CFA Society United Kingdom

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Dear Barbara, Peter, Yulia,

The Financial Reporting and Analysis Committee (FRAC) of the Chartered Financial Analyst Society of the UK (CFA UK) welcomes the opportunity to respond to the IASB's exposure draft, ED/2012/4 on proposed amendments to IFRS 9.

We are sorry that this response is late. The reasons for this include that we were initially not intending to respond. The changes were presented as minimal and felt like a fait accompli to solve practical problems with the insurance sector and the standard being developed for it. Further, the FRAC does not have a consensus view and so we were unsure how useful an ambivalent response would be.

In addition, the conceptual framework project is considering the issue of what the Other Comprehensive Income section is for, so this FVOCI proposal could be seen as a "patch" pending that deliberation. The trouble with this view is that patches tend to set precedents.

Since Peter Clark suggested, at the recent CMAC meeting, that even a description of our disparate views would be helpful, we decided to provide the following notes, which can largely be seen as responding to Question 4 of the consultation:

> *Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that: (a) interest revenue, credit impairment and any gain or loss on derecognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and (b) all other gains and losses are recognised in OCI? If not, why? What do you propose instead and why?*

The insurance analysts' view, at FRAC and in other soundings, was to welcome the proposals as solving an accounting mismatch between the treatment of liabilities and the assets held to back them. The emphasis on aligning IFRS 9 with the proposed insurance standard was also supported. An underlying concern is that "accounting mismatches" do not reflect insurers' business models and so make the sector harder for analysts and potential investors to understand.

However, other FRAC members do not believe that accounting standards should be sector specific. They are concerned that such concessions will encourage lobbying by one particular group of preparers or an industry. One such issue arises from the treatment of a portfolio of assets, some of which might be sold to meet liquidity needs. If a sub-group of assets cannot be disaggregated for this purpose, then presumably the whole portfolio would need to be categorised as trading and, therefore, FV through the P&L (FVPL). So we would see different accounting for similar portfolios, or pressure to put whole portfolios through FVOCI.

It is also important to note that consistent accounting makes it easier for non-specialist analysts and investors to understand and compare companies and to invest across sectors.

More broadly, we have consistently supported the two-category model as a substantial simplification of the previous four categories in IAS 39. This would put our views more in line with the alternative view expressed by Messrs Cooper and Engström, in AV1-3.

On this basis, there is a view that the division between "hold to collect" and FVPL (including use of the full fair value option for genuine accounting mismatches) can be made to work for a variety of business models, including the insurance industry.

We are wary of information being put in OCI, partly because of potential earnings per share manipulation and partly because of the lack of clarity over what OCI is for. We believe that OCI should not simply be a "dumping ground" for items that are difficult to classify, or that preparers object to putting through the P&L. So we welcome the focus on its purpose in the conceptual framework project, and hope this will provide a way back into the broader issue of financial statement presentation. For instance, will the idea of a remeasurements column be reconsidered? If the FVOCI category, as employed in this ED, is to be seen as an embryonic version of that, it would be useful if that were explicit.

Beyond this (and beyond specific comments made at FRAC meetings), the ED raises as many questions as it answers, including:

1. A clear motivation for the proposals is to converge with US GAAP (BC 134-135), whereas the IASB has recently made a point of going for the best accounting solution. What is the current stance?
2. According to the ED, the FASB has always favoured three categories: lending (amortised cost), investing (FVOCI) and trading or held for sale (FVPL). If this is where the case for a third category has been put most strongly, why is this not the main basis for the consultation, rather than pragmatic difficulties faced by insurers?
3. If the real issue is how to define the "hold to collect" category, as indicated in several sections of the basis for conclusions, then why was this not a fundamental debating point in the consultation?
4. Whether the definition of hold to collect is narrow (lending) or broad (accommodating tradeable assets held principally for their cash flows) is a very important question because it affects the extent to which an entity's

assets will be measured at FV versus amortised cost. There are contradictory views on this – as expressed in BC 152 and 153 – that need further debate.

5. Putting gains/losses in OCI does not solve balance sheet issues, and the financial companies affected are, arguably, analysed more on a balance sheet than an EPS basis. As Messrs Cooper and Engström say in AV4, if amortised cost is the most appropriate basis for reporting in the income statement, “this should be applied consistently throughout the financial statements”. This raises a fundamental question about the presentational, or “cosmetic”, value of putting items in OCI.
6. If preparers see a presentational advantage in using FVOCI, the concern would be that they might try to game the categories. Is this more likely to be the case with three categories than two? And will greater use of OCI aggravate the problem?

We look forward to discussing the issues raised in this response. We hope that the direction taken in this ED will not necessarily frame the debate on OCI that is due to take place in the conceptual framework project.

Yours sincerely,

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CFA Society of the UK

Tom Haywood
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Will Goodhart,
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