1810-100 Comment Letter No. 1285

FÉDÉRATION FRANÇAISE DES SOCIÉTÉS D'ASSURANCES

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LE PRÉSIDENT

Paris, 28th September 2010

Dear Mr Golden,

Exposure Draft Ref. 1810-100 "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities"

The Fédération Française des Sociétés d'Assurances (FFSA) welcomes the FASB's invitation for comments on the Exposure Draft "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities". The FFSA represents all types of insurance and reinsurance undertakings, accounting for 90% of the total French market.

The IASB has initiated a project for a comprehensive replacement of IAS 39 as part of a joint project with the FASB. This project aims at reducing complexity in reporting financial instruments, dealing with the reporting issues arising from the global financial crisis and following the conclusions of the G20 meeting and the recommendations of the Financial Stability Forum.

The IASB divided this project into three successive phases, whereas the FASB completed a comprehensive ED overhauling the accounting for financial instruments and derivatives. The FFSA welcomes the opportunity to comment on the FASB's exposure draft.

The FFSA wishes to lay stress on the following issues:

Classification and measurement of financial instruments

As stated in our answer to the IASB's ED 2009/7, the FFSA strongly supports a mixed measurement model that includes amortized cost and fair value measurement.

Mr. Russell Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

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The FFSA considers that the proposed classification in the FASB's ED would not adequately reflect the business model for financial instruments held in a medium or long-term perspective based on an asset – liability strategy in light of the duration of insurance liabilities or in a medium or long-term investment management strategy. The FFSA fears that the model without amortized cost classification for debt instruments without significant leverage held primarily to collect contractual cash flows developed by the FASB would generate undue fluctuation without economic justification into reported equity and earnings, which is detrimental to the interpretation of the financial statements.

The FFSA suggests an amended classification and measurement approach. As in the approach proposed in the IASB's and the FASB's EDs, classification and measurement would be based on the nature of the instrument and the business model of the entity but would take into account the business model for all natures of financial instruments:

Debt instruments without significant leverage held primarily to collect contractual cash flows in a medium or long term perspective: amortized cost

In agreement with the IASB, the FFSA considers that amortized cost is a relevant measurement attribute for some instruments held under specific business models. For instance, insurance companies carry significant amounts of long term investments in debt securities without significant leverage primarily to collect contractual cash flows and provide a positive return to their policyholders.

Further, the business strategy criterion defined by the FASB may not be always appropriate to reflect the characteristics of the business model of an entity. We would recommend a criterion based on the holding horizon, which is often inherently medium to long term for life and non-life insurance companies, at portfolio level. Occasional disposals should not preclude amortized cost measurement as most entities manage portfolios of financial instruments primarily on a yield basis without excluding the possibility of selling assets.

The FFSA supports the principle of incorporating expected losses in the amortized cost valuation to provide information on the effective return of a financial instrument.

The FFSA disagrees with the criteria defined in the FASB's ED to limit the use of amortized cost for financial liabilities. The FFSA believes that amortized cost classification for financial assets or liabilities should result from the business model rather than from bright lines.

Financial instruments held on a fair value basis in a medium or long term perspective: fair value through other comprehensive income

The FFSA supports the FASB's classification of debt instruments at fair value through OCI and believes this classification should be extended to equity securities. Consistently with their business model of medium to long-term holding of financial instruments on a fair value basis, insurance companies should be able to use fair value measurements for all categories of financial instruments and to record changes in fair value in OCI as long as these changes are unrealized. In the insurance business (life and non-life), these instruments are held in a medium or long-term perspective based on an asset – liability strategy in light of the duration of insurance liabilities or in a medium or long-term investment management strategy.

As proposed by the FASB, realized gains and losses, other financial income (dividends and interests) and impairments on assets classified in OCI should continue being recorded through profit and loss as, in the case of insurance companies for instance, they are intimately related to the expense recognized for policyholder claims and participation features. This will ensure internal consistency of the financial statements.

Financial instrument held in a short term perspective and unit-linked contracts: fair value through profit and loss

Financial instruments held in a short term perspective should be recorded at fair value through profit and loss as unrealized gains and losses on these instruments are likely to be realized shortly after reporting date: this is the case of assets held for trading.

