Insurance alert

IASB meeting on July 20, 2015

Since a variety of viewpoints are discussed at IASB meetings, and it is often difficult to characterize the IASB's tentative conclusions, these summaries may differ in some respects from the actions published in the IASB Observer notes. In addition, tentative conclusions may be changed or modified at future IASB meetings. Decisions of the IASB become final only after completion of a formal ballot to issue a final standard.

Highlights

On 20 July 2015 the IASB made a decision to amend IFRS 4 Insurance Contracts ("IFRS 4") to mitigate accounting mismatches from the adoption of IFRS 9 Financial Instruments ("IFRS 9") before the new insurance contracts standard is issued. The Board voted to permit insurers to exclude from profit and loss and recognize in other comprehensive income the difference between the amounts that would be recognized in profit or loss in accordance with IFRS 9 and the amounts recognized in profit or loss in accordance with IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). In order to be able to use the amendment to IFRS 4 an entity would need to meet criteria determined by the Board. The Board expects to consider further details of the potential amendment to IFRS 4 and the alternative of deferring IFRS 9 at its meeting in September.

Addressing the consequences of different effective dates of IFRS 9 and the new insurance contracts standard: IFRS 4 approach

In May 2015, EFRAG issued its draft endorsement advice for the use of IFRS 9 in the European Union where it advises the European Commission to ask the IASB to defer the 2018 effective date of IFRS 9 for insurance businesses and align it with the effective date of the new insurance contracts standard. At the education session in June 2015 the Board discussed the complexities of the adoption of IFRS 9 before the new insurance contracts standard is issued and two possible alternatives to address the complexities: an "IFRS 4 approach" and deferral of IFRS 9.

At the meeting on 20 July 2015 the Board discussed the IFRS 4 approach.

The Staff recommended that through a proposed amendment to IFRS 4, an entity should be permitted to exclude from profit and loss and recognize in other comprehensive income the difference between the amounts that would be recognized in profit or loss in accordance with IFRS 9 and the amounts recognized in profit or loss in accordance with IAS 39 for certain financial instruments.

The Staff recommended the amendment to IFRS 4 could be used if an entity:

(a) issues contracts accounted for under IFRS 4;
(b) applies IFRS 9 in conjunction with IFRS 4; and
(c) classifies financial assets at fair value through profit or loss in accordance with IFRS 9 when those assets were previously classified at amortized cost or as available-for-sale under IAS 39.

Under this approach, the net effect on profit or loss will reflect the IAS 39 accounting for those specified assets.

The Board unanimously voted in favor of the amendment to IFRS 4 and the criteria to use those amendments. The Board clarified in the vote that the option would only be available for assets relating to insurance activities (and not banking or other non-insurance activities), and only for those assets that would have been classified at amortized cost or available-for-sale under IAS 39 but would be classified at fair value through profit or loss under IFRS 9. The Board recognized that additional scoping considerations would need to be addressed in terms of identifying "insurance activities".

The Board members discussed the following advantages of the approach recommended by the Staff:

- It addresses concerns of preparers around additional temporary volatility in profit or loss as a result of adoption of IFRS 9;
- It results in transparency of the IFRS 9 impact on financial statements;
- It provides for comparability of assets within insurers and also between insurers and other industries;
- It seems to have the support of some investors recently polled who were against deferral of IFRS 9; and
- It is relatively easy to implement.

The Board members expressed mixed views on the cost implications from adoption of the approach. Some believed that maintaining accounting for financial assets within two accounting frameworks would be expensive for preparers while some considered that preparers will have to run accounting under IFRS 9 and IAS 39 at the same time anyway in the transition period.

Some Board members questioned whether the deferral of IFRS 9 would be required if the Board makes the amendment to IFRS 4. Some Board members expressed their view that the amendment to IFRS 4 should be applied at the legal entity level and non-insurance entities (for example, banks) should not be able to use the amendments for gains and losses from their financial assets. Some Board members underlined that disclosures in the case of application of the amendment would be of great importance. The Board asked the Staff to bring those matters for the discussion by the Board at future meetings.

In addition to the recommended approach, the Staff also considered two other potential approaches to amend IFRS 4:

Approach A: Permit a 'shadow adjustment' for the shareholders' interest in assets underlying participating contracts, i.e. an insurance contract liability adjustment would be permitted for the amount of recognized but unrealized gains or losses on the shareholders' interest in assets when there is the equivalent adjustment for the policyholders' share; or

Approach B: Permit a 'shadow adjustment' for non-participating contracts, i.e. the insurance contract liability would be adjusted by recognized but unrealized gains or losses on financial assets designated as backing insurance contracts, even when realized gains or losses on an insurer's assets do not have a direct effect on the measurement of the insurance contract liabilities.

Some Board members expressed support for Approach A arguing that it is similar to the variable fee approach tentatively accepted by the Board. The Board members asked the Staff to bring Approach A to the Board for discussion once all decisions on the application of the variable fee approach are tentatively made.

Some Board members did not support Approach B because they saw it as a new method to account for insurance liabilities, which would not be worth the development and implementation costs given that it would be required only for the period until the new insurance contracts standard is adopted.

The Board asked the Staff to consider the following questions at future meetings:

- The potential deferral of IFRS 9 for insurers to address concerns of stakeholders;
- Possibility to use Approach A to amend IFRS 4 in addition to the approach tentatively agreed by the Board;
- For the approach on amendment of IFRS 4 tentatively agreed by the Board:
  - What operations of a group would be affected by the amendments and how 'assets relating to insurance activities' would be defined;
  - How transfers of assets within a group between insurance and non-insurance entities could affect the financial statements of the consolidated group applying the amendments; and
  - Disclosures required for entities applying the amendments.

The IASB staff noted that there may be a need to consider whether a single approach or a variety of approaches (e.g. a combination of asset and liability based approaches) are necessary to address the issues arising from the application of IFRS 9.

One Board member expressed concern about the fact that the timeline of the project on insurance contracts is uncertain and the Staff commented that they expect the Board to continue the deliberations until the end of 2015 and thus the new insurance contracts standard is not expected to be issued before 2016.

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Contact us:

If you would like to discuss any of the issues raised in this summary, please call or contact Gail Tucker or Mary Saslow or speak with your usual contact at PwC.

Gail Tucker (PwC UK)
Partner
Phone: +44 (0) 207 212 3867
Email: gail.tucker@uk.pwc.com

Mary Saslow (PwC US)
Managing Director
Phone: +1 (860) 241-7013
Email: mary.saslow@us.pwc.com