

# FÉDÉRATION FRANÇAISE DES SOCIÉTÉS D'ASSURANCES

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## **Exposure Draft ED/2013/3 Financial Instruments: Expected Credit Losses**

Dear Mr Hoogervorst

The Fédération Française des Sociétés d'Assurances (FFSA) welcomes the opportunity to comment on the exposure draft "Financial Instruments: Expected Credit Losses" (the 'ED'). Our members represent most of the French insurance and reinsurance undertakings, constituting over 90% of the insurance market in France.

**The FFSA supports the objective of a single expected credit loss model for all debt instruments measured at amortised cost and at fair value through other comprehensive income (FVOCI) and welcomes the efforts made by the IASB in developing this model**

The FFSA agrees with the objective of the IASB to reflect the economic link between estimates of credit losses and pricing for both purchased and originated assets. In this respect, the FFSA welcomes the efforts made by the IASB to strike an acceptable balance between the representation of the underlying economics and the operational challenges of the model proposed in the exposure draft "Financial Instruments: Amortised Cost and Impairment" (the '2009 ED').

**However, the FFSA has significant concerns about various aspects of the IASB expected loss model and believes that further improvements are needed before the finalisation of the project**

- **The FFSA questions the usefulness of the information provided to users by the overstatement of expected credit losses resulting from the recognition of an amount equal to 12-month expected losses in stage 1, especially on high quality financial assets**

The FFSA understands the practical challenges that lead to the IASB's proposal to recognise the 12-month expected loss in stage 1 as a proxy for recognising a portion of the lifetime expected losses. However, the FFSA is concerned with the usefulness of the resulting information for users. It will result in an overstatement of expected credit losses for financial assets with no economic justification, especially on high quality financial assets.

- **The timing of recognition of lifetime expected credit losses should remain principle-based. It is fundamental to avoid setting unintended bright lines in the future standard**

The FFSA has serious concerns about the timing of recognition of lifetime expected credit losses and more precisely about the IASB's view that the notion of low credit risk is equivalent to the notion of investment grade, as illustrated in paragraph 6 or in BC76 of the ED.

While we believe that the exception in paragraph 6 of the ED to the analysis of the change in credit risk when the credit risk is low may be operationally useful, we also believe that some stakeholders may misinterpret this statement as implying that a lifetime expected credit loss would have to be automatically recognised on a financial asset subject to a deterioration of its credit risk (or even anticipation of deterioration as suggested by example 6) from investment grade to non investment grade, setting therefore an unintended bright line in the future standard.

The experience of insurers shows that an impairment model systematically based on external market signals, such as ratings, would lead to overestimated expected credit losses. As such, we believe that an appropriate expected loss model should anticipate expected credit losses but should avoid recognising excessive loss allowances in stage 2, allowances that would never result in incurred losses in practice.

Therefore, the FFSA considers that the IASB should clarify in the final standard that the assessment of the transfer between stage 1 and stage 2 should be based on all available information, making maximum use of the entity credit risk management, without any automatic condition or bright line such as a downgrade below investment grade by an external rating agency. In this respect, we consider that the reference of investment grade as an example of low credit risk in paragraph 6 of the ED should be removed. We also propose in the Appendix 2 to this letter an additional example to be included in the future standard. We believe that it could help illustrate that the assessment of the transfer from stage 1 to stage 2 to be performed is based on a multi factor approach.

- **The determination of interest income for financial assets that have objective evidence of impairment subsequent to initial recognition should be simplified**

We are in favour of simplifying the determination of the interest income for financial assets that have objective evidence of impairment subsequent to initial recognition by adopting an accounting treatment similar to that proposed by the FASB in its ASU published in December

2012. These financial assets would be put on a non-accrual status and interest income would be recognised on a cash basis.

