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Re: Draft CESR Consultation: "Fair Value Measurement and related disclosures of financial instruments in illiquid markets"

Dear Chairman,

The International Swaps and Derivatives Association (ISDA) welcomes the opportunity to comment on CESR's Draft Consultation Paper (CP): "Fair Value Measurement and related disclosures of financial instruments in illiquid markets". We understand that the paper has been produced in response to the recent market turmoil, and that the draft consultation paper will form the basis of preliminary views presented to ECOFIN before a meeting in September, with a final CESR statement published in October.

ISDA, which represents participants in the privately negotiated derivatives industry, is the largest global financial trade association, by number of member firms. ISDA was chartered in 1985, and today has over 840 member institutions from 56 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, 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.

ISDA's European Accounting Committee has recently discussed CESR's "Draft Fair Value Measurement and related disclosures of financial instruments in illiquid markets" and would like to stress the following key messages: -

- We are concerned that CESR input on the interpretation of existing IFRS with regards to the fair value of illiquid financial instruments could be construed as some form of European accounting guidance. CESR acknowledges in the Draft CP that the competence of setting and formally interpreting standards lies with the IASB/IFRIC. We agree wholeheartedly with this statement and it is on this basis we discourage CESR from issuing any literature that maybe treated as guidance. Issuing anything which could be read as general application guidance on IFRS could contravene CESR's own standards on enforcement in Europe ("Financial Information: Enforcement of Standards on Financial Information in Europe", Principle 20 Standard no.1, dated 12 March 2003).

- ISDA supports the convergence of national efforts to enforce procedures in relation to the transition and application of IFRS. We feel that it is important to encourage a level playing field in enforcement where no one jurisdiction is perceived as being more lenient than another. However we caution CESR over issuing any rules or further guidance that result in interpretations that diverge from the intentions of the standards and that could be construed as creating new European accounting standards rather than enforcing existing ones. We believe this could lead to a whole new set of European “carve-outs”, and potentially undermine the global convergence project.

- ISDA believes that interpretations of accounting standards become necessary only where the standards lack clarity, and not where constituents want to eliminate the need to apply judgement. Where you have “principles based” standards, ISDA members consider the role of applying judgement as an important one. “Principles-based” standards should not result in a “one-size-fits-all” accounting model. We welcome acknowledgement in the paper that the flexibility of the IASB’s “principles-based” standards, which unlike a more rules-based approach, allow for a range of interpretation depending on the different circumstances of the transaction under consideration.

- We recognise that as a result of the recent market turmoil there has been an increase in focus on the disclosures of leading financial institutions. Some of this focus has been on market practice in disclosing information on valuations and valuation methodologies. However, although we read with interest the report from the Senior Supervisory Group (SSG) entitled "Leading Practice Disclosures for Selected Exposures", published in April 2008, we question the wisdom of proposing a detailed tabular form of disclosures that may or may not prove relevant for all types of institution. Disclosure in such a format could be costly to produce and may not be relevant and/or provide decision useful information for the users of the accounts. We think it would be more useful if CESR were to work along side the IASB on reviewing the first years' IFRS 7 disclosures, and make any recommendations for enhancements based on the European experience to the IASB for their consideration. Introducing additional disclosures that would apply to a subset of IFRS preparers would not enhance the comparability and consistency of reporting .

Moreover, the draft statement duplicates and/or parallels the work that the IASB is doing through its Expert Advisory Panel (EAP) on the valuation of financial instruments in inactive markets. We suggest that that it would be much better for CESR to provide these ideas as input to the EAP than to produce separate best practice guidance itself. Regardless, given that the IASB has both fair value and financial instrument disclosure issues on its September agenda it would be better to await the outcome of the Board’s deliberations before issuing any publication in this area.

We provide our detailed comments, and response to the questions in the section below. We would be pleased to discuss our comments further with CESR and to answer any questions you may have. Please contact either Ed Duncan at ISDA (0203 088 3550) or Melissa Allen at Credit Suisse in London.

Yours sincerely

Melissa Allen
Chair of ISDA's European Accounting Committee
Managing Director, Credit Suisse

Ed Duncan
Head of Risk and Reporting at ISDA

Appendix: detailed comments and responses to the questions

Questions 1.
Do you agree with CESR's views above regarding the distinction between active and non active markets for fair value measurement?

