The overlay approach

—An option for *all* entities that issue insurance contracts, applying to *some* of their financial assets

An entity that applies the overlay approach is required to apply IFRS 9. However, under this approach, an entity would be permitted, but not required, to reclassify from profit or loss to other comprehensive income (OCI) an amount equal to the difference between:

(a) the amount reported in profit or loss when IFRS 9 is applied to the qualifying financial assets (that are newly measured at fair value through profit or loss (FVPL) under IFRS 9); and

(b) the amount that would have been reported in profit or loss if IAS 39 were applied to those assets.

How the approach is applied

The overlay approach aims to remove from profit or loss any additional volatility that may arise if IFRS 9 is applied together with IFRS 4. To achieve this, the Exposure Draft proposes that:

- reclassification is shown as a separate line item in the statement of profit or loss, OCI or both;
- additional disclosures are made to enable users to understand the effect of the overlay approach on the financial statements;
- IFRS 9 is applied in full, so information provided about financial instruments of entities issuing insurance contracts is comparable with the information provided by other entities; and
- the entity continues to apply the existing IAS 39 system to calculate the adjustment.

Illustrative statement of comprehensive income

	20XX
Profit or loss	
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Operating result	X
Investment income	X
Interest on insurance liability	(X)
Investment result	X
…	
Profit or loss	**X**
Other comprehensive income	
Overlay adjustment	X
Total comprehensive income	**X**

reclassified amount

Which entities can apply the overlay approach?

The Exposure Draft proposes that *all* entities that issue insurance contracts should be permitted to apply the overlay approach.

The overlay approach can be applied only when an entity first applies IFRS 9, including if an entity chooses to apply IFRS 9 early.

Which financial assets would qualify for the approach?

The Exposure Draft proposes that financial assets that meet *both* of the following criteria would qualify for the overlay approach:

(a) the financial assets are measured FVPL applying IFRS 9 but would not have been measured at FVPL in their entirety applying IAS 39; and

(b) the financial assets are designated by the entity as relating to insurance contracts for the purposes of the overlay approach.

Because the overlay approach applies only to assets measured at FVPL applying IFRS 9, the overlay approach would not require new information compared to applying IAS 39.

An entity that chooses to apply the overlay approach can do so for all or only some of the assets that meet (a) above and that relate to insurance contracts. However an entity could not apply the overlay approach to assets relating to non-insurance activities, such as banking activities.

The IASB thinks that the overlay approach can be applied by all entities because it provides the transparent information that results from applying IFRS 9.