

# FÉDÉRATION FRANÇAISE DES SOCIÉTÉS D'ASSURANCES

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LE PRÉSIDENT

Paris, December 13<sup>th</sup> 2010

Dear Sir David,

## **Exposure Draft “ED/2010/9 Leases”**

The Fédération Française des Sociétés d'Assurances (FFSA) welcomes the IASB's invitation for comments on the Exposure Draft “Leases”. The FFSA represents all types of insurance and reinsurance undertakings, accounting for 90% of the total French market.

Insurance companies enter into lease transactions both as lessees and as lessors. Our comments focus on lessor accounting for investment properties as these transactions are the most significant to our financial statements.

French insurers carry significant amounts of investment properties as part of their investment strategy. Investment properties account for 4% of their investment portfolios, i.e. approximately € 63 bn. Such properties are mostly recorded at cost under the insurance business model, whereby lease income contributes to investment income that, together with earned premiums, allows for payment of incurred claims, participation benefits and underwriting expenses.

We oppose the proposed changes to lessor accounting requirements for the following reasons:

- Information provided to users of financial statements is not relevant for investment properties.
- Implementation of the proposed requirements is deemed to be overly complex and costly, in excess of potential benefits to users.

We recommend that all investment properties, whether at cost or at fair value, be scoped out of the proposed lessor accounting requirements.

Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30, Cannon Street  
London  
EC4M 6XH  
United Kingdom

### **Standardized approach and volatility do not provide relevant information to users on investment property**

Information provided to users of financial statements is not relevant for investments property since the proposed requirements disregard the specificities of investment properties and introduces undue volatility in the statement of financial position and in the statement of net income.

- The specificities of investment properties compared to other leased tangible assets are not portrayed adequately in the “one-size fits all” ED proposals for all leases of tangible assets:
  - The ED considers all leases as financing transactions, which does not correspond to the economics of leases of investment properties.

Because of the perpetual right on lands and the extended lifetime of buildings, lease terms do not usually represent a significant portion of a property’s useful life. Further, leases very rarely include purchase options. As a result, properties revert to the lessor at the end of the lease and have a residual value that is larger than other leased tangible assets. This allows for active lease and property management to generate value that is not appropriately reflected in the ED.

This difference between the economics of leases of investment properties and leases of other tangible assets is evidenced in the pricing. Market prices for leases of properties reflect the law of supply and demand, whereas leases of most other tangible assets are priced based on interest rates.

- The ED assumes that lessor accounting should mirror lessee accounting, whereas rights and obligations of lessors do not mirror those of lessees in a lease of investment property.

Leases of investment properties are subject to stringent regulations in most countries. Rights and obligations of lessors often differ from those of the lessee. In France, for instance, lessors must comply with standardized lease terms, whereas lessees have the option of terminating the lease at any time for residential properties or at break option dates specified in the lease for commercial properties.

- Undue volatility in the financial statements will result from subsequent remeasurements of lease assets and lease liabilities, in particular from changes in the expected lease term.

The proposed model requires subsequent remeasurement of lease receivables and lease liabilities, based on updated expectations of lease payments. These expectations depend notably on assumptions on the lease term and on contingent rentals. Changes in the reported balance on the statement of financial position impact net income when due to changes in expected lease term. Further, significant adjustments to reflect experience are likely to occur when reality differs from highly uncertain expectations on lessee behaviour, thus increasing volatility. We consider that this volatility is inappropriate as it derives from accounting requirements but not from the long term underlying leases on investment properties.

The analysis of this volatility in both balance sheet balances and net income is likely to prove difficult for users. It contradicts the medium to long-term business model of an insurer and does not provide useful information for the users of financial statements as it means that reported results do not help in predicting long-term performance. The FFSA persistently rejected undue short term volatility in comment letters on IFRS 9 and the ED “Insurance Contracts” as it does not reflect the medium to long term nature and the asset-liability management inherent to the insurance business model.

### **Implementation complexity and costs exceed potential benefits to users**

Implementation of the proposed requirements is deemed to be overly complex and costly, in excess of potential benefits to users. These complexities and costs will be faced for each reporting period, upon transition as well as for subsequent closings.

We are concerned with the operational difficulties to determine some key assumptions used in the measurement of leased assets and corresponding liabilities, such as contingent rents or the longest possible term that is more likely than not to occur. These assumptions depend on lessee behaviours. Lessors have little meaningful information on their lessees' intent or perspectives, with regards to lease terms or contingent rentals.