- **The disclosure requirements should be simplified and reassessed in the light of the disclosures already required by IFRS 7**

We recommend the IASB to reconsider comprehensively the proposed disclosures so as to eliminate duplication between the proposed requirements and those disclosures already required by IFRS 7. We also consider that the proposed disclosure requirements should be simplified. Our comments on the needed simplifications are detailed in the appendix to this letter.

- **The interactions of the expected credit loss model with the proposals in IFRS 4 Phase 2 need to be assessed**

The treatment of expected credit losses on financial assets measured at amortised cost and FV OCI has a direct linkage with the measurement of insurance liabilities under IFRS 4. As the IFRS 4 ED has only been recently published, the FFSA believes that further work is needed to ensure that these proposals do not create any unintended interactions with the proposals in IFRS 4.

**The FFSA would not support the IASB aligning towards the FASB proposals. It would not result in an appropriate expected credit loss model. Convergence should not be at the expense of quality.**

The FFSA considers that it would be inconsistent with the underlying economics to recognise lifetime expected credit losses on initial recognition. Therefore, we would not support the IASB aligning towards the FASB proposals. We would also not be in favour of using the foreseeable future notion for stage 1, consistently with the views expressed by most of the respondents to the supplementary document jointly issued by the IASB and the FASB in 2011.

**The FFSA considers that sufficient time is needed to implement IFRS 9 in its entirety due to its operational complexity**

The time needed to analyse and to implement IFRS 9, including the proposals made in this ED, is expected to be significant. Substantial changes have to be made to internal processes and systems, especially to track the significant deterioration of credit risk since initial recognition, at a level consistent with our activities. Consequently, we believe that sufficient time is needed to properly implement IFRS 9 in its entirety once the final standard is available.

**More generally, the FFSA considers that the mandatory effective date of IFRS 9 must be aligned with IFRS 4 Phase 2 for insurers**

As we have highlighted in our recent comment letters, IFRS 9 and IFRS 4 projects are of crucial importance for insurers as they are complementary to reflect the business models of insurers in their financial statements. Therefore, it is vital that they are finalised on a consistent basis. As such, we do not believe that the revised IFRS 9 can be finalised before the insurance standard is also finalised.

The FFSA also considers that insurers should not be required (but be permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise, the usefulness of the financial reporting for users in the period between IFRS 9 and IFRS 4 adoption would be put into question, as users will experience two major changes in an insurer's financial statements in a short period of time.

The appendix to this letter sets out our views on the detailed questions posed in the ED.

Please feel free to contact Bertrand Labilloy at +33 1 42 47 93 58 to discuss any matters raised in this letter.

Yours sincerely

A handwritten signature in blue ink, consisting of a stylized 'J' and 'L' followed by a horizontal line and a small flourish.

Jean-François Lequoy

## Appendix 1

### Question 1

*(a) Do you agree that an approach that recognises a loss allowance (or provision) at an amount equal to a portion of expected credit losses initially, and lifetime expected credit losses only after significant deterioration in credit quality, will reflect:*

- i. the economic link between the pricing of financial instruments and the credit quality at initial recognition; and*
- ii. the effects of changes in the credit quality subsequent to initial recognition?*

*If not, why not and how do you believe the proposed model should be revised?*

*(b) Do you agree that recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses, discounted using the original effective interest rate, does not faithfully represent the underlying economics of financial instruments? If not, why not?*

(a) We support the objective of single expected credit loss model for all financial instruments measured at amortised cost and at fair value through OCI.

We consider that the objective of the IASB to reflect the economic link between estimates of credit losses and pricing for both purchased and originated financial assets is appropriate. We agree with the observation made by the IASB (refer to BC19) that when an entity prices a financial instrument, part of the yield compensates the entity for the initial expected credit losses. As such, no economic loss is suffered at initial recognition as those expected credit losses are implicit in the initial pricing of the instrument. However, subsequent changes in the expected credit losses are economic losses (or gains) of the entity in the period in which they occur.

