



EQUITY INSTRUMENTS - IMPAIRMENT AND RECYCLING

EFRAG DISCUSSION PAPER

MARCH 2018

1.1 What are your views on the arguments presented in paragraphs 2.3 – 2.10? Do you consider that the reintroduction of recycling would improve the depiction of the financial performance of long-term investors? Alternatively, do you consider that the existing requirements of IFRS 9 provide an adequate depiction? Please explain.

Yes we believe that reintroduction of recycling would improve the depiction of the financial performance of long-term investors.

The investment strategy of KBC's insurance companies is and should be driven by ALM considerations and should be independent of the accounting consequences of classification of gains and losses through OCI or P&L. In response to the first questionnaire of November 2017, KBC would like to stipulate again that KBC's insurance companies have considerable investments in equities, taking up to 6 % of KBC Insurances total investments and we would seriously reconsider our asset mix in case investments in equities are discouraged due to accounting rules.

KBC is still of the view that investors have more attention for a KBC's performance by analyzing the net profit as compared to OCI, what is also mentioned in the Revised Conceptual Framework for financial reporting. Our investor relations department experiences on a daily basis that investors analyze KBC's performance primarily by profit & loss which is a key metric for valuation analysis, dividend payments, return on equity etc. Therefore disabling the recycling of gains through P&L would not accurately reflect KBC's true performance. As stated on the top, our investment decision should be based on our ALM strategy and not based on a different accounting treatment of equity instruments compared to other financial instruments.

Taking into consideration the fact that the statement of profit or loss is the primary source of information on an entity's financial performance, we don't believe that the recognition of all equity fair value changes in P&L is wanted either. Accounting for equities at fair value through P&L does not correspond with the long term return aimed by our investment strategy. An insurance company invests in equities to hedge the long end of their liabilities, typically for maturities where on or only limited bond investment for such long tenors are available in the market. Therefore including the full volatility of the financial markets (due to market sentiment, liquidity, politics, ...) is not a good reflections of the long term strategy of the insurance company. This would increase the unnecessary risk of unstable income which is



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contradicting with the long term investment horizon. Therefore the insurance sector will be reluctant to recognize all fair value changes into P&L, which has a time horizon of only 1 year. For fixed income instruments the market volatility can be recorded in OCI to mitigate the market volatility of the insurance liabilities (option offered by IFRS17)

In KBC's investment strategy, equities are an essential part in our asset mix. We note that other investments by KBC's insurance companies such as fixed-income and investment property can be recycled through profit & loss upon a sale and therefore we would like to defend a similar treatment for equities. We will demonstrate below that investing in equities is important for KBC.

Within a well-balanced portfolio, equities provide a long term return and additionally it may provide also a higher return which cannot be realized with fixed-income securities or investment property. This return on equities is typically a component that is indirectly part of the return that may be distributed to the holders of investment contracts with discretionary participations features (DPF), also known as 'profit sharing'. Profit sharing on top of the guaranteed interest rate is in Belgium at discretion of the company's management based on the profit of the year. Although there is no direct link with the actual performance of the underlying assets, the expectation towards profit sharing are driven by market performance in general. In addition this profit sharing is legally based on Belgian GAAP figures, which allow the recycling of realized gains & losses to P/L. KBC Insurance, as part of a listed bank-insurance group and thus reported under IFRS, wants to stress that creating this substantial difference between Belgian GAAP and IFRS will create an unlevelled playing field with the Belgian insurance companies that have no reporting requirements under IFRS.

In Belgian GAAP and IFRS (and also in the to be-situation under IFRS17) the DPF payments are accounted for as charges through P&L and by introducing a prohibition to recycle, this would create a mismatch between the realized gains (that would stay in OCI according to the current IFRS 9 standard) and the DPF payments which are paid for a considerable amount based on those realized gains. The IFRS 9 recycling rule thus creates extra complexity and an incomplete view on performance.

If the return on equities is to be decomposed, the return comes for a major part from realized gains, rather than from dividend income, which indicates those realized gains are not to be underestimated.

2.1 What are your views on the arguments presented in paragraphs 2.11 – 2.17? Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.

KBC agrees with the IFRS principle that any recycling of gains from financial instruments should be accompanied by an impairment model.



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3.1 What are your views on the arguments and analysis presented in Chapter 3 of the DP?

3.2 Are there other improvements in presentation and disclosure that you would support?

KBC is of the view that information recognised in the financial statements is more value-relevant than information disclosed in the notes. We would not support a solution whereby we would only disclose the recycled gains.

Q4.1 What should be, in your view, the general objective and main features of a robust model for equity instruments (relevance, reliability, comparability...)?

Q4.2 Which, if either, of the two models do you prefer? Please explain.

Q4.3 Do you have suggestions for a model other than those presented in the DP? If so, please describe it and explain why it would meet characteristics such as relevance, reliability and comparability.

KBC did not has conceptual issues with the impairment model of IAS39 and supports the reintroduction of a similar impairment model.

KBC is not in favor at all for the alternative option whereby gains would be presented in OCI and losses in P&L. This would present asymmetric treatment and does even reinforces the above arguments that the long term return on equities are an part of the total investment return

Q5.1 Do you support the inclusion of quantitative impairment triggers in an impairment model? If so, should an IFRS Standard specify the triggers, or should management determine them?

Q5.2 If you do not support quantitative impairment triggers, how would you ensure comparability across entities and over time?

We are in favor of an impairment model with quantitative thresholds with rebuttable presumptions.

Q6.1 How should subsequent recoveries in fair values be accounted for? Please explain.

Q6.2 If subsequent recoveries in fair values are recognised in profit or loss, which of the approaches in paragraphs 5.2 – 5.10 do you support and why?

KBC has no strong view on if subsequent recoveries could lead to reversals of impairment and if so, how this should be defined.

Q7.1 Do you consider that the same model should apply to all equity instruments carried under the FVOCI election? If not, why not and how would you objectively identify different portfolios?

Q7.2 Do you have comments on these other considerations?

Q7.3 Are there other aspects that EFRAG should consider?



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KBC remarks that a tailored impairment model may be necessary for level 3 financial instruments. As they have not readily available market price information, they cannot be impaired by using market information as it is the case for level 1 instruments.

For quoted equity instruments (mostly level 1), we do not see any reason to differentiate the impairment model per type of equity.