IFRS NEWSLETTER
# INSURANCE

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cutting through complexity

"The Board's decision to permit a deferral of IFRS 9 increases the pressure to bring an end to the insurance contracts project."

**Joachim Kölschbach**, KPMG's global IFRS insurance leader

## MOVING TOWARDS INTERNATIONAL INSURANCE ACCOUNTING

### This edition of *IFRS Newsletter: Insurance* highlights the IASB's discussions in September 2015 on its insurance contracts project.

**Highlights**

***Addressing the consequences of differing effective dates***

- The IASB made decisions on proposed interim amendments to IFRS 4 *Insurance Contracts* that would target volatility, which is the main concern for some users.
- The Board also decided to permit deferring the effective date of IFRS 9 *Financial Instruments* for certain entities that issue contracts in the scope of IFRS 4.
- The Board was satisfied that the due process requirements had been met, and that the balloting process for the ED to amend IFRS 4 could begin.

***Disaggregating changes in market variables***

- The effects of changes in market variables would be presented in the statement of comprehensive income, consistent with changes in discount rates.
- The IASB made decisions on accounting for changes in cash flow amounts, insurance investment expense, and use of the current period book yield (CPBY) approach for contracts with no economic mismatches.

***Mitigating risks related to direct participating insurance contracts***

- The IASB addressed the issue of accounting mismatches arising from hedging activities for direct participating contracts.

***FASB and IASB project update***

- The IASB and the FASB held a joint session to update each other on the progress of their respective insurance contract projects.

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# DECISIONS REACHED ON DIFFERING EFFECTIVE DATES AND PARTICIPATING CONTRACTS

## The story so far …

The current phase of the insurance project was launched in May 2007, when the IASB published a discussion paper (DP), *Preliminary Views on Insurance Contracts*. More recently, the IASB re-exposed its revised insurance contracts proposals for public comment by publishing the exposure draft ED/2013/7 *Insurance Contracts* (the ED) in June 2013.

Since January 2014, the Board has been redeliberating issues raised through the ED. It initially focused on the model for non-participating contracts and has now turned its focus to modifications for participating contracts.

### Interaction with other standards

Throughout its redeliberations, the Board has considered whether the accounting for insurance contracts would be consistent with other existing or future standards, including the new revenue recognition standard – IFRS 15 *Revenue from Contracts with Customers*[1]. Much of the guidance contained in the ED was designed to align with the IASB's and the FASB's joint standard on revenue recognition.

The Board has also considered many of the decisions made in the new financial instruments standard, IFRS 9[2] – including the way in which IFRS 9 might interact with the final insurance contracts standard – because IFRS 9 will cover a large majority of an insurer's investments. Additionally, the Board has examined how best to address the consequences of the differing effective dates of IFRS 9 and the forthcoming insurance contracts standard.

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1. See our Issues In-Depth: Revenue from Contracts with Customers (September 2014). 'In July 2015, the IASB published targeted amendments to the new standard. For more detail, read our New on the Horizon.
2. See our First Impressions: Financial instruments – The complete standard (September 2014).

## What happened in September 2015?

At its September meetings, the IASB focused on the consequences of differing effective dates for IFRS 9 and the forthcoming insurance contracts standard, and on participating contracts.

### Differing effective dates

During August and September 2015, the Board solicited feedback from stakeholders about their concerns over the differing effective dates of IFRS 9 and the forthcoming insurance contracts standard. The Board considered the feedback received on this issue, and decided on various proposals relating to the 'overlay approach' and the 'deferral approach'.

Under these proposals, an entity whose predominant activity is issuing contracts in the scope of IFRS 4 would be permitted to defer the effective date of IFRS 9 at the reporting entity level no later than reporting periods beginning on or after 1 January 2021. Before and after this date, an entity that holds assets related to insurance activities that are in the scope of IFRS 4 would be able to apply the overlay approach in conjunction with IFRS 9 until the forthcoming insurance contracts standard is effective.

### Participating contracts

After analysing its decisions on non-participating contracts and tailoring those decisions to participating contracts, the Board made a number of decisions on disaggregating changes in the measurements of participating contracts caused by changes in market variables.

The Board made a decision to address the accounting mismatches that could arise when an entity:

- uses a variable fee approach to account for contracts that have embedded guarantees; and
- hedges itself against risks from those guarantees using derivatives.

### Status of the project

The IASB also held a joint meeting with the FASB where the Boards updated each other on the progress of their respective insurance contracts projects.

The IASB has completed most of its redeliberations. The remainder, which include evaluating the differences between the general model and the variable fee approach, and the presentation and disclosure requirements, are expected to be completed soon. An effective date will not be discussed until all other redeliberations have been completed.

The Board expects to issue the forthcoming insurance contracts standard in 2016.



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# ADDRESSING THE CONSEQUENCES OF DIFFERING EFFECTIVE DATES

**The IASB made decisions on amendments to IFRS 4 and the deferral of IFRS 9, having focused on two approaches.**

## Two alternative approaches

### What's the issue?

Earlier this year, the Board indicated that the earliest possible effective date of the forthcoming insurance contracts standard could no longer be aligned with the 1 January 2018 effective date of IFRS 9. This is because the Board does not expect to issue and finalise the forthcoming insurance contracts standard until 2016, and has decided to allow a period of approximately three years for implementation; therefore, the expected effective date may not be before 2020.

**Mixed views on the effect of differing effective dates**

The Board had solicited feedback on stakeholders' concerns over the differing effective dates. The outreach sought views from a diverse group of financial statement users – including buy- and sell-side equity analysts and credit analysts.

The Board heard mixed views on whether the differing effective dates of IFRS 9 and the forthcoming insurance contracts standard would make insurers' financial statements less understandable to users.

Those who thought insurers' financial statements would *not* be less understandable believed that volatility in profit or loss is already common in insurers' financial statements, and that most users can make the necessary adjustments to understand an insurer's financial performance. Furthermore, some noted that they focus more on the equity and surplus positions of insurance companies, and place less focus on the statement of profit or loss. Others felt that increased volatility would make the insurance industry look more uncertain and less attractive to investors.

**Overlay approach vs deferral approach**

The Board received significant support for amending IFRS 4 to permit entities that issue contracts in the scope of that standard to use the 'overlay approach' – i.e. to remove from profit or loss, and recognise in other comprehensive income (OCI), the additional volatility that could arise when IFRS 9 is applied in conjunction with IFRS 4. In July 2015, the Board decided to support such an amendment.

The Board received mixed views on using the 'deferral approach' – i.e. deferring the effective date of IFRS 9 – and on the level at which such an approach should be applied – i.e. at the reporting entity level, or at a lower level.

Most financial statement users said that comparability within the sector is critical, and that they would prefer the Board to propose a mandatory – rather than optional – approach.

The staff has considered the following options to address these concerns and issues.

| Option | | Where to find further information |
|---|---|---|
| **1** | Use existing options under IFRS 4 | Read Issue 46 of our *IFRS Newsletter: Insurance* for more details on the options available to entities under existing IFRS 4. |
| **2** | Amend IFRS 4 | Read Issue 47 of our *IFRS Newsletter: Insurance* for the Board's decisions on this option.<br><br>See the *Overlay approach* section below for the Board's further considerations and decisions. |
| **3** | Defer the effective date of IFRS 9 in some circumstances | See the *Deferral approach* section on page 9. |

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**The staff believed that the overlay approach would target the main concern of some users – volatility – by amending IFRS 4.**

## Overlay approach

### What did the staff recommend?

In July 2015, the Board decided to amend IFRS 4. For specified assets, an entity would be permitted to remove from profit or loss, and recognise in OCI, the difference between:

- the amounts that would be recognised in profit or loss under IFRS 9; and
- the amounts recognised in profit or loss under IAS 39 *Financial Instruments: Recognition and Measurement*.

In doing this, an entity would apply IFRS 9 in full, but would make the adjustments described above in profit or loss and OCI for assets that:

- were previously, or would have been, measured at amortised cost or classified as available-for-sale under IAS 39;
- are classified at fair value through profit or loss (FVTPL) under IFRS 9; and
- relate to insurance activities.

The adjustments could only be applied if the entity:

- issues contracts that are accounted for under IFRS 4; and
- applies IFRS 9 in conjunction with IFRS 4.

During the September 2015 meeting, the staff recommended proposals on the following topics that would refine the decisions made in July 2015 on permitting the overlay approach.

| Topic | Staff recommendations and considerations |
|---|---|
| **Eligibility for the overlay approach** | **What did the staff recommend?**<br>An entity should be permitted to make an overlay adjustment in respect of financial assets that meet both of the following criteria.<br>• The entity designates them as relating to contracts that are in the scope of IFRS 4.<br>• They are classified at FVTPL under IFRS 9 and would not have been classified at FVTPL under IAS 39.<br>An entity should only be able to change the above designation if there is a change in the relationship between the financial assets and contracts that are in the scope of IFRS 4.<br>**What else did the staff consider?**<br>Assets relating to insurance activities would be considered to comprise:<br>• those assets that an entity uses to fund the settlement of liabilities arising from expected levels of insurance claims and expenses; and<br>• surplus assets that:<br>– are held to fund:<br>- more frequent insured events – i.e. abnormally high lapse activity; or<br>- more severe insured events – e.g. catastrophic weather-related events; or<br>– require settlement sooner than expected. |


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| Topic | Staff recommendations and considerations |
|---|---|
| **Eligibility for the overlay approach (continued)** | This approach reflects the fact that IFRS does not define insurance activities. As such, it intends to limit the adjustment so that it applies to financial assets relating to contracts that are in the scope of IFRS 4 instead.<br><br>It may be appropriate to redesignate financial assets if there is a substantive change in the purpose for which they are held – e.g. a transfer between segments. |
| **Transition** | **What did the staff recommend?**<br><br>***Starting to apply the overlay approach***<br><br>An entity should be permitted to start applying the overlay approach only when it first applies IFRS 9 – including if it chooses to apply IFRS 9 early. An entity that has started applying IFRS 9 without applying the overlay approach should not subsequently be allowed to start applying the overlay approach.<br><br>The entity should apply the overlay approach retrospectively to eligible financial assets. It should recognise, as an adjustment to the opening balance of OCI, an amount equal to the difference between:<br>• the fair value of eligible financial assets; and<br>• their amortised cost or cost carrying amount under IAS 39, immediately before transition to IFRS 9.<br><br>The entity should restate comparative information to reflect the overlay approach only if it also restates that comparative information under IFRS 9.<br><br>***Stopping applying the overlay approach***<br><br>An entity should be:<br>• *required* to stop applying the overlay approach when it applies the forthcoming insurance contracts standard; and<br>• *permitted* to stop in any earlier reporting period.<br><br>When an entity stops applying the overlay approach, it should reclassify any balance of the prior periods' overlay adjustments accumulated in OCI to retained earnings, as of the beginning of the earliest reporting period presented.<br><br>**What else did the staff consider?**<br><br>The staff's proposed opening adjustments to accumulated OCI would be consistent with the transition adjustments required by IFRS 9.<br><br>The reclassification proposed when an entity stops applying the overlay approach would be consistent with the transition proposals in the 2013 ED. These stated that, upon transition to the forthcoming insurance contracts standard, any transition adjustments would result in an adjustment to the opening balance of retained earnings.<br><br>This approach could help reduce concerns over comparability, given that entities have the option to stop applying the overlay approach before they apply the forthcoming insurance contracts standard. |

