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### **Bulletin “Getting a Better Framework: Profit or Loss versus OCI”**

Dear Ms Flores

On behalf of the German Insurance Association (GDV) we welcome the opportunity to comment on the Bulletin “Getting a Better Framework: Profit or Loss versus OCI”, as issued by EFRAG on 14 July 2015 for public consultation. We appreciate the efforts of EFRAG to stimulate this important debate on the relevance of the use of the other comprehensive income (OCI) presentation while acknowledging the importance of the profit or loss as a primary performance measure in IFRS financial statements.

We firmly believe that an appropriate design of the revised and amended Conceptual Framework is of essential importance for future standard setting activities of the International Accounting Standards Board (IASB). In particular, we have observed an increased tendency towards the use of current values in IFRS financial statements. A proper depiction of potentially highly volatile short-term effects of subsequent re-measurements in performance reporting is of special relevance for long-term oriented insurance industry. The use of the OCI presentation serves this purpose.

In general, we agree with many conclusions of EFRAG in the Bulletin. Specifically, and similar to EFRAG, we also think that financial statements can only be meaningful for investors and other users of financial statements if relevant standards allow to reflect how a reporting entity conducts its business. Therefore, business model consideration must be qualified as an essential one in the standards setting process of the IASB. The future Conceptual Framework should recognise this matter of fact clearly. In addition, we have the strong view that the proposed treatment of the OCI presentation in the IASB’s Exposure Draft “Conceptual Framework for Financial Reporting” (ED/2015/3) effectively as an absolute rare exception is not an appropriate approach to proceed.

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We strongly believe that the OCI presentation (including mandatory recycling) is a proper and valid accounting approach, not only for simple debt instruments. In particular, the OCI presentation is - as an accounting policy choice - supported by the insurance industry at large for the current insurance contracts project (IFRS 4 Phase II). It is also a critically essential part of the current IFRS 9 Financial Instruments. Therefore, its existence must not be disqualified in an inappropriate and biased way in the revised Conceptual Framework which will form a fundament for future IFRS standard setting practice.

For all these reasons we regret that the consequences of the tentative EFRAG's views in the Bulletin are not explicitly considered with regard to the insurance contracts project (paragraph 63). The reference to the related EFRAG comment letters to the IASB in this regard is not helpful for those not closely following the insurance contracts project. And the discussions concerning the 'right' approach for profit or loss recognition versus OCI presentation are of the utmost importance for the insurance contracts project.

You will find our detailed comments regarding the specific questions of the Bulletin in the annex to this letter.

If you would like to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,



Dr. Axel Wehling  
(Member of the Executive Board)



Thomas Ilka  
(Member of the Executive Board)

## Annex

### **Question 1 – Different measurement bases**

Do you agree that different measurement bases may be needed to provide relevant information in both the statement of financial position and in the statement of profit or loss? Do you agree that the first step in the process should be to identify the most relevant measurement basis for the statement of profit or loss? Do you agree that the choice of both measurement bases be driven by the business model?

Yes, we fully agree that different measurement bases may be needed to provide relevant information in both the statement of financial position and in the statement of profit or loss. Especially, the tendency to current measurement of assets and liabilities in the balance sheet requires a carefully conducted analysis of the consequences for profit or loss presentation. In particular, the proper and transparent depiction of potentially highly volatile short-term effects of subsequent re-measurements is of essential relevance for long-term oriented insurance industry. The OCI presentation serves this purpose. It allows an adoption of a different measurement approach for the income statement (for example based on the realisation principle). The importance of different consideration for balance sheet and for income statement is currently evident especially in the insurance contracts project (IFRS 4 Phase II), in which the optional use of the OCI presentation as an accounting policy choice is of an utmost significance. The different consideration of current measurement consequences for the income statement and for the balance sheet was also an essential fundament of the IASB's decision with regard to the re-introduction of the fair value through other comprehensive income (FVOCI) treatment for simple debt instruments which are not hold for trading in IFRS 9 Financial Instruments. We continue to strongly support the use of the OCI presentation in these circumstances.

In general and similar to EFRAG we believe that financial statements can only be meaningful and useful for investors and other users if relevant standards allow reflecting how an entity conducts its business. Significantly different business models might justify the use of different measurement approaches. Therefore, business model consideration must be qualified as a critical one in the standards setting process. Standard setting process should especially take into account that certain interrelated accounting provisions should not be developed in isolation when they are affecting economically interrelated circumstances. In this respect business model consideration is useful to help to identify such circumstances.

