FÉDÉRATION FRANÇAISE DES SOCIÉTÉS D'ASSURANCES
26, Bd HAUSSMANN, 75311 PARIS CEDEX 09 - TÉLÉPHONE 01 42 47 90 00
TÉLÉCOPIE : 01 42 47 93 11 - http:/www.ffsa.fr/

Mrs Françoise Flores
Chairman
EFRAG
35 Square de Meeûs
1000 Brussels
Belgium

Email: commentletters@efrag.org

Paris, 25 June 2013

Dear Mrs Flores,

EFRAG's Public Consultation "Is there a need for specific financial reporting for long-term investing activities business models?"

The Fédération Française des Sociétés d'Assurances (FFSA) is pleased to respond to the EFRAG's Public Consultation "Is there a need for specific financial reporting for long-term investing activities business models?". Our members represent most of the French insurance and reinsurance undertakings, constituting overt 90% of the insurance market in France.

We welcome the initiative of the European Commission to consult on the Green Paper "Long-term financing of the European Economy" particularly as we have taken a very active part in the discussions on the long-term investment subject over the last years.

As stated in our response to the European Commission on the Green Paper on Long-Term Financing dated June 25, 2013, insurers in Europe, and particularly in France where they represent the largest group of institutional investors (1 808 M€ in 2012) are well aware of their responsibility as key players in the financing of the economy.

Insurers provide an ideal source of the long-term funding the Europe economy so desperately needs. That is why they are so concerned about the various policy trends that risk reducing the flow of premiums available and creating disincentives for long-term investing. These concerns arise principally in the areas of prudential regulation but also in the area of accounting.

Therefore, we welcome the decision of the EFRAG, in its role of technical advisor for financial reporting matters to the European Commission, to launch this consultation, which is focused on the role accounting plays in the long-term investment subject.

Financial statements are essential to provide information on the performance of entities consistently with the horizon of time of their activities and their business models so as to permit investors to take appropriate economic decisions

Performance of entities results from their activities e.g. from their business models. In such a context, comparability is meaningful only when activities are comparable.

Therefore, to reflect properly the performance of entities, it is essential that the accounting framework captures these business models and reflects them in an appropriate manner. If the accounting framework is designed to capture short-term volatility in assets and liabilities and short-term performance that is not representative of the activities of the entities, it would create a disconnection between the economics of the activities, their horizon of time and the information provided to investors.

Indeed, if financial statements provide information that is not in line with the business models of the entity and the way their performance is assessed internally, information provided to investors will not correspond to the manner in which the entity is managed. As such, investors would not be in a position to assess the real performance of the entity against the strategies that the management was supposed to achieve. It would lead investors to take decisions to invest or disinvest on a basis that is disconnected from the economic reality of the business and its horizon of time.

Therefore, accounting requirements should be adapted so as to appropriately reflect the business models of the activities and their horizon of time

In this context, the response to the question posed by the EFRAG in the context of the Green Paper consultation of whether there is a need for specific financial reporting for long-term investing activities business models is "yes, there is a need for a specific financial reporting for long-term investing activities business models".

Long term investors are essential for the economic growth and job creation and their importance for the future of Europe is crucial. Therefore, providing them with an appropriate framework that ensures that their economic decisions for investing and disinvesting are taken on the appropriate horizon of time is fundamental.

It is essential for entities investing in long term activities:

- to be provided with information on the long term performance of their investments, e.g. with information that is not reflecting volatility that is short term or reflecting risks that are not exposed to as long-term investors;
- to be able to provide information to their investors that reflects their business model, its long-term horizon and the way their financial position is managed accordingly. It will ensure an alignment between the interests of the investors in the entity, the long term value of the activity of the entity, its performance and the way it is managed.

<u>Therefore, different measurement bases are needed according to the horizon of the activities</u>

For activities with a short term horizon, such as trading activities which are by definition short termist, fair value information is key for both the management and the investors. A fair value measurement on a frequent basis is necessary for the management of a short term activity to take the appropriate decisions as it is intrinsically linked to the horizon of time of such an activity. It will ensure the alignment between the business model of the activity and the way its financial position and performance are reported to investors.

On the contrary, using fair value through profit and loss to assess the performance of activities that are not exposed to the short term volatility of markets is inappropriate as it will result in a profit or loss that does not reflect the economics of these activities.

We consider that the accounting framework should be adapted depending on the business models of the entities. Therefore, we believe that different measurements of assets and liabilities should be required depending on these business models with the objective to reflect in the profit and loss the performance of the entity on the appropriate horizon of time.

