

FÉDÉRATION FRANÇAISE DES SOCIÉTÉS D'ASSURANCES

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LE DÉLÉGUÉ GÉNÉRAL

Paris, March, 17th 2011

Dear Sir David,

Supplement to Exposure Draft “ED/2009/12 Financial Instruments: Impairment”

The Fédération Française des Sociétés d'Assurances (FFSA) welcomes the IASB's invitation for comments on the Supplement to Exposure Draft “ED/2009/12 Financial Instruments: Impairment”. The FFSA represents all types of insurance and reinsurance undertakings, accounting for 90% of the total French market.

In our comment letter on the IASB's ED 2009/12, we expressed our support to the overall objective of amortised cost as defined in the ED and drew the Board's attention on the following issues:

- tropism towards bank loans in the proposals that do not fit the specificities of high quality listed debt securities portfolios;
- operational challenges faced in the implementation of the ED's proposals and need for practical expedients;
- excessive information and disclosure requirements with regards to the materiality of defaults on bond portfolios.

Specificities of bond portfolios are not addressed in the supplement to the 2009 ED that shows a continuing tropism towards banking activities

As noted by the Board in § IN 20 a), the Boards are yet to redeliberate on “assets that are evaluated individually [...] and any issues specific to investments in debt securities”.

As portfolios of listed bonds account for the larger part of investments held by insurance companies, we expect further proposals from the Board that would take into consideration the specificities of debt securities that differentiates them from bank loans as far as expected losses are concerned. Insignificant losses only were incurred in recent years on bond portfolios carried by French insurance companies.

Sir David Tweedie
Chairman
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30, Cannon Street
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As insurance companies are not directly impacted by the supplement to the ED, this answer does not provide detailed comments on each question raised by the Boards. However, we understand from the wording of the supplement to the ED, related basis for conclusions and other publications (snapshots...) that the Board continues focusing on banking activities and the way banks manage these financial assets. Further, the Board underlines that future redeliberation of other issues (such as the specificities of bond portfolios) will be addressed by reference to the proposals in this supplement, assessing whether there is “sufficient justification for several impairment models”.

Therefore, we fear that the final standard is eventually based on issues specific to the banking industry carried forward to all financial assets at amortised cost and is unfit to other financial assets held by other sectors.

A comprehensive expected loss model and a reliable amortised cost measurement should be developed for all financial assets, based on historical data and past experience

We believe that a comprehensive expected loss model and a reliable amortised cost measurement should be developed for all financial assets, which would deal with the specificities of all eligible assets

Debt securities are usually listed and traded on an active market. This should not lead to an assessment of expected losses by reference to credit spreads reflected in market prices. Impairment criteria should remain entity-specific, with management using its own judgment. We consider that expected losses should be based on entity-specific criteria using historical data.

Consistently with the amortized cost principle based on an expected cash flow measurement, the expected losses under consideration should be those losses expected by the holder of the bonds, whatever prices are on the market. 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.

Moreover, implementing a new and complex method to estimate immaterial expected losses would lead to undue costs without improving information provided to the users of financial statements.

For these reasons, we believe that the expected loss model should be based only on historical data and statistics on past experience.

Proposals in the supplement introduce undue changes in the objective of amortised cost

The differentiation of credit loss recognition in the supplement to the 2009 ED introduce a floor based on losses expected to occur within the foreseeable future for the good book and immediate recognition of expected credit losses for the bad book. These proposals aim at creating an “allowance balance sufficient to cover the credit loss before they occur” (BC 74).

We consider that these proposals contradict the objective of amortised cost measurement as set in the 2009 ED: “to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument.”

These proposals may thus preclude future decisions on the objective of amortised cost measurement and how the impairment model relates to that measurement. These issues are yet to be redeliberated by the Board as stated in § IN 20.

We recommend that the Board does not carry forward these proposals to the final standard. In our opinion, the time-proportional allocation of expected credit loss (excluding the proposed floor), meets the objective of the 2009 ED and should be extended to all financial instruments.

Proposed practical expedients are likely to facilitate the initial and on-going implementation of the standard

We welcome the Board's proposals with regards to decoupling and options to allocate expected losses based on a straight-line or annuity method, discounted or not, in the time-proportional model.

We agree that these practical expedients would alleviate some of the operational burden that would have resulted from the proposals in the 2009 ED.

