Federation of European Accountants
Fédération des Experts comptables Européens

Financial Accounting Standards Board
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30 September 2010

Ref.: BAN/HvD/LF/ID

Dear Sir / Madam,

Re: FEE Comments on FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*

(1) FEE (the Federation of European Accountants) is pleased to provide you with its comments on the FASB Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the "ED").

(2) As a founding organisation of EFRAG we have also contributed to the EFRAG consultation process by submitting on 16 September 2010 the FEE comments on EFRAG's Draft Comment Letter of 28 July 2010. EFRAG has issued its final comment letter on 28 September 2010. We have considered the EFRAG Final Comment Letter in our response and make reference to the EFRAG comments where relevant.

(3) Our comments are limited to general points made in response to the issues highlighted in the covering letter of EFRAG's Final Comment Letter. We are not providing detailed answers to the individual questions of the ED since the FASB standard is not intended for application in Europe.

(4) FEE supports the comprehensive review of the IFRS relating to financial instruments undertaken jointly by the FASB and the IASB to address the call from G20 Leaders regarding the need for improvements on the accounting standards on valuation and provisioning.

(5) We fully support the calls by G20 and the Financial Stability Board to achieve a single set of high-quality global accounting standards. We strongly believe that IFRS is the best platform for that single set of global standards.

(6) In common with EFRAG, we believe that the commitment on convergence made by the IASB and FASB should not be met at the expense of quality. We are also supportive of the principles and direction set by the IASB in its project to replace IAS 39 *Financial Instruments: Recognition and Measurement*.

Comments on Summary of EFRAG recommendations: IASB Directions

(7) Our comments on the elements in the IASB approach, as highlighted by EFRAG, are as follows:

Classification criteria

(i) We support, like EFRAG, classification criteria based on the business model used by the entity in managing the financial instruments and on their characteristics.

Mixed measurement model

(ii) We agree with EFRAG and support a mixed measurement model that allows for financial instruments to be reported at either amortised cost or fair value, depending on the business model and instrument's characteristics.

(iii) FEE, like EFRAG, supports the continued application of a mixed measurement model for financial instruments and agrees with the IASB's conclusion that measuring all financial assets and financial liabilities at fair value is not the most appropriate approach to improving financial reporting for financial instruments.

Reclassification

(iv) We agree with EFRAG that reclassification should be required when there is a change in the conditions that determined the classification at initial recognition. In particular, we note that it is the change in the business model that should trigger the reclassification.

(v) If classification is based on the business model as referred to above, it follows that if the entity in rare circumstances decides to change the business model (i.e. the manner in which the entity uses and manages its instruments or certain groups of instruments), reclassification should be required. While this may introduce additional complexity for preparers in making sure any changes are fully disclosed, this seems preferable than to account for instruments in a manner inconsistent with the business model and inconsistent with transactions entered into after the change in business model, since the same instruments might be accounted differently and part of them based on the historical and superseded business model.

(vi) Like EFRAG, we would not support a full prohibition of reclassification. We believe that a classification system is at its simplest and most transparent if an instrument is required to be reclassified if it is no longer managed according to the business model that was the basis for its initial classification.

Primary financial statements reflecting one measurement attribute only

(vii) In principle, we agree with EFRAG that if the choice of measurement attribute follows directly from the characteristics of the financial instrument and the business model used by the entity in managing that financial instrument, it will be appropriate that for each financial instrument only one measurement attribute is reflected in the primary financial statements.

Expected loss approach for impairment

(viii) We support like EFRAG an approach for the impairment of financial assets measured at amortised cost based on an expected loss approach, in particular if it takes into account more relevant information about credit losses. In our view, such an approach should use all available credit-related information, including reliable and realistic forecasts of future events and future economic conditions. It would be helpful to provide further guidance on how the forecasts to determine impairment are evidenced.

Own credit risk

(ix) We agree with the general principle in the IASB approach that changes in an entity's own credit risk arising on remeasurements of liabilities designated under the fair value option should not impact profit or loss. In relation to this subject, our overall view on the question of recycling is outlined in paragraphs 8 (iii) and 8 (iv) of this letter.

Comments on Summary of EFRAG recommendations: Suggested improvements for the formulation of the final standard

(8) In general we agree with most of the principles in IFRS 9 Financial Instruments (IFRS 9), highlighted by EFRAG as a basis for a high-quality standard on financial instruments. We comment below on the few issues where we have different views:

Separate accounting for embedded derivatives

(i) EFRAG proposes separate accounting for embedded derivatives for both hybrid financial assets and hybrid financial liabilities. We are of the opinion that IFRS 9 solves the problem of the current very complex rules for bifurcation of embedded derivatives in financial assets in a principles based way and we support in principle this solution. Retaining the existing IAS 39 requirement for embedded derivatives in financial assets does not meet the objective of reducing complexity in financial instruments accounting.

(ii) Although the solution proposed by the IASB in their Exposure Draft retains the current IAS 39 rules for embedded derivatives in financial liabilities, thus avoiding unduly complex or inappropriate income statement effects arising from the fair valuation of an entity's own credit risk in its financial liabilities hosting the embedded derivative, it is not consistent with the asset side solution. If consistency is considered essential, in our view the option to classify <u>all</u> hybrid contracts in their entirety according to the current classification approach of IFRS 9 should be assessed in more detail since it might simplify the accounting requirements and eliminate the complex, rule-based and internally inconsistent provisions for embedded derivatives.

Investments in equity instruments

(iii) In our view, whether realised gains and losses on equity instruments measured at fair value should be recognised in profit or loss when unrealised changes are recognised in other comprehensive income, should be triggered by the more general and principal discussion on "recycling".

(iv) Therefore, in our view, there is a necessity for the Boards to initiate a comprehensive debate on the question of recycling in order to decide which items should be recycled into the income statement and which should remain unrecycled.

(v) On the issue of which financial instruments should be measured at fair value through other comprehensive income, we fully support EFRAG's view that the Boards should work together to ensure consistency and to better define the use and purpose of other comprehensive income. It is surprising and unfortunate that FASB allows in its ED this category only for debt instruments whereas IFRS 9 allows this category only for equity instruments.

Consistent measurement of financial assets and liabilities that are linked together

(vi) We agree with EFRAG and support in principle a consistent measurement of financial assets and financial liabilities when they are linked together and where the linkage justifies deviation from the benchmark solution. Alternatively, this issue might be solved through simplified hedge accounting provisions.

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Other matters

Equity method of accounting for investments in associates

(9) We agree with EFRAG that changes affecting the accounting standards applicable to investments in associates should be debated during the review of the relevant accounting standards.

Core deposits

(10) In our view, the discussion on the most appropriate approach for core deposits is an issue linked to the expected IASB proposals on hedging. The proposed re-measurement approach for core deposits in the FASB ED intends to address some of the concerns raised particularly by the European banking industry regarding the appropriateness of measuring core deposits at face value, in particular since the fair value of a core deposit portfolio is in principle always lower than its face value. We think that further work is needed, pending the hedge accounting proposals from the IASB, to arrive at the optimal approach.

For further information on this letter, please contact Leyre Fuertes, Project Manager, at +32 2 285 40 76 or via email at leyre.fuertes@fee.be from the FEE Secretariat.

Yours sincerely,

Hans van Damme
President