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<table>
<tr><th>Topic</th><th>Staff recommendations and considerations</th></tr>
<tr><td rowspan="4">Redesignating financial assets</td><td>What did the staff recommend?</td></tr>
<tr><td>An entity should apply the overlay approach prospectively to a financial asset at the date on which the financial asset first meets the eligibility criteria.<br><br>It should stop applying the overlay approach to a financial asset when the financial asset no longer meets the eligibility criteria. Any accumulated OCI balance relating to the overlay adjustment on that asset should be immediately reclassified to profit or loss.</td></tr>
<tr><td>What else did the staff consider?</td></tr>
<tr><td>In the staff's opinion, this accounting treatment would limit operational complexity compared to tracking the accumulated OCI balance and recognising the balance in profit or loss as the financial assets are derecognised.</td></tr>
<tr><td rowspan="2">Presentation and disclosures</td><td>What did the staff recommend?</td></tr>
<tr><td>If an entity applies the overlay approach, it should present a single line item for the amount of the overlay adjustment in profit or loss, or OCI, or both.<br><br>Also, it should disclose:<br><br>• the fact that it has made an overlay adjustment and the financial assets to which the overlay adjustment relates;<br>• its policy for determining which financial assets the overlay adjustment applies to;<br>• an explanation of the total amount of overlay adjustments made in each period, in a way that enables users of the financial statements to understand how it is derived; and<br>• the effect of the overlay adjustment on line items in profit or loss, if it is not separately identified on the face of the statement of profit or loss.<br><br>Transfers and redesignations<br><br>For financial asset transfers and redesignations of financial assets, an entity should also make the following disclosures.<br><br>
<table>
<tr><th>For financial assets that are newly in the scope of the overlay approach</th><th>For financial assets removed from the scope of the overlay approach</th></tr>
<tr><td rowspan="2">The amount of overlay adjustment that has arisen in profit or loss and OCI</td><td>The amount of overlay adjustment that would have arisen in profit or loss and OCI</td></tr>
<tr><td>The amount of overlay adjustment that is due to the reclassification of amounts in accumulated OCI to profit or loss</td></tr>
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| Topic | Staff recommendations and considerations |
| --- | --- |
| **Presentation and disclosures (continued)** | **What else did the staff consider?**<br><br>Comparability between entities that apply the overlay approach and those that do not depends on users being able to calculate what the profit before tax would have been without the overlay adjustment. Therefore, it is critical that the overall amount of the overlay adjustment is appropriately presented.<br><br>The staff recommended against issuing strict requirements on presentation formats. This is consistent with IAS 1 *Presentation of Financial Statements*, which permits an entity to determine the presentation that is most relevant to an understanding of its financial performance. |

## What did the IASB discuss?

| Staff recommendation | Board discussion |
| --- | --- |
| **Eligibility for the overlay approach** | Some members suggested that the staff provide in the basis for conclusions examples of financial assets that would be included and excluded from the overlay approach. The same members asked for clarification within the amendment that any financial assets related to non-insurance activity – e.g. banking activity – within an insurance entity would be excluded from the scope. |
| **Transition** | One Board member asked the staff to clarify their recommendation for reclassifying prior period overlay adjustments from accumulated OCI to retained earnings when an entity stops applying the overlay approach. The Board member suggested that any balance should be reclassified at the later of:<br>• the beginning of the earliest reporting period presented; or<br>• the beginning of the reporting period when the overlay approach was first applied.<br><br>Given that some jurisdictions require up to five years of comparative historic information, the Board agreed that this clarification should be added to the staff recommendation. |
| **Presentation and disclosures** | A few Board members suggested different ways to present the overlay adjustment. For example, it was suggested that the overlay adjustment should be presented either:<br>• as a single line item in profit or loss and OCI;<br>• in profit or loss at the very least; or<br>• as a single line item in profit or loss, OCI and the statement of changes in equity.<br><br>Some Board members also thought that an entity could disaggregate the amount of the overlay adjustment in profit or loss. |

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## What did the IASB decide?

The Board agreed with the staff recommendations, including the clarification on transition and presentation discussed above.

| Topic | Board decision |
|---|---|
| **Eligibility for the overlay approach** | An entity would be permitted to make an overlay adjustment in respect of financial assets that meet both of the following criteria:<br>• the entity designates them as relating to contracts that are in the scope of IFRS 4; and<br>• they are classified at FVTPL under IFRS 9 and would not have been classified at FVTPL in their entirety under IAS 39.<br>An entity may change the designation of financial assets as relating to contracts in the scope of IFRS 4 only if there is a change in the relationship between those financial assets and contracts. |
| **Transition** | An entity would be permitted to start applying the overlay approach only when it first applies IFRS 9 – including if it chooses to apply IFRS 9 early.<br>An entity would apply the overlay approach retrospectively to eligible financial assets on transition to IFRS 9. The entity would recognise, as an adjustment to the opening balance of OCI, an amount equal to the difference between the fair value of eligible financial assets and their amortised cost, or cost carrying amount under IAS 39, immediately before transition to IFRS 9.<br>An entity would restate comparative information to reflect the overlay approach if it also restates that comparative information under IFRS 9.<br>An entity would be required to stop applying the overlay approach when it applies the forthcoming insurance contracts standard, and would be permitted to stop in any earlier reporting period.<br>When an entity stops applying the overlay approach, it would reclassify any balance of the prior periods' overlay adjustments accumulated in OCI to retained earnings at the later of:<br>• the beginning of the earliest reporting period presented; or<br>• the beginning of the reporting period when the overlay approach was first applied. |
| **Redesignating financial assets** | An entity would be permitted to apply the overlay approach prospectively to financial assets when the eligibility criteria are met.<br>An entity would be required to stop applying the overlay approach to a financial asset when the financial asset no longer meets the eligibility criteria. Any accumulated OCI balance relating to the overlay adjustment on that asset would be immediately reclassified to profit or loss. |


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| Topic | Board decision |
|---|---|
| **Presentation and disclosures** | An entity that applies the overlay approach should present a single line item for the amount of the overlay adjustment in profit or loss, or OCI, or both. An entity may disaggregate the amount of the overlay adjustment in profit or loss.<br><br>An entity that applies the overlay approach would disclose in each reporting period:<br>• the fact that it has made an overlay adjustment, and the financial assets to which the overlay adjustment relates;<br>• its policy for determining the financial assets for which an overlay adjustment is made;<br>• an explanation of the total amount of overlay adjustments made in each period, in a way that enables users of the financial statements to understand how it is derived; in particular, an entity would disclose the following in respect of intra-group transfers and redesignations of financial assets:<br>– the amount of overlay adjustment in profit or loss and OCI relating to financial assets that are newly in the scope of the overlay approach;<br>– the amount of overlay adjustment that would have arisen in profit or loss and OCI in a period if financial assets had not been removed from the scope of the overlay approach; and<br>– the amount of overlay adjustment due to the reclassification of amounts in accumulated OCI to profit or loss in respect of financial assets removed from the scope of the overlay approach; and<br>• the effect of the overlay adjustment on line items in profit or loss, to the extent that they are not separately identified on the face of the profit or loss account. |

**The Board decided to permit deferring the effective date of IFRS 9 for certain entities that issue contracts in the scope of IFRS 4.**

## Deferral approach – Main considerations

### What's the issue?

In July 2015, the Board directed the staff to conduct additional research and explore options to defer the effective date of IFRS 9 in some circumstances. This deferral approach would aim to address concerns raised by users of financial statements over the differing effective dates of IFRS 9 and the forthcoming insurance contracts standard.

### What possible alternatives did the staff consider?

The staff considered two alternatives for the deferral approach, focusing on the level at which the approach would be applied.

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| Alternative | Level of applicability | Applicability | Advantages | Disadvantages |
|---|---|---|---|---|
| 1 | **Reporting entity level** | This alternative is similar to an 'all-or-nothing' approach and would apply to 'predominant insurers'.<br><br>The deferral approach would apply only for entities whose predominant activity is issuing contracts in the scope of IFRS 4.<br><br>It would not apply to entities that engage in other activities to the extent that their insurance activities would not be considered predominant. | This alternative would be simple to apply.<br><br>It would also complement the overlay approach, which would be available to entities not considered to have predominant insurance activities. | This alternative would not capture financial assets that relate to insurance activities unless such activities are predominant.<br><br>Similarly, it may capture financial assets that are not related to insurance activities. |
| 2 | **Below reporting entity level** | This alternative would apply to some, but not all, of an entity's financial assets. As a result, an entity would simultaneously report some financial assets under IFRS 9 and others under IAS 39.<br><br>An entity would be required to apply the deferral approach to all financial assets that relate to insurance activities. These could be identified in different ways, including:<br><br>• legal structure, with reference to:<br>– predominance of insurance activities; or<br>– regulation; and<br>• segment reporting. | This alternative has a more granular scope that could more appropriately cover financial assets that relate to insurance activities and exclude those that do not. | This alternative would be more complex for preparers, as they would have to apply two financial instruments standards simultaneously.<br><br>In addition, users would find financial statements harder to understand, because two different standards are being applied.<br><br>Finally, transferring assets between reporting entities would be inherently complex. |


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## What did the staff recommend?

| Topic | Staff recommendations and considerations |
|---|---|
| **The deferral approach** | **What did the staff recommend?** |
| | The staff asked the Board whether it wished to propose the deferral approach to address concerns about the differing effective dates of IFRS 9 and the forthcoming insurance contracts standard.<br>The staff believed that the deferral approach could be proposed in addition to the overlay approach and transition reliefs. However, they did not provide a recommendation to the Board. |
| | **What else did the staff consider?** |
| | The staff acknowledged the feedback received from users of financial statements, and recognised that the deferral approach could address their concerns. However, they noted that the deferral approach would only provide useful information for a small population of entities that issue contracts in the scope of IFRS 4.<br>Entities that would not be eligible for the deferral approach (along with those that *would* be eligible) would still be able to apply the overlay approach and transition reliefs. |
| **The two alternatives** | **What did the staff recommend?** |
| | If the Board were to support a deferral approach, then the staff recommended deferral at a reporting entity level (Alternative 1). |
| | **What else did the staff consider?** |
| | Based on the staff's analysis above, they believe Alternative 1 to be a simpler approach that would result in more useful information for users of financial statements, and less complex operational challenges, than Alternative 2.<br>The disadvantages of Alternative 1 could be mitigated through disclosures of IFRS 9 information in the notes to the financial statements. |

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## What did the IASB discuss?

| Staff recommendation | Board discussion |
|---|---|
| **The deferral approach** | **Board members in support based their opinion on the following factors.** |
| | • Although the overlay approach addresses some of the concerns and unintended consequences of differing effective dates between IFRS 9 and the forthcoming insurance contracts standard, implementing the overlay approach could be costly and cumbersome for some entities – a deferral approach may address those same concerns and unintended consequences in a way that is less costly and cumbersome.<br>• The overlay approach would move volatility from profit or loss to OCI, where mismatches still affect reported equity.<br>• Given that the forthcoming insurance contracts standard is expected to be completed in the near term, a deferral approach would be an appropriate way to address some users' concerns. This could be strengthened by putting a fixed expiry date on the application of the deferral approach.<br>• Some interested parties have strongly requested a deferral. The Chair said that if the Board did not respond, insurers would ask the European Commission for a carve-out allowing deferral under EU law. The Chair noted that if the Board were to vote to propose a deferral in its planned ED to amend IFRS 4, it would have a chance to reconsider the matter having received more feedback from stakeholders. |
| | **Board members not in support based their opinion on the following factors.** |
| | • Feedback received from users made it clear that the deferral option was not seen as a necessity, and that an overlay approach on its own would generally be accepted and effective.<br>• There would be a lack of comparability – i.e. some entities would apply IFRS 9 and some would not. One Board member believed that this would lead to a lack of transparent information for market participants, which would detract from financial stability.<br>• If the Board were to allow a deferral, it could set a precedent that would encourage other industries to ask for similar treatment on other issues.<br>• Some Board members cited a lack of confidence that the forthcoming insurance contracts standard would be completed in the near term. |

