STAFF PAPER

July 2015

REG IASB Meeting

Project	**Insurance contracts**		
Paper topic	Addressing the consequences of different effectives dates of IFRS 9 and the new insurance contracts Standard: IFRS 4 approaches		
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Purpose of paper

1. In June 2015 the IASB discussed the accounting consequences of applying IFRS 9 *Financial Instruments* before the application of the new insurance contracts Standard. In particular, the IASB noted that applying IFRS 9 before the new insurance contracts Standard may lead to additional accounting mismatches and temporary volatility in profit or loss. This paper considers:
   - (a) the extent to which the existing IFRS 4 *Insurance Contracts* already allows an entity to reduce any additional accounting mismatches and temporary volatility in profit or loss that could arise on application of IFRS 9 before the new insurance contracts Standard; and
   - (b) whether the IASB should make amendments to IFRS 4 that would enable entities to reduce these effects further and, if so, what those amendments should be.

Staff recommendations

2. The staff recommend that IFRS 4 *Insurance Contracts* be amended to permit an entity to exclude from profit or loss and recognise in other comprehensive income the

difference between the amounts that would be recognised in profit or loss in accordance with IFRS 9 *Financial Instruments* and the amounts recognised in profit or loss in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* provided that that the entity:

(a) issues contracts accounted for under IFRS 4;

(b) applies IFRS 9 in conjunction with IFRS 4; and

(c) classifies financial assets as fair value through profit or loss in accordance with IFRS 9 when those assets were previously classified at amortised cost or as available-for-sale in accordance with IAS 39.

Structure of this paper

3. This paper:

(a) summarises (in paragraphs 4 to 19) the methods that are available in existing IFRS 4 for reducing any additional accounting mismatches and temporary volatility in profit or loss which could arise when IFRS 9 is applied before the new insurance contracts Standard;

(b) describes (in paragraphs 20 to 29) potential amendments to IFRS 4 that would address any consequences of the effective date of IFRS 9 being before the effective date of the new insurance contracts Standard; and

(c) evaluates (in paragraphs 30 to 48) the approaches to addressing any consequences of applying IFRS 9 that require amendments of IFRS 4.

Approaches to addressing the consequences of applying IFRS 9 before the new insurance contracts Standard within IFRS 4

Existing IFRS 4

Overview

4. The existing IFRS 4 permits entities to reduce some accounting mismatches arising from the measurement of insurance contracts and the measurement of related assets using one or both of the following options:

(a) shadow accounting, discussed in paragraphs 6 to 9; and

(b) use of current market interest rates, discussed in paragraphs 10 to 12.

Those accounting mismatches include those that already exist and any additional mismatches that arise as a consequence of applying IFRS 9.

5. In addition, IFRS 4 permits an entity to change its accounting policies for insurance contracts if the change makes the financial statements more relevant to the economic decision-making needs of users of financial statements. As discussed in paragraphs 13 to 16, this option could be used to reduce any additional accounting mismatches and any temporary volatility arising from the shareholders' interest in underlying assets that arises in profit or loss when entities apply IFRS 9.

Shadow accounting

6. Shadow accounting is a way of adjusting insurance liabilities to reduce accounting mismatches that can arise when unrealised gains and losses on assets held by the entity are recognised in the financial statements but corresponding changes in the measurement of the insurance contract liabilities are not.

7. Paragraph 30 of IFRS 4 permits the use of a form of shadow accounting as follows:

> **Shadow accounting**
>
> In some accounting models, realised gains or losses on an insurer's assets have a direct effect on the measurement of some or all of (a) its insurance liabilities, (b) related deferred acquisition costs and (c) related intangible assets, such as those described in paragraphs 31 and 32[1]. An insurer is permitted, but not required, to change its accounting policies so that a recognised but unrealised gain or loss on an asset affects those measurements in the same way that a realised gain or loss does. The related adjustment to the insurance liability (or deferred acquisition costs or intangible assets) shall be recognised in other comprehensive income if, and only if, the unrealised gains or losses are recognised in other comprehensive income. This

[1] Paragraphs 31 and 32 of IFRS 4 refer to an expanded presentation that splits the fair value of insurance contracts acquired in a business combination or portfolio transfer into (a) a liability measured in accordance with the insurer's accounting policies and; (b) an intangible asset representing the difference between the fair value of the contracts acquired and (a).

