Amendments to IFRS 4

Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts*

First Impressions

IFRS

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kpmg.com/ifrs

Contents

Reducing the impact of IFRS 9

The IASB's amendments to IFRS 4 reduce the impact of the differing effective dates of the forthcoming insurance contracts standard and IFRS 9.

Given the importance of asset and liability management within the insurance industry, the industry and users of financial statements raised significant concerns about the differing effective dates of the two standards – 2018 for IFRS 9 and probably 2020 or 2021 for the forthcoming insurance contracts standard. These include:

- having to apply the IFRS 9 classification and measurement requirements before the adoption of the forthcoming insurance contracts standard;
- potential temporary increases in accounting mismatches and volatility in profit or loss and other comprehensive income (OCI) created by the change in classification of financial assets; and
- having two consecutive major accounting changes in a short period of time.

These consequences would have resulted in added costs and complexity for both preparers and users of insurers' financial statements.

The IASB has responded with its amendments to IFRS 4 *Insurance Contracts: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts,* which provide two optional solutions. One solution is a temporary exemption from IFRS 9, effectively deferring its application for some insurers. The other is an overlay approach to presentation to alleviate the volatility that may arise when applying IFRS 9 before the forthcoming insurance contracts standard.

The amendments reduce the impact, but entities need to carefully consider their IFRS 9 implementation approach to decide if and how to use them. Both solutions include various complexities – such as the eligibility criteria for the temporary exemption – that may require detailed analysis and the use of judgement on the part of management.

In this publication, we will take you through the amendments, pointing out areas of judgement and providing examples, to help you assess the potential impact on your business, and make meaningful and knowledgeable decisions when choosing your IFRS 9 implementation approach.

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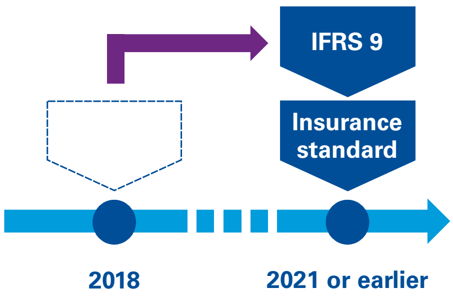
1 At-a-glance summary

1.1 Temporary exemption from IFRS 9



Rather than having to implement IFRS 9 in 2018, some entities will be permitted to continue applying IAS 39 *Financial Instruments: Recognition and Measurement*.

Eligibility criteria

An entity will be permitted to apply the temporary exemption if:

- it has not applied IFRS 9 before; and
- its activities are predominantly connected with insurance.

An entity's activities are 'predominantly connected with insurance' if:

- its liabilities arising from contracts in the scope of IFRS 4 are significant compared with its total liabilities; and
- the ratio of its liabilities connected with insurance – including investment contracts measured at fair value through profit or loss (FVTPL) – compared with its total liabilities is:
  - greater than 90 percent; or
  - greater than 80 percent but less than or equal to 90 percent, and the entity does not engage in a significant activity unconnected with insurance.

Effective date

An entity is permitted to apply the temporary exemption for annual reporting periods beginning before 1 January 2021.

Key impacts

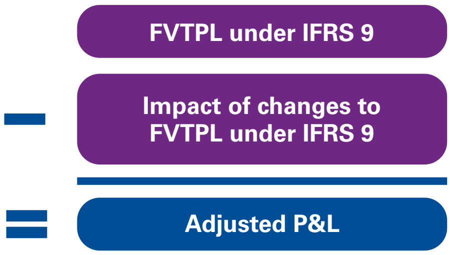
Judgement may be needed to complete the predominance assessment.

To qualify for the temporary exemption, management may have to consider both qualitative and quantitative factors in determining whether the company meets the eligibility criteria.

Applying the temporary exemption for companies within a group structure could result in companies preparing financial information under both IAS 39 and IFRS 9.

If applicable, management will have to consider the costs and complexities of these situations at the group and stand-alone reporting levels.

1.2 Overlay approach



When applying IFRS 9, an entity will be permitted to reclassify between profit or loss and OCI the difference between the amounts recognised in profit or loss under IFRS 9 and those that would have been reported under IAS 39, for designated financial assets. An entity can designate eligible financial assets on an instrument-by-instrument basis.

Eligibility criteria

A financial asset is eligible for designation if:

– it is not held for an activity that is unconnected with contracts in the scope of IFRS 4; and

– it is measured at FVTPL under IFRS 9 but would not have been under IAS 39.

Effective date

An entity is generally permitted to start applying the overlay approach only when it first applies IFRS 9, including after previously applying the temporary exemption.

Key impact

Entities applying the overlay approach will have to produce and track IAS 39 and IFRS 9 values in parallel for designated financial assets.

Entities will have to change their systems and processes to do this.

1.3 Key considerations

The amendments will help entities manage accounting change.

Entities can use the amendments to help them avoid some of the added costs and complexities that may result from the differing effective dates of IFRS 9 and the forthcoming insurance contracts standard. However, the amendments may also add other costs and complexities.

The amendments can help reduce volatility in profit or loss and OCI.

