IFRS

STAFF PAPER

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Project	**Initial Application of IFRS 17 and IFRS 9—Comparative Information (Amendment to IFRS 17)**
Paper topic	Classification overlay—scope

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Introduction

1. This paper has been prepared for the Board's redeliberations of the amendment to IFRS 17 *Insurance Contracts* proposed in the Exposure Draft *Initial Application of IFRS 17 and IFRS 9—Comparative Information* (Exposure Draft).

2. This paper sets out feedback, staff analysis, recommendations, and questions for Board members relating to the scope of the proposed amendment.

3. While all respondents supported the proposal, most suggested the Board expand the scope of the proposed amendment. This paper is structured in two parts, reflecting the two areas of feedback relating to the scope:

   (a) removing the scope restriction relating to whether a financial asset is held in respect of insurance activities (Question 1); and

   (b) expanding the scope to apply for entities that already applied IFRS 9 *Financial Instruments* (Question 2).

Summary of staff recommendations

4. The staff recommend that in finalising the amendment to IFRS 17, the Board:

   (a) remove the proposed restriction from applying the classification overlay to a financial asset that is held in respect of an activity that is unconnected with contracts within the scope of IFRS 17; and

   (b) expand the proposed scope of the classification overlay to entities that already applied IFRS 9.

1—Removing the scope limitation relating to whether a financial asset is held in respect of insurance activities

Proposal

5. Paragraph C28E(a) of the Exposure Draft proposes that an entity would not be permitted to apply the classification overlay to financial assets that are 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 eligible for the classification overlay. This is consistent with a different transition relief in paragraph C29(a) of IFRS 17.

Feedback

6. Most respondents suggested the Board remove the scope restriction described in paragraph 5 of this paper, which would align the scope of the classification overlay with that of the temporary exemption from IFRS 9 for insurers.

7. Respondents noted that the temporary exemption from IFRS 9 was not limited to apply only to financial assets held in respect of insurance activities. Rather, a qualifying insurer was permitted a temporary exemption from IFRS 9 for all of its financial assets. Respondents see no reason the classification overlay should be more restricted in scope than the temporary exemption from IFRS 9, given that both aim to reduce accounting mismatches between financial assets and insurance contract liabilities.

8. Respondents also explained that the restricted scope causes operational complexity with no perceived benefit. They noted that one of the benefits of using the

classification overlay is that they can prepare to apply the classification overlay in the exact same way that they will prepare to restate comparatives for IFRS 9. They said that if they could apply the classification overlay to all financial assets for which comparatives haven't been restated for IFRS 9, they could therefore prepare comparatives in the same way for all financial assets which would significantly reduce operational complexity.

9. Respondents also expressed a view that the use of the classification overlay can only improve the comparative information presented on initial application of IFRS 9, because it will result in the comparative information being more comparable to the IFRS 9 information presented for the reporting period. As such, they see no reason to restrict the use of the classification overlay.

Staff analysis and recommendations

10. Use of the classification overlay will have three benefits for insurers preparing their first set of financial statements applying IFRS 17 and IFRS 9, namely it will:

    (a) enable insurers to reduce potentially significant accounting mismatches between financial assets and insurance contract liabilities in the comparative information;

    (b) improve comparability between the information about financial assets presented for the reporting period (eg the 2023 financial information) and the prior period (eg the 2022 comparatives); and

    (c) reduce the operational complexity involved in preparing the comparative information.

11. It is feedback relating to the benefit described in paragraph 10(a)—that is, significant accounting mismatches between financial assets and insurance contract liabilities—that persuaded the Board to propose adding the classification overlay to the IFRS 17 transition requirements.

12. That feedback focused on concerns about accounting mismatches between insurance contract liabilities and the related financial assets (ie assets held by an insurer to enable it to meet its obligations under the insurance contracts). It was this focus of the feedback, and the Board's desire to target the proposal directly at the issue of concern,

that led to the proposal in the Exposure Draft connecting the scope to financial assets held in respect of insurance activities.

13. An insurer could only qualify for the temporary exemption from applying IFRS 9 if the insurer's activities were predominantly connected with insurance and:[1]

    (a) the carrying amount of its liabilities arising from contracts within the scope of this IFRS, is significant compared to the total carrying amount of all its liabilities;

    (b) the percentage of the total carrying amount of its liabilities connected with insurance relative to the total carrying amount of all its liabilities is:

        (i) greater than 90 per cent; or

        (ii) less than or equal to 90 per cent but greater than 80 per cent, and the insurer does not engage in a significant activity unconnected with insurance.

14. Although the criteria for the temporary exemption was based on the insurer's liabilities, the staff note that it is reasonable to assume that an entity that qualified for the temporary exemption would not have a significant proportion of financial assets that are unconnected with insurance activities. The staff is therefore of the view that the cost of requiring insurers to apply different approaches to the restatement of comparative information would outweigh any perceived benefits of excluding 'unrelated' financial assets from the classification overlay.

