiry date, even if the forthcoming insurance contracts Standard is effective later than the fixed expiry date. However, the staff expects that in setting this fixed expiry date, the Board will consider the likely effective date of the forthcoming insurance contracts Standard.

20. The consequences of the staff recommendations for this meeting together with the Board's tentative decisions from March would mean that the temporary exemption would not be available to some reporting entities that have insurance activities (see paragraph 21). Nonetheless, those consequences are expected to

increase comparability within the insurance sector compared to the ED proposals, while at the same time ensuring that any reporting entities with significant non-insurance related activities (eg banking) would not be able to apply the temporary exemption.

21. An example of a reporting entity that will not qualify for the temporary exemption under the staff recommendations is a conglomerate with insurance activities and non-related insurance activities (eg bancassurers). The Board notes that for such entities:

    (a) the entity would be required to apply IFRS 9 to all of the financial instruments reported in its consolidated financial statements. The overlay approach would be available to address any additional volatility and accounting mismatches in the entity's insurance activities arising from the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard.

    (b) The entity could, in accordance with IFRS 8 *Operating Segments,* choose to produce segmental information for its insurance activities using IAS 39 in order to facilitate comparison with other insurers applying IAS 39.

    (c) In addition, if the insurance activities were undertaken in a separate reporting entity, such as a subsidiary, and separate financial statements are prepared; then the temporary exemption could be applied in those separate financial statements. Accordingly, that insurance subsidiary could choose to apply IAS 39 to all the financial instruments reported in its separate financial statements when that standalone reporting entity qualifies for the temporary exemption. However, the subsidiary would still need to produce IFRS 9 information for the consolidated financial statements. In some cases, an entity may decide that the cost of applying the temporary exemption (ie IAS 39) in its separate financial statements and preparing IFRS 9 information for consolidation purposes is justified in order to facilitate comparison with other insurers applying the temporary exemption (ie IAS 39).

22. The outcome described in paragraph 21 is considered appropriate because evidence gathered in outreach during the comment period showed that entities, such as bancassurers, are typically compared with other bancassurers and with banks, and not with insurers.