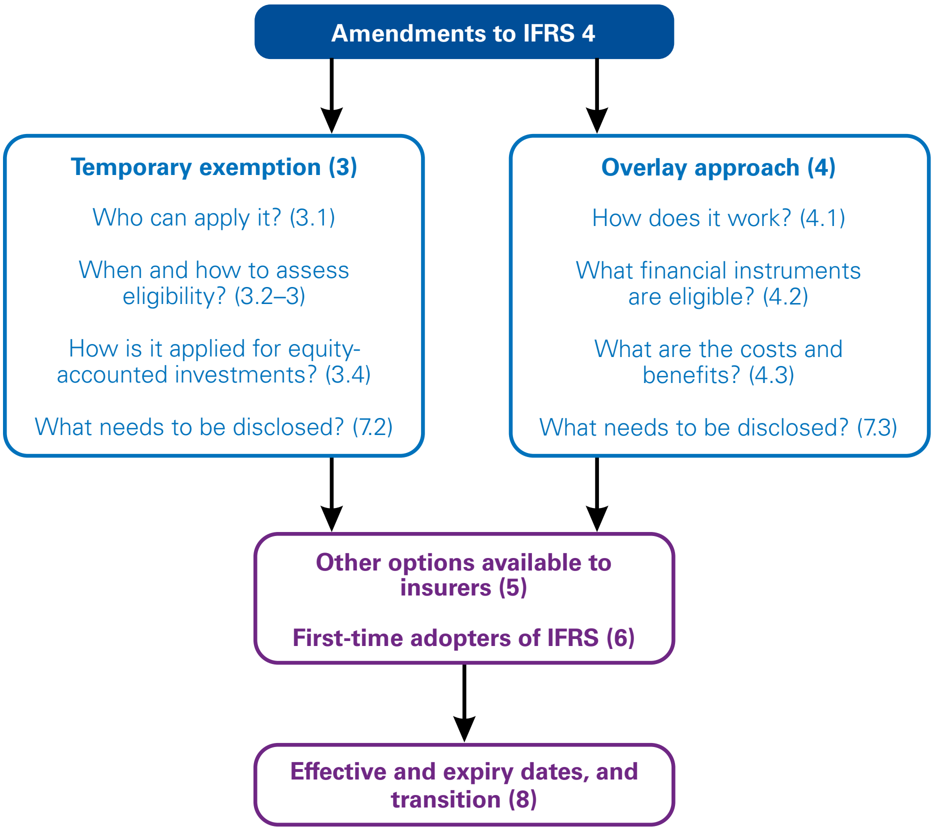
Entities that apply the amendments may be able to reduce the temporary increases in accounting mismatches and volatility that would arise in the statement of profit or loss and OCI if IFRS 9 were applied in 2018 without the amendments.

Comprehensive management analysis will be needed to decide how to best use the amendments.

Entities will have to consider the costs and benefits of the two optional solutions, and how effective each solution would be in mitigating any costs arising from the differing effective dates. They will also need to consider whether and how their peers will use the amendments, and the expectations and reactions of investors and other users of their financial statements.

2 Overview

The following diagram gives an overview of the key topics covered in the amendments.



The diagram illustrates how key elements of the amendments are explained throughout this publication. The corresponding section numbers are in brackets.

3 Temporary exemption

3.1 Who can apply it?

IFRS 4.20B(b), 35A

The IASB has allowed certain entities[1] a temporary exemption from IFRS 9. It applies for those reporting entities whose activities are predominantly connected with insurance.

IFRS 4.BC252, 260–263

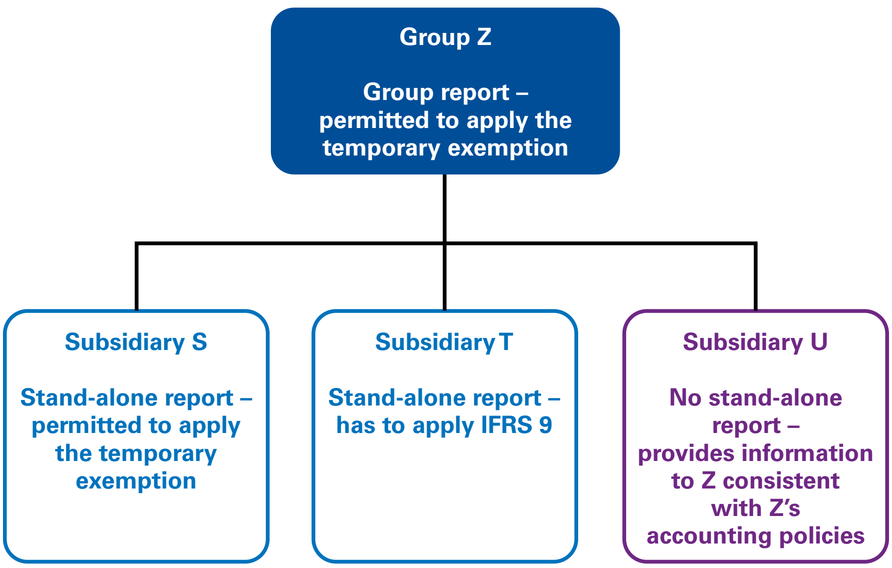
The temporary exemption is applied at the reporting entity level – i.e. it applies to all financial assets and financial liabilities held by the reporting entity.

Example – Applying the temporary exemption within a group

Group Z includes three wholly owned subsidiaries and carries out activities both connected and not connected with insurance. Neither the group nor the subsidiaries have previously applied IFRS 9.

At the group level, the group's activities are considered predominantly connected with insurance. The details of the subsidiaries are as follows.

Subsidiary	Issues stand-alone financial statements?	Activities predominantly connected with insurance?
S	Yes	Yes
T	Yes	No
U	No	No



1. The amendments are also available to issuers of financial instruments that contain a discretionary participation feature.

Z is eligible to apply the temporary exemption in its consolidated financial statements because the group's activities as a whole are predominantly connected with insurance, even though not all of its subsidiaries have activities that are predominantly connected with insurance. The decision made at the group level on whether to apply the temporary exemption is independent of the decisions made by the subsidiaries for their own stand-alone financial statements if they are also reporting entities.

In the same way, the decision made in the stand-alone financial statements of subsidiaries is not impacted by the ability (and decision) of the consolidated group or other stand-alone subsidiaries to apply the temporary exemption.

From the effective date of IFRS 9, T will have to apply IFRS 9 in its stand-alone financial statements. If Z elects to apply the temporary exemption, then T will also have to report its results to Z applying IAS 39 for group reporting purposes. As a result, T would have to prepare financial information under both standards.

Because U does not issue stand-alone financial statements, it is free to follow any accounting policy it chooses for internal management purposes. However, U will have to provide financial information to Z for group reporting purposes.