Therefore, we agree that an “ideal” model would have a loss allowance of nil at initial recognition and a loss allowance that increases as creditworthiness deteriorates (refer to IASB Snapshot page 8). The model developed by the IASB in the exposure draft ED/2009/12 (the “2009 ED”) was trying to achieve this objective. However, the operational challenges and costs of these proposals, that many respondents outlined, would have far outweighed its benefits.

The FFSA welcomes the efforts made by the IASB to strike an acceptable balance in this ED between the representation of the underlying economics and the operational challenges compared to the 2009 model.

In this respect, the FFSA understands the practical expedient that leads to the IASB’s proposal to recognise a 12-month expected loss in stage 1 as a proxy for recognising a portion of the lifetime expected losses.

However, we note that the recognition of 12-month expected loss results in an overstatement of expected credit losses for financial assets with no economic justification, especially on high quality financial assets. In this respect, we question the usefulness of the resulting information that will be provided to users.

In addition, it results in the initial carrying amount of financial assets (at amortised cost) to be set below their fair value or transaction price at this date with no conceptual justification for that.

- (b) We agree with the IASB's view that recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses does not faithfully represent the underlying economics of financial instruments.

Recognising the full lifetime expected credit losses at initial recognition ignores the existence of the compensation for these expected losses that is received by the entity (through the future interest revenue) over the life of the instrument. Therefore, such a model will not appropriately reflect the economic link between the pricing of financial instrument and the credit quality at initial recognition. It will result in an overstatement of expected credit losses at initial recognition (but not only), leading to a "non economical day one loss" that will provide inappropriate information to users.

Therefore, we would not support the IASB aligning towards the FASB proposals on recognising lifetime expected credit losses on initial recognition. In addition, we would also not be in favour of using the foreseeable future notion for stage 1, consistently with the views expressed by most of the respondents to the supplementary document issued jointly by the IASB and the FASB in 2011.

## Question 2

*(a) Do you agree that recognising a loss allowance (or provision) at an amount equal to 12-month expected credit losses and at an amount equal to lifetime expected credit losses after significant deterioration in credit quality achieves an appropriate balance between the faithful representation of the underlying economics and the costs of implementation? If not, why not? What alternative would you prefer and why?*

*(b) Do you agree that the approach for accounting for expected credit losses proposed in this Exposure Draft achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than the approaches in the 2009 ED and the SD (without the foreseeable future floor)?*

*(c) Do you think that recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition, discounted using the original effective interest rate, achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than this Exposure Draft?*

- (a) As stated in our response to question 1(a), we consider that the model proposed in the ED is an acceptable balance between the faithful representation of the underlying economics and the costs of implementation.
- (b) As stated in our response to question 1(a), we believe that the dual measurement model proposed in this ED is an acceptable balance between the appropriate representation of the underlying economics and the operational complexity and costs resulting from the model proposed in the 2009 ED. However, we have concerns relating to the usefulness of the information provided by the 12-month expected loss in stage 1 (refer to our response to question 1 (a)) and the timing of the transfer of financial assets from stage 1 to stage 2 (refer to our response to question 5).
- (c) As stated in our response to question 1(b), we consider that recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition would not achieve an appropriate result as it will not represent faithfully the underlying economics. As such, we do not support the expected credit loss model proposed by the FASB in its proposed ASU published in December 2012.

### Question 3

*(a) Do you agree with the proposed scope of this Exposure Draft? If not, why not?*

*(b) Do you agree that, for financial assets that are mandatorily measured at FVOCI in accordance with the Classification and Measurement ED, the accounting for expected credit losses should be as proposed in this Exposure Draft? Why or why not?*

(a) We agree with the proposed scope of this ED, except for short-term trade receivables (refer to our response to question 10).

(b) We support the introduction of a single impairment model for all financial assets measured at amortised cost and at FVOCI.

Concerning our view that the FVOCI category should not be limited to “simple” debt instruments, please refer to our comment letter to the ED/2012/4 “Classification and Measurement: Limited Amendments to IFRS 9”.

