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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 – Disclosures		
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Purpose of this paper

1. The purpose of this paper is to reconsider the disclosures proposed in paragraphs 37A(c)-(d) of the Exposure Draft *Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts (Proposed amendments to IFRS 4) (the ED) in the light of the feedback received. These disclosures would be required for entities that apply the temporary exemption from applying IFRS 9 (the temporary exemption).

2. This paper does not address the disclosures proposed:

   (a) in paragraphs 37A(a)-(b) of the ED because those disclosures are considered in Agenda Paper 14C *Temporary exemption from IFRS 9—Qualifying criteria*; or

   (b) in paragraph 37B of the ED because those disclosures are related to the reassessment of the eligibility criteria, which will be discussed at a future meeting.

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Staff recommendation

3. The staff recommends the Board should confirm the disclosures proposed in paragraphs 37A(c)-(d) of the ED with the following changes:

   (a) Amend the disclosure proposed in paragraph 37A(c) to require an entity to disclose the fair value at the end of the reporting period and the fair value change during the reporting period separately for:

      (i) the financial assets specified in 37A(c); ie those assets with contractual cash flows that are not solely principal and interest (SPPI); and

      (ii) all other financial assets; ie those assets with contractual cash flows that are SPPI. For the purpose of this disclosure, an asset's carrying amount measured in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* is a reasonable approximation of its fair value if the entity is not required to disclose its fair value in accordance with paragraph 29(a) of IFRS 7 *Financial Instruments: Disclosures* (eg short-term trade receivables).

   (b) Add to the disclosure proposed in paragraph 37A(c) to require an entity to present the information with a sufficient level of granularity to enable users of financial statements to understand the nature and the characteristics of the financial assets.

   (c) Add to the disclosure proposed in paragraph 37A(d) to require that, for the financial assets within the scope of that disclosure that do not have low credit risk at the end of the reporting period, an entity should disclose the fair value and the "gross" carrying amount (ie in the case of amortised cost assets, before adjusting for any impairment allowances) measured in accordance with IAS 39.

   (d) Add a disclosure to require an entity to refer to any IFRS 9 information that is not provided in the consolidated financial statements but is publicly available for the relevant reporting period in the financial statements of a subsidiary.

Background

4. During the outreach performed in the development of the ED, many users of financial statements expressed concerns that a temporary exemption would make it difficult to compare entities that continue to apply IAS 39 to those that apply IFRS 9 (both within the insurance sector and across sectors). To address these concerns, paragraph 37A of the ED proposed disclosures that would assist users of financial statements in making such comparisons without imposing excessive costs on preparers. Those disclosures:

   (a) are similar to some of the disclosures required for entities applying IFRS 9, but

   (b) rely primarily on an assessment of the contractual terms of financial assets and therefore are intended to reduce the need for an entity to assess the business model for financial assets prior to the application of the new insurance contracts Standard and IFRS 9.

5. Specifically, the ED proposed that entities that apply the temporary exemption would disclose the following information:

   (a) for financial assets that would be measured at fair value through profit or loss (FVPL) applying IFRS 9 because they do not meet the condition in paragraph 4.1.2(b) and 4.1.2A(b) of that IFRS (ie for financial assets that <u>do not meet</u> the SPPI test) - the fair value at the end of the reporting period and the fair value change during the reporting period. [paragraph 37A(c) of the ED]

   (b) for financial assets that would meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b) of IFRS 9 (ie for financial assets that <u>meet</u> the SPPI test) and are not held for trading or managed on a fair value basis - information about the credit risk exposure (including significant credit risk concentration) and the gross carrying amounts by credit risk rating grades at the end of the reporting period. [paragraph 37A(d) of the ED]

6. The staff note that the ED did not propose that an entity would be required to provide quantitative information about expected credit losses because the Board

thought that it would be burdensome for preparers to measure impairment amounts applying both IFRS 9 and IAS 39.

