



Mr. Jorgen Holmquist
Director General
DG Market
European Commission
Rue de la Loi 200
B-1049 BRUXELLES

10 November 2009

Ref.: FRP/HvD/SS/SR

Dear Mr. Holmquist,

Re: Third EC Stakeholders meeting on IAS 39 of 11 November: endorsement of IFRS 9 Financial Instruments

- (1) We thank you for your invitation to participate in the third Stakeholders meeting of 11 November. It is our understanding that the profession will be well represented in the meeting by FEE (the Federation of European Accountants), some of its Member Bodies and the larger firms. We appreciate that the EC wishes to consult with all financial reporting stakeholders on the endorsement of IFRS 9.
- (2) We believe that it is important to share the profession's views on the endorsement of IFRS 9 on financial instruments and its potential wider implications with you, the participants to the stakeholders meeting and with the ARC members in advance of the meetings on the 11th.
- (3) We support the positive draft endorsement advice on IFRS 9 as issued by EFRAG on 2 November although some matters remain unresolved. We believe that EC endorsement of IFRS 9 at this stage is appropriate for the following reasons:
 - a. Importance and need for a single set of global standards;
 - b. Comprehensive review of IAS 39: responsiveness to demands made by the G20, FSB and the EU;
 - c. Standard results after a proper due process with wide stakeholder consultation;

- d. Most of the European concerns are met, some are not;
 - e. European entities should not be deprived from the use of IFRS 9 on a voluntary basis because IFRS 9 is a better standard than the comparable parts of IAS 39 and easier to apply.
- (4) Full consideration needs to be given as to the implications and potential unintended consequences, both in Europe and world wide, if IFRS 9 were not to be endorsed.
- (5) One of the key considerations in deciding on endorsement is in our view whether a proper due process was in place. We believe that the IASB has respected its due process in the case of IFRS 9 and therefore the final standard should be acceptable to its constituency and, hence, lead to a positive endorsement in Europe.
- (6) FEE, some of our Member Bodies and the larger firms will also provide comments to EFRAG on the draft endorsement advice which EFRAG issued on 2 November supporting a positive endorsement advice.

Importance and need for a single set of global standards

- (7) The financial crisis is a global phenomenon that calls for a global reaction. FEE is strongly committed to robust, high quality global principle-based financial reporting standards and supports the objective of creating a single set of global standards. Global financial markets require financial information prepared in accordance with global standards for reasons of competitiveness and comparability and for capital raising purposes.
- (8) The G20, in their September Pittsburgh summit called upon the international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011. The International Accounting Standards Board's (IASB) institutional framework should further enhance the involvement of various stakeholders. 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.
- (9) The global solution now found by the IASB in the form of IFRS 9 should be strongly preferred to national or regional solutions and therefore, we believe that Europe needs to make every effort to prevent the creation of new deviations from IFRS. Non-endorsement of IFRS 9 at this crucial moment in time will be very damaging to the process of achieving one set of global standards and the confidence of other major economies that are currently in the process of adoption, or are considering adoption, of IFRS all over the world.

- (10) Positive endorsement of IFRS 9 provides a strong confirmation from the EU that the direction taken by an international standard setter in favour of a mixed measurement model is the right one and gives a strong signal to the IASB and others for continuing to build on a mixed measurement model at global standard setting level.

Comprehensive review of IAS 39

- (11) FEE supports a comprehensive revision of all aspects of IAS 39. However, in light of the political pressure and time constraints put on the IASB, we understand the Board's approach to opt for a complete revision of IAS 39 in stages. This position was earlier communicated in our letter to the EC dated 1 September providing input to the 4 September stakeholders meeting.
- (12) We underline that a comprehensive approach has also been advocated by the Monitoring Board which announced in a press release of 8 June 2009 that "*the members of the Monitoring Board support the recent commitments by the International Accounting Standard Board (IASB) to undertake a comprehensive review of the International Financial Reporting Standards (IFRS) relating to financial instruments to address the recent statement from G20 Leaders regarding the need for improvements on the accounting standards on valuation and provisioning.*"
- (13) Even though the development of the other two phases on impairment methodology and on hedge accounting might have some consequential implications for the classification and measurement requirements, FEE believes that it is likely that there will be only minor changes to the current new standard, if any, in particular since IFRS 9 embraces the mixed measurement model for financial assets and this model will also be applied to liabilities. A positive endorsement will confirm European support for the mixed measurement model.
- (14) Preparers will have to make a decision whether it is beneficial to early adopt where there is a possibility of further consequential amendments later on. However, the fact that some consequential changes may be made to IFRS 9 at a later stage in the project should not impact on the decision to endorse the standard in its current form, to make the standard available for those EU entities who wish to adopt early.
- (15) The IASB should consider reviewing the entire comprehensive standard when the three phases have been completed and undertake necessary improvements if any with a proper due process including public consultation. In this way the process of standard setting could benefit from the experience of those reporting entities that have opted for early adoption of the Classification and Measurement standard and perhaps of the Impairment standard. In any case, any subsequent changes to the standard will be assessed separately on their merits, since they are subject to a separate endorsement process.

Results of a proper due process with wide stakeholder consultation

- (16) The IASB and its staff are to be commended for their extensive and comprehensive consultation of all stakeholders, in particular European stakeholders, since the Exposure Draft was published in July. The final standard has been modified in comparison to the ED in several instances where stakeholder concerns were expressed. As such, it shows the responsiveness to many of the comments raised by a wide range of constituencies aiming at a robust and high quality standard. We believe that the IASB has respected its due process that the final standard should therefore be acceptable to its constituency and, hence, lead to a positive endorsement in Europe.

