

Susanne Pust Shah
Financial Reporting Council
Aldwych House
71-91 Aldwych
London WC2B 4HN

16 April 2014

Dear Ms. Shah,

I am writing on behalf of Origin Housing Ltd in response to the Invitation to Comment contained within FRED54.

Origin Housing Ltd is a not for profit housing association with c.6,000 homes under management and debt facilities totalling £350 million and net assets in excess of £90m.

Set out below are our responses to the questions raised by the FRC.

Question 1 – Do you support the proposal to amend the conditions of paragraph 11.9 and make the requirements less restrictive?

We welcome the objective of making the requirements less restrictive but have some reservations as to whether the wording as currently phrased it will be fully achieved. Please see our response to Question 2 below.

Question 2 – In your view, under the amended conditions will debt instruments be classified appropriately?

For the most part, in our view, debt instruments will be appropriately classified under the amended conditions. However, there are two types of debt instruments that are reasonably widely used within the social housing sector which under the proposed wording could be classified as either “basic” or “other”.

Certain fixed rate long term loans commonly referred to as LOBOs have embedded within them the right at set intervals for the lender to re-price the loan. The borrower has the right in the event of the lender exercising its re-pricing option to repay the loan without penalty after a period of 364 days during which time the interest charge reverts to a predetermined margin over LIBOR. Neither option is transferrable or capable of being settled independently of the loan agreement.

- Para 11.9 (c) states the contract may provide for a variation provided it is not contingent on future events other than a change in contractual variable rates or to protect the lender against a credit deterioration of the borrower. The use of the word “contingent” in this context is ambiguous. Where a loan takes the form of a LOBO (see above) the ability of a lender to vary the rate is not restricted by any external factor and thus the re-pricing can be argued to be not contingent. Alternatively it can be argued that as the borrower cannot influence the lender’s

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decision whether to exercise its option or not, from the borrower's perspective it is contingent on the lender's action. Both stances can, in our view, be supported from the wording of FRED54.

- Para 11.9 (c)(ii) states that "the new rate is a market rate of interest..." The argument can be advanced that as there is no requirement in the LOBO for a lender to set the new price at the market rate the LOBO cannot be classified as "basic". The alternative argument is that if a lender sets the price at above market rate the borrower will exercise its option to refinance without penalty thus in practice a market rate is imposed and therefore a classification of the loan as "basic" can be supported. Again, in our view, both stances can be justified from the wording in FRED 54.
- Para 11.9 (e) The argument is being advanced that the ability of the borrower to refinance with a third party without penalty is another contingent event this time from the lender's perspective. The counter argument is that as this is within the control of the borrower and not dependent on an external event and thus no contingency exists. As the meaning of contingent in this context is not defined in our view both interpretations can be supported from the wording of FRED 54.

The second type of financial instrument (commonly referred to as a Cancellable Embedded Hedge) that does not fit easily within the classification criteria set out in Para 11.9 is a loan attracting interest at a variable rate (LIBOR plus a margin) with a loan agreement that gives the borrower the right to request the lender to quote a fixed interest rate with the lender retaining the right to cancel the fixed rate and revert to the same margin over LIBOR at specified intervals during the period for which the fixed rate applies. Again the derivative features of these contracts are not capable of being transferred or settled independently of the loan to which they relate.

- The arguments that can be advanced to support the treatment of this type of transaction as either "other" or "basic" are broadly the same as those set out for a LOBO transaction.

We are aware that the professional accountancy firms who provide audit services to the social housing sector have been unable to reach a consensus on the interpretation of FRED 54 for these types of contracts. There is thus a real possibility that there will be significant inconsistency in their accounting treatment of these instruments among housing associations with the treatment adopted in each instance being dependent on the stance of the auditors. There is also the possibility of serious disputes arising between housing associations and their auditors. Consequently, we believe it important that the FRC clarifies the position prior to the amendment being made.

We propose that there should be a basic principle that the application of the rules set out in the standard should result in the classification of any debt instrument being the same for both the holder and the issuer. For this principle to be maintained there would need to be a rule which made it clear that a "contingent event" excludes the exercise of an option by either party as if a "contingent event" included the exercise of an option by the counterparty but not the preparer of

accounts a situation could arise that would breach the proposed principle. The adoption of the proposed principal and rule would, we believe, further the overall objective of making the requirements for classifying a debt instrument as "basic" less restrictive without weakening the safeguards that we recognise need to be in place to ensure that embedded derivatives that are not closely related to the host loan contract are properly and transparently reported and is therefore consistent with IFRS 102.

Question 3 – In your view are the proposed examples helpful?

In our opinion the examples provided are helpful but the inclusion of one or the other of the debt instruments described above would provide greater clarity.

Question 4 - The proposed amendments would be effective from 1 January 2015. Do you have any reservations about the proposed effective date?

We support the amendment being effective from the date FRS102 becomes effective. Any variation from this proposal would, in our view, introduce unwarranted complexity.

Question 5 – Are any specific transitional provisions in relation to the proposed amendment necessary.

Not in our view.

We hope that the above comments will be of use to the FRC in its deliberations.

Yours sincerely

A handwritten signature in blue ink, appearing to read "C. G. Trebilcock".

Mr C. G. Trebilcock BSc FCA

Director of Finance
Origin Housing Limited