Ballot begins for IFRS 4 Phase II and Deloitte comments on the “IFRS 9 decoupling” ED

The IASB moves towards completion

Francesco Nagari
Deloitte Global IFRS Insurance Lead Partner
23 February 2016

Agenda

- Highlights of the IASB meeting on 16 February 2016
- IASB Staff analysis, IASB discussion and tentative decisions
- Next steps
- Deloitte comments on the “IFRS 9 decoupling” ED

Highlights of February IASB meeting and of the Deloitte comment letter on the "IFRS 9 decoupling" ED

- On 16 February 2016 the IASB **voted unanimously** to **begin the balloting process** for IFRS 4 Phase II
- No IASB member intends to **dissent from the publication of the new IFRS**
- The **effective date** and any "sweep issues" will be brought to the IASB for decision over the next nine months.
- This is similar to the process adopted for the other major IFRS completed in the past two years (IFRS 9, IFRS 15 and IFRS 16)
- IFRS 4 Phase II could be **issued by the end of 2016** and it should become **IFRS 17 *Insurance Contracts***
- Deloitte commented on the ED addressing the "IFRS 9 decoupling" on 8 February 2016. **We favour an improved deferral approach solution over the overlay approach**
- The key improvements are on the **application of the deferral approach at "below reporting entity" level** and on the **calculation of the predominance threshold**

Due process steps

How the IASB has met the requirements of the due process steps

- Public meetings
- Documents published and comment letters considered
- Whether the proposals should be exposed again
- Public hearings, consultative groups and reporting to the IFRS Foundation Trustees
- Fieldwork
- Other outreach activities

The balloting process

Staff views

- All of the required and optional steps in the IASB's *Due Process Handbook* have been complied with
- The proposals are sufficiently developed and therefore the Staff can begin the balloting process
- The Staff expects to ask the IASB to determine the effective date of the Standard when the balloting process has sufficiently progressed
- The Staff will consider the need for future IASB discussions of issues that may arise during the balloting process

The balloting process

Permission to begin the balloting process

- The Staff prepared a package consisting of:
  a) **Agenda Paper 2A *Background to the insurance contracts project***, which summarises the background and context of the project
  b) **Agenda Paper 2B *Overview of the new insurance contracts Standard***, which provides a high-level overview of the IASB's model for insurance contracts
  c) **Agenda paper 2C *Comparison of the IASB's tentative decisions with the comment letter summary***, which provides an overview of the ways in which the IASB has addressed the comments received on the 2013 Exposure Draft
  d) **Agenda Paper 2D *The development of the requirements for the accounting for insurance contracts***, which summarises the changes to the accounting treatment for the insurance contracts over the IASB's previous three due process documents, and summarises the response to each of these
  e) **Agenda Paper 2E *Assessing the changes since the 2013 ED***, which sets out the Staff's view on why the IASB need not re-expose the new Standard.

Mandatory due process steps

IASB discussion

Outreach activity

- The Staff stated their intention to **reach out to different jurisdictions** on aspects of the new Standard in order to ensure **transparency** in the drafting process
- Several IASB members agreed with the **need for ongoing communication during drafting**
- Some IASB members **cautioned against a too wide outreach**, and suggested outreach to a broad audience on a few, selective issues combined with outreach to a small, targeted audience on a wider range of issues
- In particular, **the variable fee approach is new**, and it has not been exposed. The Staff suggested they they would prepare **a summary paper inviting comment**

Mandatory due process steps

IASB discussion (continued)

Examples in the future IFRS

- The Staff confirmed that there would be some **additional examples** in the Standard compared to the 2013 ED
- Some IASB members requested examples in order to reduce diversity in practice in the following areas:
  - Use of **OCI for indirect participating contracts**
  - **Amortisation of the CSM to P&L** over the contract coverage
  - Allocation of the CSM to P&L in the case of **contract lapses**
- A parallel was drawn with IFRS 15 which has 50 examples, compared to 12 in the 2013 ED.
- The Staff explained that the ED examples were designed to **illustrate one point at a time** and they are not a comprehensive illustration of all the new requirements
- The Staff warned the IASB that examples could **create unintentional bright lines**

Mandatory due process steps

IASB discussion (continued)

Examples in the future IFRS (cont.)

