Fédération Française
de l'Assurance

DIRECTION DES AFFAIRES FINANCIERES, PRUDENTIELLES ET COMPTABLES

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EFRAG Discussion Paper – March 2018 – Equity Instruments – Impairment and Recycling

Dear Mr Gauzès,

The Fédération Française de l'Assurance (FFA) is pleased to express our views on the EFRAG Discussion Paper (DP) regarding Equity Instruments – Impairment and Recycling. FFA is a body representing the views of French (re)insurers accounting for some 90% of premiums in France.

French insurers, and more generally European insurers, are in the business of providing protection from risks and long-term savings products. Insurance liabilities result in predictable cash outflows, to a large extent long-term even for part of non-life activities. Through an efficient asset-liability management, insurers are able to match the long-term profile of these liabilities with long term investments. The capacity of insurers to invest with a long-term horizon is key for achieving Europe's objectives of economic prosperity and sustainable development.

As long-term investors, our members particularly welcomed the European Commission request to EFRAG in May 2017 to investigate on the accounting treatment of equity instruments under IFRS 9 from a long-term investment perspective. Indeed, we have consistently held the view that appropriate accounting requirements should be developed to reflect the business model of long term investors and to not discourage long term investment.

Regarding the application of IFRS 9 to insurance activities, the following contextual elements are of particular importance:

- Our members, as the majority of European insurers, will apply IFRS 9 in conjunction with IFRS 17 in 2021 (with a year of comparative). Some may put forward that as such insurers will only be concerned by IFRS 9 after 2021 and that it is too early to take their views in consideration. However, given the size of their investment portfolios coupled to the time necessary to adjust asset allocations strategies, insurers are already taking into consideration these consequences;
- Some consider that the variable fee approach model under IFRS 17 will address the concerns resulting from the IFRS 9 treatment of equity instruments under FV OCI. However, the variable fee approach has been developed to reflect the links between assets and liabilities in the measurement of some (limited) categories of insurance contracts. The fact that it permits to better reflect this link for these contracts should not be an argument to not solve the issues resulting from the current measurement of equity instrument under FV OCI;

- Insurers do not invest only directly in equities instruments. They also invest in equities indirectly, for example through UCITs. It is of utmost importance to not create economic competitive disadvantage because the same assets are hold through different mechanisms. Therefore, to provide relevant information for the performance of long-term investors such as insurers, we consider that the accounting treatment of equity-like instruments such as UCITs should also be eligible to the FV OCI category under IFRS 9, including the envisaged changes, and thus without waiting for the outcome of the IASB's FICE project.

Regarding the proposals set out in the EFRAG's DP for equity instruments at FV OCI and in line with our previous views:

- **We support the reintroduction of recycling as it would improve the depiction of the financial performance of long-term investors**

Gains and losses when equity instruments at FV OCI are sold are constitutive of the investor's performance as dividends on these instruments. As such, there is no conceptual reason to present them differently. Reporting consistently all the components of the performance of equity instruments in profit and loss will provide complete and appropriate information to users about the performance of the related investments. This will also ensure consistency with the accounting treatment of debt instruments accounted for at FVOCI for which both interests and gains and losses when they are sold are recognised in profit and loss.

Many users of financial statements are interested by additional information that distinguishes between realised and unrealised gains and losses as they give different values to these two categories of items. Recognising gains and losses when equity instruments at FVOCI are sold in profit and loss would give a clear information to users about the disinvestment decisions taken by the management. As such, users will be in a better position to assess the stewardship of the management.

- **We support the development of an impairment model similar to that of IAS 39 with the introduction of reversal and of specific guidance on "significant" and "prolonged" to address the drawbacks of the "original" IAS 39 impairment model**

To meet this objective, we support:

- Development of specific guidance on the meaning of both "significant" and "prolonged" for impairment of equity instruments at FV OCI. This would lead to enhanced shared understanding of these concepts. As such, preparers will be able to provide relevant information to users, by appropriately reflecting the characteristics of their portfolios in the measurement of impairment while removing subjectivity in its application;
- Recognition of subsequent recoveries in fair values in profit and loss following a symmetrical approach to impairment eg using both symmetric thresholds "significant" and "prolonged". It will ensure that equally relevant information is provided to users. It will also remove one of the drawbacks of the IAS 39 impairment model that by prohibiting reversal have presumably favoured late recognition of impairment;

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- Specific disclosures on the accounting policy for impairment (with both quantitative and qualitative elements) including the thresholds used by the entity to define "significant and prolonged". This will ensure transparent information for users and enhance comparability between entities and over time.

