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International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH

Submitted via the "Open to Comment" page at [www.iasb.org](http://www.iasb.org).

Dear Sirs

### **Exposure Draft: Improving Disclosures about Financial Instruments**

I am writing on behalf of LIBA (the London Investment Banking Association) to comment on the IASB's 15 October Exposure Draft: *Improving Disclosures about Financial Instruments* ("the ED"). LIBA is, as you will know, the principal UK trade association for firms active in investment banking and securities trading; a list of our members is attached.

We commend the IASB for the improvements proposed in this ED. We acknowledge that there is growing demand from the users of the financial statements for greater transparency, particularly in relation to financial instruments where many of our members have already enhanced their existing disclosures to provide additional information. We therefore strongly agree that enhanced disclosures are necessary, and we welcome a standardised framework that builds on the body of additional disclosure that has developed through market practice, as well as the work done by the IASB's Expert Advisory panel and the FASB. Following our 3 October comment on the IASB Expert Advisory Panel's Draft Document (*Measuring and disclosing the fair value of financial instruments in markets that are no longer active*) that "any such (additional disclosures) would be better made through an amendment to IFRS 7, where the development of any new requirements would be subject to due process", we also welcome the fact that these proposals have been put forward as an amendment to IFRS 7.

We are nonetheless conscious that additional requirements need to be built into a company's systems and processes, and embedded within a suitable control framework which will maintain the credibility of that disclosure. Many of the additional proposed disclosures are similar to those required under FASB Statement No. 157 *Fair Value Measurements* (SFAS 157), and primary US GAAP reporters have noted that the preparation of such disclosures requires significant time and resources as they involve comprehensive additional data requirements to be produced within the existing control framework. We therefore urge the Board to consider carefully each element of the disclosures within SFAS 157 and to mandate only those that provide truly useful information to users at reasonable cost to preparers. Stripping away non-essential disclosures is especially important for our members given the sheer size of the financial statements required under IFRS and the resource constraints imposed by today's very difficult economic conditions.

Our detailed responses to the questions set out on pages 6-7 of the ED are set out below.

**1. Do you agree with the proposal in paragraph 27A to require entities to disclose the fair value of financial instruments using a fair value hierarchy? If not, why?**

We agree with the proposal to disclose the fair value of financial instruments using a fair value hierarchy. This requirement was initially implemented under SFAS 157 and many of our members have subsequently disclosed fair values on a similar basis to supplement their IFRS disclosures. We accept that users of the financial statements regard this as a key disclosure as it provides relevant information about the extent to which judgment has been used in valuing financial instruments.

**2. Do you agree with the three-level fair value hierarchy as set out in paragraph 27A? If not, why? What would you propose instead, and why?**

We broadly agree with the three-level hierarchy set out in the ED, but we are concerned that this differs from the IAS 39 measurement hierarchy and also from the SFAS 157 disclosure hierarchy. We believe these differences, which are summarised below, may be confusing and unhelpful for users of the financial statements.

*\* ED disclosure hierarchy differs from the IAS 39 measurement hierarchy*

IAS 39 provides for a two level measurement hierarchy: quoted prices in active markets, and valuation techniques where there is no active market. Although the population applying each level of this hierarchy will be broadly similar to the stratified population resulting from applying the hierarchy in the ED, there will be differences. The IAS 39 measurement hierarchy uses a broader definition of an active market than the proposed hierarchy in the ED (and in SFAS 157) and therefore allows greater scope for certain financial instruments to be included within Level 1. For example, some vanilla OTC derivatives (such as interest rate swaps) could be deemed to have quoted prices in active markets under IFRS because prices are readily and regularly available from brokers. By contrast, the same prices are typically not regarded as occurring with sufficient frequency and volume to provide pricing information on an ongoing basis to be categorised as Level 1 under the ED. This would lead to classification as Active Markets under IAS 39 and Level 2 under the proposed ED hierarchy. Similar situations could arise for some other derivatives as the IAS 39 measurement hierarchy indicates that quoted prices in active markets could include quoted rates.

