CFO FORUM

insurance europe

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Dear Dr. Barckow

IFRS 9 Post Implementation Review – The European Insurance CFO Forum and Insurance Europe position on equity instruments measured at fair value through other comprehensive income

This letter is from the European Insurance CFO Forum ("CFO Forum"), a body representing the views of 23 of Europe's largest insurance companies, and Insurance Europe, representing 95% of the premium income of the European insurance market. Accordingly, it represents the consensus view of the European insurance industry.

This letter follows the previous comment letter issued by us on the IASB's Request for Information ("RFI") as part of the Post Implementation Review ("PIR") of IFRS 9 Financial Instruments – Classification and Measurement. For your convenience, we have included certain extracts from this letter in the appendix. The purpose of this letter is to clarify some of the key industry positions which we believe have been mischaracterised in agenda paper 3A for the June 2022 Board meeting:

Targeted amendment rather than an additional FVOCI category

We continue to stress the critical **need for the recycling of realised gains and losses for equity instruments measured at fair value through other comprehensive income** ("FVOCI"). Our preference is for a **targeted amendment to** the existing FVOCI without recycling category whereby the realised gains or losses are recycled to the profit or loss. This will help ensure that the profit and loss account correctly reflects financial performance, in particular for all long-term investors. For entities that apply the FVOCI approach, allowing recycling of realised gains or losses to profit or loss would remove the existing accounting disadvantage for equity investments when comparing with the treatment of debt instruments, and further bring IFRS 9 in line with the Conceptual Framework.

As previously noted in our comment letters, the prohibition of recycling creates the false impression that cumulative gains and losses at the time of disposal of equity instruments are neither relevant nor economically significant, and therefore not a part of financial performance. In fact, yields from capital gains have been larger historically than dividends and are therefore more relevant. They are also a fundamental reason for investing in equities and such long-term investments are a key element of the insurance business model.

We therefore would like to correct the mischaracterisation noted in the IASB Staff preliminary view (reference paragraph 56 of paper 3A of the June IASB meeting) that the industry has requested a new classification category; we would like to clarify that the insurance industry seeks a **targeted amendment** to the existing classification category and <u>not</u> an additional classification category. We therefore call for the IASB to propose a **targeted amendment** to fix the existing FVOCI option for equity instruments to overcome the issue with the recycling ban and to create an equal treatment between capital gains and losses on equity and debt instruments.

Furthermore, and contrary to the view in paragraph 58 of the staff paper 3A for the June IASB meeting, we have the strong view that the recycling issue for equity instruments is not just a presentation matter. Indeed, disclosing realised

gains in the notes is not at all equivalent to recognising them in profit or loss. Additionally, interpreting this issue as a presentation matter, would not justify a different treatment of equity and debt instruments in this regard.

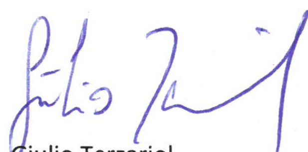
Regardless of the outcome of our proposed targeted amendment, there is no need to further clarify the scope of the equity instruments to which the FVOCI treatment can be applied. The IASB has already issued guidance on the scope of this category, being of essential importance for insurers. Restricting its scope may create further accounting mismatches, disruption in IFRS 17/IFRS 9 implementation projects and other unintended consequences. We are therefore in disagreement with paragraph 55 of paper 3A of the IASB staff preliminary view that notes a need to clarify the scope of the equity instruments to which the OCI presentation election can be applied.

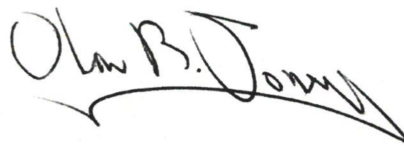
Support for a robust Impairment Model

To address previous concerns raised about recognition of impairments on equity instruments under IAS 39, **we continue to propose that a well-defined, robust reversible impairment model be introduced to accompany recycling for FVOCI equities** which would provide clear indicators for impairment. This can be achieved by explicitly defining rebuttable default calibrations such as a specific percentage decline in fair value from the acquisition cost or a specific time period over which the fair value has been below the acquisition cost to trigger an impairment. These thresholds would ensure a consistent application in practice and an early recognition of losses. We have in fact proposed an impairment model which meets those criteria in our response to the IFRS 9 RFI, which you can find in the annex.

We would very much appreciate an opportunity to meet and explain our point of view to Board and / or staff members working on this important subject at your earliest convenience.

