Association of British Insurers

Status of Trustees' Strategy Review

The ABI's response to the Trustees of the IFRS Foundation's paper for public consultation

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Introduction

1. The ABI is the voice of insurance, representing the general insurance, investment and long-term savings industry in the UK. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

2. The ABI is grateful to the Trustees of the IFRS Foundation for the opportunity to respond to their public consultation paper, '*Status of Trustees' Strategy Review'.*

ABI comments

3. We support the IFRS Foundation's mission, as this substantially reflects the primacy of the investor interest. Overall, we consider that a proper focus on investors' needs provides the most appropriate way in which the public interest may be furthered. We do not consider it appropriate that financial stability should be a separate objective of the IFRS Foundation or of the IASB's standards.

4. We support the IFRS Foundation's private sector status and its three-tier governance structure. We consider that the roles of the Monitoring Board and the IFRS Foundation trustees should be quite separate, and that the Monitoring Board's role should be limited to overseeing the trustees. Accordingly, the Monitoring Board should not play any direct part in the IASB Board's composition, its standard-setting agenda, or its standard setting. It is very important that the standard setting process is, and is seen to be, independent and protected from political influence, directly or indirectly.

5. We support the changes the IFRS Foundation has made recently to improve the IASB's agenda and standard setting processes. We suggest that time needs to be given for these changes to bed down before another effectiveness review is undertaken. Meanwhile, we would support the trustees playing a more active role in overseeing the IASB's existing processes, and the Monitoring Board being more transparent and publically accountable on how it fulfils its role in overseeing the trustees and on its effectiveness in doing this.

6. We note that, as a single private-sector body operating in an international context, the IFRS Foundation cannot achieve automaticity of financing. It will need to work with its stakeholders, including those with levying powers. We commend the supporting financing approach taken by the Financial Reporting Council in the UK.

Association of British Insurers
February 2011

The ABI's response to the IFRS Foundation's paper for public consultation

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<u>Mission: How should the organisation best define the public interest to which it is committed?</u>

1. The current Constitution states, "These standards [IFRSs] should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions." Should this objective be subject to revision?

<u>ABI response</u>

We support the IASB's formulation, in its conceptual framework, of the objective of general purpose financial reporting as being "to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. These decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans or other forms of credit". We do not consider that any changes are necessary to the current Constitution other than to highlight still further the primacy of the investor element in the public interest and to recognise the importance of the stewardship role in financial reporting. This ensures that the entity's management is accountable to its shareholders, who are its suppliers of its risk capital. Overall, we consider that a proper focus on investors' needs provides the most appropriate way in which the public interest may be furthered.

We continue to think the Constitution should not be expanded to include the public and not-for-profit sectors. Not only has the IASB quite enough to do already, but we consider that the interests of investors in private sector profit-making entities are significantly different from those of stakeholders in the public and non-for-profit sectors, thus implying financial reporting requirements that differ in important respects.

2. The financial crisis has raised questions among policymakers and other stakeholders regarding the interaction between financial reporting standards and other public policy concerns, particularly financial stability requirements. To what extent can and should the two perspectives be reconciled?

<u>ABI response</u>

We consider the investor interest to be paramount. We note that it is necessary for financial reporting standards to ensure that financial statements give adequate information to investors on the impact on the reporting entity of other public policy interests, including the requirements of prudential regulation. We consider that transparency to investors in itself helps indirectly to meet such financial stability objectives. But we do not support financial reporting requirements having any form of objective that is aimed directly at meeting financial stability and other public policy concerns.

We agree with the conclusion of the Monitoring Board in September 2009 that "whilst it is useful to consider the intersection of banking supervision and financial reporting in the light of the recent banking crisis, accounting standards should not be allowed to become a surrogate for robust risk management or effective bank supervision."

We consider that financial stability concerns may be met through financial reporting requirements that meet investors' needs to the extent that those needs are the same as those of regulators. But investors' and regulators' objectives differ. For example, investors seek not just safety through solvency but also to maximise their return on their investments in individual entities. Whereas the regulator's financial stability focus is solely on solvency at the macro-economic level. Hence their information needs also differ.

