Australian Government

Australian Accounting Standards Board

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8 February 2016

Mr Hans Hoogervorst
Chair
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Dear Hans

ED/2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*

The Australian Accounting Standards Board is pleased to submit its comments on Exposure Draft ED/2015/11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts Classification of Liabilities*. In formulating its views, the AASB sought and considered the views of its Australian constituents. The AASB's responses to the specific matters for comment in ED/2015/11 are included the Appendix to this letter.

The AASB generally supports the proposals with the exception of the proposed predominance criterion for applying the temporary exemption approach.

The AASB understands that the transition arrangements could lead to relatively less comparable financial statements among insurers. However, the AASB also notes there is currently considerable lack of comparability of insurance accounting across jurisdictions in any case.

The AASB considers the benefits of adopting a reasonably flexible view on the various transition arrangements would outweigh the costs of this concern over comparability. This is consistent with the AASB's response to IASB ED/2013/7 *Insurance Contracts* that, to achieve a single IFRS on insurance contract accounting, the IASB will need to cater for the variety of starting positions in different jurisdictions.

If you require further information on our responses please contact me (+61 3 9617 7615; kpeach@aasb.gov.au) or Angus Thomson (+61 3 9617 7618; athomson@aasb.gov.au).

Yours sincerely

K. E. Peach

Kris Peach
Chair and CEO

/Appendix

Appendix – responses to specific questions in ED/2015/11

Q1 Addressing the concerns raised

Paras BC9-BC21 describe the following concerns raised by some interested parties about the different effective dates of IFRS 9 and the new insurance contracts Standard:

(a) Users of financial statements may find it difficult to understand the additional accounting mismatches and temporary volatility that could arise in profit or loss if IFRS 9 is applied before the new insurance contracts Standard (paras BC10-BC16).

(b) Some entities that issue contracts within the scope of IFRS 4 have expressed concerns about having to apply the classification and measurement requirements in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated (paras BC17-BC18).

(c) Two sets of major accounting changes in a short period of time could result in significant cost and effort for both preparers and users of financial statements (paras BC19-BC21).

The proposals in this ED are designed to address these concerns. Do you agree that the IASB should seek to address these concerns? Why or why not?

AASB comments

1.1 The AASB agrees that the IASB should seek to address the concerns identified.

1.2 Consistent with its response to IASB ED/2013/7 *Insurance Contracts*, the AASB considers that to achieve a single IFRS on insurance contract accounting, the IASB will need to cater for the variety of starting positions in different jurisdictions. Consequently, it is appropriate for the IASB to adopt a reasonably flexible view on the various transition arrangements that might apply in respect of the revised IFRS 4 and IFRS 9.

1.3 In Australia, to the extent feasible under existing IFRS, assets backing insurance liabilities are measured at fair value through profit or loss and a current value model is applied to measuring insurance liabilities. Accordingly, stakeholders in Australia are less concerned about the interplay between IFRS 9 and the revised IFRS 4 than in other jurisdictions.

1.4 However, the IASB's decision-making on the insurance project is not yet complete and it is not yet clear whether insurance liabilities will be able to be recognised and measured at an entirely current value and where the changes in the liabilities will be presented in the statement of comprehensive income. Consequently, in order to avoid accounting mismatches, Australian stakeholders may need to be in a position to re-evaluate their accounting for financial assets once they can assess the full impact of the revised IFRS 4. Please also see our comments on Question 2.

Q2 Proposing both an overlay approach and a temporary exemption from applying IFRS 9

The IASB proposes to address the concerns described in paras BC9-BC21 by amending IFRS4:

(a) to permit entities that issue contracts within the scope of IFRS 4 to reclassify from profit or loss to other comprehensive income some of the income or expenses arising from designated financial assets that:

(i) are measured at fair value through profit or loss in their entirety applying IFRS 9 but

(ii) would not have been so measured applying IAS 39 (the 'overlay approach') see paras BC24-BC25:

(b) to provide an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 (the 'temporary exemption from applying IFRS 9') see paras BC26-BC31.

