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Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mouvement des Entreprises de France
MEDEF

Ms Sandra Thompson
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IASB
30 Cannon Street
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United Kingdom

JK/SJ/07.2004/32
RE : IAS 39 : The fair value option

Paris, Tuesday, July 20th, 2004

Dear Ms Thompson,

ACTEO & MEDEF welcome the opportunity to comment the IASB exposure draft on IAS 39: The fair value option.

ACTEO & MEDEF have supported, at the time of its introduction, the fair value option, insofar that it makes the implementation of IAS 39 easier. However, ACTEO & MEDEF understand and share the concerns expressed by the regulators in Europe, and wish that IASB would respond to them positively.

The objectives set out by the regulators are listed in both the introduction to the exposure draft and the basis for conclusions (BC 9). ACTEO & MEDEF are however surprised that IASB's proposals do not meet the objectives that seem to have been the only reason supporting the proposals. It is worth noting that:

- any debt issued with an embedded derivative is eligible to the fair value option: its value is therefore sensitive to the issuer's credit risk;
- the restrictions proposed for natural hedges ("contractually linked" and "substantially offset") along with the inadequacy of IAS 39 hedge accounting requirements would prevent entities from eliminating economic mismatches between assets and liabilities, and would therefore drive towards more artificial volatility.

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The objectives set out being not met, we believe the exposure draft should not have been issued by the IASB. We are concerned that IASB made the choice not to deal with the concerns expressed by the European regulators. We believe high-quality standard-setting should either succeed in responding positively to objectives set out and hence issue acceptable proposals, or explain the reasons for not addressing the concerns. Issuing proposals that at the same time are unacceptable and inefficient should not be part of IASB's due process.

Further detailed comments are provided in the Appendix to this letter.

We therefore urge the Board to work out acceptable solutions and meet the objectives set out by the European regulators.

We remain at your disposal should you need further clarification or background information.

Yours sincerely,

ACTEO
Philippe CROUZET
Le Président

P/O ***Jean KELLER***

Le Délégué Permanent

MEDEF
Agnès LEPINAY

Le Directeur des Affaires Economiques, Financières et Fiscales

Appendix

Question 1
Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

We do not agree with the proposals in the Exposure Draft because they do not meet the objectives set out in BC 9.

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?

At the time of its inception, the fair value option was welcome because it helped compensate for the unnecessary limitations put to the hedge accounting in IAS 39. The fair value option is particularly helpful to account for natural hedges. The limitations "contractually linked" and "substantially offset" included as (ii) and (iii) in IAS 39 paragraph 9 are likely to annihilate the benefit of the option in that area. Moreover the wording used immediately calls for interpretations and clarifications.
In consideration for the mismatches of assets and liabilities that may result from the application of IFRS from 2005 onwards, until proper accounting requirements have been developed for insurance liabilities, no limitation of any kind should restrict the use of the fair value option as the accounting treatment for natural hedges.

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 BC 9? If not, how would you further limit the use of the option and why?

As explained in our letter, the proposals made by the Board do not meet the objectives set out in BC 9. They are not consistent with the reasons for introducing the option in the first place (IAS 39 BC 74). The proposals need therefore to be removed and a sound analysis be conducted.

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.
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?

The fair value option had been identified as the easy way to value hybrid instruments containing embedded derivatives which had to be separated and of which fair value could not be reliably determined.
We therefore believe that the use of the fair value option should be limited to those cases.

We also believe that the Board should justify in which situations, beyond the accounting for natural hedges (see our answer to question 2), available for sale assets need to be valued at fair value through profit and loss.

Question 5

Are the proposed transitional requirements appropriate?

We agree with the transitional requirements proposed. However at this stage of the conversion process to IFRS, it does not appear reasonable to bring further modifications to the stable platform with mandatory application starting in 2005. IFRS 1 clearly states the need for early planning of the whole process of conversion to IFRS. This early planning which serves as a basic assumption to IFRS 1 should not be contradicted by the late introduction by IASB of new mandatory requirements.

Question 6

Do you have any other comments on the proposals?

1- verifiability threshold

In our view, there should not be different reliability thresholds. Reliability is a key qualitative characteristic that needs to be met in all circumstances. To respond positively to the regulators' concerns, the Board might investigate whether there should be restrictions in the use of valuation techniques in order to ascertain that the level of subjectivity reflected in the valuations remains acceptable in all circumstances. If IASB's answer is that no restriction should be made, then the rationale for reaching that conclusion should be sufficient to convince the regulators. Aside this suggestion, we wish to recall that we had agreed the proposed guidance of fair value measurement, at the time the exposure draft of IAS 39 amendments was issued.

2- regulator power to oversight the application of an accounting standard

We strongly oppose to any oversight power being given to regulators. The objective of adopting IFRS in the EU is harmonisation and consistency of accounting standards everywhere where IFRS are used. No difference of application should arise because of different regulatory bodies.

3- ways forward

At the time the fair value option was introduced, the expected benefits thereof were fully expressed. We believe those benefits should be fully safeguarded. The restrictions to be designed for the fair value option may be designed in a completely different direction from the choice made by the Board.

The fair value option might be restricted to:

- clearly identified situations in which it is consistently applied over time,
- full disclosure thereof.

Furthermore changes in the credit risk of the entity (or of one of its liabilities) should not have an impact –ever - on profit and loss.