STAFF PAPER

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IASB Meeting

Project	**Amendments to IFRS 4: Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts***
Paper topic	Reassessment of eligibility for the temporary exemption from applying IFRS 9

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Purpose of this paper

1. The purpose of this paper is to consider the circumstances in which an entity may be required or permitted to reassess its eligibility for the temporary exemption from applying IFRS 9 (the temporary exemption).

2. This paper discusses whether the proposals for the reassessment of eligibility for the temporary exemption included in the Exposure Draft *Applying IFRS 9* Financial Instruments *with IFRS 4* Insurance Contracts (Amendments to IFRS 4) (the ED) should be amended in the light of:

   (a) the feedback received in comment letters and other outreach; and/or

   (b) the effect of tentative decisions that the Board made at its April 2016 meeting related to an entity's *initial* assessment of its eligibility for the temporary exemption.

Staff recommendations

3. The staff recommendations are as follows:

   (a) An entity that is eligible for the temporary exemption from applying IFRS 9 should be *required* to reassess whether its activities are still predominantly related to insurance if, and only if, there has been a demonstrable change in the corporate structure of the entity that could result in a change in the predominant activities of the entity (for example, the acquisition or disposal of a business).

   (b) An entity that is required to reassess its eligibility for the temporary exemption should compute the predominance ratio using the carrying amounts of the liabilities reported on the entity's balance sheet at the end of the annual reporting period immediately following the change in corporate structure discussed in 3(a).

   (c) If, as a result of such a reassessment, an entity concludes that its activities are no longer predominantly related to insurance, the entity should be required:

      (i) to apply IFRS 9 from the earlier of:

         1. its second annual reporting period that begins after the change in corporate structure that resulted in a change to the entity's predominant activities; and

         2. its annual reporting period that begins on or after the fixed expiry date of the temporary exemption. (May 2016 Agenda Paper 14C *Fixed expiry dates and other aspects of the temporary exemption and the overlay approach* considers what that fixed expiry date should be).

      (ii) to disclose in the annual reporting period in which it reached that conclusion and in the subsequent annual reporting period before it applies IFRS 9:

         1. the fact that it is no longer eligible to apply the temporary exemption;

         2. the reason why it is no longer eligible; and

3. the date on which the change in corporate structure occurred that made it ineligible.

(d) An entity that previously was not eligible for the temporary exemption should be *permitted* to reassess its eligibility if and only if there has been a demonstrable change in the corporate structure of the entity before the mandatory effective date of IFRS 9 that could result in a change in the predominant activities of the entity (for example, the acquisition or disposal of a business).

(e) An entity that is permitted to reassess its eligibility for the temporary exemption should compute the predominance ratio using the carrying amounts of the liabilities reported on the entity's balance sheet at the end of the annual reporting period immediately following the change in corporate structure discussed in 3(d).

(f) An entity that becomes eligible for the temporary exemption applying paragraph 3(d) should disclose, as part of its explanation on how it concluded that it is eligible for the temporary exemption (paragraph 37A(b) of the ED):

(i) the reason for the reassessment;

(ii) an explanation of the change in its predominant activities; and

(iii) the date on which the change in corporate structure occurred that made it eligible.

(g) For the purposes of applying paragraphs 3(a) and 3(d), a demonstrable change in the entity's corporate structure that could result in a change in the entity's predominant activities must be significant to its operations and demonstrable to external parties.

ED proposals for reassessing an entity's eligibility for the temporary exemption

4. Paragraph 20D of the ED sets out the following proposals for initially assessing and subsequently reassessing eligibility for the temporary exemption:

(a) An entity would initially assess whether it is eligible for the temporary exemption on the date when the entity would otherwise be required to apply IFRS 9. The Board tentatively decided at its meeting in April 2016 to amend this proposal and require an entity to assess its eligibility using the carrying amounts of the liabilities reported on its balance sheet at the annual reporting date between 1 April 2015 and 31 March 2016 (the initial assessment date). This paper does not reconsider the initial assessment date but includes it only for context.