IFRS 4.20B–C, IFRS 9.5.7.1(c), 5.7.7–5.7.9, 7.2.14, B5.7.5–B5.7.20

An entity that has already applied any version of IFRS 9 is not permitted to stop applying it and revert to IAS 39. However, an entity that applies only the presentation requirements in IFRS 9 for gains and losses on financial liabilities designated as at FVTPL is not disqualified. An entity that applies the temporary exemption is permitted to subsequently apply only these specific presentation requirements and still apply the temporary exemption from the rest of IFRS 9.

KPMG insight – Group reporting implications

For groups that meet the requirements and choose to apply the temporary exemption and have subsidiaries that publish their own IFRS financial statements, entities within the group might have to prepare financial information under both standards (IFRS 9 and IAS 39).

This would be the case if some entities within the group either are not eligible to apply the exemption, or are eligible to apply it but choose not to. Alternatively, situations may arise where the group is not eligible to apply the exemption or chooses not to, and an entity within the group is eligible and chooses to apply it.

Entities should consider the costs and complexities of these situations and determine whether entities within the group would have to prepare financial information under both standards.

3.2 Activities predominantly connected with insurance

IFRS 4.20B(b)

An entity initially assesses whether its activities are predominantly connected with insurance on its annual reporting date immediately before 1 April 2016.

IFRS 4.20D, 35A

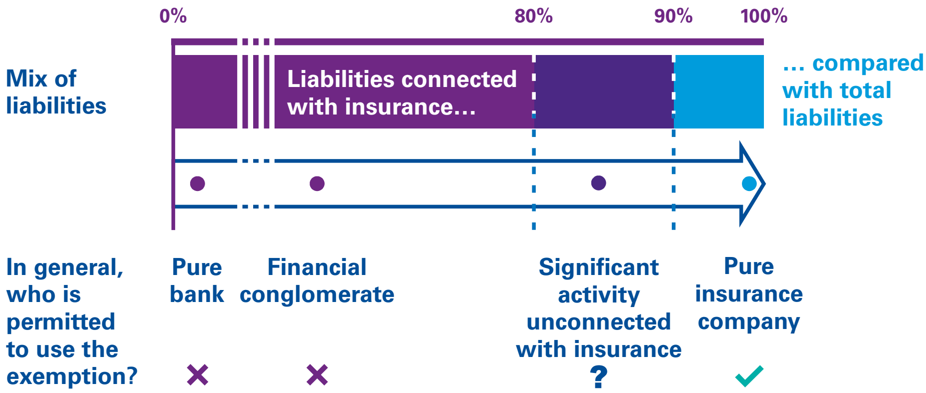
An entity's activities are considered predominantly connected with insurance if:

– the carrying amount of its liabilities arising from contracts that are in the scope of IFRS 4[2] is significant compared with the total carrying amount of all of its liabilities; and

– the ratio of the total carrying amount of its liabilities connected with insurance compared with the total carrying amount of all of its liabilities is:

  - greater than 90 percent; or

  - greater than 80 percent but less than or equal to 90 percent, and the entity does not engage in a significant activity unconnected with insurance.



IFRS 4.20E, BC255(B)

In determining the ratio above, the following types of liabilities are considered to be connected with insurance:

– those arising from contracts that are in the scope of IFRS 4[2];

– non-derivative investment contract liabilities measured at FVTPL under IAS 39, including those designated as at FVTPL; and

– other liabilities that arise because the insurer issues, or fulfils obligations arising from, the contracts above.

Examples of these other liabilities include:

– derivatives used to mitigate risks arising from insurance contracts and the assets backing those contracts;

– tax, salaries and other employment benefit liabilities of the insurance activities; and

– debt issued to boost regulatory capital.

2. This amount includes deposit components and embedded derivatives unbundled from insurance contracts in the scope of IFRS 4.

Example – Performing the assessment

Entity D has an annual reporting date of 31 December 2015. This is its initial assessment date because it is the annual reporting date immediately before 1 April 2016.

D has total liabilities at 31 December 2015 that consist of:

– 45% contracts in the scope of IFRS 4;

– 10% deposit components unbundled from insurance contracts;

– 25% investment contracts not in the scope of IFRS 4 that are measured at FVTPL;

– 12% other liabilities that arise because D issues and fulfils obligations arising from the contracts above; and

– 8% deposits from D's banking customers.

Step 1

IFRS 4.BC258

Assume that D concludes that the carrying amount of liabilities arising from contracts in the scope of IFRS 4 is significant[3] compared with the total carrying amount of all of its liabilities – i.e. 55% of its total liabilities are in the scope of IFRS 4 which includes deposit components unbundled from insurance contracts.

Step 2

D calculates that the carrying amount of its liabilities connected with insurance is 92%, as the only liabilities not included in the calculation are the 8% deposits from banking customers.

Conclusion

Because D's predominance ratio is greater than 90%, it qualifies to apply the temporary exemption without having to consider whether it engages in a significant activity unconnected with insurance.

IFRS 4.20D(b)(ii), 20F

If the ratio of the total carrying amount of an entity's liabilities connected with insurance compared with the total carrying amount of all of its liabilities is greater than 80 percent but less than or equal to 90 percent, then an entity has to determine whether it engages in a significant activity unconnected with insurance.

In performing such an assessment, the entity considers:

– only those activities from which it may earn income and incur expenses; and

– qualitative and/or quantitative factors, including publicly available information about the industry classification that users of financial statements assign to it.

3. With respect to Step 1, it should be noted that the IASB acknowledged that determining 'significance' will require judgement but decided not to provide additional guidance as this term is used in other IFRS requirements and already applied in practice.

KPMG insight – Importance of user behaviour

Entities that calculate a predominance ratio less than or equal to 90 percent but greater than 80 percent will have to assess whether they have any significant activities that are unconnected with insurance. This will involve an analysis that takes into account quantitative and/or qualitative factors.