Further, regulators have the power to require entities to supply them with information (which could be audited, should regulators require this) for their special regulatory purposes. This is quite apart from the information that is available to regulators through general purpose financial reporting. By contrast, investors have to rely on general purpose financial statements. Therefore, we consider it essential that that, should there be any conflict, the general purpose reporting needs of investors should override the special purpose reporting needs of regulators.

Further, in our view, even with a sole focus on investors' needs, many financial statements are already long and complex. This is because the economic environment, business activities and financial structures are such that investors need much information to understand the risks and rewards. Any imposition of extra regulatory reporting requirements that do not directly meet investors' needs will inevitably result in longer and more complex financial statements, and this is likely to hinder investors' understanding still further and undermine confidence in corporate reporting.

Lastly, we emphasise again that a focus on investors' needs may indirectly support regulators achieve financial stability objectives, thus furthering the public interest. This is because focused, high quality information informs investors and the markets more generally and so gives them confidence. That, in turn, helps to promote financial stability. We therefore encourage dialogue between the IASB and regulators to ensure that the views of regulators are taken into account, in the same way as are the views of other stakeholders in the standard-setting and agenda setting processes.

Governance: how should the organisation best balance independence with accountability?

3. The current governance of the IFRS Foundation is organised into three major tiers: the Monitoring Board, IFRS Foundation Trustees, and the IASB (and IFRS Foundation Secretariat). Does this three-tier structure remain appropriate?

ABI response

We agree with the Trustees that the success of IFRSs reflects the IASB's ability to produce high quality standards. We consider that an essential underpinning to this ability has been the IASB's independence as a standard-setter. Indeed, the independence of the IASB's standard-setting processes has been consistently and widely highlighted by investors and other primary users as an important source of confidence in IFRS-based financial statements. We therefore caution against any changes that would undermine the IASB's independent setting of standards as a source of the standards' legitimacy. Most importantly, we consider it essential to minimise any risk that technical standard setting processes are subject to political influences.

The establishment of the Monitoring Board met a need for wider public interest accountability, although we consider that the IASB's longer-term independence and legitimacy may be better served by the IASB having a grounding in international law. Meanwhile, we support the three-tier structure, as long as distinctions in the respective roles are clear. We consider that the Monitoring Board's engagement should be with, and via, the trustees. This means that it should oversee directly only the IFRS Foundation Trustees and not the IASB, and that the Monitoring Board should not play any direct part in determining the IASB Board's composition, the formulation of its standard-setting agenda, or the drawing up its accounting standards.

We welcome the Monitoring Board's recent decision to consult publically as part of its governance review. However, we find it difficult to understand how it came to undertake a separate yet concurrent review, with clear overlaps between its review and the trustees' strategy review. Furthermore, there is an important need for the Monitoring Board to become more transparent and publically accountable about how it fulfils its role in supervising the IFRS Foundation trustees and about how effective it is in doing this.

4. Some stakeholders have raised concerns about the lack of formal political endorsement of the Monitoring Board arrangement and about continued insufficient public accountability associated with a private-sector Trustee body being the primary governance body. Are further steps required to bolster the legitimacy of the governance arrangements (including in the areas of representation of and linkages to public authorities?

We do not accept that having a private-sector Trustee body is incompatible with public accountability and, as above, we value the independence of the IASB's standard setting. Further, in the absence of a grounding in international law, we do not agree that there should be any formal political endorsement of the Monitoring Board.

It is, however, necessary to ensure that that there is fair representation of legitimate interests in the IASB's governance arrangements. To that extent we consider that this needs to be kept under review, as the usage of IFRSs expands worldwide - whether there is an appropriate geographical balance in the composition of both the Monitoring Board and the Trustees of the IFRS Foundation, and whether the investor interest is still reflected adequately which we are not convinced is currently the case.

