

To: Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Date: 14 January 2014

DP/2013/1: A Review of the Conceptual Framework for Financial Reporting

Dear Mr Hoogervorst,

We are taking this opportunity to comment on your Discussion Paper "A Review of the Conceptual Framework for Financial Reporting" (the "DP"). This letter has been drafted by Insurance Europe, representing 95% of the premium income of the European insurance market and the European Insurance CFO Forum, a body representing the views of 21 of Europe's largest insurance companies. Accordingly it represents the consensus view of a significant element of the European insurance industry.

We would like to thank the IASB for the significant effort it has taken in developing the DP on the Conceptual Framework and we welcome the opportunity to comment on the proposals. We support the IASB's efforts to resolve the problems that have been identified with the current Conceptual Framework. Our response focuses mainly on particular areas that are important to our members in the development of an appropriate framework for financial reporting e.g. the role of the business model in financial reporting, the measurement of assets and liabilities, the presentation in profit and loss, the use of OCI and disclosures.

Our main views are the following:

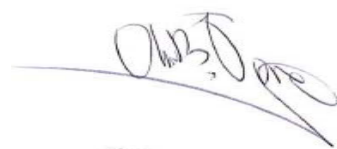
- The business model plays a role in financial reporting and thus should be part of the revised Conceptual Framework as financial statements would be made relevant by considering how an entity conducts its business activities. The notion of business model is very important for accounting for insurance activities. Insurers apply asset-liability management (ALM) strategies in which insurance liabilities and guarantees and their related assets are managed together according to the insurance contract liability profile to meet obligations towards policyholders.
- We support a mixed measurement model for assets and liabilities.
- The P&L should be the primary performance statement, separately from OCI. The Conceptual Framework should include a principle that items in OCI should be recycled through P&L. In many cases, OCI items will automatically reverse over time. There may be cases where recycling does not provide relevant information, such cases should be dealt with in individual IFRSs.
- A principle based disclosure framework is needed.
- Further analysis is required on the impact of the proposed changes.

It is important that the development of the Conceptual Framework is consistent with IFRSs currently under development, particularly IFRS 4 and IFRS 9 which are still subject to further deliberation and change. We believe the future Conceptual Framework exposure draft should identify any inconsistencies between the Conceptual Framework, existing standards and standards under development, with an explanation of how such inconsistencies will be addressed. We have also previously expressed the view that IFRS 4 and IFRS 9 should be finalised without any further delay to the extent that it is not to the detriment of their quality. Consequently, we believe that the Framework's development should not delay those standards, nor result in their reopening soon after finalisation.

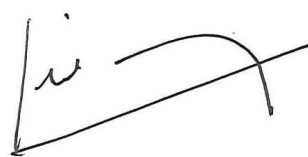
Overall, we note that the DP contains a significant amount of guidance. We consider that the final Conceptual Framework be kept principle based and as concise as possible. We recommend that most guidance on application should continue to be included in the individual IFRSs.

Please find in the appendix our detailed responses. Feel free to contact us to discuss any matters in this letter.

Yours sincerely,



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Director Economics & Finance, Insurance Europe



Gerald Harlin
Chair
European Insurance CFO Forum

■ Section 1 - Introduction

Question 1

Paragraphs 1.25–1.33 set out the proposed purpose and status of the Conceptual Framework. The IASB's preliminary views are that:

- a) the primary purpose of the revised Conceptual Framework is to assist the IASB by identifying concepts that it will use consistently when developing and revising IFRSs; and
- b) in rare cases, in order to meet the overall objective of financial reporting, the IASB may decide to issue a new or revised Standard that conflicts with an aspect of the Conceptual Framework. If this happens the IASB would describe the departure from the Conceptual Framework, and the reasons for that departure, in the Basis for Conclusions on that Standard.

Do you agree with these preliminary views? Why or why not?

We would like to express our strong support for the rationale described in paragraphs 1.22-1.24 of the DP that the changes to the Conceptual Framework should not immediately affect existing standards.

Regarding paragraphs 1.25–1.33, several discussion items in the DP could directly or indirectly impact the current deliberations on IFRS 4 and IFRS 9 (such as the definition of assets and liabilities, OCI and the notion of business model). There is a risk that this could further delay the finalisation of these standards or re-open the requirements very soon after their finalisation. It is paramount for insurers that the outcome of the DP will be consistent with, or at a minimum, not impact these standards during their development or during and shortly after their implementation period. A stable period is much needed during both the implementation periods and in the subsequent reporting periods.