Further, insurers' portfolios encompass hundreds of properties representing thousands of different lease transactions for some entities. Considering only a few scenarios on each lease transaction will induce a considerable workload and significant costs. Statistical analysis of portfolio may often not be applicable, due to the specificities of lease terms, in particular for commercial leases.

In addition, we believe that the proposed measurement and presentation model has limited use for users. We note in particular that users will be confused by the proposed presentation on the statement of financial position, whether the linked presentation under the performance obligation approach or the residual asset under the derecognition approach. Misleading mismatches may also arise in the statement of net income because of different amortization patterns of lease receivables and lease liabilities, in spite of similar initial measurement.

**The FFSA suggests scoping all investment properties, at cost or at fair value, out of the proposed standard on leases**

The drawbacks of the proposed approach, detailed above, would preclude insurers from recording their investment properties at cost. However, we draw the Board's attention to the fact that the fair value option alternative in IAS 40 generates volatility that does also not portray the medium to long term perspective inherent in the insurance business model. French insurers have rarely elected to take this option since the first time application of IFRSs, except for investment properties held to back unit-linked contracts, and this election should not be made in essence mandatory for all investment properties regardless of the business model. Amortized cost measurement for investment properties allows for consistency with bonds carried at amortized cost under IFRS 9 pursuant to the insurance business model and the asset allocation strategy.

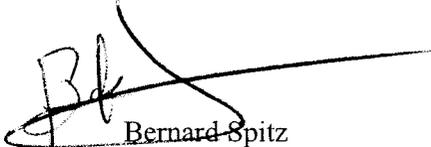
We note that current requirements in IAS 40 allow users of financial statements to get insight into the performance of investment properties. Information on both lease income and fair value is provided in the notes so that the overall profitability of investments can be assessed.

We recommend that the Board scope investment properties, whether carried at cost or at fair value, out of the proposed requirements for lessor accounting and maintain current IAS 17 / IAS 40 treatment for investment properties.

The above comments are detailed within our answers to the Board's questions in the Appendix to this letter.

We hope you find these comments useful and would be pleased to provide any further information you might require. Please contact Bertrand Labilloy at + 33 1 42 47 93 58 if you wish to discuss any of the issues raised.

Yours sincerely,



Bernard Spitz

## Appendix 1

### Question 2:

We disagree with the coexistence of two different approaches for lessors and with the proposed accounting and presentation model for each of these approaches as they would apply to investment properties.

The FFSA considers that the proposed definition of two different approaches for lessors does not meet the Board's simplification objective. Assessing the level of the remaining exposure to risks and benefits will involve significant judgment and impair comparability. *The majority of investment properties owned by insurance companies will fall under the Performance Obligation model, which we find to be conceptually incorrect. As lessor of these properties, we cannot identify the performance obligation that we are imagined to have, as continuing to make the building available under contractual terms does not seem to us to constitute a liability.*

We believe that the proposed measurement and presentation model has limited use for users. We note in particular that users will be confused by the proposed presentation on the statement of financial position, whether the linked presentation under the performance obligation approach or the residual asset under the derecognition approach. Misleading mismatches may also arise in the statement of net income because of different amortization patterns of lease receivables and lease liabilities, in spite of similar initial measurement. We note that the current presentation of an investment property and accruals for lease receivables on the statement of financial position is widely understood.

We recommend that the Board scope investment properties, whether carried at cost or at fair value, out of the proposed requirements for lessor accounting and maintain current IAS 17 / IAS 40 treatment for investment properties.

### Question 5:

No. We believe that investment properties should be scoped out of the proposed leased standard, whether carried at cost or at fair value.

The drawbacks of the proposed approach, detailed hereinafter, would preclude insurers from recording their investment properties at cost. However, we draw the Board's attention to the fact that the fair value option alternative in IAS 40 generates volatility that does also not portray the medium to long term perspective inherent in the insurance business model. French insurers have rarely elected to take this option since the first time application of IFRSs, except for investment properties held to back unit-linked contracts. Indeed, the depreciated model appears to be the most reliable way to reflect the business model of insurance company lessors, under which their main objective is to manage and hold the investments properties in order to collect cash flows and not to primarily realise cash flows through the sale of the assets. Consistently with the objective of collecting contractual cash flows, sales may occur in some circumstances such as when investment properties no longer meet the entity's investment policy, there is a need for an adjustment of the investment portfolio to reflect change in expected duration or a need to fund capital expenditures. Typically, as regards investment properties, the only way to adjust the size and the content of the portfolio to the insurance technical liabilities is to carry out some sales.