Management of such entities will need to consider whether their analysis and conclusion is supported by the observable practices of users of their financial statements. For example, if an entity's users typically evaluate its results against banks, then its users may experience a greater lack of comparability if it were to apply the temporary exemption.

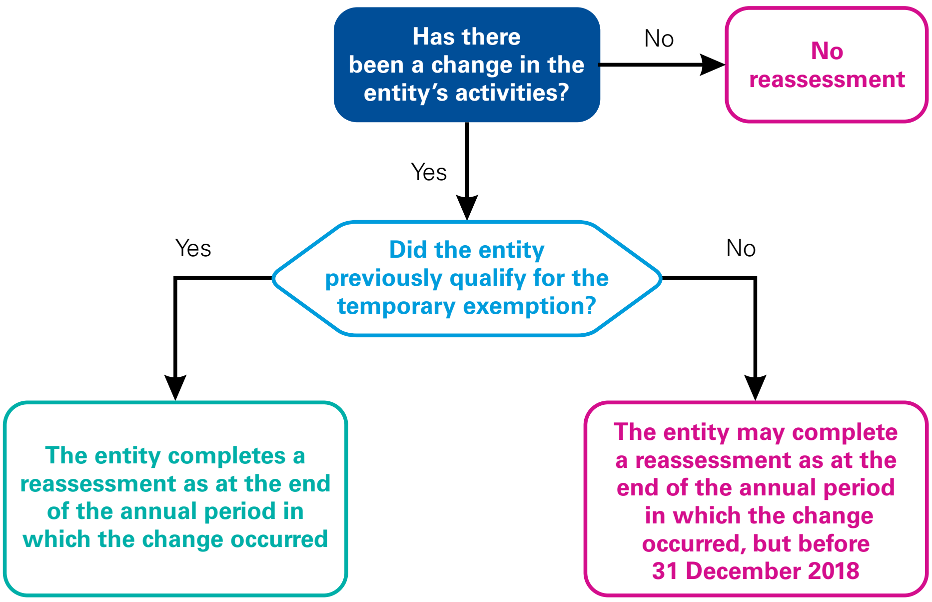
Observable information may include industry or sector classifications published by stock exchanges, market index providers and investment or credit analysts, or those used by fund managers.

3.3 Reassessing predominance

IFRS 4.20G

After the initial assessment, an entity may be required or permitted to complete an updated assessment.

Should an entity reassess whether its activities are predominantly connected with insurance at a subsequent annual reporting date?



IFRS 4.20H

A change in an entity's activities that would result in a reassessment should be determined by senior management as a result of external or internal changes; significant to its operations; and demonstrable to external parties.

IFRS 4.20H–I

Examples of changes that would require a reassessment are when an entity buys, sells or terminates a line of business that is significant to its operations, or if it significantly changes the magnitude of one of its activities. A change in funding structure that does not affect the activities, or an entity's plan to sell a business line in the future, would not result in a reassessment.

IFRS 4.20I

KPMG insight – Changes in activities

Management is responsible for determining whether a change in its activities results in a reassessment. This may require judgement, although the IASB has stated that it believes that changes that result in a reassessment will be very infrequent.

3.4 Relief for investors in associates and joint ventures

IFRS 4.20O–Q

When an entity accounts for an investment in an associate or joint venture (JV) under the equity method, the entity may retain the relevant accounting policies applied by the associate or JV. This relief applies on an investment-by-investment basis.

Investor's financial statements / Associate or JV's financial statements	IFRS 9 applied (with or without overlay adjustment)	Temporary exemption applied
IFRS 9 applied (with or without overlay adjustment)	–	Investor is permitted to retain the IFRS 9 accounting used by an associate or JV
Temporary exemption applied	Investor is permitted to retain the IAS 39 accounting used by an associate or JV	–

IFRS 4.20P

If IFRS 9 was previously applied in the equity method accounting for a specific investment, then the investor continues to apply it to that investment. Conversely, if the temporary exemption was used in the equity method accounting for a specific investment, then IFRS 9 may subsequently be applied to it.

4 Overlay approach

4.1 How does it work?

IFRS 4.35B, 35A

For designated financial assets, an entity[4] is permitted to reclassify between profit or loss and OCI the difference between the amount reported in profit or loss under IFRS 9 and the amount that would have been reported in profit or loss for those assets if the entity had applied IAS 39.

IFRS 4.35D, 35M, BC244

An entity is required to present the effect of the overlay adjustment:

- *in profit or loss:* as a separate line item (pre-tax); and
- *in OCI:* as a separate component – this item is grouped with other items that will be reclassified subsequently to profit or loss.

Example – Overlay approach presentation

Statement of comprehensive income	**20XX**
Earned premiums, net of reinsurance	X
Investment income (under IFRS 9)	X
Overlay adjustment	(X)
Benefits and claims	(X)
Other charges	(X)
Profit or loss	**X**
Overlay adjustment	X
Total comprehensive income	**X**

4.2 Designation of financial assets

IFRS 4.35C, IFRS 9.5.7.1(c), 5.7.7–5.7.9, 7.2.14, B5.7.5–B5.7.20

The overlay approach may be elected only when an entity first applies IFRS 9, including:

- when it first applies IFRS 9 after applying the temporary exemption; or
- after applying only the requirements in IFRS 9 to the presentation of gains and losses on financial liabilities designated as at FVTPL.

IFRS 4.35E, G

An entity is permitted to make this designation on an instrument-by-instrument basis. Financial assets are eligible for the overlay approach if they:

- are not held in respect of an activity that is unconnected with contracts in the scope of IFRS 4 – e.g. financial assets held in funds relating to investment contracts that are outside the scope of IFRS 4 are not eligible;
- are measured at FVTPL under IFRS 9; and

4. The amendments are also available to issuers of financial instruments that contain a discretionary participation feature.

– would not be measured at FVTPL in their entirety under IAS 39.

IFRS 4.BC240

Financial assets held by an entity to maintain regulatory or internal capital objectives can be designated for insurance business.

