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6 October 2004

Ms Andrea Pryde
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Advance copy by facsimile

06 OCT 2004

Dear Ms Pryde

IASB EXPOSURE DRAFT 7 *FINANCIAL INSTRUMENTS: DISCLOSURES*

The Commission has considered the International Accounting Standards Board (IASB) Exposure Draft 7 *Financial Instruments: Disclosures* (ED 7). We wish to express our overall support for the proposed disclosure standards contained in ED 7. We also welcome the development by the IASB of a principle-based standard addressing financial instrument disclosures across all types of entity.

Our responses to the IASB's *Invitation to Comment* on ED 7 are contained in the **attached** Schedule. We repeat here for emphasis aspects of our responses that we consider particularly important in the New Zealand context.

In our consideration of this Exposure Draft we have had regard for how the introduction of an approved New Zealand equivalent of this standard would affect the disclosure environment for financial institutions in New Zealand. Regulation of financial institutions in New Zealand which are banks, both as public issuers of securities and as entities that fall under banking regulatory supervision, has developed on the basis that specific minimum disclosure of financial information required for regulatory purposes and has been incorporated into an approved New Zealand Financial Reporting Standard. It has been considered that a major benefit of this approach is the enhancement of the usefulness of financial information disclosures when these are required in the context of the same set of standards that regulate recognition and measurement issues in relation to elements of financial information.

We note that ED 7 provides for the withdrawal of IAS 30 *Disclosures in Financial Statements of Banks and Similar Financial Institutions*, and as set out in the Basis for Conclusions (in BC55-56), following approval of ED 7. Forseeably the New Zealand equivalent of IAS 30, which at this stage also incorporates the specific disclosures currently contained in a specific New Zealand Financial Reporting Standard (referred to above), will also be withdrawn at some time in the future. This is likely to have significant consequences both for market regulation of financial institutions in New Zealand as issuers of securities, and also for banking supervisory regulation here, in so far as information disclosure is concerned. The Securities Commission is currently considering this issue in conjunction with the Reserve Bank of New Zealand.

We believe that there are several possible courses of action which could mitigate the anticipated impact of the above in New Zealand. Among these are the following:

- The Financial Reporting Standards Board in New Zealand may consider addressing the matter of accommodating additional disclosure requirements required for regulatory purposes, either by:
  - i) developing a New Zealand Financial Reporting Standard to require specific additional disclosures in the case of financial institutions; or
  - ii) requiring disclosure of additional specific financial information either within the standard that will be the New Zealand equivalent of ED 7, or within Application/Implementation Guidance that would form part of the local standard.
- Alternatively if the IASB were to consider further developing the Implementation Guidance for ED 7, or an IFRIC which would interpret ED 7 for application by financial institutions, this would be helpful in the case of New Zealand. We are not sure whether this is at all a likelihood given general comments included in the IASB's *Basis for Conclusions* on ED 7 concerning entity-specific disclosure requirements.

If the disclosure issue that has arisen in New Zealand is one that is common to a larger number of jurisdictions who have undertaken to adopt IASB standards, we would encourage the IASB to consider this issue with a view to issuing guidance or an interpretation to address the matter of how the disclosure principles contained in ED 7 should be applied in the context of financial institutions as regulated entities. If this is not the case then we believe that the only feasible alternative may be to address the issue on a local national basis.

We hope that our comments above will be of assistance to the IASB in its final consideration of ED 7 for approval. We thank the IASB for the opportunity to comment on the proposed standard.

Yours faithfully

Jane Diplock AO
Chairman

Schedule 1 – IASB Questions

New Zealand Securities Commission Responses to Questions contained in the Invitation to Comment on IASB Exposure Draft 7 *Financial Instruments: Disclosures*

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

IASB ED 7 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;

(b) information about any allowance account;

(c) income statement amounts by classification;

(d) fee income and expense

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

Response:

We agree with these proposals and support the introduction by the IASB of a principles-based IFRS that deals with financial instrument disclosures for all types of entity.

In our consideration of ED 7 we have had regard for how the introduction of an approved New Zealand equivalent of this standard would affect the disclosure environment for financial institutions in New Zealand. Consequent to the envisaged withdrawal of IAS 30, and the move from the institution-specific approach adopted in relation to disclosure by financial institutions in that standard to the more generic principles-based approach to disclosure envisaged in ED 7, we expect that there may potentially be significant impacts for the disclosure-based banking supervision framework applied in New Zealand. The market regulation of financial institutions which are issuers in New Zealand, in terms of adequacy of information disclosures for raising capital through the issue of securities to the public, may similarly be affected.

