Stig Enevoldsen
Chairman
EFRAG

35 Square de Meeûs
1000 Brussels
Belgium

commentletter@efrag.org

Date: 9 July 2009
Ref.: CESR/09-659

RE: EFRAG's draft comment letter on the IASB's Exposure Draft *Derecognition* (Proposed amendments to IAS 39 and IFRS 7)

The Committee of European Securities Regulators (CESR), through its standing committee on financial reporting (CESR-Fin), has considered EFRAG's draft comment letter on the IASB's Exposure Draft (ED) *Derecognition* (proposing amendments to IAS 39 & IFRS 7).

We thank you for this opportunity to comment on your draft letter and we are pleased to provide you with the following comments:

1. CESR agrees with EFRAG that the main crisis-related issues arising from the existing derecognition model concern disclosures. Users do not wish to be surprised by new ('hidden') risks as they have during the current financial crisis. CESR therefore believes that users' concerns could best solved by requiring more appropriate disclosures, rather than by introducing a whole new standard on derecognition. CESR agrees with EFRAG that the IASB should therefore address the need for improved disclosures in the short term, allowing more time for the design of a new derecognition principle and for a comprehensive analysis of its potential consequences.

2. That said, CESR is aware of the many issues relating to derecognition that are submitted to IFRIC, mainly because of the complexity of and the inconsistencies with the current model which have led to application problems. CESR therefore appreciates the efforts made by the IASB to consistently respond to these problems by proposing a new derecognition model. However, CESR is concerned by the short timing of the project, especially given the fundamental changes the IASB is proposing. We would have preferred a discussion paper rather than an ED, in which both the proposed model and the alternative model were developed in detail. Derecognition remains a very complex and important issue and the discussion on any future model should not be rushed.
   Additionally, we note that both the proposed and the alternative view, which contain fundamental changes to the existing derecognition model, could lead to the derecognition of more assets and liabilities. CESR wonders whether this is the right answer in the current environment.

3. CESR has some sympathy for the approach proposed in the ED of focusing on one single element, i.e. control, rather than combining several elements as in the current approach:

   a) We think a single principle would be easier to apply than the current IAS 39 derecognition requirements which are obviously difficult to understand and to apply in practice;

b) A single criterion for derecognition of financial assets based on control would mirror the criteria for recognition of assets which is also based on control;
c) The control approach is more in line with the current approach on the credit side of the balance sheet. According to existing IAS 39, if an issuer transfers a financial liability to a third party and offers the creditor a full guarantee for the credit risk, the financial liability is derecognised, although the credit risk falls for the account of the debtor who transferred the financial liability; and
d) The risks regarding derecognized assets should rather be reflected in the notes than on the balance sheet.

4. CESR tends more towards of the alternative approach which seems to be conceptually more robust, less complex and easier to comply with.

We agree with EFRAG that the proposed approach does not solve all the complexities of the current model. For instance, both the "continuing involvement" test and the "practical ability to transfer for own benefit" test seem difficult to apply.

5. However, CESR believes that the alternative approach proposes fundamental changes and agrees with EFRAG that more time is needed to discuss such changes and that such issues need more comprehensive consideration, for instance:

- *The treatment of repo-transactions*: CESR disagrees with the derecognition of repo-transactions as it seems to be inconsistent with the economic substance of these transactions, namely a secured borrowing. Indeed, although from a theoretical point of view it could be argued that these transactions are transfers rather than financing transactions, many constituents do think repo-transactions are financing transactions and should be reflected as such and not as sales.

- *The proposed treatment for sales of parts of financial instruments*: if an issuer sells a very small part of a financial asset then it should, according to the ED, derecognise the whole asset and recognise a new financial asset. The difference between the fair value of the 'new' financial assets and the carrying amount of the derecognised one should be reported in the profit and loss account. Understanding all the implications of such a treatment is important to CESR as the current continuing involvement approach seems to provide an appropriate answer to the issue. Further, the current approach is consistent with the "substance over form" principle which is extremely useful when dealing with complex or tricky situations.

In addition, CESR is of the opinion that extensive field-testing should take place, particularly with financial institutions, in order to get a better picture of the impact of the alternative approach might have on the statement of financial position. Too little information is available in the ED to decide properly at the moment on the alternative approach.

6. CESR is supportive of the objectives proposed of disclosures requirements indicated in paragraphs 42A and 42C, namely:

- To provide information that enables users to understand the relationship between the assets which have been transferred but not derecognised and the associated liabilities after the transfer; and
- To provide information that enables users to evaluate the nature of and risks associated with the entity's continuing involvement in assets that are derecognised or not.

These objectives are commendable. However, for both approaches, the list of disclosures required in paragraphs 42B and 42C regarding transferred financial assets, recognised and/or derecognised, is much more extensive than under the current requirements. We think that some of the disclosure requirements look like a checklist and are presented as "minimum

disclosures". CESR prefers a principle based approach and would encourage the IASB to reconsider the requirements as examples of relevant disclosures rather than as minimum disclosures.

7. CESR is also particularly supportive of EFRAG's comments on the ED regarding:

- The assessment at reporting level: CESR agrees that the determination of the item to be evaluated for derecognition and the assessment of continuing involvement should be made at the level of the reporting entity.

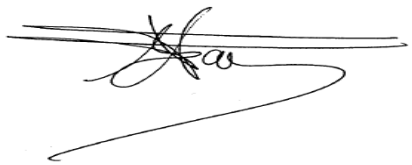
- The definition of transfer: the definition proposed in the ED is much broader than the current one. CESR is not convinced that there is a need for a new definition. In addition, CESR is concerned that a broader definition of transfer would lead to more derecognition in practice;

- Continuing involvement, especially types of involvement excluded from the definition: CESR understands that the concept of "risks and rewards" would be replaced by a "continuing involvement" test. CESR is not convinced that this continuing involvement test will prove to be more efficient than the risks and rewards one.

- The "practical ability to transfer for own benefit" test: CESR is not convinced that the assessment of the position of the transferee will be simple to apply in practice. In addition, the emphasis put on the notion of "actively traded" raises a number of questions. For instance, CESR understands that any transferred asset that is liquid will be derecognised, irrespective of the level of continuing involvement, which does not seem to be the right answer. Finally, CESR agrees with EFRAG that transferring a financial asset is not the only way of obtaining the economic benefits from that financial asset.

I would be happy to discuss all these issues or any other further with you.

Yours sincerely,



Fernando Restoy
Chairman of CESR-Fin