

FÉDÉRATION FRANÇAISE DES SOCIÉTÉS D'ASSURANCES

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LE DÉLÉGUÉ GÉNÉRAL

March 28, 2013

Re: IASB ED/2012/4 – Classification and Measurement: Limited Amendments to IFRS 9

Dear Mr Hoogervorst,

The Fédération Française des Sociétés d'Assurances (FFSA) welcomes the opportunity to comment on the exposure draft "Classification and Measurement: Limited Amendments to IFRS 9" (ED). Our members represent most of the French insurance and reinsurance undertakings, constituting over 90% of the insurance market in France.

As the revised ED IFRS 4 is not yet available, our assessment of IFRS 9 cannot be finalised until such time as we are able to assess both draft standards together and may change depending on their final outcome.

The FFSA welcomes the introduction of the FV-OCI measurement category in IFRS 9. However, the FFSA believes that further work is required to ensure a consistent measurement of the assets and the insurance liabilities reflecting the business models and the long term performance of insurers.

The introduction of a FV-OCI measurement category in IFRS 9 is a positive step in taking into account the interactions between the financial assets and the insurance contract projects.

Asset liability management (ALM) is the fundamental core of the insurance activity. Indeed, insurers manage diversified portfolios of financial and non financial assets in accordance with their liability profile to meet obligations to policyholders that depend on the nature of the contracts and the regulatory constraints that exist in the different jurisdictions. Therefore, business models of insurers depend on how they manage their portfolios of insurance contracts and the assets backing these portfolios and on how they measure and report the performance on these portfolios.

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

In this respect, we are concerned that the IFRS 9 proposals are developed in isolation, only considering financial assets, without taking into consideration the ALM. As such, accounting will not reflect the linkage that exists between assets and insurance liabilities. Therefore, insurers will not be able to appropriately reflect their business models and performance in the financial statements.

Thus, we consider that further work is needed to ensure that financial statements of insurers provide appropriate information about the ALM and the performance so as to permit users to make appropriate economic decisions. In this respect, we believe that the IASB should take the necessary time to develop a comprehensive business model driven accounting for insurers.

Based on the above, we consider that:

Measurement of financial assets and insurance liabilities should be driven by the business models of insurers. As such, portfolios of insurance liabilities and backing financial assets would have to be measured at amortised cost, FV-OCI or FV-PL¹ depending on their documented ALM strategies and the way their performance is assessed and reported. Giving primacy to the business model criterion would ensure that the financial statements reflect the long-term performance of insurers and exclude the undue short term volatility of the markets that is not representative of the time horizon of this performance. In addition, it would allow the business models of insurers to be reflected in the same manner as the business models of certain banking activities are reflected within IFRS 9, therefore achieving a level playing field between insurers and banks.

All categories of assets backing portfolios of insurance contracts should be measured at FV-OCI when the performance of the related insurance portfolios is evaluated on a “hold and sell” basis, including derivatives, equity instruments or real estate.

- **The limitation of the FV-OCI measurement category as proposed by the ED to “simple” debt instruments is not appropriate.** It would impede insurers to reflect the performance of their ALM strategies which are not limited to manage for the benefits of policyholders “simple” debt instruments but diversified categories of assets, including derivatives to manage interest rate risks or credit exposures;
- **The restriction on recycling and the absence of impairment for equity instruments measured at FV-OCI is not appropriate.** Realised gains and losses and impairment on these assets are part of the performance of the related insurance portfolios. As such they should be reported in the profit and loss and match the expense for the policyholder claims and the participation features recognised in the profit and loss.

The mandatory effective date of IFRS 9 must be aligned with IFRS 4 for insurers.

IFRS 9 and IFRS 4 projects are of crucial importance for insurers as they are complementary to reflect the business models of insurers in the financial statements. Therefore, it is vital that they are finalised on a consistent basis. As such, we do not believe that the revised IFRS 9 can be finalised before the insurance standard is also finalised.

¹ In this letter, FV references in the context of insurance liabilities refer to a current value with the changes of discount rates presented in the profit or loss for FV-PL or presented in OCI for FV-OCI

In addition, we consider that insurers should not be required (but permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise, the usefulness of the financial reporting for users in the period between IFRS 9 and IFRS 4 adoption would be put into question, as users will experience two major changes in an insurer's financial statements in a short period of time.

If the effective dates were not aligned and insurers were required to adopt IFRS 9 in advance of IFRS 4, it would be critical to include sufficient provisions in IFRS 4 to permit insurers to fully reclassify their assets when adopting IFRS 4.

Detailed responses to the questions asked in the ED are addressed in the appendix to this letter.

We encourage the IASB to pursue its active dialogue with the insurance industry so as to provide an optimal solution by producing high quality IFRSs both for financial instruments and insurance contracts that allow insurers to reflect their business models so as to give clear information to users in order to ensure appropriate economic decision-making.

Please feel free to contact Bertrand Labilloy at +33 1 42 47 93 58 to discuss any matters raised in this letter.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'JF Lequoy', written over a horizontal line.

