Our ref AWP/MJM

Your ref
Direct tel 020 7528 6290
Direct fax 020 7528 6229
Date 21 July 2004

CL 70

Sandra Thompson
Senior project manager
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Ms Thompson

Re: 'Fair Value Option' Amendments to IAS 39

In general we do not agree with the proposed amendments and consider that at present the existing requirements of IAS 39 should remain. Our concerns are summarised below and responses to the specific questions raised in the exposure draft are included in the attached appendix.

Addressing the concerns of regulators

The proposed amendments are largely in response to concerns raised by prudential supervisors of certain industries and we question whether these should be addressed in accounting standards. We believe that it is more appropriate to address regulatory concerns separately in regulatory returns rather than in accounting standards. As indicated by the IASB, accounting standards should be principles based so that they can be applied across all types of industries rather than address specific needs of individual industries. Moreover, we do not believe that a full assessment of the impact for other industries or for Phase II of the Insurance Project has been undertaken as a result of the timing of these proposals.

Verifiability of fair value

We disagree conceptually with the proposal to require fair value to be rather than reliably measured. In our view fair value should not be more narrowly defined for a specific category of assets/liabilities relative to the other IAS 39 categories. We are also concerned that the proposed 'verifiable' test could be interpreted too rigidly. Verifiable, particularly from an audit perspective, may have a specific sense of validation against observable markets which may not readily exist e.g. insurance liabilities in phase II; unlisted securities, bonds in developing markets. It is important that the drafting allows a sensible interpretation whilst ensuring reliable measurement.

Limiting the fair value option
We do not agree with the proposal to exclude loans and receivables from financial assets to which the fair value option can be applied. This may result in increased volatility where the loans and receivables are held to match insurance liabilities which are measured by reference to current interest rates

Due to the reasons stated above we believe that the IASB should revert to the December 2003 version that permitted the fair value through the profit and loss account treatment to be adopted without restriction. As with a number of other standards, it is then the role of the auditors and regulators to ensure that these principles are not applied inappropriately.

We thank the Board for the opportunity to raise our concerns and are available for further discussions relating to any of the issues raised.

Yours sincerely

ANDREW PALMER
Group Director (Finance)

APPENDIX 1

L&G Response to specific questions raised in Exposure Draft

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

We welcome the fact that the fair value option can be applied on an asset-by-asset basis to items that are financial assets other than ones that meet the definition of loans or receivables. However, we do not agree with the restrictions on the fair value option.

We appreciate that the Exposure Draft makes provisions for IAS 39 'unit-linked' liabilities to use the fair value option so that both the assets and matched liabilities are measured consistently. However, we are unclear about the impact of these proposed amendments in the longer term on non-linked investment contracts with discretionary participating features. In terms of IFRS 4 these may be accounted for under local GAAP as they will be addressed in phase II of the insurance project. Such contacts may fall short of both the proposed restrictions on the fair value option and the requirements for fair value to be verifiable instead of reliably measured.

We also do not believe that there should be narrower restrictions on fair value to be verifiable in the case of the fair value option compared to assets classified as available for sale which need to be reliably measurable. Both should satisfy the same definition of fair value and are subject to the same audit scrutiny.

We therefore believe that the IASB should revert to the December 2003 version that permitted the fair value through the profit and loss account treatment to be adopted without restriction.

(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? If so:*

(a) *please give details of the instrument(s) and why it (they) would not be eligible.*
(b) *is the fair value of the instrument(s) verifiable (see paragraph 48B) and if not, why not?*
(c) *how would applying the fair value option to the instrument(s) simplify the practical application of IAS 39?*

Refer to the answer above for the impact these amendments may have on non-linked investment contract liabilities.

(3) *Do the proposals contained in this Exposure Draft appropriately limit the use of the fair value so as to address adequately the concerns set out in paragraph BC9? If not, how would you further limit the use of the option and why?*

We do not think that any further limitations on the option would be appropriate.

(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. The Board proposes this category for the reasons set out in paragraphs BC6(a) and BC16-BC18 of the Basis for Conclusions on this Exposure Draft. However, the Board recognises that a substantial number of financial assets and financial liabilities contain embedded derivatives and, accordingly, a substantial number of financial assets and financial liabilities would qualify for the fair value option under this proposal.*

Is the proposals 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?

We agree with the Board that, for the reasons given in paragraph BC6(a), the fair value option should be available for financial assets and liabilities that contain one or more embedded derivatives even if there is no requirement for the embedded derivatives to be separated.

(5) *Paragraph 103A proposes that an entity that adopts early the December 2003 version of IAS 39 may change the financial assets and financial liabilities designated as at fair value through profit or loss from the beginning of the first period for which it adopts the amendments in this Exposure Draft. It also proposes that in the case of a financial asset or financial liability that was previously designated as at fair through profit or loss but is not longer so designated:*

(a) if the financial asset or financial liability is subsequently measured at cost or amortised cost, its fair value at the beginning of the period for which it ceases to be designated as at fair value through profit or loss is deemed to be its costs or amortised cost.

(b) if the financial asset is subsequently classified as available for sale, any amounts previously recognised in profit or loss shall not be reclassified into the separate component of equity in which gains and losses on available-for-sale assets are recognised.

However, in the case of a financial asset or financial liability that was not previously designated as at fair value through profit or loss, the entity shall restate the financial asset or financial liability using the new designation in the comparative financial statements.

Finally, this paragraph proposes that the entity shall disclose:

(a) *for financial assets and financial liabilities newly designated as at fair value through profit or loss, their fair value and the classification and carrying amount in the previous financial statements.*

(b) *for financial assets and financial liabilities no longer designated as at fair value through profit or loss, their fair value and the classification and carrying amount in the current financial statements.*

Are these proposed transitional requirements appropriate? If not, what changes do you propose and why? Specifically, should all changes to the measurement basis of a financial asset or financial liability that result from adopting the amendments proposed in this Exposure raft be applied retrospectively by restating the comparative financial statements?

We agree with the IASB's proposed transitional requirements.

(6) *Do you have any other comments on the proposals?*

We have no other comments on the IASB proposals.