(b) At the end of annual reporting periods subsequent to initial assessment, an entity applying the temporary exemption would reassess its eligibility only if there is a demonstrable change in the corporate structure of the entity (for example, an acquisition or disposal of a business that could result in a change in the predominant activity of the entity). The Basis for Conclusions (paragraph BC68) noted that an entity is not permitted or required to perform a reassessment if there is merely a change in the level of insurance liabilities relative to total liabilities because such a change, in the absence of other events, would be unlikely to indicate a change in the predominant activities of the entity.

(c) If, as a result of a reassessment, an entity concludes that it is no longer eligible to apply the temporary exemption, the entity would apply IFRS 9 from the beginning of its next annual reporting period. The Board noted in its discussions when developing this proposal that a demonstrable change in corporate structure is not a sudden event and therefore, an entity could prepare to implement IFRS 9 during the process.

Feedback received in comment letters and other outreach

5. The ED did not ask a specific question about the proposals related to reassessment. However, some respondents provided feedback on those proposals and, in general, did not support them. This is because they believed that there would be insufficient time to apply IFRS 9 from the beginning of the annual

period immediately after the entity determines it no longer qualifies for the temporary exemption. In particular, some expressed concern about the quality of the accounting information that could result from what they considered to be a 'rushed' implementation of IFRS 9. Some suggested that the implementation of IFRS 9 would require a period of approximately three years from the date that the entity determines it is no longer eligible for the temporary exemption.

Staff analysis and recommendations

6. This paper considers the following issues related to an entity's reassessment of its eligibility for the temporary exemption:

   (a) If an entity previously determined that it is eligible for the temporary exemption, should it be *required* to reassess its eligibility and, if so, under what circumstances? This is discussed in paragraphs 7-12.

   (b) If, as a result of a reassessment, an entity is no longer eligible for the temporary exemption, from what date should it apply IFRS 9 and what information should it disclose? This is discussed in paragraphs 13-24

   (c) If an entity previously determined that it is not eligible for the temporary exemption, should it be *permitted* to reassess its eligibility before the mandatory effective date of IFRS 9 and if so, under what circumstances and what information should it disclose? This is discussed in paragraphs 25-31.

   (d) Should additional application guidance be provided to describe the circumstances in which an entity is required or permitted to reassess its eligibility for the temporary exemption? This is discussed in paragraphs 32-34.

Mandatory reassessment of eligibility

7. As noted above, the ED proposed that:

   (a) an entity would be required to reassess its eligibility if, and only if, there is a demonstrable change in the corporate structure of the entity during the annual reporting period (for example, the acquisition or disposal of a business that could change its predominant activities); and

(b) the reassessment would take place at the end of the annual reporting period in which the change in corporate structure noted in paragraph 7(a) takes place.

8. The staff recommend that the Board confirm these proposals. If the entity's activities are no longer predominantly related to insurance (for example, if the entity acquires a bank), the staff thinks that the entity should no longer be eligible for the temporary exemption and therefore should be required to apply IFRS 9. That is because the temporary exemption has been developed for a specific population of entities and if the entity is no longer within that scope the staff thinks it should apply IFRS 9.

9. Consistent with the proposals in the ED, the staff recommend that an entity would not be required to perform a reassessment if there is merely a change in the level of insurance liabilities relative to total liabilities. That is because such a change, in the absence of other events, would be unlikely to indicate a change in the predominant activities of the entity.

10. The staff expect that a demonstrable change in the corporate structure of an entity applying the temporary exemption will occur infrequently and therefore a requirement to perform a reassessment only in these circumstances will not be unduly burdensome. We think that the proposal in the ED will appropriately identify those circumstances in which the entity's activities are no longer predominantly related to insurance without requiring an entity to incur the costs and effort to assess its eligibility on an annual basis.

11. The staff note that the Board tentatively decided at its meeting in April 2016 that an entity would initially assess its eligibility for the temporary exemption using the carrying amounts of its liabilities at the annual reporting date between 1 April 2015 and 31 March 2016. As a result, the recommendation discussed above would apply to any demonstrable change in the entity's corporate structure that occurs after that initial assessment date.

12. The predominance ratio is computed using the amounts reported on an entity's annual balance sheet at the assessment date. Consequently, a reassessment of

whether an entity's predominant activities relate to insurance would require the predominance ratio to be computed on the amounts reported in the entity's annual balance sheet immediately after the change in corporate structure.

