ISDA® Safe, Efficient Markets

International Accounting Standards Board
1st Floor
30 Cannon Street
London
EC4M 6XH
By email

20th September 2017

Dear Sirs,

Ref.: IASB's Request for Information: Post-implementation Review—IFRS 13 Fair Value Measurement

The International Swaps and Derivatives Association ("ISDA")[1] is pleased for the opportunity to respond to the above referenced Request for Information on the IFRS 13 Fair Value Measurement Post-implementation Review issued by the International Accounting Standards Board ("IASB").

The key concerns of our members are:

i) The costs associated with preparing the level 3 financial instrument roll forward reconciliation are disproportionate to the value to users of financial statements.

ii) Use of P*Q for level 1 instruments is rarely a fair reflection of the price that could be achieved to dispose of a significant holding of those instruments, even over a period of time. IFRS 13 incorrectly assumes that markets are sufficiently liquid that the price that may be achieved for selling one share can also be achieved to sell a large holding. Our members are unconvinced that this issue cannot be dealt with in the IFRS 13 PIR and consider that, if the issue were indeed out of scope, then a new project should be launched to reassess the unit of account for large holdings of financial instruments.

iii) Our members strongly believe that how fair value should be determined should continue to be consistent between IFRS and US GAAP; the World is not best served

[1] Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient. ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool. Today, ISDA has over 875 member institutions from 68 countries. These members comprise of a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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> by diversity on this matter. Hence, while we have identified areas of IFRS 13 that should be reconsidered, this activity should be carried out in conjunction with the FASB.

We hope you find ISDA's comments and responses informative and useful. Should you have any questions or desire further clarification on any of the matters discussed in this letter please do not hesitate to contact us.

Yours faithfully,

Lisa Bomba
Chair of ISDA's European Accounting Committee
Managing Director
Head of Accounting Policy & Advisory Group
Deutsche Bank AG

Antonio Corbi
Director
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ISDA, Inc

Appendix – Responses to specific questions raised by the IASB

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Question 1A— Your background

Please tell us:

(a) your principal role in relation to fair value measurement.

(b) your principal jurisdiction and industry. If you are a user of financial statements, which geographical regions and industries do you follow or invest in?

Question 1B— Your experience

How extensive is your experience in relation to the measurement of the following items at fair value (including the measurement of their recoverable amount on the basis of fair value less costs of disposal)?

Question 1A

The International Swaps and Derivatives Association (ISDA) is a global association representing leading participants in the derivatives industry including most of the world's major financial institutions, as well as many of the businesses, governmental entities and other end users that rely on clear and uncleared derivatives to manage efficiently the financial market risks inherent in their core economic activities. Today, ISDA has over 850 member institutions from 68 countries.

Question 1B

Collectively, the membership of ISDA has substantial professional expertise and practical experience addressing fair value measurement issues with respect to financial instruments and specifically derivative financial instruments. All our members hold significant financial instruments exposures measured at fair value and they also provide the associated disclosures in their financial statements.

Question 2—Fair value measurement disclosures

(a) How useful do you find the information provided about Level 3 fair value measurements? Please comment on what specific information is useful, and why.

(b) In your experience of Level 3 fair value measurements:

(i) how do aggregation and generic disclosure affect the usefulness of the resulting information? Please provide examples to illustrate your response.

(ii) are you aware of any other factors (either within or outside IFRS requirements) affecting the usefulness of the information? Please provide examples to illustrate your response.

(iii) do you have suggestions on how to prevent such factors from reducing the usefulness of the information provided?

(c) Which Level 3 fair value measurement disclosures are the most costly to prepare? Please explain.

(d) Is there information about fair value measurements that you think would be useful and that IFRS 13 does not require entities to disclose? If yes, please explain what that information is and why you think it would be useful. Please provide any examples of disclosure of such information.

Our response to this question is primarily from the perspective of the preparer.