These changes in the accounting for equity instruments at FV OCI under IFRS 9 – and for equity like instruments such as UCITs - should be implemented rapidly e.g. without waiting the outcome of the IFRS 9 PIR review. We are convinced that such modifications of IFRS 9 will have a positive effect for the investment in equities of long-term investors, at a time where long-term investment is desperately needed in Europe.

Our detailed comments are presented in the Appendix.

Should you have any queries about the comments in this letter please do not hesitate to contact us.

Yours sincerely,

Christine Tarral
Deputy Director

Appendix – EFRAG's questions to constituents

Preliminary comments

As long-term investors, our members particularly welcomed the European Commission request to EFRAG in May 2017 to investigate the effects on long-term investments of IFRS 9 regarding equity instruments. EFRAG's report to the European Commission of its findings in relation to the assessment phase of this request outlined that:

- the aggregate amount/value of equity instruments classified as AFS under IAS 39 by entities that consider themselves long-term investors is substantial;
- entities that are concerned about the IFRS 9's requirements often point out to a form of 'economic linkage' between their holdings of equity investments and some of their liabilities;
- asset allocation decisions of long-term investors are driven by a plurality of factors therefore including accounting requirements.

These conclusions confirm the validity of the concerns that we pointed out in our previous responses to the IASB's consultations on financial instruments and insurance contracts projects or to the European Commission's Green Paper on Long Term financing of the European Economy.

In these responses, we have consistently held the view that appropriate accounting requirements should be developed to reflect the business model of long term investors and to not discourage long term investment.

Q1.1. What are your view on the arguments presented in paragraph 2.3.-2.10? Do you consider that the reintroduction of recycling would improve the depiction of the financial performance of long-term investors?

Alternatively, do you consider that the existing requirements of IFRS 9 provide an adequate depiction? Please explain.

We support the reintroduction of recycling for equity instruments at FV OCI. We consider that it would improve the depiction of the financial performance of long-term investors for the following reasons:

- Gains and losses when equity instruments at FV OCI are sold are constitutive of the investor's performance as dividends on these instruments. As such, there is no conceptual reason to present them differently. As acknowledged by the IASB during the discussions on IFRS 9 and by the EFRAG Academic literature review published recently, "there is an understanding that investors and other users of financial statements information can more easily, quickly and completely review and absorb information presented in profit and loss". Therefore, reporting consistently all the components of the performance of equity instruments in profit and loss will provide complete and appropriate information to users about the performance of the related investments. This will also ensure consistency with the accounting treatment of debt instruments accounted for at FVOCI for which both interests and gains and losses when they are sold are recognised in profit and loss.

- Many users of financial statements are interested by additional information that distinguishes between realised and unrealised gains and losses as they give different values to these two categories of items. Recognising gains and losses when equity instruments at FVOCI are sold in profit and loss would give a clear information to users about the disinvestment decisions taken by the management. As such, users will be in a better position to assess the stewardship of the management.

Q2.1. What are your views on the arguments presented in paragraph 2.11-2.17? Do you consider that, from a conceptual standpoint, recycling should be accompanied by some form of impairment model? Please explain.

Yes, we consider that, from a conceptual standpoint, the reintroduction of recycling should be accompanied by the development of an impairment model.

We agree with the argument put forward by EFRAG in paragraph 2.12. Reintroducing an impairment model, along with the recycling, will ensure consistency of the accounting treatment of equity instruments at FVOCI under IFRS 9 with the treatment of assets other than those measured at FVPL under IFRS.

We also concur with EFRAG that the reintroduction of an impairment model will enhance the relevance of profit and loss as the primary source of information about an entity's financial performance as all the components of the performance of the investments (dividends, impairment and gains and losses when the asset is sold) will be recognised in the same place.

