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CONSEIL NATIONAL DE LA COMPTABILITE

3, BOULEVARD DIDEROT
75572 PARIS CEDEX 12

Phone **33 1 53 44 52 01**

Fax **33 1 53 18 99 43/33 1 53 44 52 33**

Internet www.finances.gouv.fr/CNCompta

E-mail antoine.bracchi@cnc.finances.gouv.fr

CHAIRMAN

AB/MPC/MA

N° 469

PARIS, 13 JULY 2004

Mrs. Sandra Thompson

IASB

30 Cannon Street

LONDON EC4M 6XH

United Kingdom

Re : Exposure-Draft of proposed Amendments to IAS 39 *Financial Instruments : Recognition and Measurement – The Fair Value Option*

Dear Mrs. Sandra Thompson,

The Conseil National de la Comptabilité (CNC) appreciates the opportunity to comment on the Exposure-Draft of proposed Amendments to IAS 39 *Financial Instruments : Recognition and Measurement – The Fair Value Option.*

The Conseil National de la Comptabilité has already set out in a letter sent to Sir David Tweedie and dated 10 December 2003 its concerns on the version of IAS 39 which was published by the International Accounting Standard Board (IASB) in December 2003 and in particular on the fair value option. It was mentioned that "the option to designate upon initial recognition any financial instrument at fair value through profit and loss is only proposed to mitigate some anomalies that arise from different measurement attributes in the Standard. As already stated, we consider that the introduction of the option is not consistent with the main objective of the Board to eliminate options in IASB's Standards. Indeed, we consider that the option will dramatically damage the comparability of the financial statements of an entity through time and between entities, and might even lead to a possibility of managing profitability to a certain extent".

As mentioned in the Background and the Basis for Conclusions of this Exposure-Draft, prudential supervisors and others regulators were also concerned that the fair value option might be used inappropriately. That is why "the Board decided to propose that the fair value option be amended so as to limit its use while preserving the key benefits of the option". We are aware that the fair value option should be considered as a pragmatic means of overcoming the complex hedge accounting requirements and can be very helpful in specific cases. This is the reason why we support the IAS Board to accommodate the concerns raised and we welcome the attempts to limit the use of the fair value option.

Nevertheless, we find the proposed limitations not effective in reaching their stated objectives (i) to address the use of inappropriate fair values, (ii) to reduce volatility in profit and loss and (iii) to avoid the recognition of gains and losses in profit or loss arising from changes in an entity's own creditworthiness.

In this context, we would like to mention our strong reservations on the following points.

- Under the current proposals, the cases in which the fair value option can be used are so many, because of, notably, the possibility of fair valuing any financial instruments with an embedded derivative, that concerns about comparability of financial reporting through time and between entities still remain.

- The lack of conformity of the "verifiable notion" with the other Standards will lead to considerable confusion for the purposes of rules relating to the fair value measurement. A change of fair value of a financial instrument will be recognised on different ways depending on whether it is required to be accounted for at fair value through profit and loss under the basic rules of IAS 39, or it is permitted to be accounted for at fair value through profit and loss under the current proposals for the fair value option. In the first case, the change in fair value measurement of a financial instrument has to be reliable, in the second case, the fair value of a financial instrument has to be verifiable. This verifiable notion does not exist in other areas of measuring fair values in any other Standards, nor in the Framework. We are concerned that this will lead to introduce a dual rule on the application of the fair value measurement.

- The proposed limitations introduce criteria such as "contractually linked" (§ 9 (b) (ii)) and "substantially offset" (§ 9 (b) (iii)). These notions are not precisely defined in the Exposure-Draft. An inappropriate application leading to an extensive use of this option cannot be excluded.

- The consequences of applying the fair value option to liabilities and gains and losses arising from changes in an entity's own creditworthiness seem to be avoided. On this issue, the answer of the IASB is a specific disclosure requirement on the changes in fair value due to other factors that the reference interest rate. We consider that such a disclosure is not a proper solution for the problem, and that this question has to be treated in the further amendments to IAS 39.

- We don't agree with the reference relating to the powers of prudential supervisors who may ensure that banks and insurance companies do not use inappropriate estimates of fair value. This could lead some to believe that those supervisors have power to overrule the application of the IASB's standards.

Therefore, in view of our comments raised in this letter, we recommend the IASB reconsiders its approach to make IAS 39 conform to the basic and usual notions underlying the present IFRS and the Framework and to take into consideration the concerns of prudential supervisors and other regulators. We suggest this Exposure-Draft be reviewed in consultation with the working group to analyse financial instruments issues.

You will find enclosed our detailed comments on the Exposure Draft. If you have any comments, do not hesitate to contact us.

Yours sincerely,

Antoine BRACCHI

Question 1

Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

We don't agree with the proposals in the Exposure-Draft for the main reasons mentioned in the cover letter. The fair value option should not be seen as an alternative to adressing the problems inherent in the hedge accounting rules of IAS 39.

Question 2

Are you aware of any financial instruments to which entities are applying, or are intending to apply, the fair value option that would not be eligible for the option if it were revised as set out in this Exposure Draft? If so:

(a) Please give details of the instrument(s) and why it (they) would not be eligible.

