

SUMMARY RECORD

<p>MEETING OF THE ACCOUNTING REGULATORY COMMITTEE OF 9 JULY 2004</p>

M. Alexander Schaub, Director General at the Internal Market DG, European Commission, chaired the ninth meeting of the Accounting Regulatory Committee ("ARC"). No implementing measure featured on the agenda of this meeting. In his opening remarks, the Chairman insisted on the importance for members and observers to the Committee to respect the confidentiality rules laid down in Article 14 of the rules of procedure of the ARC.

Agenda point 1 - Approval of the minutes of the previous ARC

The minutes (ARC/2004-04-30/4) of the ARC meeting of 30 April 2004 were approved in written procedure. The minutes (ARC/2004-06-14/4) of the ARC meeting of 14 June 2004 were adopted in session.

Agenda point 2 – IAS 39 – State of play

In his introductory remarks, the Chairman referred to the report provided by Commissioner Bolkestein to Ministers of Finance at the ECOFIN meeting on 5 July on the latest situation regarding IAS 39. In particular, Ministers of Finance were informed that further to the ARC meeting of 14 June, full endorsement of IAS 39 would be divisive -while many Member States support endorsement, a significant number of Member States oppose it- and that the Commission was therefore exploring with technical experts an intermediate solution that would consist of endorsing IAS 39, with the exception of:

- (1) the fair value option and
- (2) a limited number of provisions dealing with the hedge accounting of core deposits.

The Chairman insisted on the importance for the EU to have on 1 January 2005 an accounting standard on financial instruments as comprehensive as possible, which meant that a carve-out should be limited to only what was strictly necessary. Such a carve-out should also be limited in time until the IASB will have revised IAS 39. The Chairman said that one of the objectives was also to avoid the banking industry having to carry out more than one, expensive, system change which might prove unnecessary if an appropriate technical solution were found in the near future. The Chairman underlined the exceptional nature of the present situation, where the Union had to remedy the inability of both the International Accounting Standards Board and the European banking industry, after 2 years of long and painful discussions, to come to a mutually satisfactory solution on portfolio hedging of core deposits, an issue of particular concern to banks

operating in a fixed interest rate environment and related to a minor portion of the standard.

The Chairman urged the IASB to examine as a matter of priority the latest proposals of the European Banking Federation on interest rate margin hedges within the framework of the ad hoc working group recently set up. The Chairman also invited European constituents of the IASB in the future to be more diligent and clearer in the explanation of their problems and to come forward with innovative proposals based on sound technical arguments.

The Chairman said that, as acknowledged by the IASB itself, IAS 39 raised serious and legitimate issues for the banking industry and that the question was how to deal with this problem on the eve of the introduction of IAS in the EU, stressing that companies needed to know as soon as possible which standards they will have to apply on 1 January 2005.

The Chairman then explained the thrust of a possible Commission proposal that would consist of endorsing IAS 39, with the exception of the fair value option and a certain number of provisions (essentially at the level of the application guidance) which prevented the fair value hedging of portfolios of core deposits.

(1) Fair value option

The Chairman recalled that the International Accounting Standards Board had recently published an Exposure Draft which proposed an amendment to IAS 39 in order to restrict the fair value option contained in the standard. The Chairman indicated that the proposed amendment was a direct response to concerns expressed by the European Central Bank, by prudential supervisors as well as by securities regulators which fear that the fair value option might be used inappropriately. The Chairman added that this proposed amendment was currently debated in public and that a final version would most likely not be available before the end of 2004.

In this context, the Chairman expressed the view that the provisions in the standard relating to this fair value option should therefore not be considered applicable. The Chairman stated that as soon as the International Accounting Standards Board would have completed its work on this issue, and normally no later than by the end of 2005, the Commission would then examine the resulting amendments to IAS 39 in view of their endorsement.

(2) Portfolio hedging of core deposits

The Chairman stressed that despite the improvements brought to IAS 39 by the International Accounting Standards Board to allow macro-hedging, consultation with technical experts in the field indicated that IAS 39 did not sufficiently take into account the way in which many European banks operated their risk management particularly in a fixed interest rate environment.

The Chairman pointed out that the limitation of hedges to either cash flow hedges or fair value hedges and the strict requirements concerning the effectiveness of those hedges made it impossible for those banks to hedge their core deposits on a portfolio basis.

The Chairman explained that the objective of the proposed carve-out of a limited number of provisions in IAS 39 was to enable portfolio hedging of core deposits on a fair value measurement basis, as explained in Recital 7 of the draft. The Chairman underlined that

this proposal was not inconsistent with the principle stated in the standard (p.m. paragraph 49) that the fair value of a financial liability with a demand feature cannot be less than the amount payable on demand, as this principle did not relate to portfolios. Due to internal interactions and the law of large numbers, a portfolio hedge is different from the hedge of a single asset or a single liability.

The Chairman reiterated that the scope of the carve-out was very limited. At this stage, it appeared that the carve-out could amount to:

- 2 partial suppressions in the standard itself,
- the suppression of 4 entire paragraphs and 9 partial suppressions in the text of the application guidance (which is an integral part of the standard),

out of a standard (108 paragraphs) and guidance of 132 paragraphs (around 5%).

The Chairman informed the ARC that the technical annex to the proposed regulation had not yet been distributed to it as its technical soundness was being checked.

