

## STAFF PAPER

May 2021

## IASB® meeting

<b>Project</b>	<b>IFRS 17 <i>Insurance Contracts</i></b>	
<b>Paper topic</b>	Initial application of IFRS 17—financial assets derecognised in the comparative period	
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**Purpose of this paper**

1. This paper is about the restatement of comparative information on initial application of IFRS 17 *Insurance Contracts* and IFRS 9 *Financial Instruments* by insurers.
2. Recently, some insurers have brought to our attention the significance of an accounting mismatch between financial assets and insurance contract liabilities that could arise at the beginning of the comparative period when financial assets have been derecognised during the comparative period. The mismatch arises because entities are not permitted to restate comparative information for those assets.
3. These insurers are of the view that this accounting mismatch will be extremely difficult to explain to users of financial statements and will not provide useful information because it does not represent an economic mismatch. In light of that feedback, this paper considers whether the Board could make a narrow-scope amendment that would reduce the accounting mismatch, without having a wider effect and creating a risk of unintended consequences.

## Summary of questions for Board members

4. Board members are asked whether they agree with the staff recommendation to propose a narrow-scope amendment to IFRS 17. The amendment would permit an entity, on initial application of IFRS 17, for the purpose of presenting comparative information, to elect to measure at fair value through profit or loss financial assets derecognised between the transition date and date of initial application of IFRS 17. The amendment would be applicable only in the circumstances described in paragraph 29(b) of this paper. The transition requirements in IFRS 9 would be retained unchanged.
5. If the Board agrees with the staff recommendation, Board members are asked:
  - (a) whether they are satisfied that the Board has complied with the applicable due process steps and should begin the balloting process to publish an Exposure Draft; and
  - (b) whether any Board member intends to dissent from the proposals in the Exposure Draft.

## Structure of this paper

6. This paper provides:
  - (a) an [overview of the IFRS 9 and IFRS 17 transition requirements](#);
  - (b) [background on previous Board discussions relevant to this paper](#);
  - (c) [recent feedback](#); and
  - (d) [staff analysis, recommendations, and questions for Board members](#).
7. This paper includes the following appendices:
  - (a) [Appendix A](#)—extracts of the relevant transition requirements in IFRS 9 and IFRS 17; and
  - (b) [Appendix B](#)—due process steps taken in developing a possible amendment to IFRS 17.

## Overview of IFRS 9 and IFRS 17 transition requirements

8. The following table summarises IFRS 9 and IFRS 17 transition for an insurer. The table assumes that the insurer has a 31 December year-end, and applies the temporary exemption from applying IFRS 9 until that exemption expires (1 January 2023).

	<b>IFRS 9</b>	<b>IFRS 17</b>
<b>Date of initial application</b>	1 January 2023	1 January 2023
<b>Transition date</b>	Not applicable	1 January 2022
<b>Retrospective application</b>	Required, with some specific exceptions	Required, with some specific exceptions and reliefs
<b>Restatement of comparative information</b>	Permitted but not required	Required for the annual reporting period immediately preceding the date of initial application
<b>Scope of items for which retrospective application applies</b>	All financial assets in the scope of IFRS 9 that continue to be recognised at the date of initial application. An entity is prohibited from applying IFRS 9 to assets derecognised before that date	All insurance contracts in the scope of IFRS 17 that continue to be recognised at the transition date, or are recognised on or after that date

9. The following table summarises how the different Standards apply for that insurer, assuming the insurer voluntarily restates comparative information for IFRS 9:

Financial statements	2022	2023	
Information relating to	2022	Restated comparatives for 2022	2023
Financial assets that continue to be recognised at 1 January 2023	IAS 39	IFRS 9	IFRS 9
Financial assets derecognised between 1 January 2022–1 January 2023	IAS 39	IAS 39	Not applicable
Insurance contract liabilities	IFRS 4	IFRS 17	IFRS 17

### Previous Board discussions relevant to this paper

10. During the *Amendments to IFRS 17* project (2019–2020) some stakeholders asked the Board to amend IFRS 9 so that insurers could apply IFRS 9 from the transition date (1 January 2022) rather than from the date of initial application (1 January 2023). This would allow insurers to apply IFRS 9 to financial assets derecognised during the comparative period. Those stakeholders said that such an amendment would be helpful because the prohibition from applying IFRS 9 to derecognised financial assets:
- (a) creates inconsistency for insurers that want to voluntarily restate comparative information for IFRS 9 because some financial assets are accounted for applying IFRS 9 and others IAS 39;
  - (b) creates operational challenges for insurers that want to voluntarily restate comparative information for IFRS 9 and thus could disincentivise insurers from doing so; and