> practice is sometimes described as 'shadow accounting'.

8. Thus, shadow accounting is permitted by existing IFRS 4 when there is a direct link between the realisation of assets and measurement of insurance liabilities. This would be the case for participating contracts, including contracts with a direct participation feature.

9. However, shadow accounting under existing IFRS 4 does not reduce accounting mismatches for life contracts without participation features, non-life contracts or contracts with participation features where there is an indirect relationship between realised gains and losses on specified assets and the measurement of insurance liabilities.

Use of current market interest rates

10. Paragraph 24 of IFRS 4 permits insurers to introduce the use of current market interest rates in the measurement of insurance liabilities.

> An insurer is permitted, but not required, to change its accounting policies so that it remeasures designated insurance liabilities[2] to reflect current market interest rates and recognises changes in those liabilities in profit or loss. At that time, it may also introduce accounting policies that require other current estimates and assumptions for the designated liabilities. The election in this paragraph permits an insurer to change its accounting policies for designated liabilities, without applying those policies consistently to all similar liabilities as IAS 8 would otherwise require. If an insurer designates liabilities for this election, it shall continue to apply current market interest rates (and, if applicable, the other current estimates and assumptions) consistently in all periods to all liabilities until they are extinguished.

11. Thus, an entity may change the measurement of some or all insurance contract liabilities to reflect current market rates before the new insurance contracts Standard is applied. The staff also note that many regulatory regimes already require liability measurement using current rates or will require the use of current rates from 2016. None-the-less, the staff understand that there may be significant operational implications of applying the option to measure liabilities using current market interest

[2] Insurance liabilities in this context include related deferred acquisition costs and related intangible assets.

rates for an entity that currently measures insurance contract liabilities on a cost basis (eg, with locked-in discount rates).

12. The use of current interest rates to measure insurance contracts would partially, but not fully eliminate accounting mismatches when the assets are measured using a mix of FVPL, fair value through other comprehensive income (FVOCI) and amortised cost.

Ability to change accounting policies for insurance contracts

13. In addition to shadow accounting and the use of current market interest rates to reduce accounting mismatches, IFRS 4 permits an entity to change its accounting policies for insurance contracts if the change makes the financial statements more relevant[3] to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs.

14. Thus, an entity applying IFRS 4 would be permitted to change its accounting policies to reduce accounting mismatches because the information obtained by comparing changes in the carrying value of assets and liabilities that are measured on different bases (cost and fair value) may not provide a faithful representation of the underlying economic phenomena.

15. The staff also note the IASB issues a new Standard based on the conclusion that the new Standard provides more relevant information than any previous accounting requirements. Therefore, any change in accounting policy that is consistent with the outcome of the application of the new insurance contracts Standard, for example with the outcome of the variable fee approach for direct participation contracts, should be considered to provide more relevant information.

16. To avoid any ambiguity for preparers, the IASB could provide explicit clarification that a change to accounting policies to reduce any additional accounting mismatches and temporary volatility in profit or loss meets the requirements in IFRS 4. Such clarification could be provided, for example, through changes to implementation guidance or examples that support existing IFRS 4.

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[3] The Conceptual Framework defines relevant financial information as that which is capable of making a difference in the decisions made by users. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both.

Summary

17. The following table summarises how the existing methods in IFRS 4 could address any additional accounting mismatches and temporary volatility in profit or loss that arises from applying IFRS 9:

	Accounting mismatches for participating contracts	**Accounting mismatches for non-participating contracts**	**Temporary volatility in profit or loss from shareholders' interest in assets**
Shadow accounting	Reduces accounting mismatch	No reduction in accounting mismatch	No reduction in temporary volatility
Use of current interest rates	Can reduce accounting mismatches when assets are FVPL	Can reduce accounting mismatches when assets are FVPL. Does not reduce effect of economic mismatch in P&L	No reduction in temporary volatility
Voluntary change in accounting policy	Could reduce accounting mismatches	Could reduce accounting mismatches	Could reduce temporary volatility

18. The existing methods in IFRS 4 would not enable an entity to reduce any temporary volatility in profit or loss that arises from the shareholders' interest in financial assets that underlie contracts with direct participation features when those financial assets are measured at FVPL under IFRS 9 and were previously measured at amortised cost or available-for-sale (AFS) under IAS 39.

