New conditions for the IFRS 9 deferral

A revised criterion is approved for the "all or nothing" deferral approach on IFRS 9

Francesco Nagari
Deloitte Global IFRS Insurance Lead Partner
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Agenda

- **Highlights of the IASB meeting on 19 April 2016**
- **IASB Staff analysis, IASB discussion and tentative decisions**
- **Next steps**

Highlights of the IASB meeting on 19 April 2016

- Confirmed most of the ED proposals on the Overlay Approach
- Clarified that qualifying financial assets could include surplus assets and financial assets held by one legal entity as relating to contracts within the scope of IFRS 4 that are issued by a different legal entity within the same reporting entity
- The presentation of the Overlay Adjustment shall be one line item in P&L and one in OCI with breakdown in the notes
- Deferral Approach test changed with the numerator of 'predominance ratio' including now liabilities related to insurance plus 'other' connected liabilities, and kept the denominator equal to the total of the liabilities
- Insurance activities predominant if predominance ratio is greater than 90%, or is greater than 80% and evidence that there is not a significant unrelated activity in the remaining 20%
- Predominance ratio computed between 1 April 2015 and 31 March 2016.
- Disclosures for the Deferral Approach have been amended to cover the new qualifying criteria. In addition, consolidated financial statements will have to disclose any IFRS 9 information that may have been produced in publicly available subsidiary financial statements.

The Overlay Approach

Staff Analysis

- Inconsistent designation of financial assets relating to contracts within the scope of IFRS 4
- Clarifications about qualifying financial assets: surplus assets
  - Financial assets that an entity holds to fund the settlement of liabilities arising from expected levels of claims and expenses
  - Additional (or surplus) assets that an entity hold to meet internal capital requirements, as this is integral to an insurance business
- Clarifications about qualifying financial assets: other guidance
  - Not able to include assets that are held in respect of activities other than those associated with contracts within the scope of IFRS 4
  - Do not believe it is feasible to provide more specific guidance on identifying assets that specifically relate to insurance contracts

The Overlay Approach

Staff recommendation – Confirmation of ED proposals for qualifying assets

- A financial asset qualifies for the overlay approach if it is designated as relating to contracts that are within the scope of IFRS 4 and it is measured at FVPL when applying IFRS 9 but would not have been measured at FVPL under IAS 39
- An entity that applies the overlay approach:
  - may newly designate a previously recognised financial assets as relating to contracts within the scope of IFRS 4
  - shall de-designate a previously recognised financial asset as relating to contracts within the scope of IFRS 4 only when there is a change in the relationship with the contracts within the scope of IFRS 4
  - shall reclassify to P&L any accumulated OCI balance relating to a previously designated financial asset if it no longer meets the qualifying criteria
- Clarify that qualifying assets could include surplus financial assets held for regulatory, credit rating or internal capital requirements
- Disclose the basis for designating financial assets held by one legal entity as relating to contracts within the scope of IFRS 4 that are issued by a different legal entity within the same group

The Overlay Approach - Qualifying financial assets for the overlay approach and related disclosures

IASB discussion and tentative decision

- Several Board members expressed reservations about the basis for designating financial assets held by one legal entity as relating to contracts within the scope of IFRS 4 that are issued by a different legal entity within the same group.
- After a lively debate it was suggested changing the recommendation to "…. issued by a different legal entity within the same reporting entity" and this revised wording was supported by other Board members

Tentative decision

- The Board approved the Staff recommendations (as amended) with twelve members voting in favour and one against. One Board member was absent throughout the meeting on the IFRS 9 decoupling ED discussion

Presentation of the Overlay Adjustment

Staff Analysis

- Presentation of the overlay adjustment in P&L and OCI
  - Information could be presented differently compared with entities that apply IFRS 9 without the overlay approach, thus reducing comparability
  - Entities applying the overlay approach could present 'mixed' information, e.g. a single line item reflecting impairment losses in accordance with IFRS 9 for some financial assets and in accordance with IAS 39 for others
  - A single, separate line item provides the most useful information, and would result in the same IFRS 9 requirements for all of an entity's financial assets
  - The recommendation will result in disclosure of the effect of the overlay adjustment on individual line items in the notes to the financial statements.

