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Sandra Thompson
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH, UNITED KINGDOM

Dear Ms Thompson,

Request for comment on Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement – The Fair Value Option

We provide responses to the request for comments in relation to the above exposure draft released in April 2004. These responses are attached as Appendix 1.

QBE concurs with the view of the Australian Accounting Standards Board (AASB) not to support the proposed changes to IAS 39. In particular:

- The introduction of a new test of "verifiable" for fair value measurement adds complexity and confusion. Such a change could result in financial assets in an entity's balance sheet being recorded at fair value where the fair value is "reliable" for all assets but is "verifiable" for some assets and not for others.

- The ED was issued in May 2004 after the agreed stable platform date of 31 March 2004 with an applicable date of 1 January 2005. This ED has been issued too close to the application date of 1 January 2005 for appropriate changes to underlying systems and investment strategy to be implemented in a sensible manner. The mandatory application date in Australia is 1 January 2006, however, Australian companies utilising the extended date of 1 January 2006 may be unable to provide in their December 2005 financial statements "an explicit and unreserved statement in those financial statements of compliance with IFRS" which would not be acceptable to many companies thereby forcing an early application date of 1 January 2005.

- The amendments are being made to address issues which are only partly valid. For example, regulatory issues are often based on different requirements than those that govern the production of general financial statements.

- The proposed amendments make IAS 39 even more rules based and complex.

One of the original reasons put forward by the IASB for introducing the original option to designate at fair value through profit and loss was to "de-emphasise interpretive issues around what constitutes trading" (Basis for Conclusions BC 74 (e)).

By re-introducing restrictions around the fair value designation, such interpretive issues are emphasised again. Such a decision by the IASB should be explained in the Basis for Conclusions for the amendments, particularly as it was an argument the board used originally when introducing fair value through profit and loss.

Yours faithfully

N.G. Drabsch

Chief Financial Officer

Question 1

Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

We do not agree with the proposals in the Exposure Draft. We concur with the alternative views put forward in sections AV1 to AV7. In particular:

- The proposals change IAS 39 after the stable platform date of 31 March 2004 with an applicable date of 1 January 2005. This provides inadequate time for the due process of review, comment and implementation of changes.

- The proposals add complexity to the application of IAS 39 with apparent minimal actual impact.

- The proposals should not be introduced purely to satisfy the concerns of certain prudential supervisors and regulators where these proposals are not necessarily in the interest of other users or preparers of accounts. Prudential supervisors and regulators have an interest in adopting prudent measurements for their regulatory purposes. Prudential supervisors and regulators will also have differing needs across different jurisdictions not all of which can be satisfied through the IFRS framework. It is common for supervisors and regulators to use the accounting standards framework to determine their starting points and then adjust asset or liability values and apply risk weightings. It is therefore understandable that the requirements for reporting to a prudential supervisor or regulator may be different from those of a set of general financial statements. A set of general financial statements should reflect the wider user base, and not just reflect the wishes and needs of supervisors and regulators.

  It is unclear why prudential supervisors and regulators want to concentrate on the profit and loss account, rather then the level of assets and liabilities held by a financial entity, as is the thrust of the amendment.

  We do not agree with the reference to prudential supervision within the definition of a financial asset or financial liability at fair value through profit and loss. Such a reference, especially within a definition section, implies that the operation of this definition will vary between jurisdictions. In fact such supervisors may well include oversight of all accounting policies and decisions made, not just this one, so it is difficult to see the relevance of this point in a standard, let alone a definition.

- The proposals add a dual concept of a "verifiable" measure rather than the existing IAS 39 "reliable" measure requirement for fair value. This appears to be in response to BC9(a). The dual concept could result in financial assets in a balance sheet shown at fair value where fair value is "reliable" for all assets but is "verifiable" for some assets and not for others. This is unnecessarily confusing. In addition, it is not clear what the differences are between "verifiable" and "reliable". Is "verifiable" a more stringent test or as indicated by the AASB is "verifiable" simply one component of, and therefore inseparable from, "reliable"?

