IFRS

STAFF PAPER

June 2021

IASB® meeting

Project	**IFRS 17 *Insurance Contracts***
Paper topic	Initial application of IFRS 17 and IFRS 9—comparative information

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Purpose of this paper

1. At its May 2021 meeting, the International Accounting Standards Board (Board) discussed feedback about one-time classification differences that may arise in the comparative information that insurers will present on initial application of IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments*. The Board also discussed preliminary staff views on a possible narrow-scope amendment to IFRS 17 to address this issue.[1]

2. This paper sets out the details for such a narrow-scope amendment.

Summary of questions for Board members

3. Board members are asked whether they agree with the staff recommendation to propose a narrow-scope amendment to IFRS 17. The amendment would permit an entity to apply a classification overlay in the comparative period(s) presented on initial application of IFRS 17 and IFRS 9. The optional classification overlay would:

   (a) apply to financial assets that are related to insurance contract liabilities and to which IFRS 9 has not been applied in the comparative period(s);

[1] See Agenda Paper 2 of the May 2021 Board meeting.

(b) allow an entity to classify those financial assets in the comparative period(s) in a way that aligns with how the entity expects those assets would be classified on initial application of IFRS 9;

(c) apply for comparative periods that have been restated for IFRS 17 (that is, from the transition date to the date of initial application of IFRS 17); and

(d) apply on an instrument-by-instrument basis.

4. If the Board agrees with the staff recommendation, Board members are asked whether they:

(a) are satisfied that the Board has complied with the applicable due process steps and should begin the balloting process to publish an Exposure Draft.

(b) agree with setting a 60-day comment period for the Exposure Draft.

(c) intend to dissent from the proposals in the Exposure Draft.

Structure of this paper

5. This paper provides:

(a) a reminder of the issue; and

(b) staff analysis, staff recommendation and questions for Board members.

6. The appendix to this paper summarises the due process steps taken in developing a possible narrow-scope amendment to IFRS 17.

A reminder of the issue

7. Many insurers will first apply IFRS 9 and IFRS 17 at the same time on or after 1 January 2023. The transition requirements in the two Standards apply at different dates:

(a) the IFRS 9 transition requirements apply on the date of initial application (ie 1 January 2023 for many insurers); whilst

(b) the IFRS 17 transition requirements apply on the transition date, being the beginning of the previous annual reporting period (ie 1 January 2022 for many insurers), or earlier if the entity voluntarily restates more than one year of comparative information.

8. This difference in the transition requirements will result in the following one-time classification differences in the comparative information presented on initial application of IFRS 17 and IFRS 9 by some insurers:

   (a) significant accounting mismatches between insurance contract liabilities measured at current value and some related financial assets measured at amortised cost.

   (b) if the entity chooses to restate comparative information for IFRS 9, classification differences between financial assets derecognised in 2022 (to which IFRS 9 will not apply) and other financial assets (to which IFRS 9 will apply).

9. In addition to these classification differences, some insurers also highlighted operational challenges if the entity chooses to restate comparative information for IFRS 9. Those challenges will arise because the entity will not know which financial assets IFRS 9 does and does not apply to in the comparative information until the end of 2022 (ie once the entity knows which assets have been derecognised in 2022).

10. For further explanation of the issue, see Agenda Paper 2 of the May 2021 Board meeting.

Staff analysis and recommendations

11. In the staff view, the issue described in paragraphs 7–10 of this paper could be resolved by a narrow-scope amendment to IFRS 17. That amendment would permit an entity to apply a classification overlay in the comparative period(s) presented on initial application of IFRS 17 and IFRS 9.

12. The intention of the classification overlay would be to address those very specific one-time classification differences in the comparative period(s) in a pragmatic and targeted way, whilst not disturbing the transition requirements in IFRS 17 or IFRS 9. This will ensure that we do not risk unintended consequences or disrupt implementation processes.

The classification overlay approach

13. Under the approach, an entity would be permitted (but not required) to apply a classification overlay in the comparative period(s) presented on initial application of IFRS 17 and IFRS 9. The optional classification overlay would:

    (a) apply to financial assets that are related to insurance contract liabilities and to which IFRS 9 has not been applied in the comparative period(s) (see paragraphs 14–15);

    (b) allow an entity to classify those financial assets in the comparative period(s) in a way that aligns with how the entity expects those assets would be classified on initial application of IFRS 9 (see paragraphs 16–18);

    (c) apply for comparative periods that have been restated for IFRS 17 (that is, from the transition date to the date of initial application of IFRS 17) (see paragraph 19); and

    (d) apply on an instrument-by-instrument basis (see paragraph 20).

Related to insurance contract liabilities and to which IFRS 9 has not been applied

14. The classification overlay would apply only to financial assets that are related to insurance contract liabilities. By ‘related to insurance contract liabilities’ we mean the financial asset is not held in respect of an activity that is unconnected with contracts within the scope of IFRS 17. For example, financial assets held in respect of banking activities would not be considered as related to insurance contract liabilities. This description of ‘related to insurance contract liabilities’ is not new. It is consistent with paragraph C29(a) of IFRS 17 which also applies only to financial assets not held in respect of an activity that is unconnected with contracts within the scope of IFRS 17.