Presentation of the Overlay Adjustment

Staff Recommendation

- Amend the ED proposals on the presentation to require an entity to:
  - present in P&L information that reflects the application of IFRS 9 with a single, separate line item for the overlay adjustment, and in OCI the overlay adjustment separate from other components of OCI; and
  - disclose the effect of the overlay approach on individual line items in the notes to the financial statements
- Confirm the following ED proposals without amendment for the overlay approach:
  - the initial application of, and ceasing to apply, the overlay approach
  - applying the overlay adjustment to pre-tax profit or loss; and
  - transition to the overlay approach.

The Overlay Adjustment – Presentation, initial application and application to pre-tax profit or loss

IASB discussion and tentative decisions

Presentation of the overlay adjustment

- There was very limited discussion on these issues

Tentative decision

- The Board approved the Staff recommendation with twelve members voting in favour and one against.

Temporary exemption from IFRS 9 – Qualifying criteria

Staff Analysis

- Predominance criterion
  - Some respondents thought that the predominance criterion should be principle-based (based only on qualitative, or combined with quantitative criteria).
  - Others supported a quantitative assessment because they believe the criterion should be clear and unambiguous, a view shared by the Staff.
  - The predominance criterion should be anchored to quantitative factors because this provides a more objective assessment that can be more clearly described, understood and applied.
  - There is no qualitative factor(s) e.g. ‘regulated as an insurer’ that could achieve this in isolation

Temporary exemption from IFRS 9 – Qualifying criteria

Staff Analysis (contd.)

- Predominance criterion (contd.)
  - Concerns that the proposed predominance ratio would result in some entities considered by their stakeholders to be ‘pure insurers’ would not qualify for the exemption.
  - Describing predominance by reference to income and expenses would be subject to the same concerns, as the amounts recognised in the SOCI are linked to the carrying values of the liabilities, and also may be more volatile
  - Some respondents recommended that specific liabilities be added to the numerator because they are related to insurance activities. Others recommended deducting specific liabilities from the denominator because those liabilities are accounted for at FVPL applying both IAS 39 and IFRS 9, or they do not assist in differentiating insurance-related activities from other activities. The effect of these two recommendations on the ratio is similar.
  - Any adjustments should be added to the numerator because this is more intuitive and understandable, and only a limited number of liabilities do not assist in differentiating insurance-related activities from other activities.

Temporary exemption from IFRS 9 – Qualifying criteria

Staff Analysis (contd.)

- Predominance criterion (contd.)
  - Many respondents said that issuing investment contracts should be considered as an insurance activity in some cases, and permitting entities with significant investment contracts to apply the temporary exemption would promote comparability between entities that they consider to be peers
  - Investment contracts issued by insurers need to be distinguished from non-derivative financial liabilities unrelated to insurance activities. A simple and practical way is to include in the numerator only investment contracts measured at FVPL, as most non-derivative financial liabilities unrelated to insurance are measured at amortised cost
  - Some ‘other’ liabilities are connected to insurance activities, and should be added to the numerator. Examples of such liabilities are funding liabilities that are considered part of regulatory capital or solvency requirements, post-employment liabilities and tax liabilities when they are related to insurance activities, written put options on non-controlling interests in consolidated insurance fund held, and derivatives that are economically hedging insurance contract liabilities.

Temporary exemption from IFRS 9
Assessing whether entity meets the predominance criterion

Staff Analysis

- Important to provide sufficient guidance on how the predominance ratio determines whether or not an entity qualifies
- The following thresholds for the predominant ratio are recommended:
  - a ‘safe harbour’ at a level which it is clear that the predominant activities **are** related to insurance, which is 90%; and
  - a stated level at which it is clear that the predominant activities are **not** related to insurance, which is 80% or less
- 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
- In order to meet the predominance criterion an entity must **no**t have a non-insurance related residual activity that is considered significant, using quantitative or qualitative factors as evidence.