If fair value accounting is used for long term activities, shareholders and management will focus on short term information derived from the markets that are not representative of the values and of the risks to which the entity is exposed on a long term basis instead of focusing on the appropriate horizon of time of these activities. It would lead to inappropriate behavior of investors creating disincentives for long-term investing, by focusing on a short term vision of the entities and their performance, leading naturally to short term behavior under the pressure of inappropriate references to markets.

As it has been acknowledged in the recent years in the turmoil of the recent financial crisis, an inappropriate use of fair value can lead to procyclicality and volatility

French insurers, as long term investors, support an accounting framework that appropriately reflects the performance of their long term activities performance so as to be able to continue to play their role of long term investors

French insurers, and more generally European insurers, are in the business of providing protection from risks and long-term savings products. These products result in predictable cash outflows, to a large extent long-term. Insurers' investment strategies are determined on the basis of the profile of these liabilities. Therefore, insurers can make long-term investments in diversified assets, for example bonds or equity instruments without incurring liquidity risks. In addition, the existence of a regular flow of premiums enables them to provide liquidity to the market and to play a stabilizing role in the economy. As a result, French insurers, and more generally insurers, represent a major source of long-term funding to the French and other European countries economies.

As such, it is essential for them to both get the appropriate information on the long term performance of their investments and to provide their investors with appropriate information on their own activities and their performance.

An accounting framework based on fair value that would blur the performance of long term activities by treating all their assets and liabilities as if they were traded and creating artificial volatility would not reflect the economics of the long term activities. As such, it would restrain the ability of insurers to act as providers of long term financing which and would also prevent the shareholders and investors in insurance companies to appropriately assess the performance of these companies.

Therefore, French insurers support an appropriate accounting framework, based on different measurements according to the activities that would allow them both to assess appropriately the performance of their long term investments and to report the performance of their long term activities to shareholders and to users in a meaningful manner.

The IFRS 9 and IFRS 4 Phase 2 projects are not aiming at reflecting the business models of the insurance companies. Therefore, it will not provide investors appropriate information on the performance of insurers, including on their long term financing activities

The question of the appropriate accounting framework for the insurance activities is much debated in the context of the financial instruments and insurance contracts projects of the IASB.

Asset liability management (ALM) is the core of the insurance activity. Indeed, insurers manage diversified portfolios of assets (financial and non financial assets) in accordance with their liability profile to meet their obligations to policyholders that depend on the nature of contracts and on 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 how they measure and report the performance on these portfolios. Therefore, financial statements of insurers should provide appropriate information about these ALM strategies and their related performance so as to permit users to make appropriate economic decisions.

It is sometimes opposed to insurers that there is a fundamental principle underlying IFRS that assets and liabilities should be accounted for separately. Therefore it would justify why the current IASB's proposals for financial instruments (IFRS 9) and insurance contracts (IFRS 4 Phase 2) are developed in isolation without considering the ALM of insurance companies.

In this regard, we note that the IASB has made some efforts to resolve the volatility in the profit or loss that resulted from its initial proposals in IFRS 4 by introducing the fair value through other comprehensive income (FV-OCI) category for simple debt instruments and to present the changes in discount rate of insurance liabilities in FV-OCI. However, these proposals raise a number of concerns as they are not based on the objective of developing a real "asset/liability" accounting framework that would reflect the business models of insurers. For example:

- The IASB has introduced the notion of business model in IFRS 9 but its application is unduly restrained by the requirement to take into consideration the characteristics of the instruments;
- The IASB decision to measure insurance liabilities at current value does not take into consideration that the ALM is based on the horizon of time and on the way insurers report their performance towards policyholders and shareholders;
- The restriction of the FV-OCI category to simple debt instruments does not take into consideration the fact the ALM strategies 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 at FV-OCI. 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.

As of today, the current measurement of insurance liabilities remains central in the IASB proposals and as a consequence, some stakeholders view the current measurement of assets as the appropriate measure as it results in a consistent measurement of the balance sheet. However, this alternative does not resolve the critical issue of how to make the insurers' financial position and performance comprehensible to investors.

To conclude, insurance companies are predominantly long-term investors and therefore it is crucial that their profit and loss statements reflect a meaningful performance. An appropriate accounting framework for insurers should give primacy to the business model criterion. It would ensure that the financial statements of insurers reflect their long-term performance and exclude the undue short term volatility of markets that is not representative of the time horizon of this performance.

On this basis, portfolios of insurance liabilities and backing assets would be measured at amortised cost, fair value through other comprehensive income or fair value through profit and loss depending on the documented ALM strategies and the way the performance on these portfolios is assessed and reported.

We hope you find these comments useful. Please contact me at + 33 1 42 47 93 58 should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Bertrand Labilloy

Director Economic and Financial Affairs