We note that current requirements in IAS 40 allow users of financial statements to get insight into the performance of investment properties. Information on both lease income and fair value is provided so that the overall profitability of investments can be assessed.

We recommend the Board scope investment properties, whether carried at cost or at fair value, out of the proposed requirements for lessor accounting and maintain current IAS 17 / IAS 40 treatment for investment properties.

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| <b>Question 8:</b> |
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We disagree with the proposed definition of the lease term as it introduces undue volatility in the statement of financial position and in the statement of net income because of changes in estimates and experience adjustments. Further, recognizing an asset for rentals to be received in the optional period if the lessee exercises the renewal option does not comply with the definition of an asset in the framework.

The proposed model requires subsequent remeasurement of lease receivables and lease liabilities, based on updated expectations of lease payments. These expectations depend notably from assumptions on the lease term. Changes in the reported balance on the statement of financial position impact net income. Further, significant experience adjustments are likely to occur when reality differs from highly uncertain expectations on lessee behaviour, thus increasing volatility. We consider that this volatility is inappropriate as it derives from accounting requirements but not from the long term underlying leases on investment properties.

The analysis of this volatility in both balance sheet balances and net income is likely to prove difficult for users.

Further, we are concerned with the operational difficulties to estimate the longest possible term that is more likely than not to occur included in the measurement of leased assets and corresponding liabilities. This assumption depends on lessee behaviours. Lessors have little meaningful information on their lessees' intent with regards to lease terms, and indeed given the time horizon at which such estimates would be needed, most lessees will have little ability to reliably estimate their future behaviour.

Last, insurers' portfolios encompass hundreds of properties representing thousands of different lease transactions for some entities. Considering only a few scenarios on each lease transaction will induce a considerable workload and significant costs. Statistical analysis of portfolio may often not be applicable, due to the specificities of lease terms, such as commercial leases.

We recommend the Board scope investment properties, whether carried at cost or at fair value, out of the proposed requirements for lessor accounting and maintain current IAS 17 / IAS 40 treatment for investment properties. However, should the Board proceed with the proposed standard, we recommend that the lease term be assessed as the non-cancellable period only.

**Question 9:**

We disagree with measuring assets and liabilities under a lease contracts based on the expected outcome of contingent rentals, term option penalties and residual value guarantees as it introduces undue volatility in the statement of financial position because of changes in estimates and in the statement of net income because of adjustments to reflect experience.

Further, we are concerned with the operational difficulties to determine estimated contingent rentals to be included in the measurement of leased assets and corresponding liabilities. This assumption depends on lessee behaviours. Lessors have little meaningful information on their lessees' perspectives with regards to contingent rentals and indeed given the time horizon at which such estimates would be needed, most lessees will have little ability to reliably estimate future continhent rentals.

Last, insurers' portfolios encompass hundreds of properties representing thousands of different lease transactions for some entities. Considering only a few scenarios on each lease transaction will induce a considerable workload and significant costs. Statistical analysis of portfolio may often not be applicable, due to the specificities of lease terms, in particular for commercial leases.

In addition, we believe that the proposed measurement and presentation model has limited use for users. We note in particular that users will be confused by the proposed presentation on the statement of financial position, whether the linked presentation under the performance obligation approach or the residual asset under the derecognition approach. Misleading mismatches may also arise in the statement of net income because of different amortization patterns of lease receivables and lease liabilities, in spite of similar initial measurement.

**Question 10:**

The proposed model requires remeasuring assets and liabilities arising from a lease transaction when there is a significant change in the lease term or contingent payment estimates.

Changes in the reported balance on the statement of financial position impact net income when due to changes in expected lease term. Further, significant adjustments to reflect experience are likely to occur when reality differs from highly uncertain expectations on lessee behaviour, thus increasing volatility. We consider that this volatility is inappropriate as it derives from accounting requirements but not from the long term underlying leases on investment properties.

The analysis of this volatility in both balance sheet balances and net income is likely to prove difficult for users. It contradicts the medium to long-term business model of an insurer and does not provide useful information for the users of financial statements as it means that reported results do not help in predicting long-term performance. The FFSA persistently rejected undue short term volatility in comment letters on IFRS 9 and the ED "Insurance Contracts" as it does not reflect the medium to long term nature and the asset-liability management inherent to the insurance business model.

**Question 12:**

We disagree with the proposals relating to the presentation of the statement of financial position for lessors.

We believe that the proposed measurement and presentation model has limited use for users. We note in particular that users will be confused by the proposed presentation, whether the linked presentation under the performance obligation approach or the residual asset under the derecognition approach. Misleading mismatches may also arise in the statement of net income because of different amortization patterns of lease receivables and lease liabilities, in spite of similar initial measurement.