19. A voluntary change in accounting policy could enable an entity to reduce temporary volatility in profit or loss that arises from the shareholders' interest in financial assets. However, some entities are concerned that any changes to accounting policies under IFRS 4 could be difficult to implement in a limited period of time, and impose costs that would not be commensurate with the benefits, particularly to the extent that some benefits would last for only a few years. Furthermore some constituents are concerned about possible impediments to applying approaches to reducing accounting mismatches and temporary volatility under existing IFRS if the accounting policies of entities are restricted by local regulatory, legal or financial reporting requirements.

Although the effect of local regulations is beyond the scope of IFRS and would need to be taken up with local regulators by reporting entities, some could argue that changes to local regulation for a temporary period are not justified or would be difficult to obtain.

Potential amendments to IFRS 4

20. As described in paragraphs 4 to 16, IFRS 4 already permits entities to reduce accounting mismatches, and may also allow entities to reduce temporary volatility arising in profit or loss arising from application of IFRS 9. Nonetheless, for reasons explained in paragraphs 17 to 19, some are concerned that IFRS 4 does not sufficiently address the concerns raised, in particular regarding any temporary volatility in profit or loss arising from the shareholders' interest in assets underlying participating contracts and any additional accounting mismatches in profit or loss due to assets newly classified at FVPL that back liabilities of non-participating contracts

21. To further address those concerns, the IASB could consider making amendments to existing IFRS 4. Such amendments could enable insurers to reduce or eliminate accounting mismatches and temporary volatility in profit or loss arising from application of IFRS 9 at a lower operational cost. The staff have identified the following possible amendments, that can be broadly described as follows:

    (a) *Permit a 'shadow adjustment' for the shareholders' interest in assets underlying participating contracts:* This amendment would extend shadow accounting so that the insurance contract liability is adjusted by recognised but unrealised gains or losses on the shareholders' interest in assets when there is the equivalent adjustment for the policyholders' share.

    (b) *Permit a 'shadow adjustment' for non-participating contracts:* This amendment would extend shadow accounting so that the insurance contract is adjusted by recognised but unrealised gains or losses on financial assets designated as backing insurance contracts, even when realised gains or losses on an insurer's assets do not have a direct effect on the measurement of the insurance contract.

    (c) *Adjust insurance contracts to offset effects of IFRS 9:* This amendment would permit entities to adjust profit or loss to offset the effects of applying

IFRS 9 in profit or loss that would not persist after the entity applies the new insurance contracts Standard. The adjustment could be taken against other comprehensive income (OCI) or against insurance contract liabilities.

Shadow adjustment for shareholders' interest in underlying assets

22. In shadow accounting, the entity adjusts the insurance contract liability to reflect recognised but unrealised gains and losses on underlying assets, to the extent that those assets have a direct effect on the insurance contract liability. The IASB could amend IFRS 4 to permit an entity to make a similar adjustment for all of the unrealised gains and losses on underlying assets, including those that are attributable to the shareholders of the entity, rather than the policyholder.

23. Applying this approach:

    (a) Adjustments would be made in OCI or profit or loss depending on where unrealised gains and losses on underlying assets are recognised;

    (b) Gains and losses in respect of the shareholders' interest in underlying assets held by the entity would be recognised in profit or loss on realisation of those assets.[4]

24. As a result, the effect of changes in the fair value of the underlying assets that might otherwise be recognised in profit or loss or OCI in respect of unrealised gains and losses on the shareholders' interest in underlying assets would be eliminated.

