

PAPER FOR PUBLIC MEETING

This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts*
EFRAG TEG advice to EFRAG Board

Objective

- 1 This paper reflects the discussions of EFRAG TEG during the EFRAG TEG meeting of 4 December 2015 when recommending a draft comment letter on ED/2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* (the ED).
- 2 The session was chaired by Mike Ashley in the absence of Françoise Flores. Andrea Toselli was absent for the entire session and Phil Aspin attended part of the session.

Summary

- 3 EFRAG TEG supported both the overlay approach and the temporary exemption from applying IFRS 9 *Financial Instruments* as optional solutions, as well as the proposed expiry date for the latter option on 1 January 2021.
- 4 In general, EFRAG TEG agreed with the draft answers prepared by EFRAG Secretariat for Questions 1, 2, 3, 5 and 6 of the ED.
- 5 EFRAG TEG expressed mixed views on the appropriate answer to Question 4.

Question 4

- 6 Question 4 of the ED sought views on the proposed temporary exemption from applying IFRS 4 (the deferral approach). The majority of EFRAG TEG members present:
 - (a) supported a quantitative predominance test;
 - (b) considered that the quantitative predominance test should be wider than the predominance test proposed by the IASB; and
 - (c) the quantitative predominance test should be applied below the reporting entity level.
- 7 There was no majority EFRAG TEG view relating to how the level below the reporting entity level should be determined and the accounting for transfers.
- 8 The debate revolved around the items to be included in the predominance formula proposed by the IASB. The IASB proposed that an entity should initially assess whether its predominant activity is issuing contracts within the scope of IFRS 4 based on the carrying amount of its liabilities arising from contracts within the scope of IFRS 4 relative to the total carrying amount of the entity's liabilities (paragraph 20C of the ED).

Predominance criterion: general

- 9 No EFRAG TEG member present supported the predominance formula as defined by the IASB.
- 10 Three EFRAG TEG members supported a holistic approach (Heinz Hense, Sven Morich and Serge Pattyn).
- 11 Seven EFRAG TEG members (Mike Ashley, Christian Chiarasini, Geert Ewalts, Tommaso Fabi, Nicklas Grip, Andrew Spooner, Ambrogio Virgilio) and Hans Schoen, Chairman of the Insurance Accounting Working Group¹, supported a quantitative definition of the predominance criterion that was wider than insurance contracts within the scope of IFRS 4.
- 12 One EFRAG TEG member (Günther Gebhardt) considered that the deferral approach should not be available to any entity with few or no insurance contracts within the scope of IFRS 4. Accordingly, he did not express a view on any of the detailed issues discussed.
- 13 Two EFRAG members did not express a view (Anthony Appleton, Cédric Tonnerre).

Predominance criterion: predominance formula

- 14 All EFRAG TEG members present agreed to include in the numerator and denominator of the proposed predominance formula:
 - (a) insurance contracts issued within the scope of IFRS 4;
 - (b) investment contracts that were unbundled when IFRS 4 was first applied;
 - (c) investment contracts that are measured at FVPL both under IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9; and
 - (d) premium rebates.
- 15 All EFRAG TEG members present (except for Geert Ewalts) and Hans Schoen considered that investment contracts measured at amortised cost should not be included in the numerator of the predominance ratio.
- 16 Six EFRAG TEG members recommended that financial liabilities that are classified as equity for regulatory reporting purposes (for example hybrid instruments and subordinated debt instruments), derivatives, other liabilities such as provisions for employee benefits and current and deferred tax liabilities should be excluded from the numerator and denominator of the predominance formula (Mike Ashley, Phil Aspin, Christian Chiarasini, Tommaso Fabi, Serge Pattyn, Ambrogio Virgilio), whereas three EFRAG TEG members (Geert Ewalts, Heinz Hense, Cédric Tonnerre) and Hans Schoen recommended the opposite position.
- 17 One EFRAG TEG member (Nicklas Grip) recommended the exclusion of derivatives and the inclusion of financial liabilities that are classified as equity for regulatory reporting purposes in the numerator and denominator of the predominance formula. One EFRAG TEG member (Anthony Appleton) recommended the inclusion of derivatives and the exclusion of financial liabilities that are classified as equity for regulatory reporting purposes in the numerator and denominator of the predominance formula.