Lead time necessary to apply IFRS 9 if an entity determines it is no longer eligible for the temporary exemption

13. The ED proposed that if an entity is no longer eligible for the temporary exemption as a result of a reassessment, the entity would apply IFRS 9 from the beginning of its next annual reporting period. Most stakeholders that commented on this proposal said that it would give them insufficient time to implement IFRS 9 and asked the Board to provide a longer implementation period, for example, three years (as discussed in paragraph 5).

14. The staff note that in finalising IFRS 9, the Board decided to allow at least three years from the issuance of IFRS 9 to its mandatory effective date and, consequently, entities are required to apply IFRS 9 for annual reporting periods beginning on or after 1 January 2018. In reaching that decision, the Board considered that the mandatory effective date of IFRS 9 reflected the time and effort required to implement the new impairment requirements.

15. However, if an entity is no longer eligible for the temporary exemption as a result of a reassessment, the staff do not think it will require three years from that reassessment date to implement IFRS 9. That is because:

    (a) The completed version of IFRS 9 was issued in July 2014 and therefore will have existed in its final form for more than two years before the earliest possible reassessment date;

    (b) Market understanding and experience related to applying IFRS 9 has developed significantly since the Standard was issued in 2014 – and will be available to entities required to apply IFRS 9 after a reassessment; and

    (c) All entities that apply the temporary exemption will need to eventually apply IFRS 9 after the fixed expiry date and therefore will need to prepare for that implementation. Therefore, entities applying the temporary exemption presumably will have already begun some preparations to implement IFRS 9 before a reassessment.

16. The staff also note that the amount of time an entity has to implement IFRS 9 will reflect not only the lead time that the Board permits after the reassessment date but also will reflect:

    (a) The time period between when the entity decides to pursue a change in its corporate structure that could change its predominant activities (eg an acquisition or a disposal of a business) and when such a change actually occurs; eg an entity may anticipate that its corporate structure will change long before such a change takes place and will need sufficient time to identify opportunities, perform due diligence investigations, obtain regulatory approvals and amend employment and/or other contracts, etc. The staff think that an entity that expects such a change in its structure would begin intense preparations for implementing IFRS 9.

    (b) The time period between a change in an entity's corporate structure and the reassessment of its eligibility for the temporary exemption, eg the change in corporate structure may occur at or close to the beginning of the entity's annual reporting period and, as recommended in paragraph 7, an entity would be required to reassess its eligibility for the temporary exemption only at the end of the annual reporting period.

17. The staff acknowledge that unexpected opportunistic or urgent corporate transactions can arise. However, the staff would not expect opportunistic transactions to change an entity's predominant activities, eg, an insurer is unlikely to buy a significant banking business on an opportunistic basis, and even 'urgent' transactions are often preceded by circumstances or events that indicate that a demonstrable change in an entity's corporate structure is possible.

18. However, the staff acknowledge the feedback that an entity may not have sufficient time to prepare if it is required to apply IFRS 9 from the beginning of its annual reporting period <u>immediately</u> after the entity determines it no longer qualifies for the temporary exemption. The staff can envisage that there are circumstances, for example, in which an entity has a purchase or sale of a business

that takes place close to the end of annual reporting period, which could leave little time for the entity to complete its preparations for implementing IFRS 9.

19. However, the staff think that a lead time of two years in addition to the time noted in paragraphs 16(a) and 16(b) is unnecessary. The staff think that a lead time of one year between the reassessment date and the beginning of the annual reporting period when the entity must apply IFRS 9 is sufficient. For example, if an entity with a calendar year end changes its corporate structure in 2018 such that its predominant activities are no longer related to insurance, it must apply IFRS 9 on 1 January 2020.

20. This recommendation will be subject to when the entity is required to cease applying the temporary exemption. In particular, all entities that apply the temporary exemption must apply IFRS 9 at the latest by the fixed expiry date. In other words, this recommendation will be 'capped' by that expiry date.

Disclosures

21. The ED proposed, in paragraph 37B, that an entity that is required to apply IFRS 9 because it no longer meets the qualifying criteria for the temporary exemption should disclose in the annual reporting period in which it reached that conclusion:

    (a) the fact that it is no longer eligible to apply the temporary exemption;

    (b) the reason why it is no longer eligible; and

    (c) the date on which the change in corporate structure occurred that made it ineligible.