- (c) could create accounting mismatches during the comparative period.
11. At that time, the Board noted that when IFRS 9 was being developed the Board had extensively discussed and consulted on the IFRS 9 transition requirements, including prohibiting an entity from applying IFRS 9 to derecognised items and permitting (but not requiring) an entity to restate comparative periods in some circumstances. The Board acknowledged, both when it developed IFRS 17 and again in the *Amendments to IFRS 17* project, that the transition requirements of IFRS 9 and IFRS 17 differ as a result of the different circumstances that applied when the Board developed the respective transition requirements.
  12. Amending the date at which insurers apply the transition requirements in IFRS 9 would be a significant change. In the Board's view, it had not received evidence that suggested that such an amendment was necessary. As such, the Board did not amend IFRS 9 or IFRS 17 in response to the feedback in paragraph 10.

### **Recent feedback**

13. Some insurers that applied the temporary exemption from IFRS 9 plan to voluntarily restate comparative information on initial application of IFRS 9 alongside the required restated comparative information for IFRS 17. This will improve the understandability of the comparative information provided on initial application of the two Standards.
14. When IFRS 17 becomes effective, accounting mismatches may arise between financial assets and insurance contract liabilities as a result of financial assets continuing to be recognised at amortised cost. On initial application of IFRS 9, an entity is permitted to designate financial assets that would otherwise be measured at amortised cost instead at fair value through profit or loss to avoid such mismatches.
15. Some insurers plan to use this option. However, the issue is that they cannot apply the same option to derecognised financial assets because IFRS 9 does not apply to derecognised assets. This could result in the following accounting:

	<b>Restated comparatives for 2022</b>	<b>2023</b>
<b>Financial assets that continue to be recognised at 1 January 2023</b>	Measured at fair value (IFRS 9)	Measured at fair value (IFRS 9)
<b>Financial assets derecognised between 1 January 2022–1 January 2023</b>	Measured at amortised cost (IAS 39)	Not applicable
<b>Insurance contract liabilities</b>	Measured using current information (IFRS 17)	Measured using current information (IFRS 17)

16. Some insurers have told us that for them the accounting mismatch could be so significant that it results in negative equity at the transition date. Assisting users of financial statements to understand the changes introduced on initial application of IFRS 17 and IFRS 9 will be a challenge, and those insurers said that this accounting mismatch would only add to that challenge.
17. It should be noted that this accounting mismatch will:
- (a) exist only in the comparative information presented on initial application of IFRS 17. In addition, the mismatch will exist only until the date the relevant financial assets are derecognised (which is before the end of the comparative period).
  - (b) arise only for some insurers, and for some of those insurers the effect of the accounting mismatch may not be significant. Some insurers already measure financial assets related to their insurance contract liabilities at fair value rather than amortised cost, and some insurers already use current information to measure insurance contracts applying IFRS 4. In addition, some insurers may choose not to restate comparative information on initial application of IFRS 9.

***Insurers that applied IFRS 9 before IFRS 17***

18. This same accounting mismatch on initial application of IFRS 17 can also arise for entities that have already applied IFRS 9. Therefore, the IFRS 17 transition requirements permit those entities to apply the fair value option in IFRS 9. Consistent with the transition requirements in IFRS 9, that requirement in IFRS 17 applies at the date of initial application (1 January 2023) and therefore does not apply to derecognised financial assets. As such, those entities may face the same issue discussed in paragraphs 13–17.

**Staff analysis and recommendations**

19. In the light of recent feedback, the staff continue to agree with the Board’s previous decision not to amend IFRS 9 so that insurers can apply IFRS 9 from the transition date (1 January 2022) rather than the date of initial application (1 January 2023).
20. Stakeholders have suggested that to allow insurers to reduce this accounting mismatch the Board should delete the sentence in paragraph 7.2.1 of IFRS 9 that states “This Standard shall not be applied to items that have already been derecognised at the date of initial application”. However, we note that doing this would give rise to new challenges for assets derecognised before the date of initial application. This is because classification and measurement of financial assets as required in the IFRS 9 transition requirements is based on facts and circumstances *at the date of initial application*.<sup>1</sup> The issue we are discussing relates to assets that are derecognised before the date of initial application. In other words, there are no facts and circumstances at the date of initial application that apply to those financial assets. As such, to achieve what stakeholders requested, additional changes would need to be made to IFRS 9. For example, the Board would have needed to change the transition requirements in IFRS 9 to permit or require the classification and measurement of financial assets based on facts and circumstances at the transition date as opposed to the date of initial application.