Do you agree that there should be both an overlay approach and a temporary exemption from applying IFRS 9? Why or why not?

If you consider that only one of the proposed amendments is needed, please explain which and why.

AASB comments

2.1 The AASB agrees that there should be both an overlay approach and a temporary exemption approach because of the wide variety of existing accounting practices currently applied in reporting on insurance liabilities and the assets that back them in various jurisdictions and the need to transition the entities in all these jurisdictions into the revised IFRS 4.

2.2 As noted in our comments on Question 1, Australian entities apply the fair value through profit or loss option in IAS 39 to financial assets that back insurance liabilities and the overlay approach is not relevant.

2.3 Australian entities may be interested in deferring application of IFRS 9 in view of some potential accounting mismatches they would want to evaluate with a full knowledge of the impact of the revised IFRS 4. Provided the final revised IFRS 4 is available well before 2021, the AASB supports having an expiry date of 2021 for the temporary exemption approach. If there were to be a delay in issuing the revised IFRS 4, there may be a need to extend the exemption period.

2.4 The AASB remains a keen supporter of insurers accounting for financial assets at fair value through profit or loss and insurance liabilities being measured using current inputs, with changes in insurance liabilities being recognised in profit or loss. The AASB considers this provides the most useful information to users because it provides transparency around the insurance business. However, the AASB understands there may be a need for Australian insurers to re-evaluate the measurement of at least some financial assets in light of any global consensus that may emerge in respect of the application of IFRS 4 and IFRS 9 for particular classes of business. If such a consensus involved measuring some financial assets at fair value through other comprehensive income:

- * Australian insurers would have an incentive to be part of any such global consensus to achieve comparability with their international peers and therefore seek to re-evaluate their application of IFRS 9 in that light; and
- * the AASB would factor this into its deliberations on whether to carry forward the current Australian requirements to, where feasible under IFRS, measure assets backing insurance liabilities at fair value through profit or loss.

Q3 The overlay approach

Paras 35A-35F and BC32-BC53 describe the proposed overlay approach.

(a) Paras 35B and BC35-BC43 describe the assets to which the overlay approach can be applied. Do you agree that the assets described (and only those assets) should be eligible for the overlay approach? Why or why not? If not, what do you propose instead and why?

(b) Paras 35C and BC48-BC50 discuss presentation of amounts reclassified from profit or loss to other comprehensive income applying the overlay approach. Do you agree with the proposed approach to presentation? Why or why not? If not, what do you propose instead and why?

(c) Do you have any further comments on the overlay approach?

AASB comments

3.1 The AASB has no objection to the manner in which the IASB has structured the overlay approach, including: the description of the assets to which the overlay approach can be applied; and the presentation of a separate line item or note for reclassified amounts.

3.2 The AASB can understand that this approach would be potentially helpful in some other jurisdictions where many financial assets are accounted for at fair value through other comprehensive income. [As noted in our comments on Question 1, Australian entities apply the fair value through profit or loss option in IAS 39 to financial assets that back insurance liabilities and the overlay approach is not relevant.]

3.3 The AASB supports the overlay approach only as a transition arrangement and would not want it to become a permanent feature of IFRS.

Q4 The temporary exemption from applying IFRS 9

As described in paras 20A and BC58-BC60 the ED proposes that only entities whose predominant activity is issuing contracts within the scope of IFRS 4 can qualify for the temporary exemption from applying IFRS 9.

(a) Do you agree that eligibility for the temporary exemption from applying IFRS 9 should be based on whether the entity's predominant activity is issuing contracts within the scope of IFRS 4? Why or why not? If not, what do you propose instead and why?

(b) As described in paras 20C and BC62-BC66, the ED proposes that an entity would determine whether its predominant activity is issuing contracts within the scope of IFRS 4 by comparing the carrying amount of its liabilities arising from contracts within the scope of IFRS 4 with the total carrying amount of its liabilities (including liabilities arising from contracts within the scope of IFRS 4).

(c) Do you agree that an entity should assess its predominant activity in this way? Why or why not? If you believe predominance should be assessed differently, please describe the approach you would propose and why.