Regarding the primary purpose we agree that the revised Conceptual Framework should be developed with a focus of assisting the IASB in developing standards (paragraph 1.26). We also have the view that the Conceptual Framework can be helpful in understanding the requirements of IFRS generally and in developing accounting policies when no Standard or Interpretation specifically applies to a particular transaction or event.

We support the IASB's view that the principles of the Conceptual Framework should not override a specific standard or interpretation. We acknowledge that in some circumstances it may be necessary to depart from the Conceptual Framework in a particular IFRS or interpretation, although we note that departures may be more frequent than in "rare" circumstances. We agree that it is appropriate to describe the reasons for a departure from the Conceptual Framework in the Basis of Conclusions for an IFRS, and there to give the rationale for the departure as well.

■ Section 2 – Elements of financial statements

Question 2

The definitions of an asset and a liability are discussed in paragraphs 2.6–2.16. The IASB proposes the following definitions:

- (a) an asset is a present economic resource controlled by the entity as a result of past events.
- (b) a liability is a present obligation of the entity to transfer an economic resource as a result of past events.
- (c) an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Do you agree with these definitions? Why or why not? If you do not agree, what changes do you suggest, and why?

We agree with the revised definitions of an asset, a liability and an economic resource. The separate definition of an “economic resource” taken together with the revised definitions of assets and liabilities is consistent with the existing definitions and will possibly help to reduce any confusion that could arise between resource and obligation and resulting flows of economic benefits. However, we believe that further analysis of the impact of the new definitions is necessary given their significance to ensure the full implications of the revised definitions are understood. For example, we are interested in the IASB’s consideration on the impact of introducing the notion of “capable” for economic resources on assets and liabilities, for example, for internally generated intangible assets. Furthermore, we believe further analysis is needed on whether the definition of an asset should retain a notion of “control” or whether this notion should instead be part of recognition.

■ Section 3 – Additional guidance to support the asset and liability definitions

Question 5

Constructive obligations are discussed in paragraphs 3.39–3.62. The discussion considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. However, the IASB tentatively favours retaining the existing definition, which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion. The guidance would clarify the matters listed in paragraph 3.50.

Do you agree with this preliminary view? Why or why not?

We strongly support the IASB retaining the existing definition of a liability which encompasses both legal and constructive obligations. Limiting liabilities to obligations to only those that are enforceable by legal or equivalent means will result in providing less relevant information to users of financial statements about entity’s future cash flows. We also agree with the IASB’s proposal to add guidance to support the definition of ‘constructive obligation’ and distinguish that more clearly from economic compulsion.

Question 6

The meaning of ‘present’ in the definition of a liability is discussed in paragraphs 3.63–3.97. A present obligation arises from past events. An obligation can be viewed as having arisen from past events if the amount of the liability will be determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period. However, it is unclear whether such past events are sufficient to create a present obligation if any requirement to transfer an economic resource remains conditional on the entity’s future actions. Three different views on which the IASB could develop guidance for the *Conceptual Framework* are put forward:

- (a) View 1: a present obligation must have arisen from past events and be strictly unconditional. An entity does not have a present obligation if it could, at least in theory, avoid the transfer through its future actions.
- (b) View 2: a present obligation must have arisen from past events and be practically unconditional. An obligation is practically unconditional if the entity does not have the practical ability to avoid the transfer through its future actions.
- (c) View 3: a present obligation must have arisen from past events, but may be conditional on the entity’s future actions.

The IASB has tentatively rejected View 1. However, it has not reached a preliminary view in favour of View 2 or View 3. Which of these views (or any other view on when a

We support the IASB in rejecting View 1. We would welcome further analysis on what distinguishes View 2 from View 3 in order to be able to better evaluate the proposals, in particular what kinds of circumstances would preclude a present obligation under view 2 but support one under view 3.

■ **Section 6 - Measurement**

Question 11

How the objective of financial reporting and the qualitative characteristics of useful financial information affect measurement is discussed in paragraphs 6.6–6.35. The IASB’s preliminary views are that:

- a) the objective of measurement is to contribute to the faithful representation of relevant information about:
 - i. the resources of the entity, claims against the entity and changes in resources and claims; and
 - ii. how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources.
- b) a single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements;
- c) when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI;
- d) the relevance of a particular measurement will depend on how investors, creditors and other lenders are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:
 - i. for a particular asset should depend on how that asset contributes to future cash flows; and
 - ii. for a particular liability should depend on how the entity will settle or fulfil that liability.
- e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained; and
- f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Do you agree with these preliminary views? Why or why not? If you disagree, what alternative approach to deciding how to measure an asset or a liability would you support?

