European
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LETTER OF COMMENT NO. 46

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Email

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Canon Street
UK London, EC4M 6XH

Brussels, 2 April 2009

Subject: ***Response of the European Banking Federation to the Financial Crisis Advisory Group constituents' consultation***

Dear Sir David,

I am writing to you on behalf of the European Banking Federation (EBF) to express our view on the Financial Crisis Advisory Group constituents' consultation.

Set up in 1960, the European Banking Federation is the voice of the European banking sector, with over 30 000 billion EUR assets and 2.4 million employees in 31 European countries. The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.

You will find enclosed our detailed answers and comments to the questionnaire *(see D0520C-2009)*.

We should be grateful if the Financial Crisis Advisory Group (FCAG) could keep us informed of any developments and we are ready to discuss any questions you may have.

Yours sincerely

Guido Ravoet

Enclosures: 3

EBF response to the Financial Crisis Advisory Group constituents' consultation

***Background**: The Financial Crisis Advisory Group (FCAG) is seeking written input from constituents in the form of responses to the following set of questions, to assist the FCAG in discussing accounting and reporting matters related to the financial crisis and making recommendations thereon to the IASB and the FASB:*

1. **From your perspective, where has general purpose financial reporting helped identify issues of concern during the financial crisis? Where has it not helped, or even possibly created necessary concerns? Please be as specific as possible in your answers.**

EBF response:

The financial crisis called into question the long term intention of accounting standard setters to adopt a full fair value standard for all financial instruments. It has also emphasized the need for improving the current mixed measurement model. The European banking industry has long been engaged in arguing against the application of the fair value concept outside trading where amortized cost is a far more relevant reporting concept. The EBF has warned against artificial volatility, questioned the reliability of market prices in some circumstances and has argued against the anti-abusive rules of categorisation and hedging rules, all which have been brought to spotlight by the recent crisis. We therefore believe that a case for fundamental review of IAS 39 has been proven, aiming at the alignment of the measurement attributes to the economic activity behind particular business model.

The turmoil has demonstrated the difficulty of requiring fair value in particular for instruments for which the market has suddenly disappeared. The accounting standards did not put sufficient emphasis on the relevance of market liquidity to valuation and we strongly believe that this has exaggerated reported losses. Recent events have also raised concerns expressed in respect of proposals for calculating fair values. The complex valuation models used for instruments that do not trade or for which no active market exists rely on assumptions, estimates and past experiences of the individual bank. Appropriate valuations can only be achieved if valuation models take adequate account of all relevant characteristics of individual financial instruments[1].

Furthermore, we believe that the current rules on fair value measurement have a pro-cyclical effect resulting in further uncertainty in severely disrupted markets. Due to the application of mark-to-market rules for trading portfolios, banks were required to write down the assets in their balance sheets when markets deleverage. Since IFRS accounts are the basis of the supervisory reporting for most banks in the EU, in order to maintain the required level of

[1] Given the number and complexity of financial instruments, the crisis revealed the need for improved disclosures on valuation methods to ensure the necessary transparency to the market. Implementation of IFRS 7 and Pillar III are seen as important steps towards the transparency of financial instruments and their risks

capital, in many instances banks had to sell further assets. In turn other financial institutions were to further downgrade the value of their assets. For that reason we very much welcomed the reclassification rules adopted by the IASB in October 2008 permitting moving certain financial instruments from trading and available for sale categories to loans and receivables, thereby allowing banks to replace fair value accounting by a more proper treatment of their assets. We believe that a further review of the standards are necessary to ascertain whether there are specific rules that in current market circumstances may be considered as having a pro-cyclical effect. This includes the valuation and impairment issues within Available-For-Sale, the inability to revoke the fair value option and issues concerning embedded derivatives.

Regarding the impairment of Available-For-Sale we would like to emphasise the necessity that IASB and FASB resolve this issue urgently because of their implications under current market conditions. One of the implications of the current crisis is that equity markets are very volatile, with significant general market movements occurring frequently. This led us to consider whether the existing requirements in IAS 39 for impairment of available for sale equity securities are appropriate. In fact, under the current market conditions, we are not sure whether we can consider the current "market price" level as fair value also for equity securities which do not reflect the entities' performance, forcing the entities to recognise the impairment in the profit or loss. To avoid any inconsistency (possibly temporary) between the market price and the fair value, this case could be treated in the same way as equity instruments that do not have a quoted market price by modifying the IAS 39 requirements.

