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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **December 2008, London**

Project: **IAS 39 *Financial Instruments: Recognition and Measurement***

Subject: **Fair Value Option (Agenda Paper 6B Addendum)**

INTRODUCTION

1. Some participants in the round tables on the global financial crisis asked the boards to consider amending particular requirements related to the fair value option (FVO). Agenda paper 6B discusses the three issues that participants raised.

2. One of the issues raised is the ability to transfer out of the FVO category. In October the IASB issued amendments to IAS 39 and IFRS 7 *Reclassification of Financial Assets* that permit reclassification out of the held-for-trading category (HFT) in particular circumstances. Some participants suggested that those amendments should be extended to instruments classified under the FVO.

3. In paragraph 14 of agenda paper 6B, we note that one participant said that the IFRS criteria for designation as HFT are more stringent and restrictive than US GAAP. As a result, the participant stated that the recent amendments on reclassification do not create a "level playing field" because more instruments can be designated as HFT under US GAAP (and, thus, are eligible for reclassification in rare circumstances out of HFT).

4. In paragraph 17 of agenda paper 6B, we discuss a difference between IFRS and US GAAP related to the HFT definition.

5. However, since posting agenda paper 6B, we have received more information about the participant's concern. This paper summarizes that additional information and provides our view.

Held-for-Trading Designation under IFRS and US GAAP

IFRS

6. Paragraph 9 of IAS 39 states that a financial asset or financial liability is classified as HFT if it is:

    a. acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

    b. part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

    c. a derivative (with particular exceptions).

7. Paragraph AG14 of IAS 39 states that "[t]rading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin."

US GAAP

8. Paragraph 12(a) of SFAS 115 *Accounting for Certain Investments in Debt and Equity Securities* states that

    > …securities that are bought and held principally for the purpose of selling them in the near term (thus held for only a short period of time) shall be classified as *trading securities.* Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price.

9. The FASB published “A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers”.

10. Question #35 is relevant:

    Q: If an enterprise acquires a security without the intent to sell it in the near term, may it classify the security in the trading category?

    A: Classification of a security as trading is not precluded simply because the enterprise does not intend to sell it in the near term. The Board deliberately used the terms generally and principally in describing the trading category in paragraph 12(a). However, the decision to classify a security as trading should occur at acquisition; transfers into or from the trading category should be rare (refer to paragraph 15).

PARTICIPANT VIEW

11. The participant who raised this issue seemed to acknowledge that the wording in IFRS and US GAAP is essentially the same. Specifically, both IFRS and US GAAP state that instruments designated as HFT are acquired **principally** for the purpose of selling in the near term.

12. The staff also notes that, in addition to the use of the term **principally**, both IFRS and US GAAP state that trading **generally** reflects active and frequent buying and selling, and trading securities are **generally** used with the objective of generating profits on short-term differences in price.

13. However, the participant stated that the interpretation in practice is that the use of HFT is more limited and restricted under IFRS. Essentially, unlike the guidance in Question #35, <u>**IFRS practice**</u> appears to preclude classification of a financial instrument as HFT if the entity does not intend to sell the security in the near term.

STAFF VIEW

14. The words in paragraphs 9(a) and AG14 of IAS 39 are nearly identical to paragraph 12(a) in FAS 115.

15. Consistent with the staff recommendation in agenda paper 6B, we recommend that the board only consider the FVO as a “package”, and that making piecemeal amendments will not enhance financial reporting or improve investor confidence.

16. Moreover, we think that the board **should not** provide additional guidance on the definition of HFT to address the practice issue described in this addendum.

17. As noted in the cover paper 6 for this session, some participants at the round table meetings noted that short-term changes to attempt to create a “level playing field” would not improve financial reporting of financial instruments or enhance investor confidence in financial markets, because of the temptation to ‘cherry-pick’ particular requirements that provided a desired accounting answer but to ignore other related requirements that are not as attractive.

18. **Question for the board: The staff thinks that the board should not provide additional guidance on the definition of *held-for-trading*. Does the board agree with that recommendation? If not, what does the board suggest and how would that improve financial reporting and enhance investor confidence?**