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Initial application of IFRS 17 and IFRS 9 - comparative information – preparatory draft comment letter

Introduction

1 This document provides a preparatory version of EFRAG's draft comment letter in relation to expected IASB Exposure Draft relating to Initial application of IFRS 17 and IFRS 9 – comparative information.

2 This EFRAG preparatory DCL has exceptionally been prepared and published before the publication of the IASB Exposure Draft, in order to allow sufficient time to constituents to form and express a view on the expected IASB proposals.

3 The EFRAG preparatory DCL assumes that the IASB proposals in the Exposure Draft are aligned to the decisions taken by the IASB during its deliberations on the project relating to Initial application of IFRS 17 and IFRS 9 – comparative information.

4 The consultation process is intended to proceed fast, in order to allow constituents to benefit from the amendments as soon as possible. Once the IASB Exposure Draft is officially published by the IASB, EFRAG will adapt the wording of this document, with a very short reaction time for constituents.

5 This document has been approved by xxxx and presents xxxx views on the basis of the IASB tentative decisions available on xxxx 2021. For this reason, EFRAG's views in this document are preliminary and subject to changes depending on the final wording in the Exposure Draft.

6 The endorsement process is planned to commence as soon as possible after the final amendment by the IASB is issued – expected at the end of 2021. The endorsement is planned to be finalised before the effective date of IFRS 17 – 1 January 2023.

Questions to EFRAG TEG

1 Does EFRAG TEG agree with the drafting of the Appendix in this DCL? Please explain.

2 Does EFRAG TEG agree with the drafting of the cover letter of this DCL? Please explain.

Preparatory version of EFRAG Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by using the 'Express your views' page on EFRAG's website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.
Comments should be submitted by [date].

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[XX July 2021]

Dear Mr. Barckow,

Re: Initial application of IFRS 17 and IFRS 9 – comparative information

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the exposure draft xx, issued by the IASB on xx July 2021 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG would like to express its appreciation to the IASB's swift response and delivery of the ED as this is an urgent issue.

EFRAG agrees with the IASB proposals in the ED because this would:

- alleviate accounting mismatches between financial assets and insurance contract liabilities in the comparative period for those insurers who do not intend to provide IFRS 9 comparatives;
- address the impact of classification differences between financial assets derecognised in the comparative period (where IAS 39 will be applied) and other financial assets (where IFRS 9 will be applied); and
- ease the operational challenges for those insurers who want to restate the comparative information under IFRS 9.

In addressing the above, the comparative information in the financial statements of insurers would be more comparable, thereby providing relevant information for users.

[View on ECL model and 2022 opening balance sheet pending subject to EFRAG TEG discussion]

EFRAG welcomes and agrees with the IASB's decision to include the regulation of more than one comparative period in the amendment but notes the risk of using hindsight for these periods.

EFRAG notes that most insurers will first apply IFRS 17 together with IFRS 9 on 1 January 2023, but the IASB proposals will allow these insurers to collect the necessary information, beforehand, in order to provide the comparative information.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Didier Andries or me.

Yours sincerely,

Jean-Paul Gauzès

President of the EFRAG Board

Appendix – EFRAG's responses to the tentative decisions taken by the IASB in anticipation of an ED

> **Note to EFRAG IAWG/TEG/Board members**
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> This document, including the Notes to Constituents describing the proposals, has been prepared on the basis of the IASB's tentative decisions taken during its deliberations on the project on Initial application of IFRS 17 and IFRS 9 – comparative information, as published in the IASB Update of June 2021. Following the issuance of the ED, the content will be adjusted to reflect the contents of the ED itself. This document has been prepared on the assumption that there will be no significant changes to the IASB proposals.

Description 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 (i.e., 1 January 2023 for many insurers); and

(b) The IFRS 17 transition requirements apply on the transition date, being the beginning of the previous annual reporting period (i.e., 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[1] 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 and 2021 (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 (i.e., once the entity knows which assets have been derecognised in 2022 and 2021).

Previous approach by the IASB

10 During the *Amendments to IFRS 17* project (2019-2020) some stakeholders asked the IASB to amend IFRS 9 so that insurers could apply IFRS 9 from the transition date of IFRS 17 (i.e., 1 January 2022) rather than from the date of initial application (i.e., 1 January 2023).