We agree with the IASB’s preliminary views concerning the objective of measurement. In particular:

- We agree that there is a need for different measurement models depending on the contribution of assets to future cash flows and how liabilities will be settled.
- We support the use of mixed measurement model hence agree that there should not be a single measurement model. A single measurement model could result in irrelevant measurement of assets and liabilities in some circumstances.
- We believe that information presented in profit or loss and in OCI will, together, provide relevant information to users of financial statements. We agree when selecting the measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI.

The interaction between assets and liabilities is a fundamental core of an insurer’s approach to managing its business and reporting performance. Insurers apply asset liabilities management (ALM) strategies in which insurance liabilities, guarantees and their related financial and non-financial assets are managed together according to the insurance contract liability profile to meet obligations to policyholders. We recommend that the IASB gives consideration to an entity’s business model when developing guidance on determining the appropriate measurement model for assets and liabilities, taking into account the ALM strategies adopted by insurers.

A mixed measurement approach is important to reflect the linkage between assets and liabilities and the entity's approach to managing the assets and liabilities with consistent measurement between assets and liabilities.

Question 12

The IASB's preliminary views set out in Question 11 have implications for the subsequent measurement of assets, as discussed in paragraphs 6.73–6.96. The IASB's preliminary views are that:

- a) if assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.
- b) if assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.
- c) if financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.
- d) if an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

We agree in principle with the preliminary views of the IASB in this area. However, we believe that the measurement basis for assets and liabilities should also reflect any linkage that exists between assets and liabilities. This is particularly relevant for insurance companies due to the inherent linkage between insurance liabilities and underlying assets, especially in participating contracts. Thus, it is important to consider the entity's business model for managing assets in setting a measurement basis (e.g. in line with the role of the business model in IFRS 9).

It is also important that there are no inconsistencies between the IASB's views in the Conceptual Framework and the current deliberations on IFRS 9. For example, whilst cost-based measurements are relevant for assets that contribute to future cash flows through use, this should not be the only measurement available for such assets. Fair value measurement may also be an appropriate basis, for example when an entity assesses information about those assets on a fair value basis. This is recognised in the business model concept in IFRS 9. Inconsistencies between the Conceptual Framework and IFRSs may cause confusion for preparers and further complicate implementation of the standard. Furthermore, we believe the criteria for which financial instruments qualify for amortised cost and FVOCI measurement should be addressed within IFRS 9 and not within the Conceptual Framework. Consequently, the use of the term "insignificant variability" in contractual cash flows for cost based measurement in the Conceptual Framework is unhelpful.

Question 13

The implications of the IASB's preliminary views for the subsequent measurement of liabilities are discussed in paragraphs 6.97–6.109. The IASB's preliminary views are that:

- a) cash flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.
- b) a cost-based measurement will normally provide the most relevant information about:
 - i. liabilities that will be settled according to their terms; and
 - ii. contractual obligations for services (performance obligations).
- c) current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Do you agree with these preliminary views and the proposed guidance in these paragraphs? Why or why not? If you disagree, please describe what alternative approach you would support.

We support the IASB view of a cash flow based measurement for liabilities without stated terms as most suitable due to the lack of a cost that could be associated with such a liability. The insurance contracts project for example introduces measurement based on entity-specific current fulfilment values which are more relevant than a current market value due to the absence of observable market prices. Moreover, insurers are not trading the contracts; rather they are fulfilling a service.

We also agree that a cost based measure is more suitable for liabilities that will be settled according to their terms and contractual obligations for services. When services or obligations are fulfilled by the entity itself a cost-based measure might be more suitable because it would reflect the entity's future cash outflows.

The guidance for liability measurement should be expressed in such a way as to not be overly prescriptive as it is important the exact measurement approach is described in the respective IFRS, which may or may not reflect all aspects described in the Conceptual Framework. For example, we note that the description of factors considered in cash-flow based measurements for liabilities do not fully reflect the proposals in the Insurance Contracts Project. The description in paragraphs 6.112(c) and 6.115 of the factors considered in other cash-flow-based measurements refers to the price an investor requires for uncertainty in asset measurement, but it should also include the compensation an entity requires for uncertainty in liability measurement, as in the Insurance Contracts project.

