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IASB
30 Cannon Street
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United Kingdom

21 July 2009

Re: *Derecognition – proposed amendments to IAS 39 and IFRS 7*

Dear Sir,

We appreciate the Board's effort to accelerate its work on the projects connected with the financial markets crisis. These matters have a high significance in avoiding that any further worsening in the conditions of the financial markets might be the signal of – or interpreted as - inadequacies in the International Financial Reporting Standards.

The Exposure Draft on the Derecognition deals with several matters connected to the financial market crisis, particularly those related to the treatment of the off-balance sheet vehicles. We are aware of the pressure to define a standard - unique for both the IASB and the FASB – and to improve the reporting information on off-balance sheet vehicles, as requested by the Financial Stability Forum and then by the G-20. However, we do not believe that the derecognition model presently required by the IAS 39 failed in maintaining the prudential treatment which we believe is appropriate, particularly in a period of crisis. We would have rather expected that the criterion of risk and rewards would be maintained as the fundamental principle in derecognizing financial assets – as already mentioned in our comments on the consolidation project – together with the improvement of the disclosures on off-balance sheets vehicles.

We are conscious that the current derecognition model may give raise to certain application issues. Among these, the use of both the "risk and rewards" notion and the "control" notion, as well as the necessity to better define the term "substantially" in determining the level of risks and rewards to be transferred to permit to derecognize the financial assets. Moreover, the present model seems to be rule-based, and it is focused on determining "how" a certain economic position was reached, rather than on "representing" that position. Notwithstanding these matters, we still believe that the model based on the transfer of risks and rewards is the approach that best fits the users' expectations, that is *not* derecognizing those financial assets for which the entity is still exposed to risks.

We do not believe that the proposed model is an appropriate solution for the present derecognition accounting issues. The most significant proposed change is the abandon of the risk and rewards test. The proposed model is based on the test of the transfer of the control. If the entity's involvement in the transferred financial activities is discontinued, it is necessary to ascertain whether the transferee has obtained the control over them. The transfer of the control is assumed when the transferee can freely, without restrictions, transfer to third parties the financial assets.

We do not believe such changes represent an improvement. Rather, they seem the attempt to obtain the same results of the risks and rewards model by applying the notion of the control on the underlying asset. We believe that this approach if faithfully applied should lead to results very different than the present model.

In summary, we believe that the proposed model could give raise to the following significant issues:

- Repo transaction. Every time the transferee of an Repo transaction can freely transfer to third parties the received financial asset (a very common transaction, such as for Government bonds and any listed security/instrument) the transferor would derecognize the underlying asset. Such treatment does not reflect the substance of the transaction, which is generally entered by banks to collect liquidity, and produces inappropriate effects. Under the present approach, the Repo transaction transactions do not generate volatility effects on the profit and loss, whilst with the proposed method the transferor continuing involvement (its obligation to re-acquire) would be recognized as a derivative (see ED.AG52L) which increases the volatility of results. We are of the opinion that such volatility is fictitious and that it does not represent the substance of the operation (i.e. financing) but rather its legal form and it is therefore in contravention with a fundamental criterion (substance over form) stipulated in the Framework.
- Subjectivity in determining the control. The proposed model to determine the transfer by means of the "control" notion implies the adoption of subjective/discretional elements since the test of the transfer is made on the *transferee* conditions (i.e.: agreements entered by the transferee with third parties – see AG52Ea) that very hardly the transferor can know and evaluate. Also, defining whether a financial asset should be considered "actively traded on an accessible market (at the date of transfer)", might result in a subjective valuation as, for example, clearly happened in the second half of the year 2008 because of the crisis. We are also concerned with the introduction of a new definition of markets (i.e. accessible) which may have unintended consequences for the project of revision of IAS 39.
- Simplification goal not reached. The objective of the proposed model was to overcome some problems of the current principle. Based on our interpretation of the proposed model, it does not overcome the question of different accounting treatment between entities in a similar financial position. Furthermore it does not resolve the problem of accounting for the continuing involvement which is currently infrequent applied. The proposed accounting model for derecognition does not seem to solve the application and principle issues of the current IAS 39, but it only permits more asset transferred to be derecognised. We wonder if this was the intention of the Board or of the constituents.
- Factoring. The proposed changes could reduce the extent of certain uncertainties presently arising - under the risks and rewards model – for transactions not qualifying for their derecognition (non-substantial transfer of risks and rewards, particularly due to the difficult and consistent application of the related quantitative models). In theory, we believe that the proposed approach may clear some of these uncertainties where the underlying contract include mitigating clauses not concerning the credit risk. However, other issues might emerge from the proposed model as to the possibility for the transferor to evaluate the "practical ability" of the transferee to transfer the assets. This may result in subjective evaluations not necessarily appropriate.

We observe with interest the proposed model, considering its pure principle-based approach and its control-based focus. However, we believe it should be considered solely as a starting point useful for the development of a new Standard for the derecognition.

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Because of the pervasive nature of the foregoing comments, in the attached appendix we comment solely certain of the ED specific questions, to the extent we feel them significant.
Should you need any further information, please do note hesitate to contact us.
We remain

Yours sincerely,

Angelo Casò
(Chairman)

APPENDIX A: Answer to the Specific Questions

Question 1—Assessment of 'the Asset' and 'continuing involvement' at reporting entity level
Do you agree that the determination of the item (ie the Asset) to be evaluated for derecognition and the assessment of continuing involvement should be made at the level of the reporting entity (see paragraphs 15A, AG37A and AG47A)? If not, why? What would you propose instead, and why?