Our members recognize that it is helpful to users of financial statements that financial instruments are assessed and disclosed by Level. However, the reconciliation of Level 3 instruments required by paragraph 93 (e) is costly to prepare, and, to our knowledge, is of limited value to users. It is not information that would otherwise be prepared, since it does not help our members manage the performance or risks of these financial instruments. As such, it is not within the spirit of the IASB's Disclosure Initiative of achieving effective communication in the financial statements.

The paragraph 91 disclosure objective would be met more effectively by just requiring disclosure of:

a) the information required by sub-paragraphs (i) and (ii) (gains and losses recognised in profit or loss or in other comprehensive income); and

b) narrative disclosure to explain major changes in the amount and types of financial instruments that are classified as Level 3, compared to the previous reporting date.

Question 3—Prioritising Level 1 inputs or the unit of account

(a) Please share your experience to help us assess:

(i) how common it is for quoted investments in subsidiaries, joint ventures and associates, and quoted cash-generating units to be measured at fair value (please support your comments with examples).

(ii) whether there are material differences between fair value amounts measured on the basis of P×Q alone (when P is the quoted price for an individual instrument and Q is the quantity of financial instruments held) and fair value amounts measured using other valuation techniques. Please provide any examples, including quantitative information about the differences and reasons for the differences.

(iii) if there are material differences between different measurements, which techniques are used in practice and why.

Please note whether your experience is specific to a jurisdiction, a region or a type of investment.

(b) The Board has undertaken work in this area in the past (see Appendix 3). Is there anything else relating to this area that you think the Board should consider?

Some banks record venture capital investments which would meet the definition of associates at fair value, applying the IAS 28.18 venture capital exception. These will not normally be traded in a liquid market but, if they were, our members do not believe that it is appropriate to apply P*Q to determine their fair value, given that the unit of account is the entire investment and not the individual share.

This observation is consistent with our long held view that P*Q is not the most relevant value for any holding in an instrument which may be traded in a liquid market in small volumes but where there would be no liquid market to dispose of the entire investment without incurring a blockage discount. This will be the case for virtually any large holding in a financial instrument.

Since IFRS 13 was published, the Board has agreed to reinstate the concept of prudence in the Conceptual Framework. It is generally accepted by preparers, users and regulators that the application of P*Q is often imprudent, such that many banking regulators require financial information to be adjusted, to include blockage discounts, for prudential reporting purposes.

As the Board is required to be guided by the Conceptual Framework in the development of IFRSs, we suggest it should work together with FASB to reconsider the treatment of blockage discounts.

Our members note that BC157, which helps set out why the Board rejected the inclusion of blockage discounts, likens the discount to a transaction cost which should only be recognized on sale, as per paragraph 25. However, our members consider the blockage discount to form part of the inherent value of a large holding of a financial instrument, not a transaction cost. Moreover, as we have responded before, the standard (correctly) requires use of bid and ask prices and yet what is part of the bid price and what is a transaction cost is mostly a matter of local legal form rather than of commercial substance. The Board has never justified why bid-ask spreads are treated differently from other transaction costs and our members do not believe that blockage discounts should be excluded just because the Board believes them to be transaction costs.

Also, BC155 describes this issue as being one of *what* to measure at fair value rather than *how* to measure fair value. Our members are unconvinced that this issue cannot be dealt with in the IFRS 13 PIR and consider that, if the issue were indeed out of scope, then a new project should be launched to reassess the unit of account for large holdings of financial instruments.

Our members strongly support the maintenance of the existing convergence between IFRS and US GAAP in this area. We, therefore, recommend the Board should work together with FASB to address the comments raised above in the context of both accounting frameworks.

Question 4—Application of the concept of highest and best use for non-financial assets

Please share your experience to help us assess:

(a) whether the assessment of an asset’s highest and best use is challenging, and why. Please provide examples to illustrate your response.

(b) whether the current uses of many assets are different from their highest and best use, and in which specific circumstances the two uses vary.

