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Banking supervision
And Accounting issues Unit

The Director

Paris, March 28th 2013

Exposure Draft ED/2012/4 Classification and measurement: limited amendments to IFRS 9

Dear Sir,

The FBF welcomes the opportunity to comment on the IASB Exposure draft on Classification and measurement: limited amendments to IFRS 9.

The exposure-draft proposes clarification regarding the assessment of the contractual cash flow characteristics of financial assets.
However, we are not convinced that the proposed amendment would result in more appropriate financial assets passing the contractual cash flow characteristics assessment.

There are still some financial assets of the banking book that may not pass the SPPI test even though an amortized cost measurement would provide more useful information. The financial assets are as follows:

- Financial assets that contain interest rate mismatch features and that are subject to the "hold to collect" business model. The benchmark rate would depend on the contractual reset period of the financial assets as shown in the example B4.1.9B.

- Perpetual debt instruments with no maturity date coupons of which may be differed.

- Regulated interest rates set by local authorities and for which no benchmark instrument exists. These instruments are held under a "hold to collect" business model and a measurement other than amortised cost would not appropriately reflect the economics of these instruments.

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We would suggest that the IASB considers the following options to allow assets that are currently being measured at amortized cost and that are held with the objective to collect cash flow to continue to be measured at cost:

- The replacement of the SPPI test by the "closely related" test of IAS 39 that is broadly understood.

- A narrow scope exemption for instruments with state-regulated rates whenever these instruments are held in order to collect their cash flows and are not structured instruments with leverage.

- The reintroduction of bifurcation of financial assets as the host financial asset would be accounted for in accordance with its business model.

We welcome the creation of the third category of fair value through OCI and we support the overall approach that appropriately reflects entities' business models. We believe that the third category is appropriate for instruments held with the objective of medium or long term holding horizon in order to maximize the return of the collection of principal and interests or the appreciation of capital. Such instruments are not managed on a short-term taking profit basis but may be sold depending on opportunities or regulatory requirements.

Finally, we advocate that the Board takes the opportunity of the narrow scope amendment to IAS 39 related to novation of derivatives to allow the early application of the "own credit" provisions through IAS39 in order not to further delay the benefit of changes in own credit provisions in the presentation of financial statements.

Our answers to the exposure draft are detailed 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.

Yours sincerely,

Jean-Paul Caudal

Appendix

CONTRACTUAL CASH FLOW CHARACTERISTIC ASSESSMENT

Question 1

Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest? Do you agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?

Question 2

Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?

Question 3

Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features? Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?

We do not believe that the proposed amendment to IFRS 9 would address the main issues raised by the SPPI test. We have concerns with the way the benchmark interest rate instrument has been defined in the ED
The theoretical definition of interest retained does not reflect the components of the notion of interest other than time value of money and credit risk such as liquidity risk, funding costs, administrative cost, and profit margin.

The notion of a benchmark instrument retained in the ED seems to be limited to an interbank product based on the interbank rate. This does not correspond to the other bank products, in particular those of the Retail Banking business. It does not take into account the various indexes existing in various market segments. Therefore, the application of the contractual cash flow characteristics assessment is ineffective to allow banking products of the non-interbank market to be eligible to the amortised cost category.

We are not convinced that the proposed amendment will result in more faithful representation of the "hold to collect" business model and will result in more appropriate financial assets to pass the contractual cash flow characteristics assessment while the amortised cost measurement provides more useful information.

- The ED requires that the assessment of the modified economic relationship should be made against the appropriate benchmark instrument. However, some of the requirements are overly prescriptive and some financial assets that contain **interest rate mismatch features** and that are held to collect cash flows may not pass the SPPI test as it seems that the benchmark rate should align on the reset period.

Indeed, B4.1.9B indicates that "if a financial asset that contains a variable interest rate reset monthly to a three-month interest rate, the appropriate benchmark would be ... a variable interest that reset monthly to a monthly rate".

A question arises whether the appropriate comparable financial asset could adjust the tenor to the reset period (when the term of the loan is changed to be the same as the reset feature) rather than the reset period to the tenor.

Numerous retail loans are for instance granted on the basis of an Euribor 3 month rate refixing once a year. By choosing an annual periodicity, the objective is not to sell an exotic product to a customer, but essentially to avoid operational complexities for a product which remains vanilla.

We believe that the closer benchmark instrument in that case would be an indexed loan to Euribor 3 months resetting quarterly.