Paras BC55-BC57 explain the IASB's proposal that an entity would assess the predominant activity of the reporting entity as a whole (ie assessment at the reporting entity level).

(d) Do you agree with the proposal that an entity would assess its predominant activity at the reporting entity level? Why or why not? If not, what do you propose instead and why?

AASB comments

4.1 The AASB does not agree with the proposed predominant activity criterion because it would arbitrarily prevent some entities from being able to apply the relief and create an additional lack of comparability in the application of IFRS 9.

4.2 There are two classes of entities that would be excluded from the exemption:

* entities that have a mix of businesses, such as wealth management, banking and insurance, where insurance is not the predominant business; and
* entities that operate exclusively or predominantly as insurers but have a funding structure that includes a considerable portion of debt, which may result in their insurance liabilities not being predominant compared with other liabilities.

4.3 Financial statement users are already able to cope with there being different measurement bases applied to financial assets that are used in different businesses within a group. The AASB considers that the temporary exemption approach should be available for financial assets 'designated as relating to contracts that are within the scope of this IFRS' [that is, they relate to contracts that meet the 'insurance contract' definition in IFRS 4], which is a condition for being able to apply the overlay approach.

4.4 The AASB is also concerned that the temporary deferral would allow entities to defer application of IFRS 9 to banking activities where, for example, a group has 'predominantly' insurance activities but also has significant banking activities (explaining, say, 20% of the group's liabilities).

4.5 The AASB understands from the Basis for Conclusions to ED/2015/11 that the IASB is proposing a higher hurdle (predominance) for the temporary exemption approach because it regards the temporary exemption as a major concession and regards the overlay approach as being more transparent. However, the AASB considers that, provided the criterion for applying the temporary exemption is robust, the IFRS should permit that approach.

4.6 The AASB supports the implication in ED/2015/11 (based on paragraphs BC55 to BC57) that the transition approaches would be available on a reporting entity basis – that is, a group entity would apply the chosen approach across the whole group.

4.7 However, the AASB again notes its concern that the temporary deferral, as currently characterised, would allow entities to defer application of IFRS 9 to banking activities where, for example, a group has 'predominantly' insurance activities but also has significant banking activities (explaining, say, 20% of the group's liabilities).

Q5 Should the overlay approach and the temporary exemption from applying IFRS 9 be optional?

As explained in paras BC78-BC81, the ED proposes that both the overlay approach and the temporary exemption from applying IFRS 9 would be optional for entities that qualify. Consistently with this approach, paras BC45 and BC76 explain that an entity would be permitted to stop applying those approaches before the new insurance contracts Standard is applied.

(a) Do you agree with the proposal that the overlay approach and the temporary exemption from applying IFRS 9 should be optional? Why or why not?

(b) Do you agree with the proposal to allow entities to stop applying the overlay approach or the temporary exemption from applying IFRS 9 from the beginning of any annual reporting period before the new insurance contracts Standards is applied? Why or why not?

AASB comments

5.1 The AASB agrees that the approaches should be optional and there should be flexibility around when entities can stop using them because of the very different circumstances in which insurers might find themselves from one jurisdiction to the next.

5.2 The AASB considers there is little harm in making the approaches optional and in having flexibility around when entities can stop applying them. There should be little or no impact on comparability given the current extensive lack of comparability of insurance contract accounting across jurisdictions.

Q6 Expiry date for the temporary exemption from applying IFRS 9

Paras 20A and BC77 propose that the temporary exemption from applying IFRS 9 should expire at the start of annual reporting periods beginning on or after 1 January 2021.

Do you agree that the temporary exemption should have an expiry date? Why or why not?

Do you agree with the proposed expiry date of annual reporting periods beginning on or after 1 January 2021? If not, what expiry date would you propose and why?

AASB comments

6.1 Provided the final revised IFRS 4 is available well before 2021, the AASB supports having an expiry date of 2021 for the temporary exemption approach. If there were to be a delay in issuing the revised IFRS 4, there may be a need to extend the exemption period.