



ABI Comments to the Financial Crisis Advisory Group's request for input

April 2009

Response to FCAG

Thank you for the opportunity to reply to the Financial Crisis Advisory Group's request for input that was published on 10 March 2009. Please find below the answers of the Italian Banking Association (ABI) to the specific questions raised in this paper.

* * *

Question 1—From your perspective, where has general purpose financial reporting helped identify issues of concern during the financial crisis? Where has it not helped, or even possibly created unnecessary concerns? Please be as specific as possible in your answers.

We believe that the unconditional adoption of fair value criteria could generate inconsistencies and may result in misleading balance sheets, especially at times of economic crisis, such as the ongoing crisis.

This concept results in a pro-cyclical effect of fair value accounting, which was partially resolved by the amendments to IAS 39 issued in October 2008. Nonetheless, we believe that in order to resolve this anomaly, further measures need to be taken with respect to specific issues that, due to their inflexibility, may still result in misleading balance sheets. To that end the IAS 39 should be amended, for instance:

- to allow entities to reverse an impairment of equity securities classified as available for sale in their profit and loss account;
- to allow that the impairment of Available-For-Sale (AFS) equity securities may be carried out at value in use and not at fair value;
- to eliminate or reduce tainting provisions on debt securities classified as Held To Maturity (HTM);
- to allow entities to revoke the Fair Value Option (FVO).

In general, we believe that possible improvements may also result from reviewing the classification of financial instruments.

In particular, regarding the impairment of AFS we emphasise the necessity that IASB and FASB resolve this issue urgently because of their implications under current market conditions. One of the implications of the current crisis is that equity markets are very volatile, with significant general market movements occurring frequently. This has caused to consider whether the existing requirements in IAS 39 for impairment of AFS equity securities are appropriate. In fact, under the current market conditions, we are not sure whether we can consider the current "market price" level as fair value also for equity securities which do not reflect the entities' performance, forcing the entities to recognise the impairment in the profit or loss. To avoid the inconsistence between market price and fair value

(possibly temporary), this case could be treated in the same way as equity instruments that do not have a quoted market price by modifying the IAS 39 requirements.

Again, we recognise that the IASB differentiates between debt instruments, for which reversals are recognised in profit or loss (if conditions are met); and equity instruments, for which reversals of an impairment loss through profit or loss are prohibited. We believe that this different requirements for reversal of impairment losses should be eliminated.

Question 2—If prudential regulators were to require 'through-the-cycle' or 'dynamic' loan provisions that differ from the current IFRS or US GAAP requirements, how should general purpose financial statements best reflect the difference: (1) recognition in profit or loss (earnings); (2) recognition in other comprehensive income; (3) appropriation of equity outside of comprehensive income; (4) footnote disclosure only; (5) some other means; or (6) not at all? Please explain how your answer would promote transparency for investors and other resource providers.

Considering the amendments to IAS 1, according to which entities shall report ex-ante and ex-post "other comprehensive income" operating results, we believe that the balance sheet item to which entities should allocate the difference, if any, mentioned in this question (hypothesis (1) vs. hypothesis (2)) is not particularly significant; on the other hand, it is necessary to further investigate whether the accounting of the abovementioned items (both in the profit and loss account and in comprehensive income) may be justified on the basis of current IFRS requirements. Moreover, we do not agree with hypothesis (6) which results in ignoring this difference.

Nonetheless, we deem it appropriate to highlight that the current IAS 39 incurred loss model has undesired and misleading pro-cyclical effects; in this sense, we welcome IASB's and FASB's joint efforts to examine loan loss accounting, including the incurred and expected loss models.

Lastly, it should be noted that, with respect to this specific issue, the discretionary power of entities adopting IFRS is excessively broad and often influenced by local regulators' specific policies, thereby making it difficult to compare entities' balance sheets across the EU; therefore, introducing more detailed, high level guidelines allowing entities a certain degree of flexibility is deemed appropriate. In our opinion, the issue should be addressed by a joint IASB – Basel 2 Committee round table. Within this context, we are in favor of IASB's recent communication according to which, to that end, the issue needs to be discussed by holding meetings with the involved parties, starting with Spain's Central Bank.

Question 3—Some FCAG members have indicated that they believe issues surrounding accounting for off-balance items such as securitisations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair

value (including mark-to-market) accounting. Do you agree, and how can we best improve IFRS and US GAAP in that area?

We believe that the existing rules on the consolidation of off-balance sheet entities are substantially valid, although we welcome the opportunity to combine all the criteria set out in IAS 27 and SIC 12 in a single document (ED 10).

Nonetheless, with respect to ED 10, we'd like to highlight that abandoning a model based on risks and rewards as well as the lack of practical indicators that may be used instead to assess whether control exists may result in reducing existing consolidation parameters and in increasing uncertainty with respect to the analysis of real cases.

Question 4—Most constituents agree that the current mixed attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is overly complex and otherwise suboptimal. Some constituents (mainly investors) support reporting all financial instruments at fair value. Others support a refined mixed attributes model. Which approach do you support and why? If you support a refined mixed attributes model, what should that look like, and why, and do you view that as an interim step toward full fair value or as an end goal? Whichever approach you support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

We believe that the current mixed model, which applies both fair value and amortised cost (or cost), is correct and valid, since it is in line with management and business rationales, which vary depending on the financial instrument; adopting a full fair-value model would result in a misalignment with respect to the underlying management criteria regarding those financial instruments that are intended to be permanently included in the entity's equity as well as to distortions, such as those that the ongoing financial crisis has exposed.

Moreover, it must be noted that the current mixed model needs to be amended and simplified (please see answer to question no. 1). Specifically, we believe that the measures to be taken should be aimed at simplifying and redefining the classification of financial instruments; in particular, we agree with the results of the IASB/FASB meeting of 23/24 March with respect to the possibility of identifying only two categories by taking into account, apart from the financial instruments' characteristics, also whether the instrument is tradable as well as the "management intent/business model".

We believe that certain aspects of the "Reducing Complexity in Financial Reporting" discussion paper deserve attention and should be further investigated. To that end, we agree with the position expressed by EFRAG in its response paper with respect to the need for further examinations regarding the definition of fair value (for example, regarding "average").

POSITION PAPER April 2009

market value" and the utilization of value in use instead of fair value in certain cases).

Question 5—What criteria should accounting standard-setters consider in balancing the need for resolving an 'emergency issue' on a timely basis and the need for active engagement from constituents through due process to help ensure high quality standards that are broadly accepted?

We substantially agree with the comments contained in the EFRAG response.

Question 6—Are there financial crisis-related issues that the IASB or the FASB have indicated they will be addressing that you believe are better addressed in combination with, or alternatively by, other organisations? If so, which issues and why, and which organisations?

We substantially agree with the comments contained in the EFRAG response.

Question 7—Is there any other input that you would like to convey to the FCAG?

Nothing to report.