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## **Summary and analysis of the comment letters received**

- 1 Based on the comments received, the EFRAG Secretariat has developed a revised draft EFRAG final comment letter that is presented as agenda papers 01-04 (in mark-up) and 01-05 (clean).

### **Structure of the paper**

- 2 This comment letter analysis contains:
  - (a) Background;
  - (b) Summary of respondents;
  - (c) Summary of respondents' views;
  - (d) EFRAG TEG views not incorporated into DCL;
  - (e) Main positions in EFRAG's proposed final comment letter;
  - (f) Appendix 1 - detailed analysis of responses to questions in EFRAG's draft comment letter, EFRAG Secretariat's recommendations and questions to EFRAG TEG; and
  - (g) Appendix 2 – list of respondents.

### **Background**

- 3 On 28 July 2021, the IASB issued an Exposure Draft *Initial Application of IFRS 17 and IFRS 9 - Comparative Information (Proposed amendment to IFRS 17)* ("the ED").
- 4 EFRAG published a draft comment letter on the proposals on 5 August 2021. Many insurance entities will first apply IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments* for annual reporting periods beginning on or after 1 January 2023.
- 5 The ED proposes a narrow-scope amendment to the IFRS 17 transition requirements for entities that first apply IFRS 17 and IFRS 9 at the same time. This proposed amendment relates to financial assets for which comparative information presented on initial application of IFRS 17 and IFRS 9 has not been restated for IFRS 9. Applying the proposed amendment, an entity would be permitted to present comparative information about such a financial asset as if the classification and measurement requirements of IFRS 9 had been applied to that financial asset.
- 6 In the Draft Comment Letter, EFRAG expressed its appreciation for the IASB's swift response and delivery of the ED. Also, EFRAG commended the IASB for addressing most of the comments raised by European constituents in this area. Overall, EFRAG agreed with the IASB proposals in the ED as they form a clear improvement over the current situation. In finalising the proposals, EFRAG recommended the IASB to align the scopes of the classification overlay and the temporary exemption from applying IFRS 9 (which is under IFRS 4 *Insurance Contracts*) due to inconsistencies in the consolidated financial statements and unnecessary operational complexity.

### **Summary of respondents**

- 7 At the time of writing, 7 comment letters have been received (including two drafts).

### Summary of respondents' views

- 8 All respondents supported the classification overlay and provided the following main comments:
- (a) All respondents agreed that the scope of the classification overlay approach should be aligned with the scope of the temporary exemption from applying IFRS 9. This for conceptual and operational reasons. One respondent noted that it was unclear whether surplus assets were in the scope;
  - (b) While supportive of the proposal that the impairment approach is not required to be applied, it is suggested to adapt the wording to make this clearer;
  - (c) There was support for the IASB proposal not to require extensive disclosures but also concerns that disclosures would be required at both the effective date of 1 January 2023 as well as 1 January 2022. The latter disclosures would create operational burden with no benefit for users;
  - (d) The classification overlay approach should also be applicable to those insurers that do not intend or are not in a position to directly restate IFRS 9 numbers for the preceding period when applying IFRS 17 for the first time.
- 9 Some respondents also provided suggestions to further improve the draft comment letter. One respondent added that EFRAG should include in its endorsement advice a reference to permit the classification overlay to roll-up into conglomerate groups.

### EFRAG TEG views not incorporated into DCL

- 10 As detailed in agenda paper 01-03, some EFRAG TEG members agreed that their remaining concerns could be addressed as part of the final comment letter. In brief, the draft FCL has been updated to explain how the temporary exemption could be aligned to the classification overlay and a concern around the use of hindsight. The comment on duplication of transition disclosures is the same as in paragraph 8(c). For further information, please refer to agenda paper 01-03 *Remaining issues*. In addition, the comment related to the SEC requirements refers to paragraphs that were provided in the Notes to constituents, which are not part of EFRAG's FCL.

### Main positions in EFRAG's proposed final comment letter

- 11 The draft EFRAG comment letter has been updated for the following:
- (a) Expanding the reasoning for aligning the classification overlay and the temporary exemption from applying IFRS 9;
  - (b) Adding a request for clarification on the use of hindsight;
  - (c) Clarifying the optional requirement on impairment requirements;
  - (d) Indicating that views are supported by most insurers;
  - (e) Removal of paragraphs 20 and 21 about concerns about the comparative period opening balance sheet; and
  - (f) Welcoming the proposal not to add detailed disclosure requirements.