Again, we recognise that the IASB differentiates between debt instruments, for which reversals are recognised in profit or loss (if conditions are met) and equity instruments, for which reversals of an impairment loss through profit or loss are prohibited. We believe that this different requirement for reversal of impairment losses should be eliminated.

2. **If prudential regulators were to require 'through-the-cycle' or 'dynamic' loan provisions that differ from the current IFRS or US GAAP requirements, how should general purpose financial statements best reflect the difference: (1) recognition in profit or loss (earnings); (2) recognition in other comprehensive income; (3) appropriation of equity outside of comprehensive income; (4) footnote disclosure only; (5) some other means; or (6) not at all? Please explain how your answer would promote transparency for investors and other resource providers.**

The perceived pro-cyclicality of the Basel II framework has prompted calls for further consideration of a new regime of dynamic provisioning which according to banks would build provisions for losses starting at the point when loans were originated. The industry accepts that there must be sufficient buffers to fall cyclical pressures in the system, so that their impact on the wider economy is minimised and the need to raise capital in downturns is reduced. Dynamic provisioning can help offset the effect of pro-cyclicality, and help the company manage through a crisis.

A new regime of dynamic provisioning should be well-defined and able to ensure a level playing field at global level. This implies that banks should be put in the position to disclose the effects in a very transparent manner in order to provide users with comparable information.

Efforts to offset the volatility effects of accounting and capital regulations should not be assessed or decided in an isolated manner. We therefore invite accounting standard setters to intensify the dialogue with regulators and jointly undertake an impact analysis on the effectiveness of capital adequacy requirements in the context of changing accounting standards.

Although in general we do not believe that the current IAS 39 incurred loss model is broken, we support the standard setters' efforts to further explore the accounting for loan loss provisioning. We believe that the flexibility in the current IAS 39 (interpretation, guidance) should be analysed first to avoid changing the standard itself.

The European Banking Federation is currently reviewing a model of a dynamic loan loss provision methodology based on IRB models and compatible with IFRS where no provisions in excess of expected loss should be considered as equity if adopted at global level. The EBF is also considering pros and cons of other models (e.g. adjusting the amortised cost for expected credit losses)

3. **Some FCAG members have indicated that they believe issues surrounding accounting for off-balance items such as securitisations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting. Do you agree, and how can we best improve IFRS and US GAAP in that area?**

The EBF members believe that fair value accounting has been far more contributory to the financial crisis than issues such as securitisation and other structured entities.

The banking industry supports the currently undertaken IASB Consolidation project's (ED10-Consolidation) objectives to make improvements to the existing IFRS definition of control and to merge the IAS 27 and SIC 12 into a single principle for consolidation applied to all entities. We believe however that to allow a comprehensive evaluation of the proposed control principle, the IASB should have first completed the relevant parts of its related "Reporting Entity" project before discussing the options with respect to the control principle.

Despite the aim of the standard to move to a single control principle for all entities, we are concerned that the structure of the proposed standard inadvertently introduces a two-model control framework, one for voting entities and another for structured entities. Although we agree that control is an appropriate basis for consolidation and support the proposed definition, we do not believe that the control principle is appropriately articulated and we are concerned that there are inconsistencies in the standard with respect to the power criterion. The proposed standard states that a controlling entity needs to have the power to direct the activities of another entity, but the exercise of that power is not a necessary prerequisite of the control. It is unclear whether the definition requires that rights be currently exercised (being in the position of control) or exercisable (the ability to exercise power and obtain control). We believe that the standard should only require currently exercisable power. To avoid that consolidation would lead to the confusion of the reader in particular where several banks conduct business through the same vehicle but only one party bears the majority of risks and benefits, the proposed standard should clearly state that an entity must have significant power to direct the activities of another entity to generate returns for the entity that are significant.

We also support the need for enhanced disclosures relating to consolidation and the risks associated with non-consolidated entities. We believe that the principles required by the standard are reasonable and provide useful information. However, many of the specific disclosures included in the application guidance are overly burdensome, costly and will not provide decision useful information. We are very concerned about the fact that the necessary disclosures hinge on whether or not an entity meets the definition of a structured entity. We believe that disclosures should be graduated based on risk actually incurred. In addition, we do not believe that entities will have the required information for entities that they have not set-up or sponsored or in which they have no ongoing rights.