- Other aspects that will require careful drafting include **scope**, **cost objective in respect of the OCI approach for indirect participating contracts**, **level of aggregation** for contract lapses and onerous contracts, and **discretion**
- One IASB member stated that further consideration was required regarding **presentation and disclosure**. Examples he noted were the scope of the variable fee approach, what is meant by a market return, allocation of the CSM, and the expected future profitability of insurance contracts
- There was discussion about the possible need to **'road-test' the examples** for the new IFRS with selected constituents
- It was agreed that 'road-testing' would not be on the model itself, but would be a quality control over the words used in drafting and how they may be interpreted

Mandatory due process steps

IASB discussion (continued)

Final comments before the vote on balloting

- One IASB member proposed removing the reference to the **OCI solution** as being the preferred approach
- The Chairman expressed sympathy for this view, and asked for this point to be redrafted. He hoped that insurers would show the impact of changes in the discount rate in profit or loss
- The Chairman stated his reservations about the **variable fee approach** as in his view this reflected real economic volatility, but accepted that this was needed in order to finish the project
- Several IASB members thanked the Staff for their efforts to date, and wished them to continue with their hard work drafting the final text of the new IFRS
- The Staff assured the IASB that they will do so and that they will keep constituents up to date on their progress by means of **summary papers** and **targeted consultation**

IASB decisions

Mandatory due process steps, balloting process and possible dissents

IASB decisions

The IASB unanimously approved the following:

- The IASB is satisfied that all the mandatory due process steps have been met on this project; and
- The IASB granted the Staff permission to begin the balloting process for a new IFRS on insurance contracts

Possible dissents

- None of the IASB members intend, at this time, to dissent from the new IFRS on insurance contracts

Insurance contracts - Next steps

Balloting process and possible need for future IASB discussion

- The Staff will begin the balloting process when they expect to complete the remaining due process steps, including:
  - asking the IASB to **determine the effective date** of the Standard. The staff expect to do this when drafting has sufficiently progressed;
  - drafting quality assurance procedures, including external review; and
  - preparation of documents such as the Effects Analysis that would accompany the new Standard
- The Staff will also consider the need for future IASB discussion of issues that may arise during the balloting process
- Deloitte believes that the choice of the effective date is likely to be **1 January 2020 if the target publication date is achieved**

Applying IFRS 9 with IFRS 4

Overview of Deloitte response

- Deloitte agrees that there are valid reasons to introduce a temporary solution to the “IFRS 9 decoupling” issue
- The deferral approach, if modified, is likely to prove a more effective solution than the overlay approach. The latter should be retained only if constituents demand it
- The predominance test should be permitted at the reporting entity level or at lower levels below the parent entity
- There are improvements to the predominance test calculations that can be easily adopted
- The 1 January 2021 “sunset clause” is appropriate

Applying IFRS 9 with IFRS 4

Proposing overlay approach and temporary exemption from applying IFRS 9

Question 1 – Addressing the concerns raised

Concerns

- *Users will find it difficult to understand the additional accounting mismatches and temporary volatility that could arise*
- *Having to apply the requirements of IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated*
- *Two sets of major accounting changes in a short period of time could result in significant cost and effort for preparers and users*

Question

- *Do you agree that the IASB should seek to address these concerns?*

Deloitte response

- The IASB should address these concerns as the ED has identified valid reasons to introduce a temporary solution

Applying IFRS 9 with IFRS 4

Proposing overlay approach and temporary exemption from applying IFRS 9

Question 2 – Proposing both an overlay approach and a temporary exemption from applying IFRS 9

Proposed amendments to IFRS 4

- *Permit entities to reclassify from profit or loss to OCI some of the income or expense arising from designated financial assets that are measured at FVTPL applying IFRS 9 but would have not been measured at FVTPL applying IAS 39*
- *Provide an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing insurance contracts*

Question

- *Should there be both an overlay approach and a temporary exemption from applying IFRS 9?*

Applying IFRS 9 with IFRS 4

Proposing overlay approach and temporary exemption from applying IFRS 9

Deloitte response

- The deferral approach is likely to prove a more effective solution than the overlay approach. However it should be allowed at “below reporting entity level”. We do not support the “all or nothing” approach in the ED
- The overlay approach should be retained only if constituents demand it. With an improved deferral approach it may prove redundant

Applying IFRS 9 with IFRS 4

Overlay approach

Question 3 – The overlay approach

- *Do you agree that assets described should be eligible for the overlay approach?*
- *Do you agree with the proposed approach to presentation of amounts reclassified from profit or loss to OCI applying the overlay approach?*

