A F E P

Sir David Tweedie
Chairman of the Board
International Accounting Standard Board
30, Cannon Street
London, EC4M 6XH,
United Kingdom

Paris, November 14th, 2003

Dear Sir,

The associations representing issuers in the European Union appreciate the opportunity to offer their views on the Exposure Draft "Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk" to set out the position expressed by their members.

The recent IASB exposure draft on "macro-hedging" comprises an initial response to European expectations.

Nonetheless, even though other improvements still appear conceivable in this framework, the exposure draft, which was limited to macro-hedging of interest rate risk, accompanies the latter with conditions that are still problematic and does not make it possible to solve certain difficulties encountered by companies in such other fields as foreign currency hedges, internal contracts and in the measurement of certain securities currently classified in the category of available-for-sale financial assets.

Macro-hedging of interest rate risk: IAS 39 must meet three essential expectations

As regards macro-hedging of interest rate risk, any treatment in the area of macro-hedging of interest rate risk should fulfil three essential expectations that allow for the recognition of interest-rate risk management rules, practices and systems:

- take account of demand deposits and other temporary deposits (regulated savings, etc.), according to statistical or behavioural methods, in the determination of payment schedules and net positions that could form the subject of a hedge;

…/…

- recognize the approach currently used by European banks and companies to evaluate the ineffectiveness of a portfolio hedge (partial hedging of the risk on the hedged part of a portfolio of assets and liabilities; approach 'C', according to the classification used by the IASB);
- allow the use of a simplified method to determine the amounts to be booked for a hedge that satisfies the effectiveness conditions required (account taken in accordance with changes in the value of the hedging instrument(s)).

Foreign currency hedges, internal contracts and measurement of securities: IAS 39 still has to be improved

As regards the points that were not dealt with in the recent exposure draft, we believe it necessary for the IASB to undertake a supplementary revision of IAS 39 from 2004, via an open consultation process and in a sense which makes it possible to reflect the economy of operations more effectively.

In particular, the companies would like a revised IAS 39 standard to take account of the three following points:

1) in the area of foreign currency hedges, the possibility of assessing and documenting the conditions for hedging future transactions globally on the one hand, and on the other, of using the hedging price on recognition of the hedged item, for an effective hedge;
2) the recognition of the procedures for the centralisation and hedging of risk within groups' specialised entities, through internal contracts, once these are concluded subject to market conditions and an audit trail is provided;
3) the application of the prudence principle to measure equity instruments and certain debt securities that represent long-term investments or holdings (an application also justified by the existing 'mismatch' between assets and liabilities).

These items are specifically addressed in the attached memorandum.

We appreciate the opportunity to comment and would be pleased to discuss these comments further.

Yours sincerely,

John PIERCE
Chief Executive
The Quoted Companies Alliance

Patrick ROCHET
Directeur Général
AFEP

Dr. Hellmut Longin
Präsident
AKTIENFORUM

Mrs. Angeliki Petroulaki,
General Manager of
The SEISET Association

Evelyne DELOIRIE
Secrétaire Général
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RESPONSE TO THE IASB EXPOSURE DRAFT
"FAIR VALUE HEDGE ACCOUNTING FOR A PORTFOLIO HEDGE OF INTEREST RATE RISK"

QUESTION 1 – HEDGED ITEMS / INEFFECTIVENESS

Draft paragraph 128A proposes that in a fair value hedge of the interest rate risk associated with a portion of a portfolio of financial assets (or financial liabilities), the hedged item may be designated in terms of an amount of assets (or liabilities) in a maturity time period, rather than as individual assets or liabilities or the overall net position. It also proposes that the entity may hedge a portion of the interest rate risk associated with this designated amount.
For example, it may hedge the change in the fair value of the designated amount attributable to changes in interest rates on the basis of expected, rather than contractual, repricing dates. However, the Board concluded that ineffectiveness arises if these expected repricing dates are revised (eg in the light of recent prepayment experience), or actual repricing dates differ from those expected. Draft paragraph A36 describes how the amount of such ineffectiveness is calculated. Paragraphs BC16-BC27 of the Basis for Conclusions set out alternative methods of designation that the Board considered, their effect on measuring ineffectiveness and the basis for the Board's decisions including why it rejected these alternative methods.

Do you agree with the proposed designation and the resulting effect on measuring ineffectiveness? If not,

(a) in your view how should the hedged item be designated and why?

