December 2015

Snapshot: Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* (Proposed amendments to IFRS 4)

This Snapshot introduces the Exposure Draft *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*. It provides an overview of the main proposals that have been published for public comment by the International Accounting Standards Board (IASB).

Project objectives:	To address the temporary accounting consequences of the different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts Standard.
Comment deadline:	8 February 2016. The IASB has set a comment period of 60 days to reflect the urgency of the proposals and their narrow scope.
Next steps:	The IASB will consider the comments on its proposals and decide whether it will proceed with the proposed amendments to IFRS 4 *Insurance Contracts*. The IASB intends to complete its redeliberations as early as possible in 2016.

IFRS

Background

In July 2014, the IASB issued the completed version of IFRS 9 *Financial Instruments*, which sets out the requirements for recognising and measuring financial instruments. IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* and has an effective date of 1 January 2018 with early application permitted.

The IASB's project to replace IFRS 4 *Insurance Contracts* is at an advanced stage. However, the IASB expects to allow a three year implementation period for the new Standard. This means the earliest possible mandatory effective date of the new insurance contracts Standard will be after the effective date of IFRS 9.

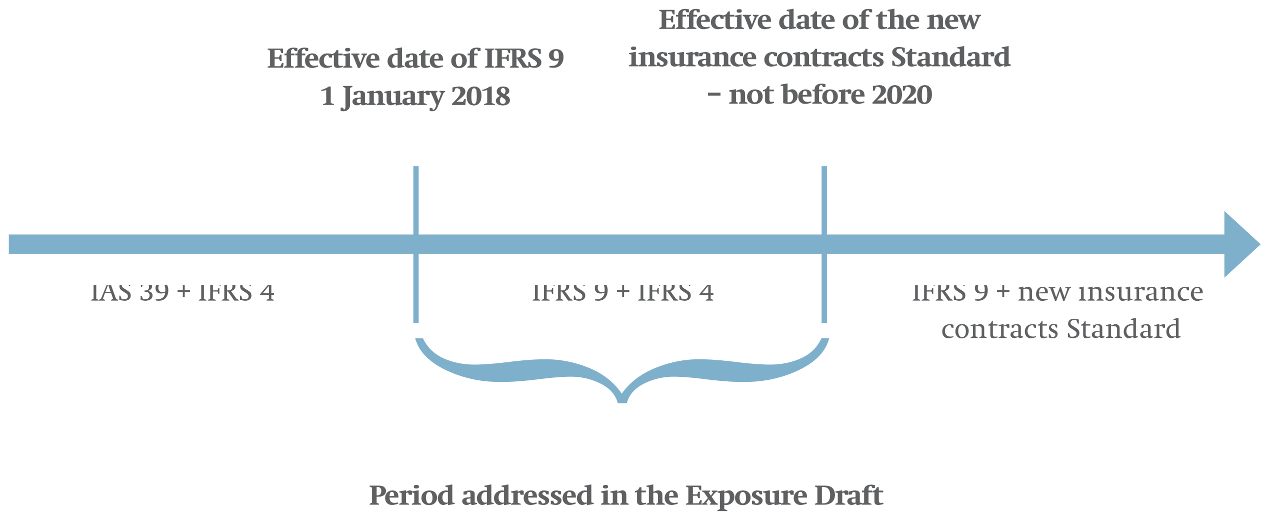
Some interested parties have raised concerns about the different effective dates of the two Standards because both of these Standards could lead to significant accounting changes for entities that issue insurance contracts.[1]

Timeline for implementation of IFRS 9 and the new insurance contracts Standard

IAS 39 and IFRS 4 do not give rise to concerns about accounting volatility in profit or loss

Interaction of IFRS 9 and IFRS 4 may result in increased accounting volatility in profit or loss

Interaction of IFRS 9 and the new insurance contracts Standard assists in reducing accounting volatility in profit or loss



1 For ease of reference, all contracts within the scope of IFRS 4, including some investment contracts, are referred to as insurance contracts in this Snapshot.

The issues

What issues is the IASB seeking to address?

Interested parties, in particular insurers and their representative bodies, have expressed concerns about the different effective dates of IFRS 9 and the new insurance contracts Standard:

(a) The financial statements of insurers may be difficult to understand because of the additional temporary volatility that could arise in profit or loss for some entities that issue insurance contracts if they apply IFRS 9 before the new insurance contracts Standard.

