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The Deputy Director General

Monday, October 25th 2004

FBF response to Exposure Draft 7 "Financial Instruments : Disclosures"

Dear Ms Pryde,

The French Banking Federation is pleased to have the opportunity to comment on Exposure Draft 7 "Financial Instruments: Disclosures".

We welcome the IASB's initiative aimed at revising IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and IAS 32 *Financial Instruments : Disclosure and Presentation* in order to provide one standard for disclosure requirements relating to financial instruments.

We view it as positive that the type and extent of the disclosures in the proposed standard are subject to the degree to which an entity uses a specific financial instrument. We would therefore suggest that a materiality criterion be clearly introduced in the standard, in order not to create an excessive disclosure burden for entities that do not significantly use financial instruments for their financial position and performance.

Nevertheless, we are concerned by the proposed additional requirements to disclose information of competitive nature, such as objectives, policies, processes for managing capital. We believe that this information is not only of little relevance for users of financial statements, but it can also be misleading in some cases. Furthermore, such disclosure requirements are not consistent with the provisions set out in the new Basel Accord on disclosures to the market, according to which a bank needs not disclose items that could undermine its competitive position by "making public information that is either proprietary or confidential in nature".

Finally, we hope that financial institutions that designed formats of financial statements based on the existing IAS 30 will still be allowed to use these formats, which reflect in their structure the specificities of banking activities.

Please find enclosed in the appendix our detailed responses to the questions raised in the exposure draft.

Yours sincerely,

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Question 1 – Disclosures relating to the significance of financial instruments to financial position and performance

The draft IFRS incorporates disclosures at present contained in IAS 32 Financial Instruments: Disclosure and Presentation so that all disclosures about financial instruments are located in one Standard. It also proposes to add the following disclosure requirements :

(a) financial assets and financial liabilities by classification (see paragraphs 10 and BC13).
(b) information about any allowance account (see paragraphs 17 and BC14).
(c) income statement amounts by classification (see paragraphs 21(a), BC15 and BC16).
(d) fee income and expense (see paragraphs 21(d) and BC17).

Are these proposals appropriate? If not, why not ? What alternative disclosures would you propose?

a) We consider it appropriate to disclose in the notes financial assets and financial liabilities by classification. By providing such disclosures, entities will give relevant additional information on their measurement.
b) Though we agree on the proposal in principle, we note that it will not contribute to comparability in the financial statements: an entity using an allowance account will have to disclose the fact, whereas an entity choosing to write off the carrying amount of the financial asset will not have to provide users with any disclosure. We believe that disclosure requirements should not depend on the method used for credit provisioning.
c) We believe that some clarification is needed on the new requirements set out in paragraph 21(a), regarding net gains and losses on financial instruments, in order to be able to assess the additional administrative burden incurred by these requirements. In particular, we suggest that the contents be specified more precisely, so that entities know whether net gains and losses include interest and dividend income, impairments or fair value attributable to the hedged risk.
d) We agree with the proposal.

Question 2 – Disclosure of the fair value of collateral and other credit enhancements

For an entity's exposure to credit risk, the draft IFRS proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable (see paragraphs 39, 40, BC27 and BC28).

Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?

We would consider it sufficient to provide qualitative disclosures about the management of credit risk in general, and about methods used for credit enhancement in particular. We do not support the proposal that requires disclosures of the fair value of collateral pledged as security and other credit enhancements, as this information is often neither relevant nor reliable. We note also an inconsistency with the requirements under Basel II, which consist of the following disclosures:

- gross credit exposure
- net credit exposure (after taking into account collateral(s) pledged).

We believe such disclosures would be more appropriate than the fair value of collateral pledged.
Moreover, we would like to indicate that the criterion of "past due" set out in paragraph 40(a) is not relevant for financial institutions.

Question 3 – Disclosure of a sensitivity analysis

For an entity that has an exposure to market risk arising from financial instruments, the draft IFRS proposes to require disclosure of a sensitivity analysis (see paragraphs 43, 44 and BC36-BC39). Is the proposed disclosure of a sensitivity analysis practicable for all entities?

If not, why not and what, if any, alternative disclosures of market risk would you propose to meet the stated objective of enabling users to evaluate the nature and extent of market risk?

The proposal is appropriate, and more suitable than other approaches. Nevertheless, we are concerned that sensibility analyses may include information of confidential or competitive nature. As we already pointed out in the cover letter, we would not like such information to be part of disclosure requirements.
As an alternative, we would propose the use of value-at-risk measurement (VaR), which provides suitable information on the risk profile of the entity, and is already used for regulatory purposes under the actual Basel Accord regarding market risk.

