International Accounting Standards Board

7 Westferry Circus, Canary Wharf

London E14 4HD

United Kingdom

8 October 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 *Initial Application of IFRS 17 and IFRS 9 – Comparative Information (Proposed amendment to IFRS 17)*, issued by the IASB on 28 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 for the IASB's swift response and delivery of the ED as this is an urgent issue. 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 and also reduce operational challenges. The narrow-scope amendment addresses an important issue related to accounting mismatches between insurance contract liabilities and financial assets arising in the comparative information presented on initial application of IFRS 17 and IFRS 9. EFRAG commends the IASB for addressing most of the comments raised by European constituents in this area.

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

- ease the operational challenges for those insurance entities who want to restate the comparative information under IFRS 9;
- 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
- alleviate accounting mismatches between financial assets and insurance contract liabilities in the comparative period for those insurance entities who do not intend to provide IFRS 9 comparatives.

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

EFRAG notes that most insurance entities will first apply IFRS 17 together with IFRS 9 on 1 January 2023, and the IASB proposals will enable these insurance entities to improve the usefulness of the comparative information presented on initial application of IFRS 17 and IFRS 9.

However, there are some remaining sources of concern that we would like the IASB to address when finalising the amendment.

Based on feedback, the difference in scope between the classification overlay and the temporary exemption from applying IFRS 9 may lead to operational complexity (due to manual extraction of information from two parallel ledgers relating to IAS 39 and IFRS 9 to populate the general ledger) and presentation inconsistencies in the consolidated financial statements thereby putting in question the usefulness of a mixed approach within one reporting entity. In finalising the proposals, EFRAG recommends the IASB to align the scope of these two approaches.

Furthermore, EFRAG suggests that the IASB states explicitly that the classification overlay may be applied from a date pre-dating the publication of the ED or the final amendment.

EFRAG appreciates that the expected credit loss approach of IFRS 9 is not required to be applied when using the classification overlay approach. Nevertheless, we suggest clarifying the wording to make this clearer by stating that the expected credit loss requirements in IFRS 9 are permitted but not required to be applied.

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 response to the ED Initial Application of IFRS 17 and IFRS 9 – Comparative Information

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 response

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 and also reduce operational challenges. 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 ECL approach 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 feedback, the difference in scope between the classification overlay and the temporary exemption from applying IFRS 9 may lead to operational complexity (due to manual extraction of information from two parallel ledgers relating to IAS 39 and IFRS 9 to populate the general ledger) and presentation inconsistencies in the consolidated financial statements thereby putting in question the usefulness of a mixed approach within one reporting entity. In finalising the proposals, EFRAG recommends to the IASB to align the scope of these two approaches.

Furthermore, EFRAG suggests that the IASB states explicitly that the classification overlay may be applied from a date pre-dating the publication of the ED or the final amendment.

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

(a) alleviate the burden with respect to restating comparatives 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) reduce accounting mismatches for those insurance entities who do not intend to restate the comparative information under IFRS 9.

2 For these reasons, EFRAG supports the IASB proposal in the ED. EFRAG also compliments the IASB for addressing most of the issues raised by European constituents regarding this IASB proposal. In particular, the issues relating to the application of expected credit loss to derecognised assets and two-year comparatives (further details are provided below).

Use of IAS 39 for financial assets derecognised in comparative period

3 EFRAG notes that the requirement to use IAS 39 to account for items derecognised during the comparative period affects all aspects of the financial statements. EFRAG also understands that at least some insurance entities consider that they would need

to provide extensive supplementary information to assist users of financial statements to understand the 'actual' comparative information.

4 Therefore, EFRAG supports the proposals and notes that the proposed amendments would improve comparability of the information provided both year on year but also between the assets and the insurance liabilities they relate to. 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

5 The European insurance industry associations have informed EFRAG that the existing IFRS 9 transition requirements are operationally burdensome 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.

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

7 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's suggestion to address accounting mismatches and implementation challenges through a classification overlay.

Application of expected credit loss

8 The transitional requirements of IFRS 9 mean that the requirements regarding expected credit loss cannot be applied to the financial assets derecognised during the comparative period. 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. The European insurance industry associations have informed EFRAG that 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.