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<sup>1</sup> Apart from the assessment of the cash flow characteristics of a financial asset, which is based on the facts and circumstances that existed at initial recognition of the financial asset.

21. This would be a significant amendment to the transition requirements in IFRS 9 that could result in a risk of unintended consequences. In addition, the Board would need to carefully consider the conditions of the amendment. As an example, the Board would need to consider whether the amendment is:
- (a) required or permitted; and
  - (b) applicable only to derecognised financial assets, only to financial assets related to insurance contract liabilities or to all financial assets.
22. Despite the analysis in paragraphs 19–21, we are sympathetic to the concern expressed in recent feedback. We think the Board could consider adding a specific transition requirement to IFRS 17 to help with that accounting mismatch, without unnecessarily disturbing the transition requirements in IFRS 9.
23. The accounting mismatch is a very specific issue that is relevant only to some insurers and only to some financial assets. As such, we think if the Board were to consider an amendment to reduce the accounting mismatch, that amendment should be a new requirement in the IFRS 17 transition requirements that:
- (a) is directly targeted at addressing the accounting mismatch. This would reduce the risk of unintended consequences and would ensure that the transition requirements for financial assets that continue to be recognised at the date of initial application remain unchanged.
  - (b) is optional for entities. This would avoid disrupting implementation and creating further work for entities that do not want or need an amendment to address the accounting mismatch. For example, introducing a requirement to apply IFRS 9 instead of IAS 39 to such derecognised financial assets at this time could be unduly disruptive to implementation processes.

24. To achieve this, we think an option would need to have the following characteristics:
- (a) it would permit an entity, on initial application of IFRS 17, for the purpose of presenting comparative information, to elect to measure at fair value through profit or loss financial assets derecognised between the transition date and the date of initial application of IFRS 17.
  - (b) it would apply only:
    - (i) when an entity chooses to provide restated comparative information applying either paragraph 7.2.15 of IFRS 9 or paragraph C31 of IFRS 17;
    - (ii) to financial assets that are related to insurance contract liabilities;
    - (iii) if application of the option would eliminate or significantly reduce an accounting mismatch between financial assets and insurance contract liabilities assessed at the transition date of IFRS 17; and
    - (iv) if the information needed to determine the fair value was obtained at the transition date of IFRS 17 and thus is possible without the use of hindsight.
25. The staff note that an option with the characteristics set out in paragraph 24 would not change the transition requirements in IFRS 9 which would continue to apply based on facts and circumstances at the date of initial application. Furthermore, assessments required by IFRS 9, such as determining the entity’s business model for managing the financial assets or significant increases in credit risk, would not apply to the derecognised financial assets that are the subject of such an option. In effect, for these assets it would continue to be the case that IFRS 9 would not apply but instead a new option would be introduced in IFRS 17 to assist in the presentation of comparative information. The only assessment that an entity would be required to make at the transition date to IFRS 17 is whether there is an accounting mismatch.

***Other feedback***

26. In addition to raising concerns about the accounting mismatch, some stakeholders have indicated that they would like an option to apply the amortised cost measurement requirements in IFRS 9 to financial assets derecognised in the comparative period to IFRS 17.

27. The staff note that it would not be possible to apply the expected credit loss model in IFRS 9 to those derecognised assets because paragraph 7.2.18 of IFRS 9 requires an entity to assess whether there has been a significant increase in credit risk based on the credit risk on the *date of initial application* (ie 1 January 2023) compared to the credit risk on initial recognition. As the financial assets have been derecognised at the date of initial application of IFRS 9, an entity would not be able to determine what the credit risk on that date would have been.
28. Furthermore, in contrast to the main topic of this paper, we are not aware of a reason for the Board to add any specific new requirement to IFRS 17 in response to this feedback. The main difference between the amortised cost measurement requirements in IFRS 9 compared to IAS 39, is that the impairment model is based on expected credit losses rather than incurred losses. Permitting an entity to present derecognised financial assets as if an expected credit loss impairment model had been applied would not reduce an accounting mismatch between financial assets and insurance contract liabilities.