More generally, we would suggest that the SPPI test to assess whether an instrument include limited leverage or not be replaced by the"closely related" test (including the "double double condition") of IAS 39 that is broadly understood.
Financial assets containing features that result in significant leverage would be measured at fair value through P&L while amortised cost measurement would be more appropriate for instruments with non-leveraged features in accordance with their business model. Such clarification would narrow the scope of instruments that would fail the amortized cost category due to the elimination of the bifurcation and it would avoid that instruments currently estimated at the amortised cost would be valued at fair value while their business model remains a " hold to collect " model.

- The removal of **bifurcation requirements** for financial assets implies that instruments that contain insignificant embedded derivative features that modify the relationship between principal and interest would result in the financial asset being measured at fair value through P&L in its entirety while it is currently valued at amortized cost, at least for the part of the host contract.

The classification at fair value of the entire hybrid financial asset would not portray correctly the business model of the entity if the entire instrument is not managed on a fair value basis. Indeed, different components of the same contract may be managed through two different business models. The host contract is usually held on a cash flow basis whereas the embedded derivative is usually managed within trading activities on a fair value basis. As a consequence, an increased number of financial instruments would be assessed at fair value which would increase volatility of profit and loss account and would not be justified by the business model.

Therefore, bifurcation of financial assets leads to more relevant information as the host financial asset would be accounted for in accordance with its business model.

Moreover, symmetry in bifurcating financial assets and financial liabilities is important. We see no reason to maintain bifurcation only for financial liabilities and non-financial host contracts.

- There are still some financial assets of the banking book that may not pass the SPPI test even though an amortized cost measurement would provide more useful information. **Perpetual debt instruments with no maturity date coupons of which may be differed are one of those instruments.**

IFRS 9 considers that these instruments cannot be qualified for amortised cost measurement, because the issuer may be required to defer interest payment and additional interest does not accrue on those deferred interest amounts, interest amounts are not consideration for the time value of money. Deferring interest does not change its qualification as representative of time value of money. It is a solvency issue or a regulatory one and counterparty risk is part of interest.

Not measuring at amortised cost these financial assets for which the issuer could be required to suspend the payment of interests (for example to respect constraints of solvency ratios) would not reflect the business model of the entity which had acquired these instruments in a perspective of long-term investments.

- Determining a hypothetical financial asset in particular for **regulated interest rates** that are the only available interest rates for specific retail products is also an issue.

Interest rates in regulated environments are regulated assets where interest rates are set by local authorities and for which no benchmark instrument exists. These instruments are hold under a "hold to collect" business model and a measurement other than amortised cost would not appropriately reflect the economics of these instruments.

IIn France for instance, the Livret A deposits are collected from individual residents by bank networks and retroceded to a public institution ("Livret A receivables"). The interest rate on the receivables mirrors the one on the deposits and is defined by Law (including a discretion feature whereby the Government could change the rate).

Under the restrictive SPPI test, the "Livret A receivables" may fail the eligibility to the amortised cost category and end up at FVTPL. However, in that case, the deposit would still be accounted for at amortised cost according to the IAS 39 rules for bifurcation. This wouldll result in a significant accounting mismatch which would not be solved using the fair value option (mainly because of the different credit spreads at stake and the fair value "floor" on the liability side).

The Livret A is a financial retail product of the traditional banking business, which business model is a "hold to collect" model. **It is not a "structured instrument" with leverage and is clearly held to collect cash flows.**
Accordingly it should not fall outside the amortised cost category as it would not reflect the economics of the product

Moreover a benchmark instrument does not really exist for this specific financial instrument which has an interest rates structure set by law. The relevance of the comparison of such instrument with a hypothetical financial asset is questioned. Financial markets are divided along segments. Most of these segments are regulated so arbitrage is precluded. Comparing these regulated rates with an interbank benchmark would be a non-sense.

Therefore, we consider that a narrow scope exemption should be created for instruments with state-regulated rates whenever these instruments are held in order to collect their cash flows and are not structured instruments with leverage.

The scope exemption should not be limited to fully regulated jurisdictions as it seems to be noted in BC44 of the ED. The exemption should relate to specific regulated "sub-markets" coexisting with broader market based on "financial market interest rates" as long as these instruments are held to collect cash flows and do not incorporate any significant structure or leverage. In these sub-markets, the regulated loan is itself a benchmark, and is observable by all the parties as the State discloses this rate whenever it is changing.