#### Question to EFRAG TEG

- 12 Does EFRAG TEG agree with EFRAG Secretariat's recommendations as described above?
- 13 Does EFRAG TEG recommend to the EFRAG Board for issue the updated comment letter?

## Appendix 1 - Detailed analysis of responses to questions in EFRAG's draft comment letter

### Question 1

Do you agree with the proposed amendment in this Exposure Draft? Why or why not? If not, what alternative do you propose and why?

#### *EFRAG's tentative position*

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

EFRAG welcomes and supports the IASB proposal as it will allow insurance entities to provide more useful information about their activities during the comparative period. EFRAG commends the IASB for addressing most of the comments raised by European constituents in this area. In particular, EFRAG notes that entities that apply the classification overlay can, but are not required to, apply the impairment requirements of IFRS 9. EFRAG also notes that the clarification not to apply the classification overlay to comparative information for reporting periods before the transition date of IFRS 17, is very helpful to address the uncertainties raised in this regard.

Based on preliminary feedback, the difference in scope between the classification overlay and the temporary exemption from applying IFRS 9 may lead to inconsistencies in the consolidated financial statements and unnecessary operational complexity (using two general ledgers relating to IAS 39 and IFRS 9). In finalising the proposals, EFRAG recommends the IASB to align the two scopes.

#### *Summary of constituents' comments*

- 14 Seven respondents support the optional classification overlay approach.
- 15 One of them supported the ED's proposal that the optional classification overlay approach should be eligible also to those insurers who do not intend or are not in a position to directly restate IFRS 9 numbers for the preceding period when applying IFRS 17 for the first time but who are still keen to achieve a consistent accounting treatment in the comparative numbers to the extent possible between the current value measurement approach for insurance liabilities under IFRS 17 and financial instruments being accounted for under IAS 39.

#### *Application of expected credit loss*

- 16 Two respondents noted that paragraph C28C is an essential part of the proposals and should be maintained in the final amendment to IFRS 17; it explicitly clarifies that the expected credit loss (ECL) model is not required to be applied when applying the classification overlay (e.g., for financial assets derecognised in the preceding period). They also understand that the ECL model is also not prohibited to be applied when useful and practical from the operational perspective of a reporting entity, and applicable without the use of hindsight.
- 17 One respondent noted the ED should specify that the impairment requirements in Section 5.5 of IFRS 9 "are permitted but not required to apply". The current wording in the ED only says in fact that entities are not required to apply them when using the overlay approach, but in our opinion, it would be very clear that entities have a choice of whether or not to apply the impairment requirements.

*Scope of the classification overlay versus the temporary exemption from applying IFRS 9*

- 18 Seven respondents agreed with the EFRAG comment letter that the scope of the overlay approach should be aligned with that of the temporary exemption from applying IFRS 9 as this would be more robust, conceptually consistent and more cost-effective.
- 19 One of them noted that the financial instruments in banking and/or asset management subsidiaries can be assessed to be insignificant from the perspective of a group reporting level if the IFRS 9 deferral is applied to the whole group. And the predominance criterion proved to be robust enough to provide useful information for users of financial statements. In addition, from the perspective of a group which is predominantly active in insurance business, it might be even argued that even these financial instruments in banking or asset management are ultimately connected to contracts within the scope of IFRS 17.
- 20 Another one noted that given the difference in scope a financial conglomerate could defer applying IFRS 9 for its entire activities. However, a conglomerate could not apply the classification overlay for financial assets within its (minor) banking activities, assuming that these are “not connected with contracts within the scope of IFRS 17”. If so, in applying the temporary exemption all financial assets are treated alike but applying the classification overlay could be complex since financial assets need to be clustered – and then be treated unlike –, depending on whether they are part of the insurance business (i.e., classification overlay available) or the banking activities (i.e., no classification overlay).
- 21 One of them noted that the approach to limit the scope of the classification overlay is conceptually not convincing. IFRS 17.C29(a) refers to “...an entity that had applied IFRS 9 to annual reporting periods before the initial application of IFRS 17”. By contrast, the classification overlay is only applicable to a financial asset that has not yet been restated for IFRS 9. Hence, the scope of application of IFRS 17.C29(a) and the classification overlay are contradictory to each other.
- 22 In this context, it should be noted that the classification overlay can only be applied by entities that have qualified and opted for the temporary exemption from IFRS 9 according to IFRS 4 paragraph 20A. Pursuant to IFRS 4 paragraph 20B(b) an insurer may apply the temporary exemption only if its activities are predominantly connected with insurance in the meaning of IFRS 4 paragraph 20D. IFRS 4 BC252 further elaborates that insurers “must assess their eligibility for the temporary exemption from IFRS 9 at the reporting entity level. That is, an entity as a whole is assessed by considering all its activities. As a result, an insurer applies either IAS 39 or IFRS 9 to all its financial assets and financial liabilities” and not only to those that are connected with insurance contracts. We believe that, for consistency reasons, the scope of the classification overlay should be aligned with the scope of the temporary exemption from IFRS 9 because those two concepts are clearly interrelated.
- 23 In addition, banking entities which file IFRS compliant separate financial statements have to apply IFRS 9 already since 1 January 2018 for this purpose. Based on this, it appears counterintuitive that banking entities which are part of an insurance group are excluded from the classification overlay and, consequently, have to apply IAS 39 for a longer period of time than the insurance entities within that group. In our opinion, the same rationale applies likewise to other activities of an insurance group, such as asset management, etc.
- 24 Another respondent noted that while the IASB considered that preparers would be familiar with ‘financial assets that are unconnected to contracts within the scope of IFRS 17’ as it is required by IFRS 17 paragraph C29(a). However, there would be no overlap between those apply paragraph C29(a) and those wanting to apply the

