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	Temporary exemption from IFRS 9—Qualifying criteria

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Purpose of this paper

1. This paper discusses recommendations for amending the qualifying criteria for the temporary exemption from applying IFRS 9 *Financial Instruments* (IFRS 9) proposed in the Exposure Draft *Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts (IFRS 4) (Proposed amendments to IFRS 4) (the ED).

2. This paper:
   - (a) sets out the staff recommendations in paragraphs 4-7;
   - (b) discusses the ED proposals, feedback received and staff recommendations and analysis as follows:
     - (i) the qualifying criteria in paragraphs 8-48;
     - (ii) the threshold for assessing an entity's predominant activities in paragraphs 49-55;
     - (iii) the date of assessment in paragraphs 56-65; and
     - (iv) the related disclosures in paragraphs 66-69.

3. There are a few remaining issues on the temporary exemption, including the proposal in the ED that would require an entity to reassess whether it still qualifies for the temporary exemption in particular circumstances. We intend to discuss those issues in May (see Agenda paper 14 *Cover note*).

Staff recommendations

Qualifying criteria (paragraphs 8-48 and Appendix A)

4. The staff recommends that an entity should be permitted to apply the temporary exemption **only** if:

   (a) the entity has not previously applied any version of IFRS 9 (except for the 'own credit' requirements in isolation) (see paragraph 19); and

   (b) the entity's activities are predominantly 'related to insurance', where such activities comprise:

      (i) issuing contracts within the scope of IFRS 4 and these contracts give rise to liabilities whose carrying amount is significant compared to the total carrying amount of the entity's liabilities (see paragraphs 41-42); and

      (ii) issuing investment contracts that are measured at fair value through profit or loss (FVPL) applying IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) (see paragraphs 36-42).

Assessing whether the entity's activities are predominantly related to insurance (paragraphs 49-55 and Appendix A)

5. The staff recommends:

   (a) defining the 'predominance ratio' as follows:

      (i) Numerator: the sum of the carrying amounts of:

         1. liabilities arising from activities related to insurance (ie the liabilities arising from the contracts described in paragraph 4(b)(i) and 4(b)(ii) plus

         2. 'other' liabilities that are connected to those activities (discussed in paragraphs 43-45). The staff recommends that examples of such 'other' connected liabilities would be provided.

      (ii) Denominator: the total carrying amount of the entity's liabilities, including all the liabilities included in the numerator (discussed in paragraphs 27-34).

(b) that an entity's activities are deemed to be predominantly related to insurance **only** if:

(i) the predominance ratio (defined in 5(a)) is greater than 90%; or

(ii) the predominance ratio (defined in 5(a)) is greater than 80% but less than, or equal to, 90% and the entity can provide evidence that it does **not** have a significant activity that is unrelated to insurance.

Date of assessment (paragraphs 56-65)

6. The staff recommends that:

(a) an entity should be required to compute the predominance ratio using the carrying amounts of the liabilities reported on the entity's balance sheet at the annual reporting date between 1 April 2015 and 31 March 2016 (ie the assessment date), unless (b) applies.

(b) if market fluctuations in the annual period leading up to the assessment date have significantly affected an entity's predominance ratio because those fluctuations have affected the carrying amounts of any of its liabilities, the entity is required to calculate the predominance ratio using an average of the relevant carrying amounts on the entity's annual balance sheet for the last three years (for example: an average of the carrying amounts at the annual reporting dates in 2013, 2014 and 2015).

Disclosures (paragraphs 66-69)

7. The staff recommends that the Board:

(a) confirm the proposed disclosures in paragraphs 37A(a) and (b) of the ED that an entity must disclose:

(i) the fact that it is applying the temporary exemption; and

(ii) how it concluded that it is eligible for the temporary exemption;

(b) add to the proposed disclosure of how the entity concluded that it is eligible for the temporary exemption, to require that an entity must also disclose:

(i) any liabilities, other than those arising from contracts within the scope of IFRS 4, that are included in the numerator of the predominance ratio (as discussed in paragraphs 4(b)(ii) and 5(a)(i)); and

(ii) the information used to determine that the entity's activities are predominantly related to insurance if the predominance ratio is greater than 80% but less than, or equal to, 90% (as recommended in paragraph 5(b)(ii)).

Qualifying criteria

ED proposals

8. The ED proposes that:

   (a) an entity qualifies for the temporary exemption only if:

      (i) it has not previously applied any version of IFRS 9 (except for the 'own credit' requirements in isolation); and

      (ii) its predominant activity is issuing contracts within the scope of IFRS 4 (the predominance criterion); and

   (b) an entity determines whether its predominant activity is issuing contracts within the scope of IFRS 4 based on the carrying amount of its liabilities arising from contracts within the scope of IFRS 4 relative to the total carrying amount of its liabilities (including liabilities arising from contracts within the scope of IFRS 4) (the predominance ratio). The ED did not prescribe a quantitative threshold for meeting that condition in the proposed mandatory materials but paragraph BC65 of the Basis for Conclusions observed, as an example, that if three-quarters of an entity's liabilities arise from contracts within the scope of IFRS 4 (and one-quarter are liabilities arising from other activities), the entity would not meet the predominance criterion.

Feedback on the ED proposals

Must not have applied IFRS 9 previously

9. Most respondents did not comment on the ED proposal that an entity that has previously applied any version of IFRS 9 (except for the 'own credit' requirements in isolation) would not be allowed to apply the temporary exemption.

Predominance criterion

10. Many respondents provided a substantial amount of comments on how an entity should determine whether its predominance activity is issuing contracts within the

scope of IFRS 4 (the predominance criterion), when compared to the other proposals in the ED. Most respondents agreed that a temporary exemption should be available to entities that predominantly undertake insurance activity, because these entities are the most affected by the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard. However, nearly all respondents that supported the temporary exemption recommended changes to the predominance criterion to increase the number of entities that would qualify. There was a variety of views on how to achieve this and those views are discussed in the paragraphs below.

