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Friday 27th, May, 2005

EFRAG Comments on IFRIC Draft Interpretation: Reassessment of Embedded Derivatives

Dear Ms Boysen,

Our members represent leading participants in the privately negotiated derivatives industry and include most of the world's major financial institutions, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. As such we believe ISDA brings a unique and broad perspective to the IASB's work on accounting for financial instruments.

Thank you for the opportunity to comment on EFRAG's views on D15 IFRIC's Draft Interpretation for the Reassessment of Embedded Derivatives. In our draft letter to the IASB (see attached) we support the consensus reached, which we believe to be the most appropriate and practical way to interpret paragraph 11 of IAS 39.

ISDA welcomes EFRAG's support for the conclusions reached by IFRIC that entities shall assess whether to separate embedded derivatives when the entity first becomes a party to the contract, and that subsequent reassessment should be restricted. However, we do not agree with the suggestion in EFRAG's draft response that "changes in the terms of the contract" should include changes in market conditions. The conclusion that IFRIC came to was that embedded derivatives should be assessed when an entity first becomes a party to the contract and that a subsequent reassessment should neither be necessary nor permitted, unless there was a change in the contract terms. It is our view that a requirement to take into account changes in market conditions would be contrary to our interpretation of IFRIC's proposal and be extremely onerous to apply.

Should EFRAG continue with the above suggested amendment to D15, then we would encourage you to clarify the example used in the letter. The example, as currently worded, seems to suggest that because the long-dated gas contract is initially priced off a proxy index, the contract will be considered (at initial inception) to contain an embedded derivative; and that when, subsequently, a gas price becomes available the embedded derivative would disappear? However, we believe that at initial inception, as there was no long term gas market at the time the contract was negotiated and as a commonly used pricing mechanism to best determine

the value of the payments due under this type of contract is by way of a proxy index, then you could consider the proxy index to be closely related to the host contract, and therefore conclude no embedded derivative exists.

We would be pleased to discuss our comments with EFRAG. Please contact Ed Duncan at ISDA on (020) 7330 3574.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ed Duncan', with a large, sweeping underline stroke below it.

Ed Duncan
Director of European Policy at ISDA.

cc.
Paul Ebling – EFRAG Technical Director (paul@efrag.org)