

Françoise Flores
European Financial Reporting Advisory Group
35 Square de Meeûs
1000 Brussels
Belgium

25 June 2013

Dear Ms Flores,

Ref.: EFRAG's Public Consultation – Is there a need for specific financial reporting for long-term investing activities business models?

Thank you for the opportunity to respond to the EFRAG's public consultation on long-term investing activities business models. We welcome the opportunity to comment on this important issue. ISDA's European Accounting Policy Committee Members represent leading participants in the privately negotiated derivatives industry that rely on over-the-counter (OTC) derivatives to manage efficiently the financial market risks inherent in their core economic activities. Collectively, the membership of ISDA¹ has substantial professional expertise and practical experience addressing accounting policy issues with respect to financial instruments and, specifically, derivative financial instruments.

Our responses to the questions posed in the consultation are outlined below:

Question 1 – Would you describe your (or one of your) business model(s) as a long-term investing business model? Please explain. If so, what is its economic purpose?

Our Members are global financial service providers engaged in personal, corporate, institutional, wealth and investment management activities with different business models. All these activities and business models involve financial transactions which usually encompass entering into derivatives. In this way, derivatives create significant value to the economy, which ranges from enabling banks, companies and governments to manage risk in their operations, to helping pension funds meet their obligations to retirees.

Derivatives are used to reduce uncertainty and foster investment especially for debt or equity products extended for a term greater than one year. Long-term financing often takes the form of a loan with a payback period. Examples of long-term financing include a 30 year mortgage or a 10-year Treasury note. Equity is another form of long-term financing, such as when a company issues stock to raise capital for a new project.

¹ Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These Members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, Members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org

Derivatives are used to segregate categories of investment risk that may appeal to different investment strategies and different types of investors. Long-term finance usually involves some type of financial structure. Some investors will be attracted by the interest rate risk and others by the market risk, equity risk, etc. Thus, derivatives play an important role in distributing risk and reducing uncertainty thereby helping to foster long-term finance. OTC derivatives are bespoke instruments used for these purposes which therefore assist in creating significant value in the economy.

Question 2 – What are your long term investing activities driven by (e.g. the need to back long-term liabilities)? What is the nature of our long-term commitments? How do you distinguish between assets held to back long term liabilities and other assets? Are you also involved in trading activities? If so, to what extent and for what purpose?

Our Members' long-term investing activities are often driven by maintaining a global and sustainable relationship with their clients. Long-term investing activities are part of specific business model type activities as outlined above.

Question 3 – What are the different types of assets you invest in?

See question 1.

ISDA's Members invest in all types of financial assets. Financial assets take many forms and can range from ultra safe low return government bonds to much higher-risk-higher-reward international stocks. Investors will often diversify their portfolio according to their specified needs. These instruments represent investments in many sectors and asset classes including education, construction, research and development, joint ventures, infrastructure assets, to name a few. These investments often include some type of derivative instrument, which help to segregate risks and hence increase the number of investors prepared to participate in long-term finance, increasing the amount of funding which can be raised from these activities.

Question 4 – How is your long term investment strategy established and how do you report on it, for both transparency and stewardship perspectives? How do you ensure that your current or potential shareholders can make the link between how you report your investment long-term strategy and the information provided in your financial statements? Could such a link be improved? How?

ISDA's Members disclose key aspects of their business strategy in line with IFRS requirements. The reporting could be further improved if the "business model" concept were explicitly taken into account and more fully articulated in the accounting requirements, including IFRS 9 and The Conceptual Framework.

Question 5 – Do you believe that the business model described above justifies a specific financial reporting treatment? If so, what should it be? Please explain how it brings relevant information to investors. Are there circumstances in which you would argue that fair value is not appropriate measure? What other measurement attribute would you suggest and why? How should measurement uncertainty be dealt with in a long-term investment activities business model?

We consider that IFRS is sufficiently flexible to allow different entities to faithfully represent their holdings of investments and their business models and to provide decision useful financial information to investors about their short-term performance and long-term strategy.

We believe that, in some cases, fair value is the most appropriate measurement category. Derivatives are always measured at fair value because fair value reflects the most useful information about the nature of these instruments and business model in which they are held, regardless of whether the investment is long-term or short-term.

For many other assets, the most appropriate measurement basis is also fair value, for example assets held for trading.

In some cases, where management intention is to hold investments that are not held for trading, they may also be carried on balance sheet at fair value with gains and losses deferred to equity. Interest and dividend income is recognised in profit or loss. The deferral of market value gains and losses in equity rather than immediate recognition in profits enables management to fairly depict the longer term nature of the investment, and the overall performance of the asset, while providing investors with the appropriate information content, i.e. what the assets were worth at the end of each reporting period.

IFRS 9 *Financial instruments*, which is intended to replace IAS 39, builds upon the principles established by IAS 39, namely that an entity's reported performance should reflect its business model and the characteristics of its assets and liabilities.

We consider that the IASB has drawn the distinction between outright fair value accounting and amortised cost broadly correctly, although we have some reservations on specific points of detail (see below). Many of our Members see the addition of the third business model, which will enable entities to include debt instruments at fair value through other comprehensive income (FVTOCI), as an overall enhancement to IFRS 9 Financial Instruments.

The accounting treatment under IFRS 9 is designed to reflect the contractual characteristics and business model and of financial instruments. For example, long-term loan and debt investments must be accounted for at amortised cost provided the debt is plain vanilla and held in order to earn an interest based return.

Equity investments may be designated at FVOCI on initial recognition, although the eventual gain (or loss) on sale can never be included in profit or loss (and nor can impairment). However relatively minor deviations in the definition or principal and interest could result in the investment being held at fair value with changes through profit or loss. In addition, the definition of a business model for the collection of principal and interest and for sale is regarded by some Members as being too narrow. These are areas of concern but, generally, ISDA's Members consider IFRS 9 to be an improvement on IAS 39.

For long-term equity investments in entities over which a company has significant influence or joint control, the accounting guidance under IAS 28 Accounting for Associates and IFRS 11 Joint Arrangements, requires the application of the equity method. In this method, the investment is initially recognised at cost and then subsequently adjusted for changes in the investor's share of net assets in the investee, unless held at fair-value-through-profit-or-loss (FVTPL). This also is appropriate given the nature of the investments. Entities for whose business model this is inappropriate (such as venture capital organisations) have the option to hold the investments at FVTPL.

Question 6 – If you are an investor in entities that are involved in long-term investment activities, what is the information that is the most relevant to you? How does IFRS financial reporting contribute to those needs today? Please explain

As noted above, ISDA's Members invest for the long term in many different ways. The information that ISDA's Members use depends on the nature of the investment. For example, for a debt security or a lending relationship it is most important to track the borrower's ability to generate profits and cash to provide interest cover and to service debt. Therefore it is important to evaluate the value of the collateral provided which is not always included in financial statements. Derivatives are generally collateralised financial instruments and 'netting' and 'collateral' are risk management tools that provide market participants' with decision useful information.

Our Members are also interested in their customers' and clients' businesses and their financial strength, track record of realised gains and losses and trading performance. Above all, we believe that high quality accounting standards should include both fair value and amortised cost categories in order to provide transparency, relevance and reliability.

We hope you find ISDA's comments useful and informative. Should you have any questions or would like clarification on any of the matters raised in this letter please do not hesitate to contact the undersigned.

Yours faithfully,



David Bradbery
Barclays Bank plc
Managing Director
Chair of Accounting Policy Committee



Antonio Corbi
ISDA
Assistance Director
Risk and Capital