Q3.1. What are your views on the arguments and analysis presented in Chapter 3 of the DP?

Q3.2. Are there other improvements in presentation and disclosure that you would support?

Q3.1 - We agree with EFRAG that presentation and disclosures solutions will not be sufficient to provide the information users would need to adjust profit and loss on the basis of FVOCI with both recycling and an impairment model. Given the size of the portfolios of equity of long term investors, even if very granular information were provided in the notes, it will not be equivalent to the information available to management to make its own quantitative assessment of impairment. Therefore, we favour the development of an appropriate impairment model to provide relevant information to users, together with the reintroduction of recycling.

Q3.2 – We consider that the level of information provided in the notes is already very detailed. Nevertheless, we also believe that additional disclosures will have to be provided to accompany the reintroduction of recycling and of impairment (refer to Q4).

Q4.1. What should be, in your view, the general objective and main features of a robust model for equity instruments (relevance, reliability, comparability...)?

Q4.2. Which if either, of the two models do you prefer? Please explain.

Q4.3. Do you have suggestions for a model other than those presented in the DP? if so, please describe it an explain why it would meet characteristics such as relevance, reliability and comparability.

Q4.1 - As mentioned above, we consider that the reintroduction of recycling should be accompanied by the development of an appropriate impairment model. The general objective and the main features of this impairment model should be to provide appropriate information to users i.e relevant, reliable and comparable information to users.

Q4.2 – We support an impairment model similar to IAS 39 with changes aimed at addressing the common acknowledged drawbacks of the "original" IAS 39 impairment.

We believe that a robust impairment model can be developed without undue costs by using IAS 39 requirements as a starting point. Nevertheless, as said above, this should be done with the objective to address the drawbacks of the "original" IAS 39 impairment model that were commonly acknowledged (e.g. diversity in its application due to the lack of guidance on the notion of "significant" and "prolonged" and due to the prohibition of reversal).

As such, we support:

- The development of specific guidance on the meaning of both "significant" and "prolonged" for impairment of equity instruments at FV OCI. These examples should illustrate quantitative applications of both thresholds (specific percentage decline from the acquisition cost and specific time period where the fair value has been below the acquisition cost) in well-defined situations, depending on the characteristics of different equity portfolios. This would lead to enhanced shared understanding of these concepts. As such, preparers will be able to provide relevant information to users, by appropriately reflecting the characteristics of their portfolios in the measurement of impairment while removing subjectivity in its application;
- Recognition of subsequent recoveries in fair values in profit and loss following a symmetrical approach to impairment eg using both symmetric thresholds "significant" and "prolonged". It will ensure that equally relevant information is provided to users. It will also remove one of the drawbacks of the IAS 39 impairment model that by prohibiting reversal have presumably favoured late recognition of impairment. Finally, it ensures consistency with the other IFRSs that allow reversal except for goodwill;
- Appropriate disclosures on the impairment (quantitative and qualitative) including the quantitative thresholds for both "significant" and "prolonged" used by the identity accompanied by qualitative explanations on their application. This will ensure transparent information for users and enhance comparability between entities and over time.

We do not support the re-evaluation model. The complexity of developing an impairment model and its related costs are often put forward to justify the prohibition of recycling. In this regard, the re-evaluation model is a "straight forward" model, simple to apply as it removes in practice all judgment in the impairment measurement. However, it also lacks relevance, as there is no assessment of the factors causing the impairment or consideration of the characteristics of the equity portfolios. As such, it does not make entities more comparable. It will also be source of volatility in the profit or loss for long term investors, in contradiction with their long-term investment strategies.

Q4.3. We do not have any suggestions for a model other than those presented in the DP.

Q5.1. Do you support the inclusion of quantitative triggers in an impairment model? If so, should an IFRS Standard specify the triggers, or should management determine them?

Q5.2. If you do not support quantitative impairment triggers, how would you ensure comparability across entities and over time?

