

**OPINION OF THE COMMITTEE ON MONETARY, FINANCIAL AND BALANCE OF
PAYMENT STATISTICS**

of 9 July 2004

**on the IASB's Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments:
Recognition and Measurement. The Fair Value Option.**

1. The CMFB welcomes the opportunity to comment on the Exposure Draft (ED) amending IAS 39. The CMFB has assessed the possible implications of this standard and, in particular, of the fair value option on EU official statistics. In response to the list of questions described in the "invitation to comment", the CMFB would like to call attention to the following points.

Question 1. Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

2. The CMFB welcomes the proposals in this ED, and in IAS 39 in general, as a positive development since it should contribute to harmonised valuation rules for certain financial instruments. However, the CMFB does have a number of specific concerns which are explained below. Furthermore, the CMFB is concerned that the delay in finalising IAS 39 could worsen the already tight timeframe within which IAS 39 should be accepted by the financial industry in the EU, on the assumption that this standard will need to be endorsed by the EU Commission and be implemented by listed companies as from the year 2005. In turn, this may have a negative impact on the quality of the reported data and thus on the statistics based on these data.
3. From a statistical perspective, the CMFB considers that the stricter criteria that have now been proposed ensure that accounting practices and statistical standards are more closely aligned. At the same time, it regrets that full consistency is not yet achieved through these proposals.
4. In particular, the CMFB welcomes the current proposals to the extent that they will reduce the scope for the application of fair value accounting (FVA) to non-negotiable instruments. Indeed, the CMFB is in favour of the amendments incorporated in the ED that confine the application of the fair value option to: (i) a limited set of five categories of financial assets and liabilities¹, and (ii) financial assets and liabilities whose fair value is verifiable.

¹ The application of the fair value option will be limited to five categories of instruments: (i) the item has one or more embedded derivative; (ii) the item is a financial liability with a contractual link to the performance of assets which are at fair value; (iii) the exposure to

5. At the same time, the CMFB wants to draw attention to the fact that this tightening of the fair value option is not sufficient for statistical purposes. In particular, the ED permits the application of fair values to "natural offsets" in which only one leg of a matched position is measured at fair value. This provision implies that loans and deposits may still be measured at fair value. Indeed, if e.g. deposits are hedged by a derivative, this is a sufficient condition to permit the application of their fair valuation, according to the ED. A quantitative simulation conducted at the ECB suggests that there may be a non-negligible impact of FVA on the stocks of deposits and loans should all loans and deposits be valued according to this principle.
6. The CMFB is concerned about the possible application of FVA to loans and deposits. The current statistical standards, as set out in the System of National Accounts (1993), require these instruments be recorded at nominal value. In particular, this is the case for the statistical balance sheets of financial institutions.
7. Furthermore, the CMFB notes that users of monetary statistics continue to need data on loans and deposits at nominal value. In particular, for monetary policy purposes, the analysis of the medium- to long-term inflationary effects of current monetary and credit developments will anyhow require a consistent valuation of non-traded instruments, preferably at nominal value. Indeed, these users need homogeneous statistical time series on stocks. Moreover, the availability of reliable statistics on transactions is deemed crucial for monetary analysis as they serve to track the underlying economic behaviour of agents disregarding valuation or reclassification effects. Therefore, in case of the application of FVA to money and banking statistics, the necessary adjustments will need to be made.
8. Nevertheless, users have expressed a strong interest in receiving additional data on a fair value basis for banking analysis, whilst acknowledging the subordinate status of the requirement and the potential costs of providing data on a dual valuation basis.
9. Therefore, the introduction of the fair value option for loans and deposits, including the possibility that within a single company different rules are applied to financial instruments within a single category, may lead to the additional collection of statistics at nominal valuation. These data are required for monetary policy analysis and other purposes. In particular, this may lead to additional legally binding statistical reporting requirements for respondents, with a possible increase of the total administration burden on business, particularly for Monetary Financial Institutions (MFIs) and other financial institutions involved in lending.

changes in the fair value of the financial asset or financial liability is substantially offset by the exposure to the changes in the fair value of another financial asset or financial liability, including a derivative, (iv) financial assets other than loans and receivables and (v) items that other Standards allow or require to be designated at fair value through profit or loss.