To remove this potential source of confusion, we encourage the IASB to consider revising the IAS 39 measurement hierarchy (preferably as part of the Board's deliberations on the wider fair value measurement project) so as to bring it into line with the proposed disclosure hierarchy within the ED and in SFAS 157.

*\* IAS 39 Level 3 measurement is not equivalent to SFAS 157 Level 3*

We also note that, even if the wording of the proposed hierarchy in the ED were identical to that in SFAS 157, the amounts that could be classified in each hierarchy level under IFRS could in some circumstances be different from the amounts so classified under US GAAP. For example, where the fair value of an instrument is

based on a valuation technique that uses unobservable inputs and differs from the transaction price, it may be necessary to defer any day-1 profit or loss on initial recognition under IAS 39, but this deferral would not be required under SFAS 157.

We believe the reasons behind such differences will not be obvious to users of the financial statements and we are concerned that any efforts by preparers to explain such differences will simply compound the poor perception of Level 3 classification. We therefore recommend that, as a part of its wider fair value measurement project, the IASB remove the requirement to defer inception gains and losses on instruments valued using unobservable inputs. Not only will this eliminate a potential source of confusion, but it will align IFRS with US GAAP and eliminate the inconsistency between initial and subsequent measurement for instruments that are valued using significant unobservable inputs.

\* *ED Disclosure Hierarchy differs from FAS 157 Hierarchy*

Regarding comparability to US GAAP, the wording of the hierarchy in paragraph 27A differs subtly from that used by the FASB, which introduces the possibility of differing interpretations. We understand the IASB intended the disclosure hierarchy in the ED to be consistent with that in SFAS 157, given its deliberations in the fair value measurement project. We therefore strongly recommend that the IASB use exactly the same language as SFAS 157 so as to remove any scope for differing interpretations and also to facilitate adoption for those firms which report under both IFRS and US GAAP.

**3. Do you agree with the proposals in:**

- (a) **Paragraph 27B to require expanded disclosures about the fair value measurements recognised in the statement of financial position? If not, why? What would you propose instead, and why?**

We agree with the proposals for expanded disclosures with the exception of the requirement for separate disclosure for unrealised gains or losses for Level 3 instruments still held at the balance sheet date, where we have a number of concerns which are set out below.

Distinguishing between realised and unrealised P&L was historically relevant for some tax authorities, certain currency hedging policies, funding cost allocations, and to facilitate the reconciliation of financial reporting systems. With the growing acceptance of fair value measurement, however, and the increased sophistication of financial instruments and operational systems, such tracking of cost and the associated allocation of P&L is not necessary for many instruments carried at fair value. It is therefore no longer used by many of our members as a relevant internal measure for management purposes for many assets carried at fair value.

To identify any measure of unrealised P&L, a preparer must first determine the cost base. For multiple holdings or partial sales, this cost base could be determined on a FIFO, a LIFO, or a weighted average, basis, with widely differing results. However, because the IASB has no plans to set a single standard for determining the cost base the method used, this choice of basis is effectively an accounting policy decision.

This will greatly reduce the comparability of such disclosure to the point that the benefits of disclosure are not likely to be outweighed by the significant cost of producing it.

Furthermore, to provide this disclosure on any meaningful basis would require developing systems which will track not just the purchases and sales, as required by paragraph 27B (b), but also the individual interim cash flows and related accruals. This is most evident in the case of derivatives where the instrument may have no initial cost or final sale proceeds but where the ongoing cash flows determine the allocation of P&L between unrealised and realised.

We understand that some users believe that the disclosure of unrealised P&L for Level 3 financial instruments still held at the balance sheet date provides relevant information about the “quality” of fair value gains or losses recognised in relation to those instruments. However, for the reasons set out above, we do not believe that the disclosure of such information provides users with sufficient relevant information to justify the development of the necessary systems to provide that disclosure.