Q5.1 –We consider that IFRS should remain principles-based. As such we do not support the inclusion of quantitative triggers in the standard. Introducing quantitative triggers (or any other bright-line limit) in the standard will be arbitrary as would not allow to take into consideration the characteristics of the equity-portfolios and the business models of long-term investors in the impairment model. We consider that management should determine the quantitative thresholds to be used for both "significant" and "prolonged".

Q5.2 – As mentioned above, we support:

- The development of specific guidance on the meaning of both "significant" and "prolonged" illustrating quantitative application of these thresholds in well-defined situations:
- The disclosures of the quantitative thresholds for both "significant" and "prolonged" used by the identity accompanied by qualitative explanations on their application.

We consider that the development of specific guidance that will reduce subjectivity and ensure consistency in the application of the impairment model coupled with the disclosure of the quantitative and qualitative information in the notes on the accounting policy of the entity will ensure comparability across entities and over time.

Q6.1. How should subsequent recoveries in fair values be accounted for? Please explain.

Q6.2. If subsequent recoveries in fair values are recognised in profit or loss, which of the approaches in paragraphs 5.2.-5.10 do you support and why?

Q6.1 – Q6-2

We support to account for subsequent recoveries in fair values in profit and loss following a symmetrical approach to impairment eg using both symmetric thresholds "significant" and "prolonged". It will ensure that equally relevant information is provided to users. It will also remove one of the drawbacks of the IAS 39 impairment model that by prohibiting reversal have presumably favoured late recognition of impairment.

Q7.1. Do you consider that the same model should apply to all equity instruments carried under the FVOCI election? If not, why not and how would you objectively identify different portfolios?

Q7.2. Do you have comments on these other considerations?

Q7.3. Are there other aspects that EFRAG should consider?

Q7.1- We consider that the same model should be applied to all equity instruments of long-term investors such as insurers except those that are hold for trading purposes.

Q7.2 – Q7.3

Regarding the application of IFRS 9 to insurance activities, the following contextual elements are of particular importance:

- Our members, as the majority of European insurers, will apply IFRS 9 in conjunction with IFRS 17 in 2021 (with a year of comparative). Some may put forward that as such insurers will only be concerned by IFRS 9 after 2021 and that it is too early to take their views in consideration. However, given the size of their investment portfolios coupled to the time necessary to adjust asset allocations strategies, insurers are already taking into consideration these consequences;
- Some consider that the variable fee approach model under IFRS 17 will address the concerns resulting from the IFRS 9 treatment of equity instruments under FV OCI. However, the variable fee approach has been developed to reflect the links between assets and liabilities in the measurement of some (limited) categories of insurance contracts. The fact that it permits to better reflect this link for these contracts should not be an argument to not solve the issues resulting from the current measurement of equity instrument under FV OCI;
- Insurers do not invest only directly in equities instruments. They also invest in equities indirectly, for example through UCITs. It is of utmost importance to not create economic competitive disadvantage because the same assets are hold through different mechanisms. Therefore, we consider that the accounting treatment of equity-like instruments such as UCITs should also be eligible to the FV OCI category under IFRS 9, including the envisaged changes, and thus without waiting for the outcome of the IASB's FICE project.

The changes we support for the accounting for equity instruments at FV OCI under IFRS 9 and for equity like instruments such as UCITs (refer to Q8.1) should be implemented rapidly e.g. without waiting the outcome of the IFRS 9 PIR review. Such modifications of IFRS 9 would have a positive effect for the investment in equities of long term investors, at a time where long-term investment is desperately needed in Europe.

Q8.1. Are there other aspects of IFRS9's requirements on accounting for holdings of equity instruments, in addition to those considered in the DP, which in your view are relevant to the depiction of the financial performance of long-term investors? Please explain.

Insurers do not invest only directly in equities instruments. They also invest in equities indirectly, for example through UCITs. It is of utmost importance to not create economic competitive disadvantage because the same assets are hold through different mechanisms. Therefore, to provide relevant information for the performance of long-term investors such as insurers, we consider that the accounting treatment of equity-like instruments such as UCITs should also be eligible to the FV OCI category under IFRS 9, including the envisaged changes, and thus without waiting for the outcome of the IASB's FICE project.