### Question 4

*Is measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses operational? If not, why not and how do you believe the portion recognised from initial recognition should be determined?*

As stated in our response to question 1 (a), we note that the recognition of 12-month expected credit loss results in an overstatement of expected credit losses for financial assets with no economic justification, especially on high quality financial assets. In this respect, we question the usefulness of the resulting information that will be provided to users.

We believe that the proposal to measure the loss allowance at an amount equal to 12-month expected credit losses can be made operational. However, French insurers, unlike some other sectors, do not have any requirement to measure 12-month expected losses for regulatory purposes. Therefore, the cost of implementing this proposal will not be minimised by building on existing systems and an appropriate lead time is necessary to put into place the necessary processes.

### Question 5

*(a) Do you agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk since initial recognition? If not, why not and what alternative would you prefer?*

*(b) Do the proposals provide sufficient guidance on when to recognise lifetime expected credit losses? If not, what additional guidance would you suggest?*

*(c) Do you agree that the assessment of when to recognise lifetime expected credit losses should consider only changes in the probability of a default occurring, rather than changes in expected credit losses (or credit loss given default ('LGD'))? If not, why not and what would you prefer?*

*(d) Do you agree with the proposed operational simplifications, and do they contribute to an appropriate balance between faithful representation and the cost of implementation?*

*(e) Do you agree with the proposal that the model shall allow the re-establishment of a loss allowance (or a provision) at an amount equal to 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met? If not, why not, and what would you prefer?*

- (a) We agree with the proposed requirement that lifetime expected credit losses should be recognised on the basis of a significant increase in credit risk since initial recognition.
- (b) We consider that the proposals regarding the timing of recognition of lifetime expected credit losses should be kept principle - based so as to avoid any unintended bright lines.

We understand that the proposed exception to not recognise lifetime expected credit losses for financial instruments with low credit risk was made with the objective to reduce the operational costs for entities that apply the model and to make the model more cost-effective (refer to BC76).

However, the FFSA has a serious concern about the IASB's view that the notion of low credit risk is equivalent to the notion of investment grade, as illustrated in paragraph 6 and in BC76 of the ED. We believe that some stakeholders may misinterpret these statements as implying that a lifetime expected credit loss would have to be automatically recognised on a financial asset subject to a deterioration of its credit risk (or even anticipation of deterioration as suggested by example 6) from investment grade to non investment grade, setting therefore an unintended bright line in the future standard.

As such, we consider that:

- The reference to investment grade as an example of low credit risk in paragraph 6 of the ED should be removed. We believe that the notion of investment grade is only one possible indicator among others in the consideration of low credit risk. Including the reference to investment grade in the standard itself would lead to a bright line requirement, which we understand was not the intention of the IASB;
- An additional example should be included in the future standard to emphasize that the transfer to stage 2 should be based on a multi factor analysis without considering that a switch from investment grade to non investment grade is a trigger in itself. In this respect, please refer to the example that we provide in Appendix 2 to this letter.

In addition, we are concerned by the set of factors used in example 6 that leads to the conclusion that the bond does not have low credit risk at the reporting date, for the following reasons:

- There is no detailed analysis of the reasons why the company experienced this decline in revenues and operating profit. In such a case, before making a judgment, we believe that the management of Company B should better understand the reasons for such a situation. In this respect, refer to our example in Appendix 2, which includes more detailed information about the context that the management of Company B should also have considered: macro context, company's strategy, sources of profits, diversification....
- Concerning "probably" in the sentence "comparison with the bond prices of peers show that the reductions are **probably** (emphasis added) company specific": we question why "probably" is sufficient to conclude;
- There is no mention about the reasons why agencies have reacted that way: what's their analysis? The impact of being under review for possible downgrade by the credit agency and the conclusion that Company A has faced a significant increase of credit risk is not clearly assessed. Generally, the assessment of a significant credit deterioration by a credit rating agency is materialised by successive and rapid downgrades or by a several notches downgrade, not by a simple "rating under review"