## What did the IASB decide?

| Topic | Board decision |
|---|---|
| **The deferral approach** | The Board voted 8–7 in support of proposing a deferral approach. This majority included the Chair's casting vote. |
| **The two options** | The deferral of the effective date of IFRS 9 would apply to all financial assets held by the reporting entity – i.e. at the reporting entity level (Alternative 1). |


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**Based on the Board's decisions to support a deferral approach, the staff made additional recommendations to the Board.**

## Deferral approach – Additional considerations

### What did the staff recommend?[3]

The staff made the following recommendations, based on the Board's decision to propose the deferral approach at the reporting entity level.

| Topic | Staff recommendations and considerations |
|---|---|
| **Eligibility for the deferral approach** | **What did the staff recommend?**<br><br>***Applying IFRS 9***<br><br>An entity that has applied IFRS 9 should not be permitted to stop applying it and revert to applying IAS 39.<br><br>An entity that issues contracts in the scope of IFRS 4 should be permitted to defer the effective date of IFRS 9 if that activity is predominant for the reporting entity. It would apply to all financial assets held by the reporting entity.<br><br>***Assessing whether insurance activities are predominant***<br><br>An entity should be required to initially assess whether its insurance activities are predominant, based on:<br>• the level of gross liabilities arising from contracts that are in the scope of IFRS 4; relative to<br>• the entity's total liabilities at the date when the entity would otherwise be required to initially apply IFRS 9.<br><br>***Changes in an entity's predominant activities***<br><br>An entity should be required to reassess whether its insurance activities are predominant at subsequent annual reporting dates if there is a demonstrable change in the entity's corporate structure that could result in a change in its predominant activities.<br><br>If, as a result of that reassessment, an entity concludes that its insurance activities are no longer predominant, then it should be required to:<br>• apply IFRS 9 from the beginning of the next annual reporting period; and<br>• disclose, in the reporting period in which the reassessment took place:<br>– the fact that it is no longer eligible for deferral;<br>– the reason why it is no longer eligible; and<br>– the date on which the change in corporate structure took place that resulted in the entity no longer meeting the predominance condition. |

3. The recommendations presented in this section are specific to the deferral approach that was decided on by the IASB – i.e. deferral at the reporting entity level (Alternative 1). The staff also presented recommendations on Alternative 2 – i.e. deferral below the reporting entity level; however, these recommendations and the Board's subsequent deliberations are not discussed in this newsletter, as they were contingent on the Board approving Alternative 2, which did not happen.

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| Topic | Staff recommendations and considerations |
|---|---|
| **Eligibility for the deferral approach (continued)** | **What else did the staff consider?**<br><br>***What 'predominance' means***<br><br>The staff suggested that 'predominance' should be a metric based on specific financial statement captions. They concluded that a metric based on gross liabilities arising from contracts that are in the scope of IFRS 4 would result in a simple and transparent assessment, providing consistent conclusions across the industry. The staff considered a metric such as shareholders' equity, but concluded that – unlike many insurance liabilities – it did not reflect the nature of the entity's business activities.<br><br>***A high threshold***<br><br>A quantitative threshold was considered but not proposed, because it would be arbitrary in nature. The predominance threshold under Alternative 1 is intended to be a high threshold. The staff provided an example whereby an entity with two-thirds of its liabilities being insurance liabilities and one-third being deposits from banking customers would not meet the predominance threshold.<br><br>The staff also considered an holistic approach to the predominance threshold, whereby management would consider all facets of the company – e.g. liability composition, income levels, regulatory environment, or whether it is a listed entity. However, they did not recommend this approach because it would be more complex and would require more management judgement than an approach based on a single factor. |
| **Permitted or required?** | **What did the staff recommend?**<br><br>An entity should be permitted, rather than required, to apply the deferral approach.<br><br>**What else did the staff consider?**<br><br>Many users of financial statements expressed a strong preference that any approach proposed by the Board should be mandatory rather than optional, to ensure comparability within the insurance sector.<br><br>Although the staff considered these concerns, they proposed that the deferral should be permitted, rather than required, for the following reasons.<br><br>• It is important that all entities are able to apply the significant improvements under IFRS 9 on a timely basis.<br><br>• The concerns over temporary volatility when IFRS 9 is applied in conjunction with IFRS 4 often relate to contracts with a locked-in discount rate. Therefore, no insurance company should be required to apply such an approach if it has:<br>  – predominant insurance operations; and<br>  – a significant contract portfolio that would not result in temporary volatility on applying IFRS 9.<br><br>• Permitting the deferral approach would be consistent with the Board's decision in July 2015 to permit the use of the overlay approach. |


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| Topic | Staff recommendations and considerations |
|---|---|
| **Transition** | **What did the staff recommend?**<br>The staff made the following recommendations.<br>• When an entity applies the deferral approach, it should use the applicable transition provisions in IFRS 9, to the extent needed to provide the disclosures required under the deferral approach.<br>• An entity that applies the deferral approach should be *permitted* to stop applying it and start applying IFRS 9 at the beginning of any annual reporting period before the forthcoming insurance contracts standard is applied. It should be *required* to do so from the beginning of the annual reporting period in which the forthcoming insurance contracts standard is initially applied.<br>• When an entity starts applying IFRS 9, it should follow the transition provisions under IFRS 9 and should stop providing the disclosures required under the deferral approach. |
| **Disclosures** | **What did the staff recommend?**<br>The staff recommended that an entity that applies the deferral approach should disclose:<br>• the fact that it has chosen to delay application of IFRS 9;<br>• an explanation of how it concluded that it is eligible for the deferral;<br>• quantitative information about carrying amounts and income and expenses in the statement of profit or loss and OCI that would have been recognised if it were applying IFRS 9; these would be aggregated by IFRS 9 financial asset measurement category, and by type of income and expenses; and<br>• those disclosures in IFRS 7 *Financial Instruments: Disclosures* that were added by IFRS 9 and are necessary to help financial statement users understand the IFRS 9 information provided in the notes – i.e. that explain the basis for the estimates of expected credit losses and the reasons for changes in those amounts.<br>If an entity reassesses its predominant activities and concludes that it no longer meets the predominance condition at the reporting date, it should also be required to provide the following disclosures:<br>• the fact that it is no longer eligible for deferral;<br>• the reason why it is no longer eligible; and<br>• the date on which the change in corporate structure took place that resulted in its no longer meeting the predominance condition. |

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## What did the IASB discuss?

| Staff recommendation | Board discussion |
|---|---|
| **Eligibility for the deferral approach** | Although there would not be a quantitative threshold for assessing predominance, some Board members suggested that the staff provide an example in the basis for conclusions specifying a general level at which an entity's insurance activities would not be considered predominant.<br><br>One Board member considered it unfair that an insurer might be disqualified because it also issued investment-linked saving contracts that were accounted for under IAS 39/IFRS 9 rather than IFRS 4. |
| **Disclosures** | Several Board members were concerned that the list of recommended disclosures proposed by the staff was too exhaustive and may result in entities that elect to use the deferral approach:<br><br>• effectively having to implement IFRS 9 twice – once for disclosure when the deferral approach is first applied and a second time when implementing IFRS 9; and<br><br>• having to parallel run IFRS 9 with IAS 39 during the proposed deferral period.<br><br>Board members suggested developing disclosure requirements that focus on:<br><br>• key comparisons – i.e. characteristics and credit quality; and<br><br>• those requirements in IFRS 9 that should not involve significant re-work when the forthcoming insurance contracts standard is implemented.<br><br>Based on this discussion, the staff revised their recommendation as follows.<br><br>An entity applying the deferral approach should disclose:<br><br>• the fact that it has chosen to delay application of IFRS 9;<br><br>• an explanation of how it concluded that it is eligible for the deferral; and<br><br>• information about the characteristics and credit quality of financial assets. |

## What did the IASB decide?

The Board agreed with the staff recommendation, including the clarifications to disclosures discussed above. Its decisions are summarised in the following table.


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| Topic | Board decision |
|---|---|
| **Eligibility for the deferral approach** | **Applying IFRS 9**<br>• An entity would be permitted to defer the effective date of IFRS 9 if it issues contracts in the scope of IFRS 4, if that activity is predominant for the reporting entity. The deferral would apply to all financial assets that it holds.<br>• An entity that has previously applied IFRS 9 would not be permitted to stop applying IFRS 9 and revert to applying IAS 39.<br>**Assessing whether the insurance activities are predominant**<br>• An entity would be required to initially assess whether insurance activities are predominant for it, based on the level of gross liabilities arising from contracts in the scope of IFRS 4 relative to the entity's total liabilities, at the date when the entity would otherwise be required to initially apply IFRS 9 – i.e. for annual periods beginning on or after 1 January 2018.<br>• There would be no quantitative threshold for assessing the predominance of insurance activities; however, the basis for conclusions to the potential amendments to IFRS 4 should include an example specifying the levels at which an entity's insurance activities would not be considered predominant for the purpose of this assessment.<br>**Changes in an entity's predominant activities**<br>• An entity would be required to reassess whether insurance activities are predominant for it at subsequent annual reporting dates if there is a demonstrable change in the entity's corporate structure – e.g. an acquisition or disposal of a business – that could result in a change in its predominant activities.<br>• If, as a result of that reassessment, an entity were to conclude that insurance activities are no longer predominant for it, then it would be required to apply IFRS 9 from the beginning of the next annual reporting period, and to disclose in the reporting period in which the reassessment took place:<br>– the fact that the entity is no longer eligible for deferral;<br>– the reason why it is no longer eligible; and<br>– the date on which the change in corporate structure took place that resulted in the entity no longer meeting the predominance condition. |
| **Permitted or required?** | Deferral of the effective date of IFRS 9 would be permitted. |

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| Topic | Board decision |
|---|---|
| Transition | When an entity applies the deferral approach, it would use the applicable transition requirements in IFRS 9 to the extent needed to provide the disclosures required under the deferral approach.<br><br>An entity that applies the deferral approach would be permitted to stop applying it and start applying IFRS 9 at the beginning of any annual reporting period before the forthcoming insurance contracts standard is applied. It would be required to do so from the beginning of the annual reporting period in which the forthcoming insurance contracts standard is initially applied.<br><br>When an entity stops applying the deferral approach, and applies IFRS 9 for the first time, it would follow the transition provisions under IFRS 9, and would stop providing the disclosures required under the deferral approach. |
| Disclosures | An entity applying the deferral approach would disclose:<br>• the fact that it has chosen to delay application of IFRS 9;<br>• an explanation of how it concluded that it is eligible for the deferral; and<br>• information about the characteristics and credit quality of financial assets – e.g. disclosure of:<br>– the fair value of financial assets that would not meet the 'solely principal and interest' characteristics test in IFRS 9, and which are therefore mandatorily measured at FVTPL under IFRS 9; and<br>– credit risk information about financial assets that would not be mandatorily measured at FVTPL under IFRS 9 – e.g. the credit risk grades of such financial assets. |

**The IASB was satisfied that the due process requirements had been met, and that the balloting process for the ED to amend IFRS 4 could begin.**

## Due process

### What's the issue?

After the Board completed its deliberations on the overlay and deferral approaches, the staff asked the Board to consider the effective dates and expiry dates of the proposed amendments and asked for permission to ballot the ED to amend IFRS 4.

### What did the staff recommend?

The staff recommended that:

- the effective date of the proposed requirements should be for annual periods beginning on or after 1 January 2018;
- early adoption should be permitted if an entity adopts IFRS 9 early; and
- an expiry date for the proposed requirements should not be specified.

The staff also asked the Board:

- whether it was satisfied that the due process requirements had been met, and that the staff had undertaken sufficient consultation and analysis to start the balloting process for the ED to amend IFRS 4; and


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- whether any members planned to dissent from the publication of the ED to amend IFRS 4.