Temporary exemption from IFRS 9
Qualifying criteria

Staff Recommendation – Qualifying criteria

Permitted to apply the temporary exemption **only** if:

- the entity has not previously applied any version of IFRS 9 (except for 'own credit' requirements in isolation; and
- the entity's activities are predominantly 'related to insurance' where such activities comprise:
  - issuing contracts within the scope of IFRS 4 and these contracts give rise to liabilities whose carrying amount is significant compared to the total amount of the entity's liabilities; and
  - issuing investment contracts that are measured at FVPL applying IAS 39

Temporary exemption from IFRS 9
Qualifying criteria

Staff Recommendation – Assessing whether the entity's activities are predominantly related to insurance

- To define the 'predominance ratio' as follows:
  - Numerator - the sum of the carrying amounts of liabilities related to insurance plus 'other' liabilities that are connected to those activities, and to provide examples of such 'other' liabilities
  - Denominator - the total carrying amount of the liabilities
- An entity's activities are deemed to be predominantly related to insurance **only** if:
  - the predominance ratio is greater than 90%; or
  - 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

Temporary exemption from IFRS 9 - Qualifying criteria and the threshold for assessing an entity's predominant activities

IASB discussions and tentative decision

- Board members stated that they supported the Staff recommendations "through gritted teeth" and referred to reservations about the inclusion of 80% and 90% "bright lines" but supported the recommendations as the Board was endeavouring to provide practical solutions which were temporary.
- Questioned whether the 10% range between 80% and 90% relied on the exercise of judgement, and the Staff confirmed this was their intention.
- Segmental disclosures might provide evidence that the entity does not have a significant activity that is unrelated to insurance.
- Concerns were expressed that the list of examples of liabilities that are connected to insurance activities was very specific and contained too many items. No immediate revision appears to have been approved though.

Tentative decision

- The Board approved the Staff recommendation with twelve members voting in favour and one against.

Temporary exemption from IFRS 9 - Date of assessment

Staff Analysis

- Assessing whether an entity qualifies for the temporary exemption at a date earlier than 2018 would reduce uncertainty about whether it is required to apply IFRS 9 in 2018.
- It would also allow entities that do not qualify for the temporary exemption to continue with their preparations to implement IFRS 9 in 2018
- There is a trade-off between requiring the use of the most up-to-date information while also reducing the 'waiting' period during which the entity is uncertain whether it qualifies for the exemption
- The recommended changes to the predominance ratio reduce the likelihood that market fluctuations could affect whether the entity meets the predominance criterion.
- Nevertheless, 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.

Temporary exemption from IFRS 9 – Date of assessment

Staff Recommendation

- Required to compute the predominance ratio:
  a) at the annual reporting date between 1 April 2015 and 31 March 2016,
  b) unless market fluctuations in the annual period leading up to the assessment date have significantly affected the predominance ratio, in which case the predominance ratio should be calculated using an average of the relevant carrying amounts for the last 3 years.

Temporary exemption from IFRS 9 – Date of assessment

IASB discussion and tentative decision

- Situation in which the predominance ratio was met on the assessment date but not in the annual period leading up to the assessment date because market fluctuations have significantly affected the carrying amounts of any liabilities
- Auditors may require an analysis of the effect of market fluctuations; therefore clarity in the drafting of this would be essential
- It might be preferable to require the calculation of the predominance ratio using an average of the relevant carrying amounts for the last three years in all cases, but the Staff explained that they had not proposed this disclosure because information becomes less relevant the further back you go
- The Board agreed that the requirement to consider market fluctuations should be deleted. This requirement would give rise to a whole host of judgements being required, and the 10% “cushion” was sufficient to give entities a second chance. The “…. unless market fluctuations” condition were deleted

Tentative decision

- The Board approved the Staff recommendation (as amended) with twelve members voting in favour and one against.

Temporary exemption from IFRS 9 - Related Disclosures

Staff Analysis

- Staff recommended confirming the proposed disclosures in the ED because this information is critical so that users are aware that IFRS 9 has not been applied.
- The Staff recommended that there should be an explanation of which other liabilities are included within the numerator of the predominance ratio, and other information used to determine eligibility when the predominance ratio is greater than 80% but less than, or equal to, 90%.