15. Although relief from operational complexity arising from restating comparative information was not the reason the Board proposed the classification overlay, the staff can understand why removing the scope restriction in paragraph C28E(a) of the Exposure Draft would reduce operational complexity for some insurers choosing to use the classification overlay.

16. Furthermore, we agree that the use of the classification overlay will only increase, rather than reduce, the usefulness of the comparative information presented on initial application of IFRS 9 and IFRS 17. In other words, there would be no information

[1] Paragraph 20G of IFRS 4 *Insurance Contracts*

loss if the classification overlay is applied to those financial assets held in respect of non-insurance activities.

17. Therefore, the staff view is that the suggestion from respondents would be an improvement on the amendment proposed in the Exposure Draft. The staff recommend that in finalising the amendment to IFRS 17, the Board removes the proposed restriction from applying the classification overlay to a financial asset that is held in respect of an activity that is unconnected with contracts within the scope of IFRS 17.

Question 1 for Board members
Do you agree with the staff recommendation in paragraph 17 of this paper?

2—Expanding the scope to entities that already applied IFRS 9

Proposal

18. Paragraph C28A of the Exposure Draft proposes that an entity that first applies IFRS 17 and IFRS 9 at the same time is permitted to apply the classification overlay. Paragraph C28C of the Exposure Draft goes on to explain that in applying the classification overlay, an entity presents comparative information as if the classification and measurement requirements of IFRS 9—rather than IAS 39—had been applied to the financial asset.

19. The proposed classification overlay would not apply to entities that have already applied IFRS 9 before initial application of IFRS 17.

Feedback

20. A few respondents suggested the Board expand the scope of the classification overlay so that it can be applied by insurers that have already applied IFRS 9.

21. Respondents explained that those insurers have the same concerns about accounting mismatches in the comparative period relating to derecognised financial assets as insurers that will first apply IFRS 17 and IFRS 9 at the same time, which resulted in the Board proposing the classification overlay.

Staff analysis and recommendations

22. When the Board developed IFRS 17, it acknowledged that entities that already applied IFRS 9 could encounter accounting mismatches between financial assets and insurance contract liabilities on initial application of IFRS 17. Hence, the Board provided the redesignation requirements in paragraph C29 of IFRS 17.

23. Paragraph C29 of IFRS 17 provides insurers that already applied IFRS 9 with the ability to redesignate financial assets on initial application of IFRS 17, similar to the designation requirements on transition to IFRS 9. On initial application of IFRS 17, an insurer that has already applied IFRS 9 may redesignate financial assets using paragraph C29 of IFRS 17 to reduce accounting mismatches with insurance contract liabilities that might arise only when IFRS 17 is applied to those insurance contracts. Consistent with the transition requirements in IFRS 9, paragraph C29 of IFRS 17 applies at the date of initial application, and therefore does not apply to the financial assets derecognised in the comparative period.

24. The staff are sympathetic to the concerns of respondents relating to derecognised financial assets. We understand that, for example, an entity may have classified a financial asset derecognised in the comparative period as measured at amortised cost applying IFRS 9 previously, but may wish to present those financial assets as at fair value through profit or loss in the comparative information presented on initial application of IFRS 17 to reduce accounting mismatches with comparative information about insurance contracts that has been restated for IFRS 17.

25. However, based on feedback we expect this may be an issue for very few entities, and for those entities, we are not aware how significant the accounting mismatches arising from the financial assets derecognised in the comparative period would be. It is our expectation that, given those entities already apply IFRS 9, they would experience less significant accounting mismatches between financial assets and insurance contract liabilities in the comparative period compared to entities that applied IAS 39 in the comparative period.

26. Nonetheless, we think that the classification overlay could be expanded to apply for entities that already applied IFRS 9.

27. As set out in the Exposure Draft, applying the proposed classification overlay to a financial asset an entity “shall use reasonable and supportable information available at

the transition date to determine how the entity expects that financial asset to be classified on initial application of IFRS 9" (ie how the asset would be classified applying the transition requirements in IFRS 9). In the staff view, if the Board were to expand the scope of the classification overlay to apply for entities that already applied IFRS 9, it would be consistent for those entities to be required to "use reasonable and supportable information available at the transition date to determine how the entity expects that financial asset to be classified applying paragraph C29 on initial application of IFRS 17".

28. On balance, while we are not aware of this being a significant issue for entities that already applied IFRS 9, the staff view is that the scope of the classification overlay should be expanded to apply for such entities. As noted in paragraph 16 of this paper, we think the use of the classification overlay can only increase, not reduce, the usefulness of comparative information about financial assets presented on initial application of IFRS 17. We do not see a risk that expanding the scope in this way would result in less useful comparative information. Furthermore, it would not disrupt implementation because the classification overlay will be optional.

29. Therefore, the staff recommend that in finalising the amendment to IFRS 17, the Board expand the proposed scope of the classification overlay to apply for entities that already applied IFRS 9.

Question 2 for Board members
Do you agree with the staff recommendation in paragraph 29 of this paper?