22. The ED did not ask a specific question about these proposed disclosures and respondents did not specifically comment on them.

23. The staff recommend that the Board confirms this disclosure because it would assist users of financial statements in understanding the change in corporate structure that has affected the entity's eligibility for the temporary exemption. The staff recommend that the disclosure is required for all annual reporting periods following the change in corporate structure until the entity applies IFRS 9.

24. As a final observation, the staff note that, in this month's Agenda Paper 14C, the staff are recommending that the Board confirms the ED's proposed effective date of the temporary exemption as 2018. Accordingly, an entity applying the

temporary exemption will be required to provide the applicable disclosures, including those recommended in this paper, from 2018 onwards. Prior to 2018, the staff think that an entity intending to apply the temporary exemption will have to disclose when the amendment to IFRS 4 is effective and its impact; and when IFRS 9 is effective for it and its impact in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8). IAS 8 paragraph 30 requires disclosure when an entity has not applied a new Standard that has been issued but is not yet effective. This disclosure includes the fact that a Standard has not yet been applied and its estimated impact on the financial statements.

Questions – mandatory reassessment of eligibility for the temporary exemption

1 Does the Board agree that:

(a) an entity that is eligible for the temporary exemption from applying IFRS 9 should be required to reassess whether its activities are still predominantly related to insurance if and only if there has been a demonstrable change in the corporate structure of the entity that could result in a change in the predominant activities of the entity (for example, the acquisition or disposal of a business); and

(b) an entity should compute the predominance ratio using the carrying amounts of the liabilities reported on the entity's balance sheet at the end of the annual reporting period immediately following the change in corporate structure?

2 Does the Board agree that if, as a result of a reassessment, an entity concludes that its activities are no longer predominantly related to insurance the entity should be required:

(a) to apply IFRS 9 from the earlier of:

(i) its second annual reporting period after the change in corporate structure that changed its predominant activities; and

(ii) its annual reporting period that begins on or after the fixed expiry date of the temporary exemption?

(b) to disclose in the annual reporting period in which it reached that conclusion and the subsequent annual reporting period before it applies IFRS 9:

(i) the fact that it is no longer eligible to apply the temporary exemption from applying IFRS 9;

(ii) the reason why it is no longer eligible; and

(iii) the date on which the change in corporate structure occurred that made it ineligible?

Optional reassessment of eligibility before the mandatory effective date of IFRS 9

25. The proposals in the ED related to reassessing eligibility for the temporary exemption applied only to entities that were eligible at the initial assessment date and subsequently had a demonstrable change in their corporate structure that could change their predominant activities. If an entity was not eligible for the temporary exemption on the initial assessment date, it would be required to apply IFRS 9 from that date and would not be permitted to reassess its eligibility[1].

26. However, as described in paragraph 4(a), the Board tentatively decided at its meeting in April 2016 that an entity would initially assess its eligibility for the temporary exemption using the carrying amounts of the liabilities reported on its balance sheet at the annual reporting date between 1 April 2015 and 31 March 2016. As a result, an entity that is not eligible for the temporary exemption at that initial assessment date may meet the criteria for eligibility before the mandatory effective date of IFRS 9 (ie before 1 January 2018). Therefore, the question arises as to whether an entity that becomes eligible for the temporary exemption (ie an entity whose predominant activities become insurance related) within the 'window' between the initial assessment date and the mandatory effective date of IFRS 9, is permitted to reassess its eligibility for the temporary exemption and, if so, under what circumstances.

27. The staff think that an entity that has a change in its corporate structure such that its activities become predominantly related to insurance should be permitted to apply the temporary exemption, as long as it has not previously applied any version of IFRS 9 (except for the 'own credit' requirements in isolation). The staff do not think there is a significant difference between an entity whose activities are predominantly related to insurance at the initial assessment date (and continue to be so) and one whose activities become predominantly related to insurance before the mandatory effective date of IFRS 9. In fact, this is consistent with the staff's observation in the April 2016 Agenda Paper 14C *Temporary*

[1] If an entity is already applying IFRS 9, the Board does not think it should be permitted to 'go back' to IAS 39 because IFRS 9 is a significant improvement to IAS 39. Accordingly, a qualifying criterion for the temporary exemption is that the entity has not previously applied any version of IFRS 9 (except for the 'own credit' requirements in isolation).

exemption from IFRS 9 – Qualifying criteria that, ideally, an entity would assess its eligibility for the temporary exemption using the most up-to-date information possible.