We support the composition of the Monitoring Board in so far as this reflects the responsibilities of capital markets authorities for providing orderly and efficient markets for investor participation. We do not think that representation is appropriate for other public interest bodies with quite different policy objectives, such as the International Monetary Fund or the Financial Stability Board. We suggest that the place of the European Commission should be taken instead by the European

Securities and Markets Authority. We continue also to question the Basle Committee's observer role, as reflecting only the banking industry.

Process: how should the organisation best ensure that its standards are high quality, meet the requirements of a well functioning capital market and are implemented consistently across the world?

5. Is the standard-setting process currently in place structured in such a way to ensure the quality of the standards and appropriate priorities for the IASB work programme?

ABI response

We consider that the IASB is already structurally a relatively open and transparent organisation. It has made a made a number of significant changes to its overall standard-setting processes in recent years. Most importantly, it has formalised and widened its consultation processes for setting its agenda, it has considerably strengthened its outreach activities (though it still has more to do in this respect), and it been more responsive to changing circumstances in setting its priorities. It is also to place greater emphasis on post-implementation reviews in its post-2011 programme.

We consider that such changes need to be given time to bed down and that the IASB be given appropriate space to concentrate on its immediate, very demanding, work programme. Only then should the IFRS Foundation should conduct a further effectiveness review. We suggest that a suitable point in time may be some way into the 'stable platform' period that FRS Foundation aims to provide shortly.

Meanwhile, whilst we recognise the considerable success of the Trustees in promoting the wider use of IFRS, we would encourage the Trustees to be more active and transparent in fulfilling their role in overseeing the IASB Board's existing processes. We note that number of stakeholders have expressed concerns in this respect. A consequence has been that eg that, in practice, it has not always been not clear enough whether:

- the IASB has responded appropriately to significant disagreements or reservations about its standards-setting proposals - for example, where there is the potential need to re-expose proposals or to suspend or terminate a project;

- the IASB's priorities fully take into account the full range of stakeholders' views - for example, in relation to the impact on its priorities of stresses that have inevitably arisen from the pursuit of the convergence agenda.

6. Will the IASB need to pay greater attention to issues related to the consistent application and implementation issues as the standards are adopted and implemented on a global basis?

ABI response

The IASB clearly needs to ensure that its standards are written and structured in a way as to facilitate their application across the world. We suggest that the success of its IFRS for SMEs demonstrates its recognition of this need. We also welcome recent initiatives such as its consultation on the effective dates for a number of IFRSs due to be published in 2011, and its increased emphasis on post-implementation reviews. The latter should help it identify where issues arise and changes are needed to its standards or to application guidance. We do not, however, consider that the IASB should take on any formal responsibility for adoption or implementation, This may impair the independence of its standard setting and the principles-based focus of its standards.

Financing: how should the organisation best ensure forms of financing that permit it to operate effectively and efficiently?

7. Is there a way, possibly as part of a governance reform, to ensure more automaticity of financing?

ABI response

The objectives for financing should not only be that it is sufficient for the purpose and is predictably and reliably so, but also that it is obtained without undue cost. It should drawn from those who benefit from the IASB's standards, but without compromise to its independence. There may be a number of ways to achieve these objectives, though we commend the approach taken by the Financial Reporting Council (the FRC) in the UK. The FRC draws most of its funding from preparers of financial statements (substantially via a levy on listed and other large companies and from the accountancy profession). Such diversification of funding should help to avoid compromise to the IASB's standard-setting independence. Furthermore, the FRC consults publically on its budgets and funding, which helps to ensure that there is due regard paid to the need for cost-management.

We note, however, that, as a single private sector entity (which status we support) that publishes standards that are used in many countries world-wide, it may not be realistic for the IFRS Foundation to aim for complete automaticity of financing. It will need to continue to work with its stakeholders, including authorities responsible for national funding regimes.

Other issues

8. Are there any other issues that the Trustees should consider?

ABI response

We suggest that the IFRS Foundation should ensure that the opportunity of the 'stable-platform' period is taken to give priority to the completion of the IASB's conceptual framework. This is essential for the IASB in addressing cross-cutting issues coherently in the future development of IFRSs.