### ***Staff recommendation and next steps***

29. Considering the analysis in paragraphs 19–28, the staff recommend the Board propose a narrow-scope amendment to IFRS 17. The amendment would:
- (a) permit an entity, on initial application of IFRS 17, for the purpose of presenting comparative information, to elect to measure at fair value through profit or loss financial assets derecognised between the transition date and the date of initial application of IFRS 17.
  - (b) apply only:
    - (i) when an entity chooses to provide restated comparative information applying either paragraph 7.2.15 of IFRS 9 or paragraph C31 of IFRS 17;
    - (ii) to financial assets that are related to insurance contract liabilities;
    - (iii) if application of the option would eliminate or significantly reduce an accounting mismatch between financial assets and insurance contract liabilities assessed at the transition date of IFRS 17; and

(iv) if the information needed to determine the fair value was obtained at the transition date of IFRS 17 and thus is possible without the use of hindsight.

30. The staff note that if the Board were to propose a narrow-scope amendment, to provide the intended relief for entities transitioning to IFRS 17, it would need to be finalised and endorsed before 1 January 2023. We also note that to apply any such narrow-scope amendment entities would need to begin collecting information from 1 January 2022. Hence, to provide certainty to stakeholders, we would aim to finalise the narrow-scope amendment by the end of this year.
31. To facilitate this timing, and considering that the amendment would be narrow in scope and optional, if the Board agrees with the staff recommendation, we intend to ask the Due Process Oversight Committee for a comment period of less than 120 days. We would then ask the Board for approval of the comment period at the June 2021 Board meeting.

**Questions for Board members**

1. Do you agree the Board should propose a narrow-scope amendment to IFRS 17 as described in paragraph 29 of this paper?
2. If the Board agrees with the staff recommendation, are you satisfied that the Board has complied with the applicable due process steps and that it should begin the balloting process for the publication of an Exposure Draft? (see Appendix B of this paper)
3. If the Board agrees with the staff recommendation, do any Board members intend to dissent from the proposals in the Exposure Draft?

## Appendix A—Extracts of relevant transition requirements in IFRS 9 and IFRS 17

### ***Relevant transition requirements in IFRS 9***

A1. Paragraphs 7.2.1 of IFRS 9 states:

An entity shall apply this Standard retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 7.2.4–7.2.26 and 7.2.28. This Standard shall not be applied to items that have already been derecognised at the date of initial application.

A2. Paragraph 7.2.2 of IFRS 9 states:

For the purposes of the transition provisions in paragraphs 7.2.1, 7.2.3–7.2.28 and 7.3.2, the date of initial application is the date when an entity first applies those requirements of this Standard and must be the beginning of a reporting period after the issue of this Standard. ...

A3. Paragraph 7.2.3 of IFRS 9 states:

At the date of initial application, an entity shall assess whether a financial asset meets the condition in paragraph 4.1.2(a) or 4.1.2A on the basis of the facts and circumstances that exist at that date. The resulting classification shall be applied retrospectively irrespective of the entity’s business model in prior reporting periods.

A4. Paragraph 7.2.8 of IFRS 9 states:

At the date of initial application an entity may designate:

- (a) a financial asset as measured at fair value through profit or loss in accordance with paragraph 4.1.5; or
- (b) an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.7.5.

Such a designation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

A5. Paragraph 7.2.15 of IFRS 9 states:

Despite the requirement in paragraph 7.2.1, an entity that adopts the classification and measurement requirements of this Standard (which include the requirements

related to amortised cost measurement for financial assets and impairment in Sections 5.4 and 5.5) shall provide the disclosures set out in paragraphs 42L–42O of IFRS 7 but need not restate prior periods. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application. However, if an entity restates prior periods, the restated financial statements must reflect all of the requirements in this Standard. ...

A6. Paragraph 7.2.18 of IFRS 9 states that for impairment:

At the date of initial application, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that a financial instrument was initially recognised (or for loan commitments and financial guarantee contracts at the date that the entity became a party to the irrevocable commitment in accordance with paragraph 5.5.6) and compare that to the credit risk at the date of initial application of this Standard.

### ***Relevant transition requirements in IFRS 17***

A7. Paragraph C1 of IFRS 17 states:

An entity shall apply IFRS 17 for annual reporting periods beginning on or after 1 January 2023. If an entity applies IFRS 17 earlier, it shall disclose that fact. Early application is permitted for entities that apply IFRS 9 Financial Instruments on or before the date of initial application of IFRS 17.

