



FEDERATION
BANCAIRE
FRANCAISE



LETTER OF COMMENT NO. 9

The Director General delegate

Paris, March 31st, 2009

Response FBF - Financial Crisis Advisory Group (FCAG) seeking Input from Constituents

Dear Sir,

The French Banking Federation (FBF) welcomes the opportunity to participate to the request of the Financial Crisis Advisory Group (FCAG) for input to accounting and reporting issues arising from the financial crisis.

The French Banking Federation (FBF) is the professional body representing over 500 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organizations.

To summarize our responses to the set of questions, we would like to focus on the following points:

- Financial crisis has shown the limit of the full fair value model. We believe that a mixed model of valuation should be preferred and that the fair value model should be reserved for financial instruments held for trading in liquid markets and for instruments internally managed or monitored on the basis of their fair value.
- In our view, fair value plays a role in the pro-cyclical effects of the financial crisis. Thus, accommodating dynamic provisioning in the accounting standards could help as a contra-cyclical tool in addition to the existing loan loss provisioning model.
- We believe that a fast-track procedure applied in certain circumstances and development of relationship with others organizations could improve due process and ensure high quality standards.

Our answers to the exposure draft are detailed 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.

Yours sincerely,

Pierre de Lauzun

**Mr Adam Van Eperen
Financial Crisis Advisory Group
c/o International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom**

Appendix - FCAG Written Submissions from Constituents

1. *From your perspective, where has general purpose financial reporting helped identify issues of concern during the financial crisis? Where has it not helped, or even possibly created unnecessary concerns? Please be as specific as possible in your answers.*

Financial crisis has highlighted the difficulties related to the valuation of financial instruments when markets are no more active and has questioned the relevance of the accounting model of fair value in those cases. As transactions are mainly based on mark-to-market valuation, investment decisions rely on volatile market prices depending on market conditions.

By forcing to recognize losses on financial instruments when their market prices have fallen without any consideration of their economic value or the way these instruments are managed, fair value accounting has worsened expected losses. It has increased the pro-cyclical effects of the financial crisis and impacted on the level of capital required for financial institutions.

Fair value should be reserved for financial instruments held for trading, and for instruments internally managed or monitored on the basis of their fair value. In our view, using fair value measurement makes sense only for these types of transactions on liquid markets. Applying fair value to other instruments would lead to recognize an "artificial volatility" in the accounts, which would not simplify the reading by the users of financial statements. Thus in the current financial crisis, financial statements could be hardly used as a tool to evaluate the economic performance of entities from a financial stability perspective as they have more reflected the collapse of financial markets.

2. *If prudential regulators were to require 'through-the-cycle' or 'dynamic' loan provisions that differ from the current IFRS or US GAAP requirements, how should general purpose financial statements best reflect the difference: (1) recognition in profit or loss (earnings); (2) recognition in other comprehensive income; (3) appropriation of equity outside of comprehensive income; (4) footnote disclosure only; (5) some other means; or (6) not at all? Please explain how your answer would promote transparency for investors and other resource providers.*

The principle of the dynamic provisioning starts from the observation that provisions accounted for in application of IAS 39 come too late. The individual provisioning is established on the basis of a loss incurred and does not anticipate the emergence of this default. Dynamic provisioning applies to healthy loan portfolio and takes into account losses incurred but not yet identified. It uses statistics of historic failures to calculate average losses over long period, possibly different according to the type of the loan. As it recognizes the risk of a loss on a credit, dynamic provisioning is additional to the individual provisioning.

Interests charged to the customers include a spread that represents the remuneration of the credit risk. Obviously, such amount must not be taken in P & L, as revenue, as long the risk it corresponds still exists. This principle for loans' revenue recognition is not different from the portfolio view taken by industrial companies for warranties commitments or by insurance companies for catastrophic events provisioning.

There is a debate on the amounts that must be set aside by application of this view: they can be evaluated by several methods aimed to close the information gap between the date the risk is assumed and the date, it materializes as a loss. Dynamic provisioning terminology encompass most of them and it is difficult to opine on the best way to record such reserves without knowing the criteria adopted to set them. As a general principle, we think that the less the methodology adopted takes into account the specific conditions of a particular bank and its credit policies, the less the provision amount has to impact its P&L.

For example, in our view, a provision required by regulators resulting from a macroeconomic analysis of the credit cycle, on top of the required deferring of credit spreads mentioned above, is best portrayed in reporting as an appropriation of equity, outside comprehensive income.

Accommodating dynamic provisioning in the accounting standards will contribute to the efforts of reducing pro-cyclicality as the provision previously built up during good times is used to cover loan losses during bad times. Therefore, we do believe that prudential and accounting requirements should not diverge on this matter.