We believe the views in the draft paper with regards to the distinction between active and non active markets are consistent with the approach to fair value measurement set out in IAS 39. It is clear that determining the fair value of illiquid instruments will always require the application of careful judgement. The application of judgement under IAS 39 is currently the subject of detailed discussions at the IASB's Expert Advisory Panel (EAP) on the valuation of financial instruments in inactive markets. We understand that as a result of these discussions the IASB is likely to issue relevant material on measurement and disclosure in the coming weeks.

Lastly, where paragraph 29 talks about identifying a forced sale, it is unclear to us as to why an internal valuation technique would be used, where current market transactions are available. If on the other hand the paper is suggesting an internal valuation technique should be used to assess whether a market transaction is a forced sale then this needs to be made more clear.

Question 2.
Do you agree with CESR's views above regarding inputs to valuation techniques for financial instruments in illiquid markets?

We would like to point out that this topic is also under review by the IASB expert panel, and we think the work of the panel will help address any outstanding concerns CESR may have in this area.

We would also like to point out that it is well understood among practitioners the list of inputs in AG82 is not meant to be exhaustive, and that valuation experts routinely consider both the liquidity and correlation risk characteristics of the instruments they are valuing.

Question 3
Do you agree with CESR's views above regarding disclosures of financial instruments in illiquid markets?

We firmly believe that the focus of any information provided to the markets should be on the quality of that information rather than the quantity and it should accordingly be released only after it has been subject to appropriate quality control and audit checks. We believe any additional disclosure requirements with regards to financial instruments in illiquid markets should be based on characteristics of relevance and whether or not it provides decision useful information.

We recognise that as a result of the recent market turmoil there has been an increase in focus on the disclosures of leading financial institutions. Some of this focus has been on market practice in disclosing information on valuations and valuation methodologies. We read with interest the report from the Senior Supervisory Group (SSG) entitled "Leading Practice Disclosures for Selected Exposures", published in April 2008, and we welcomed the conclusion in the report that disclosure practices can be enhanced without necessarily amending existing disclosure requirements. We understand the scope of the SSG report was restricted to disclosure practices regarding exposures to certain instruments, including collateralized debt obligations, residential mortgage-backed securities, commercial mortgage-backed securities, other special purpose entities, and leveraged finance. We also understood that the report was intended to provide a peer review to enable firms to benchmark their disclosure practices against other firms ("*we expect that financial firms will find this review useful in assessing and enhancing their own disclosures*"). The SSG report does not mandate enhanced disclosure partly in recognition of the fact that firms adopt different business strategies, and that not all of the examples of disclosure will be relevant to every firm.

We understand that the IASB are working on a number of projects relevant to the reporting of financial instruments exposures, including a review of IFRS 7 in light of the current market conditions. ISDA is monitoring closely the IASB's review of SFAS 157, which contains a whole set of provisions on disclosure of fair value measurement, and we have provided comments both to the FASB in the US and the IASB with regards to SFAS 157. We also encourage CESR to work with the IASB on this project and related projects, rather than seek to impose additional disclosures that would only be relevant for a sub set of IFRS filers.

Question 4
Do you agree that the benefits of the presentation of disclosures regarding financial instruments in illiquid markets in the example in Box 2 (see annex no 2) outweigh the costs of preparing this information?

We agree with the report from the SSG that disclosure practices can be enhanced without necessarily amending existing disclosure requirements. The report also recognised that because firms adopt different business strategies, not all of the disclosure examples are relevant to every firm. It is on this basis that we question the wisdom of proposing a detailed tabular form of disclosures that may or may not prove relevant for all types of institution. Disclosure in such a format could be costly to produce and may not be relevant and/or provide decision useful information for the users of the accounts. We think it would be more useful if CESR were to work along side the IASB on reviewing the first years' IFRS 7 disclosures, and make any recommendations for enhancements based on the European experience to the IASB for their consideration. Any lessons learnt in Europe will surely be relevant to the disclosures of IFRS filers outside the EU? Introducing additional disclosures that would apply to a subset of IFRS preparers would not enhance the comparability and consistency of reporting .