## What did the IASB discuss?

Various Board members agreed that there should be an expiry date for the deferral approach, as they did not want to imply that the project was going to take an unreasonable amount of time to complete.

Board members suggested an expiry date of the deferral option of 1 January 2021. However, Board members agreed that no expiry date should be specified for the overlay approach.

Based on this discussion the staff revised their recommendation, to specify an expiry date for the deferral approach of no later than reporting periods beginning on or after 1 January 2021; for periods beginning on this date or later, an entity could chose to apply the overlay approach if the forthcoming insurance contracts standard is not yet effective.

## What did the IASB decide?

The Board decided that the ED should propose:

- an effective date for the proposed requirements of reporting periods beginning on or after 1 January 2018;
- to permit early adoption of the proposed amendments if an entity adopts IFRS 9 early; and
- to specify an expiry date for the deferral approach of no later than reporting periods beginning on or after 1 January 2021, and to confirm that after this date an entity could choose to apply the overlay approach.

All Board members present were satisfied that the staff had completed the necessary due process steps to start the balloting process for the ED.

One Board member plans to dissent from the proposal for the amendment to IFRS 4.

## KPMG insight

Financial conglomerates are unlikely to benefit from the Board's decision to permit the deferral of the effective date of IFRS 9, as they would not meet the criterion that insurance activities should be predominant at the reporting entity level. However, they might be able to elect to use the overlay approach to reduce accounting mismatches that may emerge for financial assets that relate to insurance activities.

Although both the overlay approach and the deferral approach would lead to operational complexity, the ways in which that complexity would arise may differ under each approach.

### Overlay approach

The expectation is that no incremental information would be needed compared with the current requirements for assets that are subject to the overlay approach, since these are limited to assets classified at FVTPL under IFRS 9 but not under IAS 39.

This is because the information needed to measure these assets at FVTPL should be available under the entity's existing accounting systems, because IFRS 7 already generally requires disclosure of fair values for *all* financial assets.

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The only exception would be the unusual case in which the fair value of an investment in an unquoted equity instrument or related derivative was previously considered not to be reliably measureable under IAS 39.

However, entities would have to consider the complexities of the interaction between the overlay approach and their current accounting for insurance contract liabilities – e.g. participating contracts and shadow accounting adjustments.

Insurers applying the overlay approach would have to consider designing and implementing new systems and controls to:

- calculate the overlay adjustment;
- track the financial assets that are subject to the overlay adjustment for reporting and other purposes – e.g. technical provisions for bonuses and tax reporting; and
- create and review additional disclosures over and above those required for IFRS 9, when it is applied.

### Deferral approach

For entities that elect to use the deferral approach, the most complex area would be the presentation and disclosure requirements – these are expected to increase the costs of preparing the notes to the financial statements.

Although the Board has concluded that disclosures about how financial assets would have been classified under IFRS 9 should focus only on key comparisons – i.e. information about the characteristics and credit quality of financial assets – the need to maintain the necessary controls and governance systems for the relevant processes would give rise to extra costs.

## In summary

### How do the two alternatives interact?

Under the proposals agreed above, an entity whose predominant activity is issuing contracts in the scope of IFRS 4 would be permitted to defer the effective date of IFRS 9 at the reporting entity level no later than reporting periods beginning on or after 1 January 2021. Before and after this date, an entity that holds assets related to insurance activities that are in the scope of IFRS 4 would be able to apply the overlay approach in conjunction with IFRS 9 until the forthcoming insurance contracts standard is effective.


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# DISAGGREGATING CHANGES IN MARKET VARIABLES

**The effects of changes in market variables that affect amounts of cash flows would be presented in the statement of comprehensive income, consistent with changes in discount rates.**

## Changes in cash flow amounts

### What's the issue?

The 2013 ED proposed that changes in estimates of the amounts of cash flows arising from changes in market variables[4] should be recognised in profit or loss. Feedback on this proposal was mixed – some users of financial statements supported the proposal; others suggested that changes in estimate should adjust the contractual service margin (CSM); and others preferred that changes in estimates be recognised in OCI.

Based on stakeholder feedback, the IASB concluded that further deliberations were required. In March 2014, the Board decided that, for non-participating contracts, changes in the measurement of an insurance contract arising from the effect of changes in discount rates would be recognised in profit or loss or OCI, depending on an entity's accounting policy choice. The Board had not addressed whether this approach would apply to participating contracts.

Changes in market variables may cause the following changes in insurance contracts.

| Where | Changes | Notes |
|---|---|---|
| **General model** | The effects of applying a current discount rate to the measurement of the fulfilment cash flows.<br>Changes in the nominal amounts of the fulfilment cash flows arising from changes in market variables. | These changes would apply in the same way to the majority of, if not all, participating contracts. |
| **Variable fee approach for direct participating contracts** | Changes in the obligation to pay 100 percent of the fair value of the underlying items | These changes are a combination of changes in both the discount rate and the nominal amounts of fulfilment cash flows. |

During its September meeting, the Board discussed how changes in the measurement of an insurance contract arising from changes in market variables could be disaggregated between profit or loss and OCI, using previous decisions on, and requirements for, non-participating contracts.

### What did the staff recommend?

The staff recommended that – for all contracts accounted for in the forthcoming insurance contracts standard – changes in estimates of the amounts of cash flows arising from changes in market variables should be presented in the same location in the statement of comprehensive income, using the same requirements that apply to the effects arising from changes in discount rates[5].

The staff made this recommendation based on the following considerations.

- Changes in discount rates are also changes in market variables. Therefore, the recommendation would allow the effects of both changes in cash flow amounts and changes in discount rates to be presented in the same way and in the same location in the statement of comprehensive income. This would presumably result in more useful information for users of financial statements.
- The recommended approach should result in less operational complexity.

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4. The Board did not prescribe a definition of a market variable, and suggested that the terminology be improved. However, the staff did provide an example of a market variable as the value of, or return on, a pool of assets.
5. The discount rate requirements referred to in the staff's recommendation were decided by the IASB during its March 2014 meeting. For more information, read Issue 38 of our *IFRS Newsletter: Insurance*.

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- If the presentation requirements for the effects of changes in market variables and changes in discount rates were different, then preparers would have to perform additional calculations.

### What did the IASB discuss?

Some Board members queried whether changes in market variables could affect cash flows for non-participating contracts as well as participating contracts. The staff did not believe so, as participating contracts were described as those with features that shared risks and rewards through payments that are additional to compensation for losses suffered on the occurrence of the insured event. The staff also commented that changes in cash flows as a result of discretion were not changes in market variables – although one Board member pointed out that in practice there may be a relationship between changes in market variables and an entity's exercise of discretion.

Some Board members noted that the terminology should be improved – specifically, the concept of market variables and insurance investment expense[6].

Board members questioned whether an entity could, for certain contracts, choose to present:

- discount rate changes in profit or loss; and
- changes in cash flows arising from market variables in OCI,

or vice versa. The staff responded that the choice was intended to be between presenting both in profit or loss or both in OCI.

### What did the IASB decide?

The Board decided that, for all insurance contracts, an entity would present changes in estimates of the amount of cash flows that result from changes in market variables in the same location in the statement of comprehensive income as, and consistent with, changes in discount rates.

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**The Board decided that the general objective is to present insurance investment expense using a cost measurement basis – but did not prescribe detailed mechanisms.**

## Insurance investment expense

### What's the issue?

During its September meeting, the IASB considered whether to prescribe mechanics for disaggregating changes arising from changes in market variables between profit or loss and OCI for participating contracts.

These discussions were based on the Board's September 2014 deliberations[7] on the practical mechanics for disaggregating changes, by determining the insurance investment expense in profit or loss using either:

- a yield curve approach;
- a level yield approach; or
- a projected crediting method.

Both the level yield approach and the projected crediting method could be further modified to address accounting mismatches arising from:

- assets being measured using either a cost basis or a current basis; or
- gains and losses on derecognition.

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6. The term 'insurance investment expense' is synonymous with the term 'interest expense'. However, 'insurance investment expense' encompasses changes that arise from interest rates and other sources that are presented in profit or loss.
7. For more information, read Issue 43 of our *IFRS Newsletter: Insurance*.


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### What did the staff recommend?

The staff recommended that, for all insurance contracts, the forthcoming insurance contracts standard should:

- specify that the objective of disaggregating changes in the measurement of an insurance contract arising from changes in market variables between profit or loss and OCI is to present an insurance investment expense in profit or loss using a cost measurement basis; and
- not specify detailed mechanics for determining the insurance investment expense using a cost measurement basis.

Accordingly, the difference between presenting an insurance investment expense in profit or loss using a cost measurement basis and a current measurement basis should be recognised in OCI.

The staff recommended this approach because they felt that specifying the mechanics would be complex, due to the variety of participating contracts that exist across various jurisdictions.

### What did the IASB discuss?

Some Board members said that they supported the staff recommendation, because it would introduce flexibility and could reduce complexity for preparers. However, such flexibility could lead to diversity in practice.

Some suggested that the staff define the concept of a cost measurement basis in the context of the forthcoming insurance contracts standard, to avoid confusion for preparers and inconsistency between entities.

### What did the IASB decide?

The Board agreed with the staff recommendations. The Board added that it would provide additional guidance that the mechanics should result in a systematic allocation of the yield over the life of the contract – including examples based on paragraph 17 of Agenda Paper 2B.

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**The Board decided to modify the objective for these contracts to eliminating accounting mismatches in profit or loss – i.e. apply a current period book yield approach.**

## Direct participating contracts with no economic mismatches

### What's the issue?

As discussed above, the IASB decided at its September meeting that the objective when disaggregating changes arising from changes in market variables should be to present an insurance investment expense in profit or loss using a cost measurement basis.

An inherent feature of a cost measurement basis in profit or loss – e.g. fair value through other comprehensive income (FVOCI) – is that accounting mismatches are more likely to arise. This is due to recognising amounts of income and expenses that may depend in part on:

- when assets are bought/originated and sold/matured; and
- when liabilities are incurred and settled.

Due to the inherent possibility that accounting mismatches may result, the Board considered whether to modify the objective of disaggregating changes in market variables between profit or loss and OCI for contracts with no economic mismatches.

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The staff believed that economic mismatches do not exist when:

- the contract is a direct participating contract[8] – i.e. the entity has an obligation to pay policyholders the fair value of underlying items, and therefore applies the variable fee approach; and
- the entity holds the underlying items.

The current period book yield (CPBY) approach could be used to eliminate accounting mismatches in profit or loss for these types of contracts. This could be achieved by presenting an insurance investment expense (or income) that exactly matches the gains (or losses) presented in profit or loss that arise from the underlying items.

The staff considered the following arguments about modifying the objective for the presentation of the insurance investment expense when disaggregating changes in market variables – namely that using the CPBY approach would:

- introduce additional complexity in the forthcoming insurance contracts standard, as there would be two approaches for disaggregating changes in market variables between profit or loss and OCI;
- result in a more complete reduction in accounting mismatches in profit or loss compared to presenting the insurance investment expense using a cost measurement basis; and
- make the statement of profit or loss more relevant.

### What did the staff recommend?

For only the subset of direct participating contracts that apply the variable fee approach and for which economic mismatches do not exist, the staff asked the Board to consider whether to apply the modified objective for disaggregating changes in the insurance contract between profit or loss and OCI using the CPBY approach.

Under this approach, when the changes in the fair value of the underlying items in the contract correspond to the changes in fair value of the items held for the entire period that they are held, then the entity should disaggregate that change as follows.