Regulation of financial institutions in New Zealand which are banks, both as public issuers of securities and as entities that fall under banking regulatory supervision, has developed on the basis that specific minimum disclosure of financial information required for regulatory purposes has been incorporated into an approved New Zealand Financial Reporting Standard. It has been considered that a major benefit of this approach is the enhancement of the usefulness of financial information disclosures when these are required in the context of the same set of standards that regulate recognition and measurement issues in relation to elements of financial information.

In considering what possible solutions there may be to redress those expected impacts, we believe that there are several possible courses of action which might mitigate those effects. Firstly, the Financial Reporting Standards Board in New Zealand may consider making provision for the additional specific disclosure requirements to be made either:

- through development of a New Zealand Financial Reporting Standard to deal specifically with financial information disclosures required for financial institutions, or
- by incorporating additional specific financial information disclosure requirements for financial institutions either within the standard that will be approved as the New Zealand equivalent standard for ED 7, or within application/implementation material which would form part of that standard.

Alternatively, if the IASB were to consider further developing the Implementation Guidance for ED 7, or an IFRIC which would interpret ED 7 for application by financial institutions this would be a helpful outcome for New Zealand.

If the disclosure issue that we point out here is one that is common to a significant number of jurisdictions who have undertaken to adopt IASB standards, we would encourage the IASB to consider this with a view to possibly implementing one of the courses of action suggested above, which would assist with the resolution of these effects.

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

For an entity's exposure to credit risk, IASB ED 7 proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable. Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?

Response:

We agree with this proposal.

IASB Question 3 – Disclosure of a sensitivity analysis

For an entity that has an exposure to market risk arising from financial instruments, IASB ED 7 proposes to require disclosure of a sensitivity analysis. 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?

Response:

We agree with this proposal.

IASB Question 4 – Capital Disclosures

IASB ED 7 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.

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?

Response:

We agree with this proposal.

IASB Question 5 – Effective date and transition

The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged. Entities adopting IFRSs and IASB ED 7 for the first time before 1 January 2006 would be exempt from providing comparative disclosures for IASB ED 7 in the first year of adoption.

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

Response:

We agree with the proposed effective date and transition requirements.

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

The disclosure of risks arising from financial instruments proposed by IASB ED 7 would be part of the financial statements prepared in accordance with IFRSs. Some believe that disclosures about risks should not be part of the 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 IASB ED 7 should be part of the financial statements? If not, why not?

Response:

We strongly agree that the disclosures proposed by IASB ED 7 should be part of the financial statements for the reasons discussed in the Basis for Conclusions in paragraph BC41.

Also, if disclosures concerning the risks arising from financial instruments are contained in the financial statements then they will be part of the set of information that is audited. As such, investors will be able to derive a greater level of assurance from risk disclosures contained within the financial statements.

This approach to disclosure is also consistent with current New Zealand financial reporting practices where interest rate risk, credit risk, liquidity risk and currency risk are disclosed in the financial statements in accordance with FRS 31 *Disclosure of Information about Financial Instruments*.

IASB Question 7 – Consequential amendments to IFRS 4

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 IASB ED 7. The requirements in IFRS 4 were based on the disclosure requirements in IAS 32 that would be amended by IASB ED 7. The IASB'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 IASB ED 7? If not, why not and what amendments would you make pending the outcome of phase II of the IASB's Insurance project?

Response:

We agree that the risk disclosures in IFRS 4 should be amended to ensure that they are consistent with the requirements proposed in IASB ED 7.

IASB Question 8 – Implementation Guidance

The draft Implementation Guidance accompanying IASB ED 7 suggests possible ways to apply the risk disclosure requirements in paragraphs 32-45. Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

Response:

We do not have any additional proposals to make in relation to the ED 7 Implementation Guidance other than our comments in relation to financial institutions in IASB Question 1.

IASB 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 IASB ED 7, 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 requires 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; and

(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 IASB ED 7 (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a) of IASB ED 7.

Do you agree that the requirements in IASB ED 7 provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to IASB ED 7 would you propose?

Response:

We do not have any suggested amendments to the fair value disclosures contained in ED 7.

IASB Question 10 – Other comments

Do you have any other comments on IASB ED 7, Implementation Guidance and Illustrative Examples?

Response:

Please refer to the comments made in our response to IASB Question 1 above.