We recommend the IASB to undertake a more comprehensive analysis and debate on the information needs of users and on how best to meet those needs in terms of consolidations and group reporting entities before it moves further with the standard. The disclosure rules of Pillar III which made a valuable contribution in respect of transparency since they include numerous requirements to disclose securitisation positions should also be taken into account.

Question to be answered: ***Did issues surrounding accounting for off-balance items such as securitisations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting?***

Although this is a very subjective question, our answer may be yes.

4. Most constituents agree that the current mixed attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is overly complex and otherwise suboptimal. Some constituents (mainly investors) support reporting all financial instruments at fair value. Others support a refined mixed attributes model. Which approach do you support and why? If you support a refined mixed attributes model, what should that look like, and why, and do you view that as an interim step toward full fair value or as an end goal? Whichever approach you support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

A useful and relevant performance reporting cannot be achieved if the framework for financial reporting remains rigid and sticks to either an amortised cost model or a fair value one. A mixed measurement model provides investors with better information for evaluating financial institutions. It requires fair value measurement for assets and liabilities managed on a fair value basis. At the same time, it recognises that not all financial instruments, such as loans and deposits, are managed on a fair value basis, or are even capable of reliable fair value measurement. Given the hard learnt lessons about the relevance and reliability of fair values in the absence of an intent and ability to trade or manage instruments on a fair value basis, we see mixed measurement model as one and only relevant measurement model for the future. Our view is consistent with the majority of responses received to the IASB consultation on reducing complexity in financial reporting as well as with the view of SAC.

However, we agree that improvements to the current mixed measurement model in particular to the hedge accounting rules and the fair value option are necessary. The complexity in reporting could also be reduced by considering issues such as unit of account, requirement for classification in held for trading and/or fair value option, reclassification, and some of the anti-abuse provisions in IAS 39 such as the documentation and effectiveness testing, and the requirements and the rules surrounding HTM. The hedge accounting rules should be improved either by elimination of additional requirements from fair value hedging rules or extending the FVO in order to adopt an approach which treats different economic risks of financial assets and liabilities differently depending on their relevance to the business. We have set out our concrete suggestions on the improvements of the mixed measurement model in our response to the discussion paper "Reducing Complexity in Financial Reporting"[2].

5. **What criteria should accounting standard-setters consider in balancing the need for resolving an 'emergency issue' on a timely basis and the need for active engagement from constituents through due process to help ensure high quality standards that are broadly accepted?**

There are clearly instances in which the need for action outweighs the need for lengthy deliberation. We agree on the need to formalise the criteria for and rules governing a permanent fast track procedure.

Question: What criteria should accounting standard-setters consider for the fast track procedure? Should we propose to empower the Monitoring Board with the task to identify an "emergency issue" as the guardian of the public interest?

We would agree on that suggestion.

6. **Are there financial crisis-related issues that the IASB or the FASB have indicated they will be addressing that you believe are better addressed in combination with, or alternatively by, other organisations? If so, which issues and why, and which organisations?**

International Financial Reporting Standards should not be limited to an investor-oriented approach but serve multi-tier purposes in the framework of an integrated reporting system. In the case of a bank, users will be interested in other forms of reported information, including risk and liquidity figures.

As we believe that financial reporting and regulatory reporting are aligned, the IASB should aim to coordinate its activity with other regulatory authorities within a structure aimed at

[2] This paper is attached together with 'Accounting for Financial Instruments'

enhancing financial stability provided it is consistent with sound reporting on financial performance to investors.

There are clearly areas as the assessment of the effectiveness of capital adequacy requirements in the context of accounting standards modification, project on financial statements presentation or measurement project where the standards setters should work together with regulators. To this extent we would suggest that consideration should be given to permanent membership for the Basel Committee chair in the IASB Monitoring Board.

