Focus on IFRS 9 de-coupling and feedback from other standard setters

IASB decides to adopt a liability solution to the IFRS 9 decoupling but the final word is due in September

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Agenda

- Highlights of the latest IASB discussion
- Detailed analysis of the IASB discussion at the meeting held on 20 July 2015
- Highlights of the ASAF meeting's discussion on insurance contracts on 16 July 2015
- Next steps and update on timetable

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Highlights

A liability solution to the IFRS 9 de-coupling is approved unanimously at the IASB Board meeting on 20 July

- The IASB has voted to introduce a change in IFRS 4 to allow for the period between IFRS 9 effective date (1 January 2018) and the effective date of IFRS 4 Phase II (maybe 1 January 2020) a liability adjustment that will produce a net result as if the effect of IAS 39 was still in place for the insurers
- The IASB will consider in September where the deferral of IFRS 9 effective date is a preferable solution to the decision reached in this meeting

The ASAF meeting considered two proposals from the Australian and New Zealand boards on the principles to earn the CSM for non-par contracts and on the discount rate for accretion (and re-measurement) of the CSM

ASAF members also expressed their views on the IFRS 9 de-coupling issue

The timeline needs to accommodate a potential change and public exposure of a revision to IFRS 4 Phase I if this is elected as the solution to the IFRS 9 de-coupling issue

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Addressing the consequences of different effective dates of IFRS 9 and the new insurance contracts Standard

IFRS 4 approaches

- Accounting consequences that could arise when an entity that issues contracts within the scope of IFRS 4 applies IFRS 9 together with IFRS 4
- Applying IFRS 9 before the new insurance contracts Standard may lead to additional accounting mismatches and temporary volatility in profit or loss
- These issues could be addressed by existing options in IFRS 4, or by modifying IFRS 4
- IFRS 4 already allows an entity to reduce certain accounting mismatches
- The IASB could make amendments to IFRS 4 that would enable entities to reduce these effects further

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Methods available in IFRS 4

a) IFRS 4 paragraph 30: shadow accounting, which is a way of adjusting insurance liabilities to reduce accounting mismatches that can arise when unrealised gains and losses on assets are recognised in the financial statements but corresponding changes in the measurement of the insurance contract liabilities are not

b) IFRS 4 paragraph 24: use of current market interest rates in the measurement of insurance contract liabilities

c) IFRS 4 paragraph 22: general principle that allows an easier change of accounting policies for insurance contracts than it would be possible under IAS 8

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Potential amendments to IFRS 4

a) Shadow adjustments for shareholders' interests in underlying assets

b) Shadow accounting for assets backing non-participating insurance contracts

c) Apply IFRS 9 with an adjustment which offsets the effect of IFRS 9 on profit or loss

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Staff recommendation

- Amend IFRS 4 to permit an entity to exclude from profit or loss and recognise in other comprehensive income the difference between the amounts that would be recognised in profit or loss in accordance with IFRS 9 and the amounts recognised in profit or loss in accordance with IAS 39 provided that the entity:
  - issues contracts accounted for under IFRS 4;
  - applies IFRS 9 in conjunction with IFRS 4; and
  - classifies financial assets at FVPL in accordance with IFRS 9 when those assets were previously classified as amortised cost or AFS in accordance with IAS 39

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IASB discussion

- There was extensive debate on whether the recommendation would apply to a conglomerate as a whole, the legal entity or to the insurance business
- There is already a limited scope implicit in the recommendation, and the Staff will consider whether any further restriction is required
- Scope of the amendment is very important, and should not apply to banks that are subsidiaries of an insurance company
- Broad support for option (c) of the potential amendments to IFRS 4, as it is:
  - transparent;
  - deals with most of the issues;
  - relatively easy to implement; and
  - a pragmatic and principles-based solution

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IASB discussion and tentative decision

- One disadvantage of option (c) was that it would require insurers to run systems for IFRS 9 and IAS 39 in parallel until IFRS 4 Phase II is effective/adopted
- Some IASB members suggested there support for not amending IFRS 4 and to rely on disclosures to explain any additional accounting mismatches and volatility

