ED 7
Financial Instruments:
Disclosures

22 October 2004

ABI Position Paper

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?

We believe that the disclosure proposed in the draft IFRS is appropriate, but we would reserve the possibility of further consideration of the following topics, partly treated by EFRAG:

- We do not consider it necessary, as proposed, to modify EFRAG to reinstate the disclosure requirement for the effective interest rate on liabilities as provided for in the IAS 32, para. 94 (d) and more generally, in IAS 32. paras. 67- 69. BC para. 39 of the draft IFRS makes it clear that the Board intended to replace the information content of paras. 67-69 (contractual conditions and effective interest rates) with sensitivity analysis. More generally, the need to keep “under control” the effective interest rates on liabilities issued and marked to market is served in any event by the disclosure required under para. 12 of the draft IFRS. Moreover, in the international accounting standards the indications on effective interest rate are circumscribed to a limited application, not extended to all liability items.
- EFRAG’s comment on para. 22 (disclosure in case of “impairment loss”) of the draft IFRS (cfr. IAS 32, para. 94 i), while perhaps formally correct, is not entirely necessary, insofar as in our view the draft IFRS requires, in substance, detailed account of impairment, including in terms of technical form. In fact, especially if the income statement is prepared in conformity with the nature of income components, the impairment will have to be analyzed distinguishing according to portfolio and technical form both.
- In our view, EFRAG’s comment in favour of reintroducing IAS 32, para. 90 on qualitative disclosure on recognition and measurement of equity instruments not measured at fair value might not be necessary, in that it is already included in the broader request concerning the accounting standards adopted by the entity in para. 23 of the draft IFRS. But it is necessary, in our opinion, to amend para. 31(c) of the draft IFRS to include a clause avoiding as excessively costly the quantitative disclosure of alternatives to fair value with an impact on the income statement if the valuation techniques do not reflect to market values. For this request would bring into the notes a kind of “what if” analysis, which is hard for the

average user of financial statements to understand and which is strongly opposed by other accounting systems. The text would be modified as follows:
"*If changing any such assumption to a reasonably possible alternative would result in a significantly different fair value, the entity should state this fact and disclose,* **if possible**, *the effect on the fair value of those reasonably possible alternative assumption*".

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?

On the disclosure required in para. 39 (minimum disclosures on the "credit risk") of the draft IFRS, the need to include the fair value of the collateral and other credit enhancements might be unduly burdensome. We thus think it is appropriate to amend the letter b) of the paragraph by adding "*or unduly burdensome*" after "*unless impracticable*":
"...*in respect of the amount disclosed in (a)*, *a description of collateral pledged as security and other credit enhancement and, unless impracticable* ***or unduly burdensome***, *their fair value*".

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?

We agree with the new draft IFRS request of disclosure on the sensitivity analysis of market risk (para. 43) and, in particular, we agree on the conclusions of paras. BC36-39, noting the greater simplicity of this presentation compared with the table required by IAS 32, paras. 60(a), 67(a) and 67(b), in order to enable the user of the financial statements to make own considerations and draw own conclusions on the entity's market risk. However, adopting the option regime enacted by the Securities and Exchange Commission (SEC) in this sphere, the entity could be given the same option between table exposition and synthetic indicators. Further, on the question raised by EFRAG concerning the use of Value at Risk (VAR) methodologies, in our view, the possibility already exists to consider the interdependence among risk variables and to use these methodologies to satisfy the market risk disclosure requirement (draft IFRS, paras. 44, BC 37 and IG35).

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 think it is appropriate for financial statements to give capital disclosures, in line with EFRAG's position. However, the need for public disclosure of the capital requirements imposed by regulators, in the course of recommendations requested in confidential fashion, is inopportune. Moreover, we think that the disclosure of internally set capital requirements is not strictly necessary. This information, in fact, would be particularly delicate and price-sensitive.

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?

We agree with the proposals.

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?

In our opinion, the proposal in the draft IFRS is not in line with the analogous requirement of the SEC, which reserves the disclosure to a specific section of the management report. In this regard, in contrast with EFRAG, we think that the disclosure about risks from financial instruments should not be located in the notes. This information, in fact, is drawn from synthetic indicators and not immediately derivable from the accounting data, placing it in the notes thus appears inappropriate, as it is a question of operations, it should go in the management report on operations.

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?

No comment on this point.

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?

We consider the Implementation Guidance to be sufficient for application of the risk disclosure requirements.

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
(iv) 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?

No comment on this point.