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Friday, 8th April

Recent Board decisions on ED-7 Disclosures for financial instruments

Dear Ms Pryde,

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.

At the IASB's February meeting, the Board decided to require disclosure of:

- "the difference between transaction prices at initial recognition (used as fair value in accordance with paragraph AG 76 of IAS 39) and valuations made at initial recognition that result from a valuation technique whose variables do not include only data from observable markets.
- "a reconciliation showing changes in the amount of this difference during the period.
- "the entity's policy for determining when this difference is recognised in profit or loss".

ISDA has a number of issues and points that the IASB should consider before proceeding with the proposed disclosures:

i) The new requirement has been introduced without exposure or discussion with those firms that will be most affected. The amendment is, in our view, too significant to make without exposure, especially as there is currently no similar disclosure requirement under US GAAP. Also, as discussed below, we have concerns with the practical implementation of this requirement unless there is consultation with the firms most affected on the wording of the requirement. It seems incongruous for such an important additional disclosure to be agreed by the IASB so close to the publication of the final standard, without consultation.

ii) In revising IAS 39 the Board concluded that it was necessary for valuations to include only observable market data in order to "provide reasonable assurance" that the fair value was other than the transaction price for the purpose of recognising up-front gains or losses (BC 104). Paragraph AG76, would indicate that IAS 39 allows an entity to calibrate its model on Day One such that its result equates to the transaction price. The entity should then periodically recalibrate and test for validity using observable prices or inputs. If this was the case, the disclosures required by the proposals would seem non-sensical, since the model that includes unobservable data does not exist.

iii) Further, institutions may apply different assumptions and methodologies in the recalibration for observable parameters and other valuation adjustments. When applying valuation adjustments, an institution will generally apply adjustments at a portfolio level (such as liquidity and/or bid-offer) and then review relevant transactions individually for Day One P&L deferral. The assumptions involved at each level can vary significantly between firms. Without further discussion around the objectives of the Board the resulting disclosures and comparisons between different institutions will not necessarily be meaningful.

We would be pleased to discuss our comments with the Board or staff. Please contact Melissa Allen at CSFB on (020) 7883 3598 or Ed Duncan at ISDA on (020) 7330 3574.

Yours sincerely

Melissa Allen
Chair of the ISDA European Accounting Committee.

Ed Duncan
Director of European Policy at ISDA.