15. In addition, the classification overlay would be available only for financial assets to which IFRS 9 has not been applied in the comparative periods presented on initial application of IFRS 17 and IFRS 9. An entity is permitted but not required to restate comparative information for IFRS 9. If the entity chooses to restate comparative information, IFRS 9 does not permit restatement of comparative information for financial assets derecognised during the comparative period. Therefore, the classification overlay would be available for both:

(a) entities that restate comparative information for IFRS 9 (for them, it will be available only for financial assets derecognised in the comparative period(s) because IFRS 9 does not apply to those assets); and

(b) entities that do not restate comparative information for IFRS 9 (for them, it will be available for any financial assets related to insurance contract liabilities).

Alignment with IFRS 9 classification

16. Applying the classification overlay in the comparative period(s), an entity would classify financial assets in a way that aligns with how the entity expects those financial assets would be classified on initial application of IFRS 9. However, applying the classification overlay would *not* require an entity to apply the assessments required by IFRS 9 (ie the business model and contractual cash flow characteristics). Paragraphs 24–27 of this paper discuss how the staff expect entities may apply the classification overlay from a practical perspective.

17. The classifications that an entity could apply using the classification overlay are:

For investments in debt instruments

(a) amortised cost measurement;

(b) fair value through profit or loss measurement; or

(c) fair value through other comprehensive income measurement.

For investments in equity instruments

(a) fair value through profit or loss measurement; or

(b) fair value changes presented in other comprehensive income.

18. An entity would recognise in opening retained earnings any difference between:

(a) the carrying amount of the financial assets at the transition date to IFRS 17 applying the classification overlay; and

(b) the previous carrying amount at that date.

From the transition date to date of initial application of IFRS 17

19. The classification overlay would be available only for comparative periods presented that are restated for IFRS 17 (that is, from the transition date to the date of initial application of IFRS 17). For many entities this means that the approach will apply for one comparative period presented. However, an entity could choose to restate more than one comparative period on initial application of IFRS 17. The staff note that, similar to if an entity chooses to restate comparative information for IFRS 9, an entity would need to collect the relevant information to apply the classification overlay in real time to avoid the risk of using hindsight.

Instrument-by-instrument basis

20. The classification overlay would apply on an instrument-by-instrument basis. This would allow entities to identify which financial assets are related to insurance contract liabilities and are the subject of classification differences, and then to decide which of those assets they wish to apply the classification overlay to. Given that entities want to reduce accounting mismatches and achieve greater consistency with how IFRS 9 will be applied from the date of initial application, we do not think that this optionality would lead to a risk of 'cherry picking'. In addition, from a practical perspective, given the purpose of the overlay is to achieve consistency with the classification outcomes that will result when IFRS 9 is applied, we expect that entities may apply it at a higher level of aggregation similar to the level at which the expected business model would be assessed (which would not be prohibited).

Benefits of the classification overlay approach

21. The classification overlay approach would not result in information loss for the users of financial statements. In fact, it should enhance the usefulness of the comparative information because it would:

    (a) enable entities to avoid significant classification differences and mismatches that would not reflect economic mismatches because they are purely the result of differences in the transition requirements of IFRS 17 and IFRS 9; and

    (b) provide improved information about the classification of financial assets that is expected to be generally consistent with the initial application of

IFRS 9. Therefore, it would enhance comparability between periods (ie data series).

22. Applying the classification overlay to financial assets avoids requiring an entity to apply IFRS 9 to those financial assets solely for the purpose of presenting comparative information. That is, for those financial assets, the entity would not assess the business model or contractual cash flow characteristics (ie solely payments of principal and interest), neither would it apply the expected credit losses model. This avoids creating a burden for insurers who are seeking relief and avoids introducing significant diversity amongst insurers.

23. The classification overlay approach also avoids requiring an entity to separately identify in the comparative period(s) financial assets to which the classification overlay is applied from financial assets that are restated for IFRS 9 (if the entity chooses to restate comparatives for IFRS 9). Paragraphs 24–27 explain why.

24. The staff understand that in the run-up to applying IFRS 9 from 1 January 2023, some insurers will 'parallel run' IFRS 9 alongside IAS 39 throughout 2022. From a practical perspective this will make it easier for them to retrospectively apply IFRS 9 on 1 January 2023 and to prepare restated comparative information (if they chose to do so).

25. Even though IFRS 9 permits an entity to restate comparative information, it still requires the relevant assessments that determine classification of financial assets (including designation under the fair value option to reduce an accounting mismatch) to be based on the facts and circumstances that exist at the date of initial application of the Standard.[2] This means that those entities in their parallel run will essentially classify financial assets based on the classification they *expect* to apply from the date of initial application of IFRS 9. In other words, they would 'pre-analyse' how they expect those financial assets will be classified when applying IFRS 9 at 1 January 2023. We expect that entities will prepare to apply the classification overlay approach in the same way.

