LIBA

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7 October 2004

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Sandra Thompson
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To: CommentLetters@iasb.org.uk

Dear Sandra,

Exposure Draft of Proposed Amendments to IAS 39
Transition and Initial Recognition of Financial Assets and Financial Liabilities

I am writing on behalf of the London Investment Banking Association (LIBA) to comment on the IASB Exposure Draft of proposed amendments to IAS 39 – Transition and Initial Recognition of Financial Assets and Financial Liabilities, which was published on 8 July. LIBA is, as you know, the principal UK trade association for investment banks and securities houses; a full list of our members is attached.

Financial instruments form a key component of the European business activities of the majority of LIBA members. We have therefore closely followed, and have in large measure supported, the IASB work on accounting for financial instruments, and we are very pleased to have the opportunity to comment on this further Exposure Draft.

Overall, we support the proposals in the ED. We commend the Board for its pragmatic approach in trying to incorporate into the existing standard requirements that, from a purely technical perspective and to ensure the greatest level of comparability with other IFRS filers, should be implemented on a retrospective basis.

Consequently, due to the difficulties many entities would have in applying the requirements on a fully retrospective basis, we agree that entities should be given a pragmatic alternative. The Board should however be aware that the alternative proposals as drafted will not result in full comparability to US GAAP, both because of the differences between IAS 39 Revised and EITF 02-03 and because the generally accepted date for application of EITF 02-03 was actually 21 November 2002. To ensure greater comparability, we suggest the date in the final revised standard should be amended from the October date in the ED.

Our detailed responses to the questions in the Invitation to Comment section of the ED are set out below.

Question 1

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

We agree that entities should be given a pragmatic alternative to fully retrospective application of the 'day one' measurement recognition requirements for financial instruments not from an active market. We also believe that such an alternative should apply both to existing users of IFRSs and to first-time adopters, to ensure the greatest level of comparability.

We note that paragraph BC6 considers some of the practical issues that preparers would face without such an alternative, but we feel it does not go far enough to cover all the issues entities would have. In particular, paragraph BC6(a) presumes that an entity "would not need to re-estimate the fair value of financial instruments. Rather they would recognise them at the transaction price." This would have the effect of precluding any recognition of day one gains or losses for transactions prior to implementation, irrespective of whether an alternative fair value could have been determined at the time of the transaction, using data from observable markets. As well as the difficulty in identifying past transactions to which these restrictions would apply, determining what was observable at the time would require the use of hindsight, and may require the gathering of data not readily available after the event.

Even if the Board amends the proposed date to the actual date used for application of EITF 02-03, the Board should be aware that both in its scope and its application, EITF 02-03 differs to the requirements already laid out in IAS 39 Revised. This appears to be recognised by the Board in paragraphs 5 and BC3, which refer to "very similar requirements in US GAAP". However, the other ED references to US GAAP imply that the requirements are exactly the same, including the comment in paragraph 6, that this proposed change would "enable entities to eliminate any reconciling differences with US GAAP".

We believe that greater consistency could be achieved, both between Revised IAS 39 and US GAAP and between the two approaches in Revised IAS 39 for active and non active markets, if a further change were made to AG 76. We support the current drafting, under which "an entity obtains market data consistently" to determine fair value, but we do not see the logic for restricting this data, where the instrument itself is not in an active market, to "the same market where the instrument was originated or purchased".

Overall, we hope the IASB will continue to work closely with the FASB to develop a more consistent approach to the fair value measurement of financial instruments, building on the existing guidance under both GAAPs.

Question 2

Do the proposals contained in this Exposure Draft appropriately address the concerns set out in paragraph 5 of the Background on this Exposure Draft? If not, why not and how would you address those concerns?

We agree with the concerns expressed in paragraph 5, but we strongly refute the implied suggestion in paragraph 5 that the reason this ED is required is because respondents did not "raise any specific concern about retrospective application" with the original 2002 ED. The proposal to incorporate what is effectively a P&L based requirement into what is otherwise a balance sheet based standard was not taken until 2003 and the relevant drafting was not exposed for comment. We followed the Board's public discussions on this and related matters very closely, and we were concerned, as stated in several letters to the IASB during 2003, that the fair value measurement guidance, as well as other sections of IAS 39 that were being extensively rewritten, would benefit from further public exposure, or at least from closer consultation with organisations closest to the practical issues of applying this accounting standard.

Question 3

Do you have any other comments on the proposals?

We are pleased that the Board has attempted to clarify the subsequent recognition of any gain or loss not recognised on 'day 1', but we are concerned that the clarification as drafted in paragraph AG76A could be interpreted as more restrictive than we believe the Board intended. The Basis for Conclusions makes reference to (quite rightly) eliminating any presumption that a 'day 1' gain or loss held up should be automatically reversed on 'day 2', but it otherwise provides little further insight as to how AG76A should be interpreted. We understand the Board did not intend to eliminate the possibility that 'day 1' gains or losses could be recognised as unrealised P&L before maturity but, quite rightly, did not want at this stage to be too prescriptive about the methodologies to be applied. To avoid confusion, we suggest that:

1) The last sentence of AG 76A be amended slightly, so that it reads:

   "Accordingly, a gain or loss shall be recognised after initial recognition only to the extent that it arises from a change (such as observability or time) in a factor that market participants would consider in setting a price."

2) Wording along the following lines be added to the Basis for Conclusions of the revised IAS 39:

"The Board decided to clarify that recognition on an unrealised basis of the initial 'day 1' gain or loss could be appropriate, but only if:

a) the subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses were consistent with the requirements in IAS 39; and

b) accordingly, a gain or loss should be recognised after initial recognition only to the extent it arises from a change (such as observability or time) in a factor that market participants would consider in setting a price."

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I hope that the comments in this letter are helpful. We would of course be very pleased to discuss further any of our drafting suggestions, if that would be helpful, or to expand on any particular points which may be unclear.

Yours sincerely

Ian Harrison
Director

LONDON INVESTMENT BANKING ASSOCIATION

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