

Dora Cheung
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International Accounting Standards Board
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Dear Ms Cheung

Exposure Draft of proposed improvements to International Financial Reporting Standards

This letter is the British Bankers' Association's response to the above exposure draft. The BBA is the leading UK banking and financial services trade association and acts on behalf of its members on domestic and international issues. Our 230 banking members are from 60 different countries and collectively provide the full range of banking and financial services. They operate some 130million accounts, contribute £50bn to the UK economy and together make up the world's largest international banking centre.

Before commenting on the proposed improvements, we wish to caution against the danger of unintended consequences. IFRS has progressed markedly in recent years to a position where it is on the verge of becoming the globally accepted basis for financial reporting. Whilst the desire to eliminate all imperfections in IFRS is laudable it must be accepted that due to limited resources minor imperfections are likely to persist. There is a real danger that numerous minor amendments to address these short-comings will obscure the need for more fundamental revisions and that an amendment that appears to be innocuous could have wider, unintended, consequences. The cost to the IASB and its constituents in preparing and reviewing the amendments, including the costs and time taken to translate and promulgate relatively minor wording changes, should be borne in mind to ensure that these costs are not greater than benefits achieved. It is also important to be alert to the risk of IFRS moving from a principles-based regime to a rules-based one.

Nevertheless, we support the practice of bringing forward groups of sufficiently important but relatively minor amendments together in one annual exposure draft. Below we comment on the amendments of particular interest to the banking industry. At the outset we wish to make clear that we do not believe that the annual improvements process is the correct mechanism to deal with the issues of compliance with IFRS or the definition of a derivative. The first is an issue which goes beyond standard setting and is an issue for regulators, the second merits a stand-alone exposure draft.

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INVESTOR IN PEOPLE

IFRS 1**Question 4**

Do you agree with the proposal to require an entity that cannot make an unreserved statement of compliance with IFRSs to describe how its financial statements would have been different if prepared in full compliance with IFRSs? If not, why?

We fully agree that entities should disclose the accounting policies that have been used to prepare their financial statements. This is necessary for users to sufficiently understand the information presented and to ensure that there is clarity as to which entities have adopted 'full' IFRS and those which have not. However, we disagree with the amendment and support the views expressed in the alternative views.

If the amendment is being introduced to combat a belief that users are interpreting statements such as "these financial statements have been prepared in accordance with IFRS as adopted for use in XX" to mean that they are fully compliant with IFRS, we see this as an educational issue and an issue for regulators of capital markets and not an issue that standard setters can effectively address through standards.

The amendment as drafted implies a narrative explanation of differences. However, some may interpret it to require a numerical analysis of differences along the lines of the reconciliation to US GAAP. Given the history of the US GAAP reconciliation, we are of the view that the costs of any numerical analysis are likely to exceed any benefit to users. In any case, the requirement for the provision of such information is in the remit of capital market regulators rather than the IASB.

IFRS 7**Question 3**

The Board proposes to amend paragraph IG13 of the guidance on implementing IFRS 7 *Financial Instruments: Disclosures* to resolve the potential conflict with IAS 1. Do you agree with the proposal? If not, why?

We agree that there is a potential conflict between the two standards and so agree with the amendment on this basis.

IAS 39**Question 30**

Do you agree with the proposal to amend IAS 39 by removing from the definition of a derivative the exclusion relating to contracts linked to non-financial variables that are specific to a party to the contract? If not, why?

Contracts in the scope of IFRS 4 are already excluded from the scope of IAS 39 by paragraph 2(e). Therefore, we believe the reference to non-financial variables is useful in helping to identify contracts and terms embedded in contracts which meet the current definition of a derivative. Amending the definition in this way is likely to have far reaching implications and result in changes to existing practice. While these changes may improve accounting, we are not convinced that sufficient evidence has been obtained that this is the case or that the increased efforts to find and measure embedded derivatives will exceed the benefits. For example, the change could potentially lead to confusion over royalty schemes where a percentage of the turnover is handed over in royalty and employee bonus schemes where employees are pledged a percentage of the company's profits [if in scope of IAS 19 then outside IAS 39 already].

It also seems possible that the amendment would conflict with the proposed amendment to IAS 21 to recognise contingent rent as incurred if the contingent rent feature was also considered to be an embedded derivative since leases are within the scope of IAS 39 for embedded derivatives. Furthermore, the fair values of non-financial variables that are specific to a party to the contract may be subject to variability in the range of reasonably possible fair values and the probabilities of the various estimates with the range may not be able to be reasonably assessed and used in estimating fair value. It seems inequitable for fair value to be required for such derivatives when derivatives linked to unquoted equity instruments are not fair valued in these circumstances. For these reasons we do not consider this to be an appropriate issue to be addressed in an Annual Improvements process and ask that further analysis is completed.

Question 31(a)

Do you agree with the proposal to amend IAS 39 to clarify the definitions of a financial instrument classified as held for trading? If not, why?

We agree that the proposed amendment clarifies the situation, although we are not aware of any misunderstanding in this area.

Question 31(b)

Do you agree with the proposal to insert in IAS 39 paragraph 50A to clarify the changes in circumstances that are not reclassifications into or out of the fair value through profit or loss category? If not, why?

We agree that paragraph 50 should not apply to instances when a derivative starts or stops being designated as a hedging instrument in accordance with the retrospective rules in IAS 39. However, we would combine paragraphs 50 and 50A by making the following change as proposed by EFRAG:

50 An entity shall not reclassify a financial instrument into or out of the fair value through profit or loss category while it is held or issued, unless

~~50A The following changes in circumstances are not reclassifications for the purpose of paragraph 50:~~

- (a) a derivative that was previously a designated and effective hedging instrument no longer qualifies as such;
- (b) a derivative becomes a designated and effective hedging instrument.

Question 32

Do you agree with the proposal to amend paragraph 73 of IAS 39 to remove the references to segment reporting? If not, why?

We agree with the proposed amendment.

Question 33

Do you agree with the proposal to amend paragraph AG8 of IAS 39 to clarify that the revised effective interest rate calculated in accordance with paragraph 92 should be used, when applicable, to remeasure the financial instrument in accordance with paragraph A8? If not, why?

We support the proposed clarification.

Question 34

Do you agree with the proposal to amend paragraph AG30(g) of IAS 39 to clarify that prepayment options, the exercise price of which compensates the lender for loss of interest by reducing the economic loss from reinvestment risk, as described in paragraph AG33(a), are closely related to the host debt contract? If not, why?

We agree that in principle the amendment is correct. We would caution, however, that there is a possibility that the amendment might create structuring opportunities, as the extent to which a reduction has to occur is not specified, but can offer no solution that addresses this risk.

Yours sincerely,

A handwritten signature in black ink, reading "Paul Chisnall". The signature is fluid and cursive, with the first name "Paul" and last name "Chisnall" clearly distinguishable.

Paul Chisnall
Executive Director

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