



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

13 December 2010

Dear Sir David,

Exposure Draft: Leasing

We are taking this opportunity to comment on the Exposure Draft Leases (the 'ED'). This letter has been drafted by the European Insurance CFO Forum, a body representing the views of 20 of Europe's largest insurance companies. Accordingly it represents the consensus view of a significant element of the European insurance industry, an industry that is affected by the proposed rules, both as a lessee as well as a lessor. On top of that, as a significant holder of investment properties, insurers may be further affected depending on their elected accounting model for investment properties.

We are supportive of the efforts of the IASB and FASB to improve the financial accounting for leases. While we agree that there are some flaws in the existing accounting models for leases, we do not believe that a fundamental revision is an appropriate solution. We therefore encourage the Boards to address the existing grey areas that are causing the misrepresentation of certain types of transactions, which mainly relate to leasing of core assets, i.e. those assets that are primarily used in an entity's core production processes or provision of services. These grey areas represent the specific issues that the Board should seek to address, rather than proposing fundamental changes to accounting for all leases which would add significant complexity with little or no benefit for users of financial statements.

Our specific concerns with the proposals are set out below.

General view

The ED adds a lot of complexity to an accounting model that works well for the majority of contracts that are currently accounted for under IAS 17 *Leases*. While we do realise that for a small number of leasing arrangements the accounting may not properly reflect the underlying

economics, we question whether the introduction of an entirely new conceptual approach to leasing is the most efficient way of solving this.

The 'right of use approach' introduced by the ED is a concept that seems to be in conflict with the definition of an asset in the conceptual framework, since it is not necessarily 'controlled' by the entity. This will lead to assets being recognised on the balance sheet that are not controlled by the lessee.

The 'right of use approach' also puts a greater emphasis on drawing a boundary between lease arrangements and service arrangements. We are concerned that currently there is a great amount of uncertainty in the existing guidance in IFRIC 4 Determining whether an arrangement contains a Lease and that it will fail to provide adequate and clear distinctions between the two types of transactions.

The 'right of use approach' will replace rental expenses by amortisation and interest expenses that are front-loaded due to the use of the effective interest rate method. We do not see why leasing of operating assets that are used evenly during the leasing period should have different charges to the income statement over time. We do not believe that this will provide useful information for users of financial statements. Furthermore, the proposed model would lead to an increase in yields during the first years of a lease and to a decrease during the last years. It would also introduce volatility in earnings with potentially significant impact in the case of a change in occupancy duration assumptions.

Another significant element of the proposal is that it no longer focuses on the contractual lease term but requires estimating the possibility of renewal options and contingent rentals using a probability weighted approach. This gives rise to significant practical issues. For example, for long term lease contracts, such as multi-year property leases, it is impossible to assess with any reasonable degree of certainty whether or not the renewal option will be exercised. The requirement to include a value for this highly uncertain and optional component, reassessed at each balance sheet date, results in complexity and potentially spurious accounting entries which we do not believe will provide decision useful information for users. In our view the IASB should instead consider including a definition of the contract boundary consistent with the approach proposed in the Insurance Contracts ED. This would ensure that all contractual obligations are recognised and to the extent that renewal options and contingent rentals do not represent an obligation at the balance sheet date then they should be subject to disclosure only in the notes to the financial statements

The ED proposes two models for lessors, the 'performance obligation' approach and the 'derecognition' approach. In our view a single or partial derecognition will better represent the asset risk that the lessor is exposed to, because the approach more appropriately reflects the economic benefits retained by the lessor in the form of a residual asset and does not perpetuate the 'right of use approach' which we object to for the reasons previously stated.

Investment properties held by lessors

Insurance companies are significant holders of investment properties and depending on the business model of each insurer under IAS 40, hold investment properties either at cost or fair value. For leases of real estate the ED provides a two-way approach to the accounting for lessors. Entities that measure their real estate portfolios at fair value under IAS 40 are exempt from the ED, whereas those that measure their real estate at cost under IAS 40 are not. We

do not see why a different accounting model should be introduced for investment property held at cost, and we question if there are any benefits to the users of the financial statements.

Moving from one mixed measurement model for real estate investments (FV or cost + rental revenue) to a modified mixed measurement model for real estate investments (FV or cost + present value of performance obligation) grosses up the balance sheet and adds complexity to already well understood accounting methods. From a preparer perspective, this complexity adds cost, especially when considering the need to reassess estimates at every reporting period. Although we understand the reasoning of the Board, as set out in the Basis for Conclusions, we think this could be more adequately solved by including additional disclosures when investment properties are held at cost, rather than fundamentally changing the measurement model.

The ED is unnecessarily complex

We believe that it is important that the Boards take into consideration the serious complexities and difficulties that are inherent in the proposed models. The models rely on a significant degree of estimation and judgement. This will increase the complexity in lease accounting requiring entities to make complex judgements and probability assessments related to their lease terms. In addition, these estimates will need to be reassessed at each reporting date.

Cost benefit consideration

We believe that the Boards have not taken into consideration the amount of administrative work and operational costs that will result from the proposed new standards. The proposals require preparers to reassess both the lease terms and the contingent rentals if facts or circumstances indicate that there is a significant change since the last reporting period. This will require undue cost and effort and raises the concern of cost versus benefits of the proposed new regulations.

The ED provides some relief for lease contracts with a maximum possible lease term, including options to renew or extend, of twelve months or less. However, as the relief only relates to discounting it actually does not provide a real relief. We therefore propose that short-term leases should continue to use the current operating lease model included in IAS 17.

The 'right of use approach' will require information and data that is not available through the current accounting systems. Lessees and lessors will have to make adjustments in their current IT systems for this purpose and lessees will also need to rely on information that is provided to them by lessors on an ongoing basis.

Conclusion

We are concerned about the general direction that this project is taking. We do not think that a sufficiently strong case has been made as to why a total revision of the current accounting model is required. In the current accounting model for leases, the dividing line between finance leases and operating leases reflects the different economic characteristic of the arrangement. Although in some instances this distinction may not be sufficiently clear and can lead to abuse, we believe that this is a straight forward approach that captures the economic

substance of the different arrangements. We would propose the Boards look more to a solution to the current model rather than introduce an entirely new model.

As a final comment we would like to reiterate our comment made previously that: the Board is currently in the process of rewriting a number of Standards that have a deep impact on the insurance business. The introduction of ED 10 Consolidated Financial Statements, IFRS 9 Financial Instruments and IFRS 4 Insurance Contracts (Phase II) will lead to a considerable implementation effort. Adding a Standard on leasing will further increase the workload, without bringing any discernible benefits to the quality of the financial statements.

Yours sincerely

A handwritten signature in black ink, appearing to read "Dieter Wemmer". The signature is fluid and cursive, with a prominent initial "D" and a long, sweeping tail.

Dieter Wemmer
Chair, European Insurance CFO Forum