Besides, the FFSA notes that the accounting treatment of unit-linked contracts was to be addressed within the insurance contract project discussed jointly by the Boards. Currently, unit-linked assets are recorded at fair value through profit and loss to match the corresponding changes in liabilities. The FFSA encourages the Boards to establish a comprehensive treatment for assets and liabilities resulting from this business.

Reclassification and fair value option

As the classification is based on the business model, the FFSA considers that reclassifications should not be prohibited – as required by the FASB – or limited to rare circumstances - as indicated in the IASB's model - but required when the business model changes or when financial instruments are transferred between portfolios managed according to different business models. For insurance companies, reclassifications would be applicable for instance to transfers from the unit-linked portfolio to the general portfolio.

Issuers should be allowed to designate a financial asset or financial liability at fair value through profit and loss or OCI to eliminate or reduce an accounting mismatch between instruments within the scope of topic 320 / IFRS 9 or with other standards requiring or permitting the recognition of changes in value through profit and loss or other comprehensive income.

> Own credit risk on financial liabilities at fair value

The FFSA is of the opinion that the fair value change that is attributable to changes in the credit risk of the liability whether in equity, in other comprehensive income (OCI) or in profit or loss should be prohibited, until these gains and losses are realized.

The FFSA believes that financial liabilities should be recorded at amortized cost or using the "frozen credit spread" method considered by the IASB, when the effect of own credit-risk is only included in the measurement of the liability upon initial recognition.

Impairment

Measurement of impairment

For credit impairments of debt instruments without significant leverage evaluated at amortized cost or fair value through OCI, the FFSA notes that the FASB's proposal relies on estimates of cash flows based on current conditions at the reporting date. Bonds portfolios account for the larger part of investments held by French insurance companies. These bonds consist mostly of high-quality bonds issued by OECD member states and, to a lesser extent, of investment grade corporate bonds. Debt securities are usually listed and traded on an active market. This should not lead to an assessment of losses by reference to credit spreads reflected in market prices. Impairment criteria should remain entity-specific, with management using its own judgment. Losses under consideration should be those losses expected by the holder of the bonds. For instance, market data or ratings issued by rating agencies should only be used as potential indicators of future defaults. Similarly, spreads observed in the CDS market prices should not be used as a benchmark to value the credit risk of bonds which are held for collecting cash flows and not for trading. Market expectations of defaults - in bearish as well as in bullish markets, may introduce an undue bias in management's expectation of future cash flows.

Impairments of all other financial assets at fair value through OCI should be recorded when there is a significant or prolonged decline in their fair value.

Further, the FFSA is strongly opposed to the recognition of day one losses recorded through net income when all contractual cash flows are expected not to be collected, as it opposed the immediate catch-up effect on net income in the IASB's model when expectations of future losses are revised

Reversal of impairment

The FFSA believes that reversal of impairments should be recorded through profit and loss for all financial assets.

For assets acquired at an amount that includes a discount related to credit quality, the FFSA understands that the effective interest rate should be recalculated at each closing date whenever cash flows expected to be collected exceed the allowance for credit losses or the estimate of cash flows upon acquisition. The FFSA considers that this provision will generate undue complexity and significant operational challenges.

Hedge accounting

The FFSA welcomes the proposed amendments to hedge accounting that simplify current requirements.

However, the proposed model does not include adequate accounting treatment for macro-hedges, or portfolios hedges, that would appropriately reflect common current practice of economic hedge. Indeed, hedge accounting should be extended to hedges of portfolios designated by the entity.

The FFSA draws the Boards' attention to the specificities of the insurance industry in this respect, where the entity hedges risks related to liabilities resulting from insurance contracts rather than risks related to assets.

Interactions with other on-going projects

This ED on financial instruments has multiple interactions with other projects of the FASB or of the IASB and with other standards, notably Fair Value Measurement, Derecognition, Revenue Recognition, Financial Statement Presentation or Insurance Contracts. The FFSA is deeply concerned that current thoughts on financial instruments may pre-empt on future decisions to be taken.