When assessing the value of a fixed rate prepayable item, we agree that the two reasons for a change in value (change in the discount rate and in the likelihood of prepayment) should be considered simultaneously. However, as the hedging strategy focuses on hedging the interest risk component (or a portion thereof) associated with a designated amount, we disagree that they should be considered simultaneously when assessing hedge effectiveness. Prepayment is taken into account when allocating the assets and liabilities to each time period on the basis of expected repricing dates (rather than contractual dates) and when determining the portion of the risk associated with the hedged amount (see paragraph (b)).

We also believe that in a hedge of the interest rate risk associated with a portion of a portfolio of financial assets or financial liabilities, the hedged item may be designated in terms of an amount in a maturity time period, rather than as individual assets or liabilities.

However we disagree that such a hedge should be accounted for as a fair value hedge, as it relates to net cash flows – or interest margins -, not to the fair value of individual assets or liabilities . We also disagree that, in a portfolio including assets and liabilities, the hedged item is an amount of assets <u>or</u> liabilities from the identified portfolio and that designation of a net amount including assets and liabilities is not permitted.

The Board's conclusion appears to result from concerns about questions of measurement (see paragraph BC12), in particular with regard to liabilities, and also from "the inability to associate hedging gains and losses with a specific line item being hedged and, correspondingly, to objectively determine the period in which such gains and losses should be recognised in net profit or loss" (IAS 39.133 and Implementation Guidance 121-1).

We believe that the designation of the hedged item based on the net position should be permitted under IAS 39, because this is consistent with risk management practices, which include liabilities in the determination of the net position being hedged.
Companies take into consideration their financial liabilities, including liabilities with a demand feature, in determining the natural offset of risk between assets and liabilities, their overall net exposure to interest rate risk and the related hedge as well as in testing for effectiveness. They do so by using statistical or other techniques.

It should be noted that a company that designates a net position as a hedged item is able to identify and document the components of the portfolio from which the net position is identified, to measure the risk component being hedged and, if ineffectiveness arises, to include the *amount* removed from the balance sheet in the gain or loss which relates to derecognised items (under the treatment proposed in paragraphs 154 and A38 of the exposure draft).

(b) would your approach meet the principle underlying IAS 39 that all material ineffectiveness (arising from both over- and under-hedging) should be identified and recognised in profit or loss ?

Designation of the hedged amount determines how much, if any, ineffectiveness arises if actual repricing dates in a particular maturity time period vary from those estimated or if the estimated repricing dates are revised.

Using the exposure draft's approach (approach D), the entity designates as the assets (liabilities) being hedged an amount that is considered as a percentage of the assets (liabilities), which percentage measure is used for testing and calculating ineffectiveness (percentage of the assets or liabilities that is hedged in each maturity time period).

Under this approach, ineffectiveness would arise on a percentage of the decrease (e.g. resulting from assets prepaying *earlier* than expected) or increase (e.g. resulting from assets prepaying *later* than expected) in the amount of assets and liabilities used to determine the amount being hedged, rather than on this amount. In other words, the consequences of the revisions of repricing dates (dates on which an item will be repaid or repriced) would be allocated to both the hedged amount and the unhedged amount.

This approach would not be consistent with the Board's views that the portfolio is not itself designated as the hedged item.

Furthermore we believe that the increase in the amount of assets and liabilities used to determine the hedged amount ("upwards revision") should not result in ineffectiveness, as later than expected prepayments are not hedged in the designated period and merely result in additional amounts to be hedged in future periods. When entities use expected repricing dates, we believe that they hedge only the interest rate risk up to the chosen date. Consequently we are of the view that the exposure draft's approach (approach D) is inappropriate and should not be retained.

Under approach C, assuming there are 100 of fixed rate prepayable assets and the entity designates as the hedged item an amount of 20, the entity hedges only a portion (e.g. 16) of the risk associated with this hedged amount ; if some assets prepay earlier than expected the reductions in the amount of assets (e.g from 100 to 90) are assumed to come *first* from the undhedged risk (e.g. 4) associated with the hedged amount of 20 (therefore designated as the "top" layer of 20).

We consider Approach C to be the appropriate way of designating the hedged amount. This approach is consistent with recognised practices and existing systems and correctly relates this amount to the initial risk position. In this respect, it should be noted that the risk management strategy separates the prepayment risk from the interest rate risk by applying a partial-term hedge strategy and focuses on hedging the interest rate risk component. We further believe that – in the case of a partial hedge of the net position – prepayment does not lead to ineffectiveness as long as the amount prepaid does not exceed the part of the net position that was initially unhedged (4 in the example). In other words ineffectiveness arises only when the net position in the portfolio has become over-hedged (hedged amount becoming lower than the amount of hedging instrument(s) ; e.g. 6 in the example).