- It should determine the insurance investment expense (or income) on the insurance contract in profit or loss, at an amount equal and opposite to the gains (or losses) presented in profit or loss for the items held. Accordingly, the difference between these values would be zero.
- Any difference between:
  - the insurance investment expense (or income) presented in profit or loss; and
  - the change in the measurement of the insurance contract recognised in the statement of comprehensive income – i.e. the total change in the fair value of the underlying items should be presented in OCI.

### What did the IASB discuss?

Some Board members had concerns that introducing the CPBY approach would result in additional complexity for preparers. Others argued that this approach should be optional, not mandatory.

However, some Board members viewed the introduction of the CPBY approach as a way to alleviate possible accounting mismatches for contracts with no economic mismatches, and believed that it would reduce complexity for users.

8. For information about how a direct participating contract is determined, read Issue 46 of our *IFRS Newsletter: Insurance*.


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### What did the IASB decide?

The Board decided that the objective of disaggregating changes in market variables between profit or loss and OCI should be modified for contracts in which there is no economic mismatch between the insurance contract and the related items – e.g. the assets and the liabilities – held by the entity.

The modified objective would be to present the insurance investment expense that eliminates accounting mismatches in profit or loss between the insurance investment expense and the items held that are measured using a cost measurement basis in profit or loss – i.e. the CPBY approach.

Accordingly, in the CPBY approach, the difference between:

- the changes in the contract arising from changes in market variables – i.e. changes in the fair value of the underlying items; and
- the insurance investment expense would be recognised in OCI.

The Board agreed that economic mismatches do not exist when:

- the contract is a direct participating contract – i.e. the entity has an obligation to pay policyholders the fair value of the underlying items, and therefore applies the variable fee approach; and
- the entity holds the underlying items, either by choice or because it is required to.

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**The Board added requirements for contracts that no longer qualify, or newly qualify, for the CPBY approach.**

## Moving between approaches

### What's the issue?

Having decided on a different disaggregation approach for contracts with no economic mismatches, the IASB had to consider how to address contracts that move between approaches – i.e. those that cease or start to give rise to economic mismatches. Therefore, the Board needed to consider:

- how the accumulated OCI balances should be accounted for when a contract is transferred between approaches;
- whether the entity should restate comparative period information; and
- whether additional disclosures should apply.

The staff believed that the Board would need to specify these additional requirements, because without them an entity could choose between different approaches for transfers, resulting in a lack of comparability.

### What did the staff recommend?

If an entity is required to change to or from the CPBY approach, then it should:

- not restate the opening accumulated OCI balance;
- not recognise in profit or loss the accumulated OCI balance on the date of the change or in future periods – i.e. the accumulated OCI balance should remain in equity;
- not restate prior period comparatives; and
- disclose, in the period that the change in approach occurred:

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- an explanation of the reason for the change and the effect of the change on each financial statement line item affected; and
- the value of the contracts that no longer qualify for the CPBY approach but previously qualified (and vice versa).

### What did the IASB discuss?

One Board member proposed that an entity should reclassify to profit or loss any gains or losses that have accumulated in OCI at the date of the change, in the period of the change and in future periods, as follows.

- If the entity had previously applied the effective yield approach, then it should apply an effective interest yield approach going forward, using the same assumptions that applied before the change.
- If the entity had previously applied the CPBY approach, then it should continue to reclassify the accumulated OCI balance to profit or loss using the same assumptions that applied before the change.

### What did the IASB decide?

The Board agreed with the staff recommendation subject to the proposed modification outlined above.

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**The Board extended the accounting policy choice for non-participating contracts to participating contracts.**

## Accounting policy choice

### What's the issue?

In March 2014, the IASB decided that for *non-participating contracts*, an entity may elect to disaggregate the effects of changes in discount rates between profit or loss and OCI. The Board now considered whether such a disaggregation should also be an accounting policy choice for *participating* contracts.

### What did the staff recommend?

The staff recommended that the Board extend its previous decisions on non-participating contracts to participating contracts. This would mean that an entity should choose one of the two accounting policies illustrated below.


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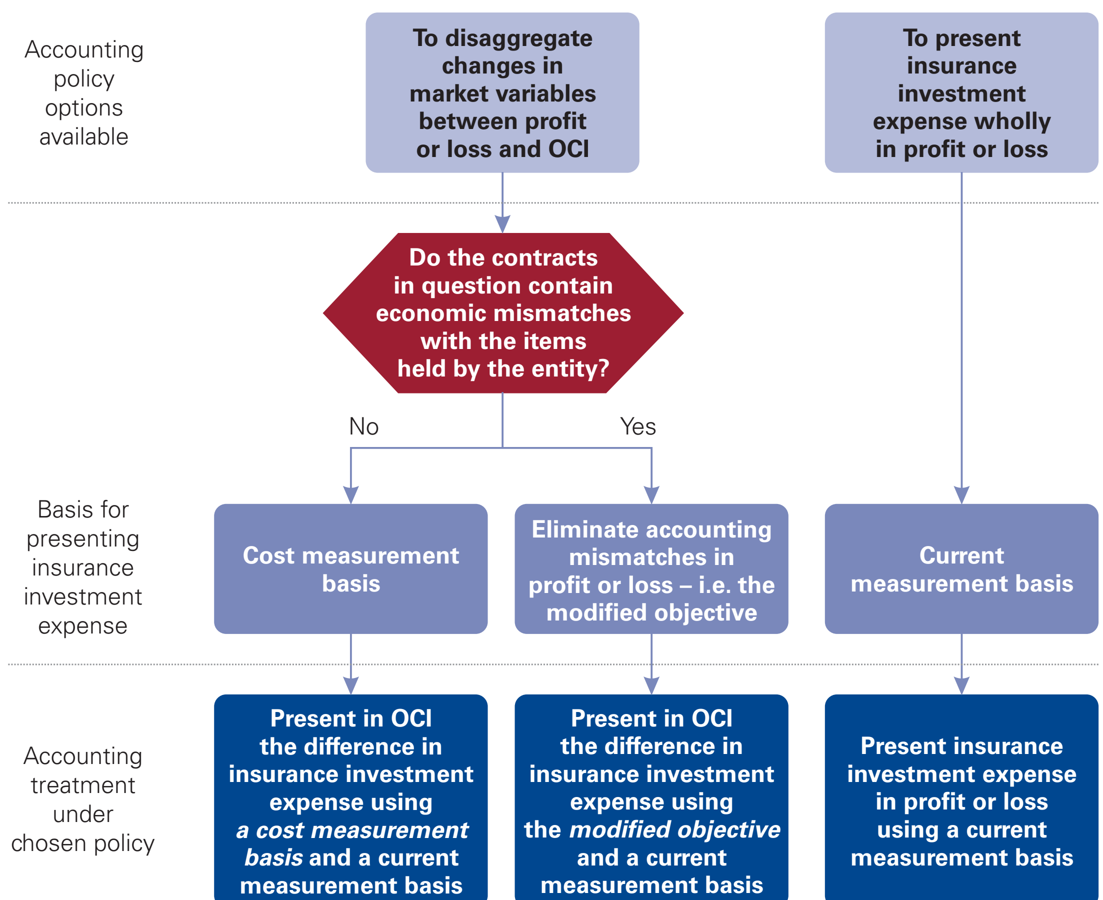


It would also mean that an entity should:

- apply that accounting policy to groups of similar contracts, taking into consideration:
  - the portfolio in which the contracts are included;
  - the assets that the entity holds; and
  - how those assets are accounted for; and
- apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to any changes in that accounting policy.

## What did the IASB discuss?

Board members commented that the choice provided by the staff's recommendation would reduce accounting mismatches in certain circumstances and would help preparers avoid additional complexity.

## What did the IASB decide?

The Board decided that it should extend to contracts *with* participating features its previous decisions for contracts *without* participation features. Accordingly, for all insurance contracts, an entity:

- could choose, as its accounting policy, either:
  - to disaggregate changes in market variables between profit or loss and OCI; or

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  - to present insurance investment expense in profit or loss using a current measurement basis.
- would apply that accounting policy to groups of similar contracts, taking into consideration:
  - the portfolio in which the contracts are included;
  - the assets that the entity holds; and
  - how those assets are accounted for; and
- would apply the requirements in IAS 8 to any changes in that accounting policy.

**The Board included a simplified transition method for contracts in which changes in market variables affect the amount of cash flows.**

## Simplified transition requirements

### What's the issue?

On transition to the forthcoming insurance contracts standard, an entity that elects to disaggregate changes in market variables between profit or loss and OCI would be required to determine insurance investment expense retrospectively, on a cost measurement basis. This would require historical information that may be impracticable to obtain.

### What did the staff recommend?

For circumstances when such full retrospective application is impracticable, the staff recommended simplifying the approach for determining insurance investment expense (and accumulated OCI) for contracts in which changes in market variables affect the amount of cash flows. They made the following recommendations.

- For contracts whose objective is to present an insurance investment expense using a cost measurement basis in profit or loss, an entity should assume that the earliest market variable assumptions that should be considered are those that occur when the entity first applies the forthcoming insurance contracts standard. Accordingly, on initial application of the forthcoming insurance contracts standard, the accumulated OCI balance for the insurance contract would be zero.
- For contracts under the CPBY approach, insurance investment expense (or income) would be equal and opposite in amount to the gains (or losses) presented in profit or loss for the items held by the entity. Accordingly, the accumulated OCI balance should be determined as follows.
  - When the items held are measured at FVTPL, there would be no amount accumulated in OCI.
  - When the items held are measured at cost in profit or loss, the accumulated OCI for the insurance contracts would be the difference between the cost and fair value of the items held.

### What did the IASB discuss?

Based on a Board member's query, the staff confirmed that most indirect participating contracts would be in scope.

### What did the IASB decide?

The Board agreed with the staff recommendation.


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### KPMG insight

Under IAS 8, an entity may voluntarily change its accounting policy only if doing so results in the financial statements providing reliable and more relevant information. An entity may need to apply judgement in determining whether changing its accounting policy for presenting the effects of changes in market variables would meet this criterion.

For participating contracts, the Board's approach is to consider what changes are needed to the general model. During its September meeting, the Board agreed to modifications that focus on market variables, addressing certain issues over accounting mismatches. It seems that these decisions, along with the variable fee approach, would replace the mirroring approach introduced in the 2013 ED. However, the Board did not explicitly state this, so its intentions are not entirely clear.

Furthermore, the Board seems to have focused on maintaining a general model, tailoring it for participating contracts to avoid inconsistency in measuring different insurance contract features, and to alleviate excessive complexity and cost for preparers.

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# MITIGATING RISKS RELATED TO DIRECT PARTICIPATING INSURANCE CONTRACTS

**The IASB addressed the issue of accounting mismatches arising from hedging activities for direct participating contracts.**

## What is the issue?

For direct participating insurance contracts, accounting mismatches can arise under the IASB's proposed variable fee approach if an entity, as part of its risk management activities, uses derivatives to protect itself from the risk that a minimum return guarantee to the policyholder embedded in the insurance contract will not be matched by actual returns on the underlying investments held by the insurer[9].

Accounting mismatches can arise because of the different accounting recognition of the effects of changes in financial market variables on the carrying amounts of derivatives and of the direct participating insurance contract, as follows.

| Instrument | Accounting treatment for changes in financial market variables |
|---|---|
| **Derivative** | Recognise changes in fair value immediately in profit or loss. |
| **Insurance contract** | Adjust some effects of changes in interest rates against the CSM, because these changes affect the amount of the variable fee that the entity expects to earn from the contract. |

The forthcoming insurance contracts standard would require an entity to:

- separate distinct components without highly inter-related cash flows; and
- measure those components under the relevant IFRS.

Therefore, the conditions to avoid accounting mismatches by applying hedge accounting under IFRS 9 (whereby a risk component has to be a separately identifiable and reliably measurable component of the contract) would not be met.