11. Some suggested simply lowering the eligibility threshold by replacing the notion that insurance activities must be 'predominant' with a notion of 'significant' or 'material' insurance activities.

Principle-based approach

12. Some recommended a principle-based approach to assess whether an entity's predominant activity is issuing contracts within the scope of IFRS 4. They argued that a principle-based approach that considers all relevant facts and circumstances is more consistent with IFRS Standards than a single assessment that compares liabilities arising from contracts within the scope of IFRS 4 to total liabilities. Of these respondents, some suggested a variety of quantitative and qualitative factors. Others did not provide specific suggestions but said only that the assessment should be more comprehensive and consider more factors than proposed in the ED.

13. Some believed that assessing predominance based only on the carrying amount of contracts within the scope of IFRS 4 relative to total liabilities may not be an accurate measure of predominance because there are differences in how entities measure their insurance liabilities across different jurisdictions and products (eg between short duration and long duration contracts and the basis for measurement of long duration contracts). Accordingly, some were concerned that the application of such a ratio would cause entities they consider as insurers to fail. A few provided examples of other factors that they thought should be considered in assessing predominance, such as a ratio of insurance-related revenue compared to total revenue, a ratio of the entity's full-time employees working on insurance-

related activities compared to total full-time employees, or other metrics. Other suggestions were similar to those discussed below in paragraph 15.

Additional factors

14. Some recommended that the quantitative predominance criterion proposed in the ED should be retained but supplemented with additional factors to assess predominance. Suggestions included:

    (a) whether the entity is a regulated entity, because they note that insurance is regulated in most jurisdictions; and

    (b) segmental disclosure based on business activities.

15. However, some indicated that they would not support a regulated entity approach because they were concerned that:

    (a) using a 'regulated entity' criterion might inappropriately exclude some entities because of their group structures, for example, if:

        (i) the holding company in a group is not regulated as an insurer; or

        (ii) legal entities in the group that hold the assets that back the insurance liabilities are not regulated as insurers.

    (b) There is a difference between the contracts defined as insurance contracts by regulation and IFRS 4. For example, in the extreme, an entity can be regulated as an insurer and **not** issue contracts within the scope of IFRS 4.

    (c) There are differences in regulation among different jurisdictions, which may result in a lack of comparability.

16. Similarly, some did not support an approach based on segmental disclosure because they question whether such an approach would be operational because an entity is not required to produce segmental disclosures based on operating segments.

Continuing with a quantitative predominance criterion

17. Some respondents, on balance, supported a quantitative predominance criterion based on liabilities as proposed in the ED because it:

    (a) is simple and pragmatic; and

(b) is clear and unambiguous – and providing clarity on whether an entity would qualify for the temporary exemption would make the condition auditable and enforceable.

18. However, many suggested specific changes to the predominance ratio proposed in the ED:

(a) Most provided examples of liabilities they believe should not have an effect on whether or not an entity qualifies for the temporary exemption (commentators provided differing examples). For example:

(i) differences in funding structures (ie whether funding is raised solely by issuing equity instruments or by issuing both debt and equity instruments);

(ii) pension liabilities;

(iii) current and deferred tax liabilities;

(iv) written put options on non-controlling interests in consolidated insurance funds; and

(v) derivatives that are hedging insurance liabilities.

Some recommended adding specific liabilities to the numerator, while others suggested deducting specific liabilities from the denominator. Those advocating the addition of specific liabilities to the numerator viewed those liabilities as being related to insurance activities. In contrast, the specific liabilities proposed to be deducted from the denominator were viewed as unrelated to the type of business activities in which an entity engages and thus an ineffective way to identify pure insurers; or those specific liabilities are accounted for at FVPL applying both IAS 39 and IFRS 9.

(b) Most thought that the numerator should include deposit components that are unbundled under IFRS 4. As permitted by IFRS 4, some entities apply the financial instruments requirements (ie IAS 39) to those investment components (eg premium refunds, or a deferred annuity prior to the annuitisation option being exercised). By including only liabilities accounted for in accordance with IFRS 4 in the numerator there was a concern that an inappropriate distinction was being drawn between entities writing similar contracts.

(c) Many thought that the presence of investment contract liabilities (without significant insurance risk) should not affect whether an entity qualifies for the temporary exemption. They argue:

(i) some of these contracts are sold alongside similar products issued with significant insurance risk;

(ii) in some jurisdictions, these contracts are regulated as insurance contracts even though they have no significant insurance risk and therefore do not meet the definition of an insurance contract under IFRS 4;

(iii) these contracts are accounted for at FVPL under IAS 39. Therefore, these liabilities are backed by assets accounted for at FVPL under IAS 39. Those who argued that these contracts should not affect whether an entity qualifies for the temporary exemption stated that these liabilities and assets will continue to be measured at FVPL under IFRS 9 and thus implementing IFRS 9 will have no material impact on these contracts. In their opinion no information would be lost if, in this situation, if the entity did not apply IFRS 9; and

(iv) these contracts are not different economically to investment contracts, in which asset managers typically do not recognise the assets and liabilities of the fund on their balance sheets because they are acting in the capacity of an agent.

Staff analysis and recommendation

Must not have previously applied any version of IFRS 9

19. The staff recommends that the Board confirm the ED proposal that an entity that has previously applied any version of IFRS 9 (except for the ‘own credit’ requirements in isolation) should **not** qualify for the temporary exemption. The temporary exemption is designed to address concerns raised by stakeholders that would arise from applying IFRS 9 before the forthcoming insurance contracts Standard. Those concerns arise only if the entity is currently applying IAS 39. Consequently, if an entity is already applying IFRS 9, the staff does not think it should be permitted to ‘go back’ to IAS 39.