Presentation and disclosure requirements

The FFSA fears that the information usefulness of the extensive presentation and disclosure requirements set in the ED would be impaired as the amount of default to be reported in the income statement and in the notes to the financial statements is likely to be immaterial on bonds portfolios.

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,

A handwritten signature in black ink, appearing to read 'JF Lequoy', with a horizontal line extending to the right.

Jean-François Lequoy

Appendix 1

Question 1 –

Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (ie delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

We agree that the proposed approach is likely to create an “allowance balance sufficient to cover the credit loss before they occur” (BC 74) in most cases when deterioration in credit rating is slow and continuous.

However, it would not permit early recognition of sudden deteriorations in credit quality or defaults.

Further, we consider that these proposals contradict the objective of amortised cost measurement as set in the 2009 ED: “to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument.” Early recognition of losses so as to build an allowance balance that sufficient to cover credit losses before they occur will distort information on the effective return on the financial instruments over its expected life.

These proposals may thus preclude future decisions on the objective of amortised cost measurement and how the impairment model relates to that measurement. These issues are yet to be redeliberated by the Board as stated in § IN 20.

We recommend that the Board does not carry forward these proposals to the final standard.

Question 2

Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not? Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

In their approach to closed and open portfolios, the Boards elaborated proposals based on concepts that are specific to the banking sector and the way banks manage their loan portfolios. These concepts and business models are not representative of the way other sectors manage their financial instruments.

As noted by the Board in § IN 20 a), the Boards are yet to redeliberate on “assets that are evaluated individually [...] and any issues specific to investments in debt securities”.

As portfolios of listed bonds account for the larger part of investments held by insurance companies, we expect further proposals from the Board that would take into consideration the specificities of debt securities that differentiates them from bank loans as far as expected losses are concerned. In particular, we consider that expected losses should not be assessed by reference to credit spreads reflected in market prices but based on entity-specific criteria using historical data. Insignificant losses only were incurred in recent years on bond portfolios carried by French insurance companies. As insurance companies are not directly impacted, this answer does not provide detailed comments on each question raised by the Boards.

However, we understand from the wording of the supplement to the ED, related basis for conclusions and other publications (snapshots...) that the Board continues focusing on banking activities and the way banks manage these financial assets. Further, the Board underlines that future redeliberation of other issues (such as

the specificities of bond portfolios) will be addressed by reference to the proposals in this supplement, assessing whether there is “sufficient justification for several impairment models”.

Therefore, we fear that the final standard is eventually based on issues specific to the banking industry carried forward to all financial assets at amortised cost and is unfit to other financial assets held by other sectors.

A more suitable approach would be to develop a comprehensive expected loss model and a reliable amortised cost measurement for all financial assets, which would deal with the specificities of all eligible assets.

Debt securities are usually listed and traded on an active market. This should not lead to an assessment of expected losses by reference to credit spreads reflected in market prices. Impairment criteria should remain entity-specific, with management using its own judgment. We consider that expected losses should be based on entity-specific criteria using historical data.

Consistently with the amortized cost principle based on an expected cash flow measurement, the expected losses under consideration should be those losses expected by the holder of the bonds, whatever prices are on the market. 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.

For these reasons, we believe that the expected loss model should be based only on historical data and statistics on past experience.

Question 3

Do you agree that for financial assets in the ‘good book’ it is appropriate to recognise the impairment allowance using the approach described above? Why or why not?

We refer to our comments in question 2 on the use of the “good book” concept that derives from management practices in the banking sector.

Further, the proposals in the supplement to the 2009 ED introduce a floor for credit loss recognition based on losses expected to occur within the foreseeable future for the good book. This proposal aims at creating an “allowance balance sufficient to cover the credit loss before they occur” (BC 74).

We consider that this proposal contradicts the objective of amortised cost measurement as set in the 2009 ED: “to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument.” We support the objective of amortised cost defined in the 2009 ED.

This proposal may thus preclude future decisions on the objective of amortised cost measurement and how the impairment model relates to that measurement. These issues are yet to be redeliberated by the Board as stated in § IN 20.

We recommend that the Board does not carry forward this proposal to the final standard. In our opinion, the time-proportional allocation of expected credit loss should not include the proposed floor to meet the objective of the 2009 ED.

Question 4

Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

We refer to our answer on question 3 above. Excluding the floor requirement on the time-proportional approach will not only meet the amortised cost objective defined in the 2009 ED, but also alleviate the efforts in the operational implementation of the proposals.