(b) Is the fair value of the instrument(s) verifiable (see paragraph 48B) and if not, why not?

(c) How would applying the fair value option to the instrument(s) simplify the practical application of IAS 39?

Representatives of banks, insurance companies and enterprises who participate to the consultation organized by the CNC have not identify financial instruments that would not be eligible for the option if IAS 39 were revised as set out in the Exposure-Draft.

Regarding the "verifiable notion", we don't support the introduction of such concept. As already mentioned in the cover letter, we consider its lack of conformity with the other Standards will lead to considerable confusion for the purposes of rules relating to the fair value measurement.

Nevertheless, in order to improve and simplify the practical application of IAS 39 whilst avoiding the introduction of an option, we suggest to redefine the trading category to allow the classification of liabilities that are used to fund assets that are classified as held-for-trading.

Question 3

Do the proposals contained in this Exposure Draft appropriately limit the use of the fair value option so as to address adequately the concerns set out in paragraph BC9? If not, how would you further limit the use of the option and why?

We consider that the proposed criteria for applying the fair value option (described in paragraph 9 (b)) don't limit sufficiently the use of the fair value option.

For example, loans and receivables are excluded from the fair value option under the fourth criteria (§ 9 (b) (iv)). But if they contain an embedded derivative, or are part of natural hedge, they become eligible for the fair value option respectively under criterion (i) and criterion (iii).

As already mentioned in the cover letter, the proposed limitations introduce criteria such as "contractually linked" (§ 9 (b) (ii)) and "substantially offset" (§ 9 (b) (iii)). These notions are not precisely defined in the Exposure-Draft. An inappropriate application leading to an extensive use of this option cannot be excluded.

Furthermore, our analysis is confirmed by the fact that we have not identify financial instruments to which entities are applying or are intending to apply the fair value option that would not be eligible for the option if it were revised as set out in the Exposure-Draft.

Question 4

Paragraph 9(b)(i) proposes that the fair value option could be used for a financial asset or financial liability that contains one or more embedded derivatives, whether or not paragraph 11 of IAS 39 requires the embedded derivative to be separated. The Board proposes this category for the reasons set out in paragraphs BC6(a) and BC16-BC18 of the Basis for Conclusions on this Exposure Draft. However, the Board recognises that a substantial number of financial assets and financial liabilities contain embedded derivatives and, accordingly, a substantial number of financial assets and financial liabilities would qualify for the fair value option under this proposal.

Is the proposal in paragraph 9(b)(i) appropriate? If not, should this category be limited to a financial asset or financial liability containing one or more embedded derivatives that paragraph 11 of IAS 39 requires to be separated?

As already mentioned, it is our understanding that the objectives of the proposed amendments will not necessarily be met ; volatility is further increased as soon as any financial instrument contains an embedded derivative which is not separable by itself contrary to present IAS 39 (revised version of March 2004).

It is particularly true for debt instruments issued by companies with embedded derivatives for which an entity would recognise a gain simply because its rating deteriorates.

Accordingly, we recommend the IASB to reconsider this approach.

Question 5

Paragraph 103A proposes that an entity that adopts early the December 2003 version of IAS 39 may change the financial assets and financial liabilities designated as at fair value through profit or loss from the beginning of the first period for which it adopts the amendments in this Exposure Draft. It also proposes that in the case of a financial asset or financial liability that was previously designated as at fair value through profit or loss but is no longer so designated:

(a) ***if the financial asset or financial liability is subsequently measured at cost or amortised cost, its fair value at the beginning of the period for which it ceases to be designated as at fair value through profit or loss is deemed to be its cost or amortised cost.***

(b) ***if the financial asset is subsequently classified as available for sale, any amounts previously recognised in profit or loss shall not be reclassified into the separate component of equity in which gains and losses on available-for-sale assets are recognised.***

However, in the case of a financial asset or financial liability that was not previously designated as at fair value through profit or loss, the entity shall restate the financial asset or financial liability using the new designation in the comparative financial statements.

Finally, this paragraph proposes that the entity shall disclose:

(a) ***for financial assets and financial liabilities newly designated as at fair value through profit or loss, their fair value and the classification and carrying amount in the previous financial statements.***

(b ***for financial assets and financial liabilities no longer designated as at fair value through profit or loss, their fair value and the classification and carrying amount in the current financial statements.***

Are these proposed transitional requirements appropriate? If not, what changes do you propose and why? Specifically, should all changes to the measurement basis of a financial asset or financial liability that result from adopting the amendments proposed in this Exposure Draft be applied retrospectively by restating the comparative financial statements?

We support the proposed transitional requirements.

Question 6

Do you have any other comments on the proposals?

The fair value option should provided pragmatic means of overcoming the complex hedge accounting requirement. So long as IAS 39 does not permit hedge accounting for transactions between entities in the same group in consolidated financial statements, the IASB's aim to simplify the implementation of the Standard will not be reached.

For example, in case of offsets of non-derivative financial assets or non-derivative financial liabilities by internal derivatives, the entity has to demonstrated that the internal contracts are offset by derivative contracts with external parties to the consolidated group. Tracking the external offset of the internal derivatives is very complex and the use of the fair value option doesn't allow to avoid this fundamental difficulty of IAS 39.