Predominance criterion

20. The next section discusses:

(a) whether the predominance criterion should be determined using only quantitative factors, using only qualitative factors, or using both, in paragraphs 21-26; and

(b) if the predominance criterion is determined using quantitative factors, whether there should be changes to the liability-based predominance ratio proposed in the ED in paragraphs 27-48.

Quantitative or qualitative factors (or both)?

21. The ED proposed that an entity assess its predominant activity based on the carrying amount of its liabilities arising from contracts within the scope of IFRS 4 relative to the total carrying amount of its liabilities.

22. As noted above in paragraphs 12-14, some respondents thought that the predominance criterion should be principle-based (either based only on qualitative criteria or on a combination of qualitative and quantitative criteria). They argue that this is more consistent with IFRS Standards and/or are concerned that a strict quantitative criterion may create a cliff effect with the result that some entities they consider to be insurers would fail to qualify. But others supported the quantitative based assessment proposed in the ED because they believe the criterion should be clear and unambiguous.

23. The staff thinks that the predominance criterion should be anchored to quantitative factors because doing so provides a more objective assessment that can be more clearly described, understood and applied. The staff believes that there is no qualitative factor(s) that could achieve this in isolation (see paragraph 14 for some qualitative factors that respondents recommended). For example, some recommended using 'regulated as an insurer' as a qualitative factor; however, different respondents noted difficulties with that qualitative factor. Staff agrees that those difficulties could arise; especially because insurance regulation is typically applied at the legal entity level, which in most cases would be at a lower level than an assessment at 'the reporting entity level' (ie an assessment at the reporting entity level considers 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). At its March 2016 meeting, the Board tentatively decided that the assessment for qualifying for the temporary

exemption is done at the reporting entity level. In addition, staff thinks it may be difficult to define what it means to be 'regulated as an insurer' because of differences in the regulation of insurance products between jurisdictions. Accordingly, staff thinks 'regulated as insurer' would not be operational as a sole qualifying criterion.

24. The staff thinks that the predominance criterion must be clear and unambiguous for the following reasons:

(a) The consequences of qualifying, or not qualifying, for the temporary exemption are considerable (ie the ability to choose not to apply IFRS 9 versus being required to apply IFRS 9).

(b) IFRS Standards do not currently provide any requirements or other guidance that could be used to identify the Board's target population for the temporary exemption. Existing IFRS Standards acknowledge that entities that 'issue contracts within the scope of IFRS 4' are a larger population than entities that are considered, and/or regulated, as 'insurers'. For example, entities that issue contracts within the scope of IFRS 4 would include some banks and manufacturers; and those entities would not be considered 'insurers' by users of financial statements. Consequently, the proposals in the ED target a 'new' subset of entities and that subset must be clearly identified.

(c) While there may be some agreement amongst stakeholders about the subset of entities that are 'pure insurers' and should be eligible for the temporary exemption, there were different views expressed in the feedback on how the proposed predominance criterion should be amended and which types of entities should be captured by that amended criterion. The staff thinks some of those different views indicate that there are different opinions on whether entities that have significant activities other than issuing contracts within the scope of IFRS 4 (eg conglomerates) should qualify and if so, which ones. The staff thinks that highlights a need for clear and specific guidance for determining whether such entities would qualify for the temporary exemption.

25. Moreover, the staff thinks that many of the concerns on the predominance assessment proposed in the ED arose because those respondents did not think that the proposal captured the appropriate population and, in particular, that it was too strict. The staff believes that many of those objections could be better (and successfully) addressed by changes to the proposed criterion, as discussed in paragraphs 27-48 of this paper, rather than newly developing a different (qualitative) assessment.

26. Accordingly, the staff thinks that identifying the appropriate population of entities eligible for the temporary exemption is best achieved by using a quantitative predominance criterion as an anchor. Nevertheless, in paragraphs 49-55, the staff considers whether any qualitative factors should also be considered in specific circumstances.

The predominance ratio

27. Many respondents suggested changes to the liability-based predominance ratio as discussed in paragraph 18. This section considers whether the predominance ratio proposed in the ED should be amended, and if so, how.

28. As noted previously in this paper, a few argued that the ED's predominance ratio should be replaced, or supplemented by, other quantitative criteria based on income and expense information (eg revenue; segmental information (ie contributions of different segments to net profit) and/or operating expenses). The primary rationale provided for this recommendation was that some contracts with significant insurance risk have relatively smaller carrying values (eg non-life contracts and some life contracts such as term life) when compared to other life insurance contracts (see paragraph 13) and therefore, the ratio proposed in the ED would have the result that some entities that those stakeholders consider to be 'pure insurers' would not qualify for the temporary exemption.

29. The staff acknowledges those concerns but thinks they can be effectively addressed by revising the predominance ratio proposed in the ED (discussed in paragraphs 35-48) or by supplementing that quantitative assessment with qualitative factors in some circumstances (discussed in paragraphs 49-55).

30. Furthermore, the staff notes that the Board has considered describing predominance by reference to income and expenses but rejected such an approach,

as explained in paragraph BC63 of the Basis for Conclusions of the ED. The staff thinks that a predominance ratio based on amounts recognised in the statement of comprehensive income has the following challenges:

(a) It would be subject to the same concerns as a predominance ratio based on the carrying amounts of the entity's liabilities. This is because, under existing practice, the amounts recognised in the statement of comprehensive income are linked to the carrying values of the liabilities. For example, in practice today, most entities recognise premiums (either received or written) in the statement of comprehensive income and as liabilities in the balance sheet. Also, some noted the differences between the accounting treatment of non-life contracts (and specific life contracts (eg term life)) and most life contacts that result from differences that may arise due to the cash flows considered to be in the contract boundary, ie on the inclusion of renewal premiums in the determination of the liability. However, such differences arise because many view that those two groups of contracts have different economic rights and benefits, and the existing accounting treatment has similar accounting outcomes for the amounts recognised on both the balance sheet and the statement of comprehensive income.

(b) It may be more volatile than a predominance ratio based on amounts on the balance sheet.

