Financial Reporting Council

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The Secretary General
The Committee of European Securities Regulators
11-13 avenue de Friedland
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12 September 2008

Dear Sir

CESR Statement, 'Fair value measurement and related disclosures of financial instruments in illiquid markets'

We welcome CESR's initiative in producing a synthesis of the IFRS standards relevant to this topical and important area. Illiquidity in wholesale credit markets remains a problem and we believe that the final statement will be relevant and timely to assist directors preparing for their next annual reports and accounts. Our comments are as follows:

1. The paper strikes a good balance between identifying relevant IFRS requirements and commenting upon best practice. We believe, however, that some refinement to the drafting is necessary as the consultation paper occasionally seems to stray into interpretation of the standards; specific examples are referred to below. There is a risk that any interpretation, either explicit or implicit, could increase rather than reduce potential diversity in application.

2. We are concerned that the overall balance of the commentary places excessive weight on a distinction between active and inactive markets. We believe that the underlying philosophy that fair values are based on the best information about prices that would occur in the market is common to all financial instrument valuations and remains the paramount principle. Accordingly, we recommend that a number of paragraphs (such as paragraph 16) should be redrafted to invoke this principle and to reduce the emphasis on the distinction between active and inactive markets.

3. Particular attention also needs to be given to the last sentences in paragraphs 23 and 29. Paragraph 23 suggests that bid/ask prices should be ignored where markets have become illiquid, whilst bid/ask prices might continue to be highly relevant. Paragraph 29 suggests that entity specific information about the price that the seller could achieve can be used, without the caveat that such prices need to be available to market participants.

4. We support the paper's emphasis on the overarching disclosure principles of IFRS 7. The reference to IFRS 7.31, which requires that sufficient information is disclosed to enable users to identify the nature and extent of risks arising from financial instruments, is important. We suggest that it might be helpful to remind readers that application of such a principle requires the exercise of judgement rather than a "tick box" approach. Hence disclosures based solely on the requirements of the subsequent paragraphs in IFRS 7 are unlikely to be sufficient.

5. IFRS 7 permits disclosures to be given either in the financial statements or incorporated into the financial statements by cross-reference. We recommend that the paper should emphasise the importance of identifying disclosures explicitly as being part of the audited financial statements when they appear outside the financial statements.

6. We believe that there is an opportunity to highlight best practice when disclosing key assumptions underlying valuations of a multitude of illiquid instruments. Many banks hold a large variety of such instruments. It might be helpful if some comments could be made about the challenges faced in aggregating such information and how they might be overcome.

7. The paper (paragraphs 45 and 46) refers to disclosures required by IAS 1 concerning judgements and estimation uncertainties. We believe that these disclosures are of particular importance and would encourage you to give these comments a higher profile.

8. Paragraph 46 refers to disclosure of key judgements as required by paragraph 113 of IAS 1 and gives the example of the judgement management makes in determining whether assets are classified as held to maturity. We suggest that the examples given in the paper are extended, for example, to include judgements about determining whether investments are impaired.

9. Finally, we believe it would be helpful to reconsider the title of the paper, as you may wish to widen its application. The paper provides guidance about valuing all financial instruments rather than just illiquid instruments impacted by recent market conditions.

10. We have set out our responses to your detailed questions in the Appendix to this letter. If you wish us to expand on any area of this response, please do not hesitate to contact Ian Wright on 0207 492 2330 (i.wright@frc.org.uk).

Yours sincerely,

Ian Wright

Director of Corporate Reporting

APPENDIX – Response to Questions in CESR Consultation Paper

Q1 Do you agree with CESR's views above regarding the distinction between active and non-active markets for fair value measurement?

> The paper should be modified to de-emphasise the suggested distinction between active and inactive markets. We believe that the paper should instead emphasise that there is no difference in the measurement objective which is to establish from the best evidence available the price that would be agreed by willing buyers and willing sellers.

Q2 Do you agree with CESR's views above regarding inputs to valuation techniques for financial instruments in illiquid markets?

> We believe that the commentary is helpful. The text,however, should be reviewed to ensure that the guidance does not go beyond or modify the requirements of IFRS.
>
> Paragraph 38 covers the use of the ABX.HE index. The discussion appears to suggest a risk of under valuation, however, using the index without due care might equally lead to an over valuation.

Q3 Do you agree with CESR's views above regarding disclosure of financial instruments in illiquid markets?

> We support the focus on the overarching disclosure principles in IFRS 7.

Q4 Do you agree that the benefits of the presentation of disclosures regarding financial instruments in illiquid markets in the example in Box 2 outweigh the costs of preparing this information?

> IFRS 7 requires disclosures based on internal reporting on financial risks to the board of directors, and the external reporting of this information should not involve significant incremental costs. If, however, directors do not monitor risks using the metrics in the pro-forma in Box 2, they may need to build new systems to capture this data. This could be challenging for multinational banks with diverse business activities and the costs could be substantial.