IFRS 4.35F, 35I(a)

After electing this approach, an entity:

– may designate financial assets for the overlay approach on their initial recognition;

– may designate a previously recognised financial asset for the overlay approach if it now meets the criteria above but previously did not; and

– is required to de-designate a financial asset if it no longer meets those same criteria.

IFRS 4.35J, IAS 1.7

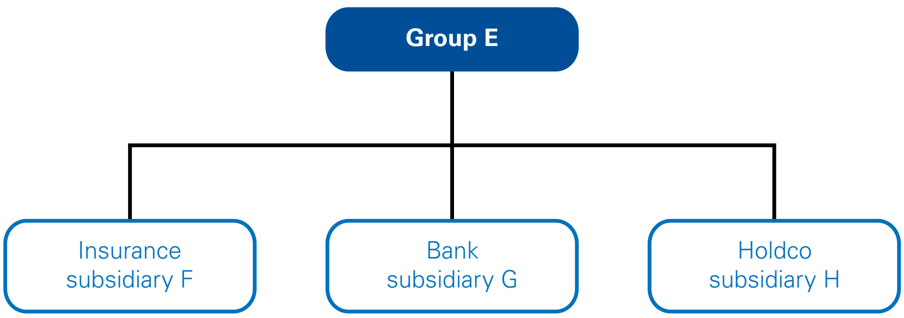
When an entity de-designates a financial asset, any balance in accumulated OCI associated with it is reclassified to profit or loss.

IFRS 4.35I(b), IAS 8.19–25

An entity is permitted to stop applying the overlay approach at the beginning of any annual reporting period before the entity implements the forthcoming insurance contracts standard. If it does, then the change in accounting policy is accounted for retrospectively to the extent practicable.

Example – Transferring financial assets within the group

Group E consists of an insurance subsidiary (F), a banking subsidiary (G), and an investment holding subsidiary (H).



Some of F's financial assets meet the eligibility criteria above and F chooses to apply the overlay approach for the purpose of reporting in E's consolidated financial statements. This results in F recognising in OCI the effects of certain changes in the fair value of financial assets that would otherwise have been presented in profit or loss under IFRS 9.

If F subsequently transfers to G those financial assets to which F had previously applied the overlay approach and the transferred assets are associated with G's banking activities – which are unconnected with contracts in the scope of IFRS 4 – then the cumulative effect of changes in fair value of those financial assets, previously presented in OCI, would be immediately reclassified to profit or loss in E's financial statements.

Alternatively, if F subsequently transfers those financial assets to H, and the group still does not associate the transferred assets with activities unconnected with contracts in the scope of IFRS 4, then the overlay approach would continue to be applied to the designated financial assets. An explanation of the basis for designation is required in the notes to the financial statements.

In both cases, the key consideration is whether the financial assets are held in respect of an activity that is unconnected with contracts in the scope of IFRS 4.

4.2.1 Shadow accounting

IFRS 4.30, 35L, BC246

Shadow accounting is an approach under IFRS 4 that enables an entity to adjust aggregate insurance liabilities to reduce accounting mismatches that can arise if:

– unrealised gains and losses on assets held by the entity are recognised in the financial statements (in profit or loss or in OCI); and

– realisation of those gains and losses would have a direct effect on the measurement of insurance liabilities.

Shadow accounting may be applicable if an entity applies the overlay approach. The following example illustrates the application of the overlay approach together with shadow accounting.

Example – Overlay approach interaction with shadow accounting

Insurance Entity T issues contracts for which policyholders participate in 90% of realised profits. The financial assets associated with these contracts do not meet the solely payments of principal and interest (SPPI) test under IFRS 9 and therefore are measured at FVTPL under IFRS 9. Under IAS 39, these assets were classified as available-for-sale.

T's policy is to apply shadow accounting to these insurance liabilities and it designates the associated financial assets to the overlay approach under IFRS 9.

The fair value of the assets at the start of the period is 100 and the fair value at the end of the period is 150. Therefore, the increase in value of 50 that would have been recognised in OCI under IAS 39 is recognised in profit or loss under IFRS 9.

Applying its accounting policy choice, T first records the increase in value of the financial assets, with a corresponding increase in profit or loss, and then applies an overlay adjustment to reclassify the unrealised gain of 50 from profit or loss to OCI. Then, T applies a shadow adjustment to recognise a loss in OCI and a remeasurement of the policyholder liability of 45 to reflect the policyholder share in the unrealised gain (90% x 50). The net effects on profit or loss and OCI after the overlay and shadow adjustments are the same as under IAS 39.

This example does not illustrate tax effects – these effects should be considered when applying IAS 12 *Income Taxes*.

4.2.2 Investments in associates and JVs

IFRS 4.BC281

The IASB did not provide relief to investors in associates and JVs that apply the overlay approach from the requirement to use uniform accounting policies. This is because a reporting entity does not need to apply the overlay approach to all qualifying assets.

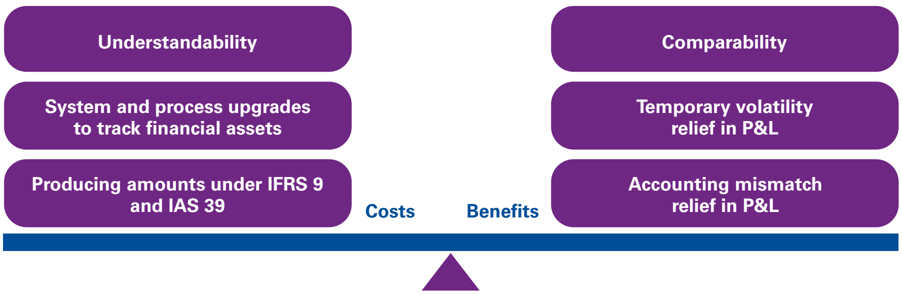
Consequently, an investor may choose to apply the overlay approach to its own designated financial assets but not those of its investee, or vice versa, without contravening the requirement to use uniform accounting policies.