Yours sincerely,





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Appendix – Extract from previous comment letter issued by us on the IASB's RFI as part of the PIR of IFRS 9 Financial Instruments – Classification and Measurement

IFRS 9 PIR Staff Paper Reference:	Industry Feedback:
Question—Equity instruments and other comprehensive income (a) Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not? (b) For what equity instruments do entities elect to present fair value changes in OCI? (c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?	**The reintroduction of recycling for equities measured at Fair Value through Other Comprehensive Income (FVOCI) is our top priority and should be treated expeditiously by the IASB through an amendment to IFRS 9.** Under IFRS 9, when fixed income instruments (e.g. bonds) classified as FVOCI are sold, the gains or losses realised are recognised in the income statement. However, unlike FVOCI bonds, IFRS 9 requires that when FVOCI equity instruments are sold, their gains or losses are not recognised in the income statement. Recognising gains or losses in the income statement when the instrument is sold ("recycling of realised gains/losses") should be available for equity instruments as the lack of recycling on equity instruments results in a misrepresentation of the Income statement and does not achieve the principles of quality and usefulness of the IFRS financial statements of insurers and creates an accounting disadvantage for equity investments which need to either be measured at FVPL or at FVOCI without recycling. We strongly support the reintroduction of the recycling of FVOCI gains and losses in the P&L on equity investments when realised. Entities that apply the FVOCI measurement model, including many insurers, have recurring significant amounts of realised gains and losses, and not reflecting these in profit or loss would significantly affect these entities' financial results. Allowing for recycling of realised gains and losses of equities measured at FVOCI is therefore crucial because: • The prohibition of recycling results does not reflect an entity's business model and fails to convey information about management performance and stewardship. Insurers typically invest in equity securities on a long-term basis. Thus, a measurement at FVPL is not always relevant as it does not always reflect the long-term nature of equity investments. Due to the prohibition of recycling, gains or losses on disposal of FVOCI equity instruments are not reported in profit and loss (in contrast to IAS 39). As a result, the general principle to show in a transparent way all realised gains and losses in the profit and loss account has been left out under IFRS 9. This creates the false impression that these gains and losses at the time of disposal are not relevant or economically insignificant, and therefore not a part of the financial performance. In fact, capital gains on average have been larger than dividends and are fundamental to insurer's rationale of investing in equities. • Insurers have a significant potential appetite for greater equity investing and the economic need for equity investment is explicitly formulated by states' governments. It is important therefore to remove any barriers or accounting disadvantage that could reduce or restraint insurers equity investments. • The Conceptual Framework acknowledges that amounts should be recognised in profit or loss when it results in more relevant information. Therefore, gains and losses should be presented in profit or loss when realised as the profit or loss is the primary statement of performance under the Conceptual Framework for Financial Reporting. We fully acknowledge that the IASB considers a robust impairment model to be the precondition for recycling. To address previous concerns raised about impairments of equity instruments under IAS 39, we propose that a well-defined, robust reversible impairment model is introduced to accompany recycling for FVOCI equities which would provide clear indicators of a potential impairment. This could be done by defining a specific percentage decline from the acquisition cost and a specific time period over which the fair value has been below the acquisition cost. We propose a rebuttable presumption

IFRS 9 PIR Staff Paper Reference:	**Industry Feedback:**
	that an impairment exists when either of the following criteria are met: • Significant - an equity instrument's fair value is more than 25% below its acquisition cost; OR • Prolonged - an equity instrument's fair value is below its acquisition costs value for more than 6 months. Introducing such a robust impairment model for FVOCI equity instruments, based on rebuttable quantitative impairment triggers to be applied consistently by all IFRS preparers, would improve the quality and comparability of IFRS financial statements and would also provide useful information to the users of financial statements which currently does not exist for FVOCI equity instruments. As valuations can change, reversals of impairments should also be allowed. The concept of 'once impaired always impaired' would not correctly reflect the economic reality of recovery in fair market values. We also disagree that the recycling of gains and losses creates earnings management opportunities. In fact, when such recycling is accompanied with robust impairment with thresholds, they prevent from not reflecting losses in the statement of profit and loss. Finally, we consider that the inclusion of rebuttable thresholds is a balanced approach consistent with the principles-based approach used in IFRS standards, whilst ensuring a consistent application in practice. In addition, further to our position developed in question 3 on the treatment of investments in investment funds which substantially hold debt instruments that pass the SPPI test, we believe that similar fact patterns should be treated similarly. Therefore, non-consolidated investments in redeemable or puttable investment funds holding equity securities and responding to movements in market variables in a similar way to equity instruments should also be eligible to FVOCI with recycling. The same rationale applies to accounting for private equity structures. The puttable instruments exception which allows the related investments to be treated as equity by issuers under IAS 32 should also apply on the investor's side under IFRS 9, which would allow an investor in private equity structures to use FVOCI for these typically long-term investments. Indeed, in case no changes are proposed in the accounting treatment of equity instruments, we expect the attractiveness of these types of investments to decrease significantly. Therefore, we ask the IASB to consider this detrimental accounting treatment for directly and indirectly held investments in equity instruments to allow insurance companies to continue to invest in this asset category from a long-term investment perspective and in the context of a well-diversified asset portfolio.