DIE DEUTSCHEN VERSICHERER

Ms Françoise Flores
Chair of the
European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000 Brussels
BELGIUM

Ref
F 2

Phone extension
-5430

Date
29.04.2014

Getting a Better Framework
EFRAG, ANC, OIC, ASCG, FRC: Bulletin on Complexity

Dear Ms Flores

As the German Insurance Association (GDV) we welcome the opportunity to comment on the Bulletin "Complexity" issued on 10 February 2014 by EFRAG in cooperation with the national standard setters of France, Italy, Germany and UK. We appreciate the continuous efforts undertaken by EFRAG to stimulate the European exchange of views on issues related to the global debate on IASB's efforts to review and amend the Conceptual Framework as a conceptual basis for International Financial Reporting Standards (IFRS). Consequently, we encourage EFRAG to share the outcome of TEG's deliberations on this Bulletin with the IASB.

We fully acknowledge the rationale of those who advocate that Conceptual Framework should include an explicit discussion on complexity [paragraph 20 of the Bulleting]. Nevertheless, we are deeply concerned about the potential unintended consequences of such a step in the long-run. We are especially afraid that additional reference to complexity as an explicit conceptual constraint for the IASB in the standard setting process might lead to further cases of oversimplified depiction of the economic reality and unnecessary tensions in the standard setting process. Therefore, we are strongly supportive of the view of the ASCG [paragraph 21 of the Bulletin].

Especially the recent history of controversial discussions about the appropriate design of accounting requirements for insurance contracts (IFRS 4 Phase II) or for financial instruments (IFRS 9) provides the best evidence how valuable efforts to reduce accounting complexity might lead to an unacceptable outcome when the complexity argument is misused. The GDV does not believe that a 'one size fits all'-approach or artificial simplifications is an appropriate attempt to deal with a global diversity of business models or products.

Gesamtverband der Deutschen Versicherungswirtschaft e. V.

German Insurance Association

Wilhelmstraße 43 / 43 G, D-10117 Berlin
Phone: +49 30 2020-5000
Fax: +49 30 2020-6000

51, rue Montoyer
B - 1000 Brussels
Phone: +32 2 28247-30
Fax: +32 2 28247-39

E-Mail: h.saeglitz@gdv.de

www.gdv.de

We hope that our general comments and the detailed response will be helpful for TEG's members in reaching their final conclusions on the issue raised in this Bulletin. If you would like to discuss our comments further we would be delighted.

Yours sincerely,

Dr. Axel Wehling
Member of the Board
German Insurance Association

Hans-Juergen Saeglitz
Head of Accounting
German Insurance Association

Appendix

We would welcome your views on any aspect of this Bulletin. In particular: **(i) Do you think there should be explicit discussion of the different aspects of complexity in the Conceptual Framework?** **(ii) Are there any aspects of complexity in accounting not covered by this Bulletin that should be covered?**

No. The revised Conceptual Framework should not include an explicit additional discussion on complexity as such. We are especially concerned about the potential unintended consequences of such step in the long-run. In particular, we are afraid that additional reference to complexity as explicit additional conceptual constraint for the IASB in standard setting process might lead to further attempts of oversimplified depiction of the economic reality in financial statements and thus to unnecessary tensions in the IFRS standard setting process.

Our rationale

The relevance and the impact of appropriate accounting requirements for financial reporting should not be underestimated. Financial reporting standards will only be acceptable for long-term oriented insurers if they fit the existing stable business model rather than compel the insurance industry to change its products or investment strategies to fit the standards provisions. The appropriate design of accounting rules is essential, their consistent interaction of utmost importance. The discussion of complexity should not be misused to finalise extremely important projects on too simplified assumptions.

The recent history of controversial discussions about the appropriate design of accounting requirements for financial instruments (IFRS 9) does demonstrate in a very illustrative manner how the IASB might fail to appropriately reflect the needs of diverse industries when developing not-industry specific standards and seeking for (too) simple answers. The final revision of the initial decision via allowing the fair value through other comprehensive income (FVOCI) category for debt instruments was necessary as neither the 'full fair value approach' nor the measurement 'at amortised cost' was fully appropriate to reflect the interaction with the insurance contracts measurement provisions.