KPMG insight – Overlay approach effectiveness

The overlay approach requirements could address insurers' concerns about temporary accounting mismatches and volatility in profit or loss, but may not address the same factors in OCI and equity if assets are measured at amortised cost under IAS 39 and are measured at fair value under IFRS 9 (although shadow accounting may be of use in this regard).

The concern about implementing two significant accounting changes within a short period of time will not be addressed under the overlay approach. However, for entities that designate most of their assets as at FVTPL under IAS 39, the impact of applying IFRS 9 before the effective date of the forthcoming insurance contracts standard might not be as significant – e.g. for some financial assets held in funds relating to investment contracts that are outside the scope of IFRS 4 – as the impact on an entity with asset portfolios made up primarily of financial assets not at FVTPL under IAS 39. Entities will need to evaluate these factors when considering whether to apply the overlay approach.

4.3 Costs and benefits of the overlay approach



KPMG insight – Costs and benefits of applying the overlay approach

Insurers should consider the costs and benefits of applying the overlay approach before electing to apply it.

Potential costs

Understandability

Financial statements may be more difficult for users to understand if the overlay approach is applied.

System and process upgrades

Insurers will need to change their systems and processes to produce and track IAS 39 and IFRS 9 values in parallel for designated financial assets. They will also have to consider the costs to design, implement and maintain systems and controls under both standards, and develop methods to calculate the overlay adjustment and track financial assets that are subject to the overlay approach for reporting and disclosure purposes.

An entity will also have to consider the costs of applying the overlay approach to systems and processes other than those directly related to financial instruments. For example, entities will need to consider what impact the approach may have on their reporting and disclosure of deferred taxes.

Producing amounts under IFRS 9 and IAS 39

The information needed to measure financial assets classified at FVTPL under IFRS 9 but not under IAS 39 should be available under the entity's existing accounting systems.

- If these assets are classified as available-for-sale under IAS 39, then they are already measured at fair value.
- If they are measured at amortised cost under IAS 39, then IFRS 7 *Financial Instruments: Disclosures* already requires the disclosure of fair values for them.

An exception would be if the fair value of an investment in an unquoted equity instrument or related derivative was previously considered not to be reliably measureable under IAS 39 – this is an unusual situation and will arise infrequently.

An entity will have to implement the expected credit loss impairment model in IFRS 9 between the differing effective dates for financial assets that are measured at amortised cost or fair value through OCI (FVOCI) at initial application of IFRS 9, even if they will be subsequently designated as at FVTPL under the forthcoming insurance contracts standard.

Potential benefits

Entities that apply the overlay approach will still benefit from the significant improvements in accounting for financial instruments introduced by IFRS 9.

Comparability

Applying the overlay approach, rather than the temporary exemption, may enhance the comparability of an entity's financial statements with those of competitors that elect to apply IFRS 9, including competitors that may be part of another industry – e.g. banks.

Relief from temporary volatility and accounting mismatches

This approach will help insurers address temporary volatility and accounting mismatches that may arise in profit or loss because of the differing effective dates of IFRS 9 and the forthcoming insurance contracts standard. Insurers will be able to select the financial assets to which they apply an overlay adjustment, so they will be able to avoid excessive costs to maintain or change systems and processes in the case of those financial assets for which the costs are considered to outweigh the benefit of reducing temporary volatility in profit or loss.

5 Other options

Within IFRS accounting, there are other options that may be available to address some of the temporary volatility and accounting mismatches that could arise for entities that do not qualify or do not wish to apply either the temporary exemption or overlay approach.

IFRS 4.30

– *Shadow accounting:* An entity could adopt shadow accounting to adjust aggregate insurance liabilities to reduce accounting mismatches between unrealised gains or losses on assets held by the entity and the corresponding changes in the value of related contract liabilities.

IFRS 4.24

– *Use of a current market interest rate:* Entities are permitted under IFRS 4 to introduce a current market interest rate to measure insurance liabilities.

IFRS 4.22, BC145, IAS 8.21

– *Other voluntary change in accounting policy:* IFRS 4 permits an entity to update its accounting policies to reduce accounting mismatches.

– *Disclosure:* Consistent with current accounting requirements, temporary increases in accounting mismatches and other sources of volatility in profit or loss could be explained using enhanced disclosures in the financial statements or other published reporting.

KPMG insight – Other options available to insurers

Although some of these options may not have been common in the past, we expect them to become more relevant in the short term as entities evaluate whether to use the amendments.

Entities may also consider using alternative measures in addition to IFRS measures – e.g. non-GAAP measures. However, it is critical that they evaluate whether any alternative measures would be acceptable under applicable reporting and regulatory requirements about the use of non-GAAP measures, and that they would be useful and presented effectively for users of financial statements. For example, entities should consider the recent statement on non-GAAP financial measures published by the International Organization of Securities Commissions.

6 First-time adopters of IFRS

IFRS 4.20B(b), 20L, 35N

First-time adopters of IFRS are permitted to apply these amendments – i.e. the temporary exemption from IFRS 9 and the overlay approach – if they meet the applicable eligibility criteria.

In assessing its eligibility for the temporary exemption, a first-time adopter uses carrying amounts determined under IFRS for its initial eligibility assessment – i.e. on its annual reporting date immediately before 1 April 2016.

First-time adopters that apply the overlay approach restate comparative information to reflect the overlay approach if they restate comparative information under IFRS 9.

KPMG insight – First-time adopters of IFRS

The potential eligibility of first-time adopters of IFRS for the temporary exemption and overlay approach may increase comparability within the insurance industry and may limit the need for some first-time adopters to report under IAS 39 and IFRS 9 simultaneously for stand-alone and group reporting.

However, first-time adopters will also be required to implement all applicable IFRS requirements on implementation, including those of IAS 39 – i.e. IAS 39 if applying the temporary exemption, or IAS 39 (partially) and IFRS 9 if applying the overlay approach. In view of this, they will have to consider the costs and benefits of implementing IAS 39 systems and processes for a short period of time while applying the temporary exemption or overlay approach, compared with applying IFRS 9 without the overlay approach.