- 3. Some FCAG members have indicated that they believe issues surrounding accounting for off-balance items such as securitizations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting. Do you agree, and how can we best improve IFRS and US GAAP in that area?*

As mentioned in response to question 1, we believe that fair value accounting has more contributed to the financial crisis.

Regarding IFRS standards, the issues related to accounting for off-balance items are rather a matter of further information to be provided to readers of financial reporting. We believe that implementation of consolidation IFRS standards is globally satisfactory. Improvements need to be made to enhance useful disclosures relating to consolidation and the risks associated with non-consolidated entities. However, these improvements need further analysis regarding disclosures already required within the accounting standards or within the supervisory rules as additional information could prove burdensome.

- 4. Most constituents agree that the current mixed attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is overly complex and otherwise suboptimal. Some constituents (mainly investors) support reporting all financial instruments at fair value. Others support a refined mixed attributes model. Which approach do you support and why? If you support a refined mixed attributes model, what should that look like, and why, and do you view that as an interim step toward full fair value or as an end goal? Whichever approach you support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?*

We strongly disagree to a full fair value accounting model as we have already mentioned in our previous comment letters to the IASB consultations (for example Discussion Paper «Reducing Complexity in Reporting Financial Instruments », « IASB Expert Advisory Panel : Measuring and disclosing the fair value of financial instruments in markets that are no longer active »).

Fair value generates artificial volatility in the valuation of financial instruments as the recent financial crisis has shown it.

Fair value is relevant for trading instruments under normal circumstances when active markets do exist. When market transactions are limited in volume, prices observed in inactive markets do not provide the best evidence of fair value as entities do not intend to sell their financial instruments notably when the prices of the transactions are not meaningful because no one wants to deal these transactions. We believe that accounting model should be consistent with the way financial instruments are intended to be managed or are able to be managed regarding the structure and characteristics of the markets.

A mixed measurement model provides readers of financial reporting with better information regarding financial instruments held by the entities.

The mixed accounting model we propose is based on the following principles:

- Fair value accounting should be held for financial assets meant to be used for trading on organized market.
Non-trading assets held by the entity or the liabilities issued or received by the entity should be valued regarding their usefulness for the entity.
- A prudent approach must be set out as a principle where uncertainty related to the value of the assets of the entity must be provisioned.

For those reasons, the proposed mixed model of accounting should be viewed as end goal. Moreover, instead of willing to adopt a full fair value principle, the improvement on fair value accounting would be to limit the scope of fair value to the appropriate trading instruments which make a sense regarding the economic logic of those transactions compared to the banking book instruments.

We would like to refer to the conceptual paper published by the International Banking Federation (IBFed) in April 2008 "Accounting for Financial Instruments" as an initial response to the IASB's discussion paper on reducing complexity in financial instruments. This paper presents the banking industry's views in favor of a mixed measurement model which "is essential for the faithful representation of an entity's business model and how it generates earnings".

5. What criteria should accounting standard-setters consider in balancing the need for resolving an 'emergency issue' on a timely basis and the need for active engagement from constituents through due process to help ensure high quality standards that are broadly accepted?

The following criteria could be used to determine whether an accounting issue should be assessed under an emergency procedure.

- A fast-track process should be followed when exceptional circumstances modify substantially usual conditions for applying accounting disposals and need further clarification or when exceptional circumstances increase the impact of accounting differences between IFRS and USGAAP or when the issues concerned are of extraordinary significance.
- The due process should be kept when more comprehensive analysis and debate are needed to improve standards or to define new principles

However, we believe that the need of an emergency procedure should be considered on a case by case basis in the light of urgent issues or circumstances and under the control of the oversight body of the standard-setters. The principle of such procedure could be set out as a principle in the constitution of the standard-setters organization without giving too restrictive conditions of application.

6. *Are there financial crisis-related issues that the IASB or the FASB have indicated they will be addressing that you believe are better addressed in combination with, or alternatively by, other organizations? If so, which issues and why, and which organizations?*

We believe that the IASB and the FASB should developed relationship with others organizations such as relevant inter-governmental and regulatory authorities or auditors and preparers organizations. The aims of this cooperation would be to strengthen accounting and financial issues prioritisation, to enhance the transparency and comparability of financial reporting, to ensure financial stability.

As far as financial crisis-related issues are concerned, they could be addressed in combination with for example the European Commission as it has highlighted specific issues to be addressed by standards setters and the Basel Committee regarding the way to reduce differences between financial and regulatory reporting as much as possible, for example on the provisioning issues. Permanent membership of the Basel Committee in the Monitoring Group could be envisaged in order to enhance common issues.

7. *Is there any other input that you'd like to convey to the FCAG?*

The other input that should be addressed is the response to the synthetic CDOs issue. Despite letters, comments or proposed amendments on this matter, the differences between auditors' interpretation of IFRS and the FASB Implementation Issue need still to be clarified in order to ensure a level playing field between IFRS and USGAAP.