ED General Presentation and Disclosures: Question 14 -Other comments:

Presentation of revenue and costs in different business lines.

KBC Group as a financial conglomerate wants to react on the draft comment letter that EFRAG prepared by answering on the following question posed by EFRAG to constituents (§250) :

Do you agree that the IASB should consider providing more guidance for the presentation of revenues and costs when they are allocated to different business activities on the face of the statement of profit or loss, including consistency with IFRS8 and disclosure on judgement applied in the allocation process?

KBC Answer

We agree with the statement that more guidance should be considered for the presentation of revenues and costs when allocated to different business activities as financial conglomerates (bankinsurers) are confronted with specific issues when IFRS17 'Insurance contracts' comes into force.

Executive summary:

- No illustrative example exists for financial conglomerates, creating concerns on the comparability of financial statements amongst peers.
- The operating expenses of all businesses are not presented in one line on the face of the income statement as IFRS 17 requires to determine the 'directly attributable expenses to insurance contracts' and to present these as part of 'insurance service result'.
- The operating expenses of the different business activities are recognized in a different manner and presented mixed either by function or by nature on the face of the income statement
- Profitability of each business is difficult to determine as the requirement of intercompany elimination according to IFRS10 'Consolidated financial statements' remains still in place.
- Operational burden occurs when applying the 'look through' approach on a group level by calculating the Contractual Service Margin, representing all income and expenses of the financial conglomerate related to a group of insurance contracts. Implies calculating a second CSM for group reporting purposes.

The main businesses of a financial conglomerate are banking, insurance, asset management and related financing activities (leasing, factoring etc.). According to the ED primary financial statements the financial conglomerate should classify all income and expenses in the 'operating' category of the income statement.

Most financial conglomerates principally opt for a semi-functional balance sheet and income statement (e.g. the interest income of the banking and insurance entity is integrated and presented in one line on the face of the income statement). Below an example is included on how a semi-integrated income statement could look like after IFRS17 comes into force:

Net Interest Income	
Interest income	
Interest expense	
Insurance revenues before reinsurance	
Non-Life	
Life	
Dividend income	
Net Result from FI at FV through profit or loss	
Net Fee and Commission Income (1)	
Fee income	
Fee expense	
Net insurance finance result before reinsurance (2)	
Other net income	
Total income	
Operating expenses excluding Direct Attributable OPEX (Insurance)	
Total opex without banking tax	
Total banking tax	
Minus: Opex allocated to insurance service expenses	
Insurance service expenses before reinsurance	
Non-Life	
O.w. incurred claims	
Life	
Net result from reinsurance contracts held	
Impairment	
O.w. Impairment on FA at AC and FVOCI	
Operating profit	
Share in results of integral assoc. comp & joint-ventures (3)	
Result before tax	
Income tax	
Result after tax	
Attributable to Minority Interest	
Net Result - attributable to equity holders of the parent	
Of which banking	
Of which insurance	
Insurance service result after reinsurance Non-Life	
Insurance service result after reinsurance Life	
Insurance finance result after reinsurance	
Of which holding activities	

(1) excluding commissions directly attributable to insurance service expenses
(2) includes the change in carrying amount of insurance contracts arising from the effect of the time value of money and the effect of financial risk in profit or loss
(3) integral = closely connected to KBC's activities

The choice on how to present the balance and the income statement of a bankinsurer based on current ED becomes difficult when IFRS17 comes into force as some issues arise as listed below:

- Concerns about comparability of financial statements amongst peers as no illustrative example for financial conglomerates exists. Some entities will focus on a more integrated scheme as other will develop a so called functional scheme (splitting the income statement per activity banking versus insurance).