11 The IASB acknowledged, both when it developed IFRS 17 and again in the *Amendments to IFRS 17* project, that the transition requirements of IFRS 9 and

[1] For those companies that present more than one period of comparative information under IFRS 17, the comparative periods may include 2021.

IFRS 17 differ as a result of the different circumstances that applied[2]. The IASB concluded that amending the date at which insurers apply the transition requirements in IFRS 9 would be a significant change. In the IASB's view, it had not received evidence that suggested that such an amendment was necessary. As such, the IASB did not amend IFRS 9 or IFRS 17 in response to the previous feedback.

Previous EFRAG response to transition related issues

12 EFRAG acknowledged in its Final Endorsement Advice, dated 31 March 2021, the operational burden that can be caused by applying in the comparative period both IFRS 9 and IAS 39 (the latter to be applied to assets that have already been derecognised) together.

IASB tentative decision - 22 June 2021

13 The IASB tentatively decided at its June 2021 meeting to propose a narrow-scope amendment to IFRS 17. The amendment would permit an entity to apply a classification overlay in the comparative periods 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 periods;

(b) allow an entity to classify these financial assets in the comparative periods based on a reasonable expectation of how these assets would be classified on initial application of IFRS 9;

(c) apply to 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.

14 For those entities that have not been applying IFRS 9, the classification overlay would be available for financial assets in the comparative period(s) presented on initial application of IFRS 17. This could be relevant in two cases:

(a) financial assets derecognised in the comparative period(s) for insurers that restate comparative information for IFRS 9; and

(b) financial assets related to insurance contract liabilities for insurers that do not restate comparative information for IFRS 9.

Question 1

To be completed.

EFRAG's response

EFRAG welcomes the rapid response by the IASB in response to important and urgent issue identified by the insurance industry.

EFRAG notes that the proposals are intended to avoid accounting mismatches for those insurers who do not intend to restate the comparative information under IFRS 9 and for derecognised financial assets in the comparative period for those who do intend to restate IFRS 9 comparative information. Furthermore, it will also alleviate the operationally burdensome requirements when restating comparative information under IFRS 9.

[2] The IFRS 9 transition requirements were determined as a simplification to the first-time adoption for the banking industry, as the preparers in that industry indicated that they would not be able to restate comparatives.

EFRAG agrees that this will lead to more relevant information for users and would reduce the need for extensive supplementary information to enable users to understand the statement of financial position. The reason is that the amendment would result in more comparable information being provided to users over the two (or more) periods.

The proposed amendment will also alleviate the operationally burdensome requirements for derecognised assets for those insurers who want to restate the comparative information under IFRS 9.

[View on ECL model and 2022 opening balance sheet pending subject to EFRAG TEG discussion]

EFRAG welcomes and agrees with the IASB's decision to include more than one comparative period in the amendment but note that the risk of using hindsight for these periods.

EFRAG acknowledges that the overlay approach[3] currently in IFRS 4 would not be impacted by the proposed amendment as the overlay approach applies to insurers that apply IFRS 9 in the comparative period while the classification approach only applies to insurers who do not apply IFRS 9.

15 EFRAG welcomes the IASB's quick response to the urgent issue as identified by the insurance industry. EFRAG notes that the proposals are intended to:

(a) reduce accounting mismatches for those insurers who do not intend to restate the comparative information under IFRS 9;

(b) reduce accounting mismatches relating to financial assets derecognised in the comparative period for those who do intend to restate comparative information under IFRS 9; and

(c) alleviate the burden with respect to restating comparatives under IFRS 9.

Use of IAS 39 for investments derecognised in comparative period

16 EFRAG notes that the requirement to use IAS 39 to account for investments derecognised during the comparative period affects all aspects of the financial statements. EFRAG also understands that currently at least some insurers consider that they would need to provide extensive supplementary information to assist users of financial statements to understand the 'actual' comparative information.