This is the case for the "Livret A" rate, which is used to index other instruments. Indeed, some instruments refer to the "Livret A" rate to describe their remuneration. For example, we can find instruments paying "Livret A" rate + 0,50%. These instruments are within the above-mentioned "sub-market", in which the livret A rate is the benchmark.

A sub-market should in our view fulfill 3 conditions to be granted the exemption:

- The rate should not be leveraged (based on the "double / double" test which should be re-introduced)
- The rate should be itself a benchmark for other instruments referring to this rate for their own fixing
- The rate should be observable.

BUSINESS MODEL ASSESSMENT

Question 4

Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that:

(a) interest revenue, credit impairment and any gain or loss on derecognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and

(b) all other gains and losses are recognised in OCI?

Question 5

Do you believe that the Exposure Draft proposes sufficient, operational application guidance on how to distinguish between the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the guidance provided to describe those business models? If not, why? What additional guidance would you propose and why?

We welcome the creation of the third category of fair value through OCI and we support the overall approach that appropriately reflects entities' business models.

The third category is appropriate for instruments held with the objective of medium or long term holding horizon in order to maximize the return of the collection of principal and interests or the appreciation of capital. Such instruments are not managed on a short-term taking profit basis.

The third category would allow to measure these financial assets at fair value in the balance sheet consistently with their characteristics, and to present their related income on an amortised cost basis consistently with their holding purpose.

The third category would allow better taking into account regulatory requirements related to liquidity buffers. Indeed, entities are required to provide liquidity under stressed scenarios and to maintain a sufficient regulatory buffer in case of increased liquidity need. Regulators require demonstration of liquidity that could be provided through occasional sales. The fair value through OCI category would be appropriate by integrating securities portfolios intended to be adjusted to follow the evolutions of the balance-sheet masses and so by avoiding introducing some volatility in the income statement.

Besides, the IASB's decision to prohibit the fair value through OCI with recycling to profit and loss for equity instruments would question management of quoted and unquoted shares not held for trading

We see no conceptual rationale to limit the proposed fair value through OCI category to debt instruments only. Similar principles of collecting dividends and realizing gains and losses on disposal should apply to equity instruments.

For equity instruments that are not held for trading but with a medium or long term view to maximize returns of collecting dividends and realizing gains and losses on disposal when the opportunity arises, the fair value through OCI category with recycling to profit and loss upon disposal is more appropriate. Impairment losses should be taken when necessary and reversed when the impairment is no longer justified.

Question 6

Do you agree that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI? If not, why and what would you propose instead?

We agree that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI in order to eliminate or significantly reduce an accounting mismatch. This is consistent with the existing option under IFRS 9 for financial assets at amortized cost. There is no reason to treat differently financial assets at fair value through OCI when an accounting mismatch might otherwise arise.

EARLY APPLICATION

Question 7

Do you agree that an entity that chooses to early apply IFRS 9 after the completed version of IFRS 9 is issued should be required to apply the completed version of IFRS 9 (ie including all chapters)? If not, why? Do you believe that the proposed six-month period between the issuance of the completed version of IFRS 9 and when the prohibition on newly applying previous versions of IFRS 9 becomes effective is sufficient? If not, what would be an appropriate period and why?

We agree that after IFRS 9 is finalised, an entity early applying IFRS 9 should be required to apply IFRS 9 in its entirety.

We believe that the Board should revise the application date of 1st January 2015 as it is no more realistic. We believe a three year implementation period is needed from the time the standards will be issued. Fact is that the implementation of the completed revised IFRS 9 standard will require significant burden to move to and will involve significant changes in the existing IT systems and high level implementation and operational costs in order to meet these requirements.

OWN CREDIT PROVISIONS

Question 8

Do you agree that entities should be permitted to choose to early apply only the 'own credit' provisions in IFRS 9 once the completed version of IFRS 9 is issued? If not, why and what do you propose instead?

We agree that entities should be permitted to choose early application of the "own credit" provisions in IFRS 9 once the completed version of IFRS 9 is issued.
However, we advocate that the Board takes the opportunity of the narrow scope amendment to IAS 39 related to novation of derivatives to allow the early application of the "own credit" provisions through IAS39 in order not to further delay the benefit of changes in own credit provisions in the presentation of financial statements.

FIRST-TIME ADOPTION

Question 9

Do you believe there are considerations unique to first-time adopters that the IASB should consider for the transition to IFRS 9? If so, what are those considerations?

We do not have any specific comments regarding first-time adopters.