- Operating expenses: no total Opex-line
  Instead of presenting one total line of operating expenses, IFRS17 'Insurance contracts' split the operating expenses in (i) 'Directly attributable expenses to insurance contracts' as part of 'Insurance service result' and (ii) 'Operating expenses', referring to the expenses that are not directly attributable to insurance contracts.
  As a consequence, these not directly attributable expenses and all non-insurance related operating expenses of the financial conglomerate (e.g. bank, asset management,…) are presented as 'operating expenses' and as such the total operating expenses of the bankinsurer group are split over different lines in the income statement.
  Reconciliation between income statement and disclosure on analysis of operating expenses as required by the ED becomes more difficult.

- Mix of presentation of operational expenses by nature or by function of expense method.
  The new ED requirement to present operating expenses either by nature (e.g staff or IT expenses) or by function(e.g sales expenses) makes it difficult by combining a banking and insurance income statement.
  For a bank presenting operating expenses by nature seems more appropriate (see also Illustrative example II-3 of the ED) whereas for the insurance business a presentation by function of expense method is required by IFRS17 being:
    - Split of the operating expenses as explained in the previous bullet in either (i) 'Directly attributable expenses to insurance contracts' as part of 'Insurance service result' and (ii) 'Other Opex'
    - Within the 'Directly attributable expenses to insurance contracts' a further split by function is required as the expenses made for acquiring insurance contracts are recognized in a different manner. Those acquisition expenses are deferred over the lifetime of the insurance contracts. The actual acquisition expenses are not recognized in the income statement and as such not addable with the operating expenses of the banking industry.

- How to demonstrate the profitability of each business of the financial conglomerate ?

  Two issues can be identified :

  (a) Does elimination of intercompany transactions give a true and fair view ?

  E.g. the bank acts as a distributor of insurance contracts in its banking agencies and earns a fee on it.

  Under a functional scheme (=bank and insurance business separately presented on the face of the income statement) it seems that elimination of intercompany transactions makes no sense because this would not give a fair view on the profitability of each business. Eliminating the fee paid to the bank, would 'wrongly' improve the profitability of the insurance business, compared to the situation in which the insurance contract would be distributed via another channel such as the agent network or external brokers. Not eliminating the intercompany transactions would mean that the fee and commission income in banking would include the fees earned from the insurance business and the insurance service expenses would include fees paid to the bank. From an IFRS point of view, this treatment can only argued based on IAS 1.15-24 (overriding principle of fair presentation), while IFRS10 requires to eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group.

  Moreover, the recognition of the fees would even not be symmetrical as the recognition in the bank would be upfront in accordance to the requirements of IFRS 15 'Revenue recognition' as the performance obligation is performed at the moment of the sale of the contract. The insurer spreads the costs of the fees paid over the lifetime of the insurance contracts (which for life business can go up to 40 years).

(b) 'look through' approach for insurance contracts complicates the accounting and reporting

A 'look through' approach at group (bankinsurance) level under IFRS17 'Insurance contracts' means calculating a Contractual Service Margin (CSM) taking into account all income and expenses of the financial conglomerate related to a group of insurance contracts, as such also the income and expenses faced by the bank (e.g. costs of the agencies to distribute insurance products) and/or asset manager (e.g. fee earned and costs borne for managing the underlying assets of the unit-linked products with insurance cover).

Depending on how the group structure is organized, this would imply two calculations of CSM for each group of insurance contracts:

- A CSM at the level of the insurance level (local or consolidated reporting level), which takes into account only the returns earned by the insurer (incl. the costs paid to the bank and fee received from asset manager)
- A CSM at the level of the financial conglomerate, which does no longer take into account the (expected) costs paid by the insurer to the bank and asset manager (as these would be eliminated as intercompany transaction) but would take into account the underlying costs incurred and income earned by the bank and asset manager for the insurance contracts.

As a consequence of this 'look through' approach the typically IFRS17 requirements (e.g. determining directly attributable expenses for insurance contracts') are introduced into the reporting process of the bank and asset manager. Also the calculation of two CSM's within the strict closing deadlines puts extra stress and complexity on the calculation and reporting of the financial statements, increasing the costs.