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LE PRÉSIDENT

Paris, September 4, 2009

Dear Madam,

EFRAG's Draft Comment Letter on the IASB's Exposure Draft "Financial Instruments: Classification and Measurement"

The Fédération Française des Sociétés d'Assurances (FFSA) welcomes the EFRAG's invitation for comments on their draft comment letter on the IASB's Exposure Draft "Financial Instruments: Classification and Measurement". The FFSA represents all types of insurance and reinsurance undertakings, accounting for 90% of the total French market.

The FFSA wishes to contribute to the on-going analysis made by the EFRAG on the ED and hopes its input will be useful in the process of finalizing the EFRAG's position.

The FFSA's overall position on the ED is close to the EFRAG's:

- as the EFRAG, the FFSA agrees with:
    - a mixed measurement model
    - a simplification of the existing requirements
- as the EFRAG, the FFSA disagrees with the:
    - treatment of derivatives,
    - prohibition of reclassifications or of recycling from OCI to profit and loss
    - omission of the reliability exemption to measure all equity securities at fair value.

Further, the FFSA has similar concerns about the criteria used to design the nature of instrument and business model tests underlying the classification of financial instruments.

As detailed below, our main diverging view with the EFRAG's position relates to the accounting treatment of financial instruments recorded at fair value through OCI:

- the OCI category should not be restricted to equity instruments but should also include all financial instruments held on a medium or long term perspective.
- revenues and expenses on these financial instruments should be reported in the income statement during the accounting period when they arise.

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The FFSA notes that the EFRAG has identified several issues related to the insurance business that are not addressed in the ED. These issues are of the outmost importance to insurance companies as they will impact the faithfulness of the representation of the underlying business model and the internal consistency of the financial statements. Notably, the following issues regarding consistency with related projects undertaken by the IASB - such as IFRS 4 Phase II are raised by the EFRAG:

- §15 and §16: "we do find it difficult to assess the proposed classification and measurement proposals in isolation from the other aspects of IAS 39 replacement project—impairment recognition and hedge accounting—as well as some of the other active IASB projects that have a significant bearing on the information that will be provided on financial instruments, such as the insurance contracts project and the project on financial statement presentation."
- §17: "We suspect that will also mean that preparers will be reluctant to make definitive decisions on some of the accounting choices these proposals allow without knowing what the "overall package" will be. For that reason we think it will be very important that the IASB allows entities to reconsider some of the accounting choices made while implementing these proposals (for example, the presentation choice for equity instruments or application of the fair value option) when implementing later phases of the replacement project and standards such as the replacement for IFRS 4 Insurance Contracts.
- §85 b: "The problem is that it is difficult to resolve this issue "in isolation from other issues". For example, we are aware that in some jurisdictions insurance companies are required to allocate all realised gains and losses on certain of their insurance funds to policyholders. Such allocations will result in changes in liabilities that will typically be recognised in profit or loss. If the related realised gains and losses are not also recognised in profit or loss at the same time, an accounting mismatch will result."
- §83 - accounting treatment of financial instruments classified at fair value through other comprehensive income: "The proposal also raises some insurance-related issues about the desirability of adopting the same accounting treatment for insurance liabilities and for the assets on which those liabilities are based."

We will support the EFRAG's request to the Board to address these items. We believe that, in their comment letter, the EFRAG should elaborate an amended model that addresses these issues.

The FFSA intends to suggest an amended model to the Board. 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:

- 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 Board, 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.

  'Basic loan features'

  We express concerns that the proposed approach would impose inappropriate limits to amortized cost classification for some debt instruments and we estimate that the implementation of a 'basic loan feature' criterion would meet significant practical challenges:

- performing the assessment for each security will require time-consuming efforts and result in important costs;
- the treatment of some instruments appears unclear or inappropriate to us, in particular for constant maturity rate debt, convertible bonds, perpetual instruments (e.g. financial institutions' Tier 1 instruments), subordinated debt, indexed securities (inflation...), fully funded CDOs...

Because of the above shortfalls in the definition provided by the Board for the nature of instruments to be recorded at amortized cost, we suggest replacing the 'basic loan feature' criterion mentioned in the ED by 'debt instruments without significant leverage'.

'Managed on a contractual yield basis'

The interpretation of the 'managed on a contractual yield basis' criterion may not always be appropriate to reflect the characteristics of the business model of an entity (EFRAG's questions §11 and §12), e.g. when an entity manages portfolios of financial instruments on a yield basis without excluding the possibility of selling assets (mixed model).