Absent a complete revision of the framework, this is a controversial issue. However, it should be noted that the derecognition model should be applied at consolidated level. Should not this be the case, assets derecognized in the separate financial statements could have lead not to consolidate the vehicle. Because of that, the derecognition standard should deal also with the preparation of separate financial statements.

Question 5— 'Practical ability to transfer for own benefit' test
Do you agree with the proposed 'practical ability to transfer' derecognition test in paragraph 17A(c)? If not, why? What would you propose instead, and why?
(Note: Other than the 'for the transferee's own benefit' supplement, the 'practical ability to transfer' test proposed in paragraph 17A(c) is the same as the control test in IAS 39.)
Do you agree with the 'for the transferee's own benefit' test proposed as part of the 'practical ability to transfer' test in paragraph 17A(c)? If not, why? What would you propose instead, and why?

This test implies several arguable elements. Please refer to various comments in the accompanying letter.
A specific case where the model does not seem to be operational is the transfer of financial receivables with a sold put option. According to paragraph AG52L, "*the transferee appears to have the ability to transfer the Asset; however, the transferee may be unwilling to give up the value of the put option and thus economically be constrained from transferring the Asset in isolation (eg the put option might be sufficiently valuable to the transferee—whether that is the case will require judgement). As a result, the transferee is unlikely to have obtained control of the Asset (again, assuming that the derivative is not net settled).*" The mere fact that no derecognition is applied because the transferee would recognize a loss on the purchased put option does not seem to be a strong reason to do so. The loss that the transferee would suffer does not restrict its rights to transfer the assets, but only reduces the probability for it to do so. Hence, it seems that the transferee controls the asset, whilst the alternative method – purely based on the control – would have permitted the derecognition. This example leads us to think that the possibility of transactions structured to that purpose are greater under the proposed model than applying the risk and rewards approach.
A similar opportunity to purposely structure the transaction would be given by the distinction between *readily obtainable* and *not readily obtainable*, should such a difference be considered a trigger element to derecognize or not.

Question 7—Approach to derecognition of financial assets
Having gone through the steps/tests of the proposed approach to derecognition of financial assets (Questions 1–6), do you agree that the proposed approach as a whole should be established as the new approach for determining the derecognition of financial assets? If not, why? Do you believe that the alternative approach set out in the alternative views should be established as the new derecognition approach instead, and, if so, why? If not, why? What alternative approach would you propose instead, and why?

We are contrary to the proposed model. Please refer to the companying letter.
The alternative approach results in very significant discontinuity versus the current accounting treatment, more stringent than the proposed change. For example, assets transferred with repurchase obligation would be subject to derecognition also in the case of assets not readily obtainable: hence, all repo transactions would be subject to derecognition, given that the transferee has no longer access to

the cash flows from the related assets. Similarly, all securitizations would be subject to derecognition, and the sole junior portions would remain recognized, at fair value.
Finally, we believe there are aspects that the Board should consider in a possible development of this accounting model:

- The model should distinguish between funding transactions and sale of financial assets.
- The retained interest should be measured on the basis of its nature (i.e.: provision, fund, financial asset), and not always at its fair value.

Question 8—Interaction between consolidation and derecognition
In December 2008, the Board issued an exposure draft ED 10 Consolidated Financial Statements. As noted in paragraphs BC28 and BC29, the Board believes that its proposed approach to derecognition of financial assets in this exposure draft is similar to the approach proposed in ED 10 (albeit derecognition is applied at the level of assets and liabilities, whereas consolidation is assessed at the entity level). Do you agree that the proposed derecognition and consolidation approaches are compatible? If not, why? Should the Board consider any other aspects of the proposed approaches to derecognition and consolidation before it finalises the exposure drafts? If so, which ones, and why? If the Board were to consider adopting the alternative approach, do you believe that that approach would be compatible with the proposed consolidation approach?

We believe that the combined dispositions of the two EDs is largely more permissive than the present approach base on risks and rewards. The possibilities to purposely structure the transactions would proportionally increase. We do not believe this effect meets the expectations of both Financial Stability Forum and G-20, which requested an improvement on financial information on off-balance sheets vehicles.
For example:

- Entity A securitizes financial assets that qualify for derecognition through a vehicle and purchases senior securities from it. Based on the proposed consolidation principle, the vehicle is not consolidated, since the Reporting Entity does not have control over it;
- Entity A transfer senior securities, listed at BCE, to the purpose of re-financing.The senior securities are deemed readily obtainable and therefore the Reporting Entity can derecognize them.

This is only an example of how an operation of securitization aimed to finance the reporting entity, is misrepresented as a sale by the proposed accounting model.

Question 10—Transition
Do you agree with the proposed amendments to the transition guidance in paragraphs 106 and 107? If not, why? How would you propose to amend that guidance instead, and why?

We are generally in favor of a retrospective application, but in this case we understand the IASBs reasons for a prospective application.

Question 11—Disclosures
Do you agree with the proposed amendments to IFRS 7? If not, why? How would you propose to amend those requirements instead, and why?

Once again (see also our comments on the Consolidation) we believe that the proposed disclosure is excessive and – in certain cases – not readily available to the entity. For example, if the entity has derecognized the assets but maintained its continued involvement, will it be able to analyze the expected periodic outflow and perform a sensitivity analysis on the fair value?

We are concerned that sometimes certain disclosures are required to obviate weaknesses in the Standard, or that by means of a number of disclosures the decisions of the investors are facilitated. We do not share this opinion. The primary source of information for the investors seats in the financial

prospectuses and only secondarily in the footnotes. Moreover, an excess of analytical data would confound the investors, particularly if they are not completely coherent each other.
We finally think that the Financial Stability Forum and G-20 request for disclosures on off-balance sheet elements should not be referred to IFRS 7, but rather to a lack in SIC 12.