

6 October 2008

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

CommentsLetters@iasb.org

Dear Sirs

DISCUSSION PAPER: REDUCING COMPLEXITY IN REPORTING FINANCIAL INSTRUMENTS

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £3.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the Annual IMA Asset Management Survey shows that in 2007, IMA members managed holdings amounting to 44% of the domestic equity market.

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Therefore, we have an interest in the requirements governing how such companies prepare their accounts and the information disclosed to our members as users of that information.

Undoubtedly recent credit market conditions have posed a greater risk to corporate reporting than has been experienced for years and the principles of fair value accounting have received much criticism and been under attack in recent weeks. We should say at the outset that, in general, we support the use of fair value, mark to market or mark to model, for financial institutions' financial assets and liabilities where it is not intended that they are held to maturity. In particular, the current crisis originated in the collapse of the leveraged loan and bank loan markets – banks still originate loans but no longer carry them to maturity. Only by exposing the “bad news” by marking such assets down to realistic prices can confidence in those markets be restored, trading resume and markets recover. The absence of realistic and transparent information is likely to mean that markets apply their own more exaggerated discounts.

Furthermore, the Troubled Asset Relief Program in the Emergency Economic Stabilization Act of 2008 is relevant in that it gives the US Securities and Exchange Commission (SEC) the power to suspend FAS 157, Fair Value Measurements altogether. We would not support such a move and consider that for the SEC to do so could have long lasting consequences. For example, in response to the crisis in Japan in the 1990s, the government revised banking regulations to permit investments in marketable securities to be valued at cost as opposed to the lower of cost and net realisable value and thus avoided unrealised losses being reported. A rule was also introduced that allowed deferred tax assets to be recorded without limit. These measures made banks look adequately capitalised when they were not and as a result, many consider that much needed banking reform was delayed and the crisis had lingering and more long-term consequences.

That said, we would welcome simplification of the current accounting requirements for financial instruments but have concerns about certain of the proposals in the DP.

First, the DP proposes that the long term solution to the complexity in reporting financial instruments is a single measurement principle for all financial instruments in a single standard and that this should be fair value.

IMA disagrees with this “one size fits all” approach and considers that it does not reflect the views of many respondents to/participants in the IASB’s various consultations/discussions. Given the number of different business situations and the different rationales for holding financial instruments, IMA believes a mixed attribute model is more appropriate than full fair value. Users do not necessarily want to determine liquidation values from accounts, as would be the case with exit values and a full fair value model, but want to know what management has generated from its operations and the resources allocated to it. Thus in certain circumstances, entry price, which in effect is historic cost, rather than exit price, should be used, particularly where the asset or liability is not expected to be transferred or disposed of. We currently have a mixed measurement model and we consider that the IASB should focus on improving that.

Secondly, the DP claims that one of the main reasons for the complexity in current reporting requirements is the many different ways of measuring financial instruments in that the methods used depend on the instrument’s categorisation and whether hedge accounting has been applied. IMA does not consider that the number of different bases necessarily gives users difficulty in understanding accounts but rather that it is the lack of adequate disclosures. Users of accounts face a wide array of information on financial instruments and find it increasingly difficult to extract and understand what is important. For example, it is often not clear how management has applied valuation profiles, the sensitivity of those valuations to changes in the key assumptions and the uncertainties around the valuations themselves, particularly when due to illiquid markets, instruments that were previously marked to market are marked to model. Furthermore, should a full fair value model be adopted, the volume of the disclosures that would be necessary would further increase the complexity of accounts.

Lastly, the DP acknowledges that there are a number of concerns that must be addressed before a full fair value model can be adopted and suggests a number of intermediate improvements in the meantime including:

- elimination of either the held-to maturity or available-for-sale category, or to require fair value measurement for all instruments for which there exists an active market;
- requiring fair value measurement for all financial instruments, with an optional exemption allowing amortised cost measurement that would be limited to instruments with fixed or slightly variable cash flows (such as loans with variable interest rates); and
- simplifying the rules for hedge accounting, or to eliminate hedge accounting entirely.

IMA considers that each of these approaches gives rise to concerns that the resulting accounting would not reflect the true nature of the business for many entities. For example, in valuing instruments that the entity proposes to hold until maturity at fair value, the DP argues that, among other things, reporting changes in their fair value permits an assessment of the effect of management's decision to hold an instrument rather than sell it, i.e. it is difficult for investors to discern, without information about changes in the instrument's fair value; whether the entity would have been better off if the instrument had been sold before maturity. We do not agree with this approach and consider that changes in fair value of a held-to-maturity financial asset (other than incurred credit losses) are irrelevant because the fair value changes do not reflect the way the assets are managed. Furthermore, each of these approaches would result in increased volatility in the profit and loss account and obscure what management had generated from operations.

In conclusion, it is clear from the DP that no simple solution exists to reduce immediately the complexity of accounting for financial instruments. We do not consider that the intermediate solutions presented in Section 2 are superior in approach and do not support a long term goal of full fair value accounting. We believe the aim should be develop standards that provide a flexible, principles-based framework within which the information provided to investors is useful and that the issue of measurement needs to be fully debated.

Please do contact me if you would like clarification on any of the points in this letter or the attached, or if you would like to discuss any issues further.

Yours faithfully



Liz Murrall
Director, Corporate Governance and Reporting