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Paris, March, 30, 2010

LE PRÉSIDENT

Dear Sir,

EFRAG's Draft Comment Letter on the IASB's Exposure Draft "Measurement of Liabilities in IAS 37"

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 "Measurement of Liabilities in IAS 37". 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 generally agrees with the Board's overall requirements set in the ED related to the measurement of liabilities based on a best estimate corresponding to the probability weighted cash flows reflecting future possible scenarios plus a risk adjustment reflecting the variability in those future possible scenarios that is not reflected in the best estimate.

<u>Support to a measurement based on probability weighted cash flows</u>

We agree with the overall requirements, especially as detailed in §BC2 to BC11, which are generally in line with the economic approach the insurance industry usually practices with regards to measuring risks (refer to our answer to the ED's question #1 in the appendix).

The FFSA agrees with the Board's requirement of a measurement based on probability weighted cash flows, which is consistent with the Board's tentative decisions on the measurement of liabilities arising from insurance contracts within the IFRS 4 Phase II project.

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Support to a risk adjustment

Contrary to the EFRAG, the FFSA strongly supports the Board's proposed measurement requirements relating to the risk adjustment (refer to our answer to the ED's question #1 in the appendix).

Conceptually, the measurement of liabilities in IAS 37 should indeed reflect the variability in future possible scenarios that is not reflected in the best estimate. The best estimate, or expected value of future outflows, indeed only reflects the weighted average of possible scenarios but provides no information as to how wide the range of scenarios is. We acknowledge that two sets of future outflows with the same best estimate but that have sharp differences in the variability of underlying scenarios, in terms of their amount and their timing, should not give rise to the same amount recognised in the financial statements. Simply put, an obligation with a best estimate of 10 CU ± 1 CU should not be measured at the same amount as an obligation with a best estimate of 10 CU ± 10 CU. Similarly, an obligation with a best estimate of 10 CU and a timing of possible outflows ranging from 4 to 6 years should not be measured equally with an obligation whose best estimate is 10 CU and whose timing of possible outflows is ranging from 1 to 9 years from the reporting date.

This approach is consistent with the Board's tentative decisions on the measurement of liabilities arising from insurance contracts within the IFRS 4 Phase II project. The FFSA notes that in their comment letter dated 22 February 2008 on the discussion paper related to insurance contracts, the EFRAG also requested the inclusion of such a risk adjustment in the measurement of insurance liabilities. The EFRAG agreed that "insurance liabilities should be measured at an amount that comprises the discounted value of an unbiased estimate of the future cash flows plus some sort of margin" and that "the liability measure should include a pure risk margin…".

Nevertheless, the FFSA reckons that the practical assessment of the variability of possible outcomes is easier and more reliable for a portfolio of homogenous liabilities, such as insurance liabilities, than for single events measured under IAS 37.

Concerns on the relevance of the service margin

As the EFRAG, the FFSA considers that the service margin required in the ED for obligations that will be fulfilled by rendering a service at a future date is not relevant (refer to our answer to the ED's question #2 in the appendix).

Apart from the reasons developed in the EFRAG's draft comment letter, the FFSA believes that the Board's assumption that active markets exist for most types of services is unrealistic. Further, entity specific cost allocations are already used under other IFRS. When taking rational business decisions about which activities to outsource, entity specific cost allocations need also be relied upon in comparison to market prices.

Agreement on the scope exclusion of onerous insurance contracts

As the EFRAG, the FFSA agrees with the Board's decision to scope out of this project the onerous contracts arising from transaction within the scope of IFRS 4 to include these contracts in the current overall insurance contract project (refer to our answer to the ED's question #3 in the appendix).

Detailed comments to the questions asked by the Board in their exposure draft are provided in the Appendix to this letter.

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

Detailed Answers to Questions Asked in the Board's Exposure Draft

Question 1 – Overall requirements

The proposed measurement requirements are set out in paragraphs 36A–36F. Paragraphs BC2–BC11 of the Basis for Conclusions explain the Board's reasons for these proposals.

Do you support the requirements proposed in paragraphs 36A–36F? If not, with which paragraphs do you disagree, and why?

We agree with the overall requirements, especially as detailed in §BC2 to BC11, which are generally in line with the economic approach the insurance industry usually practices with regards to measuring risks.

Furthermore, as (re)insurers, we would like to emphasise the issue of the risk margin, or adjustment for risk. We consider that the standard and the exposure draft may explicit further what is the purpose of the risk margin as well as how to calculate it, in particular in the case of single events, which we acknowledge is challenging.

Our understanding, as (re)insurers, is that the risk margin should reflect the variability in future possible scenarios that is not reflected in the best estimate / expected value of future outflows. The best estimate, or expected value of future outflows, indeed only reflects the weighted average of possible scenarios but provides no information as to how wide the range of scenarios is.