Similarly, whilst we believe that insurance liabilities would be intended to be captured by part (a) on cash flow based measurement, elements of insurance contracts could equally be captured by (b) i and ii. As (b)i could apply to fixed benefits within insurance contracts (e.g. surrender values and immediate or regular pay-out annuities) and (b)ii could capture certain performance obligations under insurance contracts (e.g. asset management services).

■ Section 7 – Presentation and disclosure

Question 16

This section sets out the IASB's preliminary views about the scope and content of presentation and disclosure guidance that should be included in the *Conceptual Framework*. In developing its preliminary views, the IASB has been influenced by two main factors:

- a) the primary purpose of the *Conceptual Framework*, which is to assist the IASB in developing and revising Standards (see Section 1); and
- b) other work that the IASB intends to undertake in the area of disclosure (see paragraphs 7.6–7.8), including:
 - i. a research project involving IAS 1, IAS 7 and IAS 8, as well as a review of feedback received on the Financial Statement Presentation project;
 - ii. amendments to IAS 1; and
 - iii. additional guidance or education material on materiality.

Within this context, do you agree with the IASB's preliminary views about the scope and content of guidance that should be included in the *Conceptual Framework* on:

- a) presentation in the primary financial statements, including:
 - i. what the primary financial statements are;
 - ii. the objective of primary financial statements;
 - iii. classification and aggregation;
 - iv. offsetting; and
 - v. the relationship between primary financial statements.
- b) disclosure in the notes to the financial statements, including:
 - i. the objective of the notes to the financial statements; and
 - ii. the scope of the notes to the financial statements, including the types of information and disclosures that are relevant to meet the objective of the notes to the financial statements, forward-looking

information and comparative information.

Why or why not? If you think additional guidance is needed, please specify what additional guidance on presentation and disclosure should be included in the Conceptual Framework.

In relation to (b), we support the IASB's work on a principle-based disclosure framework which is needed to overcome the burdens that entities and users are currently facing. We are convinced that a holistic and principle based approach, a conceptual disclosure framework, is much needed. We are concerned that any other approach might not be successful in attempting to rationalize the disclosure requirements or to address the problem of information overload. Furthermore, although the materiality concept will always remain a matter of judgment, we have the strong view that it is important for preparers, users and auditors to have a common understanding of materiality and disclosure objectives.

■ **Section 8 – Presentation in the statement of comprehensive income – profit or loss and other comprehensive income**

Question 19

The IASB's preliminary view that the *Conceptual Framework* should require a total or subtotal for profit or loss is discussed in paragraphs 8.19–8.22.

Do you agree? Why or why not?

If you do not agree do you think that the IASB should still be able to require a total or subtotal profit or loss when developing or revising particular Standards?

Question 20

The IASB's preliminary view that the *Conceptual Framework* should permit or require at least some items of income and expense previously recognised in OCI to be recognised subsequently in profit or loss, ie recycled, is discussed in paragraphs 8.23–8.26.

Do you agree? Why or why not? If you agree, do you think that all items of income and expense presented in OCI should be recycled into profit or loss? Why or why not?

If you do not agree, how would you address cash flow hedge accounting?

Our view is that the profit or loss statement should be the primary performance statement, separately from OCI and the Conceptual Framework should include such a principle. The Conceptual Framework should require a profit or loss total/subtotal that permits relevant items of income and expense to be recycled from OCI to profit or loss. As a consequence, the Conceptual Framework should also contain a principle (with limited exceptions) that items of income and expense included in OCI should be recycled to profit or loss. In many cases, OCI items will automatically reverse over time.

There may be cases where recycling does not provide relevant information. Any exception to recycling determination of when OCI items should not be recycled should be determined at the standard level (for example as in IAS 19).

In general, we believe that it would not be appropriate to have items permanently part of OCI without the opportunity of realising the economic effects unless the items naturally reverse over time. Without any possibility of recycling we believe that in some circumstances the performance of an entity depicted in profit or loss would not fully portray the performance of the entity.