A8. Paragraph C2 of IFRS 17 states:

For the purposes of the transition requirements in paragraphs C1 and C3–C33:

- (a) the date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 17; and
- (b) the transition date is the beginning of the annual reporting period immediately preceding the date of initial application.

A9. Paragraph C4 of IFRS 17 states:

To apply IFRS 17 retrospectively, an entity shall at the transition date:

- (a) identify, recognise and measure each group of insurance contracts as if IFRS 17 had always applied; ...

A10. Paragraph C29 of IFRS 17 states:

At the date of initial application of IFRS 17, an entity that had applied IFRS 9 to annual reporting periods before the initial application of IFRS 17:

- (a) may reassess whether an eligible financial asset meets the condition in paragraph 4.1.2(a) or paragraph 4.1.2A(a) of IFRS 9. A financial asset is eligible only if the financial asset is not held in respect of an activity that is unconnected with contracts within the scope of IFRS 17. Examples of financial assets that would not be eligible for reassessment are financial assets held in respect of banking activities or financial assets held in funds relating to investment contracts that are outside the scope of IFRS 17.
- (b) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if the condition in paragraph 4.1.5 of IFRS 9 is no longer met because of the application of IFRS 17.
- (c) may designate a financial asset as measured at fair value through profit or loss if the condition in paragraph 4.1.5 of IFRS 9 is met.
- (d) may designate an investment in an equity instrument as at fair value through other comprehensive income applying paragraph 5.7.5 of IFRS 9.
- (e) may revoke its previous designation of an investment in an equity instrument as at fair value through other comprehensive income applying paragraph 5.7.5 of IFRS 9.

A11. Paragraph C31 of IFRS 17 states:

An entity that applies paragraph C29 is not required to restate prior periods to reflect such changes in designations or classifications. The entity may restate prior periods only if it is possible without the use of hindsight. If an entity restates prior periods, the restated financial statements must reflect all the requirements of IFRS 9 for those affected financial assets. If an entity does not restate prior periods, the entity shall recognise, in the opening retained earnings (or other component of equity, as appropriate) at the date of initial application, any difference between:

- (a) the previous carrying amount of those financial assets; and
- (b) the carrying amount of those financial assets at the date of initial application.

## Appendix B—Due process steps taken in developing a possible amendment to IFRS 17

B1. The table in this appendix sets out the required due process steps for developing an exposure draft and the actions that will satisfy those steps if the Board decides to propose amendment to IFRS 17 as described in this paper.

Step	Actions
<b>Board meetings are held in public, with papers available for observers. All decisions are made in public sessions</b>	The Board is discussing the topic in public at its May 2021 meeting.
<b>Consultation with the Trustees and the Advisory Council</b>	The Trustees and Advisory Council will be updated on the project as part of the discussions of the Board’s technical activities.
<b>Analysis of likely effects of the forthcoming Standard or major amendment, for example, initial costs or ongoing associated costs</b>	This would be a narrow-scope amendment that would affect only the restated comparative information presented by some entities on initial application of IFRS 17. The likely effect for entities that choose to apply the amendment is an improvement in the usefulness of the comparative information provided on initial application of IFRS 17. Entities that choose to apply the amendment may incur some additional operational costs, but we do not expect those to be significant and entities could avoid those costs by choosing not to apply the amendment.
<b>Finalisation</b>	
<b>Due process steps reviewed by the Board</b>	This paper asks the Board to review the due process steps.

<p><b>The Exposure Draft has an appropriate comment period</b></p>	<p>If the Board agrees with the staff recommendation in this paper, we intend to ask the Due Process Oversight Committee for a comment period of less than 120 days. We would then ask the Board to approve the comment period at the June 2021 Board meeting.</p>
<p><b>Drafting</b></p>	
<p><b>Drafting quality assurance steps are adequate—The Translations team and the IFRS Taxonomy team have been included in the review process</b></p>	<p>The translations team and the IFRS Taxonomy team will review drafts during the balloting process of the Exposure Draft.</p>
<p><b>Publication</b></p>	
<p><b>Exposure Draft published</b></p>	<p>The Exposure Draft will be made available on the project website when published.</p>
<p><b>Press release to announce publication of the Exposure Draft</b></p>	<p>A press release will be published on our website with the Exposure Draft.</p>