(c) under your approach, how and when would amounts that are presented in the balance sheet line items referred to in paragraph 154 be removed from the balance sheet ?

When assets or liabilities contained in the hedged portfolio are derecognised, any amount included in a separate line item referred to in paragraph 154 that relates to those items shall be removed from the balance sheet.

We agree with the principle mentioned in the example of paragraph A39 that, when it cannot be determined in which time period the related hedged items are derecognised, the amounts are removed from the earliest available time period.

<u>QUESTION 2 – LIABILITIES WITH A DEMAND FEATURE</u>

Draft paragraph A30(b) proposes that all of the assets (or liabilities) from which the hedged amount is drawn must be items that could have qualified for fair value hedge accounting if they had been designated individually.

It follows that a financial liability that the counterparty can redeem on demand (ie demand deposits and some time deposits) cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment. Paragraphs BC13-BC15 of the Basis for Conclusions set out the reasons for this proposal.

Do you agree that a financial liability that the counterparty can redeem on demand cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment ?

We do not agree that a financial liability that the counterparty can redeem on demand or after a notice period (i.e. demand deposits and some time deposits) cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment.

Demand deposits may be *contractually* withdrawn on demand by customers. However, the range of fluctuations in demand deposit outstandings can be assessed using historical data and econometric analyses, as done for other financial instruments (options, trade receivables, …). The statistical or other techniques used generally highlight their remarkable stability.

In determining the residual interest risk and the partial hedges of the net positions relating to the various maturity time periods, the Asset/Liability Management therefore allocates liabilities with a demand feature to those periods and does so based on expected repricing dates.

Those hedges relate to net cash flows – or interest margins -, not to the fair value of individual assets or liabilities.

We believe that the accounting treatment should be consistent and in accordance with the entity's risk management procedures and objectives, which include liabilities with a demand feature in the determination of the partial hedges of the net positions.

(a) If you do not agree, do you agree with the Board's decision (which confirms an existing requirement in IAS 32) that the fair value of such a financial liability is not less than the amount payable on demand ? If not, why not ?

Based on the remarks above, we believe that the appropriate question for the Board to consider is not about the fair value of a liability with a demand feature, but rather how hedge accounting should reflect the two major characteristics of a macro hedging including liabilities with a demand feature, i.e. (a) the economic fact that the amounts being hedged are net cash flows ; (b) the fact that those net cash flows relate to a group of assets and liabilities recognised on the face of the balance sheet, not to future transactions.

The issue of fair valuing core deposits arises because the Board is attempting to fit the described hedging activity within the current cash flow/fair value hedging classifications.
In fact, as mentioned above, there are legitimate arguments to support the view that the hedged item is an interest margin (or a portion of an interest margin), rather than individual assets or liabilities and thus the change in its value need not be allocated to those assets and liabilities.

(b) would your view result in such a liability being recognised initially at less than the amount received from the depositor, thus potentially giving rise to a gain on initial recognition ? If not, why not ?

We believe that the determination of the change in value of the hedged item should be based on the change in value of the hedging instrument(s). As the changes in value to be recognised should be limited to the corresponding changes in value of the hedging instrument(s), and the hedged item(s) is (are) an interest margin(s), there should not be a gain on the initial recognition of a liability with a demand feature, as suggested in the exposure draft.

This is applicable only if the IASB's preferred approach – the fair value hedge approach - is accepted.

IAS 39 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT
POINTS NOT DEALT WITH IN THE EXPOSURE DRAFT
COUNTER-PROPOSALS

In particular, companies would like a revised IAS 39 standard to take account of the three following points:

1) The principle of hedging a net position, an interest rate or an exchange rate risk, which is essential for managing day to day risks (macro-hedging) ;

2) The recognition of the procedures for the centralisation and hedging of risk within groups' specialised entities (hedging through internal contracts);

3) Application of the same classification and identical measurement methods for the hedged items and hedging instruments, and application of the principle of prudence for the measurement of equity instruments.

These items form the subject of the developments and counter-proposals below.
The issue relating to the macro-hedging of interest rate risk is specifically addressed in paragraph 1 and detailed in the response to the IASB exposure draft on macro-hedging.