An example is the absence of recycling for realised gains and losses on equity instruments measured at FVOCI under IFRS 9. For an insurer an accounting mismatch could arise where there are linked benefits paid to policyholders on realisation which would be required to be recognised in profit or loss. We think realised gains and losses on equity instruments should be capable of recycling to achieve linked and consistent presentation.

Question 21

In this Discussion Paper, two approaches are explored that describe which items could be included in OCI: a narrow approach (Approach 2A described in paragraphs 8.40–8.78) and a broad approach (Approach 2B described in paragraphs 8.79–8.94).

Which of these approaches do you support, and why?

If you support a different approach, please describe that approach and explain why you believe it is preferable to the approaches described in this Discussion Paper.

Overall we appreciate the efforts of the IASB to determine which items should be eligible to be included in OCI. We expressed in our recent comment letters on the IFRS 9 and IFRS 4 projects the need for the OCI category.

We do not believe it is necessary to make a distinction between a “narrow” and “broad” approach in the final Conceptual Framework. We think that the specific categories “mismatched remeasurements”, “bridging items” and “transitory remeasurements” are helpful, but we also believe that further conceptual reflection is needed in order to develop a more general principle for P&L/OCI and to avoid unintended scope restrictions.

We suggest that the starting point for such a general principle could be that the P&L is the primary source of relevant information about performance, and that additional information should be given instead in OCI only to the extent that it would obscure performance presented in the P&L. A good example of this would be the effects on some insurers of changing discount rates on matching debt security assets and insurance liabilities that are both held for the long-term.

In addition, we believe that the use of OCI regarding specialised items, such as pensions, should be most appropriately dealt with in the relevant IFRS standard. We encourage the IASB to define a general principle as a dividing line for profit or loss or OCI recognition.

■ Section 9 – Other issues

Question 23

Business model

The business model concept is discussed in paragraphs 9.23–9.34. This Discussion Paper does not define the business model concept. However, the IASB’s preliminary view is that financial statements can be made more relevant if the IASB considers, when developing or revising particular Standards, how an entity conducts its business activities.

Do you think that the IASB should use the business model concept when it develops or revises particular Standards? Why or why not?

If you agree, in which areas do you think that the business model concept would be helpful?

Should the IASB define ‘business model’? Why or why not?

If you think that ‘business model’ should be defined, how would you define it?

We support the IASB's preliminary view that financial statements can be made more relevant by considering how an entity conducts its business activities when developing IFRS standards and therefore we agree that the notion of 'business model' should be reflected within the Conceptual Framework. However, we do not believe that the business model must be defined within the Conceptual Framework. Instead, how an entity conducts its business activities and the definition of a particular 'business model' should be addressed within individual IFRSs. Furthermore, we caution against the over-simplified use of business models in IFRSs that does not recognise fully enough the linkages between different business activities and the variety of ways in which those linkages are managed.

For example, the notion of business model is very important for accounting for insurance activities. Insurers apply asset-liability management (ALM) strategies in which insurance liabilities and guarantees and their related financial and non-financial assets are managed together according to the insurance contract liability profile to meet obligations towards policyholders. This means that it is necessary to consider all the relevant assets used to back insurance liabilities, and not just some of them. It is also necessary to avoid presenting changes in values of linked assets and liabilities in different places in OCI and P&L. Furthermore, because of the variety in insurance products, an insurer can have different business models and thus follow different ALM strategies.

Overall, accounting requirements that rest on an oversimplified notion of the business model and so deal with individual components in isolation, separate from the overall ALM strategy, can, with inappropriate prescription particularly of presentation in P&L or OCI, result in measurement and presentation that does not adequately reflect the insurance business models and so may distort information to users about the company's performance.

Question 24

Unit of account

The unit of account is discussed in paragraphs 9.35–9.41. The IASB's preliminary view is that the unit of account will normally be decided when the IASB develops or revises particular Standards and that, in selecting a unit of account, the IASB should consider the qualitative characteristics of useful financial information.

Do you agree? Why or why not?

We agree with the IASB's view that the unit of account should be defined in particular standards. We believe it is important to properly define the unit of account in the respective standards in order to clarify the appropriate accounting treatment in the context of the subject that is being considered by that standard. There are many situations within IFRS where a defined unit of account is needed and, it would be difficult to define a unit of account in the Conceptual Framework which would be appropriate in all circumstances. However, we support the inclusion of guidance on qualitative characteristics in the Conceptual Framework to provide clarification for the individual IFRSs, and we would welcome further development of the IASB's thinking in this area.