Deloitte response

- Designation of assets should be made only when there are documented policies
- As either fair value gains or losses might be recognised under IFRS 9 on individual assets, the overlay adjustment could affect both investment income and investment expense. Presentation of the effect of the overlay adjustments on each line item on the face of the income statement should be required, and a single line item should be used in OCI to enhance comparability
- We recommend clearer requirements for reclassification of amounts presented in OCI are introduced

Applying IFRS 9 with IFRS 4

The temporary exemption from applying IFRS 9

Question 4 – The temporary exemption from applying IFRS 9

- *Do you agree that the eligibility for temporary exemption should be based on whether the predominant activity is issuing contracts within the scope of IFRS 4?*
- *Do you agree that an entity should assess its predominant activity in this way?*
- *Do you agree that an entity would assess its predominant activity at the reporting entity level?*

Deloitte response

- We agree that a predominance criterion based on the carrying amount of liabilities is the appropriate test but it needs refinements to allow its application at "below reporting entity level"
- The resulting non-uniform accounting for financial assets in consolidated financial statements is acceptable on a temporary basis when accompanied by suitable disclosures that ensure transparency

Applying IFRS 9 with IFRS 4

The temporary exemption from applying IFRS 9

Deloitte response (continued)

- Application of the predominance test be permitted either at reporting entity level or a lower level to capture more predominantly insurance activities and draw a more precise boundary around financial assets related to insurance activities
- A ‘one-way system’ for intra-group transfers should be established such that assets transferred to an entity using IAS 39 from another that uses IFRS 9 continue to be measured under IFRS 9
- When transfers of financial assets are made within the reporting entity from insurance subsidiaries with assets using IAS 39 to another using IFRS 9:
  - recognise at fair value if the financial asset will be measured at FVTPL or FVTOCI with the cumulative change in fair value recognised in profit or loss or OCI; and
  - if they will be measured at amortised cost under IFRS 9, the carrying value should be treated as the initial measurement value under IFRS 9
- Disclosure of the total amounts sold and relevant gains or losses should be required

Applying IFRS 9 with IFRS 4

The temporary exemption from applying IFRS 9

Deloitte response (continued)

- There is a balance between a simple calculation of the 'predominance' of liabilities which might justify a lower threshold, and a more precise calculation that seeks to exclude certain balances because it is not those balances that enable the identification of an insurer
- Examples include:
  - those liabilities that fund the insurance business so the predominance test is not influenced by whether the entity is debt or equity funded, or
  - contracts linked to segregated funds that are financial liabilities measured at FVTPL under IAS 39 and are likely to continue to be so measured under IFRS 9

Applying IFRS 9 with IFRS 4

Optional overlay approach and temporary exemption

Question 5 – Should the overlay approach and the temporary exemption from applying IFRS 9 be optional?

- *Do you agree with that the overlay approach and the temporary exemption from applying IFRS 9 should be optional?*
- *Do you agree to allowing entities to stop applying the overlay approach or the temporary exemption from applying IFRS 9 from the beginning of any period before the new insurance contracts Standard is applied?*

Deloitte response

- We agree that the solution should be optional and that entities be permitted to stop applying the solution prior to application of the new insurance contracts Standard

Applying IFRS 9 with IFRS 4

Expiry date for the temporary exemption from applying IFRS 9

Question 6 – Expiry date for the temporary exemption from applying IFRS 9

- *Do you agree that the temporary exemption should have an expiry date?*
- *Do you agree that the proposed expiry date should be for annual reporting periods beginning on or after 1 January 2021?*

Deloitte response

- Agree with proposed expiry date for the reasons stated in the Basis of Conclusions
- Strongly recommend that the IASB concludes on its deliberations on the new insurance contracts Standard so that the effective date is within the timeline set by the deferral approach

Contact details

Francesco Nagari

Deloitte Global IFRS Insurance Lead Partner

+852 2852 1977 fnagari@deloitte.co.uk

Keep Connected on IFRS Insurance by:

Follow my latest LinkedIn posts

Follow me on @Nagarif

Subscribe to Insights into IFRS Insurance Channel on YouTube

Connect to IFRS Insurance LinkedIn Group for all the latest IFRS news

Add Deloitte Insights into IFRS Insurance (i2ii) www.deloitte.com/i2ii to your favourites