Summary of the feedback received

7. Interested parties expressed mixed views on the disclosures proposed in paragraphs 37A(c)-(d) of the ED:

   (a) Some preparers disagreed with the proposed disclosure requirements because they believed those disclosures would be unduly burdensome. As a more general comment, some stated that any disclosures that would require the entity to run two reporting systems (ie to produce IFRS 9 information in addition to IAS 39 information) should be avoided.

   (b) Many users of financial statements that commented on this topic thought that the disclosures proposed in the ED would improve comparability between entities that defer application of IFRS 9 and entities that apply IFRS 9. However, those users of financial statements stated that the Board should require more disclosures of IFRS 9 information compared to the proposals in the ED but most did not provide specific examples of any additional disclosures.

8. Some users of financial statements and a few regulators emphasised the importance of requiring sufficient disclosures about the credit quality of financial assets if, as a consequence of applying the temporary exemption, an entity continues to measure those assets using the incurred loss model in accordance with IAS 39. In fact, some users of financial statements expressed the view that the loss of information about expected credit losses is not a justifiable side effect of addressing concerns related to the different effective dates of IFRS 9 and the forthcoming insurance contracts Standard. One user of financial statements specifically noted that entities that invest mostly in 'simple' bonds may not experience any increased volatility as a result of applying IFRS 9 (for example, if those financial assets would be measured at amortised cost under both IAS 39 and

IFRS 9). However, under the ED proposals, such entities would still be able to defer the application of IFRS 9 (if they qualify in accordance with the ED) and thus continue to apply the impairment requirements in IAS 39. Consequently, some users of financial statements, including members of the Capital Markets Advisory Committee (CMAC) and the Corporate Reporting Users Forum (CRUF), stated that the Board should require more disclosures about expected credit losses, including quantitative information, for entities that apply the temporary exemption.

9. In addition, some preparers did not understand the rationale for the disclosure in paragraph 37A(c) of the ED, which proposed that fair values would be disclosed for financial assets that do not meet the SPPI test. It appears that some preparers thought that the proposal applies (or should apply) only to financial assets that are newly measured at FVPL (ie financial assets that will be measured at FVPL applying IFRS 9 but are not measured at FVPL applying IAS 39).

Staff analysis

Fair value for financial assets that do not meet the SPPI test

10. As noted in paragraph 4, the disclosures in paragraphs 37A(c)-(d) of the ED were proposed to promote comparability between entities that apply the temporary exemption and entities that apply IFRS 9, without imposing significant costs on preparers. The staff think the disclosures proposed in paragraph 37A(c) achieve that objective because they:

    (a) require an entity applying the temporary exemption to provide the fair value at the end of the reporting period (and the fair value change during the reporting period) for financial assets that would be measured at FVPL applying IFRS 9 based on their cash flows characteristics regardless of how those financial assets are measured applying IAS 39. That is similar to the information that entities applying IFRS 9 would provide in accordance with paragraphs 8(a)(ii) and 20(a)(i) of IFRS 7.

(b) do not impose significant costs on preparers because paragraph 25 of IFRS 7 currently requires entities to disclose the fair value of all financial assets and financial liabilities[1].

11. However, the staff think that the disclosed fair value information would be more useful to users of financial statements if the requirement was amended as follows:

(a) Instead of disclosing a single number (ie a sum for all financial assets that do not meet the SPPI test), an entity would present this information with a sufficient level of granularity to enable users to understand the nature and the characteristics of the financial assets (similar to the granularity that is expected to be presented by entities applying IFRS 9). For example, an entity would present the fair value of derivatives separately from non-derivatives.