26. However, we note that when entities apply IFRS 9 they will be required to assess at 1 January 2023 whether any expected classification ('pre-analysis') for financial assets

[2] Except for the assessment of a financial asset's cash flow characteristics (ie solely payments of principal and interest) which is based on facts and circumstances at initial recognition of the financial asset.

that continue to be recognised at that date was accurate. This is because IFRS 9 requires those assessments to be made based on the facts and circumstances at the date of initial application (1 January 2023). If the expected classification ('pre-analysis') was not accurate, the entity will need to update the information prepared during the parallel run accordingly.

27. The staff also note that the disclosure requirements in paragraphs 42I–42S of IFRS 7 *Financial Instruments Disclosures* for the initial application of IFRS 9 would not require an entity to distinguish in the comparative period(s) financial assets to which the classification overlay approach is applied from financial assets that are restated for IFRS 9. This is because the disclosure requirements relate to financial assets accounted for applying IFRS 9 *at the date of initial application* (ie 1 January 2023). To provide the transition disclosures, an entity will compare the classification and carrying amount of those financial assets as at 1 January 2023 applying IFRS 9 (ie date of initial application of IFRS 9) to the classification and carrying amount at 31 December 2022 applying IAS 39 (ie information from the 2022 financial statements).

Staff recommendation

28. The staff recommend the Board propose a narrow-scope amendment to IFRS 17 as described in paragraph 3 of this paper.

Comment period for possible exposure draft

29. Paragraph 6.7 of the Due Process Handbook states that the Board normally allows a minimum period of 120 days for comment on an exposure draft. However, if the matter is narrow in scope and urgent, the Board may consider a comment period of no less than 30 days. This is subject to obtaining approval from the Due Process Oversight Committee (DPOC).

30. The narrow-scope amendment recommended by the staff in this paper will benefit entities transitioning to IFRS 17 if finalised before 1 January 2022. This is because to apply this amendment entities would need to begin collecting information from 1 January 2022. Hence, if the Board agrees with the staff recommendation, we would aim to finalise the amendment by the end of 2021 (subject to stakeholders' feedback on the exposure draft and the Board's decisions during its redeliberations).

31. Considering the timeline to publish an exposure draft and finalise the amendment, the staff recommend the Board set a comment period of 60 days. Given the limited number of insurers affected, the narrow scope of the proposal and its intended outcome, we think such a comment period would provide stakeholders with sufficient time to consider and comment on the proposal.

32. In advance of this Board meeting, we have asked the DPOC at its June meeting to approve a comment period of no less than 30 days (in case the Board decides to propose a comment period shorter than the 60 days recommended by staff).

Questions for Board members
1. Do you agree the Board should propose a narrow-scope amendment to IFRS 17 as described in paragraph 3 of this paper? **Questions 2–4 are asked only if the Board agrees to Question 1.** 2. Are you satisfied that the Board has complied with the applicable due process steps and that it should begin the balloting process to publish an Exposure Draft? (see Appendix A of this paper) 3. Subject to DPOC approval, do you agree to setting a 60-day comment period for the Exposure Draft? 4. Do any Board members intend to dissent from the proposals in the Exposure Draft?

Appendix A—Due process steps taken in developing a possible narrow-scope amendment to IFRS 17

A1. The table in this appendix sets out the required due process steps for developing an exposure draft and the actions that will satisfy those steps if the Board decides to propose a narrow-scope amendment to IFRS 17 as described in this paper.

Step	Actions
Board meetings are held in public, with papers available for observers. All decisions are made in public sessions	The Board is discussing the topic in public at its May 2021 and June 2021 meetings.
Consultation with the Trustees and the Advisory Council	The Trustees and Advisory Council will be updated on the project as part of the discussions of the Board's technical activities.
Analysis of likely effects of the forthcoming Standard or major amendment, for example, initial costs or ongoing associated costs	This would be a narrow-scope amendment that would affect only the comparative information presented by some entities on initial application of IFRS 17 and IFRS 9. The likely effect for entities that choose to apply the amendment is an improvement in the usefulness of the comparative information provided on initial application. The amendment is intended to provide relief and as such we expect it would reduce operational costs for some entities that choose to apply it. However, some entities that choose to apply it could incur additional operational costs, but we do not expect those to be significant and entities could avoid those costs by choosing not to apply the amendment.

Finalisation	
Due process steps reviewed by the Board	This paper asks the Board to review the due process steps.
The Exposure Draft has an appropriate comment period	This paper asks the Board to set the comment period.
Drafting	
Drafting quality assurance steps are adequate—The Translations team and the IFRS Taxonomy team have been included in the review process	The translations team and the IFRS Taxonomy team will review drafts during the balloting process of the Exposure Draft.
Publication	
Exposure Draft published	The Exposure Draft will be made available on the project website when published.
Press release to announce publication of the Exposure Draft	A press release will be published on our website with the Exposure Draft.