17 EFRAG notes that the proposed amendments would improve comparability of the information provided both year on year but also between the assets relating to insurance liabilities and those liabilities. This would enable users to understand better the statement of financial position. Therefore, this proposed amendment would result in more relevant information and would reduce the need for supplementary information in this regard.

IFRS 9 transition rules being operationally burdensome

18 Some have indicated that the existing IFRS 9 transition requirements are operationally burdensome for insurers and may constitute a significant part of the IFRS 9 implementation costs. EFRAG understands that the operational burden may become an obstacle to the voluntary presentation of comparative information under IFRS 9.

19 Furthermore, some indicated that the current transitional requirements in IFRS 9 necessitates entities to use data that come from two different accounting ledgers and pointed out that running two different ledgers in parallel is costly and technically

[3] Please refer to the Regulation here.

challenging. This would disincentivise for example, companies from restating comparative information, with a negative impact on comparability.

20 EFRAG acknowledges the operational burden related to the current transition requirements and also notes the increase in usefulness of the information resulting from the proposed amendments. Hence, EFRAG welcomes the IASB suggestion to address accounting mismatches and implementation challenges through a classification overlay.

Application of ECL to derecognised assets

21 Some insurers have noted that the transitional requirements of IFRS 9 means that the requirements regarding expected credit loss cannot be applied to the financial assets derecognised during the comparative period.

22 This would not impact the net profit or loss but the split between the profit on disposal and the amounts recognised in profit or loss relating to provision for impairment. This may not be material, but the effort involved to prove that it is not material is of concern. Furthermore, the efforts involved with applying IAS 39 to these items would mean the same difficulties as previously indicated.

Question to EFRAG TEG

23 Does EFRAG TEG agree with the comments in paragraph 21 and 22 above and/or do you consider that further comments need to be added? If so, please explain.

Comparative period opening balance sheet concerns not alleviated

24 Some insurers have noted that even with the classification overlay, they would be unable to finalise their opening balance sheet as at 1 January 2022 until 31 December 2022 (as only at the end of the year the assets derecognised in the period would be known). This would mean that they would not be in practice able to provide provisional IFRS 17 and IFRS 9 information during 2022 nor to restate the IFRS 9 information which may be negatively perceived by investors.

Question to EFRAG TEG

25 Does EFRAG TEG agree with the comments in paragraph 24? Please explain.

Scope of the classification overlay versus the deferral

26 Some insurers have noted the scope of the classification overlay is different to that of the temporary exemption from applying IFRS 9 currently in IFRS 4 paragraphs 20A and 20B.

27 EFRAG notes the scope of the classification overlay and the temporary exemption from applying IFRS 9 are as follows:

IASB Scope classification overlay	**IASB scope temporary exemption from applying IFRS 9**
Instrument by instrument basis Financial assets that relate to insurance contract liabilities	Reporting entity level All financial assets and financial liabilities subject that an insurer's activities are predominantly connected to insurance (> 80% and no significant activity unconnected to insurance)

Note to constituents:

28 In addition, EFRAG notes the specific situation of financial conglomerates who, as part of the European top-up, benefit from an extension of the temporary exemption for their insurance activities. While this situation creates its own uncertainties [how to separate assets that relate to insurance liabilities from those relating to banking activities and transfers between those, timing needed for the endorsement process for an additional top-up], EFRAG considers these are not part of its comment letter which is to be addressed to the IASB but rather part of the endorsement process when that occurs.

29 EFRAG understands that the difference in scope leads to operational complexity and inconsistencies in presentation for those financial assets that relate to the insignificant banking or asset management activities of a predominant insurer. EFRAG is of the view that for predominant insurers, it is important for users of financial statements to be able to have comparable information within the population of those predominant insurers. EFRAG suggests that the scope of the classification overlay to be aligned to the temporary exemption from applying IFRS 9 which is under IFRS 4.

30 For financial liabilities within the scope of IAS 39/IFRS 9 (i.e., not relating to insurance contracts), the issue may not be practically significant as it would result in the same classification and measurement under either standard.

More than one year of comparatives

31 EFRAG further notes that SEC registrants[4] are allowed to provide one year (instead of two) of comparative information for the statements of income, changes in shareholders' equity and cash flows prepared in accordance with IFRS Standards.