Jean-François Lequoy

Appendix

Contractual cash flow characteristics assessment: a modified economic relationship between principal and consideration for the time value of money and the credit risk

Question 1

Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest? Do you agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?

Contractual cash flow characteristics assessment

Consistent with our view that the classification of financial assets should be driven by the business model, it would not be necessary in such an accounting model to assess the contractual cash flow characteristics.

Conversely, in the context of this ED, the assessment of the contractual cash flow characteristics is essential. In this regard, we welcome the clarification that the IASB did not always intend to measure financial assets at FV-PL due to the existence of a modified relationship between principal and the consideration for the time value of money and the credit risk.

However, we consider that the notion of “not more than insignificantly different from the benchmark cash flows” is too restrictive and raises a number of practical issues.

- The proposal is aimed at determining the classification and measurement of a financial asset in its entirety. In this perspective, we believe that an assessment that would result in classifying a financial asset at FV-PL instead of amortised cost or FV-OCI due solely to cash flows in one of its components not meeting a very restrictive threshold would not provide appropriate information to users about the business model of the entity. As stated in our comment letter to the *ED Financial Instruments: Classification and Measurement*, dated 10 September 2009, we consider that such inappropriate FV-PL measurement would apply to financial assets that may otherwise not have been classified as such under IAS 39, for example to:
 - some perpetual debt instruments with contingent coupons (e.g. distributable profit, change in control...) or that may have a deferred coupon which does not accrue for solvency constraints; or
 - some debt instruments without significant leverage.
- The notion of benchmark instrument raises a number of practical issues for example in regulated environments for which no benchmark instruments may exist. We recommend the IASB to deal with this topic as envisaged (refer to ED.BC 44). In our view, the objective of accounting should be to appropriately reflect the business models and the economics of the transactions that also naturally depend on the nature of the contracts and the regulatory constraints that exist in the different jurisdictions;

Therefore, we consider that the “no more than insignificantly” notion should be changed to “without significant leverage” as proposed in our comment letter to the *ED Financial Instruments: Classification and Measurement*, dated 10 September 2009. In this regard, we propose the IASB to use as a proxy the “double-double” test maintained in IFRS 9 for financial liabilities.

Furthermore, we also note that the IASB has recently decided in the impairment project to change the notion of “more than insignificant deterioration” to retain the notion of “significant deterioration”.

Bifurcation of financial assets

Consistent with our view that the classification of financial assets should be based on the business model, financial assets should also be bifurcated when their components are separately managed under different

business models. It would ensure that the measurement of financial instruments appropriately reflects how entities manage their assets at an appropriate level of granularity (e.g. at the appropriate unit of account) and therefore provide more relevant information to users of financial statements. It would also ensure symmetry of treatment between the financial assets and the financial liabilities and non financial assets.

Question 2

Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?

Refer to Question 1.

Question 3

Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features? Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?

Refer to Question 1.

Business model assessment: the 'fair value through other comprehensive income' measurement category for financial assets that contain contractual cash flows that are solely payments of principal and interest

Question 4

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 FFSA welcomes the introduction of the FV- OCI measurement category in IFRS 9. However, the FFSA believes that further work is required to ensure a consistent measurement of the assets and the insurance liabilities reflecting the business models and the long term performance of insurers.

The introduction of a FV-OCI measurement category in IFRS 9 is a positive step in taking into account the interactions between the financial assets and the insurance contract projects.

Asset liability management (ALM) is the fundamental core of the insurance activity. Indeed, insurers manage diversified portfolios of financial and non financial assets in accordance with their liability profile to meet obligations to policyholders that depend on the nature of the contracts and the regulatory constraints that exist in the different jurisdictions. Therefore, business models of insurers depend on how they manage their portfolios of insurance contracts and the assets backing these portfolios and on how they measure and report the performance on these portfolios.

In this respect, we are concerned that the IFRS 9 proposals are developed in isolation, only considering financial assets, without taking into consideration the ALM. As such, accounting will not reflect the linkage that exists between assets and insurance liabilities. Therefore, insurers will not be able to appropriately reflect their business models and performance in the financial statements.

Thus, we consider that further work is needed to ensure that financial statements of insurers provide appropriate information about the ALM and the performance so as to permit users to make appropriate economic decisions. In this respect, we believe that the IASB should take the necessary time to develop a comprehensive business model driven accounting for insurers.

Based on the above, we consider that:

Measurement of financial assets and insurance liabilities should be driven by the business models of insurers. As such, portfolios of insurance liabilities and backing financial assets would have to be measured at amortised cost, FV-OCI or FV-PL² depending on their documented ALM strategies and the way their performance is assessed and reported. Giving primacy to the business model criterion would ensure that the financial statements reflect the long-term performance of insurers and exclude the undue short term volatility of the markets that is not representative of the time horizon of this performance. As such, only those financial assets and insurance liabilities that are managed together in accordance with a documented ALM strategy and for which the performance is reported on a fair value basis would be measured at FV-PL. In this context, we consider that it would not be appropriate to permit a FV-PL option for assets and insurance liabilities only to avoid complexity or to resolve accounting mismatches as an alternative to develop a business model driven accounting.

