Analyst Representative Group

2 November 2010

This document is an IASB staff summary of the matters discussed at the public sessions of the meeting of the Analyst Representative Group that took place in London on 2 November 2010.

All of the papers discussed by the Analyst Representative Group in the public sessions are available on the IASB website. A full recording of each of the public sessions is also available on the pages of the projects discussed.

Financial Instruments - Hedge accounting

1. Martin Friedhoff (MF) (IASB staff) presented the session and discussed the main points of the proposed model using the prepared slide deck.

2. He stated that there are some significant changes in the proposed model, as compared to the existing model for accounting for hedge accounting. This is because the Board decided to address hedge accounting comprehensively, and not just to undertake an improvements project. He highlighted the areas of significant change.

3. MF added in response to a question that the proposed model should offer significant relief to a number of entities, but perhaps not for those entities that have a dynamic hedging strategy (resetting hedged items regularly – difficult to track and identify hedge ineffectiveness).

4. In response to another question, he stated that it is unlikely that application of the hedge accounting model would be mandatory, for a number of practical reasons. However, he said that it is possible, if more entities apply hedge accounting in the future, that there may be more of a natural compulsion for entities who are not applying the model to follow suit.

5. MF briefly discussed the case of derivatives as hedged items, as well as the hedging of groups and net positions. He also discussed purchased options as hedging instruments.

6. On hedge effectiveness, he noted that the 'bright line' of 80–125% has been removed and the proposed model follows a more objective–based hedge effectiveness test. Reducing hedge ineffectiveness remains a primary objective.

7. MF briefly discussed some presentation issues and the impact of the proposed model on OCI, and answered some related questions (e.g. accounting for longevity hedges).

8. Steve Cooper (SC) suggested that the topic be presented again at a future session of the ARG, once the exposure draft has been published.

Leases – Lessor accounting

9. Aida Vatrenjak (AV), Barbara Davidson (BD) and David Humphreys (DH) (IASB staff) presented the session. AV provided a brief overview of the lessor accounting

model, based on the slide deck provided. She then moved onto the questions included in the slide deck.

10. A number of questions were discussed. All of the questions asked which of the 5 approaches would best reflect the economics of the transaction dealt with in the particular example: (1) derecognition, (2) finance lease, (3) performance obligation, (4) operating lease and (5) operating lease at FV.

11. Question 1 involved a one week rental of a Ford Focus by Hertz. In this case, an operating lease approach was the most popular option. Relevant depreciation policies were discussed.

12. Question 2 involved a 3 year Boeing 737 (estimated useful life of 25 years) lease by Boeing. The point was raised that a business like Boeing has typically a selling and a leasing segment – are there internal 'selling' issues to consider first? There could be an opportunity to improve (or 'window-dress') profits by internally transferring assets between the leasing and the selling divisions. Good disclosure around such internal transfers would definitely be needed.

13. Question 3: a 5 year lease of a retail outlet in One New Change by Land Securities. Operating lease plus FV was the most popular option – therefore show the investment property at fair value on the balance sheet, with disclosure between the rental stream and the residual value in the notes. It was noted however that some jurisdictions prefer not to show investment properties at fair value.

14. Question 4: 20 year Boeing 737 lease by: (1) Barclays, (2) Boeing. The point was made that the transaction is of a different nature – Barclays is a financial institution and Boeing is a manufacturer/lessor business. Some members thought that the treatment should be the same for each of the entities. AV stated that the derecognition approach appeared to be the answer for such a transaction.

15. There was no time in the session to discuss any further examples, but the staff encouraged the members to have a look at the survey on the Board's website on lessor accounting.

Discount rates and insurance

16. SC stated that the discount rate issue is a cross-cutting issue across a number of Board projects - insurance, pensions, financial liabilities, and non-financial liabilities, inter alia.

17. Alessandro D'Eri (AD) presented the session on discounting insurance liabilities. He discussed the main points of the issue and an example using the prepared slide deck. He said that the discussion would be focused on non-participating insurance contracts (where payments to the policy holders were not linked to the performance of the assets).

18. He stated that determining the appropriate discount rate for liabilities relating to non-participating insurance contracts, a number of items could be factored in. Also, the asset return rate could be used, or a risk-free rate. Both of these options have been supported in turn by various jurisdictions.

19. The exposure draft suggests the risk-free rate plus an adjustment for liquidity is the appropriate discount rate to be used. Staff stated that this method is not supported by some entities because of the volatility in earnings it may cause, and possible day one differences.

20. A member stated that the risk-free rate would be preferable, to rule out any subjectivity on determining the liquidity premium and also to ensure comparability between entities. Staff mentioned that some jurisdictions do not have a reliable risk-free rate available.

21. A question was then asked, why add in a liquidity premium? The most supported answer was that it is included in order to recognise the advantage of the long-term nature of non-participating insurance liabilities – and therefore, the point was made, such a rate may also be relevant to some pension liabilities. SC re-iterated the cross-cutting nature of the discount rate debate.

22. Generally, the use of the asset return rate was not supported (apart from one member), because of the non-participating nature of the liability.

Financial Instruments - Impairment

23. Martin Friedhoff (MF) presented the session and discussed the main points of the proposed model using the prepared slide deck. He spent some time discussing the feedback that the Board had received on the various approaches, and also the Board's current thinking on which approach was preferable, taking cost-benefit considerations into account.

24. One member stated that the larger banks should already have information to hand to make the Expected Cash Flow (ECF) approach viable. MF stated that perhaps some of them do, but the feedback the Board had received was that certain information (specifically for open portfolios) could not be extracted from an entity's systems without significant effort and cost. The member suggested then that banks should disclose the information for portfolios for which it was available, and not for those where it was not available. He said such a flexible approach may overcome some of the practical difficulties and the information would be very useful to the user.

25. SC confirmed that certain entities had stated that their systems did not retain historical vintage data for open portfolios, but such feedback was only given to the Board only once the exposure draft (ED) had been finalised, hence the need for re-deliberations of the ED proposals. Staff stated it was a possibility for entities to show the information required for closed portfolios in the meantime, while a solution was being found for gathering the information for open portfolios.

26. MF then discussed the day 1 loss issue, and SC briefly discussed certain aspects of the FASB's view of the topic. MF went on to discuss the Board's re-deliberations of the ED proposals.

Work plan update

27. Peter Clark (PC) discussed the latest Board workplan. There were some questions, relating to continued inclusion of lessor accounting in the *Leases* project, timing of the *Joint Arrangements* standard, *Revenue Recognition* and the interaction with the *Impairment* proposals, *Financial Statement Presentation* (whether aspects of the

proposals could be implemented individually), Post-2011 Agenda, *Effective dates on transition* (the members' attention was drawn to the fact that there is an exposure draft out for comment) and convergence issues.

28. SC noted that a session on Disclosure at the next ARG meeting (February 2011) would be useful.

29. The incoming (July 2011) Chair of the Board, Hans Hoogervorst, was introduced to the members, and a brief discussion followed.