32 EFRAG welcomes and agrees with the IASB's decision to include more than one comparative period in the amendment but notes that the risk of using hindsight may exist for these periods. However, EFRAG also notes that the required disclosures for financial instruments carried at amortised cost per IFRS 13 *Fair Value Measurement* and IFRS 7 *Financial Instruments: Disclosures* will be useful in this regard.

33 Some preparers currently present two years of comparative information and the question arises if an entity needs to restate two years of comparative information of IFRS 9, or whether restating only one year is sufficient if the entity presents one year of comparative information for IFRS 17. Restating two years of IFRS 17 information may be impracticable because the implementation of IFRS 17 is currently (during 2021) not yet finished and may thus lead to the use of hindsight later on.

34 [To add if the wording of the ED is unclear or different to the expectation set out below].

[4] Note to constituents: This is a subset of the insurers in Europe that have to apply IFRS including IFRS 17.

Note to constituents: Two years of comparatives where the first is under IFRS 4

2023	IFRS 9 applied	IFRS 17 applied
2022	IFRS 9 – restated comparatives	IFRS 17 – transition date
2021	IAS 39 – no restated comparatives	IFRS 4

35 EFRAG is of the view that the classification overlay is intended to work with the application of IFRS 17 and therefore, IFRS 9 comparative information is not intended to be applicable in this case. Furthermore, EFRAG notes that preparers should not use hindsight in the application of IFRS 9.

36 Applying the classification overlay criteria:

(a) *The classification overlay allows an entity to classify financial assets in the comparative periods based on a reasonable expectation of how these assets would be classified on initial application of IFRS 9*

It is noted that if an entity has not collected sufficient information in 2021, there would be a risk of hindsight when applying IFRS 9.

(b) *The classification overlay would apply to comparative periods that have been restated for IFRS 17.*

Applying this criterion, EFRAG notes that if an entity chooses to restate only one comparative year for IFRS 17, i.e., 2022, then IFRS 9 would be applied only for 2022 because the classification overlay is only applicable in the comparative period where IFRS 17 is applied.

IFRS 4 Overlay approach vs IFRS 17 Classification overlay

Note to constituents

37 As a recollection, IFRS 4, paragraph 35B notes that an insurer is permitted, but not required, to apply the overlay approach to designated financial assets. When doing so, the insurer shall reclassify between profit or loss and other comprehensive income an amount that results in the profit or loss at the end of the reporting period for the designated financial assets being the same as if the insurer had applied IAS 39 to the designated financial assets.

38 Paragraph 35E states that a financial asset is eligible for designation for the overlay approach if, and only if, the following criteria are met:

(a) it is measured at fair value through profit or loss applying IFRS 9 but would not have been measured at fair value through profit or loss in its entirety applying IAS 39; and

(b) it is not held in respect of an activity that is unconnected with contracts within the scope of this IFRS. Examples of financial assets that would not be eligible for the overlay approach are those assets held in respect of banking activities or financial assets held in funds relating to investment contracts that are outside the scope of this IFRS.

