Date

15 March 2005

Le Président

Fédération des Experts Comptables Européens

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Sir David Tweedie
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Dear Sir David,

Re: Amendments to IAS 39 Financial Instruments: The Fair Value Option – Roundtable meetings 16 March 2005

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased to submit its views on the further Proposed Amendments to IAS 39, Financial Instruments: The Fair Value option. FEE has not been invited to participate in the Roundtable meetings on 16 March 2005. However, we would like to submit our views on the proposal for the fair value option and hope these will be considered in the discussion and finalisation of the proposal.

We welcome the new approach for the fair value option in IAS 39. On balance and notwithstanding our comments below, we feel the proposals strike the right balance between the views of those in favour of the current fair value option in IAS 39 and those requiring a revision of the standard in respect of the fair value option. Given the need for a solution in respect of the fair value option and the fact that this proposal is more principles-based than the Exposure Draft on the Fair Value Option of April 2004, we feel the proposals are appropriate and would accept these amendments to IAS 39. Disclosure requirements as proposed though are still considered complex.

We first provide some comments in relation to the questions raised by the IASB on the proposals and thereafter provide more detailed comments, including drafting comments to improve the text of the proposals.

Questions raised by the IASB

Question 1
Does the tentative proposal address all situations in practice in which entities are likely to want to use the fair value option?

The proposals in our view address all possible situations. We believe that the principles are sufficiently broad and flexible. We are not aware of situations where the proposed amendments could not be used although in practice this would be needed. It is however unclear whether the proposed amendments are also applicable when mismatches arise between the measurement and/or recognition of a combination of financial and non-financial (i.e. insurance) instruments.

We question whether the rules in respect of designation at inception without the possibility of a later change continue to be appropriate. The proposals set out specific conditions for using the fair value option; circumstances may change such that those conditions are no longer met. To prevent inappropriate volatility, later reclassifications out of the fair value through profit and loss account category could be considered. We accept that, as at present, the fair value designation continues to be an accounting policy that is applied at inception and consistently thereafter.

Question 2
Is the attached tentative proposal operational? Does it provide effective guidance on when the option is available and, equally important, when it is not?

Whilst in our view the accounting principles are operational, we are concerned that some of the additional disclosures required for financial reporting purposes in the proposal are not all operational and that some are too rules-based and onerous, without proving any real value to the users of general purpose financial statements.

The addition of so many disclosure requirements in ED 7 goes against the stated intention of the Board not to require unnecessary disclosures on financial instruments in the successor standard of IAS 32.

The total of the requirements is out-of-balance and seems to also come from fear that the fair values are not reliable and thus the notion that theses unreliable fair values should be adjusted through additional disclosures. In our view, if the fair values were not expected to be sufficiently reliable, that would require revisiting the reliability notion in IAS 39 rather than additional disclosure requirements. If these disclosures are for the use of regulators, they should and can be required in the regulatory reports of those supervisors and should not overload external financial reporting.

We welcome the withdrawal of the concept of verifiability.

We question why a number of similar financial assets or financial liabilities could be designated while a portion cannot be designated. We note that the application of the fair value option for financial assets and financial liabilities where for example a mismatch is present in respect of the valuation of interest rate risk may also create volatility, as a result of the measurement of other risks, such as credit risk. In light of the current IAS 39, we agree with the choice made by the IASB not to allow portions to be designated, as that could lead to implementing an easier to apply type of hedge accounting. However, we recommend that this issue is re-considered at some later stage.

If the proposals are adopted and the standard is amended, the transitional arrangements will need to be considered carefully where asset and liabilities have been designated under the current rules (i.e. not subject to the proposed conditions) and also specifically for first time adopters which currently do not have the ability to designate liabilities as held at fair value. For first time adopters, in particular in Europe, it is of great important that the amended standard supports retrospective application of the amended proposals to the transition date (in Europe generally either 1 January 2005 or 1 January 2004 for IAS 39) to ensure relevant information in the first IFRS financial statements.

In our view, retrospective application of the amended standard would be possible to ensure consistency between the application of accounting principles in 2005 and the comparative year. The amended standard would restrict the fair value option and limitatively determine when it can be applied. This will also support the consistent application of the fair value option and decrease the risk of applying inappropriate hindsight.

Other comments per paragraph

Paragraph	*Comments*
9 (b)	"An entity shall use this designation…" The use of the word "shall" could be taken to imply that when the situations outlined in paragraph 9 or 11A are present, fair value measurement <u>is</u> required. We believe that the designation at fair value continues to be a choice. By using the words "can only" rather than "shall" this would be clarified.
9 (b) i	"It eliminates or significantly reduces…" The interpretation of "significantly reduces"

may create confusion. The application guidance (AGX4.c) clarifies that “significantly reducing” is a lower level test than the requirements for effectiveness. Without the application guidance, the word “significantly” would suggest a level similar to the effectiveness level for hedge accounting. It would be preferable to use a clearer and different wording.

9 (b) 2nd para	“Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value…”. To avoid misunderstanding and to clarify the paragraph the coma should be removed. The text of IAS 39.46 (c) does not include a coma. Both conditions are required for no designation as at fair value through profit or loss.
11A	The paragraph introduces ‘substantive’ as a criterion. In the application guidance (AG 33B) the words ‘insignificant’ and ‘clear’ are used. We would prefer one criterion to be used rather than several, and therefore potentially confusing, ones. We suggest that instead of ‘substantive’ the words ‘not insignificant’ are used in this paragraph and in the appendix. We would prefer the consistent use of ‘not insignificant’ as compared to ‘clear’. We do not understand why AG 33B (b) is introduced. Clearly and closely related embedded derivatives (including prepayment options) may well be significant and an entity might wish to manage this risk economically without meeting the strict hedge criteria of IAS 39. We fail to see why this option should be precluded.
48A	The text of these paragraphs is taken from IAS 39 AG74 and AG76. By placing this text in the standard itself, it seemingly becomes more important than the rest of the application guidance on fair valuation. We do not understand why this should be the case. Furthermore in our view the last part of the paragraph in respect of the testing of the valuation methods for validity are more internal control/audit measures that are in fact better placed in the application guidance.
AGX5	We question why a number of similar financial assets or financial liabilities could be designated while a portion cannot be designated. In particular this contracts oddly with the hedging rules under IAS 39.
Disclosure ED 7	We have included a number of comments on some of the paragraphs proposed; however, we feel that we can only provide truly useful comments on these disclosures if we can consider the proposed disclosures in the full proposed text of ED 7.
ED 7. 3	We fail to see the benefit and the relevance of the disclosure on net gains or losses of designated instruments.
ED 7.4	It may be difficult to determine and separate the amount attributable to credit risk in particular if the instruments designated at fair value have a quoted market price. Regulators could request such information without it having to be disclosed in the notes to the financial statements.
ED 7.5	We do not see why disclosure on maximum credit exposure is required separately for loans and receivables designated at fair value, and not for other financial assets. It is also unclear to us why information on credit derivatives is more relevant to loans designated as at fair value rather than other loans.
ED 7.6(b)	This requirement is confusing to us and seems to contradict the requirement, underlying paragraph 4a to assess such movements on a “faithful” basis. In addition the reference to paragraph 5(c) is confusing as changes in fair values of loans and

receivables will not be affected by changes in “its” credit risk.

We would be pleased to discuss any aspect of this letter you may wish to raise with us.

Yours sincerely,

David Devlin
President