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Re: OIC response to the European Commission Green Paper: Long-Term Financing of the European Economy.

Dear Sir/Madam

The Organismo Italiano di Contabilità (Italian standard setter) is very interested in the green paper recently launched by the European Commission on "long-term of the European Economy". As explained in your paper, long-term investments are a fundamental driving force of the economy in Europe, and it is therefore important that the cost of raising long-term capital is reduced to the minimum. After the crisis, the diminished role of commercial banks in long-term lending needs to be balanced by favoring other institutional investors to fund SMEs directly, and this, according to the green paper, could be pursued in a number of ways. Among the various options, you recognize the following:

- The capacity of financial institutions to channel long-term finance;
- The efficiency and effectiveness of financial markets to offer long-term financing instruments;
- Cross-cutting factors enabling long-term saving and financing; and
- The ease of SMEs to access bank and non-bank financing.

All the above items are very important in enhancing the long-term financing of the European economy, especially reforms that tend to facilitate access to funding for SMEs. However, in

accordance with the mission of the Italian Standard Setter, we prefer to focus our response on the part of the document related to accounting principles (question n. 20).

We are not convinced that the use of fair value accounting principles has led to short-termism in investor behaviour. This might have played a role, but, according to the consultation with our stakeholders, it does not seem to have been critical in determining the investment strategies.

We are convinced that accounting principles are beneficial when they are able to faithfully depict an entity's financial position and economic performance during the period. To this end, fair value measurement – and in general a current measurement approach – obviously plays an important role not least because it does not obscure the strength of the capital base and, in a downturn, it alerts in advance to possible liquidity problems. The importance of financial reporting – as a means for communicating with the markets – especially for some institutional investors has brought, during the financial crisis, fair value measurement into the spotlight. In particular, critics have highlighted the alleged contribution of fair value to bringing volatility to the results in the income statements, especially when the business model of an entity is not to sell the investment in the short term. Therefore, we believe that the cost-basis (with impairment where required) for measurement is the best model to depict a long-term investment strategy, but fair disclosure of fair value is equally important.

However, consistent feedback from our stakeholders has emphasized that the question "Fair value measurement, yes or no?" risks simplifying a rather more complex question, which is "How (and in which statements) changes in assets and liabilities resulting from the application of fair value measurement should be presented?". For example, a fair value approach applied to a certain asset may be useful to provide an updated picture of its value; however, if the asset is held under a long-term perspective, the income statement should not be affected by any short-term fluctuations in its value.

In general, we acknowledge that investors recognize the relevance of fair value measurement to depict the value of promptly tradable financial investments when changes in the strategy to manage them is subject to sudden changes in response to changes in the economic environment in which the entity operates.
Considering this assertion, in the presence of a long-term investment business model, it is important to focus on the way in which a financial investment in promptly tradable securities affects or has affected the performance of the entity, distinguishing the realized part that could be gained only if the asset were sold in the short term. For these investments, a fair value measurement is acceptable if the profit or loss statement includes only the realized components of the annual fair value variation.

Such a mixed model – fair value in the statement of financial position, and realized effects in the profit or loss – seems to be applicable, especially for financial assets tradable in an active market, otherwise the information related to the unrealized changes in fair value is less relevant. In fact, what does fair value communicate if the item being measured cannot be promptly sold?

Moreover, in establishing the business model for long-term investments, it should be taken into account that some institutional investors, for example insurance companies, determine their investment strategy on financial assets in close conjunction with the features of their obligations towards policyholders (insurance liabilities). Especially in life assurance, the liabilities are usually long term, with quite predictable cash flows and linked to the investments performance - in terms of realized book returns - through participating features included in the contracts or in statutory regulation. For this business, it is key to reflect the asset and liability management strategy in the

accounting, allowing for consistent financial reporting of long-term investments and related insurance liabilities.

Yours sincerely,

Angelo Casò

(Chairman)