classification overlay. The former applies to those entities who applied IFRS 9 before applying IFRS 17 whereas the latter will be relevant to those who will first apply the two standards at the same time.

- 25 Therefore, the respondent would support the aligning of the scope of the overlay with the scope of the temporary exemption as the current differences in scope would create unnecessary complexity when adopting these standards. The respondent also notes that entities applying the classification overlay would necessarily be familiar with the scope exemption from IFRS 9.
- 26 One respondent noted it was not clear whether surplus assets are in scope of the approach.

*Two years of comparatives*

- 27 One respondent noted that the SEC requires two years of comparatives for the statements of comprehensive income, but that for IFRS reporters these should comply with full IFRS. The SEC in this respect accepts the transition requirements in IFRS. This implies that para 30 of the EFRAG draft response letter should not start with ‘Other than SEC registrants’.

*Disclosures*

- 28 One respondent welcomed the IASB’s proposal in the ED not to introduce any extensive disclosures requirements for reporting entities when using the classification overlay approach. Introducing potentially overly burdensome detailed disclosures would be indeed rather contradictive to the very pragmatic nature of this important and very much needed one-time relief. Specifically, any disclosures which would force reporting entities again to distinguish between financial assets to which the classification overlay approach was applied and to which it was not, would be fully counterproductive as it would create the operational issues which are currently assessed as overcome when the proposed amendment to IFRS 17 is finalized as is.
- 29 Two respondents noted that it is not clear if IFRS 9 transition disclosures would be required at both the effective date of 1 January 2023 as well as at the transition date which under the classification overlay approach would be 1 January 2022. Requiring disclosures at both dates may confuse the users of the financial statements as to why IFRS 9 transitional disclosures are provided for two different years. Furthermore, two sets of transitional disclosures would create an operational burden for no added benefit. The amendment to IFRS 17 should therefore clarify that IFRS 9 transitional disclosures are only required as at 1 January 2022, given that first application impacts in equity for IFRS 17 will refer also to this date, but not at both dates.

*Other comments*

- 30 One respondent suggested the following changes to the draft comment letter:
- (a) Replace “some insurance entities” with “most insurance entities” to emphasize that the issue of comparatives is not an issue faced by a small number of insurers; and
  - (b) Remove paragraphs 20 and 21 in the draft comment letter as using the IFRS 9 expected credit loss requirements would help addressing the issue of finalising the 1 January 2022 balance sheets in a timely way.

*Financial conglomerates*

- 31 One respondent requests EFRAG to include in its endorsement advice to the European Commission a reference to permit this approach to roll-up into conglomerate groups, not only at the level of the insurance companies.

## **Appendix 2 – List of respondents**

1 Respondents whose comment letters were included in this analysis (those received by 17 September 2021) were as follows:

<b>No</b>	<b>Name</b>	<b>Country</b>	<b>Type of respondent</b>
CL01	GDV	Germany	Preparer organisation
CL02	Allianz	Germany	Preparer
CL03	ASCG	Germany	Standard Setter
CL04	ESBG	Europe	Preparer organisation
CL05	CFOF and Insurance Europe	Europe	Preparer organisation
CL06	Draft 1		
CL07	Draft 2		