28. The staff think that the ‘trigger’ for such an option to reassess eligibility for the temporary exemption needs to be restricted to when there is a change in an entity’s predominant activities, in the same way as the mandatory reassessment discussed in paragraphs 9-10, and that there is not a compelling reason to have a different trigger. In addition, the staff think that such a high threshold could avoid a situation in which an entity might engage in ‘window dressing’ of its liabilities simply to affect its predominance ratio for the purposes of reassessing its eligibility (eg, bring forward settlement of some liabilities and delay others).

29. Accordingly, the staff recommend that an entity that previously was not eligible for the temporary exemption because its activities were not predominantly related to insurance is permitted to reassess its eligibility before the mandatory effective date of IFRS 9 <u>if, and only if,</u> there has been a demonstrable change in the corporate structure of the entity that could result in a change in its predominant activities (for example, the acquisition or disposal of a business).

Disclosures

30. When an entity was not initially eligible for the temporary exemption but subsequently becomes eligible, the staff think it is important that the reasons for that change are transparent. Accordingly, staff are recommending additional disclosures as part of an entity’s explanation how it concluded that it is eligible for the temporary exemption. At the April 2016 meeting, the Board confirmed that the entity must disclose how the entity concluded that it is eligible for the temporary exemption (proposed in paragraphs 37A(b) of the ED).

31. The staff recommend additional disclosures as follows.

An entity that becomes eligible for the temporary exemption based on a reassessment of its predominant activities should disclose:

(a) the reason for the reassessment;

(b) an explanation of the change in its predominant activities; and

(c) the date on which the change in corporate structure occurred that made it eligible.

Questions – optional reassessment of eligibility for the temporary exemption
3 Does the Board agree that: (a) an entity that previously was not eligible for the temporary exemption should be permitted to reassess its eligibility if and only if there has been a demonstrable change in the corporate structure of the entity before the mandatory effective date of IFRS 9 that could result in a change in the predominant activities of the entity (for example, the acquisition or disposal of a business); and (b) an entity should compute the predominance ratio using the carrying amounts of the liabilities reported on the entity's balance sheet at the end of the annual reporting period immediately following that change? 4 Does the Board agree that an entity that becomes eligible for the temporary exemption in accordance with question 3 above should disclose, as part of its explanation on how it concluded that it is eligible for the temporary exemption (paragraph 37A(b) of the ED): (a) the reason for the reassessment; (b) an explanation of the change in its predominant activities; and (c) the date on which the change in corporate structure occurred that made it eligible for the temporary exemption?

Additional guidance on the circumstances in which an entity is required or permitted to reassess its eligibility for the temporary exemption

32. The ED proposed that an entity would be required to reassess its eligibility only if there is a demonstrable change in the corporate structure of the entity (for example, an acquisition or disposal of a business that could result in a change in the predominant activity of the entity). Paragraph BC69 of the Basis for Conclusions on the ED noted that the Board does not expect changes in the structure of entities applying the temporary exemption to occur frequently.

33. A few stakeholders asked the Board to provide further clarity on how an entity could identify a demonstrable change in corporate structure and to assess when such a change would result in a change in the entity's predominant activities.

34. Accordingly, the staff recommend that the Board provides guidance, analogous to that provided in IFRS 9 in respect of reclassification of financial assets (paragraph B4.4.1 of IFRS 9) as a result of a change in business model, ie, that a change in corporate structure that is capable of changing the predominant activities of an entity must be significant to the entity's operations and demonstrable to external parties.

Question – guidance on when to reassess eligibility for the temporary exemption
5 Does the Board agree that, for the purposes of determining whether an entity is required or permitted to reassess its eligibility for the temporary exemption from IFRS 9, a demonstrable change in an entity's corporate structure that could result in a change in its predominant activities must be significant to its operations and demonstrable to external parties?