(c) whether, when applying highest and best use to a group of assets and using the residual valuation method, the resulting measurement of individual assets in the group may be counter-intuitive. If so, please explain how this happens, and in which circumstances.

(d) whether there is diversity in practice relating to the application of the concept of highest and best use, and when and why this arises.

Please note whether your experience is specific to a jurisdiction, a region or a type of asset

This question is of less relevance to our members and so we have not responded to it.

Question 5—Applying judgements required for fair value measurements

Please share your experience to help us assess the challenges in applying judgements when measuring fair value:

(a) is it challenging to assess whether a market for a asset or a liability is active? Why, or why not?

(b) is it challenging to assess whether an input is unobservable and significant to the entire measurement? Why, or why not?

Please provide specific examples to illustrate your response and note whether your experience is specific to a jurisdiction or a region or a type of asset or liability.

Our members believe that while these assessments can be challenging, they are used to making them when determining the fair values of financial instruments and that further requirements and guidance on this matter would be of limited value.

Question 6A—Education on measuring biological assets at fair value

Please describe your experience of measuring the fair value of biological assets:

(a) are any aspects of the measurement challenging? Why, or why not? Please provide examples to illustrate your response.

(b) what, if any, additional help would be useful in applying IFRS 13? In which areas?

This is not a topic that is relevant to our members.

Question 6B—Education on measuring unquoted equity instruments at fair value

Please describe your experience of measuring the fair value of unquoted equity instruments:

(a) in 2012, the IFRS Foundation Education Initiative published Unquoted equity instruments within the scope of IFRS 9 Financial Instruments. Have you used this education material? If so, how did this material help you to measure the fair value of unquoted equity instruments?

(b) do you have questions not covered in Unquoted equity instruments within the scope of IFRS 9 Financial Instruments? Do you think that additional help would be useful in applying the requirements? Why, or why not? Please provide examples to illustrate your response.

Limited use is made of this material by banks. Our members see no pressing need for further guidance on this topic.

One of the strengths of IFRS 13 is that it measures fair value of an asset or liability using the assumptions that market participants would use when pricing the asset or liability. As these assumptions are continually changing, the principle-based approach of IFRS 13 provides the flexibility to change the assumptions to reflect evolving market practice. There is a significant risk that detailed guidance will lag behind market practice.

Question 7—Effects and convergence

a) Please share your experience of the overall effect of IFRS 13:

(i) what effect did IFRS 13 have on users' ability to assess future cash flows? If you are a user of financial statements, please provide us with examples of how you use information provided by entities about their fair value measurements and any adjustments you make to the measurements.

(ii) what effect did IFRS 13 have on comparability of fair value measurements between different reporting periods for an individual entity and between different entities in the same reporting period?

(iii) what effect did IFRS 13 have on compliance costs; specifically, has the application of any area of IFRS 13 caused considerable costs to stakeholders and why?

(b) Please comment on how you are affected by the fact that the requirements for fair value measurement in IFRS 13 are converged with US GAAP; and please comment on how important it is to maintain that convergence.

As we have already mentioned, the most significant compliance cost of IFRS 13 was the creation of reconciliations of Level 3 financial instruments, for which the costs are disproportionate to the perceived value.

The key principle of IFRS 13, that the fair value of an asset or liability should be measured using the assumptions that market participants would use when pricing that asset or liability, is consistent with the approach that was followed by our members before the standard was issued. Hence, on how to measure the fair value of financial instruments, IFRS and US GAAP were already converged.

Our members strongly believe that *how* fair value should be determined should continue to be consistent between IFRS and US GAAP; the World is not best served by diversity on this matter. Hence, while we have identified areas of IFRS 13 that should be reconsidered, this activity should be carried out in conjunction with the FASB.

Question 8—Other matters

Should the Board be aware of any other matters as it performs the PIR of IFRS 13? If so, please explain why and provide examples to illustrate your response.

We have no other matters to report in response to the DP.