31. Accordingly, staff recommends confirming the ED proposal that the predominance ratio is based on the entity's liabilities on the balance sheet.

Changes to the numerator or denominator (or both)

32. As discussed previously in this paper, some recommended that specified liabilities should be added to the numerator because they believe those liabilities are related to insurance activities. On the other hand, some recommended deducting specified liabilities from the denominator because either those liabilities are accounted for at FVPL applying both IAS 39 and IFRS 9 (discussed in paragraph18(c)) or because they believed those liabilities do not assist in differentiating insurance-related activities from other activities.

33. The staff notes that the effect of those two recommendations on the ratio is similar because:

(a) as the numerator increases, the value of the ratio increases too (and vice versa); and

(b) as the denominator decreases, the value of the ratio increases (and vice versa).

34. The staff recommends that any adjustments to the predominance ratio for the specified liabilities discussed in paragraphs 35-45, should be added to the numerator (rather than subtracted from the denominator). The staff's reasoning is as follows:

(a) adding those liabilities to the numerator (ie liabilities related to insurance) is more intuitive and understandable than deducting them from the denominator (ie total liabilities). This is because:

(i) the denominator remains the entity's total liabilities, which is simple to understand and is anchored to an amount on the balance sheet.

(ii) the numerator reflects the liabilities related to the entity's insurance activities.

(b) Only a limited number of liabilities could be deducted from the denominator (eg there are a limited number of liabilities that do not assist in differentiating insurance-related activities from other activities) and thus adjusting the denominator likely will not address all of the concerns raised by stakeholders (ie the numerator will still need to adjusted).

This may result in a ratio where some liabilities are added to the numerator and other liabilities are deducted from the denominator. The staff thinks this would be more complex than simply considering whether some specified liabilities related to insurance activities should be added to the numerator.

Broadening the notion of 'activities related to insurance' (ie the numerator)

35. This section considers whether the following liabilities should be considered related to insurance activities, and hence should be added to the numerator, as recommended by stakeholders:

    (a) investment contracts measured at FVPL applying IAS 39 (in paragraphs 36-42); and

    (b) 'other' liabilities that are connected to insurance activities (in paragraphs 43-45).

    Paragraphs 47-48 discuss the consequences of the staff recommendations.

Investment contracts

36. Life insurers typically issue investment contracts with no significant insurance risk (investment contracts). Accordingly, those contracts are accounted for applying the financial instrument requirements (ie IAS 39). In determining the predominance ratio proposed in the ED (see paragraph 8), some entities would not qualify for the temporary exemption only because they have significant balances of investment contracts on their balance sheets. Sometimes, the carrying amounts of those liabilities are similar in size, or larger, than the carrying amounts of the liabilities arising from contracts within the scope of IFRS 4. Such investment contracts are generally measured at FVPL.

37. The feedback in 18(c)(i) and 18(c)(ii) noted that, in many jurisdictions, such investment contracts are sold alongside similar products with significant insurance risk and are regulated as insurance contracts (even though they do not meet the definition of an insurance contract applying IFRS 4). Thus many respondents, from all respondent types including some users of financial statements, think that issuing investment contracts should be considered as an insurance activity in some cases. Those respondents noted that permitting entities with significant investment contracts to apply the temporary exemption would be useful because it would promote comparability between entities that they consider to be peers (ie as insurers). Accordingly, the staff recommends that the predominance ratio is amended to include in the numerator those investment contracts that are typically issued by insurers.

38. In identifying the investment contracts typically issued by insurers, the staff thinks it is important to distinguish them from other non-derivative financial liabilities that are unrelated to insurance activities. Financial liabilities that are unrelated to insurance activities include those liabilities relating to banking activities, such as deposit-taking, or manufacturing activities, such as accounts payable. However, the staff notes that IFRS Standards do not have guidance related to specifically identifying investment contracts issued by insurers. Therefore, the staff thinks that a simple and practical way to identify such investment contracts is to include in the numerator of the predominance ratio only those investment contracts that are measured at FVPL. This is because most non-derivative financial liabilities that are associated with activities unrelated to insurance are generally measured at amortised cost. Accordingly, this approach, while simplistic, will assist in including the appropriate investment contracts in the numerator (and exclude financial liabilities unrelated to insurance activities).

39. Accordingly, the staff recommends that the predominance criterion for the temporary exemption is amended such that ‘the entity’s predominant <u>activities are related to insurance’;</u> and that activities related to insurance comprise issuing contracts within the scope of IFRS 4 and issuing investment contracts measured at FVPL. This is different from the ED, which proposed that ‘the entity’s predominant <u>activity is issuing contracts within the scope of IFRS 4</u>’. The staff acknowledges that the recommended changes will allow entities to qualify for the temporary exemption if they issue investment contracts with carrying amounts that are similar in size, or larger, than the carrying amounts of liabilities that arise from issuing contracts within the scope of IFRS 4. As discussed in paragraph 37, those changes are recommended to allow those entities that many consider as ‘insurers’ to qualify for the temporary exemption.

40. The staff noted, but did not agree with, the arguments set out in paragraphs 18(c)(iii) and 18(c)(iv) above, that:

(a) implementing IFRS 9 would not have a material impact on investment contracts measured at FVPL, and therefore issuers of such contracts should be eligible for the temporary exemption. The staff notes that identifying circumstances in which there may not be a material difference between applying IAS 39 versus applying IFRS 9 is not the objective of the temporary exemption. Rather, the temporary exemption is intended to provide relief to those entities that are the most affected by the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard.

(b) such investment contracts are not different economically to investment contracts issued by asset managers. The staff believes there is indeed an economic difference between contracts where the entity is working as an agent and those where the entity is working as a principal. When investment contract liabilities, and their corresponding assets, are recognised on the balance sheet, that is because the entity has control of those liabilities and assets (ie the entity is acting as a principal rather than an agent).

