

FA Module 15: Financial investments (overview 3rd edition)

(The attached PDF file has better formatting.)

(Readings from the third 3rd edition of the Robinson text.)

Insurers have large portfolios of financial assets (bonds, stocks, real estate) and may be structured as groups of affiliated corporations. This module deals with passive investments, where the firm does not have influence or control over the investee. The next two modules deal with active investments: (i) when the investor has influence but not control over the investee; (ii) when the investor has control over the investee.

Reading: chapter 15

- ! § 2 basic corporate investment categories
- ! § 3 investments in financial assets IAS 39, excluding section 3.5 (reclassification of investments)
- ! § 4 investments in financial assets IFRS 9, excluding section 4.2 (reclassification of investments)

The discussion forum reading explains current IFRS 9, including the changes since the CFA textbook was published. IAS 39 has been replaced by IFRS 9, but the discussion of IAS 39 helps you understand the GAAP rules. The readings on the discussion forum explain current U.S. GAAP along with current IFRS 9.

Know the GAAP classification of passive investments

- ! held to maturity securities: amortization methods and interest income
- ! held for trading purposes: unrealized capital gains in profit and loss
- ! available for sale: unrealized capital gains in other comprehensive income

The CFA textbook explains these in detail; the discussion forum postings add recent GAAP updates.

The GAAP classification is not always the same as the IFRS classification. The final exam problems will tell you the classification of the financial security. You will not be tested on the exceptional cases where the GAAP and IFRS classifications differ.

IFRS 9 has two tests for whether fixed income assets (bonds) can be amortized:

- ! Securities with principal and interest payments only
- ! Business strategy test

IFRS 9 classifies other investments into

- ! fair value through profit and loss (GAAP = "held for trading")
- ! fair value through other comprehensive income (GAAP = "available for sale")

The final exam problems test the accounting treatment of the two categories directly above.

From Exhibit 1 Summary of Accounting Treatments for Investments, know the three rows for Influence, Typical percentage interest, and Financial Reporting.

Know the three categories at the bottom of Exhibit 4 Financial Assets Classification and Measurement Model, IFRS 9; the GAAP categories are the same, with different terms. The flowchart summarizes the classification rules, but you will not be tested on the flowchart.

Impairment refers to permanent credit losses, not temporary interest rate and exchange rate losses. The impairment rules are complex and are not tested on the final exam.

1. GAAP has a two step impairment tests dealing with credit events and duration of price decline
2. IFRS uses twelve month and lifetime expected credit losses

GAAP and IFRS differ in their accounting for reversals of impairment.