Similarly controversial was the IASB's approach to introduce a simple solution when requiring in the ED/2010/8 "Insurance Contracts" (July 2010) a current measurement for insurance contracts while fully ignoring the highly volatile effects of interest rate changes for the profit or loss presentation. The same applies for the attempt to lock-in the contractual service margin (CSM) representing the unearned profit or to oversimplify the transitional provisions via erasing the CSM for existing business. Especially, the latter decision was suitable to distort the value of insurers' financial reporting for many subsequent years.

The improved set of proposals in the Exposure Draft ED/2013/7 "A revision of ED/2010/8 Insurance Contracts" and in particular the introduction of the unlocking principle for the CSM, the use of other comprehensive income (OCI) and the retrospective approach for transition allow for performance presentation which is more in line with the underlying stable business model of long-term oriented insurers. The recent Board's decision to allow the optional use of OCI supplements the decisions. Thus, the attempts to apply 'one size fits all'-approach clearly failed and have led to controversial (political) tensions in the global debate and unfortunately to a significant delay the finalisation of the globally important standard.

Illustration of consequences of an oversimplified depiction of the reality

In our strong view, the main path of argumentation against the use of transparent OCI presentation approach in the financial reporting standard for insurance contracts (IFRS 4 Phase II project) is based on the misuse of the complexity argument. The GDV strongly believes that clarity and transparency are superior objectives than artificial complexity avoidance.

The attempt to provide (too) simple solutions seems to be also one of the main reasons for the not fully preferable outcome of IASB Board's decisions on IFRS 9 when completing the project IFRS 9 (replacement of IAS 39). Although the inclusion of FVOCI-category for simple debt instruments, based on a defined business model, is seen as a significant improvement which makes the standard in general acceptable for insurers, there are some significant concerns outstanding regarding the final outcome:

- Prohibition of recycling on equities measured at FVOCI.
- Prohibition of an explicit FVOCI option for simple debt instruments in amortised cost category.

In both cases above there is a clear rational for necessary changes.

- The prohibition of recycling disadvantages the long-term equity investments (measured at FVOCI) and distorts the income statement presentation of insurers when expensing the policyholders' participation in realised gains in profit or loss.
- The missing explicit FVOCI option for portfolios of debt instruments measured mandatorily at amortised cost will lead to an accounting mismatch and artificial volatility in equity, causing unnecessarily increased cost of capital for insures.

A remark on the recent decisions on European level

From the European perspective we would want to note that the Article 9 (4) of the new 'Regulation (EU) No 258/2014 of the European Parliament and of the Council of 3 April 2014 establishing a Union programme to support specific activities in the field of financial reporting and auditing for the period of 2014-2020 and repealing Decision No 716/2009/EC' requires the European Commission to especially consider on year-by-year basis whether IFRS-Standards take due account of different business models, reflect the actual consequences of economic transactions, are not overly complex, and avoid artificial short-term and volatility biases.

The GDV understands that this requirement of the new Regulation is not focusing solely on the complexity argument but also refers to the necessity to depict the nature of the underlying business model and its economics in an appropriate way. In addition, the requirement to avoid artificial short-term and volatility biases in financial statements reflects the core position of GDV.

Conclusions

For the reasons above we appreciate that the Bulletin is explicitly distinguishing between the 'unavoidable' and 'avoidable' complexity. The attached survey of illustrative examples in the Bulletin is also very valuable. Nevertheless we believe that decision of that kind should be based on cost/benefits consideration at standard level only where the primary objective of the IFRS accounting should be to ensure a faithful presentation of financial position and financial performance of the reporting entity.

In focus of financial reporting should be the consideration of how to ensure that the true financial position or financial performance is faithfully presented and not the search for (too) artificial simplifications, in contradiction to diversity in economic reality. In addition, the information provided in financial statements should be understandable, transparent and reliable. Finally, the financial reporting requirements should consider the underlying business model to ensure that relevant information is provided to investors and other users of financial statements on financial markets.

Thus, although we respect the intention of the efforts to avoid 'avoidable' complexity in financial statements, we believe that the question what "avoidable" is, can be approached at the standards level only. Robust principle-based standards should have the ability to allow for pragmatic solutions how the objective of the particular standard can be best met by prepares.

As a final result, the GDV supports the view of the ASCG as expressed in paragraph 21 of the Bulletin. The GDV does <u>not</u> recommend including additional explicit discussions on complexity into the revised Conceptual Framework.