(b) Some entities that issue insurance contracts may find it difficult to apply the classification and measurement requirements for financial assets in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated.

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

How the IASB proposes to address the issues

The proposals in the Exposure Draft are a part of a package of measures developed by the IASB to address the concerns expressed about the different effective dates of the two Standards. Those measures balance addressing those concerns with meeting the information needs of users of financial statements.

The measures that the Exposure Draft proposes to introduce into IFRS 4 are:

(a) the **'overlay approach'**—an option for all entities that issue insurance contracts to adjust profit or loss to remove any additional accounting volatility that may arise from qualifying financial assets; and

(b) the **'deferral approach'**—an optional **temporary exemption** from applying IFRS 9 for entities whose predominant activity is issuing insurance contracts.

Those new measures would supplement other measures, including:

(a) the flexibility offered by the existing IFRS 4 in choosing an accounting policy for insurance contracts; for example, an option to adjust the measurement of insurance contracts to reduce accounting volatility; and

(b) the transition reliefs to be included in the new insurance contracts Standard for entities that apply that Standard after they apply IFRS 9.

The overlay approach

— An option for *all* entities that issue insurance contracts that applies to *some* of their financial assets

An entity that applies the overlay approach is required to apply IFRS 9 from its effective date, 1 January 2018. However, under this approach, an entity would be permitted, but not required, to reclassify from profit or loss to other comprehensive income (OCI) an amount equal to the difference between:

(a) the amount reported in profit or loss when IFRS 9 is applied to the qualifying financial assets (that are newly measured at fair value through profit or loss (FVPL) under IFRS 9); and

(b) the amount that would have been reported in profit or loss if IAS 39 were applied to those assets.

How the approach is applied

The overlay approach aims to remove from profit or loss any additional volatility that may arise if IFRS 9 is applied together with IFRS 4. To achieve this, the Exposure Draft proposes that:

- the reclassification is shown as a separate line item in the statement of profit or loss, OCI or both;
- additional disclosures are made to enable users to understand the effect of the overlay approach on the financial statements;
- IFRS 9 is applied in full, so information provided about financial instruments of entities that issue insurance contracts is comparable with the information provided by other entities; and
- the entity will continue to apply the existing IAS 39 system to relevant financial assets to calculate the adjustment.

Illustrative statement of comprehensive income

	20XX
Profit or loss	
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Operating result	**X**
Investment income*	X
Interest on insurance liability	(X)
Investment result	X
...	
Profit or loss	**X**
Other comprehensive income	
Overlay adjustment	X
Total comprehensive income	**X**

* Investment income reflects reclassification of the overlay adjustment from profit or loss to OCI. An entity could also disaggregate this amount to show separately the investment income determined applying IFRS 9 and the overlay adjustment.

Which entities can apply the overlay approach?

The Exposure Draft proposes that *all* entities that issue insurance contracts would be permitted to apply the overlay approach.

The overlay approach can be applied only when an entity first applies IFRS 9, including if an entity chooses to apply IFRS 9 early.

Which financial assets would qualify for the approach?

The Exposure Draft proposes that financial assets that meet *both* of the following criteria would qualify for the overlay approach:

(a) the financial assets are measured at FVPL applying IFRS 9 but would not have been measured at FVPL in their entirety applying IAS 39; and

(b) the financial assets are designated by the entity as relating to insurance contracts for the purposes of the overlay approach.

The overlay approach would not require new information compared to applying IAS 39 because, applying IAS 39, an entity would have been required to disclose fair value information for assets that would not have been measured at FVPL in their entirety.

An entity that chooses to apply the overlay approach can do so for all or only some of the assets that meet criteria (a) and that relate to insurance contracts. However, an entity would not be permitted to apply the overlay approach to assets relating to non-insurance activities, such as banking activities.

The IASB thinks that the overlay approach can be applied by all entities, because it provides the improved information that results from applying IFRS 9 and the proposed presentation and disclosure requirements will make the effect of the overlay approach transparent.

Temporary exemption from applying IFRS 9

— An option for *some* entities that issue insurance contracts that applies to *all* of their financial assets

The deferral approach would permit entities whose predominant activity is issuing insurance contracts to defer the application of IFRS 9 until the earliest of:

(a) the application of the new insurance contracts Standard; or

(b) 1 January 2021.