IFRS 1.8

First-time adopters of IFRS that intend to adopt IFRS 9 in their first IFRS financial statements before implementing the forthcoming insurance contracts standard could also consider the other options available to insurers, as described in Chapter 5.

7 Disclosures

7.1 Objective

The objective is to enable users to understand…

Temporary exemption

How an entity qualified for the exemption

How to compare insurers applying IFRS 9 with those that are not

Overlay approach

How the adjustment is calculated

The effect on the financial statements

7.2 Temporary exemption

IFRS 4.39B

If an entity applies the temporary exemption, then it provides disclosures that enable users of financial statements to:

– understand how the entity qualified for the temporary exemption; and

– compare entities that apply the temporary exemption with those that do not.

7.2.1 Disclosures on qualifying for the temporary exemption

IFRS 4.39C

Disclosures required about information on qualifying for the temporary exemption on the initial assessment date will depend on the mix of the entity's liabilities, as follows.

– If the carrying amount of its liabilities arising from contracts in the scope of IFRS 4[5] was less than or equal to 90 percent of the total carrying amount of all of its liabilities, then it discloses the nature and carrying amounts of the liabilities connected with insurance that are not liabilities arising from contracts in the scope of IFRS 4.

– If the entity qualified for the temporary exemption with a predominance ratio – i.e. the percentage of its liabilities connected with insurance relative to all of its liabilities – less than or equal to 90 percent, then it discloses how it determined that it has no significant activity that is unconnected with insurance, including the information considered.

– If the entity qualified for the temporary exemption on the basis of a reassessment, then it discloses:

  - the reason for the reassessment;

  - the date on which the relevant change in activities occurred; and

  - an explanation of the change in activities and its effect on the financial statements.

5. Including deposit components or embedded derivatives unbundled from insurance contracts.

Similar disclosures would be provided when an entity concludes that it no longer qualifies for the temporary exemption.

7.2.2 Disclosures to provide comparability

IFRS 4.39E

An entity discloses the fair value and change in the fair value at the reporting date, separately for each of the following groups:

- financial assets that meet the SPPI test in IFRS 9, excluding any financial assets that meet the definition of held for trading in IFRS 9 or that are managed and evaluated on a fair value basis; and
- all other financial assets: i.e. financial assets that do not meet the SPPI test, that do meet the definition of held for trading, or that are managed and evaluated on a fair value basis.

IFRS 4.39G

For financial assets that meet the SPPI test, excluding any financial assets that meet the definition of held for trading in IFRS 9 or that are managed and evaluated on a fair value basis, an entity discloses:

- by credit risk rating grades, the carrying amounts under IAS 39; and
- the fair value and carrying amounts under IAS 39 for financial assets that do not have low credit risk at the reporting date.

IFRS 4.39H

An entity also discloses references to any IFRS 9 information that is not provided in the consolidated financial statements, but is publicly available for the relevant period in the individual financial statements of entities within the group.

IFRS 4.39I–J

Additional disclosures are required if an entity applies the exceptions permitted for investments in associates and JVs (see Section 3.4).

KPMG insight – Financial reporting challenges

Entities should be aware that applying the temporary exemption does not imply that there is no change in disclosure requirements. Also, certain assessments introduced by IFRS 9 may need to be performed.

For financial assets held to back unit-linked funds, both under insurance and investment contracts, the disclosure requirements will not require an SPPI test to be performed if those financial assets are managed and evaluated on a fair value basis or held for trading.

However, relief from the SPPI test does not include financial assets that are designated as at FVTPL to eliminate accounting mismatches.

Although some of this information may already exist due to current disclosure requirements under IFRS 7, the SPPI test is not required for companies applying IAS 39. Entities need to consider what accelerated system development and associated costs will be required to do this.

7.3 Overlay approach

IFRS 4.39K

Disclosures are required to enable users of financial statements to understand how the total amount reclassified between profit or loss and OCI was calculated and how it affects the financial statements.

IFRS 4.39L

An entity discloses its basis for determining the financial assets for which an overlay adjustment is made and an explanation of how the overlay adjustment was derived in the period, and its effects on each affected line item in profit or loss.

IFRS 4.39L(f), 39M

Additional disclosures are required in a reporting period if an entity changes the designation of financial assets or if it applies the overlay approach when accounting for an investment in an associate or JV using the equity method.

8 Effective and expiry dates, and transition

8.1 Effective and expiry dates

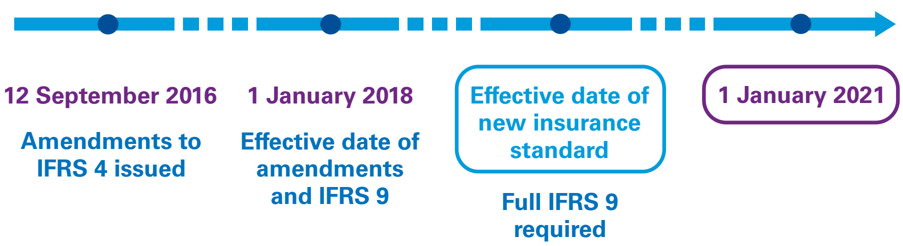
8.1.1 Amendments timeline

IFRS 4.46, 48

The effective date of the amendments permitting the temporary exemption is for annual reporting periods beginning on or after 1 January 2018. The amendments allowing the overlay approach are applicable when an entity first applies IFRS 9.

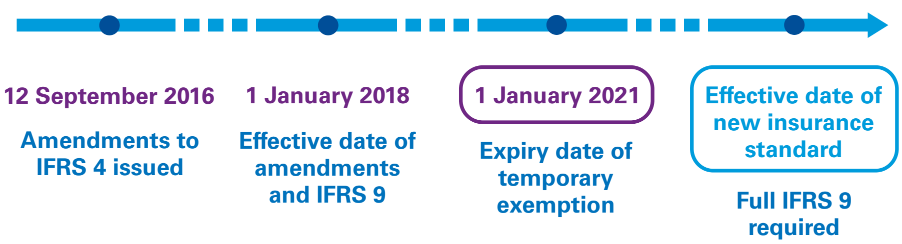
They result in the following options potentially being available to entities from now until the effective date of the forthcoming insurance contracts standard.