9 Therefore, EFRAG welcomes the proposal that in applying the classification overlay, entities can, but are not required to, apply the impairment requirements in Section 5.5. of IFRS 9. This will allow insurance entities that are sufficiently advanced in their implementation to apply the impairment requirements while those that are not sufficiently advanced are not obliged to do so but can still benefit from applying the classification overlay. We suggest clarifying the wording by stating that the application of the ECL approach in Section 5.5 of IFRS 9 is permitted but not required to apply.

10 Also, EFRAG understands that the optional application of the ECL would be consistent with the classification overlay, i.e., available on an instrument-by-instrument basis. We also suggest clarifying that the choice is on an instrument-by-instrument basis.

11 EFRAG also considers that the IAS 39 impairment requirements would apply in the absence of the IFRS 9 requirements, but such a clarification may be useful.

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

12 Most insurance entities have noted that 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.

13 EFRAG notes that 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 are held in respect of an activity that is not unconnected with contracts within the scope of IFRS 17	Reporting entity level All financial assets and financial liabilities, subject to an insurance entity's activities being predominantly connected to insurance (> 80% and no significant activity unconnected to insurance)

14 EFRAG is of the view that the scope of the classification overlay and the temporary exemption from applying IFRS 9 should be aligned for the following reasons:

(a) Cost-benefit reasons because the existing IFRS 9 transition requirements would be applied to assets that meet the IFRS 9 temporary exemption criteria but not the classification criteria. Also, it would require manual extraction of information from two parallel ledgers relating to IAS 39 and IFRS 9 to populate the general ledger, resulting in operational complexity.

(b) The proposed approach results in inconsistencies in presentation for those financial assets that relate to the insignificant banking or asset management activities of a predominant insurance entity (where IAS 39 is applied) compared to financial assets under the classification overlay (where IFRS 9 is applied). Therefore, EFRAG questions the usefulness of the resulting mixed approach (same instruments measured according to IAS 39 or IFRS 9 in different segments within one reporting entity).

(c) In addition, EFRAG is of the view that it is important for users of financial statements to be able to have comparable information within the population of those predominantly insurance entities.

(d) The IASB, in BC19 of the ED, explains that entities will be familiar with this concept because it is also required by paragraph C29(a) of IFRS 17. EFRAG notes, however, that that concept applies in very different circumstances, i.e., when IFRS 9 has been applied before IFRS 17.

15 On the basis of the reasons as described above, EFRAG recommends to the IASB in finalising the proposals, to align the scope of the classification overlay and the temporary exemption from applying IFRS 9, in order to avoid operational complexity, for cost-benefit reasons and also in order to provide more useful information. As a result, EFRAG also recommends the deletion of paragraph BC19 of the proposed amendment prohibition.

16 EFRAG also suggests that the IASB deletes paragraphs C28E(a), the second sentence of BC11(b) and BC19 of the ED to ensure that the classification overlay could be applied to all financial assets by entities applying the temporary exemption as implied by the words in C28A ("*that first applies IFRS 17 and IFRS 9 at the same time is permitted to apply the classification overlay*").

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

Applicability of the classification overlay pre-dating the ED publication

18 EFRAG notes that the ED only addresses the use of hindsight in the Basis for Conclusions (BC21 and BC26), even though entities may elect to show 2 years of comparatives (i.e., 2021 and 2022) and the amendment will not be finalised until late 2021. In the absence of guidance, there may be questions as to the applicability of the classification overlay when the ED was only published at the end of July. One way to limit the use of hindsight is to require contemporaneous documentation at the date of transition but this may prove difficult here.

19 Therefore, EFRAG considers that the final amendment should state explicitly that the classification overlay may be applied from a date that pre-dates the publication of the ED or the final amendment.

Disclosures

20 EFRAG agrees with and welcomes the IASB proposal not to add detailed disclosures about applying the classification overlay approach. We support that disclosing the fact of using the classification overlay will also avoid operational burden for the entities.

21 While not putting into question the disclosure requirements under IFRS 9 at this stage, we note that our constituents consider that when applying the classification overlay, providing IFRS 9 transitional disclosures - which are required only as of 1 January 2023 as per paragraphs 42I, 42L and 42M - as from 1 January 2022 would provide useful and relevant information to users. However, the current requirement would mean providing IFRS 9 transition disclosures at 1January 2023 and this would create an additional burden, given the timing constraints in the context of the transition.

22 EFRAG suggests that the IASB considers the need of users to understand potential material differences between the application of the classification overlay as at 31 December 2022 and first time application of IFRS 9 on 1 January 2023.