Further, the FFSA draws the Boards' attention to the insurance industry's call for a consistent approach between insurance liabilities to be dealt within the insurance contract project (applicable to both insurance contracts and investment contracts with discretionary participation features), and financial instruments backing those liabilities. This principle led in the past to the recognition of shadow accounting and fair value option for accounting mismatch.

Specific attention should be given to the respective effective dates of these interacting projects so as to avoid unexpected and inappropriate accounting consequences. For instance, at this stage, it is unclear for insurance companies whether classifying financial instruments at fair value through OCI would result in accounting mismatches with liabilities relating to insurance contracts, due to potential differences in effective dates or to on-going differences in the underlying measurement principles.

Detailed comments to some of the Board's questions are presented in the appendix 1 to this letter. The FFSA focused on the main issues that need to be considered by the Boards in their convergence efforts and did not answer all questions asked by the FASB.

Our answers to the IASB's exposures drafts 2009/7 and 2009/12 as well as our overall letter to the IASB on the IFRS 9 dated March 2010 are referenced in appendix 2, 3 and 4 to this letter. A description of the insurance business model is presented in appendix 5.

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

Question 3: The proposed guidance would require deposit-type and investment contracts of insurance and other entities to be measured at fair value. Do you agree that deposit-type and investment contracts should be included in the scope? If not, why?

The FFSA agrees that investment contracts issued by insurance companies should be recorded under the provisions of the financial instruments standard, providing that these contracts do not include significant insurance features or discretionary participating features that are interdependent with the financial instrument component. Contracts including significant insurance features or discretionary participation features should be in the scope of the insurance contracts standard.

Question 13: The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?

The FFSA disagrees with fair value being the default measurement attribute for financial instruments.

As stated in our answer to the IASB's ED 2009/7, the FFSA strongly supports a mixed measurement model that includes amortized cost and fair value measurement. The FFSA considers that the proposed classification in the FASB's ED would not adequately reflect the business model for financial instruments held in a medium or long-term perspective based on an asset – liability strategy in light of the duration of insurance liabilities or in a medium or long-term investment management strategy. The FFSA fears that the model developed by the FASB would generate undue fluctuation without economic justification into reported equity and earnings, which is detrimental to the interpretation of the financial statements.

The FFSA suggests an amended classification and measurement approach. As in the approach proposed in the ED, classification and measurement would be based on the nature of the instrument and the business model of the entity but would take into account the business model for all natures of financial instruments. This amended approach is described in further details in appendix 2.

Question 14: The proposed guidance would require that interest income or expense, credit impairments and reversals (for financial assets), and realized gains and losses be recognized in net income for financial instruments that meet the criteria for qualifying changes in fair value to be recognized in other comprehensive income. Do you believe that any other fair value changes should be recognized in net income for these financial instruments? If yes, which changes in fair value should be separately recognized in net income? Why?

The FFSA supports the proposed provisions in the FASB's ED for equity securities as well as for debt instruments held in a medium or long-term perspective based on an asset – liability strategy in light of the duration of insurance liabilities or in a medium or long-term investment management strategy.

The FFSA opposed the IASB's proposal of recording financial instruments at fair value through OCI without recycling of dividends or realized gains and losses through net income. Realized gains and losses should be recycled to net income as the financial result is an essential component of the measure of performance for insurance companies and so as to reflect the business model of insurance (e.g. to match the expense recorded for policyholder claims and participation recorded through profit and loss)

However, for financial liabilities, fair value changes attributable to changes in the credit risk of the liability whether in equity, in other comprehensive income (OCI) or in profit or loss should be prohibited, until these gains and losses are realized.

Question 15: Do you believe that the subsequent measurement principles should be the same for financial assets and financial liabilities? If not, why?

Financial liabilities should be recorded at amortized cost or using the "frozen credit spread" method considered by the IASB, when the effect of own credit-risk is only included in the measurement of the liability upon initial recognition.

Question 16: The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?

The FFSA deems that reclassification should not be prohibited – as in the FASB's model- or limited to rare circumstances - as requested in the IASB's model.