## What possible approaches did the staff consider?

The staff considered the following possible approaches to addressing accounting mismatches between:

- minimum guarantee features in direct participating contracts; and
- derivatives that are held to mitigate the risks arising from those guarantees.

| Approach | | Advantages | Disadvantages |
|---|---|---|---|
| 1 | **Account for direct participating contracts using the general accounting model for insurance contracts** | • Less complex than other approaches – the guarantee would be measured consistently and together with the other components of the insurance contract<br>• No additional accounting requirements would be needed | • Less comparable – some direct participating contracts would be measured on a different basis from others |

9. For example, interest rate risks.



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| Approach | | Advantages | Disadvantages |
|---|---|---|---|
| 2 | **Recognise in profit or loss changes in the value of the guarantee embedded in the insurance contracts, determined using fulfilment cash flows** | • Consistent accounting for all direct participating contracts – only changes in the value of the guarantee would be presented in profit or loss<br>• Consistent measurement of the guarantee and other insurance contract components using current fulfilment cash flows<br>• Simpler to apply than Approach 3 – measuring the guarantee would be the same as measuring other parts of the insurance contract | • Possibility of arbitrary allocation – the change in the guarantee's value would need to be separated (its cash flows are inter-related with the other cash flows of the insurance contract)<br>• Possible accounting mismatches in profit or loss – a guarantee may be measured on a different basis from the derivative used to mitigate the guarantee |
| 3 | **Recognise in profit or loss changes in the fair value of the guarantee embedded in the insurance contract, determined using a hypothetical derivative that matches the critical terms of the guarantee** | • Consistent accounting for all direct participating contracts – only changes in the value of the guarantee would be presented in profit or loss<br>• More consistent with the objective of reflecting risk mitigation activities than the other approaches – changes in the guarantee and the underlying derivative would be measured on a consistent basis | • Possibility of arbitrary allocation – the change in the guarantee's fair value would need to be separated (its cash flows are inter-related with the other cash flows of the insurance contract)<br>• Complexity – an entity would need to identify and value a notional derivative that perfectly matches the promise to the policyholder<br>• Possible measurement differences between:<br>– the value of the guarantee recognised in the statement of financial position (which is based on fulfilment cash flows); and<br>– the fair value changes of the guarantee recognised in profit or loss |

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The staff considered two methods for specifying the qualifying criteria for an entity to recognise changes in the guarantee's value in profit or loss.

| Method | | Premise | Criteria | Notes |
|---|---|---|---|---|
| A | **Risk management** | Reflecting an entity's risk management activities | • Risk mitigation has to be consistent with the entity's risk management strategy.<br>• An economic offset has to exist between the guarantee and the derivative – i.e. the values or cash flows from the embedded guarantee and the derivative generally move in opposite directions because of changes in the risk being mitigated. An entity should not consider accounting measurement differences in assessing the economic offset.<br>• Credit risk does not dominate the economic offset. | In addition, the staff believed that an entity should be required to:<br>• document, before it starts recognising changes in the value of the guarantee in profit or loss, the entity's risk management objective and the strategy for using the derivative to mitigate the financial market risk embedded in the insurance contract; and<br>• stop recognising in profit or loss changes in the guarantee's fair value prospectively from the date on which the economic offset no longer exists. |
| B | **Accounting mismatch** | Mitigating anomalies that result from different measurement attributes | • Has to reduce or eliminate an accounting mismatch.<br>• Irrevocable designation has to be made at inception of the insurance contract. | This method would also be similar to the existing practice under IFRS 4, whereby an entity may choose to unbundle some components of insurance contracts and measure them under the financial instruments standards.<br>However, the staff noted that the criteria could be broader than intended and may not allow an entity to reflect changes in risk management. |

## What did the staff recommend?

The staff recommended that the Board permit Approach 2, because it would allow an entity to minimise accounting mismatches that occur when the entity hedges risks, without the complexity of:

- changing the measurement for the whole insurance contract (as proposed in Approach 1); or
- revaluing the guarantee using fair value (as proposed in Approach 3).


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The staff also recommended that the Board use criteria based on the entity's risk management activities (Method A above). They believed that the objective of this method is closer to the objective of recognising changes in the value of the guarantee in profit or loss.

In addition, the staff made proposals to address the lack of comparability (depending on the entity's risk management strategy and whether it elects to present changes in the guarantee's value in profit or loss) between insurance contracts under Approach 2.

They proposed that an entity should disclose, *as part of its reconciliation of the CSM*, the cumulative effect of recognising changes in the fulfilment cash flows of the guarantee in profit or loss – instead of *as* an *adjustment* to the CSM. This would enable users of financial statements to determine the CSM that would have arisen if the changes in the guarantee's fair value had been adjusted against the CSM.

## What did the IASB discuss?

The majority of Board members supported Approach 2.

One Board member believed that Approach 2 is closest to reflecting the economics of a hedge and others argued that it gave a reasonable view of the economics. A few Board members did not support any of the staff's proposed approaches because they argued that the Board should not try to address all accounting mismatches that exist.

All Board members supported the criteria proposed under Method A. One Board member believed that companies would prefer Method A because it would allow them to apply the approach when the mismatches arise – not necessarily from inception, as the other criteria under Method B would require. The Board asked the staff to provide additional clarification on how an entity would discontinue Approach 2.

The Board chose not to discuss the staff's presentation recommendations for this topic. The Board will consider it in the general context of presentation and disclosure recommendations for participating contracts at a future meeting.

## What did the IASB decide?

The Board reached the following decisions.

- If an entity uses the variable fee approach to measure insurance contracts, and uses a derivative measured at FVTPL to mitigate the financial market risk from a guarantee embedded in the insurance contract, then it would be permitted to recognise in profit or loss the changes in the value of the guarantee embedded in an insurance contract, determined using fulfilment cash flows, but only if the following criteria are met.
  - That risk mitigation is consistent with the entity's risk management strategy.
  - An economic offset exists between the guarantee and the derivative – i.e. the values or cash flows from the embedded guarantee and the derivative generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated. An entity would not consider accounting measurement differences in assessing the economic offset.
  - Credit risk does not dominate the economic offset.
- An entity would be required to:
  - document, before it starts recognising changes in the value of the guarantee in profit or loss, its risk management objective and its strategy for using the derivative to mitigate the financial market risk embedded in the insurance contract; and
  - discontinue recognising in profit or loss changes in the value of the guarantee prospectively from the date on which the economic offset no longer exists.

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### KPMG insight

The Board has an active project on its agenda relating to the accounting for dynamic risk management activities when an entity hedges its risks. This project may be helpful in some aspects of accounting for insurance contracts that are measured using the variable fee approach.

However, the staff indicated that their dynamic risk management project is unlikely to completely address the issue of accounting mismatches for direct participating contracts, as explained above.

For more information on the project, read our IFRS Newsletter: Financial Instruments.


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**The IASB and the FASB held a joint session to update each other on the progress of their respective insurance contract projects.**

## What's the issue?

The FASB has split its insurance contract project into separate sub-projects for short-duration and long-duration contracts. It has focused on targeted improvements to the existing US GAAP guidance, rather than moving forward with the proposed amendments that were developed together with the IASB.

At a joint meeting in September 2015, the two Boards provided each other with an update on their respective insurance contract projects. The IASB's project is the subject of this newsletter series, so its update is not repeated here. The FASB's update is summarised below.

## What did the FASB's update cover?

In May 2015, the FASB issued Accounting Standards Update No. 2015-09, *Financial Services—Insurance* (Topic 944): *Disclosures about Short-Duration Contracts*, which enhances disclosures, but retains current US GAAP recognition and measurement for short-duration contracts.

The FASB decided to focus on making targeted improvements to the existing US GAAP for long-duration contracts because the feedback from financial statement users indicated that the benefits of implementing the joint IASB/FASB proposals would not outweigh the costs. The following areas for improvement were identified.

| Area for improvement | FASB decisions |
|---|---|
| **Updating the assumptions used to determine the liability for future policy benefits** | All assumptions would be updated annually, during the fourth quarter.<br><br>Cash flow assumptions would be updated using a retrospective approach.<br><br>Discount rate assumptions would be updated using an immediate approach.<br><br>Balances that are currently discounted using an expected investment yield would be discounted using a rate based on a portfolio of high-quality fixed income instruments. |
| **Simplifying how deferred acquisition costs (DAC) are amortised** | For all types of long-duration contracts (with the exception of certain investment contracts), DAC would be amortised over the expected life of a book of contracts in proportion to the amount of insurance in force.<br><br>If this amount could not be identified, then DAC would be amortised on a straight-line basis instead.<br><br>For investment contracts that are subject to the exception, an entity would continue to amortise DAC using an effective interest method. |

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| Area for improvement | FASB decisions |
|---|---|
| **Minimum benefits and guarantees** | The FASB is developing a process to enable consistent accounting treatment for guarantees throughout the industry.<br><br>Feedback and outreach activities found that insurers account for contracts with similar guarantees and risks in different ways based on how an entity interprets the current derivatives guidance when applied to its products.<br><br>To help resolve this issue, the FASB has decided to include guidance on measurement for these guarantees in ASC 944, *Financial Services—Insurance* based on a fair value model.<br><br>The scope of this approach includes all contracts where policyholders have discretion over selecting investments.<br><br>The FASB is currently deliberating how changes in credit risk should be presented. |
| **Disclosure enhancements** | Information about the liability for future policy benefits would be disclosed, including the assumptions used to calculate the carrying amount of the liability. |

In future meetings, the FASB will continue its discussions of benefit guarantees, conforming changes to the accounting model for participating contracts, disclosures and transition. The FASB expects to issue an ED before finalising its standard, and to complete its decision-making process in 2016.


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# APPENDIX: SUMMARY OF IASB'S REDELIBERATIONS

| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Targeted issues** | | |
| **Unlocking the CSM** | • Favourable changes in estimates that arise after losses have previously been recognised in profit or loss would be recognised in profit or loss to the extent that they reverse losses that relate to coverage and other services in the future. | Yes |
| | • Differences between the current and previous estimates of the risk adjustment that relate to coverage and other services for future periods would be added to, or deducted from, the CSM, subject to the condition that the CSM would not be negative. Consequently, changes in the risk adjustment that relate to coverage and other services provided in the current and past periods would be recognised immediately in profit or loss. | Yes |
| | • For non-participating contracts, the locked-in rate at inception of the contract would be used for:<br>– accreting interest on the CSM; and<br>– calculating the change in the present value of expected cash flows that adjust the CSM. | No |
| **Presenting the effects of changes in the discount rate and other market variables in OCI** | • An entity could choose as its accounting policy either:<br>– to disaggregate changes in the discount rate and other market variables between profit or loss and OCI; or<br>– to present insurance investment expense in profit or loss using a current measurement basis. | Yes |
| | • An entity would present changes in estimates of the amount of cash flows that result from changes in market variables in the same location in the statement of comprehensive income as, and consistent with, changes in discount rates. | Yes |
| | • The objective of disaggregating changes in the measurement of an insurance contract arising from changes in market variables between profit or loss and OCI is to present an insurance investment expense in profit or loss using a cost measurement basis. The IASB has not specified detailed mechanics for determining the insurance investment expense using a cost measurement basis. | Yes |
| | • Application guidance would be added to clarify that, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity would select and apply its accounting policies consistently for similar contracts, considering the portfolio in which the contract is included, the assets that the entity holds and how those assets are accounted for. | Yes |
| | • The requirements in IAS 8 would be applied without modification to changes in accounting policy relating to the presentation of the effects of changes in discount rates and other market variables. | Yes |
| | • If an entity chooses to present the effects of changes in discount rates and other market variables in OCI, then it would recognise:<br>– *in profit or loss:* the interest expense determined using the discount rates that applied at the date on which the contract was initially recognised; and<br>– *in OCI:* the difference between the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date and the amount of the insurance contract measured using the discount rates that applied at the date on which the contract was initially recognised. | Yes |