41. Although the staff thinks that issuing significant investment contracts measured at FVPL should not preclude an entity from qualifying for the temporary exemption, the staff notes that the Board's objective is still to provide the temporary exemption only to those entities that are appreciably affected by the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard. That is only the case if the entity issues contracts within the scope of IFRS 4. Accordingly, the staff recommends that an additional condition for qualifying for the temporary exemption is that the carrying amount of an entity's liabilities arising from contracts within the scope of IFRS 4 is significant compared to the total carrying amount of its liabilities (as set out in question 1(b)(i)).

42. Staff notes that determining 'significance' will require judgement. However, staff does not recommend additional guidance on meaning of 'significance' because this term is used in IFRS Standards and is already applied in practice.

'Other' liabilities connected to insurance activities

43. Most respondents also recommended that other specified liabilities that are connected to insurance activities (see paragraph 18) are included in the numerator so that the ratio better captures entities that are considered as 'insurers'. They note that even if an entity undertakes only insurance activity and no other activities, some other liabilities would arise. The staff agrees that some 'other' liabilities are connected to insurance activities and thus, recommends that the

predominance ratio should be amended further to better capture the appropriate population of entities that are considered as 'insurers' by adding those liabilities to the numerator.

44. Specifically, the staff thinks that examples of liabilities that are connected to insurance activities include:

    (a) funding liabilities that are considered to be part of regulatory capital or solvency requirements for insurance;

    (b) post-employment liabilities when they are related to insurance activities (eg for the employees of the entity issuing contracts within the scope of IFRS 4);

    (c) tax liabilities when they are related to insurance activities, such as deferred tax liabilities that are temporary taxable differences arising on contracts within the scope of IFRS 4 or tax collected for specified insurance contracts (eg premium taxes);

    (d) written put options on non-controlling interests in consolidated insurance funds held; and

    (e) derivatives that are economically hedging liabilities arising from contracts within the scope of IFRS 4.

45. Assuming the Board agrees with the staff recommendation to include investment contracts measured at FVPL in the numerator (as discussed in paragraphs 36-42), then staff recommends that liabilities similar to those discussed in paragraph 44 that are connected to those investment contracts should also be added to the numerator.

Unbundled deposit components

46. The staff notes that some respondents were concerned that deposit components that are unbundled[1] from an insurance contract under IFRS 4 today would not be considered part of the 'carrying amount of the liabilities arising from contracts within the scope of IFRS 4' (ie they were concerned that such components would be excluded from the numerator of the predominance ratio proposed in the ED). However, the staff notes that the notion of 'contracts within the scope of IFRS 4' captures contracts with significant insurance risk (that are not excluded from the scope of IFRS 4 in paragraph 4) and investment contracts with discretionary participation features. Consequently, while the financial instruments requirements typically apply to those unbundled deposit components, the requirement to unbundle those investment contracts is in IFRS 4 (ie they are a component of a contract within the scope of IFRS 4). Accordingly, those unbundled deposit components are part of the 'carrying amount of the liabilities arising from contracts within the scope of IFRS 4'.

Consequences of staff recommendations

47. The paragraphs above explain why the staff recommends that the predominance criterion is revised:

    (a) to broaden the notion to 'activities related to insurance' which includes (in addition to contracts arising from contracts within the scope of IFRS 4):

        (i) issuing investment contracts measured at FVPL applying IAS 39; and

        (ii) 'other' insurance related liabilities; but

    (b) to require that issuing contracts within the scope of IFRS 4 gives rise to liabilities whose carrying amount is significant compared to the total carrying amount of its liabilities.

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[1] In accordance with paragraphs 10-12 of IFRS 4, entities are required to unbundle deposit components from an insurance contract in specified circumstances. In addition, entities have the option to unbundle a deposit component when specified circumstances are met. Deposit components that are unbundled from an insurance component are typically accounted for using the IFRS requirements for financial instruments (IAS 39). Examples of deposit components that are unbundled include account balances, premium refunds payable, payables arising from claims incurred, and the amounts deposited (with the accumulated investment income) during the accumulation phase of a deferred annuity product.

48. As a consequence of these recommendations:

(a) many entities considered to be insurers by respondents, including users of financial statements, are likely to qualify for the temporary exemption. This includes:

(i) entities that would have qualified using the predominance ratio that was proposed in the ED (ie the 'adjustments' to the predominance ratio discussed in paragraphs 36-45 are unlikely to impact them).

(ii) additional entities that are impacted by the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard but less so compared to the entities that qualified under the proposals in the ED; in other words, more entities will qualify compared to the ED.

(b) entities with any significant activities that are unrelated to insurance (eg banking activities) would **not** qualify for the temporary exemption, consistently with the proposals in the ED. To ensure this objective continues to be met using the revised predominance criterion, the staff thinks that a higher threshold for the predominance ratio is required (discussed in paragraph 49-55).

(c) the calculation of the predominance ratio is more complex because additional liabilities are included in the numerator. However, the staff thinks the additional complexity is justified because the revised (and more tailored) predominance ratio will increase comparability between entities considered to be insurers.

Assessing whether the entity meets the predominance criterion

ED proposal

49. The Basis for Conclusions on the ED (paragraph BC65) provided an example that if three-quarters of an entity's liabilities are liabilities arising from contracts within the scope of IFRS 4, then that entity would not meet the predominance criterion, and therefore, would not qualify for the temporary exemption. The Board wanted to indicate that 'predominance' was intended to be a high hurdle.

Feedback received

50. Some commented on the example in paragraph BC65 of the Basis for Conclusions:

    (a) Some stated that the example should either be deleted, because it is a bright line, or, if the Board intends that it is mandatory guidance, the example should be moved into the body of the Standard.

