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Date: 21 July 2004

Ms Sandra Thompson
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Comments on Exposure Draft of Proposed Amendments to IAS 39 – 'The Fair Value Option'

Dear Ms Thompson,

We have reviewed the Exposure Draft and have the following comments.

Question 1

As stated in our response in October 2002 to the exposure draft of proposed amendments to IAS 39, we support the option to allow entities to designate a financial instrument at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit and loss.

The hedging rules in IAS 39 are complex and extremely onerous to apply. The fair value option allows entities to make use of naturally offsetting positions to achieve a hedged result, without the burden of the documentation and effectiveness testing required by IAS 39. The fair value option is particularly helpful in areas where there is a high volume of transactions that would make it operationally impossible to document and monitor IAS 39 hedge compliance.

We also note and agree with the dissenting views as set out in AV1 to AV7 of the exposure draft.

We therefore oppose the exposure draft as it is currently written. In view of the short time remaining before first-time IAS adoption at 1 January 2005, our preferred approach is to retain the existing wording within IAS 39 with respect to the fair value option.

Question 2

One of the key functions of our treasury management operations is to act as banker to the Group. It is a key source of funding to the Group, raising money in the money and capital markets through deposits, the issuance of Certificates of Deposit, Commercial Paper and Medium Term notes. Diversifcation of our investor base by instrument, invesor type and currency is an important factor in our liability management strategy.

The currency and interest rate repricing profile of the liabilities is very different to that of the assets that they are funding and derivatives play a critical role in managing these exposures. We have been planning to use the fair value option in two areas:

i) at the shorter end of the maturity spectrum where the volume of transactions would make it very onerous to apply the IAS 39 hedging rules; and

ii) in situations where medium term funding in one non- functional currency is swapped to fund assets in a second non-functional currency, where we are advised that the fair value hedging approach it not permitted.

We are also concerned at the proposed amendment to paragraph 9(iii) that would require us to demonstrate “substantial offset”. This is both very vague and could involve almost as much work as a full hedging approach.

<u>Question 3</u>

We note the concerns of the regulators in BC9. Taking each in turn:

(a) *entities might apply the fair value option where the fair value is not verifiable* – We think it unlikely that an entity would choose to do this, but accept that it is possible. We note and agree with the dissenting view in AV4 that it is illogical to require held for trading items to be fair valued (even if not verifiable) but to prohibit it for the fair value option.

(b) *use of the option might increase rather than decrease volatility in profit or loss* – This is possible, but it is hard to imagine why an entity would want to increase volatility. The fair value option is much more likely to decrease volatility as it will enable natural offsets to be used. Without the fair value option many entities may decide that hedge accounting is too difficult to achieve in some areas, and accept the artificial volatility arising from the IAS 39 mixed measurement model.

(c) *use of the option might result in an entity recognising gains in profit and loss resulting from a deterioration in its own creditworthiness* – This is true, and an undesireable effect of fair value accounting. However, we note that IAS 32 paragraph 94(f) would require disclosure of such a gain and the regulator would be able to interpret the results accordingly.

<u>Questions 4,5 and 6</u>

We have no further comments on these questions.

Yours sincerely,

Gary Wilkinson

Director of Accounting & Taxation