(b) In order to provide context for this disclosure and, in particular, to enable users of financial statements to understand the magnitude of an entity's assets that do not meet the SPPI test (and thus are considered to be 'complex' when applying IFRS 9) relative to all the financial assets in the entity's financial statements, the staff believe that an entity should also disclose the fair value of financial assets that meet the SPPI test (ie the remaining financial assets in the financial statements). As noted in paragraph 10(b) of this paper, IFRS 7 currently requires entities to provide the fair value of financial assets and therefore this additional requirement is not expected to be burdensome for preparers. However, the staff note that paragraph 29(a) of IFRS 7 does not require entities to disclose fair value when the carrying amount is a reasonable approximation of fair value (eg short-term trade receivables) and therefore, for those assets, the staff recommend that entities are permitted to use the carrying amounts measured in accordance with IAS

[1] The staff acknowledge that paragraph 29 of IFRS 7 provides relief for equity investments that are measured using the 'cost exception' in IAS 39. However, when developing the proposals in the ED, the Board did not expect that insurers will hold many of those assets and further believed that the benefits of providing that information exceed the costs.

39 as a reasonable approximation of their fair value for the purposes of this disclosure.

Information about credit risk exposure for financial assets that meet the SPPI test

12. As explained in paragraph 8, some users of financial statements emphasised that it is important that there are sufficient disclosures about the credit quality of financial assets that entities will continue to measure using an incurred loss model in accordance with IAS 39. Consequently, those users of financial statements asked the Board to consider requiring more disclosures about expected credit losses, including quantitative information.

13. The staff agree with that feedback and think that an entity should provide additional information for a subset of the financial assets within the scope of paragraph 37A(d) of the ED – specifically financial assets that do not have low credit risk (as described in IFRS 9)[2]. The staff think that the additional disclosures should apply to such financial assets because:

    (a) Users of financial statements were particularly concerned about the credit risk of those assets and observed that the difference in the impairment amounts calculated applying IFRS 9 and IAS 39 could be significant.

    (b) It should not be unduly burdensome for preparers because the disclosures would apply to only a subset of financial assets. Furthermore, entities that issue insurance contracts tend to hold high-quality financial assets and therefore this disclosure should apply to a relatively limited population of financial assets.

[2] Paragraphs B5.5.22-B5.5.24 of IFRS 9 discuss the meaning of low credit risk. The relevant paragraphs of IFRS 9 are reproduced in the Appendix to this paper.

14. The staff considered two alternative types of information about financial assets that do not have low credit risk:

    (a) Alternative 1: disclose the lifetime expected credit losses measured applying IFRS 9 for those assets, along with related information about the inputs, assumptions and estimation techniques used to measure that amount as well as information about how (and why) that amount changed during the reporting period.

    (b) Alternative 2: disclose the fair value of those assets and their "gross" carrying amounts (ie in the case of amortised cost assets, before adjusting for any impairment allowances) in accordance with IAS 39.

15. The staff acknowledge that some users of financial statements asked the Board to require entities to provide quantitative information about expected credit losses because it would provide useful information and would increase comparability between entities that apply IFRS 9 and those that apply the temporary exemption. The staff note that, according to Alternative 1, entities would be required to only measure lifetime expected credit losses; and therefore, entities would not need to distinguish between those financial assets that have significantly increased in credit risk and those that have not, as required by IFRS 9.
However, entities would still be required to measure impairment amounts applying both IFRS 9 and IAS 39, which could impose significant, additional costs; and thus could reduce the potential benefits of the temporary exemption. The staff are sympathetic to the concern expressed by preparers about having to provide information that would require them to run two accounting systems and consequently the staff rejected Alternative 1.

16. The staff therefore recommend Alternative 2 because it achieves a better balance between meeting the information needs of users of financial statements and avoiding additional costs for preparers. Specifically:

    (a) Fair values (compared to the carrying amounts applying IAS 39) will be useful for users of financial statements in assessing the credit risk exposure for those riskier assets and the potential effect of applying the

expected credit loss requirements in IFRS 9 (because information about expected credit losses would be reflected in the fair values); and

(b) Providing fair value information should not be burdensome for preparers because they already are required to provide such information in the disclosures in accordance with IFRS 7, as previously noted in paragraph 10(b) of this paper.