25. The following example illustrates the mechanics for such an approach:

Example of shadow adjustments for shareholders' interest in underlying assets (when IFRS 9 is applied)

Assumptions:

a) Policyholders have a right to receive 90% of income and realised gains from a specified pool of financial assets

b) Financial assets are classified as 50% FVOCI and 50% FVPL

[4] In contrast, the staff note that gains and losses that adjust the contractual service margin in the variable fee approach would be recognised in profit or loss through allocation on the basis of time.

c) Unrealised gains arise on the financial assets of CU100

d) Tax is ignored in this example

Without shadow accounting

Dr assets	100	
Cr P&L – unrealised gains		50
Cr OCI – unrealised gains		50

With shadow accounting as currently applied per IFRS 4

Dr assets	100	
Cr deferred policyholder liability		90
Cr P&L – unrealised gains		5
Cr OCI – unrealised gains		5

100% Shadow accounting

Dr assets	100	
Cr deferred policyholder liability		90
Cr additional shadow liability		10

Shadow accounting for assets backing non-participating insurance contracts

26. In this approach the entity would be permitted to adjust the insurance contract liability by recognised unrealised gains and losses on the assets designated as backing insurance contracts, even when there is no direct relationship in the contract with the assets, eg, in non-life insurance contracts, life insurance contracts without participation features, or indirect participation contracts. For example, unrealised gains on debt securities measured at FVPL that are deemed to be held in respect of non-participating insurance contracts would give rise to an offsetting adjustment in profit or loss and corresponding insurance contract liabilities.

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

27. This approach would permit entities to recognise an adjustment to profit or loss in order to offset the effect on profit or loss of applying IFRS 9 instead of IAS 39.

28. This approach would, in effect, result in the deferral of the effects of application of IFRS 9 in profit or loss prior to applying the new insurance contracts Standard while ensuring that the improved information provided by IFRS 9 would be in the statement of financial position, line items within the statement of comprehensive income and disclosures. For example, if the overall effect on profit before tax of applying IFRS 9 to a defined set of financial assets under IFRS 9 was to increase profit by CU100, the following adjustment could be made in a single line item in profit or loss:

Dr	profit or loss	CU100	
Cr	OCI or insurance contract liability		CU100.

29. There are several potential variations to this approach, for example:
    (a) adjustments to profit or loss could be recognised in OCI or as an adjustment to insurance contract liabilities;
    (b) the approach could be applied to all financial assets held by eligible entities or only a subset of those assets.

Evaluation of approaches to amending IFRS 4 in order to address the consequences of applying IFRS 9 before the new insurance contracts Standard

30. The following paragraphs consider whether the potential approaches to addressing any additional accounting mismatches and temporary volatility arising from shareholders' interest in underlying assets would:
    (a) be effective in addressing both of these issues and would target only those issues;
    (b) not require extensive operational change that is not needed to apply IFRS 9 or the forthcoming insurance contracts Standard;

(c) can be easily explained to, and understood by, users of financial statements as a temporary measure to address any consequences of different effective dates for IFRS 9 and the new insurance contracts Standard; and

(d) can be finalised expeditiously by the IASB so that entities could be provided with certainty and clarity as soon as possible.

31. None of the approaches considered in this paper alter the accounting for financial assets. Each approach would therefore result in all financial assets being accounted for in accordance with IFRS 9, consistently with financial assets issued by other entities. Accordingly, none of the approaches considered in this paper creates the risk that entities continue to apply IAS 39 to assets relating to non-insurance activities that an entity undertakes, in particular assets relating to banking activities.

Shadow adjustments for shareholders' interest in underlying assets

32. As noted in paragraphs 6 to 9, shadow adjustments in respect of the shareholders' interest in assets that underlie participating contracts, would be effective in eliminating temporary volatility in profit or loss. However such adjustments:

(a) would not reduce accounting mismatches for non-participating insurance contracts.

(b) would adjust profit or loss to remove some of the effect of changes in the fair value of underlying assets that may currently be reflected in profit and loss under IAS 39. Such effects could arise, for example if the underlying assets are already required to be measured at FVPL. Therefore, this amendment could overcompensate for the change that arises from applying IFRS 9.

33. The staff note that although this amendment would be consistent with the outcome of the variable fee approach as tentatively agreed in the June 2015 board meeting, the contracts eligible for the variable fee approach may differ from the contracts to which shadow accounting may be applied. Thus it is possible that this amendment may eliminate the effect of changes in the fair value of the underlying assets that may currently be reflected in profit and loss, and may eliminate volatility in profit or loss that is not temporary but would otherwise persist after the new Standard is applied.