1) MACRO HEDGING OF INTEREST RATE RISK

The difficulty for companies practising macro-hedging arises from the fact that, according to IAS 39, the effectiveness of a hedge (condition for the use of hedge accounting) can only be assessed by a comparison between the hedging instrument (or a group of similar hedging instruments) and the hedged item (or a group of similar hedging instruments). The standard excludes the possibility that a comparison may be made between the hedging instrument (or a group of similar hedging instruments) and a general net position (e.g. the net for all of the fixed rate assets and liabilities with identical maturities), rather than a specific hedged element.

IASB justifies this provision by difficulties in evaluating the effective nature of the hedge of a net position and in ensuring the monitoring of this position if one of the elements of the net position leaves the balance sheet.

The IASB discussions to find a compromise solution have broken down on two essential points:

- The method for measuring the position, with IASB proposing to value the intermediation portfolio ('banking book') at fair value, contrary to the practice in force and the IAS 39 provisions applicable in the absence of hedging;

- The taking into account of demand deposits in the position, with European banks wishing to have them included in the position's schedule.

Counter-proposals

- Recognise the current practice involving *dynamic* hedging of a net position resulting from assets and liabilities, with the hedging procedure being submitted to effectiveness conditions (designation of the elements, measure and monitoring of its effectiveness) ;

- In keeping with requests from banks that reflect their risk management practices, consider that demand deposits and similar accounts can be included in a net position as an element that generates an interest rate risk, on the basis of behaviour models;

- Having recognised the concept of a net position:

  . Do not consider that each of the assets and liabilities making up the position is a specifically hedged element, which would wrongly lead to its systematic measurement at fair value, even if this element is measured at cost according to IAS 39;

  . Ensure that the changes in value of the hedging element are included in net profit or loss on the sole basis of the ineffective portion of the hedge.

2) FOREIGN CURRENCY HEDGES

Foreign currency hedge of future transactions and macro-hedging

Analysis of existing provisions

The IAS 39 standard provides for the possibility of an enterprise hedging a forecasted transaction (such as an expected sale or purchase), notably subject to this transaction being highly probable. Where applicable, an enterprise should discontinue hedge accounting if this condition is no longer fulfilled or if the realisation of the committed or forecasted transaction is no longer expected to occur (IAS 39.163). In the first case, the cumulative amount reported in equity remains in equity until the forecasted transaction occurs (IAS 39.163 (b) and Implementation Guidance 121-2-h); in the second, it is reported in net profit or loss (IAS 39.163 (c)).

For the IASB (Implementation Guidance 137-4), it is unlikely that a company can reliably predict 100% of revenues for a future year. However, it is possible that a portion of predicted revenues, normally those expected in the short-term, will meet the 'highly probable' criterion.

The term 'highly probable' indicates a significantly greater likelihood of occurrence than the term 'more likely than not' (Implementation Guidance 142-1), and higher than the term 'expected to occur' (Implementation Guidance 163-1). According to the Implementation Guidance (142-1), the probability of an operation should be supported by observable facts and the attendant circumstances. In assessing the likelihood that a transaction will occur, consideration should be given to the following circumstances:

- The frequency of similar past transactions;
- The financial and operational ability of the entity to carry out the transaction;
- Substantial commitments of resources to a particular activity (e.g. a manufacturing facility that can be used in the short run only to process a particular type of commodity);
- The extent of loss or disruption of operations that could result if the transaction does not occur;
- The likelihood that transactions with substantially different characteristics might be used to achieve the same business purpose (e.g. an entity that intends to raise cash may have several ways of doing so, ranging from a short-term bank loan to a common stock-offering); and
- The enterprise's business plan.
- The length of time until a forecasted transaction is projected to occur is also a consideration in determining probability. The more distant a forecasted transaction is, the less likely it is that the transaction would be considered highly probable and the more this hypothesis has to be shored up. For example, a transaction forecasted to occur in 5 years may be less likely to occur than a transaction forecasted to occur in one year.

Issues description

Similarly as for macro-hedging of interest rate risk, IAS 39 also should recognise the principle of macro-hedging.

According to the existing provisions, the hedged forecasted transaction must be specifically identified and documented so that when the transaction occurs, it is clear whether the transaction is or is not the hedged transaction. Therefore, a forecasted transaction cannot be specified solely as a percentage of sales or purchases during a period (Implementation Guidance 142-5).

