Federation of European Accountants
Fédération des Experts comptables Européens

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Ref.: BAN/HvD/LF/ID

Dear Ms. Flores,

Re: FEE Comments on EFRAG's Draft Comment Letter on IASB Exposure Draft *Fair Value Option for Financial Liabilities*

(1) FEE (the Federation of European Accountants) is pleased to provide you with its comments on the EFRAG Draft Comment Letter on the IASB Exposure Draft *Fair Value Option for Financial Liabilities* (the "ED").

(2) We agree with the IASB and EFRAG that changes in an entity's own credit risk arising on remeasurement 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 14-17 of this letter.

(3) Like EFRAG, we do not support the proposed two-step approach of firstly presenting the entire fair value change in the profit and loss account and then "backing out" from profit or loss the portion of the fair value change that is attributable to changes in the liability's credit risk and transferring that amount to other comprehensive income. This goes against the fundamental desire for simplification of financial reporting and creates a completely new recognition pattern for performance which will be difficult to interpret and hardly understood by users.

Our responses to the questions in the Invitation to comment of the ED are included as an Appendix to this letter, whereas on the additional questions to constituents posed by EFRAG, we believe further debate is needed following which we should be able to respond thereto.

For further information on this letter, please contact Leyre Fuertes, Project Manager.

Yours sincerely,

Hans van Damme
President

Presenting the effects of changes in a liability's credit risk in profit or loss

Question 1
Do you agree that for all liabilities designated under the fair value option, changes in the credit risk of the liability should not affect profit or loss? If you disagree, why?

Question 2
Or alternatively, do you believe that changes in the credit risk of the liability should not affect profit or loss unless such treatment would create a mismatch in profit or loss (in which case, the entire fair value change would be required to be presented in profit or loss)? Why?

(4) We agree with EFRAG and support the proposal that for all liabilities designated under the fair value option, changes in the credit risk of the liability should not affect profit or loss. Please note that our overall view on the question of recycling is outlined in paragraphs 14-17 of this letter.

(5) In our comment letter on the IASB Discussion Paper "Credit Risk in Liability Measurement" (issued to EFRAG on 26 August 2009):

(i) we supported EFRAG's viewpoint that changes in own credit risk should not be taken into account in subsequent measurement of liabilities, with the exception of financial liabilities (and possibly also insurance liabilities) which, in accordance with the business model, are expected to be disposed of at Fair Value (i.e. are held for trading purposes and actively traded);

(ii) we agreed with EFRAG that the credit risk inherent in the financial assets held by the entity and its own liabilities – even though in certain cases assets and liabilities may be related – are unlikely to be identical, as the credit risk of the former relates to the underlying investee and the credit risk of the latter relates to the reporting entity;

(iii) we also shared the opinion of EFRAG that, although the credit risk is included in the fair value from the perspective of those that hold an entity's debt instrument as an asset, the perspective of holders of those instruments and the perspective of those obligated to settle the instruments are different.

(6) Therefore, the accounting mismatch does not constitute, in our view, a convincing argument to report own credit risk effects from remeasurements of liabilities in profit or loss.

Questions to constituents

Do you agree with EFRAG's view concerning the accounting mismatch that arises in the case of financial assets that are linked to an issuer's own credit risk?

Are you aware of any other circumstances in which this type of mismatch arises?

(7) Our understanding is that unit-linked contracts will not be affected by the proposals. However, we note that some may have concerns that the way the proposals in the ED are drafted could mean that the credit risk of financial liabilities includes the effects of changes in credit risk of the financial asset underlying the unit-linked contract. We understand that this is not the intention of the ED.

(8) In addition, we agree with EFRAG that paragraph 10 of IFRS 7 clarifies that, where there are unit-linking features, the changes in the performance of the related internal or external investment fund are part of the changes in market conditions.

Presenting the effects of changes in a liability's credit risk in other comprehensive income

Question 3
Do you agree that the portion of the fair value change that is attributable to changes in the credit risk of the liability should be presented in other comprehensive income? If not, why?

(9) We agree with EFRAG and support the IASB's proposals that the portion of the fair value change attributable to changes in the credit risk of an existing liability is presented in other comprehensive income. See also our overall view on the question of recycling contained in paragraphs 14-17 below.

(10) Like EFRAG, in our response on the IASB Discussion Paper "Credit Risk in Liability Measurement", we supported an approach to measure liabilities designated under fair value option excluding completely the effects of changes in the own credit risk in the measurement of the liability (the so-called "frozen credit spread" approach). We note that users are strongly opposed to such a measurement attribute, as pointed out by EFRAG and in paragraphs BC26 and BC27 of the Basis for Conclusions to the ED. We accept, in common with EFRAG, the majority view that liabilities designated under the fair value approach should be measured at the full fair value in the statement of financial position.