34. The IASB staff do not expect that identifying the shadow adjustments for the shareholders' interest in underlying assets would require significant operational effort. This is because this approach would be applied only by entities that already apply shadow accounting that is permitted by IFRS 4 to the insurance contracts and related assets to which they apply shadow accounting. Accordingly, such entities would already need to identify the policyholder share of unrealised gains and losses. Thus, instead of recognising, for example, 90 per cent of unrealised gains on underlying assets as a shadow liability, an entity would recognise an amount equal to 100 per cent of such unrealised gains in liabilities.

Shadow accounting for assets backing non-participating insurance contracts

35. Shadow adjustments for assets backing non-participating contracts would be effective in reducing any additional accounting mismatches for non-participating contracts. However:

    (a) it could also potentially obscure the effect of any economic mismatches in profit or loss as well; as described in paragraph 36. This is because it would adjust insurance liabilities by all changes in the fair value of assets deemed to back non-participating insurance contracts – including the effect of factors that affect only financial assets. In addition, this approach would adjust insurance liabilities to remove some unrealised gains and losses that are currently reflected in profit and loss under IAS 39, for example if the assets are already required to be measured at FVPL. Thus it is possible that this amendment could overcompensate for the consequences of applying IFRS 9 and obscure the effect of economic mismatches in profit or loss that are currently reported in profit or loss; and

    (b) it would not reduce temporary volatility in profit or loss represented by the shareholder's share of financial assets underlying contracts with direct participation features.

36. As noted in paragraph 35(a), measuring financial assets backing non-participating insurance contracts at FVPL could result in accounting mismatches when the insurance contract is measured using locked-in discount rates, but would also reflect economic mismatches. To illustrate this point further, consider a debt instrument that

does not have payments that are 'solely principal and interest'. That debt is held by the entity to fund expected cash flows for a non-participating insurance contract measured on a cost basis. In this case there may be no change in the measurement of the liability when market interest rates change, but there would be a remeasurement of the debt instrument – with the effect presented in profit or loss. Part of the volatility in profit or loss would be economic (the fair value of the feature that is not principal and interest, including any duration mismatches) but part would be an accounting mismatch (the change in the fair value of assets due to interest rate changes). Making a shadow adjustment to ensure there is no net effect in profit or loss when interest rates change could give the misleading impression that liabilities track assets in non-participating contracts more closely than is in fact the case.

37. The staff note that this approach could require operational change that is not needed to apply either IFRS 9 or the forthcoming insurance contracts Standard, as follows:

    (a) because this approach would apply to contracts where there is no direct link between the insurance contract liability and specific assets, an entity would need to designate the assets that would give rise to adjustments to non-participating insurance contract liabilities, ie, determine which assets back insurance contract liabilities as opposed to those that represent surplus. As discussed in Agenda Paper 2A, it is difficult for standard setters to identify appropriate assets that back non-participating contract liabilities and potentially arbitrary for preparers to do so.

    (b) the application of shadow accounting for assets backing contracts without direct participation features would require entities to track the assets that back non-participating contracts. Such tracking would not be required to apply the proposed new Standard or existing IFRS 4.

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

38. This approach in effect defers the profit or loss effect of applying IFRS 9 to financial assets newly classified as FVPL under IFRS 9. Accordingly, it would be effective in reducing accounting mismatches for participating and non-participating contracts, and eliminate the temporary volatility in profit or loss arising from applying IFRS 9.

39. At the same time, a key advantage of this approach is that it provides information about financial instruments that is comparable with the information that is provided by all entities, ensures that all financial instruments within a reporting entity are reported consistently, and eliminates the need for any complex transfer, scoping or transition requirements for insurance entities.

40. As noted in paragraph 29, there are several potential variations to this approach. However:

    (a) the staff note that, in many circumstances, adjusting OCI would result in the same statement of comprehensive income and the same equity as would have been the case under IAS 39. In contrast, adjusting the insurance liability would be consistent with the variable fee approach agreed by the IASB at its June 2015 meeting. Therefore, adjusting OCI would be easier to explain to users of financial statements in the period before the new insurance contracts Standard is applied, and would be capable of wider applicability. Accordingly, the staff propose to adjust the profit or loss effect of applying IFRS 9 in OCI rather than insurance contract liabilities.