As a final point, we agree with the final paragraph of 27B which requires disclosure of any other relevant information but we feel that the example given (information about instruments in one level of the hierarchy that are hedged by instruments in another level) should be removed, and it should also be made clear that this disclosure of relevant information may be qualitative.

- (b) Paragraph 27C to require entities to classify, by level of the fair value hierarchy, the disclosures about the fair value of the financial instruments that are not measured at fair value? If not, why? What would you propose instead, and why?**

While not objecting to the requirement to disclose a hierarchy level for these fair values, we question whether this information is relevant to users of the financial statements and therefore whether it justifies the effort involved.

We would expect a user to be interested in the fair value of a financial instrument that is not carried at fair value, as this would provide relevant information about management decisions surrounding the alternative uses for the asset. Similarly, we would expect a user to be interested in the hierarchy of fair value used for a financial instrument that is measured at fair value, as this would provide relevant information about the sensitivity of the reported P&L to management assumptions. However, it is not immediately apparent how the hierarchy level of an asset that is not measured at fair value would be useful to a user of the financial statements.

We suggest the IASB should reconsider the reasons for proposing this disclosure and assess whether the desired objective has been met, and that the “basis for conclusions” in the final amendment should contain an appropriate reference to this assessment.

- 4. Do you agree with the proposal in paragraph 39(a) to require entities to disclose a maturity analysis for derivative financial liabilities based on how the entity manages liquidity risk? If not, why? What would you propose instead, and why?**

We welcome the opportunity to disclose liquidity risk on a basis consistent with the way internal management manages the risk. However, we believe that the requirement to present different analyses for derivatives and non-derivatives will lead to confusion, particularly for hybrid instruments. In our view a reporting entity should be required to disclose a single table consolidated for all liabilities based on the way that the entity manages liquidity risk, with hybrid instruments selected under the FVO disclosed on the same basis as derivatives.

- 5. Do you agree with the proposal in paragraph 39(b) to require entities to disclose a maturity analysis for non-derivative financial liabilities based on remaining expected maturities if the entity manages liquidity risk on that basis? If not, why? What would you propose instead, and why?**

Yes, we agree with this proposal. In addition, where an entity does not manage liquidity based remaining expected maturity but uses an alternative method, we believe there should be a requirement to disclose a maturity analysis on that alternative basis. This would be consistent with the requirement for derivative liabilities in paragraph 39(a).

- 6. Do you agree with the amended definition of liquidity risk in Appendix A? If not, why? What would you propose instead, and why?**

We agree with the amended definition.

- 7. Do you agree with the proposed effective date? If not, why? What would you propose instead, and why?**

We agree with the proposed effective date.

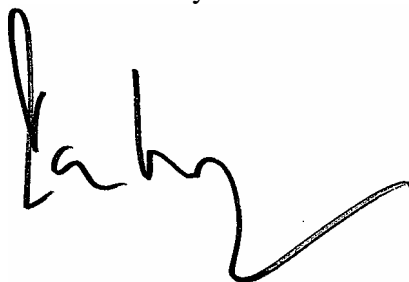
- 8. Are the transition requirements appropriate? If not, why? What would you propose instead, and why?**

We agree that the transition requirements are appropriate, but in order to encourage early adoption we would like to see an exemption from preparing comparatives for these disclosures where they are adopted early.

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I hope these comments are helpful. We would of course be pleased to expand on any points which you may find unclear, or where you would like further details of our views.

Yours sincerely



**Ian Harrison**  
**Director**

# LONDON INVESTMENT BANKING ASSOCIATION

## LIST OF MEMBERS

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Ambrian Partners Limited	Investec plc
Arbuthnot Latham & Co., Limited	Jefferies International Limited
Arbuthnot Securities Limited	JP Morgan Cazenove Ltd
Arden Partners plc	JP Morgan Securities Ltd
Banc of America Securities Limited	KBC Peel Hunt Ltd
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