The FFSA believes that classification and measurement should reflect the nature of the instrument and the business model. As a result, the FFSA believes that reclassifications should be required when the business model changes or when financial instruments are transferred between portfolios managed according to different business models. For insurance companies, reclassifications would be applicable for instance to transfers from the unit-linked portfolio to the general portfolio.

Question 18: Do you agree that a financial liability should be permitted to be measured at amortized cost if it meets the criteria for recognizing qualifying changes in fair value in other comprehensive income and if measuring the liability at fair value would create or exacerbate a measurement attribute mismatch? If not, why?

Refer to our answer to question 15 above for our proposal of classification and measurement for financial liabilities.

The FFSA disagrees with the criteria defined in the FASB's ED to limit the use of amortized cost for financial liabilities. The FFSA believes that amortized cost classification for financial assets or liabilities should result from the business model rather than from bright lines.

The FFSA also supports a fair value option for financial assets or liabilities when it reduces or eliminates an accounting mismatch.

A description of the insurance business model is presented in appendix 5.

Question 20: Do you agree that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income in combination with other deferred tax assets of the entity (rather than segregated and analyzed separately)? If not, why?

In this case, the FFSA believes that the need for a valuation allowance should be segregated and analyzed separately as the entity does not expect the unrealized loss to ever be realized in a future reporting period if it holds the debt instrument until maturity. As a result, the deductible temporary difference relating to debt securities measured at fair value with qualifying changes in fair value recognized in OCI will reverse automatically. Consequently, the unrealized losses will never require any other source of future taxable income to demonstrate realization of the deferred tax assets.

Question 22: Do you believe that the recognition of qualifying changes in fair value in other comprehensive income (measuring the effects of subsequent changes in interest rates on fair value as well as reflecting differences between management's and the market's expectations about credit impairments) will provide decision-useful information for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows? If yes, how will the information provided influence your analysis of an entity? If not, why?

In our capacity of long term investors using financial statements as a primary source for investment decisions, the FFSA believes that the most decision-useful measurement for financial instruments should reflect both the nature of the instrument and the business model. This can be achieved in a mixed measurement model combining amortized cost, fair value through OCI and fair value through net income as described above.

The FFSA reckons that the fair value of financial instruments carried at amortized cost on the statement of financial position is a valuable piece of information and believes it can be presented in the notes to the financial statements.

Question 25: For hybrid financial instruments that currently would require bifurcation and separate accounting under Subtopic 815-15, do you agree that recognizing the entire change in fair value in net income results in more decision-useful information than requiring the embedded derivative to be bifurcated and accounted for separately from the host contract? If yes, how will the information provided be used in the analysis of an entity? If not, for which types of hybrid financial instruments do you believe that it is more decision useful to account for the embedded derivative separately from the host contract? Why?

The FFSA considers that recognizing the entire change in fair value in net income does not result in more decision-useful information than requiring bifurcation.

The FFSA believes that bifurcation of embedded derivatives from the host contract should be allowed, to reduce a measurement inconsistency for instance, as it may convey more decision-useful information on the underlying financial instrument.

Question 30: Do you believe that the proposed criteria are operational to qualify for measuring a financial liability at amortized cost? If not, why?

The FFSA believes that amortized cost classification for financial assets or liabilities should be based on principles and result from the business model of the entity rather than from bright lines.

Question 32: For financial liabilities measured at fair value with all changes in fair value recognized in net income, do you agree that separate presentation of changes in an entity's credit standing (excluding changes in the price of credit) is appropriate, or do you believe that it is more appropriate to recognize the changes in an entity's credit standing (with or without changes in the price of credit) in other comprehensive income, which would be consistent with the IASB's tentative decisions on financial liabilities measured at fair value under the fair value option? Why?

Refer to our answer to question 15 above.

Question 38: Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?

The FFSA strongly opposes the proposed requirements and supports the IASB's proposed recognition of initially expected credit losses as a reduction in interest income over the life of the financial instrument as it reflects more accurately the effective yield of the investment.

The FFSA is confident that a workable solution can be reached to evaluate impairments on equity or debt securities carried at fair value with qualifying changes in fair value recorded in OCI, such that issues linked to the assessment of a "significant or prolonged" decline and its divergent applications are avoided.