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| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Presenting the effects of changes in the discount rate and other market variables in OCI (continued)** | • An entity would disclose the following information.<br>– *For all portfolios of insurance contracts:* An analysis of total interest expense included in total comprehensive income disaggregated at a minimum into:<br>- the amount of interest accretion determined using current discount rates;<br>- the effects on the measurement of the insurance contract of changes in discount rates in the period; and<br>- the difference between the present value of changes in expected cash flows that adjust the CSM in a reporting period measured using the discount rates that applied on initial recognition of insurance contracts and current discount rates.<br>– *In addition, for portfolios of insurance contracts for which the effects of changes in discount rates are presented in OCI:* An analysis of total interest expense included in total comprehensive income disaggregated at a minimum into:<br>- interest accretion at the discount rate that applied at initial recognition of insurance contracts reported in profit or loss for the period; and<br>- the movement in OCI for the period. | Yes |
| | • For non-participating contracts accounted for under the premium allocation approach (PAA), when an entity presents the effects of changes in discount rates in OCI, the discount rate that is used to determine the interest expense for the liability for incurred claims would be the rate locked in at the date the claim was incurred. This would also apply if a liability for onerous contracts is established under the PAA, in which case the locked-in discount rate would be the rate on the date the liability is recognised. | Yes |
| **Insurance contract revenue** | • An entity would be prohibited from presenting premium information in profit or loss if that information is not consistent with commonly understood notions of revenue. | No |
| | • An entity would present insurance contract revenue in profit or loss, as proposed in paragraphs 56–59 and B88–B91 of the ED. | No |
| | • An entity would disclose the following:<br>– a reconciliation that separately reconciles the opening and closing balances of the components of the insurance contract asset or liability;<br>– a reconciliation from the premiums received in the period to the insurance contract revenue in the period;<br>– the inputs used when determining the insurance contract revenue that is recognised in the period; and<br>– the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position. | No |
| | • For contracts accounted for under the PAA, insurance contract revenue would be recognised on the basis of the passage of time. However, if the expected pattern of release of risk differs significantly from the passage of time, then it would be recognised on the basis of the expected timing of incurred claims and benefits. | Yes |


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| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Participating contracts** | | |
| **The variable fee approach** | • For direct participating contracts – i.e. those that meet the following criteria – the CSM would be unlocked for changes in the estimate of the variable fee for service that the entity expects to earn:<br>– the contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items;<br>– the entity expects to pay to the policyholder an amount equal to a substantial share of returns from the underlying items; and<br>– a substantial portion of the cash flows that the entity expects to pay to the policyholder is expected to vary with the cash flows from the underlying items. | Yes |
| **Recognising the CSM in profit or loss** | • An entity would recognise the CSM in profit or loss on the basis of the passage of time. | Yes |
| **Accounting mismatches arising from hedging activities for direct participating contracts** | • If an entity uses the variable fee approach to measure insurance contracts, and uses a derivative measured at FVTPL to mitigate the financial market risk from a guarantee embedded in the insurance contract, then it would be permitted to recognise in profit or loss the changes in the value of the guarantee embedded in an insurance contract, determined using fulfilment cash flows, but only if the following criteria are met.<br>– That risk mitigation is consistent with the entity's risk management strategy.<br>– An economic offset exists between the guarantee and the derivative – i.e. the values or cash flows from the embedded guarantee and the derivative generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated. An entity would not consider accounting measurement differences in assessing the economic offset.<br>– Credit risk does not dominate the economic offset. | No |
| | • An entity would be required to:<br>– document, before it starts recognising changes in the value of the guarantee in profit or loss, its risk management objective and its strategy for using the derivative to mitigate the financial market risk embedded in the insurance contract; and<br>– discontinue recognising in profit or loss changes in the value of the guarantee prospectively from the date on which the economic offset no longer exists. | No |

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| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Disaggregating changes arising from market variables – direct participating contracts with no economic mismatches** | • For contracts for which there is no economic mismatch between the insurance contract and the underlying items, the objective of disaggregating changes would be modified to present the insurance investment expense that eliminates accounting mismatches in profit or loss between:<br>– the insurance investment expense; and<br>– the items held that are measured using a cost measurement basis in profit or loss – i.e. the CPBY approach.<br>• Accordingly, the difference between the changes in the contract arising from changes in market variables – i.e. changes in the fair value of the underlying items – and the insurance investment expense would be recognised in OCI. | Yes |
| | • Economic mismatches do not exist when:<br>– the contract is a direct participation contract – i.e. the entity has an obligation to pay policyholders the fair value of the underlying items, and therefore applies the variable fee approach; and<br>– the entity holds the underlying items, either by choice or because it is required to. | Yes |
| | • If an entity is required to change to or from the CPBY approach, then it should:<br>– not restate the opening accumulated OCI balance;<br>– recognise in profit or loss the accumulated OCI balance at the date of the change, in the period of change and in future periods, as follows:<br>- if the entity had previously applied the effective yield approach, then it should recognise the accumulated OCI balance in profit or loss using an effective yield determined by applying the same assumptions that applied before the change; and<br>- if the entity had previously applied the CPBY approach, then it should continue to recognise the accumulated OCI balance in profit or loss using the same assumptions that applied before the change;<br>– not restate prior period comparatives; and<br>– disclose, in the period that the change in approach occurred:<br>- an explanation of the reason for the change and the effect of the change on each financial statement line item affected; and<br>- the value of the contracts that no longer qualify for the CPBY approach but previously qualified (and vice versa). | Yes |
| **Accounting policy choice for contracts with participating features** | • For participating contracts, including direct participating insurance contracts with no economic mismatches with the underlying items held, the entity would make the accounting policy choice as described above for disaggregating changes arising from changes in market variables in the statement of comprehensive income. | Yes |


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| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Transition** | | |
| **Transition** | • An entity would apply the forthcoming insurance contracts standard retrospectively in accordance with IAS 8, unless this is impracticable. | No |
| | • For the simplified retrospective approach, instead of estimating the risk adjustment at the date of initial recognition as the risk adjustment at the beginning of the earliest period presented, an entity would estimate it by adjusting the risk adjustment at the beginning of the earliest period presented by the expected release of the risk before the beginning of the earliest period presented. The expected release of risk would be determined with reference to the release of risk for similar insurance contracts that the entity issued at the beginning of the earliest period presented. | Yes |
| | • For circumstances when full retrospective application is impracticable, the approach for determining insurance investment expense (and accumulated OCI) for contracts in which changes in market variables affect the amount of cash flows would be simplified as follows.<br>– For contracts whose objective is to present an insurance investment expense using a cost measurement basis in profit or loss, an entity would assume that the earliest market variable assumptions that should be considered are those that occur when the entity first applies the forthcoming insurance contracts standard. Accordingly, on initial application of the forthcoming insurance contracts standard, the accumulated OCI balance for the insurance contract would be zero.<br>– For contracts under the current period book yield (CPBY) approach, insurance investment expense (or income) would be equal and opposite in amount to the gains (or losses) presented in profit or loss for the items held by the entity. | Yes |
| | • If the simplified retrospective approach is impracticable, then an entity would apply a fair value approach. The entity would determine the:<br>– CSM at the beginning of the earliest period presented as the difference between the fair value of the insurance contract and the fulfilment cash flows measured at that date; and<br>– interest expense in profit or loss, and the related amount of OCI accumulated in equity, by estimating the discount rate at the date of initial recognition using the method in the simplified retrospective approach proposed in the ED. | Yes |
| | • For each period presented for which there are contracts measured in accordance with the simplified retrospective approach or the fair value approach, an entity would disclose the information proposed in paragraph C8 of the ED separately for contracts measured using the:<br>– simplified retrospective approach; and<br>– fair value approach. | Yes |

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| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Non-targeted issues** | | |
| **Recognising the CSM in profit or loss** | • The remaining CSM would be recognised in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of the services under the insurance contract. | No |
| | • For non-participating contracts, the service represented by the CSM would be insurance coverage that:<br>– is provided on the basis of the passage of time; and<br>– reflects the expected number of contracts in force. | Yes |
| **Fixed-fee service contracts** | • Entities would be permitted, but not required, to apply the revenue recognition standard to fixed-fee service contracts that meet the criteria stated in paragraph 7(e) of the ED. | Yes |
| **Significant insurance risk** | • The ED's guidance will be adjusted to clarify that significant insurance risk occurs only when there is a possibility that an issuer will incur a loss on a present-value basis. | Yes |
| **Portfolio transfers and business combinations** | • Paragraphs 43–45 of the ED will be amended to clarify that contracts acquired through a portfolio transfer or a business combination would be accounted for as if they had been issued by the entity at the date of the portfolio transfer or the business combination. | Yes |
| **Determining discount rates when there is a lack of observable data** | • The discount rates used to adjust the cash flows of an insurance contract for the time value of money would be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract. | No |
| | • In determining those discount rates, an entity would use judgement to:<br>– ensure that appropriate adjustments are made to observable inputs, to accommodate any differences between observed transactions and the insurance contracts being measured; and<br>– develop any unobservable inputs using the best information available in the circumstances, while remaining consistent with the objective of reflecting the way market participants assess those inputs – accordingly, any unobservable inputs should not contradict any available and relevant market data. | Yes |
| **Asymmetrical treatment of gains from reinsurance contracts** | • After inception, entities would recognise in profit or loss any changes in estimates of cash flows for a reinsurance contract that arise as a result of changes in estimates of cash flows that are recognised immediately in profit or loss for an underlying insurance contract. | Yes |


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| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Level of aggregation** | • The objective of the proposed insurance standard is to provide principles for measuring an individual insurance contract; but in applying the standard, an entity could aggregate insurance contracts, provided that the aggregation would meet that objective. | No[10] |
| | • The definition of a portfolio of insurance contracts would be amended to "insurance contracts that provide coverage for similar risks and are managed together as a single pool". | Yes |
| | • Guidance would be added to explain that, in determining the CSM or loss at initial recognition, an entity would not aggregate onerous contracts with profit-making contracts. An entity would consider the facts and circumstances to determine whether a contract is onerous at initial recognition. | Yes |
| | • Examples would be provided of how an entity could aggregate contracts but nevertheless satisfy the objective of the proposed insurance standard when determining the CSM on subsequent measurement. | Yes |
| **Differing effective dates of IFRS 9 and the forthcoming insurance contracts standard** | | |
| **Proposed interim amendment to existing IFRS 4 – Overlay approach** | • IFRS 4 would be amended. For eligible assets that relate to insurance activities, an entity would be permitted to remove from profit or loss, and recognise in OCI, the difference between:<br>– the amounts that would be recognised in profit or loss under IFRS 9; and<br>– the amounts recognised in profit or loss under IAS 39. | N/A |
| | • The adjustments could only be applied if the entity:<br>– issues contracts that are accounted for under IFRS 4; and<br>– applies IFRS 9 in conjunction with IFRS 4. | N/A |
| | • The effective date of the proposed requirements would be for annual reporting periods beginning on or after 1 January 2018. Early adoption would be permitted if an entity adopts IFRS 9 early. | N/A |
| | • There would be no expiry date for the overlay approach. | N/A |
| **Overlay approach – Eligibility of financial assets** | • An entity would be permitted to make an overlay adjustment in respect of financial assets that meet both of the following criteria:<br>– the entity designates them as relating to contracts that are in the scope of IFRS 4; and<br>– they are classified at FVTPL under IFRS 9 and would not have been classified at FVTPL in their entirety under IAS 39. | N/A |
| | • An entity may change the above designation only if there is a change in the relationship between the financial assets and contracts that are in the scope of IFRS 4. | N/A |

10. In the staff's view, this decision represents a clarification of the principle already included in the ED. However, many respondents to the ED noted that they were unsure how to apply the different levels of aggregation. Consequently, this clarification may result in a change in the application of the principle.