It is clear that transactions such as commercial offers can form the subject of exchange rate hedging. However, some conditions, as specified by IASB (the criterion of high probability, specific identification and documentation of the forecasted transaction) mean that it is difficult in practice to retain hedge accounting for such transactions, notably for those that are expected to occur beyond one year where the forecasted transactions gradually transform themselves into orders.

The accounting figures then no longer reflect the economic reality of exchange rate hedges which can relate to a part of an order book that is not specifically identified.

Counter-proposals

- Recognise the following current practices used by companies, with the hedging procedure being subject to measurement conditions and forecast monitoring :

  . exchange rate hedging of a percentage of planned sales or purchases;
  . hedging of commercial offers made in accordance with coefficients for the realisation of these offers that are known to companies and documented;
  . hedging of long periods that are coherent with the company's cycle of activity.

- For these operations, make it possible to use hedge accounting until the realisation of the percentage hedged.

Initial measurement of an element forming the subject of foreign currency hedge

Analysis of existing provisions

According to IAS 21, a transaction is recorded in the results at its exchange rate at the date of the transaction (spot rate) and the value of the corresponding balance sheet monetary item is adjusted at each closing date at the price on that date until settlement, with the differences being recognised as income or as expenses (IAS 21.9, 11 and 15).

If the company proceeds with hedging of the transaction, it can choose to designate this hedge as a cash flow hedge or as a fair value hedge (e.g. a currency sale realised in the Implementation guidance 137-10) :

- In the case of a *fair value* hedge (based on the idea of hedging *balance sheet items*), the adjustments from remeasuring the hedging instrument at fair value are recognised immediately in *net profit or loss*, similarly to adjustments in value of the hedged item attributable to the risk being hedged (IAS 39.153);

- In the case of a *cash flow* hedge (based on the idea of hedging the *settlement*), the adjustments of the value of the hedging item *are recognised directly in equity for the effective portion of the hedging* (IAS 39.158). *The treatment of the amount previously recognised in equity varies according to the element forming the object of the hedge* :

  . If the item being hedged is a forecasted transaction or a firm commitment which leads to recognising an asset or liability, this amount enters into the initial measurement of the acquisition cost or other carrying amount of the asset or liability' *when recognising the asset or liability*, a treatment which is qualified as a 'basis adjustment' (IAS 39.160 and the example of foreign currency hedge of a forecasted transaction in Implementation guidance 160-1) ;

  . Otherwise, this amount is included in net profit or loss in the same period(s) during which the hedged firm commitment or forecasted transaction affects net profit or loss (e.g. when a forecasted sale actually occurs) (IAS 39.162).

In the case of a *cash flow hedge initiated on recognition of the balance sheet item*, no amount is recognised in advance in equity and, according to Implementation guidance 137-10, this second treatment applies.

For a *cash flow hedge initiated before recognition of the balance sheet item* (hedge of a forecasted transaction or firm commitment), the basis adjustment is made *at the time when* the balance sheet item is *recognised. After recognition*, neither the standard nor Implementation guidance explicitly indicates the later treatment of adjustments in the value of the hedging item: IAS 39.160 and 162 relate to the treatment of amounts that were *previously* recognised in equity. However, *IAS 39.160, which alone allows a basis adjustment, does not apply*, because it exclusively relates to the treatment of such amounts on recognition of the balance sheet item. Moreover, IASB tends to consider that IAS 39.162 applies, as adjustments of the value of the hedging element are 'directly' recognised in equity (IAS 39.158), and then after a moment of rightful existence, begin to be included in net profit or loss; in any case, this is the approach that prevails in the Implementation guidance 137-10 where hedge is nonetheless initiated on recognition of the balance sheet item.

Thus, the basis adjustment of an asset or liability appears limited to the case of a cash flow hedge for the sole adjustments in value of the hedging item recognised in equity before recognition of this asset or liability.

In the other cases, adjustments in the value of the hedging item are included in net profit or loss at the same time as the hedged counterpart affects net profit or loss, whether this involves a fair value hedge (IAS 39.153) or a cash flow hedge (IAS 39.162).

Issues description

In all cases, the impact on net profit or loss is identical. However, the impossibility of taking account of the hedge in the measurement of the hedged item in certain circumstances does not make it possible to reflect how the operations are managed and followed up, introduces distortions and can complicate accounting operations.

It is necessary to emphasise that in an industrial and commercial enterprise, the decision to hedge the foreign exchange risk on a sale, notably in the long term, is often closely related to the sale. This management decision makes it possible to both set the turnover and the margin.

