



Liberté • Égalité • Fraternité

RÉPUBLIQUE FRANÇAISE



AUTORITE DES NORMES COMPTABLES

3, Boulevard Diderot

75572 PARIS CEDEX 12

Phone 33 1 53 44 52 01

Fax 33 1 53 44 52 33

Internet <http://www.anc.gouv.fr/>

Mel jerome.haas@anc.gouv.fr

Chairman

JH

n°61

Paris 30th September 2010

FASB

401 Merritt 7

PO BOX 5116

NORWALK CT 06856-5116

Re : Exposure Draft "Accounting for financial instruments and revisions to the accounting for derivative instruments and hedging activities"

Dear Sir or Madam,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned Exposure Draft.

As part of a joint FASB/IASB project, the FASB issued in May 2010 proposed changes to financial instruments accounting, which address all the following main aspects : (1) classification and measurements, (2) credit risk impairment and (3) hedge accounting.

1- Classification and measurements

The ANC is strongly opposed to the FASB classification and measurement model for financial instruments, which is mainly based on a full fair value approach.

1) Conceptually, the FASB's ED does not bring new proposals. As stated by the FASB in its basis for conclusions, fair value measurement has been a very controversial subject (BC57) and the Board recognizes that there are strongly held views on both sides of the fair value versus amortized cost debate (BC58). However, the FASB deliberately chose to extend the use of fair value on the face of the statement of financial position. Moreover, this proposal, coupled with the project to require a unique statement of comprehensive income (including both net income and OCI), will lead to measuring financial performance as the net change in full fair value of all financial instruments.

The FASB explains its choice as a response to investors' needs, presumed to focus only on short term market views. However, many investors, which are not taken into account by the FASB, consider the long term horizon for their investments (e.g. insurance companies).

2) The FASB does not draw the lessons from the crisis and does not address all major requirements of the G20:

The G20 at the London meeting on 2nd April 2009 required that the valuation of financial instruments should be based on their liquidity and investors' holding horizons, taking into account valuation uncertainty.

On the contrary, under the FASB proposal :

- the category at fair value in net income will notably include the most complex – and therefore often the less tradable and liquid – instruments, that are precisely those which could not be fair valued properly, neither at the height of the crisis, nor even before, as they were not really traded and no reliable market information was available;
- the classification is not mainly based on economic features, although the need to reflect the different business models of the financial industry and their specific contribution to the financing of the economy, is seen as a key lesson to learn from the crisis :
 - all equity instruments will be measured at fair value in net income, even for equity instruments held with a long term view, which would discourage such investments ; this is worse than the IASB model although the option provided of accounting for the changes in fair value in OCI is not acceptable either as sale of equity cannot be recycled to net income ;
 - Most hybrid instruments will be measured in their entirety at fair value in net income even when they are held in order to collect or pay contractual cash flows. Maintaining the current bifurcation requirements for embedded derivatives would better reflect the nature and cash flows of each component of hybrid instruments. Moreover, it would avoid the increase of the recognition of own credit risk changes in net income (for financial liabilities), which is counter-intuitive and does not result in decision-useful information

3) Information needs must be prioritised

The FASB proposal to present on the face of financial statements both amortised cost and fair value will provide confusing information. While providing information on fair value may be helpful for some users, it is not relevant to provide it on the face of financial statements when it is not consistent with an entity's business model. Information needs must be prioritized in order to provide the most useful information on the face of the financial statements and to provide other helpful information in disclosures.

4) Developing an improved mixed-measurement model

The ANC is in favour of a mixed-measurement model which should be driven by the following main principles :

- Be consistent with the business model and holding time horizon of the entity (leading to different categories of financial instruments : trading, collection of cash-flows, medium term investment,...)
- Take into account the uncertainty related to illiquid instruments in the definition of the fair value through net income category in order to avoid recognizing in the net income fair value gains or losses which are not realisable in short-term.

Although based on a mixed-measurement model, IFRS 9 does not follow these principles and raises very strong concerns already expressed in our comment letter to IASB ED *financial instruments : classification and measurement* in September 2009.

2- Credit risk impairment :

The ANC disagrees with the FASB proposed approach although the 'probable' trigger has been removed. This approach does not resolve the weakness and bias of the current incurred loss model, i.e. it does not portray adequately the risk the entity bears before any credit event and therefore, as the crisis has demonstrated, overstates interest revenues for this period by unduly recognizing as revenue the credit premiums collected from customers in order to cover the materialization of that risk over the life of the loans. Moreover, the proposed approach may lead to recognizing losses in the first period of reporting (BC180) which is inconsistent with the timing recognition of the credit risk premium as revenue.

The ANC supports the decision of the IASB to promote a credit risk impairment model based on expected losses (EL) rather than incurred losses. The ANC considers that the principles underlying the Expected losses approach can improve the representation of the economic effect of credit risk on revenues generated over the life of a financial asset measured at amortised cost.

While the expected loss approach of the IASB is more appropriate than the FASB proposed model, we nevertheless have concerns regarding the application of this EL approach that is made by the IASB (see our comment letter to the IASB ED “financial instruments : amortised cost and impairment” June 2010).

3- Hedging

We support the following proposals made by the FASB :

- To remove the quantitative threshold for the assessment of hedge effectiveness;
- To require a qualitative assessment of hedge effectiveness at inception only, unless facts and circumstances suggest otherwise.

However, we do believe that in the process of revising hedge accounting principles, the FASB should go beyond addressing the issues related to hedge effectiveness assessment.

Current hedge accounting rules under US GAAP and IAS 39 would need to be replaced by robust principles in order to appropriately reflect in the financial statements the economic effect of hedging activities and to avoid the current disincentive for entities to manage their risks, which was identified a long time before the financial crisis occurred.

Hedge accounting should be based on transparent risk management and hedging policies effectively applied by entities, without imposing arbitrary effectiveness thresholds or eligibility rules. Therefore, both the FASB and the IASB would need to reconsider the definition of a hedgeable risk in a hedging relationship.

If you have any questions concerning our comments, we would be pleased to discuss them.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Haas', with a stylized flourish extending to the left.

Jérôme Haas