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The Stock Exchange of Hong Kong Ltd.

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BY FAX (2865 6776)
AND BY POST

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Mr. Steve Ong
Director, Standard Setting
Hong Kong Institute of Certified Public Accountants
37/F., Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

Dear Steve,

IASB Exposure Draft on Measurement Uncertainty Analysis Disclosure for Fair Value Measurements ("Exposure Draft")

I refer to your letter dated 23 July 2010 on the above to our Mr. Mark Dickens which has been passed to me for my attention.

We have completed our review of the Exposure Draft and our views are set out below.

In May 2009, the IASB issued an exposure draft to propose a hierarchy for the categorisation of fair value measurements of assets and liabilities into three levels. The current Exposure Draft sets out a proposal to require disclosure of a *"measurement uncertainty analysis"* of the inputs used to measure fair value in Level 3.

The purpose of the disclosure is set out in paragraph BC5 of the Exposure Draft which states that the disclosure is intended *"to provide users of financial statements with a sense of the potential measurement uncertainty of fair value measurements categorised within Level 3 of the fair value hierarchy, particularly given that fair value measurements determined using valuation techniques are more subjective than those derived from an observable market price. The Board thought that information about the use of valuation techniques should be disclosed, including the sensitivities of fair value measurements to the main valuation assumptions"*.

According to the hierarchy, Level 3 includes assets and liabilities that are measured at fair value based on valuation techniques and unobservable inputs because market/observable data is not available.

As explained in our letter to you dated 27 August 2009 on the exposure draft on "Fair Value Measurement", inputs for fair value measurements made under hierarchy Level 3 are based entirely on assumptions and are inherently subjective and not verifiable. Subsequent events may prove that any one of the assumptions adopted may be invalid,

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which in turn may have a significant impact on the valuation and the company's reported results and financial position.

It is for this reason we have concerns on the adoption of fair value as a measurement basis. Fair value measurements are based on hypothetical transactions with hypothetical parties and as a result are inherently subjective. We believe that the proposal to include a measurement uncertainty analysis acknowledges the fact that the recorded fair values are hypothetical and prone to possible significant error. When a valuation technique is used, the resulting valuation is subject to any weaknesses in the valuation model and the variables and assumptions used.

Based on the illustrative example of the disclosures expected as shown on page 11 of the Exposure Draft (see **Appendix**), we do not support the proposals as we question whether the analysis provides useful, relevant and understandable information. We believe that the proposed disclosures would be onerous, add to complexity and costs and would not provide users with additional useful information. The illustrative example indicates that columns are expected to be included in the analysis showing "Increase in fair value" and "Decrease in fair value", together with a brief summary of the "Significant unobservable inputs". We believe that a reader of the financial statements would not be more informed by the proposed disclosures. There is no information on "variations" in the specific unobservable inputs used that cause the increase or decrease in fair values (both by the type of the different inputs used and the specific assumptions concerning the relevant input).

If the IASB decides to allow fair value as a basis of measurement we believe the principle that should be adopted is that a clear description of the valuation methodology used in arriving at the fair value and details of the specific variables and assumptions used should be disclosed. Comparative information on the variables and assumptions adopted in prior years should also be disclosed or a statement that there has been no change.

To illustrate, where fair value is based on "market value" under Level 1 fair value measurement, appropriate disclosures should include the name of the relevant observable market and the prices quoted on that market on the date of the valuation. This would give readers relevant information as to the source and reasonableness or reliability of the valuation. Similarly, in the case of Level 3 fair value measurement, the valuation technique or model used should be explained together with the specific variables and assumptions concerning the variables used in the calculation. Where the valuation technique is a mathematical formula or model, the formula should be disclosed together with details of the specific assumptions for each key and significant variable used in the formula (e.g. if the model includes a key and significant variable such as a discount rate / growth rate, the specific assumptions, namely, the specific discount rate / growth rate should be disclosed).

We believe that this will provide a reader with more relevant information to understand how the fair value was determined and, where necessary, he will make his own assessment of the formula and assumptions used concerning the variables.

In effect, the *"measurement uncertainty analysis"* proposed under the Exposure Draft provides information on possible different values but does not provide any relevant information on the different assumptions or the valuation model used which we believe is more relevant. Although paragraph BC16 of the Exposure Draft states that *"the disclosure is not meant to provide users of financial statements with information for 'second guessing' an entity's fair value measurements"*, we believe this is what it will do. The proposed analysis in substance shows different fair values based on *"reasonably possible alternative assumptions"* despite the IASB's wish to avoid the term as mentioned in paragraph BC15 of the Exposure Draft. We believe it will raise the question of why a specific fair value was chosen to prepare the financial statements that are regarded as presenting a true and fair view but where other alternative fair values are also regarded as reasonable which result in a significantly different picture of the reported results and financial position of the entity.

We hope that the above comments are helpful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited

Colin Chau
Senior Vice President
Listing Division

CC/ESA/el
Encl.

c.c. Mr. Mark Dickens – Head of Listing

Measurement uncertainty analysis for fair value measurements using significant unobservable inputs (Level 3)

(CU in millions)

		Difference in fair value from using different unobservable inputs that could have reasonably been used		
	Fair value at 31/12/X9	Increase in fair value	Decrease in fair value	Significant unobservable inputs
Debt securities:				
Residential mortgage-backed securities	125	24	(18)	Prepayment rates, probability of default, severity of loss, yield (including the effect of correlation between prepayment rates and probability of default)
Commercial mortgage-backed securities	50	13	(6)	Probability of default, severity of loss, yield
Collateralised debt obligations	35	5	(3)	Implied collateral valuation, default rates, housing prices
Total debt securities	210	42	(27)	
Hedge fund investments:				
High-yield debt securities	90	5	(3)	Fund investment statements
Total hedge fund investments	90	5	(3)	
Unquoted equity instruments:				
Private equity investments	25	4	(3)	Fund investment statements
Other equity investments	10	3	(2)	Investee financial statements
Total unquoted equity instruments	35	7	(5)	
Derivatives:				
Credit contracts	38	6	(5)	Voliatility of credit
Total derivatives	38	6	(5)	
Investment properties:				
Asia	13	2	(3)	Adjustments to comparable property values
Europe	15	2	(2)	Adjustments to comparable property values
Total investment properties	28	4	(5)	
Total	401	64	(45)	

(Note: A similar table would be presented for liabilities unless another format is deemed more appropriate by the entity.)