Other disclosures

17. The staff note that in some circumstances, a subsidiary of an entity may be required or may choose to provide IFRS 9 information in its separate financial statement, even if an entity in the consolidated financial statement applies the temporary exemption. The staff recommends that an entity is required to refer to any IFRS 9 information that is not provided in the consolidated financial statements but is publicly available for the relevant reporting period in the financial statement of a subsidiary[3]. This disclosure:

(a) would provide a link to additional information if an entity applies the temporary exemption but one of its subsidiaries applies IFRS 9 in its standalone financial statements (eg the subsidiary has significant banking activity and therefore could not apply the temporary exemption or the regulator requires IFRS 9 information).

(b) would not impose additional burden on preparers because it would not require providing any new information but instead it would simply refer to another source of information (rather than reproducing or copying any of that information).

(c) would prevent information asymmetry if some, but not all, users were aware of the availability of the additional information.

[3] The staff note that the interaction between the temporary exemption and investments in associates (including the relevant disclosures) will be discussed at a future meeting.

Question to the Board

Do the Board members agree to confirm the disclosures, for entities that apply the temporary exemption, proposed in paragraph 37A(c)-(d) of the ED with the following changes:

(a) Amend the disclosure proposed in paragraph 37A(c) to require an entity to disclose the fair value at the end of the reporting period and the fair value change during the reporting period separately for:

(i) the financial assets specified in 37A(c); ie those assets with contractual cash flows that are not solely principal and interest (SPPI); and

(ii) all other financial assets; ie those assets with contractual cash flows that are SPPI. For the purpose of this disclosure, an asset's carrying amount measured in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* is a reasonable approximation of its fair value if the entity is not required to disclose its fair value in accordance with paragraph 29(a) of IFRS 7 *Financial Instruments: Disclosures* (eg short-term trade receivables).

(b) Add to the disclosure proposed in paragraph 37A(c) to require an entity to present the information with a sufficient level of granularity to enable users of financial statements to understand the nature and the characteristics of the financial assets.

(c) Add to the disclosure proposed in paragraph 37A(d) to require that, for the financial assets within the scope of that disclosure that do not have low credit risk at the end of the reporting period, an entity should disclose the fair value and the "gross" carrying amount (ie in the case of amortised cost assets, before adjusting for any impairment allowances) measured in accordance with IAS 39.

(d) Add a disclosure to require an entity to refer to any IFRS 9 information that is not provided in the consolidated financial statements but is publicly available for the relevant reporting period in the financial statements of a subsidiary.

Appendix: Relevant paragraphs from IFRS 9

Financial instruments that have low credit risk at the reporting date

B5.5.22 The credit risk on a financial instrument is considered low for the purposes of paragraph 5.5.10, if the financial instrument has a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. Financial instruments are not considered to have low credit risk when they are regarded as having a low risk of loss simply because of the value of collateral and the financial instrument without that collateral would not be considered low credit risk. Financial instruments are also not considered to have low credit risk simply because they have a lower risk of default than the entity's other financial instruments or relative to the credit risk of the jurisdiction within which an entity operates.

B5.5.23 To determine whether a financial instrument has low credit risk, an entity may use its internal credit risk ratings or other methodologies that are consistent with a globally understood definition of low credit risk and that consider the risks and the type of financial instruments that are being assessed. An external rating of 'investment grade' is an example of a financial instrument that may be considered as having low credit risk. However, financial instruments are not required to be externally rated to be considered to have low credit risk. They should, however, be considered to have low credit risk from a market participant perspective taking into account all of the terms and conditions of the financial instrument.

B5.5.24 Lifetime expected credit losses are not recognised on a financial instrument simply because it was considered to have low credit risk in the previous reporting period and is not considered to have low credit risk at the reporting date. In such a case, an entity shall determine whether there has been a significant increase in credit risk since initial recognition and thus whether lifetime expected credit losses are required to be recognised in accordance with paragraph 5.5.3.