Most of the European concerns are met, some are not

- (17) In the EC letter of 15 September 2009 in reaction to the ED Financial Instruments: Classification and Measurement a number of issues were raised that to different extents were shared by the European stakeholders:
- a. Impairment of AFS debt securities;
 - b. Fair value accounting;
 - c. Mixed measurement model and the need for more emphasis on the business model;
 - d. Reclassification;
 - e. Other issues:
 - i. Extent to which equity instruments classified at fair value through OCI should be recognized in the profit and loss account;
 - ii. Bifurcation of embedded derivatives;
 - iii. Measurement of financial liabilities.

Impairment of AFS debt securities

- (18) The solution proposed by the IASB for the asset side in our view deals with the concerns about AFS. Since the debt securities currently classified as AFS will either be reclassified to the amortised cost category or to the fair value through profit and loss category, the proposal solves the problems related to the impairment of AFS debt securities. As a result there is no longer a need for more complex and potentially rules-based amendments, similar to those introduced by the FASB in April 2009.

Fair value

- (19) There is no clear evidence that IFRS 9 would lead to more fair value through profit or loss. This position will vary between preparers, and often quite considerably. It will depend on the business model of a reporting entity whether the proposals would lead to an increased use of fair value.

- (20) In our view, the observation whether or not more instruments are valued at fair value is not a good criterion for assessing the appropriateness of an accounting treatment and use of fair value. The question is whether the right instruments are valued at fair value. By applying the business model as main criterion we believe IFRS 9 has achieved the objective of appropriate use of fair value, resulting from a proper distinction between the amortised cost and fair value categories. With the business model as predominant driver for the accounting, a proper cut-off for the classification of instruments at fair value will result.

Mixed measurement model driven by the business model

- (21) It should be welcomed that the IASB continues to support a mixed measurement model and that the mixed measurement model is the basis of IFRS 9, driven by classification based on the business model. IFRS 9 includes improved guidance on the boundaries between the amortised cost and fair value categories by way of a series of examples. Positive endorsement of IFRS 9 gives a strong signal to the IASB and others for continuing to require a mixed measurement model at global level as the best and viable solution.

Reclassification

- (22) IFRS 9 follows a classification based on the business model and requires mandatory reclassification if the entity in relevant circumstances decides to change the manner in which it manages its instruments as was requested by the EC and many other stakeholders including the FEE.

Other issues

- (23) As indicated in paragraphs 17 to 22 most of the key concerns are solved by IFRS 9. The remaining issues, where there has been no consensual solution proposed by the European stakeholders, have been carefully considered and the IASB believes it has found compromises. These relate mainly to the following issues:
- a. The “fair value through OCI” option for equity instruments requires recognition of dividends in the income statement, which has been requested by many stakeholders and also was proposed as a compromise solution by others. The issue of recycling realised gains and losses will need to be reviewed within further pending IASB projects;
 - b. IFRS 9 solves the problem of the current very complex rules for bifurcation of embedded derivatives in financial assets in a principle-based way and – in line with the FEE proposals – retains the current rules for embedded derivatives in financial liabilities, thus avoiding undue income statement effects from fair valuation of own credit risk in financial liabilities hosting the embedded derivative. Retaining the existing requirement for embedded derivatives in financial assets would not meet the objective of reducing complexity in financial instruments accounting;

- c. As proposed by the EC, financial liabilities are scoped out from IFRS 9, since these instruments already follow the two category approach and the debate on inclusion of own credit risk in measurement, which is liability specific, is still not finalised. We will carefully consider our position when the IASB publishes its proposals on this complex matter;
 - d. As unquoted equity instruments may be important for certain preparers, further guidance on the valuation of those instruments would be helpful.
- (24) FEE commented on the ED Financial Instruments: Classification and Measurement both to EFRAG and the IASB in letters dated 14 September and we are pleased to note that the nearly final draft of IFRS 9 as published on 2 November meets our principal concerns.

European entities should not be deprived from the use of IFRS 9 on a voluntary basis.

- (25) IFRS 9 envisages a long transition period and entities are only obliged to use IFRS 9 for their 2013 financial statements. We welcome the relief provided by the IASB in the transition provisions in order to facilitate not only early application of IFRS 9 for the 2009 financial statements but also for entities with non-calendar year ends and for the interim financial statements. One can only speculate as to how many entities would actually adopt IFRS 9 for the 2009 year-end financial statements, but EU financial institutions should have a choice whether or not to adopt.
- (26) In our view, EU entities should be able to decide for themselves whether it would be of benefit to them to apply IFRS 9 early, similar to their peers in other IFRS countries outside the EU, rather than be put in a situation where it would be forbidden to use this standard. We are of the opinion that IFRS 9 is a better standard than the comparable parts of IAS 39 and easier to apply since it is based on the business model and less complex.
- (27) The transition provisions have been simplified to facilitate early adoption from 2009 onwards, with mandatory application in 2013. Comparability between entities during this transition period can in our view be ensured by the requirement to provide disclosures that highlight the effects from transition to IFRS 9 on reported information.

Conclusion

- (28) In view of the overall objective at stake - a single set of high quality global accounting standards as called for by the world's major governments through the G20 - as well as based on technical merit and due process considerations, we recommend the endorsement of IFRS 9.

For further information on our observations, please contact either me or Saskia Slomp, FEE Technical Director.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Hans van Damme', written over a horizontal line.

Hans van Damme
President

cc: David Wright
Pierre Delsaux
Jeroen Hooijer
ARC
EFRAG