At a practical level, when foreign currency hedges are centralised for a group in a treasury department, the treasury department generally guarantees the exchange rates to its subsidiaries at the start of the year or transaction by transaction. These exchange rates are used by subsidiaries to book their turnover, purchases, trade receivables or payables. Moreover, internal contracts can also be implemented to facilitate the monitoring and allocation of hedging transactions (see developments under the next paragraph). If the subsidiaries book operations at the day exchange rate and the treasury department revalues the hedging transactions for its part at market value, it is certain that the cumulation of the two will not give the anticipated result. Finally, the non-recognition of the use of hedging rates or the non-recognition of the use of internal contracts in the exchange area leads to greater risks of errors than the method currently used by companies.

Centralised and documented monitoring of the use of the foreign currency hedges within the treasury department in the case of hedges of forecasted cash flows and the booking of hedging transactions and the hedged underlying item for firm orders at market value make it possible to guarantee monitoring of the effectiveness of foreign currency hedges.

Counter-proposals

For foreign currency hedges:

- Make it possible to book the hedged item directly at its hedging rate, when the hedge is initiated *before or on recognition* of this balance sheet item, with the hedge being submitted to effectiveness conditions;

- When ineffectiveness arises, account for the transaction at the exchange rate at the date of the transaction, with the ineffective portion being included in net profit or loss and the effective portion being accounted for according to the rules applicable to fair value hedges or cash flow hedges.

3) INTERNAL CONTRACTS

Analysis of existing provisions

According to IAS 39, only derivatives that involve a party external to the enterprise can be designated as hedging instruments. The profits and losses recorded on internal hedging transactions are eliminated on consolidation. Internal hedging can only be accepted if a *unitary* relationship is established between an external hedging contract and the position that generates risks, which must be identified precisely. This position can also be eliminated on consolidation.

Issues description

Certain hedging operations (e.g. swaps) concluded with (non-related) third parties aim to eliminate (interest rate and exchange rate) risks resulting from an asset and liability position recognised at company level. Whereas the qualification of hedging is retained at company level, partly on the basis of this position (for the currency portion), elimination of one of the elements of the position for consolidation purposes could result in no longer totally recognising the qualification of hedging.

This difficulty notably arises within the framework of centralised treasury management for a group, where the validity of an internal contract concluded at a market price is not recognised.

Counter-proposals

- Generally speaking and in compliance with the position expressed by companies, allow the designation of operations which, for consolidation purposes, are eliminated in the consolidated accounts as hedging elements or hedged elements, once an audit trail (traceability) is ensured and the internal contracts are implemented in line with market conditions;
- Allow the retention of the concept of a synthetic element, even if its counterpart is eliminated (partially, for the currency portion) in the process of consolidating financial statements.

  . In particular, when two swaps are concluded to transform the currency and then the interest rate of a balance sheet item (e.g. borrowing), recognise that the two swaps are hedging instruments, without it being necessary to refer to the backing element (e.g. loan), with the latter being eliminated in consolidation.

4) EVALUATION OF INVESTMENT SECURITIES

Measurement of financial assets outside trading at fair value creates the major problem of the lack of value matching between assets measured at fair value on the one hand and on the other, financial liabilities which remain measured at cost under the IAS 39 standard (it is this ‘mismatch’ which justifies the recording of unrealised gains directly in equity, with, in the case of a turnaround, a fall in equity and a charge recorded in the result below the cost).

A problem of this nature exists for industrial and commercial companies as it does for banks, as soon as assets are measured at fair value. It arises also for insurance companies, notably during phase 1 of the IASB Insurance project, which formed the subject of discussions with the European Commission and for which IASB is requested to re-open discussions with the insurers.

The problem of volatility in the case of turnaround would arise with even greater acuteness, were all unrealised gains and losses to be included in net profit or loss, as recently envisaged by the IASB.

Counter-proposals

- In the current category of available-for-sale financial assets, distinguish equity instruments whose lasting holding is useful for the company’s activity, as they represent stakes in the capital or long-term investments;
- In this category also distinguish insurance company bonds whose lasting holding is useful for the company’s activity, as they represent long-term investments (in the case of disposal or transfer of securities in the category of assets held to maturity, it is no longer possible, for 2 to 3 years, to classify other assets in this category, and therefore measure them at historical cost);
- Classify these equity instruments and bonds separately and measure them at historical cost (in the absence of maturity, shares cannot be classified in the category of financial assets held until maturity) ;
- For the other securities, maintain the financial assets available for sale treatment.