Question 4 – Capital disclosures

The draft IFRS proposes disclosure of information that enables users of an entity's financial statements to evaluate the nature and extent of its capital. This includes a proposed requirement to disclose qualitative information about the entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance (see paragraphs 46-48 and BC45-BC54).

Is this proposal appropriate? If not, why not? Should it be limited to only externally imposed capital requirements? What, if any, alternative disclosures would you propose?

We agree to disclosures on the externally imposed capital requirements. As banks will be subject to such disclosure requirement under Basel II, it would be appropriate not to duplicate these requirements in this Standard. Moreover, we believe this information should be disclosed outside the financial statements. It would be more suitable to locate such disclosures in the Management Discussion and Analysis' document.
Regarding quantitative information about management's internal capital targets, we previously mentioned in our cover letter that we opposed to their being disclosed because of their confidential or competitively sensitive nature. Moreover, these targets are not derived from accounting figures and would not be auditable.

Question 5 – Effective date and transition

The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged (see paragraphs 49 and BC62-BC67). Entities adopting IFRSs and the draft IFRS for the first time before 1 January 2006 would be exempt from providing *comparative disclosures for the draft IFRS in the first year of adoption (see Appendix B, paragraph B9).*

Are the proposed effective date and transition requirements appropriate? If not, why not? What alternative would you propose?

An early application would be appropriate for those entities that will prepare their first set of accounts under IFRSs in 2005, in order to avoid applying IAS 30 and 32 for too short a period.

We welcome the transitional provisions set out in Appendix B, paragraph B9.

Question 6 – Location of disclosures of risks arising from financial instruments

The disclosure of risks arising from financial instruments proposed by the draft IFRS would be part of the financial statements prepared in accordance with International Financial Reporting Standards (see paragraph BC41). Some believe that disclosures about risks should not be part of financial statements prepared in accordance with IFRSs; rather they should be part of the information provided by management outside the financial statements.

Do you agree that the disclosures proposed by the draft IFRS should be part of the financial statements? If not, why not?

We do not support locating disclosures on risks from financial instruments because this information is not of accounting nature: it is actually derived from synthetic indicators.
Moreover, locating these disclosures in the financial statements would imply that the risk management policy of the entity would have to be assessed by auditors, whereas this matter does not come within their remit.

Question 7 – Consequential amendments to IFRS 4 (paragraph B10 of Appendix B)

Paragraph B10 of Appendix B proposes amendments to the risk disclosures in IFRS 4 Insurance Contracts to make them consistent with the requirements proposed in the draft IFRS. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by the draft IFRS. The Board's reasons for proposing these amendments are set out in paragraphs BC57-BC61.

Do you agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS? If not, why not and what amendments would you make pending the outcome of phase II of the Board's Insurance project?

We would suggest waiting until phase II of the Insurance project is achieved.

Question 8 – Implementation Guidance

The draft Implementation Guidance accompanying the draft IFRS suggests possible ways to apply the risk disclosure requirements in paragraphs 32-45 (see paragraphs BC19, BC20 and BC42-BC44).

Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

The draft Implementation Guidance is sufficient.

Question 9 – Differences from the Exposure Draft of Proposed Statement of Financial Accounting Standards Fair Value Measurements published by the US Financial Accounting Standards Board (FASB).

The FASB's Proposed Statement of Financial Accounting Standards Fair Value Measurements, which is open for public comment at the same time as this Exposure Draft, proposes guidance on how to measure fair value that would apply broadly to financial and non-financial assets and liabilities that are measured at fair value in accordance with other FASB pronouncements. That Exposure Draft proposes disclosure of information about the use of fair value in measuring assets and liabilities as follows:

(a) For assets and liabilities that are remeasured at fair value on a recurring (or ongoing) basis during the period (for example, trading securities):

- *(i) the fair value amounts at the end of the period, in total and as a percentage of total assets and liabilities,*
- *(ii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and*
- *(iii) the effect of the remeasurements on earnings for the period (unrealised gains or losses) relating to those assets and liabilities still held at the reporting date.*

(b) For assets and liabilities that are remeasured at fair value on a non-recurring (or periodic) basis during the period (for example, impaired assets), a description of

- *(i) the reason for remeasurements,*
- *(ii) the fair value amounts,*
- *(iii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and*
- *(i) the effect of the remeasurements on earnings for the period relating to those assets and liabilities still held at the reporting date.*

Disclosures similar to (a) (ii) above are proposed in paragraph 31 of the draft IFRS (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a).

Do you agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to the draft IFRS would you propose?

We agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft.

Question 10 – Other comments

Do you have any other comments on the draft IFRS, Implementation Guidance and Illustrative Examples?

We do not have any other comments.