Question 45: The proposed guidance would require that an appropriate historical loss rate (adjusted for existing economic factors and conditions) be determined for each individual pool of similar financial assets. Historical loss rates would reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool. Do you agree with that approach?

The FFSA agrees with the proposed guidance and draws the Board's attention to the specificities of bonds traded on active markets that represent a significant portion of insurance companies' investment portfolios. These bonds consist mostly of high-quality bonds issued by OECD member states and, to a lesser extent, of investment grade corporate bonds.

Debt securities are usually listed and traded on an active market. This should not lead to an assessment of losses by reference to credit spreads reflected in market prices. Impairment criteria should remain entity-specific, with management using its own judgment. Losses under consideration should be those losses expected by the holder of the bonds. For instance, market data or ratings issued by rating agencies should only be used as potential indicators of future defaults. Similarly, spreads observed in the CDS market prices should not be used as a benchmark to value the credit risk of bonds which are held for collecting cash flows and not for trading. Market expectations of defaults - in bearish as well as in bullish markets, may introduce an undue bias in management's expectation of cash flows.

Question 56: Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

Question 58: Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? Why or why not?

The FFSA welcomes the proposed simplifications to hedge accounting requirements.

Question 60: Do you believe that the proposed changes to the hedge accounting model will provide more transparent and consistent information about hedging activities? If yes, why and how would you use the information provided? If not, what changes do you disagree with and why?

The FFSA recommends improving the proposed hedge accounting model by including an appropriate treatment for hedges of portfolios designated by the reporting entity, as such hedges are commonly used in practice.

Question 68: Do you agree with the transition provision in this proposed Update? If not, why?

The FFSA is deeply concerned that current thoughts on financial instruments may pre-empt on future decisions to be taken in other projects being developed by the Boards.

Further, the FFSA draws the Board's attention to the insurance industry's call for a consistent approach between insurance liabilities to be dealt within the insurance contract project (applicable to both insurance contracts and investment contracts with discretionary participation features), and

financial instruments backing those liabilities. This principle led in the past to the recognition of shadow accounting and fair value option for accounting mismatch.

Specific attention should be given to the effective dates of these interacting projects so as to avoid unexpected and inappropriate accounting consequences. For instance, at this stage, it is unclear for insurance companies whether classifying financial instruments at fair value through OCI would result in accounting mismatches with liabilities relating to insurance contracts, due to potential differences in effective dates or to on-going differences in the underlying measurement principles.

The FFSA's comment letter on the IASB's ED 2009/7 "Financial Instruments – Classification and Measurement" can be found on the IASB's website:

http://www.ifrs.org/NR/rdonlyres/835D0B67-F444-4C23-AE82-0CC45BF6E84C/0/CL37.pdf

Appendix 3

The FFSA's comment letter on the IASB's ED 2009/12 "Amortised Cost and Impairment" can be found on the IASB's website:

http://www.ifrs.org/NR/rdonlyres/0E636FD7-0493-491E-A3CE-8539451C40A8/0/CL3.pdf

In March 2010, the FFSA sent the following letter to the IASB, commenting on the overall IAS 39 replacement project:

Sir David Tweedie

Chairman

International Accounting Standards Board

30, Cannon Street

London

EC4M 6XH

United Kingdom

Subject: IFRS 9, Financial Instruments - Classification and Measurement

Dear Sir David,

We are writing to you with regards to IFRS 9 Financial Instruments – Classification and Measurement as issued by the IASB in November 2009. Like several other insurance industry representatives, the FFSA commented on the ED. We are pleased to note that several of the matters raised in the various comment letters submitted on behalf of insurers were considered by the Board in finalising IFRS 9 for issue, but we consider that certain critical issues should be addressed by the Board as the financial instruments and insurance contracts projects proceed. We believe that some of these issues require reopening IFRS 9.

The medium-long term insurance business must be reflected in the way financial instruments are accounted for

While the fair value categories in IFRS 9 (i.e. FV P&L and FV OCI) may be appropriate for trading business models, neither of these categories appropriately reflect the economic reality for medium to long term investors such as insurers.