¹ Hans Schoen, as Chairman of the EFRAG IAWG, has voting rights on insurance matters according to article 28.7 of the EFRAG internal rules.

- 18 Two EFRAG TEG members (Günther Gebhardt, Andrew Spooner) did not express a view.

At or below reporting entity level

- 19 Five EFRAG TEG members (Christian Chiarasini, Tommaso Fabi, Heinz Hense, Andrew Spooner, Ambrogio Virgilio) considered that the predominance test should be applied at reporting entity level.
- 20 Seven EFRAG TEG members (Mike Ashley, Anthony Appleton, Geert Ewalts, Nicklas Grip, Sven Morich, Serge Pattyn, Cédric Tonnerre) and Hans Schoen considered that the predominance test should be applied below the reporting entity level.
- 21 Geert Ewalts preferred a 'Waterfall Approach', i.e. for an entity to start with a predominance test at reporting entity level (widened to include liabilities from investment contracts, derivatives and other business activities) and if it would fall under this scope it is allowed to have a full deferral of IFRS 9. If it would not fall under this scope, it would have to assess if the insurance activities are material and then the predominance test will not be applied at the reporting entity level, but at a lower level.
- 22 One EFRAG TEG member (Günther Gebhardt) did not express a view.
- 23 EFRAG TEG recommended that the draft comment letter should discuss the different levels (at or below reporting entity level) at which IFRS 9 could be applied, with their respective advantages and disadvantages, and include a question to constituents.
- 24 Based on the above views, all EFRAG TEG members present proposed that the draft comment letter should include the following questions to constituents:
- (a) whether financial liabilities that are classified as equity for regulatory reporting purposes and derivatives should be included in the predominance test or excluded;
 - (b) whether the predominance test should be applied at reporting entity level or below reporting entity level or both; and
 - (c) whether the criteria in paragraph 14 above should be included in both the numerator and denominator.

Transfers

- 25 All EFRAG TEG members present considered that, when financial instruments are transferred between an IFRS 9 and an IAS 39 environment, the original accounting should follow the financial instrument transferred and that the draft comment letter should seek the views of constituents on the accounting for transfers.

Additional topics and discussions

First-time adoption of IFRS

- 26 All EFRAG TEG members present considered that the proposed amendment to IFRS 1 *First-time Adoption of IFRS* that prohibited first-time adopters from applying either the deferral or the overlay approach should be amended to permit first-time adopters that already prepare a reporting package based on IFRS for a group to apply either approach. This proposal was based on the consideration that those entities have systems to support IAS 39 and it would be too costly for them to have

to implement an IFRS 9 system when the group as a whole is not doing so. EFRAG TEG members did not support permitting other first-time adopters of IFRS to apply the deferral or the overlay approach.

- 27 It was argued that a first-time adopter that is an entity, included in a group which applies the deferral or overlay approach for consolidated purposes, should be allowed to apply paragraphs D16 and D17 of IFRS 1 and therefore apply the accounting policies used for consolidation purposes, including deferral of IFRS 9 and overlay approach in its individual/separate financial statements.

Overlay approach

- 28 EFRAG TEG discussed whether the overlay approach could be applied to those equity instruments measured using the cost exemption under IAS 39. All EFRAG TEG members present concluded this was acceptable based on the argument that had these instruments been capable of reliable measurement under IAS 39 they would have been accounted for as available for sale which would have resulted in the gains/losses being recognised in other comprehensive income (like the overlay adjustment). Consequently, this would result in the same outcome. In addition, had there been an impairment, then this amount would be recognised in profit or loss under IAS 39.
- 29 EFRAG TEG also discussed whether physically settled derivatives over equity instruments measured using the cost exemption under IAS 39 should be eligible for the overlay approach. Some EFRAG TEG members (Nicklas Grip, Andrew Spooner) present did not agree with the idea of including these specific instruments within the scope. EFRAG TEG did not take an explicit position on the issue.
- 30 On presentation, EFRAG TEG members had different views, but overall preferred a presentation where profit or loss was determined by applying IFRS 9 with an adjustment made to eliminate accounting mismatches.
- 31 EFRAG TEG recommended the inclusion of a question to constituents seeking information on whether they would use the overlay approach.