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| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Overlay approach – Transition: Starting to apply the approach** | • An entity would be permitted to start applying the overlay approach only when it first applies IFRS 9 – including if it chooses to apply IFRS 9 early. An entity that has started applying IFRS 9 without applying the overlay approach would not be allowed to subsequently start applying it. | N/A |
| | • An entity would apply the overlay approach retrospectively to eligible financial assets on transition to IFRS 9. It would recognise, as an adjustment to the opening balance of OCI, an amount equal to the difference between:<br>– the fair value of eligible financial assets; and<br>– their amortised cost, or cost carrying amount under IAS 39, immediately before transition to IFRS 9. | N/A |
| | • An entity would restate comparative information to reflect the overlay approach only if it also restates that comparative information under IFRS 9. | N/A |
| **Overlay approach – Transition: Stopping applying the approach** | • An entity would be required to stop applying the overlay approach when it applies the forthcoming insurance contracts standard, and would be permitted to stop in any earlier reporting period. | N/A |
| | • When an entity stops applying the overlay approach, it would reclassify any balance of the prior periods' overlay adjustments accumulated in OCI to retained earnings at the later of the beginning of the earliest reporting period presented or the beginning of the reporting period when the overlay approach was first applied. | N/A |
| **Overlay approach – Redesignating financial assets** | • An entity would be permitted to apply the overlay approach prospectively to a financial asset at the date the financial asset first meets the eligibility criteria. | N/A |
| | • An entity would be required to stop applying the overlay approach to a financial asset when the financial asset no longer meets the eligibility criteria. Any accumulated OCI balance relating to the overlay adjustment on that asset would be immediately reclassified to profit or loss. | N/A |
| **Overlay approach – Presentation and disclosures** | • An entity that applies the overlay approach would present a single line item for the amount of the overlay adjustment in profit or loss, or OCI, or both. An entity may disaggregate the amount of the overlay adjustment in profit or loss. | N/A |
| | • And entity that applies the overlay approach would disclose in each reporting period:<br>– the fact that it has made an overlay adjustment, and the financial assets to which the overlay adjustment relates;<br>– its policy for determining the financial assets for which an overlay adjustment is made;<br>– an explanation of the total amount of overlay adjustments made in each period, in a way that enables users of the financial statements to understand how it is derived; and<br>– the effect of the overlay adjustment on line items in profit or loss, to the extent that they are not separately identified on the face of the profit or loss account. | N/A |


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<table>
<tr><th>What did the IASB discuss?</th><th>What did the IASB decide?</th><th>Is there an identified change to the ED?</th></tr>
<tr><td>Overlay approach – Presentation and disclosures (continued)</td><td>• For financial asset transfers and redesignations of financial assets, an entity would also make the following disclosures.<br>
<table>
<tr><th>For financial assets that are newly in the scope of the overlay approach</th><th>For financial assets removed from the scope of the overlay approach</th></tr>
<tr><td>The amount of overlay adjustment that has arisen in profit or loss and OCI</td><td>The amount of overlay adjustment that would have arisen in profit or loss and OCI</td></tr>
<tr><td></td><td>The amount of overlay adjustment that is due to the reclassification of amounts in accumulated OCI to profit or loss</td></tr>
</table></td><td>N/A</td></tr>
<tr><td>Proposed interim amendment to existing IFRS 4 – Deferral approach</td><td>• IFRS 4 would be amended to defer the effective date of IFRS 9 for certain entities that issue contracts in the scope of IFRS 4.</td><td>N/A</td></tr>
<tr><td></td><td>• An entity that has applied IFRS 9 would not be permitted to stop applying IFRS 9 and revert to applying IAS 39.</td><td>N/A</td></tr>
<tr><td></td><td>• The effective date of the proposed requirements would be for annual reporting periods beginning on or after 1 January 2018. Early adoption would be permitted if an entity adopts IFRS 9 early.</td><td>N/A</td></tr>
<tr><td></td><td>• The expiry date of the deferral approach would be no later than reporting periods beginning on or after 1 January 2021, after which an entity could choose to apply the overlay approach if the forthcoming insurance contracts standard is not yet effective.</td><td>N/A</td></tr>
<tr><td></td><td>• An entity would be permitted, rather than required, to apply the deferral approach.</td><td>N/A</td></tr>
<tr><td>Deferral approach – Eligibility</td><td>• An entity that issues contracts in the scope of IFRS 4 would be permitted to defer the effective date of IFRS 9 if that activity is predominant for the reporting entity. It would apply to all financial assets held by the reporting entity.</td><td>N/A</td></tr>
<tr><td></td><td>• An entity would be required to initially assess whether its insurance activities are predominant, based on:<br>– the level of gross liabilities arising from contracts that are in the scope of IFRS 4; relative to<br>– the entity’s total liabilities at the date when the entity would otherwise be required to initially apply IFRS 9.</td><td>N/A</td></tr>
<tr><td></td><td>• There would be no quantitative threshold for the assessment of predominance of insurance activities; however, the basis for conclusions would include an example specifying the levels at which an entity’s insurance activities would not be considered predominant for the purpose of this assessment.</td><td>N/A</td></tr>
<tr><td></td><td>• An entity would be required to reassess whether insurance activities are predominant for it at subsequent annual reporting dates if there is a demonstrable change in the entity’s corporate structure that could result in a change in its predominant activities.</td><td>N/A</td></tr>
</table>

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| What did the IASB discuss? | What did the IASB decide? | Is there an identified change to the ED? |
|---|---|---|
| **Deferral approach – Eligibility (continued)** | • If, as a result of that reassessment, an entity concludes that insurance activities are no longer predominant for it, then it would be required to:<br>– apply IFRS 9 from the beginning of the next annual reporting period; and<br>– disclose, in the reporting period in which the reassessment took place:<br>- the fact that it is no longer eligible for deferral;<br>- the reason why it is no longer eligible; and<br>- the date on which the change in corporate structure took place that resulted in the entity no longer meeting the predominance condition. | N/A |
| **Deferral approach – Disclosures** | • An entity applying the deferral approach would disclose:<br>– the fact that it has chosen to delay application of IFRS 9;<br>– an explanation of how it concluded that it is eligible for the deferral; and<br>– information about the characteristics and credit quality of financial assets. | N/A |
| **Deferral approach – Transition** | • When an entity applies the deferral approach, it would use the applicable transition provisions in IFRS 9 to the extent needed to provide the disclosures required under the deferral approach. | N/A |
| | • An entity that applies the deferral approach would be permitted to stop applying it and start applying IFRS 9 at the beginning of any annual reporting period before the forthcoming insurance contracts standard is applied. It would be required to do so from the beginning of the annual reporting period in which the forthcoming insurance contracts standard is initially applied. | N/A |
| | • When an entity starts applying IFRS 9, it would follow the transition provisions under IFRS 9, and would stop providing the disclosures required under the deferral approach. | N/A |


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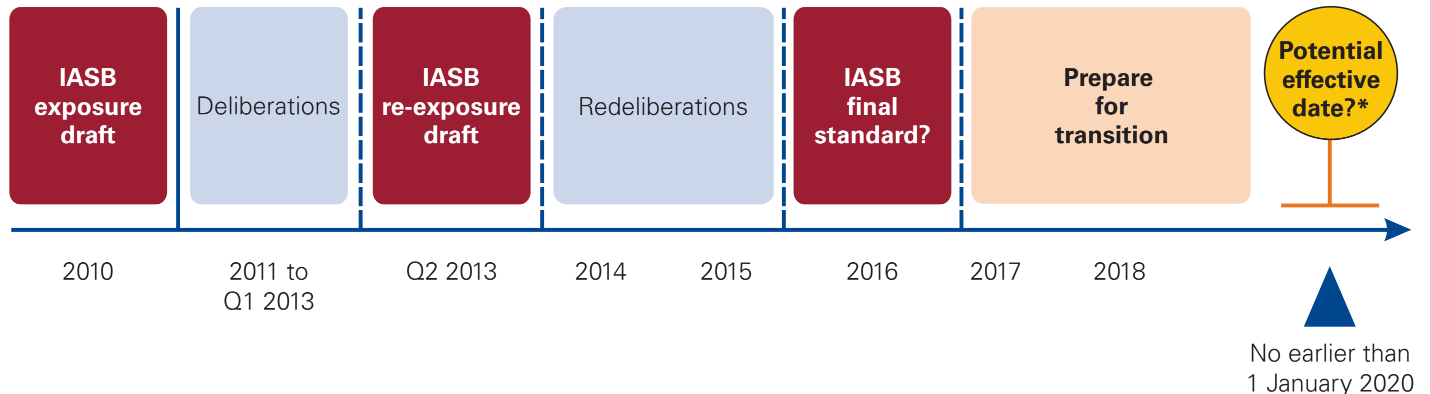
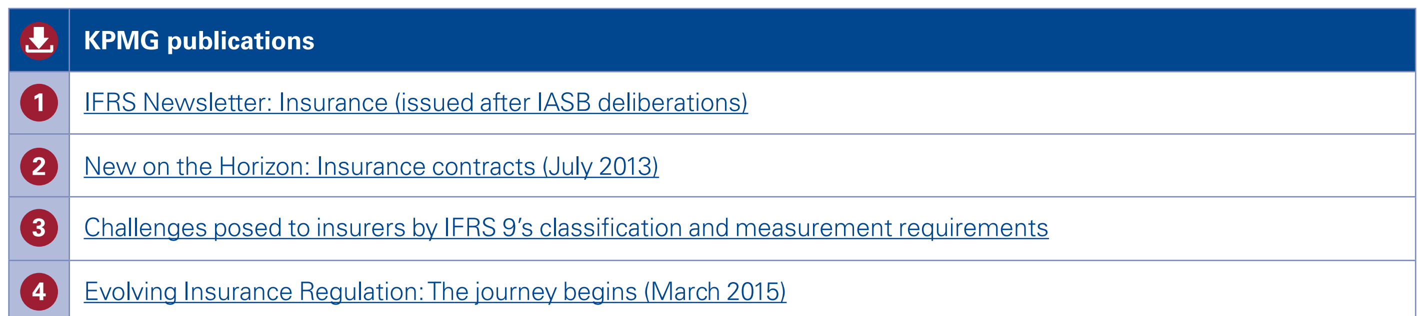
# PROJECT MILESTONES AND TIMELINE FOR COMPLETION

The IASB re-exposed its insurance contracts proposals and issued ED/2013/7 *Insurance Contracts* in June 2013. A final standard is no longer expected during 2015.




* The effective date of the final standard is expected to be approximately three years after the standard is issued. The IASB staff do not expect the final standard to be published before the end of 2015. The mandatory effective date will be considered after the redeliberations on the model for participating contracts have been completed.

Our suite of publications considers the different aspects of the project.



| | KPMG publications |
|---|---|
| 1 | IFRS Newsletter: Insurance (issued after IASB deliberations) |
| 2 | New on the Horizon: Insurance contracts (July 2013) |
| 3 | Challenges posed to insurers by IFRS 9's classification and measurement requirements |
| 4 | Evolving Insurance Regulation: The journey begins (March 2015) |

For more information on the project, including our publications on the IASB's insurance proposals, see our website. You can also find, in the same place, information about the FASB's insurance contracts project before February 2014, when this newsletter stopped following that project. For information on the FASB's project subsequent to February 2014, see KPMG's Issues & Trends in Insurance.

The IASB's website and the FASB's website contain summaries of the Boards' meetings, meeting materials, project summaries and status updates.

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