We welcome the Board's proposals with regards to decoupling and options to allocate expected losses based on a straight-line or annuity method, discounted or not, in the time-proportional model.

We agree that these practical expedients would alleviate some of the operational burden that would have resulted from the proposals in the 2009 ED.

Question 5

Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

We refer to our answer to question 3 above.

We consider that this proposal contradicts the objective of amortised cost measurement as set in the 2009 ED: "to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument."

We believe that the objective of amortised cost defined in the 2009 ED would result in more useful information being provided.

Question 6

Is the requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

As commented in our answer to question 2, we consider that the Boards elaborated proposals based on concepts that are specific to the banking sector and the way banks manage their loan portfolios, differentiating "good book" and "bad book". These concepts and business models are not representative of the way other sectors manage their financial instruments.

Further, under the proposal, the amount of loss allowance transferred from the good to the bad book together with the transferred asset would be the time-proportional amount. However, the interaction of this transfer with the allowance on other assets remaining in the good book may result in unintended consequences. Indeed, in most cases, actual defaults on items in the portfolio will not be spread on each asset as the allowance of expected loss assessed at portfolio level is but concentrated on selected assets. For instance, if an entity expects that only one item in a portfolio is likely to default, we believe that the time-proportional amount of expected losses on the whole portfolio should be transferred to the bad book when an asset is subsequently transferred.

We recommend this distinction not be carried forward to the final standard.

Question 7

Is the requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

As commented in our answer to question 2, we consider that the Boards elaborated proposals based on concepts that are specific to the banking sector and the way banks manage their loan portfolios, differentiating “good book” and “bad book”. These concepts and business models are not representative of the way other sectors manage their financial instruments.

We recommend this distinction not be carried forward to the final standard.

Question 8

Do you agree with the proposed requirement to differentiate between the two groups (ie ‘good book’ and ‘bad book’) for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

As commented in our answer to question 2, we consider that the Boards elaborated proposals based on concepts that are specific to the banking sector and the way banks manage their loan portfolios, differentiating “good book” and “bad book”. These concepts and business models are not representative of the way other sectors manage their financial instruments.

As noted by the Board in § IN 20 a), the Boards are yet to redeliberate on “assets that are evaluated individually [...] and any issues specific to investments in debt securities”.

As portfolios of listed bonds account for the larger part of investments held by insurance companies, we expect further proposals from the Board that would take into consideration the specificities of debt securities that differentiates them from bank loans as far as expected losses are concerned. In particular, we consider that expected losses should not be assessed by reference to credit spreads reflected in market prices but based on entity-specific criteria using historical data. Insignificant losses only were incurred in recent years on bond portfolios carried by French insurance companies. As insurance companies are not directly impacted, this answer does not provide detailed comments on each question raised by the Boards.

However, we understand from the wording of the supplement to the ED, related basis for conclusions and other publications (snapshots...) that the Board continues focusing on banking activities and the way banks manage these financial assets. Further, the Board underlines that future redeliberation of other issues (such as the specificities of bond portfolios) will be addressed by reference to the proposals in this supplement, assessing whether there is “sufficient justification for several impairment models”.

Therefore, we fear that the final standard is eventually based on issues specific to the banking industry carried forward to all financial assets at amortised cost and is unfit to other financial assets held by other sectors.

Further, we consider that the floor and “bad book” proposals contradict the objective of amortised cost measurement as set in the 2009 ED: “to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument.”

These proposals may thus preclude future decisions on the objective of amortised cost measurement and how the impairment model relates to that measurement. These issues are yet to be redeliberated by the Board as stated in § IN 20.

We recommend that the Board does not carry forward these proposals to the final standard. In our opinion, the time-proportional allocation of expected credit loss (excluding the proposed floor), meets the objective of the 2009 ED and should be extended to all financial instruments.

Question 9

The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this model. Specifically, on the following issues:

(a) Do you agree with the proposal to require a floor for the impairment allowance related to the ‘good book’? Why or why not?

(b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the ‘good book’ only in circumstances in which there is evidence of an early loss pattern?

(c) If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?

(d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

(e) Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.

(f) If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a ‘ceiling’ should be established for determining the amount of credit impairment to be recognised under the ‘floor’ requirement (for example, no more than three years after an entity’s reporting date)? If so, please provide data and/or reasons to support your response.

Question 9 a:

The floor proposal aims at creating an “allowance balance sufficient to cover the credit loss before they occur” (BC 74).