We note that current requirements in IAS 40 allow users of financial statements to get insight into the performance of investment properties. Information on both lease income and fair value is provided so that the overall profitability of investments can be assessed.

We recommend the Board scope investment properties, whether carried at cost or at fair value, out of the proposed requirements for lessor accounting and maintain current IAS 17 / IAS 40 treatment for investment properties.

**Question 13:**

We disagree with a separate presentation of lease income from other income in the statement of net income for leases of investment properties.

French insurers carry significant amounts of investment properties as part of their investment strategy. Lease income contributes to investment income that, together with earned premiums, allows for payment of incurred claims, participation benefits and underwriting expenses.

As a result, we believe that lease income should not be separated from other investment income if it does not reflect the business model of the reporting entity.

Further, we note that misleading mismatches may also arise in the statement of net income because of different amortization patterns of lease receivables and lease liabilities, in spite of similar initial measurement. We also understand that rent income may differ significantly from the actual rent received, notably for long term leases where the lessee terminates the lease ahead of the expected termination date. We believe that this difference does not portray adequately the return or the cash flows generated by the underlying asset.

**Question 14:**

We disagree with a separate presentation of lease income from other income in the statement of cash flows for leases of investment properties.

We refer to our comments on question 13 above.

**Question 15:**

The FFSA is concerned with the ever increasing list of disclosure requirements and would prefer that the final standard retains the overall objective defined in paragraph 70 with a list of disclosure in the BC that was considered useful by the Board as long as they meet the information needs for the types of leases carried by the issuer.

In this respect, the FFSA notes the Board's consideration in paragraph 71 on the level of aggregation and believes this should be extended to the principle underlying disclosures. Information would then be provided "as long as they do not obscure useful information by either the large amount of insignificant details or the aggregation of items that have different characteristics".

**Question 16:**

We consider that retrospective application pursuant to IAS 8 is conceptually stronger.

Accordingly, the FFSA supports revised transition requirements that would allow for a retrospective application where practicable at a reasonable cost - acknowledging that it would probably not be practicable in some cases, and allow for the current proposal as an alternative treatment where retrospective application is not practicable.

**Question 17:**

We disagree with the Board's assessment that the benefits of the proposals would outweigh the costs. Implementation of the proposed requirements is deemed to be overly complex and costly, in excess of potential benefits to users. These complexities and costs will be faced for each reporting period, upon transition as well as for subsequent closings.

We are concerned with the operational difficulties to determine some key assumptions used in the measurement of leased assets and corresponding liabilities, such as contingent rents or the longest possible term that is more likely than not to occur. These assumptions depend on lessee behaviours. Lessors have little meaningful information on their lessees' intent or perspectives, with regards to lease terms or contingent rentals.

Further, insurers' portfolios encompass several thousand leases of investment properties for some entities. Considering only a few scenarios on each lease transaction will induce a considerable workload and significant costs.

In addition, we believe that the proposed measurement and presentation model has limited use for users. We note in particular that users will be confused by the proposed presentation on the statement of financial position, whether the linked presentation under the performance obligation approach or the residual asset under the derecognition approach.

**Question 18:**

Information provided to users of financial statements under the ED is not relevant for investment properties since the proposed requirements disregard the specificities of those assets.

Indeed, the specificities of investment properties compared to other leased tangible assets are not portrayed adequately in the "one-size fits all" ED proposals for all leases of tangible assets:

- The ED considers all leases as financing transactions, which does not correspond to the economics of leases of investment properties.

Because of the perpetual right on lands and the extended lifetime of buildings, lease terms do not usually represent a significant portion of a property useful life. Further, investment property leases rarely include purchase options. As a result, properties revert to the lessor at the end of the lease and have a residual value that is larger than other leased tangible assets.

This allows for active lease and property management to generate value that is not appropriately reflected in the ED.

This difference between the economics of leases of investment properties and leases of other tangible assets is evidenced in the pricing. Market prices for leases of properties reflect the law of supply and demand, whereas leases of most other tangible assets are priced based on interest rates.

- The ED assumes that lessor accounting should mirror lessee accounting, whereas rights and obligations of lessors do not mirror those of lessees in a lease of investment property.

Leases of investment properties are subject to stringent regulations in most countries. Rights and obligations of lessors often differ from those of the lessee. In France, for instance, lessors must comply with standardized lease terms, whereas lessees have the option of terminating the lease at any time for residential properties or at break option dates specified in the lease for commercial properties.