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Jeroen Hooijer
European Commission
Internal Market and Services DG
Financial Reporting Unit
Rue de Spa, 2 - 00/89
B-1049 Brussels
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By email to: Markt-F3@ec.europa.eu

Dear Mr Hooijer,

Ref.: European Commission second Stakeholders' meeting in Brussels on IAS 39

The International Swaps and Derivatives Association ("ISDA") would like to thank the European Commission for the opportunity to put forward our views on the future development of IAS 39. We continue to support the proactive approach of the IASB in addressing these accounting issues and we welcome the interaction between the IASB and the European Commission on this matter.

Further to the discussion at the 22 July stakeholders' meeting on IAS 39, ISDA is pleased to provide the following comments with respect to the Commission's request on the issues concerning the above referenced subject.

ISDA has over 820 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 that ISDA brings a unique and broad perspective to the work of the IASB.

<u>General issues related to the standard-setting activities and IFRS:</u>

- ISDA vigorously supports independent standard setting with robust due process. Independent standard setting and robust due process are key requirements for the production of high quality accounting standards.

- ISDA members do not support European “carve-outs.” Jurisdictional carve-outs impair the IFRS brand, damage confidence in accounting standards, jeopardise current efforts to converge various national accounting standards with IFRS and develop a robust global accounting standard.

- It is of paramount importance that there be only one financial instrument standard, applied by both IFRS and US GAAP reporters. Our members are concerned that current proposals may lead to divergence in accounting. The IASB and the FASB must work together to avoid this.

- Our members are also concerned about the piecemeal nature of the new proposals, so that we are being asked to comment on the classification and measurement ED without knowledge of the plans for hedge accounting. It is also of concern that entities will be required to make fair value option elections if they implement early, before the hedge accounting amendments are agreed.

- The amendments to IAS 39 are being completed in an accelerated time frame. The majority of our members would support extending the date at which the IASB has set for completion of the classification and measurement amendment. This would allow the IASB and the FASB to jointly develop a robust high quality standard

<u>Specific comments in relation to the IAS 39 Classification and Measurement ED:</u>

1) Mixed Measurement Model:

The majority of ISDA members support a mixed measurement model. We believe that the criteria for classification in the new standard should require financial instruments to be classified in a robust and consistent manner in line with their economic substance. There should be strong linkage between the entity’s underlying business model as adopted by their governing body and the entity’s risk management strategies and practices while considering the characteristics of the instruments. However we would like to highlight the following views of a majority of our members:

- The business model should be the primary indicator (which has a bearing on reclassifications, embedded derivatives etc, see below);
- The principle of ‘managed on a contractual yield basis’ lacks clarity and open to a wide variety of interpretations. Issues such as leverage and disposal before maturity need to be explicitly addressed;
- The principle of ‘basic loan features’ is also not well defined and the treatment of a number of common features such as extension options, change of control repayment clauses and inflation linkage is not clear;
- The treatment of securitizations needs to avoid arbitrary rules which have no justification in the economic substance of the transaction, particularly when a transaction represents the distribution of an earnings approach. Our members have considered several

alternative solutions but believe that securitizations should be discussed more fully at the IASB round tables. We believe the line between fair value and amortised cost has moved too far in the direction of fair value. We therefore believe the discussions at the round table should focus on alternative models to that proposed by the IASB to differentiate securitization structures accounted for at fair value versus those accounted for at amortized cost. Undue reliance on the current form-driven approach is both inflexible and would provide structuring opportunities.

2) Fair Value Option:

- The majority of our members support the retention of the option for accounting mismatches and where there are embedded derivatives (see Embedded Derivatives, below);

3) Reclassifications:

- If the business model is to be the primary indicator it follows that reclassifications should be required if the business model changes;

4) Embedded Derivatives and Own Credit:

- Some of our members would prefer to retain the ability to separate embedded derivatives and hold the host instrument at amortized cost. Otherwise our members support resolving the open issue of when and how changes in fair value due to changes in own credit risk should be reported.

5) Equity instruments:

- Some of our members believe that certain infrastructural and strategic investments, such as holdings of exchanges and clearing houses should not be required to be recorded at fair value.
- The majority of our members believe that when equity investments are accounted for through OCI, dividends and gains or losses on realization should be recorded through profit or loss. We note that such an approach would require a robust and transparent impairment model, including reversals of impairment losses where appropriate.

6) Transition:

- It is not conducive to early adoption (due to the effort required), and not meaningful (due to the inability to restate hedging relationships) to restate comparative numbers in the year of first application. The transition should be as of the beginning of the year of first application, similar to the transition to IAS 39 for first time adopters in 2005.

We hope you find ISDA's comments useful and informative. Should you have any questions or would like clarification on any of the matters raised in this letter please do not hesitate to contact the undersigned.

Yours sincerely,

Charlotte Jones
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Chair, European Accounting Policy Committee

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