Comparison IFRS 4 overlay approach vs IFRS 17 classification overlay

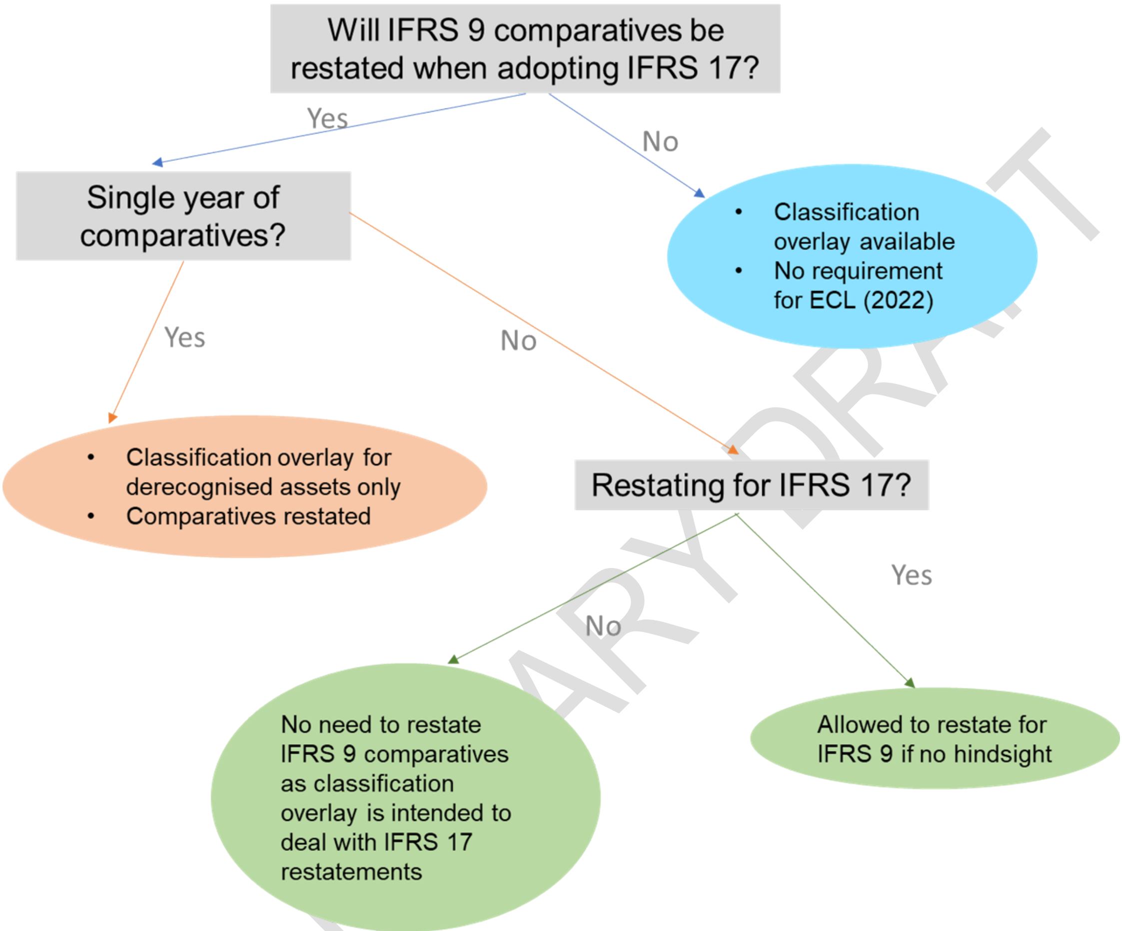
	IFRS 4 Overlay approach	**IFRS 17 Classification overlay**
IFRS 9 applied or not?	When applying the overlay approach the insurer applies IFRS 9 but not IFRS 17	Insurer applies IFRS 17 but IFRS 9 is not applicable to the comparatives or specific items
Which financial assets applied?	Designated financial assets	Financial assets that relate to insurance contract liabilities
Approach applies to recognised or derecognised financial assets?	Recognised financial assets	Derecognised (during comparative period) financial assets Recognised assets but comparative information is not restated for IFRS 9.

39 In analysing the IASB proposals, EFRAG has considered the interaction of the classification overlay with the overlay approach, if any, in IFRS 4 *Insurance Contracts*.

40 EFRAG understands that these approaches do not overlap as the IFRS 4 overlay approach is applied by those insurers that apply IFRS 9 before 2023 and the IFRS 17 classification overlay by those insurers that do not apply IFRS 9 before 2023. In addition, by accounting for the difference in financial asset carrying amounts, between the transition date to IFRS 17 and the previous carrying amount at that date, in equity, the classification is aligned with insurers who apply the overlay approach. [Wording to be updated based on ED wording]

Annex 1: Decision tree re proposed classification overlay and related aspects – for those applying IAS 39 currently

1. This annex is intended to explain the tentative decisions of the IASB and to help constituents understand the possible scenarios and outcomes. However, the final wording in the amendment will take precedent.



Annex 2: Decision tree re proposed classification overlay and related aspects – for those applying IFRS 9 currently

1. This annex is intended to explain the tentative decisions of the IASB and to help constituents understand the possible scenarios and outcomes. However, the final wording in the amendment will take precedent.