If the forthcoming insurance contracts standard is effective *before* 2021



Companies may apply:	1 January 2018	Effective date of new insurance standard	1 January 2021
Temporary exemption	✓	✗	✗
Overlay approach	✓	✗	✗
Full IFRS 9	✓	✓	✓

If the forthcoming insurance contracts standard is effective *after* 2021



Companies may apply:	1 January 2018	1 January 2021	Effective date of new insurance standard
Temporary exemption	✓	✗	✗
Overlay approach	✓	✓	✗
Full IFRS 9	✓	✓	✓

8.1.2 Temporary exemption

IFRS 4.20A, 35C(a)

The temporary exemption is available for annual reporting periods beginning before 1 January 2021 and will expire once the forthcoming insurance contracts standard becomes effective. If the forthcoming insurance contracts standard is not yet effective on 1 January 2021, then an entity could choose to apply the overlay approach as it does not include a fixed expiry date and is effective when an entity first applies IFRS 9.

IFRS 4.20J

An entity may be required to stop applying the temporary exemption sooner as a result of a reassessment (see Section 3.3). In this case, an entity would be permitted to continue to apply IAS 39 until the earlier of:

- the end of the annual period that began immediately after the reassessment; and
- its last annual reporting period beginning before the fixed expiry date of the temporary exemption – i.e. 1 January 2021.

IFRS 4.20K

An entity that previously applied the temporary exemption is permitted to apply IFRS 9 at the beginning of any subsequent annual reporting period.

IFRS 4.BC273, IAS 8.30

An entity should provide information about the expected effect of the amendments before they are effective, including whether it expects to apply the temporary exemption.

KPMG insight – Reassessment consequences

The decision to allow a grace period for entities that become ineligible for the temporary exemption will give them additional time to plan their implementation of IFRS 9. However, for some entities, this grace period may not be long enough. Therefore, it is critical for entities that are considering significant acquisitions, disposals or similar restructurings to plan ahead.

Entities may need to be proactive in forecasting whether any strategic business decisions – e.g. corporate structure activities – could impact their ability to apply the temporary exemption. Those that foresee that it is reasonably likely that changes in activities may impact their predominance ratio should consider developing pro forma financial balances and developing probabilities and sensitivities of how such changes will affect their ability to apply the temporary exemption. They may then use these results to help them develop a forward-looking plan for implementing IFRS 9.

8.1.3 Overlay approach

IFRS 4.35C, 35I(b), 48, IFRS 9.5.7.1(c), 5.7.7–5.7.9, 7.2.14, B5.7.5–B5.7.20

An entity is permitted to start applying the overlay approach only when it first applies IFRS 9, or when it first applies IFRS 9 after previously applying only the presentation requirements in IFRS 9 for gains and losses on financial liabilities designated as at FVTPL. An entity is permitted to stop applying the overlay approach to all designated financial assets at the beginning of any subsequent annual reporting period.

8.2 Transition

An entity that elects to apply the amendments needs to take the following actions.

Approach	When an entity *starts* applying the approach	When it *stops* applying the approach
Temporary exemption (*IFRS 4.47*)	The entity uses the applicable transition provisions in IFRS 9 to the extent needed to provide the disclosures required.	The entity follows the transition provisions under IFRS 9.
Overlay approach (*IFRS 4.35I(b), 49, IAS 8.19–25*)	The approach is applied retrospectively. For example, an adjustment to the opening balance of accumulated OCI – equal to the difference between the designated financial assets' fair values under IFRS 9 and their carrying amounts under IAS 39 – is recognised. An entity restates comparative information under the overlay approach if, and only if, it restates comparative information when applying IFRS 9.	The entity follows IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to account for the change in accounting policy – i.e. retrospective application to the extent practicable.

KPMG insight – Transition reliefs on applying the forthcoming insurance contracts standard

Some insurers have concerns about assessing the classification and measurement of financial assets before the effective date of the forthcoming insurance contracts standard. The IASB has indicated that it plans transition reliefs that will allow entities that have already applied IFRS 9 to reassess the business model criterion for classifying financial assets under IFRS 9 – and make or revoke FVTPL and FVOCI designations of financial assets – on initial application of the forthcoming insurance contracts standard.

About this publication

This publication has been produced by the KPMG International Standards Group (part of KPMG IFRG Limited).

Content

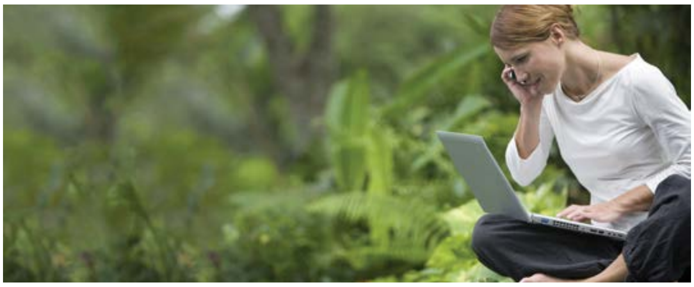
Our *First Impressions* publications are prepared on the release of a new standard, or amendment(s) to the requirements of existing standards. They include a discussion of the key elements of the new standard and highlight areas that may result in a change in practice.

This edition considers the requirements of *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)* published by the IASB in September 2016.

The text of this publication refers to IFRS 4 and to selected other current standards in issue at 22 September 2016.

Further analysis and interpretation will be needed for an entity to consider the potential impact of the requirements in light of its own facts, circumstances and individual transactions. The information contained in this publication is based on initial observations developed by the KPMG International Standards Group and these observations may change.

Keeping you informed



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