    (b) The staff propose that adjustments should be restricted to financial assets that are newly classified as FVPL as a result of applying IFRS 9, in order to target the identified issue. It would also have the advantage that other aspects of IFRS 9 would not be reversed, eg the profit or loss effect of the IFRS 9 impairment model on assets measured at amortised cost and FVOCI.

    (c) The staff propose that this approach should not be restricted to assets that underlie participating contracts, to allow entities to both reduce accounting mismatches in non-participating contracts, and to eliminate temporary volatility arising from the shareholder's interest in underlying assets.

    (d) The staff propose that this approach should not be restricted to assets designated to back contracts within the scope of IFRS 4 because this would require an entity to distinguish between surplus assets and those held to back non-participating insurance contracts. The staff believe that in many cases such a choice would be essentially arbitrary and consequently difficult for users to understand.

41. Any permission to apply the approach described in paragraphs 27 to 29 would, as a minimum, be restricted to entities that issues contracts within the scope of IFRS 4. If the IASB tentatively decides to allow such an option, the staff will consider at a later meeting, potentially in conjunction with any discussion on deferral of the effective date of IFRS 9, whether the scope should be restricted further.

42. Financial assets within the scope of this approach would need to include those purchased after the application of IFRS 9 for consistency between similar assets. As a result, entities would need to develop criteria for determining whether an asset measured at FVPL under IFRS 9 would have been different under IAS 39. The criteria would need to be consistent with practice under IAS 39.

Parallel running IFRS 9 and IAS 39 accounting systems

43. The staff note that an approach that adjusts profit or loss for the effects of applying IFRS 9 would require that entities identify financial assets measured at FVPL under IFRS 9 that would have been classified at amortised cost or as AFS under IAS 39. An entity would need to:

    (a) track these assets;

    (b) maintain a record of the accounting under IAS 39; and

    (c) compare the accounting and generate journals to eliminate the profit or loss effect of the difference.

44. Parallel running of IAS 39 and IFRS 9 for relevant financial assets may require changes to the reporting processes and systems of insurers. However, the benefits of changes to apply IFRS 9 would persist after the new insurance contracts Standard is applied, and in most cases, information would already exist under IAS 39 (eg the fair value of assets would already be required where those assets are measured at AFS or amortised cost). Furthermore, as discussed in Agenda Paper 2A, the staff expect that any approach the IASB permits to address these issues would result in the requirement to hold information about the effects of applying IFRS 9 to financial instruments within the scope of IFRS 9, so this cost is likely to arise for all approaches that the IASB might consider.

45. This approach could be explained to users of financial statements as providing:

(a) Information about financial instruments on a consistent basis with other entities; and

(b) Profit or loss that is consistent with the profit or loss previously reported under IAS 39 and IFRS 4.

46. The adjustment could be explained as the bridge between these two measures.

Summary evaluation of options to amend IFRS 4

47. The staff summarise the relative merits of each approach in the following table

	When effective?	Favourable aspects	Unfavourable aspects	Other aspects
A. Shadow adjustments for shareholders' interest in underlying assets for contracts with direct participation features	• Reducing temporary volatility in P&L for shareholder's interest only	• Consistent application of IFRS 9 to all assets • No significant effort to apply for entities that apply shadow accounting under existing IFRS 4 • Easy to identify the relevant assets • Does not require an entity to continue to apply IAS 39 after applying IFRS 9	• Eliminates volatility in P&L and OCI that exists today (ie not limited to changes to FVPL classification by IFRS 9) • Unrealised gains on shareholder interest in assets increase liabilities (decrease equity) compared with existing IFRS 4	• Scope of a shadow adjustment may differ from the variable fee approach so not limited to eliminating *temporary* volatility