Tentative decision

- IASB Board members voted unanimously in favour of the Staff recommendation

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Deloitte assessment of the new decision

- The adjustment from the revised IFRS 4 will create a gain or loss associated with insurance contracts that will offset the gains and losses under IFRS 9 such that the net result would be based on the IAS 39 recognition and measurement
- The question for the use of the fair value option remains. It could be possible that if not restricted beyond what IFRS 9 imposes an insurer could apply it to all its assets that would have moved from any IAS 39 categories other than FVTPL to FVTOCI and AC thus avoiding the implementation of the new impairment model before the effective date of IFRS 4 Phase II.
- At that juncture the current transition rules would require the revocation of any FVO designation if the accounting mismatch that led to the previous designation no longer exists. This situation can be created if the insurer decides to use the OCI solution for insurance contracts

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Deloitte assessment of the new decision (cont.)

- The adoption of this IFRS 4 amendment requires a number of items that the IASB would have needed to deliberate also in the event of an IFRS 9 deferral for insurance companies:
  - Define the entities that issue insurance contracts;
  - Introduce the definition of “assets backing insurance liabilities”
  - The accounting of transfers of assets between insurers and other fellow subsidiaries in a financial conglomerate
- Although nominally the liability solution appears to respect the principle of application of a uniform accounting for financial instruments in a group with insurers and other entities, the proposed IFRS 4 adjustment recreates a net result based on IAS 39 within those subsidiaries that will be permitted to use it

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Accounting Standard Setters Advisory Forum

Meeting on 16 July 2015 covered insurance contracts

- The standard setters of Australia and New Zealand proposed to introduce a rebuttable presumption for the earning of the CSM using the passage of time (non-participating contracts). They argued that risk release could be more appropriate in certain instances
- They also recommended that the presentation of time value of money through P&L or split between P&L and OCI should apply also to the accretion rate applicable to the CSM
- The IASB Staff produced papers that effectively rejected both suggestions
- Discussion took place on the IFRS 9 de-coupling and the direction the IASB may take to adopt a liability solution
- Some accounting standard setters noted their preference to a deferral of IFRS 9 for insurers

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The next steps

Remaining technical decisions and publication date

- The IASB intends to discuss the scope of the amendments to IFRS 4 and whether the effective date of IFRS 9 should be deferred for the insurance industry during its September meeting
- The IASB is expected to consider the last technical issues on the insurance contracts Standard during the remainder of 2015
- In particular, the presentation of interest expense for contracts with participation features, and whether the differences between the general model and the variable fee approach can be / need to be eliminated
- The new Standard is expected to be published in 2016
- Its mandatory effective date will not be considered until after the IASB has concluded its deliberations.

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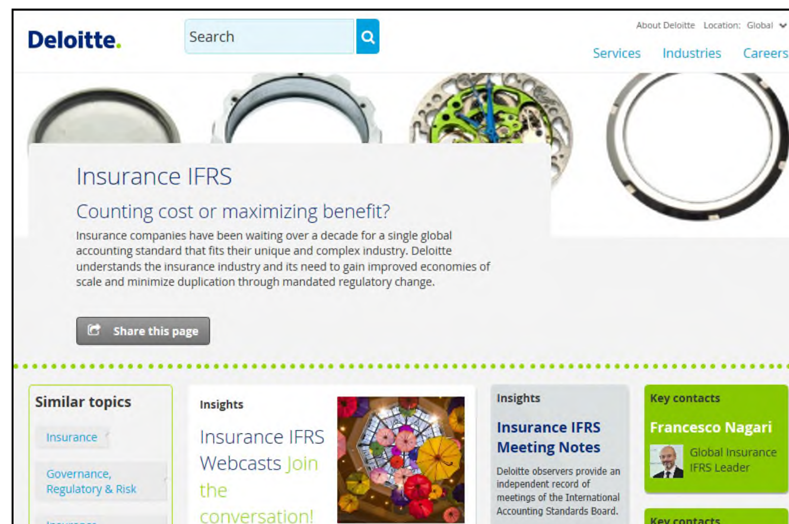

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