For instance, insurance companies carry significant amounts of long term investments in debt securities without significant leverage to collect contractual cash flows and provide a positive return to their policyholders. Some assets in the portfolio may be disposed of to enhance the return to the policyholders. These disposals should not be erroneously interpreted as a change in the life and non-life insurance business models (holdings in a medium or long-term perspective based on an asset – liability strategy in light of the duration of life and non-life insurance liabilities or in a medium or long-term investment management strategy). The FFSA agrees with the suppression of the existing tainting rule on assets that were designated as held to maturity and carried at amortized cost.

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. This indicator is in line with the position expressed in the G20's declaration on strengthening the financial system published on 2 April 2009.

The FFSA concurs with the EFRAG in that the result of these two tests will be identical, irrespective of their order.

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

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, these instruments are held in a medium or long-term perspective based on an asset – liability strategy in light of the duration of life and non-life insurance liabilities or in a medium or long-term investment management strategy. Realized gains and losses, other financial income 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 (EFRAG's question §87 & §88). This will ensure internal consistency of the financial statements.

Impairments should take into account a recovery value determined in accordance with the holding horizon. This holding horizon reflects the investment timeframe inherent in the insurance business model. Reversal of impairments should be recorded through profit and loss for all financial assets.

The FFSA is deeply concerned that the respective accounting treatments for financial instruments at fair value through OCI proposed by the Board and by the EFRAG would generate an accounting mismatch. The accounting treatment proposed by the EFRAG does not take into consideration the relationship, described in §85 b, between revenues from financial instruments and allocations to policyholders which is inherent in the business model of some insurance companies.

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

  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 is to be addressed within the project IFRS 4 phase II included in the IASB's work plan. Currently, unit-linked assets are recorded at fair value through profit and loss to match the corresponding changes in liabilities. The FFSA will encourage the Board to establish a comprehensive treatment for assets and liabilities resulting from this business.

- <u>Reclassification and fair value option</u>

  As the classification is based on the business model, the FFSA considers that reclassifications should be required not only when the business model changes, which should rarely occur as mentioned by the EFRAG, but also when financial instruments are transferred between portfolios managed according to different business models (EFRAG's questions §55 to §58). For insurance companies, reclassifications would be applicable for transfer 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 IAS 39 or with other standards requiring or permitting the recognition of changes in value through profit and loss or other comprehensive income.

A summarized decision tree for the classification approach suggested by the FFSA is presented in the Appendix 1.

Transition guidance should include the possibility for issuers to reclassify their financial instruments when other related projects are applied for the first time and, for insurance entities, to extend the transition period up to the effective date for the new IFRS 4.

We hope you find these comments useful and would be pleased to provide any further information you might require.

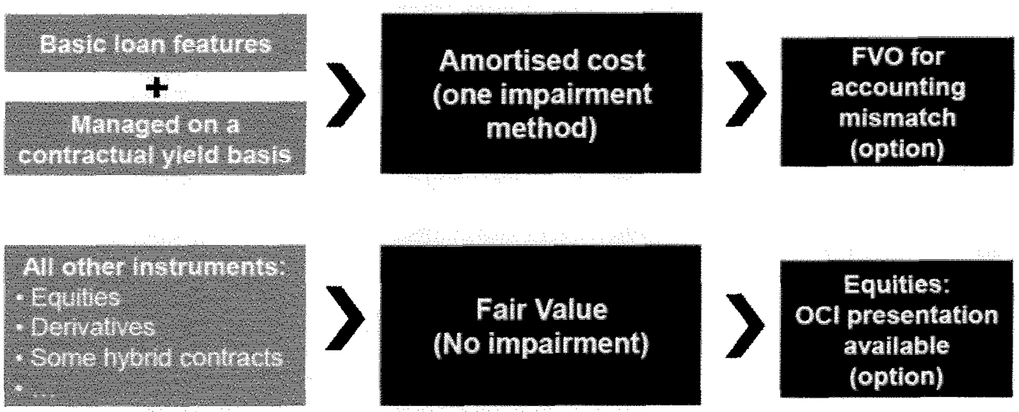
Please contact Bertrand Labilloy at + 33 1 42 47 93 58 if you wish to discuss any of the issues raised.

Yours sincerely,

Bernard Spitz

Appendix 1

- Classification model suggested by the Board



- Alternative classification model suggested by the FFSA