



The voice of banking  
& financial services

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Dear Mr Golden,

30 September 2010

### **Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities**

This is the British Bankers' Association's response to the above exposure draft; we welcome the opportunity to comment. By way of background, we are a trade association based in London, representing 220 banks from 60 countries which conduct at least some of their activities in the UK.

As a body representing firms from 60 countries, we are firmly supportive of the G20's recommendation that the two main accounting standard setters should work towards a single set of high quality accounting standards. The convergence of standards relating to financial instruments must be the cornerstone of this objective. It is therefore with regret that we view the significant level of divergence between the proposals for financial instruments put forward by the two boards. Indeed, the level of divergence between the two sets of proposals is such that we struggle to see how such fundamental differences might be reconciled.

Notwithstanding the failure to achieve convergence, we note that the main objective of the exposure draft is to 'provide financial statement users with a more timely and representative depiction of an entity's involvement in financial instruments, while reducing the complexity in accounting for those instruments'. Whilst this is laudable as an objective, and the exposure draft sets out a coherent framework in which to present information on financial instruments, our assessment is that the proposals do not represent an improvement in financial reporting.

To us, high quality accounting standards should provide users with relevant, reliable and decision-useful information. We believe that the IASB has responded to this and has taken important steps towards the development of a standard for financial instruments which reduces the complexity of IAS 39. Although not perfect, IFRS 9 represents a better starting point for a high quality converged standard than the proposed Accounting Standard Update.

We firmly believe that the mixed measurement model encapsulated in IFRS 9 will provide the users of financial statements with information that is more relevant to the nature of the business model of financial institutions, with instruments held for the collection of contractual cash flows where those cash flows are in the nature of principal and interest measured at amortised cost and other financial instruments measured at fair value through profit or loss. This is significantly less complex than the model proposed in the ASU. We believe that the presentation of significant classes of financial instrument under two different measurement attributes on the face of the balance sheet would do nothing to reduce the complexity of financial reporting. Furthermore, the proposal to extend the use of fair value measurement to almost all financial instruments would introduce significant

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measurement uncertainty into financial statements, reducing their reliability and increasing volatility at the very time the G20, standard setters and prudential regulators worldwide are trying to achieve the opposite.

Although we can concede that users might find fair value information about loans and receivables decision-useful, we nevertheless believe this information is less relevant given the context in which these types of instruments are measured. It is for this reason that we continue to believe that fair value information for instruments held to receive contractual cash flows is best presented in the notes to the financial statements, allowing ample opportunity for management to provide narrative contextual disclosure.

If nothing else, the experience of the last three years teaches us that during periods of uncertainty it is possible for the liquidity of certain asset classes to reduce and that this is typically followed by a widening of spreads due, in part, to risk aversion. Banks holding instruments subject to these forces at fair value will be required to report write-downs to their published shareholder equity bases leading, in turn, to market concern about the safety and soundness of the institution. We therefore believe that unless write-down of this type is likely to be realized then there is a very real risk that the accounting model proposed by the ASU will exacerbate this cycle.

As a final observation, we are concerned by the rules-based nature of the standard. We are firmly of the view that principles-based standards result in the preparation of financial statements which reflect the economic reality of transactions and are the most effective means of reducing the complexity of standards.

We hope these views are of interest to you. As we have participated in the preparation of the responses you have received to the ASU from the International and European Banking Federations we have chosen not to provide detailed commentary on the ASU. However, we would be more than willing to provide our comments on any specific points should this be necessary.

Yours sincerely

A handwritten signature in black ink that reads "Paul Chisnall". The signature is written in a cursive, flowing style.

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