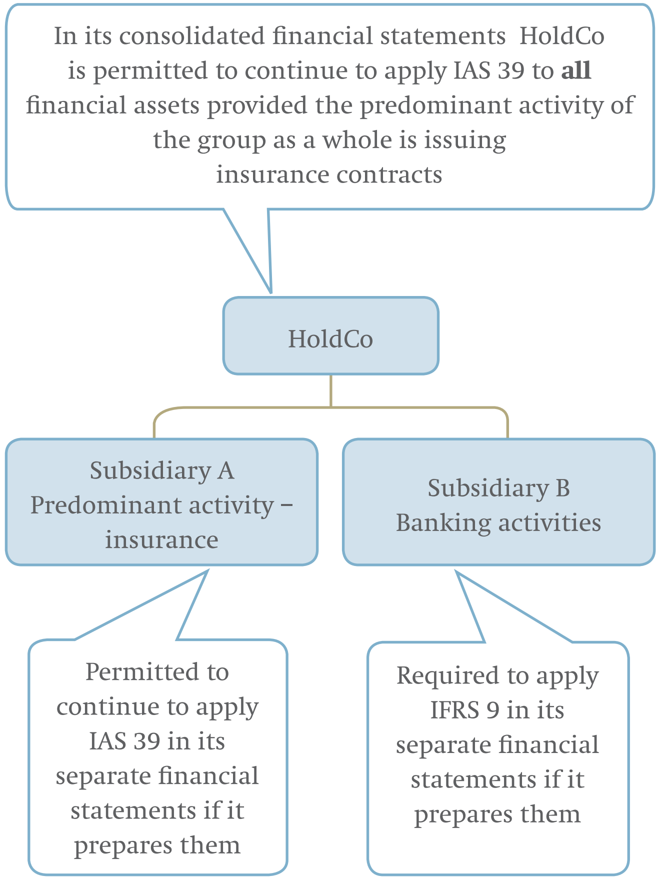
If an entity elects to use this temporary exemption, it would continue to apply IAS 39 and provide some key disclosures to assist users of financial statements to make comparisons with those who apply IFRS 9.

How the temporary exemption is applied

The Exposure Draft proposes that only *some* entities should be permitted to apply the temporary exemption, depending on their predominant activity.

Entities that use the approach would be required to make additional disclosures to enable users to make comparisons with entities that do not apply the temporary exemption.

Example—applying the temporary exemption



Which entities can apply the temporary exemption?

The Exposure Draft proposes that the temporary exemption from applying IFRS 9 should be available only to entities whose predominant activity is issuing insurance contracts. It would be an *option* available to these entities.

Predominance is assessed by comparing the amount of an entity's insurance contracts liabilities with the total amount of its liabilities.

'Predominance' is intended to be a high threshold to avoid IAS 39 being applied to assets relating to non-insurance activities to the extent possible. For example, the IASB has indicated that the predominance condition would not be met if three-quarters of an entity's liabilities are liabilities arising from insurance contracts and one-quarter are liabilities arising from other activities.

Which financial assets would qualify for the temporary exemption?

The IASB proposes that the temporary exemption would be applied to *all*, rather than some, financial assets of entities that qualify for and elect to apply this approach. Applying the exemption to all, rather than some, financial assets:

(a) would avoid the simultaneous application of IFRS 9 and IAS 39 in one set of financial statements;

(b) would avoid the need to determine which assets within an entity are related to insurance activities;

(c) would avoid the possibility of transfers of financial assets between insurance and non insurance activities made to achieve a particular accounting outcome; and

(d) would be consistent with feedback received from users of financial statements that one Standard should be applied to financial instruments in one set of financial statements.

Further information

The Exposure Draft includes questions on the topics presented. Respondents are invited to respond to any or all of those questions and to comment on other matters that the IASB should consider when finalising the proposals. The IASB's redeliberations of the proposals will take place in public meetings. To access information about those public meetings, please visit **www.ifrs.org**.

To view the Exposure Draft, submit your comments, stay up to date with the latest developments and to sign up for email alerts about the project, please visit the project homepage on **go.ifrs.org/IFRS4-IFRS9**.

The deadline for comments on the Exposure Draft is 8 February 2016.

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