    (b) Some suggested that the percentage threshold in the example (ie three-quarters) should be lowered because a 'pure' insurance company is likely to have liabilities other than those arising from contracts within the scope of IFRS 4 (eg tax) and, as a result, may not meet the threshold. (The staff notes that this comment assumes that the proposed predominance ratio in the ED would remain unamended.) A few commentators recognised that there was a trade-off between:

        (i) retaining a relatively simple predominance assessment (as proposed in the ED) with a lower threshold percentage than that discussed in the Basis for Conclusions on the ED; or

        (ii) a more complicated predominance assessment that is more tailored to insurance activities with a threshold percentage equal to or greater than that discussed in the Basis for Conclusions on the ED.

    (c) A few respondents suggested that the threshold should be raised if the Board were to amend the ratio by adding particular liabilities to the numerator and/or subtracting particular liabilities from the denominator, as recommended in paragraph 18.

Staff analysis and recommendation

51. Many thought that the example in paragraph BC65 was a 'bright line', when the Board did not intend that to be the case (ie the observation was included in the Basis for Conclusions, rather than the Standard). For example, the Board did not intend for that example to imply that an entity could automatically conclude that it has met the predominance criterion if more than 75% of its liabilities arise from contracts within the scope of IFRS 4.

52. Nevertheless, the staff thinks it is important to provide sufficient guidance on how the predominance ratio determines whether or not an entity's predominant activities are related to insurance so that this assessment is consistently applied and it is clear that 'predominance' is a high threshold. As noted earlier in paragraphs 23-24, given the significant effect of applying the temporary exemption, staff thinks it is important that the criterion is clear and capable of being applied consistently. Accordingly, to target the population of entities considered as 'insurers' and to exclude entities that are considered as 'non-insurers', including conglomerates, staff recommends the following thresholds for the predominance ratio:

    (a) a 'safe harbour' that is the level at which it is clear that an entity is eligible for the temporary exemption because its predominant activities are related to insurance—when the predominance ratio is greater than 90%.

    (b) a stated level at which it is clear that an entity's predominant activities are **not** related to insurance, and thus, the entity would not qualify for the temporary exemption—when the ratio is 80% or less.

53. The staff thinks that requiring an entity to consider qualitative and/or quantitative factors when the ratio is greater than 80% and less than, or equal to, 90% could provide an appropriate assessment of whether an entity is considered to be a peer of an 'insurer' or non-insurer. To achieve this objective, the staff recommends that when the ratio falls in that band, an entity must be able to satisfy the

following additional condition to meet the predominance criterion —an entity must **not** have a non-insurance related activity that is considered significant. An entity could use quantitative or qualitative factors (or both) as evidence. Staff thinks that an entity with at least one significant non-insurance related activity is not likely to be comparable to entities that are regarded as 'insurers' but instead are comparable to other conglomerates. An entity could meet the predominance criterion if it had some non-insurance related activities that, when considered in aggregate, are significant, as long as each of those activities is not considered significant on a stand-alone basis. The staff thinks this is appropriate because when an entity has a non-insurance related activity but that activity is not significant, that entity is unlikely to be compared to other entities engaging in the same non-insurance related activity.

54. The staff considered an additional condition that would have required the entity to be regulated as an insurer but rejected that condition because staff does not think that it could be easily operationalised in an effective or helpful manner. A reporting entity that is regulated as an insurer *is* more likely to be considered an insurer. However, in some jurisdictions, regulation is applied at the legal entity level rather than at the consolidated group level. Accordingly, such a condition would not be applicable in some jurisdictions as the Board has tentatively decided that the assessment of whether an entity qualifies for the temporary exemption is done at the reporting entity level (eg consolidated group level). If the 'regulation' condition was applied at the legal entity level, the staff thinks that almost all conglomerates would 'pass' that condition because they would have at least one legal entity that is regulated as insurer. Consequently, the staff thinks the 'regulation' condition would not assist in identifying reporting entities that are comparable to an insurer. In addition, the staff thinks it may be difficult to define what it means to be 'regulated as an insurer' because of differences in the regulation of insurance products across jurisdictions.

55. The staff proposes differing thresholds for meeting the predominance criterion than was contemplated in the ED. However, that is because the ED proposed a predominance ratio that would result in a significantly smaller numerator than could arise under the staff recommendations in paragraphs 35-48. If the Board agrees with the staff's recommendation that other liabilities are added to the

numerator, the staff believes the thresholds for the predominance ratio should also be adjusted. The staff believes the result is consistent with the Board's objective that:

(a) entities considered to be insurers would qualify for the temporary exemption. This will include:

(i) entities that would have qualified in the ED; and

(ii) additional entities that staff thinks are largely comparable to those that would have qualified in the ED.

(b) entities with significant non-insurance related activities (eg banking, manufacturing) would continue to **not** qualify for the temporary exemption. That is because those entities are generally not considered as insurers.

Appendix A provides a flowchart to illustrate the application of the staff recommendations for the qualifying criteria, including these thresholds.

Questions—Qualifying criteria for the temporary exemption

Qualifying criteria (paragraphs 8-48 and Appendix A)

1. Does the Board agree that an entity should be permitted to apply the temporary exemption **only** if:

(a) the entity has not previously applied any version of IFRS 9 (except for the 'own credit' requirements in isolation) (see paragraph 19); and

(b) the entity's activities are predominantly 'related to insurance', where such activities comprise:

(i) issuing contracts within the scope of IFRS 4 and these contracts give rise to liabilities whose carrying amount is significant compared to the total carrying amount of the entity's liabilities (see paragraphs 41-42); and

(ii) issuing investment contracts that are measured at fair value through profit or loss (FVPL) applying IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) (see paragraphs 36-42).

Assessing whether the entity's activities are predominantly related to insurance (paragraphs 49-55 and Appendix A)

2. Does the Board agree:

(a) to define the 'predominance ratio' as follows:

(i) Numerator: the sum of the carrying amounts of:

1. liabilities arising from activities related to insurance (ie the liabilities arising from the contracts described in Question 1(b)) plus

2. 'other' liabilities that are connected to those activities (discussed in paragraphs 43-45) and to provide examples of such 'other' connected liabilities.