The Chairman added that in effect, this limited carve-out concerned only banks, as it related to portfolio hedging of core deposits and that the only potential spill-over effect on other industries was the relaxation of the effectiveness test for fair value hedging of portfolios. The Chairman noted that however, very few other industries other than the banking industry were likely to use macro-hedging, because of its complexity and that de facto, the approach, though not a sectoral one, would only matter for banks.

The Chairman said that in any case, the effect of this carve-out was that these provisions would not become mandatory under Community law.

At the end of his introduction, the Chairman asked the Member States for their initial reactions in particular on a possible Commission proposal on a partial endorsement of IAS 39:

- Many Member States adopted a very positive stance vis-à-vis a possible Commission proposal to adopt IAS 39 with the exception of the fair value option and of certain provisions relating to hedge accounting. Whilst a significant number of Member States were in favour of the Commission proposal, they needed more time and information to evaluate the suggestion properly. Two Member States emphasised the necessity to limit in time the application of the Commission proposal in order to accelerate the talks between the banking industry and the IASB. In addition, some Member States asked for clarification in respect of the legal position of the Commission proposal. Two Member States asked for a mention in the Recitals of a draft Commission Regulation of the need for the IASB to address as a matter of priority the problems faced by insurance companies with IAS 39 (insurance mismatch and deposit floor).
- Many Member States in favour of full endorsement indicated nevertheless their willingness to find constructive solutions and hence their readiness to examine a possible intermediate solution as sketched out by the Commission.
- A few Member States maintained their strong preference for full endorsement of IAS 39 and rallied to an alternative proposal put forward by one of them that would consist

of endorsing IAS 39 while granting Member States the possibility to disapply collectively or individually some of the provisions of IAS 39. This alternative did not attract much support and was opposed by some other Member States on the ground that it would lead to discrepancy in financial reporting throughout the EU and be contradictory to the objective of harmonisation sought after through the IAS Regulation.

Questions were raised by the supporters of full endorsement as to the legal feasibility of the approach proposed by the Commission, the impact on the measures for first-time application of IAS, the impact on the audit opinion, the impact on markets. The partisans of full endorsement stated that it would be important to ensure that companies that want to apply IAS 39 in full be allowed to do so. Four Member States insisted particularly on the need to allow the application of the fair value option. Another Member State indicated that a scope-out of the fair value option would not lead to divergence with US GAAP, as the latter did not offer that option.

- Five Member States were not in a position to offer a view, as they had not yet completed their domestic consultations on the Commission proposal. Three Member States were not represented at the meeting.
- A significant number of Member States insisted on the importance of allowing the full application of IAS 39 by companies that would wish to do so.

On the question on the legal feasibility of a carve-out under Regulation 1606/2002, the Chairman answered that this was possible as the provisions to be scoped out were distinct and separable from other parts of the standard. The Chairman insisted on the fact that the scope out of some provisions of IAS 39 was limited both in scope and in time.

The Chairman then outlined the next main steps of the procedure with the transmission early August of the draft implementing measures to the ARC and the European Parliament in view of a formal vote of at the ARC meeting of 8 September and adoption by the Commission at the end of October, in full respect of the comitology's due process.

The Chairman thanked Member States for their contributions and invited them to submit or confirm their position in writing to the Commission by 15 July 2004.

The Chairman thanked the Member States for their participation and announced that the next ARC meeting would take place on 8 September.

ACCOUNTING REGULATORY COMMITTEE

Meeting of 9 July 2004

PARTICIPANTS' LIST

Austria

Justizministerium

Belgium

Commission des Normes Comptables

SPF Economie

Fod. Economie

Czech

Ministry of Finance

Denmark

Danish Commerce and Companies Agency

Estonia

Estonian Accounting Standards Board

France

Conseil National de la Comptabilité (CNC)

Ministère de l'Economie, des Finances et de l'Industrie (Trésor)

Finland

Permanent Représentation

Germany

Bundesministerium der Justiz

Bundesministerium für Wirtschaft und Arbeit

Greece

Ministry of Economy and Finance

S.O.E.L

Hungary

Ministry of Finance

Permanent Représentation

Ireland

Institute of Chartered Accounts in Ireland

Permanent Représentation

Italy

CONSOB

ISVAP

Ministry of Economy and Finance

Banca d'Italia

Latvia

Ministry of Finance

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Lithuania

Ministry of Finance

Accounting Institute

Luxembourg

Commission de Surveillance du Secteur Financier

Ministère de la Justice

Netherlands

Ministerie van Justitie

Ministry of Finance

Poland

Ministry of Finance

Portugal

CMVM

Permanent Representation

Slovakia

Ministry of Finance

Spain

Banco de España

ICAC

Sweden

Ministry of Justice

United Kingdom

Department of Trade and Industry

OBSERVERS

European Institutions

European Central Bank (ECB)

Committee of European Banking Supervisors (CEBS)

Committee of European Securities Regulatory (CESR)

Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

European Financial Reporting Advisory Group (EFRAG)

Commission

Alexander Schaub, Director General of the DG Internal market, Chairman of the ARC

David Wright, Director "Financial markets"

Karel Van Hulle, Head of Unit "Accounting & Auditing", Chairman of the ARC

Philippe Pellé, Secretary to the ARC/ G5

Mikael Lindroos/ G5

Thomas Scholz/ G5

Jürgen Tiedje/ G2

Ulf Linder/ F3

Allister Wilson, Adviser to the European Commission