The IASB should also clarify in the final standard that:

- the assessment of the transfer between stage 1 and stage 2 should be based on all available information, making maximum use of the entity credit risk management, without any automatic condition or bright line such as a downgrade below investment grade by an external rating agency or by an implied probability of default based upon the market price of bonds or CDS;
- entities should not give more weight to external or quoted inputs for the assessment and measurement of expected credit losses. It is of the highest importance to make clear that it was not the IASB's intention to introduce a hierarchy in the information to be used to determine when the recognition of lifetime credit losses is required (and especially not a hierarchy in the information similar to that of IFRS 13, giving more weight to observable inputs on the market).

More generally, the experience of insurers shows that an impairment model systematically based on external market signals, such as ratings, would lead to overestimated expected credit losses. As such, we believe that an appropriate expected loss model should anticipate expected credit losses but should avoid recognising excessive loss allowances in stage 2, allowances that would never result in incurred losses in practice.

- (c) We agree that the assessment of when to recognise lifetime expected credit losses should be based on the probability of a default occurring, rather than the whole expected credit losses (or credit loss given default 'LGD').
- (d) As stated in our response to question 5 (b), we consider that the introduction of operational simplifications by the IASB should not be misinterpreted as setting bright lines. Therefore, we recommend clarifying that operational simplifications should only be used if they are consistent with the credit risk management of the entity and not be automatically considered as bright lines.
- (e) The FFSA agrees with the proposal that the proposed model shall allow the re-establishment of a loss allowance at an amount equal to 12-month expected credit losses (stage 1) if the criteria for the recognition of lifetime expected credit losses (stage 2 or 3) are no longer met.

#### **Question 6**

*(a) Do you agree that there are circumstances when interest revenue calculated on a net carrying amount (amortised cost) rather than on a gross carrying amount can provide more useful information? If not, why not, and what would you prefer?*

*(b) Do you agree with the proposal to change how interest revenue is calculated for assets that have objective evidence of impairment subsequent to initial recognition? Why or why not? If not, for what population of assets should the interest revenue calculation change?*

*(c) Do you agree with the proposal that the interest revenue approach shall be symmetrical (ie that the calculation can revert back to a calculation on the gross carrying amount)? Why or why not? If not, what approach would you prefer?*

We understand the conceptual basis for requiring interest income to be calculated on a net carrying amount for assets that have objective evidence of impairment subsequent to initial recognition. We also note that this treatment would be in line with existing requirements in IAS 39.

However, we are in favour of simplifying this requirement by adopting a treatment similar to what the FASB is proposing in its ASU published in December 2012. These financial assets would be put on a non-accrual status and interest income would be recognised on a cash basis.

### Question 7

*(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?*

*(b) Do you foresee any specific operational challenges when implementing the proposed disclosure requirements? If so, please explain.*

*(c) What other disclosures do you believe would provide useful information (whether in addition to, or instead of, the proposed disclosures) and why?*

We support the principle of disclosures that will help users to appropriately understand what type of information entities have used to estimate expected credit losses and the use of the entity's judgment that is inherent to the proposed model.

However, we note that the ED proposes to introduce a large volume of detailed disclosures. Many of these disclosures are either already required or seem to be similar to information already required by IFRS 7. Therefore, we recommend the IASB to comprehensively reconsider the proposed disclosures so as to eliminate duplication between the proposed requirements and those disclosures already required by IFRS 7. We also recommend the IASB to incorporate any new expected credit loss disclosures through an amendment of IFRS 7 and not through IFRS 9.