In addition, given primacy to the business model criterion would allow the business models of insurers to be reflected in the same manner as the business models of certain banking activities are reflected within IFRS 9, therefore achieving a level playing field between insurers and banks.

All categories of assets backing portfolios of insurance contracts should be measured at FV-OCI when the performance of the related insurance portfolios is evaluated on a “hold and sell” basis, including derivatives, equity instruments or real estate.

- **The limitation of the FV-OCI measurement category as proposed by the ED to “simple” debt instruments is not appropriate.** It would impede insurers to reflect the performance of their ALM strategies which are not limited to manage for the benefits of policyholders “simple” debt instruments but diversified categories of assets, including derivatives to manage interest rate risks or credit exposures;
- **The restriction on recycling and the absence of impairment for equity instruments measured at FV-OCI is not appropriate.** Realised gains and losses and impairment on these assets are part of the performance of the related insurance portfolios. As such they should be reported in the profit and loss and match the expense for the policyholder claims and the participation features recognised in the profit and loss. We acknowledge that measuring equity instruments at FV-OCI raises the issue of impairment. In this regard, as stated in our comment letter to *the ED Financial Instruments: Classification and Measurement, dated 10 September 2009*, we recommend that the IASB should develop an impairment model for equity instruments that would take into account the investor’s holding horizon. We believe that taking into consideration this characteristic would ensure that the business model of long term investors, in particular insurers, is appropriately reflected in the financial statements avoiding undue short term volatility of the markets. Reversal of impairment should also be allowed if there is evidence that the reasons for it do not longer exist.

Question 5

Do you believe that the Exposure Draft proposes sufficient, operational application guidance on how to distinguish between the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the guidance provided to describe those business models? If not, why? What additional guidance would you propose and why?

Refer to our response to Question 4

Question 6

Do you agree that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI? If not, why and what would you propose instead?

² In this letter, FV references in the context of insurance liabilities refer to a current value with the changes of discount rates presented in the profit or loss for FV-PL or presented in OCI for FV-OCI

Consistent with our view that the measurement of assets and insurance liabilities of insurers should be based on their business models, there is normally no need for a fair value option per se.

However, we consider that a fair value option would be necessary for practical expedient in the rare circumstances where the bifurcation of hybrid financial assets whose components are separately managed under different business models raises operational difficulties or significant costs (refer to question 1).

Early application

Question 7

Do you agree that an entity that chooses to early apply IFRS 9 after the completed version of IFRS 9 is issued should be required to apply the completed version of IFRS 9 (ie including all chapters)? If not, why? Do you believe that the proposed six-month period between the issuance of the completed version of IFRS 9 and when the prohibition on newly applying previous versions of IFRS 9 becomes effective is sufficient? If not, what would be an appropriate period and why?

IFRS 9 and IFRS 4 projects are of crucial importance for insurers as they are complementary to reflect the business models of insurers in their financial statements. Therefore, it is vital that they are finalised on a consistent basis. As such, we do not believe that the revised IFRS 9 can be finalised before the insurance standard is also finalised.

In addition, we consider that insurers should not be required (but permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise, the usefulness of the financial reporting for users in the period between IFRS 9 and IFRS 4 adoption would be put into question, as users will experience two major changes in an insurer's financial statements in a short period of time.

However, there may be situations, such as when an insurer is part of a banking group, where the insurer may to early adopt IFRS 9 in advance of IFRS 4. We are convinced that in such a case, the current provisions in IFRS 9 related to re-designation of financial instruments are not sufficient to cover all the circumstances in which re-designation may be necessary upon adoption of IFRS 4. Therefore, we recommend the IASB to revisit its proposals to permit to "IFRS 9 early adopters" insurers to fully reassess their financial instruments classification when adopting IFRS 4.

Presentation of 'own credit' gains or losses on financial liabilities

Question 8

Do you agree that entities should be permitted to choose to early apply only the 'own credit' provisions in IFRS 9 once the completed version of IFRS 9 is issued? If not, why and what do you propose instead?

We have indicated previously that, in order to avoid conveying inappropriate information in the financial statements, we believe that the effects of changes in a financial liability's credit risk should not affect profit or loss or OCI, until these gains and losses are realized. In our view, financial liabilities should be recorded at amortized cost or using the "frozen credit spread" method.

However, even if the "own credit" provisions proposed in IFRS 9 partially address our concerns, we support their application without unnecessary delay. In this respect, we note that the IASB acknowledges that to provide non-GAAP information that adjusts for the changes in own credit risk is not an ideal situation (ED.BC102).

Therefore, we recommend that the IASB amends IAS 39 to incorporate the "own credit" provisions of IFRS 9 as soon as possible. This would ensure that this topic, for which there is a wide agreement, is addressed within a short delay, as the IASB recently proposed for the novation of OTC derivatives.

First-time adoption

Question 9

Do you believe there are considerations unique to first-time adopters that the IASB should consider for the transition to IFRS 9? If so, what are those considerations?

We do not have any specific comments in respect of first-time adopters of IFRSs.