(ii) Denominator: the total carrying amount of the entity's liabilities (including all the liabilities included in the numerator) (discussed in paragraphs 27-34).

(b) that an entity's activities are deemed to be predominantly related to insurance **only** if:

(i) the predominance ratio is greater than 90%; or

(ii) the predominance ratio is greater than 80% but less than, or equal to, 90% and the entity can provide evidence that it does **not** have a significant activity that is unrelated to insurance.

Date of assessment

ED proposal

56. The Board proposed that an entity would assess whether it qualifies for the temporary exemption on the date when it would otherwise be required to initially apply IFRS 9 (Paragraph 41I of the ED).

Feedback received

57. Some said that entities would need to assess whether they are eligible for the temporary exemption much earlier than that proposed date because an entity would need adequate time to implement IFRS 9 if it does not qualify for the temporary exemption. Accordingly, they recommend that the Board should require an earlier assessment date than the date proposed in the ED. In addition, a few were concerned that the effects of significant market fluctuations in the period leading up to the assessment date could inappropriately impact whether an entity is eligible for the temporary exemption.

Staff analysis and recommendation

Assessment date

58. The staff understands the concerns raised and thinks that assessing whether an entity qualifies for the temporary exemption at a date earlier than that proposed in the ED (ie 2018) would reduce uncertainty about whether an entity is required to apply IFRS 9 in 2018. Moreover, an earlier assessment date would be appropriate to allow entities that do not qualify for the temporary exemption to continue with their preparations to implement IFRS 9 in 2018.

59. Accordingly, the staff recommends that the assessment date is changed to an earlier date (ie before 2018). Specifically, the staff recommends that the assessment date is changed to the annual reporting date between 1 April 2015 and 31 March 2016 (ie for annual periods ending between 1 April 2015 and 31 March 2016). For example, if an entity's annual reporting date is 31 December, it would assess whether it is eligible for the temporary exemption based on its balance

sheet as at 31 December 2015. The staff has recommended that assessment date by considering the following factors:

(a) There is a trade-off between requiring an entity to use the most up-to-date information while also reducing the ‘waiting’ period during which the entity is uncertain whether it qualifies for the temporary exemption or will need to apply IFRS 9 in 2018.

(b) An assessment date in 2017 may not significantly reduce the uncertainty about whether the entity is required to apply IFRS 9 in 2018.

(c) An assessment date in 2016 (ie an annual period ending between 1 January and 31 December 2016) may be viewed as giving an advantage to those entities whose year-end occurs after the Board has made the relevant decisions related to the temporary exemption compared with those whose annual reporting period ends before that decision is made (eg 31 March 2016).

60. Accordingly, staff recommends that the assessment date for the temporary exemption is an entity’s annual reporting date between 1 April 2015 and 31 March 2016. Staff thinks this recommendation balances the trade-off between using the most up-to-date information while reducing uncertainty about whether the entity will be required to apply IFRS 9 in 2018.

61. The staff acknowledges that the recommended change in the assessment date may impact the analysis on whether, in particular circumstances, an entity is required to subsequently reassess its eligibility for the temporary exemption. As discussed in paragraph 3, the staff intends to discuss the issue of reassessment in May.

Fluctuations in market value

62. A few were concerned that unusual market fluctuations in the period leading up to the assessment date could affect whether an entity meets the predominance criterion proposed in the ED because such market fluctuations could affect the carrying amounts of liabilities that are measured using a current discount rate (eg those liabilities measured at fair value). If the entity has some liabilities at current values and other liabilities at cost, those unusual market fluctuations may have the

result that the predominance ratio does not reflect the entity's activities; ie the ratio would be significantly different if it had been calculated on an earlier or later date.

63. In particular, these respondents were concerned that an entity's predominance ratio would not meet the necessary threshold at the assessment date but if a different assessment date was used (or if an average of the carrying amounts at the end of several annual periods was used), the entity may have a higher ratio that more appropriately reflects their activities and therefore, would qualify for the temporary exemption.

64. The staff thinks that the recommended changes to the predominance criterion set out in this paper reduce the likelihood that market fluctuations during the annual period could affect whether the entity meets the predominance criterion. This is because additional liabilities are included in the numerator of the predominance ratio and the entity may consider qualitative factors when the predominance ratio is greater than 80% but less than, or equal to, 90%.

65. Nevertheless, the staff acknowledges that it would be inappropriate to permit an entity to apply the temporary exemption, or prohibit an entity from applying the temporary exemption, solely due to market fluctuations in the annual period leading up to the assessment date. Consequently, the staff recommends an additional requirement that if market fluctuations in the annual period leading up to the assessment date have significantly affected an entity's predominance ratio because those fluctuations have affected the carrying amounts of any of the entity's liabilities, the entity is required to calculate the predominance ratio using an average of the relevant carrying amounts on the entity's annual balance sheet for the last three years (for example: an average of carrying amounts for the annual periods of 2013, 2014 and 2015).

Questions—Date of assessment

3. Does the Board agree that:

    (a) an entity should be required to compute the predominance ratio using the carrying amounts of the liabilities reported on the entity's balance sheet at the annual reporting date between the 1 April 2015 and 31 March 2016 (ie the assessment date), unless (b) applies; and

    (b) if market fluctuations in the annual period leading up to the assessment date have significantly affected an entity's predominance ratio because those fluctuations have affected the carrying amounts of any of its liabilities, the entity is required to calculate the predominance ratio using an average of the relevant carrying amounts on the entity's annual balance sheet for the last three years (for example: an average of the carrying amounts at the annual reporting dates in 2013, 2014 and 2015).

Related disclosures

ED proposal

66. Paragraphs 37A(a) and 37A(b) in the ED propose that an entity that applies the temporary exemption must disclose that fact and explain how it concluded that it is eligible for it. (The ED proposes additional disclosures for those applying the temporary exemption, which are discussed in Agenda Paper 14D *Temporary exemption from IFRS 9—Disclosures* at this meeting.)