Last but not least, we have identified a number of examples where we believe the requirements could be simplified:

- Par. 35 requires a roll-forward of the gross carrying amounts by class of assets, which would include not only relevant information related movements in credit allowances but would also include purchases, sales etc. The key allowance information related to adjustments and changes will now be included in what could become an information overloaded heavy table as illustrated in IE 72. We suggest that the IASB maintains a simplified roll-forward of the credit related allowance movements only;
- Par. 39 and 42: the explaining of the estimation process for the credit loss amounts and changes in credit risk should remain a principles based descriptive disclosure of the judgmental process. It should not be an explanation of the mechanics or formulas used. Additionally, the requirement of 39 (d) (ii) of the discount rate (percentage) used would be meaningless when the effective interest rate is used for individual bonds on an instrument by instrument basis;
- Par. 40a: the requirement to provide *any* changes in the quality of collateral as a result of deterioration” is excessive. Collateral may be one of many aspects of credit quality of a financial instrument and we believe that it would be more helpful to focus on the key aspects of the credit quality of a particular financial instrument, or a portfolio of financial instruments, rather than applying prescriptive requirements specifically for collateral irrespective of its significance. The EDTF report contains a helpful recommendation in this area (recommendation No 30): “Provide qualitative information on credit risk mitigation, including collateral held for all sources of credit risk and quantitative information where meaningful. Collateral disclosures should be sufficiently detailed to allow an assessment of the quality of collateral.”

- Par. 41 specifically singles out the disclosure of positive or negative effects caused by a portfolio or geographical area. The loss allowance determination should consider many factors and this singled out disclosure is not necessary. If this factor is important then it would be mentioned in the descriptive disclosure;
- Par. 44: we disagree to disclose in all cases, the required disclosure of credit rating grades is illustrated in IE 73. We consider that the requirement of par 44 (illustrated by IE 73) should be based on the internal risk rating grades used by the entity for determining the loss allowance. Similarly, providing the gross carrying amount by associated loss allowance as required by IE73 by external rating grades would not be useful when external rating grades are not used in isolation but are only one of the indicators used by the entity in its process.

### **Question 8**

*Do you agree with the proposed treatment of financial assets on which contractual cash flows are modified, and do you believe that it provides useful information? If not, why not and what alternative would you prefer?*

We agree with the proposed treatment of financial assets on which contractual cash flows are modified.

However, we are still questioning the relevance of the assessment of the increase in credit risk based on the original, unmodified contractual terms, instead of assessing this increase by reference to the credit quality at the date of the modification.

### **Question 9**

*(a) Do you agree with the proposals on the application of the general model to loan commitment and financial guarantee contracts? Why or why not? If not, what approach would you prefer?*

*(b) Do you foresee any significant operational challenges that may arise from the proposal to present expected credit losses on financial guarantee contracts or loan commitments as a provision in the statement of financial position? If yes, please explain.*

We agree with the proposals on the application of the general model to loan commitments and financial guarantee contracts that are in the scope of the proposals.

### **Question 10**

*(a) Do you agree with the proposed simplified approach for trade receivables and lease receivables? Why or why not? If not, what changes do you recommend and why?*

*(b) Do you agree with the proposed amendments to the measurement on initial recognition of trade receivables with no significant financing component? If not, why not and what would you propose instead?*

(a) We consider that the cost of implementing an expected loss model for short-term receivables, even under a simplified model, does not outweigh the benefits of the resulting information due to the short term maturity of these assets. Therefore, we consider that an incurred loss model should be retained for short-term receivables.

(b) We agree with the proposed amendments to the measurement on initial recognition of trade receivables with no significant financing component at their transaction price.

### ***Question 11***

*Do you agree with the proposals for financial assets that are credit-impaired on initial recognition? Why or why not? If not, what approach would you prefer?*

We agree with the proposals for financial assets that are credit impaired on initial recognition that are consistent with existing IAS 39 requirements (i.e.AG5).

### ***Question 12***

*(a) What lead time would you require to implement the proposed requirements? Please explain the assumptions that you have used in making this assessment. As a consequence, what do you believe is an appropriate mandatory effective date for IFRS 9? Please explain.*

*(b) Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?*

*(c) Do you agree with the proposed relief from restating comparative information on transition? If not, why?*

- (a) As we have highlighted in our recent comment letters, IFRS 9 and IFRS 4 projects are of crucial importance for insurers as they are complementary to reflect the business models of insurers in their financial statements. Therefore, it is vital that they are finalised on a consistent basis. As such, we do not believe that the revised IFRS 9 can be finalised before the insurance standard is also finalised.

