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Le Président

JFL/EP

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**IASB**

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The current market crisis has made it urgent for the IASB to work on certain issues, notably the valuation of financial instruments when markets are illiquid, consolidation and disclosures.

We congratulate the Board for issuing the draft report in such a speedy manner.

The choice of issuing a draft expert report is not without causing concerns though : also it is clearly stated in the draft that it does by no means constitute an interpretation of the applicable standards, we fear it might be used in practice to set up reporting standards. In order to avoid any confusion, we would recommend that the IASB consider revising IAS 39 on a short term basis, taking into account the input it received from its consultation on how to simplify the accounting for financial instruments, as well as the result from the consultation of its expert panel.

Also, more substantially, we question some of the conclusions of the Draft report. Notably, it seems to us that the Draft fails to address some of the issues related to illiquid markets. If we agree that under normal circumstances, a market transaction between willing parties cannot be ignored when evaluating the fair value of a financial instrument, whether the transaction has occurred for a same or a similar instruments, we also believe that there might be cases where markets are so dysfunctional that market transactions occur at prices that cannot be considered representative of fair value. On the contrary, in such cases, we do consider that an entity specific value, based on management estimates of future cash flows and risk premiums, better represents such a fair value.

Therefore, putting undue emphasis on market prices occurring under stressed circumstances would be contrary to the on going concern, as the companies holding the instruments have no intention of selling them at the current distressed prices, that do not reflect anything but the fact that a liquidity crisis is undergoing, and do not represent the fundamentals of the issuers of the financial instruments.

Please, find below our detailed comments to the draft report.

Yours sincerely.

**Jean-François LEPETIT**

## **1/ Measurement**

### **Applying the fair value measurement objectives :**

This paragraph starts with a statement that fair value requirements in IAS 39 are clear and generally well understood. We do not support this statement. We recently issued a research paper on Synthetic CDOs underlying the different needs for clarification of the measurement requirements in IAS 39.

**Fundamental value versus fair value.** Please, refer to our general comments above.

### **Forced transactions :**

We do not believe that forced transactions, as described under the three bullet points of the paragraph, are rare. For example, mutual funds are under legal requirements to transact when for example, their shareholders want to redeem their shares. It is therefore unclear what it meant when it is said that forced transactions are rare.

Also, it is questionable if the paper, as drafted, gives clear answers to a numbers of situations :

- In the current market context, one could question whether transactions entered into by entities that have severe liquidity problems or are under Chapter 11, should be considered as normal transactions. For us, it is unclear whether these situations are captured by the indicators that are listed on page 4 ;
- We would also question whether the criteria are the same when dealing with prices for entire instruments and when selecting inputs for valuation models ? We believe the latter is not discussed in the paper.

### **Valuation adjustments :**

We do agree that liquidity should be considered when making valuation adjustments under normal circumstances. However, it seems to us this is a different case under market crisis, when there is no liquidity, which is the case the Exposure draft should be addressing.

### **Information from broker service and pricing services :**

It is said in the Exposure draft that if an entity uses services of a broker or pricing agency, and if its own estimates fall within the range of prices that the agency has come up with, then the entity can use the result of its own model. This seems to imply that, when the result of the model are outside the range of prices provided by the agency, then the prices cannot be used. However, there have been cases when the estimates of the company have proven to be more accurate than the one of the agency. This is notably the case when an entity is a first entrant on a market.

## II/ Disclosures

We generally agree with the guidance provided in the second part. We note that some of this guidance was already discussed at the last IASB Board and tentative decisions were made as part as its response to the FSF recommendations re. the current market crisis and amendments to IFRS 7 (fair value hierarchy, reconciliation of movements on fair values of instruments measure using unobservable inputs, frequency of disclosure, use of tabular format for quantitative information...).

- How this guidance will be incorporated within the current IFRS 7 if this is incorporated (but we understand this is the final goal) ;
- As long as it is not included in IFRS 7 is it considered to be prescriptive? What is its status ?
- Whether auditors are currently well equipped in order to audit these information since we understand that this information belongs to the F/S of the entity ;
- We find that some information mentioned are very detailed and difficult to communicate for example as far as banking institutions are concerned. For example, this could be the case for the use of broker quotes... We find it difficult for an institution that has thousands of different instruments to communicate at a level that would make sense on this type of information (number of quotes obtained, what brokers or pricing services are used and why....). On the reverse we would find rational that if an entity use broker quotes/pricing services that it is stated in the description of its control environment and that precision are given re. the level of control that exists when such quotes/services are used.