FÉDÉRATION BANCAIRE FRANÇAISE

Banking supervision
And Accounting issues Unit

The Director

Paris, January 29th, 2021.

FBF comments on EFRAG's consultation on its draft endorsement advice on IFRS 17 *Insurance contracts* as resulting from the June 2020 amendments.

Dear Mr. Gauzès,

The French Banking Federation (FBF) welcomes the opportunity to comment on EFRAG's Draft Endorsement Advice on IFRS 17 '*Insurance Contracts'* as resulting from the June 2020 amendments.

We appreciate the EFRAG's implication on IFRS 17 issues raised by stakeholders and the extensive work provided in the assessment of these issues to improve the standard.

In line with the Groupement Français des Bancassureurs and the French Insurance Federation, we welcomed the IASB decision to reopen the standard as well as many of the proposed amendments, but we believe that some significant issues are still ongoing and not resolved, the most important of which is the annual cohort requirements for intergenerational mutualised insurance contracts.

As a matter of fact, the annual cohort for intergenerational mutualised insurance contracts requirement is of significant material importance for the life insurance business, and among others for insurance subsidiaries within bankinsurers' groups, and therefore for bankinsurers' groups themselves.

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Also in line with le Groupement Français des Bancassureurs and the French Insurance Federation and other stakeholders, we believe that the annual cohort requirements neither meet the technical endorsement criteria, nor are conducive to the European Public Good.

With regard to the analysis of the European Public Good, this is all the more true at a time when, in order to get through this Covid crisis and ensure the rebound of the economy in the years to come, long-term investment and the strengthening of the equity capital of our European corporate is a key issue for Europe, fully supported by these life insurance products and by strong solvability of our bankinsurers' groups. Therefore, there is an urgent need for a European solution as part as the European endorsement process without delaying the IFRS 17 implementation.

Indeed, we support the endorsement of IFRS 17 with a 2023 effective date provided that there is an adequate solution to the annual cohorts' issue as part of the endorsement and an appropriate prudential solution that addresses the undue negative impact on CET1.

Therefore, so as not to penalize the policyholders and not to create impediments to the financing of the economy that would be totally contrary to the European public good at a time when long term financing support towards European corporates is needed, we call for a European solution for life insurance products as part of the endorsement of IFRS 17 by the European Union.

Regarding the volatility in OCI, given it is an issue arising from the application of IFRS 17 that affects prudential requirements for financial conglomerates, the FBF requests EFRAG recommending the European Commission to consider specific changes in the CRR made in conjunction with the IFRS 17 endorsement process. In this regard, a change in the CRR so that the CSM is considered as eligible own funds, at least in part, should be further analysed.

Regarding life insurance products, the European solution that we would propose would be an optional carve-out for annual cohort requirements, and should not delay IFRS 17 effective date of 2023, as follows:

i) the optional carve out would allow a principle-based exception to IFRS 17 for annual cohorts;
ii) the optionality would be limited in time until the IASB addresses the topic;
iii) the optionality would also permit entities that have less significant life savings and retirement insurance activities to decide whether they prefer to apply the full IFRS 17 standard or whether they opt to the exception to the application of the specified provisions and retain IFRS 4.

The proposed optional carve-out would not put other insurance entities at a disadvantage since these entities do not compete on an activity they do not have.

Accordingly, we support the French standard setter's (*Autorité des Normes Comptables (ANC)*) practical solution to define the scope of an exception to the annual cohorts' requirements that meets the requirements of stakeholders and the requirements of a high-quality standard.

The practical solution proposed would capture the characteristics of contracts for which applying the annual cohort requirement would not provide relevant information to users of the financial statements. The scope of the exception would be defined as embedding contracts:

i) which cash flows that affect or are affected by cash flows to policyholders of other contracts (as outlined in IFRS 17.B67-B71);
ii) with direct participation in a common pool of assets; and
iii) that meet the VFA criteria.

The proposed solution should apply to all intergenerationally mutualised contracts, irrespective of their geographical origin, and be limited to those contracts (preventing tainting to other contracts).

This exception would be temporary until the IASB itself amends the standard in a way that solves the issue.

Besides, there are still unresolved remaining issues in IFRS 17 that should not impact the endorsement process, but that should be carefully re-evaluated and addressed as part of IFRS 17 Post-Implementation Review or other standards maintenance projects:

- Non eligibility of reinsurance contracts to the variable fee approach,
- Presentation of insurance receivable and payables, and collateral reinsurance deposits,
- Accounting treatment of the Time Value of Financial Options and Guarantee (TVOG).
- Contracts acquired in their settlement period in a business combination or portfolio transfer.

In addition, other issues are linked with IFRS 9 as detailed as follows:

- For insurers electing to produce IFRS 9 comparative information for financial instruments in the first financial statements prepared under IFRS 17, only financial instruments still present in the balance sheet as at 1st January 2023 will be measured under IFRS 9. Therefore, for the 2022 comparative period, financial instruments will be disclosed under a mix of IFRS 9 and IAS 39 requirements. This will not be consistent with 2023 data; it will not be relevant for users and it will be operationally burdensome. One solution would be that, as part of the European endorsement process, a full IFRS 9 comparative information would be allowed for insurers applying IFRS 17 and IFRS 9 simultaneously for the first time. This could be possible with the carve-out of the last sentence of paragraph 7.2.1 of IFRS 9.

- As long-term investors, French bankinsurers are especially concerned by the prohibition to recycle in profit or loss the amounts accumulated in other comprehensive income (OCI) for equity instruments measured at fair value through OCI. We therefore strongly support the suggestions made by EFRAG in its technical advice of 30 January 2020 to the European Commission regarding the measurement of long-term investments in equity and equity-type instruments. We fully agree with EFRAG's advice that the European Commission should recommend to the IASB an expeditious review of IFRS 9 in order to reintroduce recycling combined with a robust impairment model. We encourage EFRAG to reiterate these solutions as part of the Post-Implementation Review of IFRS 9 that the IASB has just started.

Finally, for banks that are shareholders of insurance companies, the expected impacts of IFRS 17 are globally negative on the opening equity of the insurance subsidiaries and impact the Common Equity Tier 1 (CET1) ratio of the banking groups. Indeed, while the insurers' share of unrealized capital gains on assets covering participating contracts are currently recognized in the income statement (P&L) or in other comprehensive income (OCI), the latter will be recognized under IFRS17, in the CSM (contractual service margin: future profits recognized in technical liabilities) and therefore as a liability and no longer as equity as it is today. This is especially true in the current context of low interest rates which may increase the Time Value of Options and Guarantees[1] within the Best Estimate Liabilities and conversely reduce the CSM (or event create a Loss Component).

Consequently, given that the Common Equity Tier 1 ratio (CET1) integrated at the bank level is determined based on the insurance company's net equity under IFRS, the bank solvency ratio will be reduced by these amounts.

We hope these major concerns and the solution proposed will hold your attention and we would be pleased to provide any further information you may require.

Yours sincerely,

Bertrand Lussigny

[1] Under IFRS 17, the measurement of the Best Estimate Liability captures the Time Value of Options and Guarantees (“TVOG”), and the change in the measurement of the TVOG is recorded against the CSM.