In our comment letter on the ED dated 22 September 2009, we advocated that financial instruments held in a medium or long term perspective on a fair value basis should be accounted for at fair value through other comprehensive income. We indeed mentioned that: "Consistently with their business model, insurance companies should be able to use fair value measurements and to record changes in fair value in OCI as long as these changes are unrealized. In the insurance business (life and non-life), these instruments are held in a medium or long-term perspective based on an asset liability strategy in light of the duration of

insurance liabilities or in a medium or long-term investment management strategy. Realized gains and losses, other financial income (dividends and interests) and impairments on assets classified in OCI should continue being recorded through profit and loss as, in the case of insurance companies for instance, they are intimately related to the expense recognized for policyholder claims and participation features. This will ensure internal consistency of the financial statements."

We still consider it is not appropriate that the categories defined under IFRS 9 make no distinction between realized and unrealized fair value changes. Just as it would be improper for a long-term investor to recognize a short-term unrealized gain in P&L, so too would be preventing the recognition of realized gains in the P&L upon a sale. In contrast, and as indicated in our letter to you dated 1st July 2009, the current available for sale ("AFS") category takes the more sensible approach of reflecting performance of long-term investors on the basis of cash flows. Indeed, anything else would mislead users of the financial statements, all the more so when participation benefits served to policyholders on the basis of realised gains or losses are recorded in income statement.

Furthermore, the current AFS category is critical for addressing certain insurance-specific mismatch issues. Asset/liability matching is a central tool that allows insurers to make sure they have enough liquid assets to meet claims when they occur, to factor investment returns into the product pricing and to offer guaranteed return rates to policyholders.

Critics may argue that maintaining the AFS category is fundamentally inconsistent with the Board's stated goal of reducing complexity. Although we advocate the elimination of unnecessary complexity, we also recognize that oversimplification limits the decision usefulness of information in the financial reporting of buy-and-hold investors such as insurance entities. Moreover, as the Board has already introduced certain AFS characteristics into IFRS 9 (e.g. dividend treatment for FV OCI), making the remaining changes to maintain the AFS category would not introduce much additional complexity. A perceived weakness of the current version of IAS 39 relates to the difficulties with the implementation of IAS 39 impairment provisions for equity securities. We are confident that a workable solution can be reached such that issues linked to the assessment of a "significant or prolonged" decline and its divergent applications are avoided.

For the reasons set out above we believe that the AFS category should continue to be one of the classification categories for financial instruments in IFRS 9 and would be pleased to assist the Board in this objective. The AFS category allows for a better reflection of the medium to long-term asset management of insurers whose business model is not based on a trading basis. In addition, we consider that the removal of the AFS category, in particular for equity instruments, may result in a change to some insurance companies' investment strategies, and we do not believe that to be among the Board's objectives.

Transition and adoption date issues for insurers

The concurrent development of IFRS 9 and IFRS 4 Phase II raises significant issues for insurers. We are pleased that the Board has acknowledged that they are aware of these issues and will address them in the future, as part of the IFRS 4 Phase II transitional arrangements and as future consequential amendments to IFRS 9. In this regard, we would like to reiterate the following:

- Mandatory application of IFRS 4 Phase II and IFRS 9 must be concurrent: The 2013 mandatory application date of IFRS 9 must be reconsidered if the IFRS 4 Phase II adoption is not mandated until 2014 because insurers must concurrently adopt both standards. Again we note that the Board has moved the mandatory effective date of IFRS 9 to 1 January 2013 to align the effective date with IFRS 4 Phase II, and that in case of subsequent delays in the insurance contract project, the effective date of IFRS 9 would be revised accordingly. We also believe that the transitional provisions should be reviewed in this regard, for example in relation to relief from providing comparatives.
- Insurers must have the ability to change the designation of financial assets upon transition to IFRS 4 Phase II: specifically, insurers adopting IFRS 9 ahead of the 2013 mandatory date must have the ability to redesignate some or all of their financial assets when they change their accounting policies for insurance liabilities upon adoption of IFRS 4 Phase II. This would be consistent with the current provisions in IFRS 4 (paragraph 45). We note that the Board has indicated that this issue will be addressed as part of the IFRS 4 Phase II transition arrangements and consequential amendments to IFRS 9 (BC115). However, the Board has considered only allowing reclassification of certain financial assets as measured at fair value through profit or loss². We consider that reclassification should be allowed without precluding any specific category (i.e. amortized cost, FV P&L or FV OCI) given the uncertainties regarding IFRS 4 Phase II.

