# Progress in new transition option for IFRS 17

Global IFRS Institute

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## Classification overlay aims to alleviate accounting mismatches in comparative information

### Highlights

- What's the issue for insurers?
- What's the optional classification overlay approach?
- What are the benefits of this approach?
- Next steps

When transitioning to IFRS 17 *Insurance Contracts* and *IFRS 9 Financial Instruments*, significant **accounting mismatches** may arise between financial assets and insurance contract liabilities in the comparative information.

The International Accounting Standards Board (the Board) is proposing a narrow-scope amendment to IFRS 17 to alleviate the potential mismatches. It will shortly publish an exposure draft with a 60-day comment period.

### What's the issue for insurers?

The different transition requirements of IFRS 17 and IFRS 9 could result in operational complexities and one-time classification differences in the comparative information presented by some insurers on initial application of these standards, as discussed by the Board in its May 2021 meeting.

To alleviate these issues, the Board is proposing a narrow-scope amendment to IFRS 17 to provide insurers with an option to present comparative information about financial assets on a basis that is more consistent with how IFRS 9 will be applied in future reporting periods using a classification overlay approach, without unnecessarily disturbing the implementation processes for both IFRS 17 and IFRS 9.

**"The proposed narrow-scope amendment will benefit insurers transitioning to IFRS 17."**

Joachim Kölschbach
KPMG Global IFRS Insurance Leader

### What's the optional classification overlay approach?

The proposed amendment would create an optional classification overlay approach: insurers would be able to choose to apply a 'classification overlay' in the the comparative period(s) presented on initial application of IFRS 17 and IFRS 9. The optional approach would apply to both insurers that restate and those that do not restate comparative information for IFRS 9.

<table>
<tr><th>Optional approach would:</th><th colspan="2">What does this mean?</th></tr>
<tr><td>Apply to financial assets that are connected to insurance contract liabilities and to which IFRS 9 has not been applied in the comparative period(s)</td><td colspan="2">The classification overlay approach would not apply to assets held for an activity that is unconnected with contracts in the scope of IFRS 17 – e.g. banking activities.</td></tr>
<tr><td rowspan="7">Allow an insurer to classify those financial assets in the comparative period(s) in a way that aligns with how the insurer expects those assets would be classified on initial application of IFRS 9</td><td colspan="2">Under the classification overlay approach, an insurer would not need to assess the business model or contractual cash flow characteristics, or apply the expected credit loss model before the date of initial application of IFRS 9. If an insurer's pre-analysis of a financial asset's expected classification is inaccurate for financial assets still held at the date of initial application, then the insurer would need to update the information.<br><br>The classifications that an insurer could apply are as follows:</td></tr>
<tr><td>Type of investments</td><td>Classifications</td></tr>
<tr><td rowspan="3">Debt instruments</td><td>Amortised cost</td></tr>
<tr><td>Fair value through profit or loss</td></tr>
<tr><td>Fair value through other comprehensive income</td></tr>
<tr><td rowspan="2">Equity instruments</td><td>Fair value through profit or loss</td></tr>
<tr><td>Fair value changes presented in other comprehensive income</td></tr>
<tr><td>Apply for comparative periods that have been restated for IFRS 17 – i.e. from the date of transition to the date of initial application of IFRS 17</td><td colspan="2">It would be available for an insurer that chooses to restate more than one comparative period on initial application of IFRS 17. However, the IASB® staff (the staff) believed that applying the overlay approach would require collecting information in real time to avoid the risk of using hindsight.</td></tr>
<tr><td>Apply on an instrument-by-instrument basis</td><td colspan="2">The overlay approach would apply on an instrument-by-instrument basis; however, the staff expects insurers to apply the approach at a higher level of aggregation, similar to the level at which the business model would be assessed for IFRS 9.</td></tr>
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## What are the benefits of this approach?

The optional approach would enhance the usefulness of comparative information by:

- enabling insurers to avoid significant mismatches and inconsistencies that do not reflect economic mismatches; and
- enhancing the comparability between periods by providing information about the classification of financial assets that is expected to be consistent with that presented for periods from the initial application of IFRS 9.

Additionally, the approach would avoid the need to separately identify financial assets derecognised during the comparative period if the insurer chooses to restate comparative information for IFRS 9. The proposed amendment could also reduce implementation costs, because the comparative information would not need to be restated for all IFRS 9 requirements.

## Next steps

The Board is aiming to finalise the amendment before 1 January 2022, because insurers would need to begin collecting information from 1 January 2022 to apply the classification overlay approach to comparative information for 2022. Therefore, the Board plans to publish an exposure draft with a 60-day comment period.

Insurers are encouraged to look out for a new exposure draft and get ready to communicate any fatal flaws to the Board. Insurers will need to analyse the draft proposals, identify the remaining operational steps, re-evaluate their approach to presenting comparative information on financial assets for 2022 and make sure that they are ready to implement any necessary system changes next year.

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