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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

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<u>Reference: Exposure Draft "*Measurement of Liabilities in IAS37* (limited re-exposure of proposed amendments to IAS37)</u>

Dear Sir David,

CEIOPS welcomes the opportunity to provide comments to the International Accounting Standards Board on the 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 having in mind the possibility that the measurement objective for IAS37 could 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.

On the one hand, 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 induces not to recognize obligations in the balance sheet 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 will resolve 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) will likely require recognizing contingent liabilities as liabilities in the balance sheet, which 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

On the other hand, we consider that the Board's efforts to improve the explanation regarding the principles of valuation of the liabilities bring more clarity than the existing development of IAS 37 that was partially ambiguous.

However, we are not convinced by the "lowest of" principle proposed in paragraph 36B. In our view, measurement should reflect the future outflow of resources to fulfill, cancel or transfer the obligation – where these opportunities are legally available- based on management's expectation regarding the way to be relieved of the obligation.

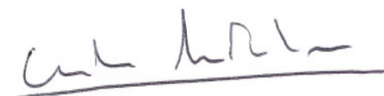
Furthermore, we think that the Exposure Draft is ambiguous regarding the definition of the measurement attributes described in 36B (a). This measurement attribute should be better defined so as to more accurately set up the purpose of the risk margin and develop adequate guidance regarding its calculation.

Considering the interaction between the present project and the fundamental question raised in the framework regarding the definition of a liability, we urge the Board to pursue these two projects in relation with its work on Insurance contract. This complementary of time would be an opportunity to solve the essential issues raised by the members of Board who developed divergent views.

We hence share the concerns expressed by some regarding the due process. We believe that it would be appropriate to re-expose the entire proposed standard, giving stakeholders the opportunity to comment on the consistency of the principles with others projects quoted above as well as on the sufficient level of guidance and disclosure.

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

Appendix

Question 1 – Overall requirements

The proposed measurement requirements are set out in paragraphs 36A–36F. Paragraphs BC2–BC11 of the Basis for Conclusions explain the Board's reasons for these proposals.

Do you support the requirements proposed in paragraphs 36A–36F? If not, with which paragraphs do you disagree, and why?

We agree the overall approach retained by IASB and Board's reasons for its proposals which are in line with our conception of what useful information for user should be regarding the measurement of a liability.

However, CEIOPS is 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.

We think that the Exposure 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 a prospective valuation is carried out, we agree with the alternative view concerning the lack of guidance regarding what this risk margin is willing to represent within the measurement proposed and how such a risk adjustment should be determined. The measurement attribute being insufficiently defined in the Exposure Draft, the adjustment for risk that is essential 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. It is why; the proponents of the alternative view are unable to determine the extent to which the risk adjustment should consider risk is diversifiable.

Question 2 – Obligations fulfilled by undertaking a service

Some obligations within the scope of IAS 37 will be fulfilled by undertaking a service at a future date. Paragraph B8 of Appendix B specifies how entities should measure the future outflows required to fulfil such obligations. It proposes that the relevant outflows are the amounts that the entity would rationally pay a contractor at the future date to undertake the service on its behalf.

Paragraphs BC19–BC22 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you support the proposal in paragraph B8? If not, why not?

We do not support the proposal in paragraph B8.

We consider that the principles underlying the determination of this service margin are inconsistent with the principles for measuring the liabilities. For a liability, the current value is determined in reference to probable estimated future cash flows of the liability with an additional risk margin, which for instance in a exit value represents the remuneration that would be asked by a market participant to accept the risk of uncertainty in the future cash flows. No additional margin is needed. This comment is still more valid in the context of a fulfillment value.

Regarding more specifically the present project, we are not convinced by the fact that an obligation that is not linked to a contract could be considered as a service. Furthermore the intentions of the Board appear unclear and apparently not really consistent. On the one hand, the Board indicates that the entity must retain the amount that it would rationally pay to be relieved of an obligation and that amount should reflect the value of the resources that it will have to sacrifice to fulfill the obligation (36A and 36B). On the other hand, the Board requires that the entity should measure the liability based on outflows resulting of market prices that the entity would pay a potential or hypothetical contractor to undertake the service on its behalf (B8).

It is not clear if the Board is willing to introduce an artificial profit margin that do not represent an actual outflow of the entity's resources (BC 20(b)) or determine a proxy of a market risk margin as suggested within the illustrative example.

Whatever the objective pursued, it is either conceptually unfunded or unnecessarily complex. The result would be to measure the liability at a hypothetical amount that doesn't represent a payment or an actual outflow of the entity's resources or to introduce the possibility to retain a wide range of profit margin for an identical obligation.

We agree with the members of the Board who developed alternative view, that an obligation to provide resources should be measured at the expected cost of fulfilling that obligation plus a risk margin. If the entity expects to fulfill the obligation by its self, the amount should be the costs it will incur to fulfill the obligation, including a risk margin.

Question 3 – Exception for onerous sales and insurance contracts

Paragraph B9 of Appendix B proposes a limited exception for onerous contracts arising from transactions within the scope of IAS 18 Revenue or IFRS 4 Insurance Contracts. The relevant future outflows would be the costs the entity expects to incur to fulfil its contractual obligations, rather than the amounts the entity would pay a contractor to fulfil them on its behalf.

Paragraphs BC23–BC27 of the Basis for Conclusions explain the reason for this exception.

Do you support the exception? If not, what would you propose instead and why?

We supports the exception allowed under B9 for onerous contracts within the scope of IAS 18 "Revenue" or IFRS 4 "Insurance Contracts", which are currently the subject of improvement projects.

Moreover, we believe that the requirement of B9 should not only be a limited temporary exception but should be mandated in the final standards as a permanent requirement for onerous contract within the scope of both standards.