Other ongoing projects should also result in a proper reflection of our business

Although we welcome the decision to retain the amortized cost measurement category in IFRS 9 and we note that the amortized cost category is of particular importance for insurers,

We also await revised hedge accounting rules. Insurers commonly seek to use hedging strategies in order to achieve asset/liability matching, but are often limited from reflecting economic reality by the current rules. Accordingly, we request that hedge accounting be addressed in a practical manner in light of our statements above.

Besides, as stated above, there are already considerable uncertainties with respect to IFRS 4 Phase II. Other initiatives such as the financial statement project and related performance reporting cast additional uncertainty over the measurement basis for a significant portion of an insurer's liabilities, as well as the presentation of the comprehensive income statement.

¹ How the IASB has responded to European concerns, November 2009

² IASB project summary and feedback statement, November 2009

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Given the potential impact of these projects on our business, we emphasize that significant unforeseen changes may result in having to reassess our views on classification and measurement under IFRS 9.

Please feel free to contact us should you wish to discuss further any matters raised in this letter.

Yours sincerely,

Bernard Spitz

Chairman - Fédération Française des Sociétés d'Assurances

The following is a description of the insurance business model that the FFSA considers should be reflected in the way insurance contracts and the related financial assets are accounted for:

Main features of the insurance business model

Insurance can be defined as the transfer of the risk of a loss from one party to another, in exchange for a premium, and can be thought of as a guaranteed and known small loss to hedge against the risk of a contingent, large and possibly devastating loss.

The business model can be summarized in a simple equation: Profit = earned premium + investment income - incurred loss - underwriting expenses.

Insurers make money in two ways:

- through underwriting, the process by which insurers select the risks to insure and decide how much in premiums to charge for accepting those risks;
- by investing the premiums they collect from insured parties.

Insurers in most cases perform their obligation by pooling homogeneous risks so that the law of large numbers renders the average expected loss less volatile and more predictable. This requires a large and efficient diversification of risks underwritten.

The asset and liability management (ALM) concept is the cornerstone of the business model for life insurance and annuity products, which have a long duration and guaranteed rates.

- insurance companies are in the business of collecting and investing premiums to pay claims in the future.
- investment returns are factored into the product pricing
- actual investment experience that differs from pricing is an economic gain or loss.

Main difference between the insurance business model and the banking business model

Insurance is about managing liability risks while banking consists in managing asset risks.

Unlike banks, the business model of insurers largely insulates them from economic cycles, market volatility and liquidity crises, eventually.

Insurers are funded mainly by upfront premiums before having to pay for claims (inverted production cycle) while

- for retail banks, lending activity generates later returns that are subject to how their customers fare in the economic cycle,
- for investment banks, performance is highly dependent on the day-to-day ups and downs of markets.

Insurance policyholders often face restrictions to lapses that obviate early redemptions before the insurance contract term, which makes insurers inherently less vulnerable to liquidity crises, while a significant percentage of bank liabilities can mature on short notice and generate a so-called bank run during a crisis.

Likewise, interconnectedness between insurers is low, thus reducing contagion or systemic risk within the industry in times of stress, when compared with the day-to-day refinancing of banks on the interbank market and the immediate credit crunch that results from the failure of a single player and that triggers central bank or government interventions as lenders of last resort or guarantors.

Finally, the three levels of solvency requirements placed on insurers (solvency capital requirement, minimum capital requirement and requirement on technical provisions) create a ladder of regulatory intervention that does not exist in banking prudential regulation and that allows for regulatory action while a company still has net assets to meet its obligations toward policyholders. Banks have a single solvency capital requirement and no technical provisions, since they manage asset risks first.