Question 4
Do you agree that the two-step approach provides useful information to users of financial statements? If not, what would you propose instead and why?

Question 5
Do you believe that the one-step approach is preferable to the two-step approach? If so, why?

(11) Like EFRAG, we do not support the two-step approach. We would favour the one-step approach suggested as an alternative whereby the entity would present the portion of the fair value change that is attributable to changes in the liability's credit risk directly in other comprehensive income. As highlighted in our covering letter, the two-step approach is not consistent with the fundamental desire for simplification of financial reporting and creates a completely new recognition pattern for performance which will be difficult to interpret and hardly understood by users.

(12) In addition, we agree with EFRAG that any further information deemed relevant to achieve additional transparency can be disclosed directly in the notes to the accounts.

Question 6
Do you believe that the effects of changes in the credit risk of the liability should be presented in equity (rather than in other comprehensive income)?
If so, why?

(13) We agree with EFRAG that the effects of changes in the credit risk of the liability should be presented in other comprehensive income rather than directly in equity. We support the argument in BC34 (b) that remeasurements of assets and liabilities meet the definition of gains (or losses) and are not transactions with equity holders. Therefore, the changes should not be presented directly in equity.

Reclassifying amounts to profit or loss

Question 7
Do you agree that gains or losses resulting from changes in a liability's credit risk included in other comprehensive income (or included in equity if you responded 'yes' to Question 6) should not be reclassified to profit or loss? If not, why and in what circumstances should they be reclassified?

Question to constituents

Are you in favour of reclassification of gains or losses resulting from changes in a liability's credit risk to profit or loss? If so, why? If not, why not?

(14) We are not sure that the conceptual reasoning to prohibit reclassifying amounts from other comprehensive income to profit or loss ("recycling") has been elaborated sufficiently in the ED. This issue illustrates well the lack of conceptual approach to recycling in the current set of IFRS, which makes it extremely difficult to decide which items should be recycled into the income statement and which should remain unrecycled.

(15) We acknowledge that if the liability is held to maturity, the question of recycling will not arise. However, not all liabilities measured at fair value by designation are held to maturity.

(16) In addition, we note that not reclassifying the gains or losses resulting from changes in a liability's credit risk included in other comprehensive income would be inconsistent with the reclassification of any gains and losses on instruments measured at amortised cost. Therefore, in this context we support the argument presented by those EFRAG members who are in favour of reclassification that it is difficult to understand why the derecognition of a debt instrument measured at amortised cost would result in gains and losses that are recorded in profit or loss, but if an entity records credit related gains and losses in other comprehensive income they will not be recycled to profit or loss on debt extinguishment before its maturity. In our view, this inconsistency provides further argument for the necessity for the Board to put forward a comprehensive debate on the question of recycling.

(17) In the light of the above, we would currently favour reclassifying amounts from other comprehensive income to profit or loss ("recycling") while waiting for the Board to present a comprehensive discussion on the recycling issue to arrive at a conceptual approach.

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

Determining the effects of changes in a liability's credit risk

Question 8
For the purposes of the proposals in this exposure draft, do you agree that the guidance in IFRS 7 should be used for determining the amount of the change in fair value that is attributable to changes in a liability's credit risk? If not, what would you propose instead and why?

(18) We agree that the guidance in IFRS 7 should be used.

Effective date and transition

Question 9
Do you agree with the proposals related to early adoption? If not, what would you propose instead and why? How would those proposals address concerns about comparability?

(19) On the question of whether the various phases of IFRS 9 should all be adopted in "one package", addressing the requirements of the Fair Value Option for Financial Liabilities as an isolated issue could resolve one of the existing problems. On the other hand, we acknowledge potential problems if endorsing it without the remaining phases, such as the issue of significant incomparability among entities until all of the phases of the project are mandatorily effective.

(20) A possible solution to this question could be to implement this change in relation to the fair value option for financial liabilities as an improvement of IAS 39, not as part of IFRS 9.

(21) On the basis that the Board commits to addressing the issue of recycling as soon as possible and as a consequence of making a change directly to IAS 39 and not IFRS 9, enabling early application could make sense.

(22) We favour allowing, but not requiring, early adoption.

Question 10
Do you agree with the proposed transition requirements? If not, what transition approach would you propose instead and why?

(23) Like EFRAG, we support the proposal that the transition requirements apply retrospectively consistently with the general approach of changes in accounting methods.