FK | Finanssialan Keskusliitto
FC | Finansbranschens Centralförbund
FFI | Federation of Finnish Financial Services

18.10.2013

Kahola Marja-Liisa

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18 October 2013

Dear Ms Flores,

The Federation of Finnish Financial Services welcomes the opportunity to respond to the EFRAG Draft Comment letter on the IASB's revised Exposure Draft: Insurance Contracts. We provide our comments to the questions of Appendix 1 below.

## EFRAG DRAFT COMMENT LETTER ON IASB'S REVISED EXPOSURE DRAFT: INSURANCE CONTRACTS

### Appendix 1

### CONTRACTS THAT REQUIRE THE ENTITY TO HOLD UNDERLYING ITEMS AND SPECIFY A LINK TO RETURNS ON THOSE UNDERLYING ITEMS (Question 2)

The purpose of the proposed "mirroring approach" is to remove accounting mismatches, and is as such supportable. The proposal is quite complex, which is why we appreciate the efforts to develop an alternative approach. However, if an alternative approach is developed, it is important that it applies to all participating contracts and contracts with discretionary participation features. For example insurance contracts of Finnish insurance companies differ from insurance contracts in Germany or UK in that policyholder benefits do not directly vary or at most weakly vary with the returns of investments.

### PRESENTATION OF INSURANCE CONTRACT REVENUE AND EXPENSE (Question 3)

Regarding questions 87–89 we are pleased to inform you that for Finnish insurance companies it is neither difficult nor costly to compute the investment component amounts from revenue. We support the earned premium revenue approach in the ED for the presentation of earned premium revenue and expenses, because revenue number is an important metric. We believe that preparing and presenting revenue according to the ED proposals will not be difficult or costly, and do not think additional application guidance will be necessary.

### INTEREST EXPENSE IN PROFIT OR LOSS (Question 4)

We have welcomed the Board's decision to introduce an OCI model in IFRS 4 and to reintroduce FVOCI in IFRS 9, as we consider OCI a vital element to adequately reflect the performance of certain insurance products in a current measurement environment. However, we think that **FVOCI should not be mandatory and FVPL application should**

**also be available in order to present the changes in the insurance liability that arise from changes in the discount rate in P&L.**

Because of this starting point the following response addresses only the need for FVPL, and should not be understood in any way to oppose FVOCI presentation. In Finland insurance companies need both presentations.

We believe the IFRS 4 standard should reflect the business model a company has chosen. It would therefore be important for the insurance liability accounting model to be suitable for both FVOCI and FVPL environments. The ability to recognize changes at FVOCI is important for insurance companies that have business models where insurance contracts are typically managed at a more aggregate level together with associated assets. However, there is also a wide range of other business and asset liability models. Finnish insurance companies do not associate insurance liabilities and assets; there is not even allocation of assets between liabilities and equity. In many Finnish insurance companies, the mandatory FVOCI would lead to unduly complex presentation with accounting mismatches in both P&L and OCI, and moreover, economic mismatches would be suppressed or distorted. This presentation would neither be useful nor faithful, and would cause costs which cannot be justified.

In the ED of IFRS 9 Classification and Measurement and IAS 39 standard, the IASB has aimed at finding a proper presentation for financial assets and financial liabilities that would take into account the purposes for which they are held.

> If a company uses bonds to manage cash flows of the insurance liability and assets, the duration mismatch is reported in OCI. But if a company manages duration mismatch with derivatives, the duration mismatch is scattered between P&L and OCI. If the standard has a mandatory requirement to use OCI for the liabilities, it would penalize the use of derivatives and could discourage their use even though it would be good risk management.
>
> Finnish insurance companies have a lot of equity holdings in their balance sheet (39% of investments of life-insurers and 33% of investments of non-life insurers were equity holdings at the end of 2012). Some companies actively trade their assets. It is not possible for these companies to get good accounting matching in P&L and OCI even though they classify their assets to be measured at FVOCI. When sales and purchases of assets occur, the difference between holding and realized value is recycled from OCI to P&L, while there is no equivalent recycling for liabilities, as recycling occurs only when liabilities are derecognised.

We are concerned about the comparability and transparency of the accounts if the proposed IFRS 4 standard is not changed. If the IFRS 4 and IFRS 9 are applied consistently, the presentation will be useful. If they are applied inconsistently or FVOCI is mandatory, total liability changes are comparable between companies but the disaggregated results in P&L and OCI will be useless.

We agree with the EFRAG that reporting underwriting performance is important. We suggest that if a company applies FVPL, the underwriting performance could be presented in the notes of the accounts.

**In summary, we believe that the most useful, relevant and faithful presentation is achieved if companies can choose to present changes in insurance contract liabilities on a basis consistent with that applied to the corresponding asset values, and that the choice should be based on the business model that underpins a company's asset/liability management.**

## DETAILED RESPONSES TO EFRAG'S POSITION AND QUESTION

*108 Do you believe the suggested approach described above will lead to financial statements that provide relevant information that faithfully represent the company's financial position and performance for contracts? Please consider whether the suggested approach eliminates or reduces accounting mismatches in Profit or Loss and OCI.*

**Response:** We cannot support EFRAG's response at this stage.

*Measure at FV-OCI the assets that relate to the insurance liabilities – including in particular debt instruments that do not meet the contractual cash flow characteristics assessment, equity shares and property – presenting in Profit or Loss (i) return on the assets, (ii) gains and losses on realisation, (iii) impairment losses; and other gains and losses in OCI.*

**Response:** We do not believe the proposal is a faithful presentation of all the companies that manage their business by the fair values. The costs caused by this presentation cannot be justified. Extending the FVOCI presentation to all or several other asset classes will not help those companies who actively trade their assets. In addition, these solutions should not be preferred over the ability to present the result in P&L.

The Finnish insurance industry wants a high-quality insurance contract standard as soon as possible. If IFRS 9 also needs to be radically changed before the insurance contract standard becomes effective, it could postpone the insurance contract standard by many years.

*109 Are you aware of any circumstances in which, from your point of view, measurement of both insurance liabilities and the related financial assets at FV-PL might be needed instead of, or combined with, measurement at FV-OCI? If so, please provide a description of the portfolios of insurance contracts concerned and how the asset-liability management strategy differs from other portfolios.*

**Response:** Yes. Above, we have described companies that manage their business fair value based and also companies which actively trade their assets or have contracts with regular premiums.

*110 Do you believe that EFRAG should suggest how the assets related to insurance liabilities should be identified? If so, what would you recommend and why?*

**Response:** No. In the Finnish insurance business there is no such association between the assets and the liabilities that the suggestion would help.

*111 Do you believe that derivatives should also be accounted for using OCI? If so, how could objective evidence be gathered in respect of derivatives that only play a role in matching insurance liabilities?*

**Response:** No.

*112 Should any other assets apart from those included in paragraph 105 be measured at FV-OCI? Please explain why.*

**Response:** Please see our response to 108.

FEDERATION OF FINNISH FINANCIAL SERVICES

Esko Kivisaari