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Dear Mr. Enevoldsen

<u>Reference</u>: EFRAG´s draft comment letter to the IASB on the IASB ED "*Measurement of Liabilities in IAS37* (limited re-exposure of proposed amendments to IAS37)

<u>Introduction</u>

We are pleased to provide you with the following comments on EFRAG´s draft comment letter on the IASB Exposure Draft *Measurement of Liabilities in IAS37*.

Although our comments are relevant for any kind of liabilities covered by IAS37, we have more specifically considered this Exposure Draft and the related EFRAG Comment letter having in mind the possibility that the measurement objective for IAS37 would become applicable to Insurance Contracts.

As insurance supervisors, we have a particular interest in the accounting framework that will be developed by the IASB for insurance contracts under the Phase II of IFRS4. Should the IASB decide to apply the IAS37 approach to Insurance Contracts, it is important that decisions taken for the revision of IAS37 properly reflect the insurance business and result in information that provides useful information to users from that point of view. In this regard, we are particularly concerned by the fact that the comments made by EFRAG in its comments letter would result in measurement principles under IAS37 that would be not be consistent with the tentative IASB decisions on the Phase II for Insurance Contracts and with the orientations followed by the IASB in the revision of IAS19 (see the 03/2008 Discussion Paper: *Preliminary views on Amendments to IAS19 Employee Benefits*).

As indicated below, we do not think that the alternative solutions proposed by EFRAG result in relevant and useful information for users. Further, some of EFRAG's points do not seem in line with the current requirement of IAS 37 and the way IAS37 is applied.

On this basis, we disagree with most of the comments made by EFRAG on the substance as well as with the alternatives proposed by EFRAG.

Comments

1. *Due process*

We share the concerns expressed by EFRAG on due process. We believe that it would have been appropriate to re-expose the entire proposed standard, giving stakeholders the opportunity to comment on the consistency of the text as well as on the sufficient level of guidance and disclosure.

2. *Recognition of liabilities*

On the one hand, unlike EFRAG, we consider that the removal of the ´more likely than not recognition criterion` is likely to provide more decision-useful information. The current criterion that conducts not to recognize in the balance sheet obligations with a reliable valuation is particularly contra-intuitive in an accounting approach. Consequently, it seems to us that basing the recognition criterion of liabilities on the existence of an obligation is more relevant than on a high probability of outflow test. So, we expect that a clearer separation between recognition criterion and valuation principles resolves the current ambiguity around the measurement objective and improves the understanding of accounting principles.

This improvement should lead to the recognition as liability on the balance sheet of obligations whose outflows of resources can be measured with sufficient reliability, while such obligations may currently be off balance sheet because the probability of outflow of resource is more unlikely than not. This change is clearly in line with the recommendations of the G20 to improve the reporting standards in a way that provides more transparency about transactions that are currently off balance sheet. The transparency is improved by showing the transactions on the primary statements instead of only having a disclosure in the notes. The European Commission and Member States have recently stressed the importance of this aspect in the discussions regarding the development of the level 2 measures on the Solvency II project. The Solvency II implementing measures (level 2) probably will require recognizing contingent liabilities as liabilities in the balance sheet that will be used for monitoring the insurance solvency.

On this basis, we think that the modifications proposed by the IASB are going in the right direction by requiring entities to recognize more obligations as liabilities. Therefore we do not support the recommendation of EFRAG asking the Board to abandon the proposed revision of IAS 37.

3. *Measurement of liabilities*

a. Measurement principles

We do not share the objections of EFRAG concerning the valuation model based on the probability-weighted average of the outflows, for the two following reasons:

- The expected value model is usually applied where a prospective value of future cash flows with multiple possibilities of outflows needs to be measured ;
- This model is actually already used under the current standard IAS 37, allowing for single obligation to be measured in a simplified way on the basis of the information available.
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CEIOPS is however concerned by the IASB's proposal to measure liabilities at the lowest of three values (see paragraph 36B of the ED), especially if this principle would be applicable to insurance contracts. We believe that the valuation on the balance sheet should reflect the business model of the entity and the way it intends and is able to meet its commitments. If the entity's practice and constraints are to fulfill the obligation; then only the "present value of the resources required to fulfill the obligation" should be the applicable measurement objective.

Furthermore, unlike EFRAG we are fully convinced that the value to fulfill an obligation must include an allowance for risk and this for the following reasons:

- The risk margin is needed to convey useful information to users of financial statements about the uncertainty associated with liability. The solution proposed by EFRAG, i.e. to reflect the risk through disclosure in the notes, would not only obscure the relevance of the amounts shown on the balance sheet, but is also in contradiction with the principle laid down in IAS1, § 18: "*An entity cannot rectify inappropriate accounting policies (…) by notes or explanatory material*". The risk related to possible developments in amounts or timing is an important element of information for users and should not be separated from the measurement on the balance sheet. Reflecting risk in the measurement is also giving information in a concise way about the way the reporting entity manages the risks.
- The principle of an adjustment for risk is present in many standards and draft of standards where the valuation is prospective and includes uncertainty (IFRS4 - Phase II, Exposure Draft on Amortised Cost and Impairment or Revision of IAS19). It is also included explicitly in the current standard IAS 37 (paragraph 42).

In particular, it concerns CEIOPS that the argument brought forward by EFRAG, especially in paragraph 43 of the draft letter, rejecting the appropriateness of a risk margin would, if deemed valid, hit not only the measurement approach applied on liabilities falling within IAS 37 but all liabilities, e.g. insurance liabilities, measured on the basis of probability-weighted cash flows.

b. Application guidance

We think that the Expose-Draft is ambiguous regarding the possible differences, if there are any, between the measurement attributes described in 36B (a) and an exit value.

Even though we consider that a risk margin is needed in each case valuation of an item is carried out, we agree with the alternative view concerning the lack of guidance

regarding the circumstances in which a risk adjustment should be included in the measurement of a liability and how such a risk adjustment should be determined.
The adjustment for risk that is included for giving useful information regarding the uncertainty about the probability estimates could be seen according to the referred measurement attribute as a benefit for transferring the risk or an additional safety margin. The measurement attribute being insufficiently defined, it is not clear whether the risk adjustment should consider the extent to which risk is diversifiable.

4. *Exception for onerous sales and insurance contracts*

We agree with EFRAG's view expressed in relation to the proposed exception for measurement of onerous contracts.

If you have any questions or wish to discuss all this further with us, please feel free to contact jarl.kure@ceiops.eu.

Best regards

Carlos Montalvo
Secretary General