Temporary exemption from IFRS 9 - Related Disclosures

Staff Recommendation

- Confirm the proposed disclosures in the ED:
  - The temporary exemption is being applied by the entity
  - How it was concluded that it is eligible for the temporary exemption
- Add the following disclosures:
  - Any liabilities, other than those arising from contracts within the scope of IFRS 4, that were added to the numerator of the predominance ratio
  - The information used to determine the entity's activities are predominantly related to insurance if the predominance ratio is greater than 80% but less than, or equal to, 90%

Temporary exemption from IFRS 9 - Related disclosures

IASB discussion and tentative decision

- The extent of disclosures that would be required about published Standards that had not been applied in respect of the temporary exemption from applying IFRS 9 discussed (under IAS 8 paragraph 30-31). The Staff responded as follows:
  - confirmed that the intention whether or not to apply IFRS 9 in 2018 should be disclosed; and
  - agreed with a view that if the 90% test was met there was no need for any further disclosures to provide details about this test

Tentative decision

- The Board approved the Staff recommendation with twelve members voting in favour and one against.

Temporary exemption from IFRS 9 - Disclosures

Staff Analysis

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

- The disclosures in the ED promote comparability between entities that apply the temporary exemption and entities that apply IFRS 9
- Disclosure of fair value of financial assets that do **not** meet the SPPI test that enables their nature and characteristics to be understood, and disclosure of fair value of financial assets that **do** meet the SPPI test would be useful

Credit risk exposure for financial assets that meet the SPPI test

- The Staff agree with feedback from users on the importance of disclosures about the credit quality of financial assets that are measured using an IAS 39 incurred loss model, specifically for financial assets that do not have low credit

Other disclosures

- IFRS 9 information may be provided in the financial statement of a subsidiary, but not in the consolidated financial statements even where the temporary exemption is applied. Referring to this would be helpful, it would not impose additional burden and it would ensure that all users are aware of this information.

Temporary exemption from IFRS 9 - Disclosures

Staff Recommendation

- The disclosures for entities that apply the temporary exemption proposed in the ED should be confirmed with the following changes:
  - disclose the fair value at the end of the reporting period and the fair value change during the reporting period separately for financial assets with contractual cash flows that **are not** solely SPPI; and
  - all other financial assets, i.e. those with contractual cash flows that **are** SPPI
- Add the following disclosures:
  - present fair value information with a sufficient level of granularity to enable the nature and characteristics of the financial assets to be understood
  - for financial assets that do not have a low credit risk disclose the fair value and the “gross” carrying amount (for amortised cost assets, before adjusting for any impairment allowances) measured in accordance with IAS 39
  - reference to any IFRS 9 information not provided in the consolidated financial statements but is publicly available for the relevant reporting period in the financial statements of a subsidiary.

Temporary exemption from IFRS 9 - Disclosures

IASB discussion and tentative decisions

- Staff stated that IFRS 7 is the basis of the disclosures, and the intention is to disclose how credit risk might affect the gross carrying amount of financial assets
- Difficult to disclose credit risk information if the option to defer IFRS 9 was applied, but the disclosure of the fair value of financial assets would give an indication of potential credit losses
- The need to refer to any IFRS 9 information that is not provided in the consolidated financial statements but is publicly available in the financial statements of a subsidiary was questioned because the subsidiary may publish its financial statements months after the consolidated financial statements
- The Staff explained that some users can find fair value information easily in the financial statements whereas others are not aware of where this can be found
- Staff clarified that there would be no requirement to reproduce this information, but only to cross-refer to it or to provide a link to where the information is disclose

Tentative decision

- The Board approved the Staff recommendation with eleven members voting in favour and two against.

Amendments to IFRS 4: Applying IFRS *9 Financial Instruments* with IFRS 4 *Insurance Contracts*

Next steps

- The IASB is on track to meet the timescale it has set in respect of this project
- Remaining technical issues which will be discussed at the May meeting are:
  - what the fixed expiry date for the deferral approach should be;
  - whether to require an entity to reassess if it still qualifies for the deferral approach in particular circumstances;
  - whether there should be a fixed expiry date also for the overlay approach
  - whether first time adopters should be prohibited from applying either the deferral or the overlay approaches;
  - whether an exemption should be provided from uniform accounting policies for financial instruments on application of the equity method when accounting for investments in associates and joint ventures; and
  - whether additional disclosures related to issues set out in the first two bullet points above are needed
- The Board aims to issue the final amendments to IFRS 4 in September 2016.

Contact details

Francesco Nagari
Deloitte Global IFRS Insurance Lead Partner
+852 2852 1977 fnagari@deloitte.co.uk

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