For all these reasons above insurance industry is permanently and since many years continuing to argue that the inherent economic linkage between insurance liabilities and financial assets backing them should be recognised by the IASB and appropriately reflected in their related standard setting activities. We believe that the consistent depiction of this economic interaction at standard level is absolutely indispensable, i.e. requirements of IFRS 4 Phase II and IFRS 9 must interact with each other and not lead to artificial accounting mismatches in profit or loss, other comprehensive income or in equity. An accounting policy option (at portfolio level) to use the OCI presentation in IFRS 4 Phase II is an essentially important measure in this respect, considering the mixed measurement model in IFRS 9 which we fully support. Therefore we would not support removing any optionality at large as indicated by EFRAG in the paragraph 34 of the Bulletin.

Taking into account the matter of fact that investors and other users of financial statements have been focusing mainly on performance reporting in the income statement of reporting entities it might be quite appropriate for the IASB to consider if the asset/liability approach as currently followed is still the most suitable one as the starting point for the standard setting process. Nevertheless, we also believe that such a fundamental change in approaching standard setting might not be absolutely necessary if the IASB is continuously and thoroughly taking into consideration and properly addressing the potential unintended consequences caused by the asset/liability approach for the performance reporting. Finally, having the firm view that business model consideration should play a role in the process of setting financial reporting standards (Question 2) we think that the first step should be this specific consideration. On balance, both approaches under consideration might lead to similar challenges for the IASB in standard setting. For example, effects on profit or loss presentation in the income statement as a starting point for accounting might require consideration in which cases the asset respective liability recognition criteria might be overridden by the accrual consideration of the matching principle.

## **Question 2 – Considering the business model**

Do you agree with the descriptions of the various business models? Do you agree with the suggestions in the paper in how they would be portrayed in the profit or loss and financial position of entities? Are there other business models that it would be necessary to identify for financial reporting perspectives? If so what are they? What measurement bases would they require and why?

We assess that the Bulletin provides a useful contribution to the discussion with regard to the challenging question how many different business models could be distinguished for accounting purposes and the subsequent implicit question if this level of detail is appropriate or even necessary at the level of the future Conceptual Framework. And we agree with many of the conclusions regarding the measurement consequences of these considerations.

Based on our assessment however we do not believe that the detailed descriptions provided in the Bulletin would be a suitable amendment to the future Conceptual Framework. In addition, we do miss in the Bulletin a more high level consideration what the leading drivers should be for the IASB when deciding if specific facts and circumstances create a separate business model or not. In our view, the uniqueness of the specific business approach might give a particular reason for a careful IASB's consideration whether specific treatment is sufficiently justified or not.

We focus our following comments on the uniqueness the business model of the insurance industry. We believe, that the description "liability driven business models" might be useful as an indication but not appropriate to describe the business model of insurers entirely.

The business model of insurers is to provide insurance risk coverage, i.e. to take business risk and manage it on portfolio basis. In detail, insurers' activities are taking advantage of the law of large numbers and also take into consideration mutualisation aspects. Equalisation effects over time are the further key characteristic of the insurance business. Therefore, although the contractual rights and obligations arise from individual contracts, entities in general manage, and used to measure, contracts on a portfolio basis. Consequently, the objective of the future insurance contracts Standard (IFRS 4 Phase II) needs to be to provide principles for the measurement of insurance contracts at the portfolio level, in line with how the insurance entities manage them. Only the portfolio approach is the conceptual right unit of account for insurance contracts accounting to ensure a faithful presentation of the unique nature of insurers' business model.

Another essential element of the insurers' business model is the inherent linkage between insurance obligations and financial assets (and other assets as well). To meet the insurance liability profile, i.e. to meet the obligations towards policyholders, insurers follow appropriate investment strategies. In case of participating business the returns of investments (and other predefined sources of participating) influence the measurement of insurance liabilities as well. The linkage between insurance contracts and financial assets might be deferent in different insurance product and because of differences in regulatory environments, but it is always inherent to the business model. Therefore, the particular asset/liability management strategy ('ALM strategy') is always only a consequence of the uniqueness of the insurance business model and not a starting point which is to take the business risk.

In addition, it is obviously true that also insurers follow on the asset side investment strategies described in paragraph 23 (d) as long-term investment business models. However, insurers do it in close relationship to the management of insurance liabilities, not in isolation. Consequently, also the related Standards can't be developed or adopted in isolations as well. Regarding the relevance of the (optional) OCI presentation for long-term oriented insurers we refer to our comments to Question 1. One of the further consistent consequences of this integrated thinking would be to allow the optional use of FVOCI accounting also for investment properties in scope of IAS 40 (in line with the note of paragraph 36 of the Bulletin).