In addition, the FFSA considers that insurers should not be required (but be permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise, the usefulness of the financial reporting for users in the period between IFRS 9 and IFRS 4 adoption would be put into question, as users will experience two major changes in an insurer's financial statements in a short period of time.

The impact of analysing and implementing IFRS 9, including the proposals of this ED, is expected to be significant and substantial changes to internal processes and systems will be required. For example, the proposals will lead to significant implementation time and costs for bonds which constitute the majority of insurers' financial assets. Appropriate systems to track the deterioration of credit risk at a very low level will have to be put into place, as some similar bonds issued by the same counterparty may have to be classified in stage 1 or 2 depending on the date of initial recognition and the deterioration of credit risk since this date.

Consequently, the FFSA believes that sufficient time is needed to properly implement IFRS 9 in its entirety once the final standard is available.

- (b) We welcome the IASB's intention to introduce an exception to the retrospective application of the final standard. However, consistently with our comments on the transfer of financial assets between stage 1 and stage 2 (refer to our response to question 5 (b)) we believe that the requirement that "provision shall be determined only on the basis of whether the credit risk is low at each reporting date" should specify "based on all the information available, including the use of management judgment".
- (c) We agree with the proposed relief from restating comparative information as it will contribute to reduce the operational costs of implementation of the new model. However, we would like to stress that the overall cost of this implementation will remain very significant, especially for insurers considering the size of their portfolio of financial assets and the changes to be made to their existing systems and procedures.

***Question 13***

*Do you agree with the IASB's assessment of the effects of the proposals? Why or why not?*

At this stage, our members are in the process of achieving their detailed impact analyses of the IASB's proposals. Therefore, we are not in a position to confirm the completeness of the IASB's assessment of the effects of these proposals.

Our comments on the preliminary assessments of these proposals are set out in our responses to the above questions.

In this respect, we have also noted that the treatment of expected credit losses on financial assets measured at amortised cost and FV OCI may have a direct linkage with the measurement of insurance liabilities under IFRS 4. As the IFRS 4 ED has only just been published, we believe that further work may be needed to ensure that these proposals do not create any unintended interactions with the proposals in IFRS 4.

## Appendix 2 – Illustrative example proposed for inclusion in the ED

As stated in our response to Q5, concerning the reference to an investment grade notion, we consider that it is important to include an example in the final standard to illustrate the fact that a non investment grade instrument should not automatically be transferred into the stage 2.

*Considering the same set of assumptions as presented in Example 6 IE29 – IE 31:*

IE32.a - Subsequent to initial recognition, Company B evaluates whether the bond has a low credit risk at the reporting date, using all reasonably available and supportable information. Factors considered:

- The latest quarterly report of Company A revealed a quarter on quarter decline in revenues of 20% and in operating profit by 12%.
- Rating agencies have reacted negatively to a profit warning by the Company and have decreased the credit rating from investment grade to non-investment grade.
- The bond price has declined.
- However,
  - It is noted that prior period amounts included accelerated sales in a key region that was introducing new tax regulations, such that customers moved purchases forward from their typical purchasing behavior. Ongoing revenues are expected to return to a more predictable level for this important region.
  - Rating agencies have also announced “review” status for many of the competitors in one of the business lines of the Company as the agencies are cautious about the industry as a whole. However, Company A is well diversified and has announced a strategy change to focus on other lines of business.
  - The decline in bond prices is across the board and appears to be more macro-economically based with market participants impacting the pricing levels in general rather than a reflection of company specifics.

IE 33a. As a result of the factors described above, Company B assesses that the bond has not experienced a significant decrease in credit quality. Company B continues to recognize a loss allowance at an amount equal to 12 month expected credit losses.