We acknowledge that two sets of future outflows with the same best estimate but that have sharp differences in the variability of underlying scenarios, in terms of their amount and their timing, should not give rise to the same amount recognised in financial statements. Simply put, an obligation with a best estimate of 10 CU ± 1 CU should not be measured at the same amount as an obligation with a best estimate of 10 CU ± 10 CU. Similarly, an obligation with a best estimate of 10 CU and a timing of possible outflows ranging from 4 to 6 years should not be measured equally with an obligation whose best estimate is 10 CU and whose timing of possible outflows is ranging from 1 to 9 years from the reporting date.

Similarly, we acknowledge that a single event would probably give rise to a higher variability in its outcomes than a pool of homogeneous risks whose range of possible outcomes would converge to the best estimate (i.e. be more predictable) thanks to the law of large numbers. As a result, a single event would probably require a higher risk margin than a pool of homogeneous risks.

We however recognise that the lack of meaningful sets of statistics regarding a single event as well as the limited set of scenarios used to determine the best estimate might hamper an entity's ability to assess the related risk margin. While methods such as the cost-of-capital method or quantiles would be relevant to large pools of risks, no such method would be applicable to single events.

Question 2 – Obligations fulfilled by undertaking a service

Some obligations within the scope of IAS 37 will be fulfilled by undertaking a service at a future date. Paragraph B8 of Appendix B specifies how entities should measure the future outflows required to fulfil such obligations. It proposes that the relevant outflows are the amounts that the entity would rationally pay a contractor at the future date to undertake the service on its behalf.

Paragraphs BC19–BC22 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you support the proposal in paragraph B8? If not, why not?

We do not support the proposal in paragraph B8.

We understand that it purports to measure obligations fulfilled by undertaking a service at the cost of the service plus a service margin. The Board's conclusion relies on undocumented assertions. The first one is there is a market for most types of services [BC21 (a)]. However, the Board does not provide any study to support such a claim. There is for instance no market for the decommissioning of nuclear power plants currently. There is no market for a carmaker willing to recall some of its models to repair, modify or upgrade them so as to meet security requirements.

The Board's second argument is that rules on which costs should be included in the measurement would be essentially arbitrary [BC21 (b)]. This is however the approach already taken in other IFRSs, such as IAS 2 *Inventories*, where such considerations apparently have not raised any issue with the Board to date.

The Board's third argument is that calculations based on contractor prices could be easier to prepare and verify than those based on accumulations of costs and allocations of overheads [BC21(c)]. In the same paragraph, the Board states that preparers of financial statements would have to use the same benchmark data about contractor prices that they would have obtained to help them reach rational business decisions about which activities to outsource. We do not understand how preparers of financial statements could reach rational business decisions about which activities to outsource if they were not able to reliably accumulate internal costs and allocate overheads in order to compare the resulting figure with contractor prices.

The Board's fourth argument is that the amount an entity would rationally pay to be relieved of an obligation would reflect the value –not just the cost– of the resources that it will have to sacrifice to fulfil the obligation [BC21 (d)]. This reads in contradiction with the measurement objective in § 36B setting forth that the amount an entity would rationally pay to be relieved of an obligation is the lowest of the amount of internal resources required to fulfil the obligation [option (a)] and the amounts required to cancel or transfer the obligation to a third party [options (b) and (c)]. If internal resources are to be measured including a service margin that would close the gap with the price to transfer the obligation, options (a) and (c) would read the same and § 36B would become somehow groundless.

The Board's final argument if that an entity should recognise some profit when it carries out the activities necessary to fulfil the liability, on the ground that these activities are part of the wider performance obligation of the entity, i.e. the entity could not run its business and make profit without fulfilling such obligations. Unless we read this wrongly, we understand that this conceptually implies the following:

- First, the service margin accrued upon first recognition of the obligation would actually reflect the opportunity cost that an entity incurs when it has to allocate resources to fulfil the obligation rather than to generate revenue. Such a concept is new to IFRSs and should probably be investigated further in discussions surrounding the wider Framework.

- Then, recognising the service margin as a profit into the statement of comprehensive income upon the fulfilment of the obligation would actually consist in apportioning part of the entity's revenues to the cost of fulfilling the obligation. We deem that the Board does not explain all implications of that concept, including how it articulates with other IFRSs relative to revenue recognition specifically, such as IAS 18 or IAS 11.

Question 3 – Exception for onerous sales and insurance contracts

Paragraph B9 of Appendix B proposes a limited exception for onerous contracts arising from transactions within the scope of IAS 18 Revenue or IFRS 4 Insurance Contracts. The relevant future outflows would be the costs the entity expects to incur to fulfil its contractual obligations, rather than the amounts the entity would pay a contractor to fulfil them on its behalf.

Paragraphs BC23–BC27 of the Basis for Conclusions explain the reason for this exception.

Do you support the exception? If not, what would you propose instead and why?

As (re)insurers, we answer to that question specifically with regard to IFRS 4. We believe that the exception relative to IFRS 4 is justified by the Insurance Contracts project that is ongoing in parallel to this exposure draft and that will specifically address the issue of onerous insurance contracts.