10. For example, specific accounting rules for statistical purposes will need to be introduced in the Regulation of the European Central Bank of 22 November 2001 concerning the consolidated balance sheet of the monetary financial institutions sector (ECB/2001/13)². This is necessary because Regulation ECB/2001/13 is currently not yet prescriptive in terms of the accounting rules to be followed in the statistical data. To date, statistical compilers usually follow the national commercial accounting rules, which as said above, will differ from the statistical requirements if the Exposure Draft is not altered.
11. The Exposure Draft is expected to also have an impact on harmonised interest rates statistics compiled by the ESCB, which also require that loans and deposits are recorded at nominal value. In particular, where the elementary data are collected by means of implicit rates, the use of the fair value option for deposits and loans may introduce a bias. The significance of this bias depends on the importance of loans and deposits that are recorded at fair value in relation to the total stock of loans/deposits.
12. For the purpose of external statistics, euro area financial accounts and government finance statistics, it is expected that IAS 39 will also improve the overall data quality. However, the wider use of FVA may create inconsistencies among various types of statistics. Whereas the European System of Accounts (ESA 95) currently requires nominal values for deposits and loans, corporations complying with IAS 39 may report data on loans and deposits on a fair-value basis. Since this could create some consistency problems, it is necessary to distinguish between negotiable and non-negotiable instruments as only the former should be recorded at market value.
13. For statistics compiled by EU Member States, and collected and published by the European Commission (Eurostat), the application of IAS39 may lead to a considerable decrease in the quality of data on loans and deposits. Or, alternatively, the need arises to increase the reporting burden by requiring the creation of a separate reporting system, with nominal valuation for loans and deposits. Furthermore, the quality of structural business statistics (SBS) on the financial sector may be negatively influenced by the use of the Fair Value Option for non-negotiable financial instruments such as loans and deposits. Breaks in time series may occur. SBS are sourced from individual annual accounts. The difference in scope and timing of the application of the Fair Value Option to individual accounts throughout the EU may cause a decrease in the comparability of SBS between Member States and within Member States between financial institutions. Furthermore, non-financial corporations will also be affected by IAS39. To the extent that the difficulties outlined above also apply to these institutions, the statistics by industry, size of corporations etc. and the national accounts, which are partly based on the corporate accounts, will be affected as well.

² The need to amend this ECB Regulation is also explained in chapter 6.3 of the ECB Occasional Paper No. 13 on "Fair value accounting and financial stability" (April 2004).

14. Against this background, the CMFB would see clear advantages to amend the present Exposure Draft by introducing a clear separation between negotiable and non-negotiable instruments and by allowing only the former to qualify for fair value accounting.

Questions 2 to 5.

15. The CMFB understands that these technical questions are addressed to practitioners of commercial banks and prudential supervisors. The aim of the CMFB is only to convey the points described in the answer to question 1.

Question 6. Do you have any other comments on the proposals?

16. In general, in view of the strong and growing linkages between accounting and statistics, the CMFB is of the opinion that relaying in an effective manner views on overlapping concerns between the IASB and the statistical community may become of increasing importance. This issue has also been addressed during the second ECB conference on statistics held at the ECB on 22-23 April 2004, in one of the first occasions where the accounting and statistical parties have discussed common issues³.
17. Against this background, the CMFB would welcome a closer cooperation between the IASB and the statistical community, in order to minimise, to the extent possible, the administrative burden on business and to provide the best possible and optimally consistent information to users of micro-economic (accounting) and macro-economic (statistics) data.
18. The above-mentioned change to the ECB legal framework and the consequent increase of the reporting burden of companies could be avoided if the fair value option is confined only to negotiable financial instruments and not to loans and deposits.
19. The CMFB has no objection to making this opinion publicly available. This opinion will be published on the CMFB website.

³ The proceedings of this conference are published on the ECB website (www.ecb.int).