We consider that this proposal contradicts the objective of amortised cost measurement as set in the 2009 ED: “to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument.” We support the objective of amortised cost defined in the 2009 ED.

This proposal may thus preclude future decisions on the objective of amortised cost measurement and how the impairment model relates to that measurement. These issues are yet to be redeliberated by the Board as stated in § IN 20.

We recommend that the Board does not carry forward this proposal to the final standard. In our opinion, the time-proportional allocation of expected credit loss should not include the proposed floor to meet the objective of the 2009 ED.

Question 9 b:

We refer to our answer to question 9 a above.

We recommend that the Board does not carry forward a floor proposal to the final standard. In our opinion, the time-proportional allocation of expected credit loss should not include the proposed floor to meet the objective of the 2009 ED.

Question 9 c:

We disagree with the proposed minimum allowance amount (see our answer to question 9 a).

Question 9 d, e & f:

Should the Boards carry forward their proposals on the floor to the final standard, we consider that bright lines should not be carried forward to the final standard. The foreseeable future should be assessed based on the facts and circumstances at closing date.

Question 10

Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a)(i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

We have no comments on this issue.

Question 11

The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

- (a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the approach described in paragraph B8(a)? Why or why not?**
- (b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?**

We welcome the Board's proposals with regards to options to allocate expected losses on a discounted or undiscounted basis, and providing flexibility in the selection of an appropriate discount rate.

Question 12

Would you prefer the IASB approach for open portfolios of financial assets measured at amortised cost to the common proposal in this document? Why or why not? If you would not prefer this specific IASB approach, do you prefer the general concept of the IASB approach (ie to recognise expected credit losses over the life of the assets)? Why or why not?

As mentioned in our answer to question 3, we consider that the time-proportional allocation of expected credit loss should not include the proposed floor. The time proportionate approach (excluding the proposed floor) should be extended to all financial instruments.

Question 13

Would you prefer the FASB approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific FASB approach, do you prefer the general concept of this FASB approach (ie to recognise currently credit losses expected to occur in the foreseeable future)? Why or why not?

We disagree with the FASB's approach.

Like the floor included in the common proposal in this document, the FASB's approach aims at creating an "allowance balance sufficient to cover the credit loss before they occur".

We consider that this approach contradicts the objective of amortised cost measurement as set in the IASB's 2009 ED: "to provide information about the effective return on a financial asset or financial liability by allocating interest revenue or interest expense over the expected life of the financial instrument." We support the objective of amortised cost defined in this ED.

This approach may thus preclude future decisions on the objective of amortised cost measurement and how the impairment model relates to that measurement. These issues are yet to be redeliberated by the Board as stated in § IN 20.

We recommend that the Board does not carry forward this approach to the final standard.

Question 14Z

Do you agree that the determination of the effective interest rate should be separate from the consideration of expected losses, as opposed to the original IASB proposal, which incorporated expected credit losses in the calculation of the effective interest rate? Why or why not?

We welcome the Board's proposals with regards to decoupling.

We agree that this practical expedient would alleviate some of the operational burden that would have resulted from the proposals in the 2009 ED.

Question 15Z

Should all loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37) be subject to the impairment requirements proposed in the supplementary document? Why or why not?

We have no comments on this issue.

Question 16Z

Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

We have no comments on this issue.

Question 17Z

Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

The FFSA fears that the information usefulness of the detailed presentation requirements set in the ED would be impaired as the amount of default to be reported in the income statement is likely to be immaterial on bonds portfolios.

Question 18Z

- (a) Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why?**
- (b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) for the proposed impairment model and why?**

As commented in our answer to question 2, we consider that the Boards elaborated proposals based on concepts that are specific to the banking sector and the way banks manage their loan portfolios, differentiating “good book” and “bad book”. These concepts and business models are not representative of the way other sectors manage their financial instruments.

Further, we fear that the information usefulness of the detailed disclosure requirements set in the ED would be impaired as the amount of default to be reported in the notes to the financial statements is likely to be immaterial on bonds portfolios.

Question 19Z

Do you agree with the proposal to transfer an amount of the related allowance reflecting the age of the financial asset when transferring financial assets between the two groups? Why or why not? If not, would you instead prefer to transfer all or none of the expected credit loss of the financial asset?

We refer to our answer on question 7 on the differentiation between a good book and a bad book.

We recommend this distinction not be carried forward to the final standard.