Feedback received

67. Respondents did not express any concerns about those proposed disclosures.

Staff analysis and recommendation

68. The staff recommends confirming those disclosures proposed in the ED because this information is critical so that users of financial statements are aware that the entity has not applied IFRS 9 to its financial instruments (but rather is still applying IAS 39) and can understand any judgements that the entity made to conclude that it is eligible.

69. As a result of the staff's recommendations related to the predominance criterion and the predominance ratio, the staff recommends that entities are also required, as part of their disclosure explaining how they concluded that they are eligible for the temporary exemption, to explain:

    (a) which liabilities, other than those arising from contracts within the scope of IFRS 4, are included in the numerator of the predominance ratio (as discussed in paragraphs 35-48); and

    (b) other information used to determine the entity's eligibility when its predominance ratio is greater than 80% but less than, or equal to, 90% (as discussed in paragraphs 49-55).

Question—Disclosures

4. Does the Board agree to:

   (a) confirming the proposed disclosure in paragraphs 37A(a) and (b) of the ED that an entity must disclose:

      (i) the fact that it is applying the temporary exemption; and

      (ii) how it concluded that it is eligible for the temporary exemption;

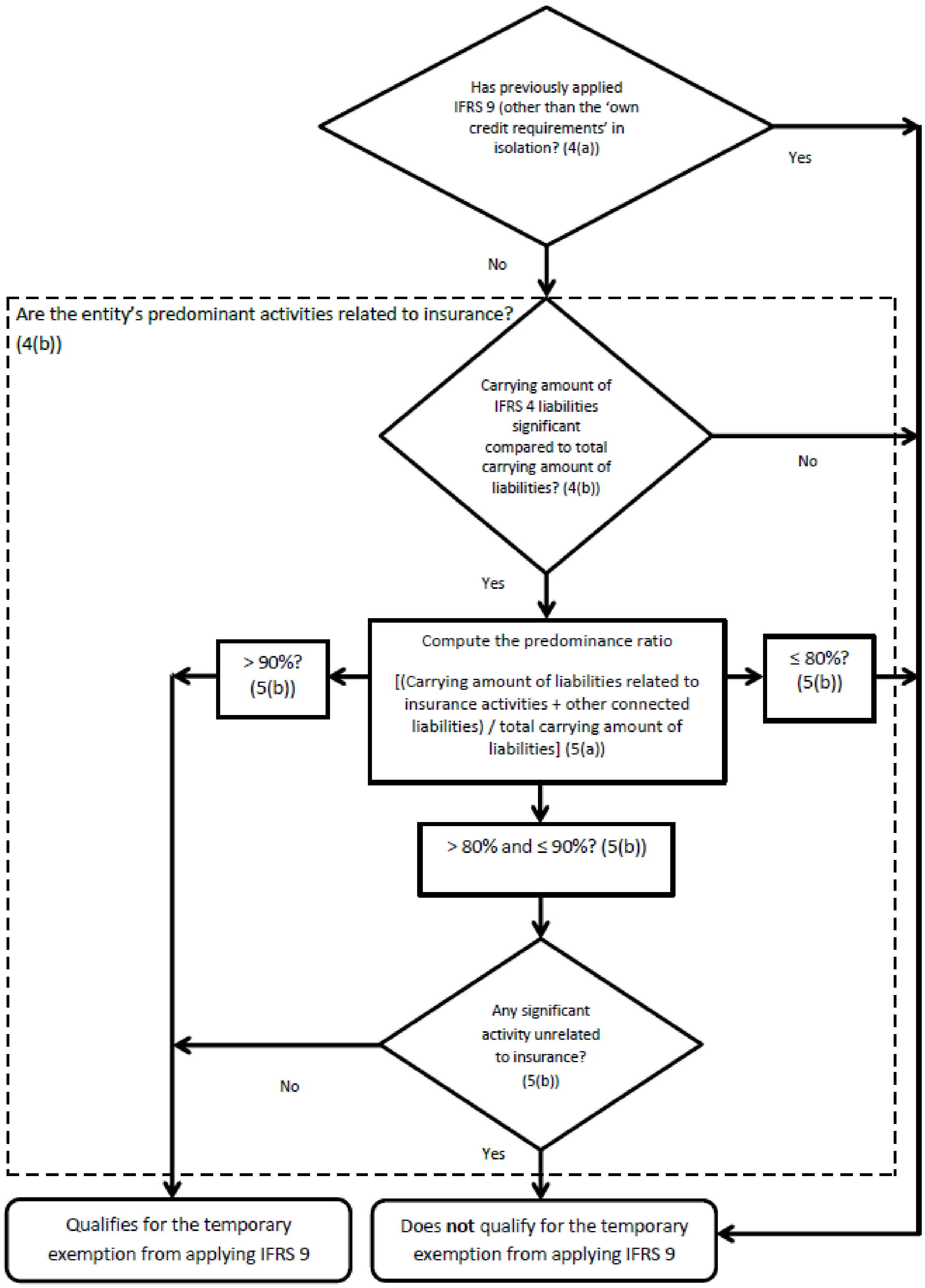
   (b) adding to the proposed disclosure of how the entity concluded that it is eligible for the temporary exemption, to require that an entity must also disclose:

      (i) any liabilities, other than those arising from contracts within the scope of IFRS 4, that were added to the numerator of the predominance ratio (as discussed in Questions 1 and 2); and

      (ii) the information used to determine that the entity's activities are predominantly related to insurance if the predominance ratio is greater than 80% but less than, or equal to, 90% (see Question 2).

Appendix: Illustrative flow chart

A1. The flow chart illustrates the staff recommendations in paragraphs 2-7 on the process for determining if an entity qualifies for the temporary exemption.



* References in parentheses denote relevant paragraph numbers in Agenda Paper 14C.