Finally, unfortunately, the Bulletin does not elaborate how the business model thinking as used in the Bulletin refers to the IASB's business model consideration in IFRS 9 Financial Instruments. In our view, IFRS 9's business model approach refers to the observable consequences of management strategies for financial instruments. On the contrary, the Bulletin seems to be based on a different logic as it refers rather to the essence of the different business models themselves. We believe that the term "business model" should be used consistently in IFRS. This can only be ensured if the IASB will be successful in creating a conceptual foundation for the application of business model thinking in the future Conceptual Framework, in contrast to the management intent approach. From this point of view, we fully acknowledge EFRAG's request that IASB should provide a robust conceptual foundation for business model oriented standard setting in the future Conceptual Framework.

### Question 3 – OCI items

What are your views on the proposal to include differences resulting from applying different measurement bases and incomplete transactions in OCI?

We are supportive of the proposal as the two particular cases provide an appropriate example how the use of the OCI presentation can significantly contribute to meaningful and transparent performance reporting in the income statement.

We would however not agree with the tentative conclusion in the paragraph 21 of the Bulletin, in which the assumption is made about the precondition what should not be reported in OCI at all. We have observed that at the Board meeting in September 2014 the IASB's has taken the conceptually important decision (based on Agenda Paper 10E: *Conceptual Framework: Measurement - Initial measurement*) that there is an essential need for consistency between initial and subsequent measurement (*IASB Update, September 2014*). We are not aware of any valid reasons to not adopt this thinking and the related underlying rationale consistently to the presentation approach in IFRS. Taking this view into account we believe that there might be cases in which the OCI presentation for effects of initial measurement might be useful. Especially, if the use of the OCI presentation would be based on the realisation principle, some day one gains or losses would be better reflected in OCI instead of in profit or loss or specific asset or liability deferral.

### Question 4 – Recycling

What are your views on the proposal to recycle amounts included in OCI as a result of applying different measurement bases under long-term investment business models?

As a matter of fact we have the strong view that recycling should be the principle to follow when using the OCI presentation. This principle should be rebutted at the standard setting level only in very rare cases. Therefore, we believe that recycling is absolutely necessary as a principle, also as a result of applying different measurement bases under the long-term investment business models.

For example, it is truly a concerning issue when IFRS 9 prohibits recycling for equities measured at fair value through other comprehensive income (FVOCI equities). It is misleading and confusing for users of financial statements when realised gains or losses on FVOCI equities are not reported in profit or loss for the period in which the realisation occurred.

In addition, the development of the balance sheet item “accumulated OCI” (i.e. outstanding gains or losses) is less understandable when recycling is not allowed.

**Question 5 – Current value measurements in the statement of financial position**

For the purpose of the statement of the financial position (not the statement of profit or loss), would you be in favour of greater use of current value measurements than required today? What are the reasons for your views?

In general, we have the strong view that greater use of current measurement for the purpose of the balance sheet than today is not desirable for IFRS. The current values of items which are not held for trading or sale do not provide relevant information for investors or other users of financial statements. In such cases accounting based on amortised cost measurement is more appropriate and more cost-effective.

Considering the interaction with the current fulfilment value approach for measurement of insurance liabilities in the future insurance contracts standard (IFRS 4 Phase II) and taking into account the related accounting policy choice to use the other comprehensive income presentation for market related changes, the accounting treatment based on the fair value through other comprehensive income approach should be eligible for relevant assets. Hence, the scope of the FVOCI measurement should not be constrained in an artificial way, e.g. for the simple debt instruments only.

**Question 6 – Changes in interest rates**

Do you think the discount rate should be updated, and if so, should the effect of the changes be included in OCI or in profit or loss? What are the reasons for your views?

We believe that there might be circumstances in which the use of updated discount rates might be appropriate. For example, the IASB has decided for insurance contracts project (IFRS 4 Phase II) that for the purpose of the balance sheet the fully current fulfilment value of insurance liabilities has to be determined. In such case the requirement to use the updated discount rates is a reasonable and consistent approach.

However, the IASB has also acknowledged that it has to be safeguarded that the effects of these periodical changes in current discount rates are not overshadowing the relevant performance reporting in the income



statement as the related effects reverse over time. Therefore, IASB decided to allow the OCI presentation of effects of discount rate changes as an accounting policy choice (to be exercised at a portfolio level). We fully support this IASB's decision and appreciate that EFRAG expressed the same view in its comment letter of 15 November 2013 regarding the IASB's revised Exposure Draft ED/2013/7 Insurance Contracts, issued by the IASB on 20 June 2013).

In general, for all middle- and long-term positions changes of current values which are only caused by changes in market interest rates shouldn't affect profit or loss immediately because such changes are not part of the "real performance" of a reporting entity. The OCI presentation serves this purpose.