	When effective?	Favourable aspects	Unfavourable aspects	Other aspects
B. Shadow accounting for assets backing non-participating insurance contracts	• Reducing accounting mismatches in P&L between assets at FVPL and liabilities on a cost basis only	• Consistent application of IFRS 9 to all assets • Does not require an entity to continue applying IAS 39 after applying IFRS 9	• Eliminates SCI effect of economic mismatches between assets and non-par liabilities to the extent that assets are FVPL or AFS under IAS 39 • Difficult for standard setters to identify appropriate assets that back non-participating contract liabilities and potentially arbitrary for preparers to do so • Introduces operational complexity for preparers that do not necessarily track assets that back non-participating insurance contracts	• Current interest rate adjustment to liability is consistent with direction of the new Standard but other aspects are inconsistent, eg, effect of change in credit spreads on assets backing non-par

	When effective?	Favourable aspects	Unfavourable aspects	Other aspects
C. Apply IFRS 9: adjust P&L and OCI to offset P&L effect of applying IFRS 9 for **all asset types held by the entity classified as FVPL** as a result of applying IFRS 9	• Reducing temporary volatility in P&L for shareholders' interest in underlying assets • Reducing accounting mismatches in P&L between assets at FVPL and liabilities on a cost basis for non-participating insurance contracts	• Consistent application of IFRS 9 to all assets • Provides IFRS 9 information in income statement (with a separate line adjustment to apply this approach • Addresses both of the main issues arising from applying IFRS 9 before applying the new insurance contracts Standard • Does not require identification of assets backing non-participating insurance contracts • Does not eliminate P&L volatility that exists today • Does not affect equity	• Requires parallel running of IAS 39 and IFRS 9 for a longer period than otherwise required – for a potentially large number of financial assets • Effort to track a sub set of assets [eg those classified differently under IFRS 9]	• Effect of economic mismatches for surplus / shareholder assets and those backing insurance contracts, eg, non-participating contracts, will continue not to be reported in P&L prior to realisation • Deciding how assets purchased after IFRS 9 application would have been classified under IAS 39 will require controls. • Avoids need to identify assets backing non-participating contracts but would need a scope to exclude assets used for banking and other non-insurance activities (eg, in a conglomerate)

Staff recommendation

48. In assessing each approach identified in the table in paragraph 47, the staff placed weight on the factors described in paragraph 30, as follows:

   (a) approaches that address both the additional accounting mismatches and temporary volatility in profit or loss that remain after the existing options in IFRS 4 have been applied are preferable to those that address only one or the other. This counts against approaches (A) and (B).

   (b) Approaches that do not require extensive operational change that is not otherwise needed to apply IFRS 9 or the forthcoming insurance contracts Standard are preferable. This factor counts against approach (B) which requires entities to identify and track assets backing non-participating contracts. Approach (C) would require an entity to continue applying IAS 39 after applying IFRS 9, but as described in paragraph 44, this may not be onerous for many entities and is unlikely to be limited to these approaches due to the disclosures likely to be needed for comparability.

   (c) The staff think it is important that any approach is easily explained to, and understood by, users of financial statements as a temporary measure to address the consequences of different effective dates for IFRS 9 and the new insurance contracts standard. This is particularly important because the main argument raised as a basis for the IASB to address the consequences of different effective dates for IFRS 9 and the new insurance contracts Standard is the usefulness of the information provided to users of financial statements. The staff believe that understandability is enhanced if it can be explained in terms of existing accounting requirements, rather than pre-empting new accounting requirements, and if it maximises comparability between entities. In addition, the staff note that approach (B) could create the misleading impression that liabilities for non-participating contracts track assets as described in paragraph 36. Similarly, approach (A) might also eliminate

economic volatility that is reported today and would still be reported when the insurance contracts Standard is applied. Accordingly, the staff reject approaches (A) and (B).

Question to board members

Does the IASB agree that, when an entity

(a) issues contracts accounted for under IFRS 4 *Insurance Contracts;*

(b) applies IFRS 9 *Financial Instruments* 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 amortised cost or as available-for-sale under IAS 39 *Financial Instruments: Recognition and Measurement*.

the entity should be permitted to exclude from profit and loss and recognise in other comprehensive income the difference between the amounts that would be recognised in profit or loss in accordance with IFRS 9 and the amounts recognised in profit or loss in accordance with IAS 39?