Question 2

Are you aware of any financial instruments to which entities are applying, or are intending to apply, the fair value option that would not be eligible for the option if it were revised as set out in this Exposure Draft? If so:

(i) please give details of the instrument(s) and why it (they) would not be eligible.

(ii) is the fair value of the instrument(s) verifiable (see paragraph 48B) and if not, why not?

(iii) how would applying the fair value option to the instrument(s) simplify the practical application of IAS 39?

As noted above, there is insufficient clarity over the difference between "reliable" and "verifiable" as a measure of fair value and therefore it is very difficult to identify specific financial instruments which would satisfy the test of "reliable" and not "verifiable".

Some jurisdictions, most notably Australia where we are based, have a history of requiring certain companies, such as insurance companies, to fair value through profit and loss all investments in the insurance business. This can be achieved, whilst still complying with the current IAS 39, by inserting a simple requirement in the local insurance standard (AASB 1023) that such financial assets should be accounted for under the fair value through profit and loss account designation. If the proposed amendment goes through, then the process of both drafting the local standard and complying with it will become a lot more complicated, for little or no gain.

Question 3

Do the proposals contained in this Exposure Draft appropriately limit the use of the fair value option so as to address adequately the concerns set out in paragraph BC9? If not, how would you further limit the use of the option and why?

The concerns in BC9 are not necessarily valid. They assume entities would select options that introduce greater volatility in the profit and loss which would be unlikely. We do not believe the fair value option needs to be restricted.

Question 4

Paragraph 9(b) (i) proposes that the fair value option could be used for a financial asset or financial liability that contains one or more embedded derivatives, whether or not paragraph 11 of IAS 39 requires the embedded derivative to be separated. The Board proposes this category for the reasons set out in paragraphs BC6 (a) and BC16-BC18 of the Basis for Conclusions on this Exposure Draft. However, the Board recognises that a substantial number of financial assets and financial liabilities contain embedded derivatives and, accordingly, a substantial number of financial assets and financial liabilities would qualify for the fair value option under this proposal.

Is the proposal in paragraph 9(b) (i) appropriate? If not, should this category be limited to a financial asset or financial liability containing one or more embedded derivatives that paragraph 11 of IAS 39 requires to be separated?

No comment.

Question 5

Paragraph 103A proposes that an entity that adopts early the December 2003 version of IAS 39 may change the financial assets and financial liabilities designated as at fair value through profit or loss from the beginning of the first period for which it adopts the amendments in this Exposure Draft. It also proposes that in the case of a financial asset or financial liability that was previously designated as at fair value through profit or loss but is no longer so designated:

As we come from a jurisdiction that is only adopting IFRS from 2005, we have no comment on this aspect of the ED.

Question 6

Do you have any other comments on the proposals?

1. The majority of companies that will use IFRS from 2005 onwards will be those from Europe, Australia, South Africa and similar jurisdictions that will be first time adopters as of that date. For such companies, the changes from current GAAP to IFRS are enormous, and in many cases have entailed large and complex projects. In some cases substantial systems changes have had to be made.

In this extremely tight timescale for IFRS, the stable platform of 2005 standards, as finalised by March 2004, should only be amended if absolutely necessary. Other amendments should only be made mandatory from 2006, albeit early adoption may be encouraged. We don't believe that this amendment to IAS 39 is sufficiently vital to warrant amendment of the stable platform.

2. IAS 39 incorporates detailed requirements as to hedge accounting. Among the reasons behind the availability of the fair value option was the fact that fair valuing both sides of a transactions can achieve roughly the same effect without the administrative burden related to hedging. This works where the fair value option is available. Any restriction in its availability means that companies have to go back to the detailed hedging rules in IAS 39. Doing this on the basis of rules that are likely to be published at the end of 2004 at the latest seems onerous.