7. Is there any other input that you'd like to convey to the FCAG?

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EBF Ref. N° 0549/D1372F

Sir David Tweedie
International Accounting Standards Board

Brussels, 18 September 2008

Subject: ***Comment letter of the European Banking Federation[1] to the Discussion paper "Reducing Complexity in Reporting Financial Instruments"***

Dear Sir David,

Thank you for the opportunity to comment on the Discussion paper (DP). We welcome the Discussion Paper and note that it meets the promise in the Memorandum of Understanding with the FASB to issue a due process document relating to the accounting for financial instruments by 2008. We will first provide some comments on the paper itself and then provide some suggestions for improvements to the existing standards. Lastly, we will set out answers to the specific questions raised in the paper.

Reducing complexity

While it seems unlikely that the discussion of the benefits of a single measurement basis for all financial instruments will convince those who favor the mixed measurement model, we welcome the aim of the paper to contribute to an examination of whether financial instruments reporting can be made less complex.

The aim of financial reporting is to communicate the results and financial position in as straight-forward and understandable way as possible that is consistent with reflecting the economic affect of the transactions undertaken in the period. There is some complexity that is inherent in what is being reported and some complexity that arises from the collating and categorization process which is an integral part of financial reporting. However, there is also an unnecessary complexity that can result from the accounting standards themselves through poor drafting of requirements, anti abuse provisions or the sheer volume and lack of focus of disclosure requirements.

We draw the IASB's attention to the role accounting standards themselves can play in creating unnecessary complexity and support the development of principles based standards in the future. We also support efforts made to improve existing standards to tackle the sources of unnecessary complexity.

[1] Set up in 1960, the European Banking Federation is the voice of the European banking sector, with over 30 000 billion EUR assets and 2.4 million employees in the 31 EU and EFTA countries. The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.

Accounting standards are not about pursuing academic theory to a logical conclusion at the expense of the usefulness of financial reporting as a communication tool. The aim must be to create meaningful financial reporting that meets users' needs at a reasonable cost. Therefore we support the application of stringent cost/benefit criteria to any short term change to the existing requirements given the time and effort preparers, auditors and users have put into implementing the requirements to date. There are also other priorities in the IASB work plan, such as fair value measurement, the conceptual framework and financial statements presentation that will need to be progressed before any significant change to existing financial instruments requirements can be contemplated.

It would also have been helpful if the paper considered current events and the IASB's own plans in other areas. For example, before concluding that users have difficulty in understanding IAS 39 categorisations, it would have been useful to analyze whether the changes in reporting introduced by IFRS 7 in the 2007 reporting season have helped users understand accounting classifications. Because of the relative "silo" approach, suggestions in the paper to reduce the classification and hedge accounting complexity in IAS 39 are likely to introduce additional reporting complexity as a result of their interaction with other IASB projects such as the performance reporting project and the debt/equity project. While we understand that everything cannot be worked on at the same time, any improvements to IAS 39 should make sense within the overall IASB work plan and measurement cannot be considered in isolation.

We also note that other areas are either scoped out of the discussion or not addressed including derecognition and embedded derivatives which are also sources of complexity. Improvements could also be made to the disclosure requirements, for example consideration could be given to the applicability of the IFRS 7 requirements to wholly owned subsidiaries. Therefore there are other areas where improvements could be made if the main objective is to reduce complexity.

A single measurement basis does not provide more relevant information

While fair value measurement was not at the source of current market conditions, it should be noted that some are questioning whether fair value reporting as defined in the current requirements provided useful information in all situations. Therefore, we cannot see any benefit in reporting more financial instruments at fair value, particularly which are not traded on active markets and where the business model is to originate and retain the instruments for the longer term.

Until it is clear what fair value is in terms of entry price, exit price and how illiquid markets should be addressed, i.e. work on the FAS 157 discussion paper is progressed, it seems inappropriate for the IASB to suggest a long term solution to use fair value. The determination of what is meant by fair value will need to be made in the light of experience gained in current market conditions.

We therefore welcome that future work from the IASB will address fair value measurement in thin or non-existent markets and how measurement uncertainty can best be reflected in relevant disclosures.

The paper sets out the long-term objective of the IASB without convincing explanations of the reasons why fair value should be superior to the current mixed measurement model. A model for measuring financial instruments must be judged by the extent to which it is suited to achieving the objectives of financial reporting. The DP does not address whether fair value measurement for all financial instruments would faithfully represent the business activity, fulfill the aim of performance reporting, increase transparency, enhance comparability, provide more reliable information to users of financial statements than the mixed measurement model does. The DP does not address whether fair value alone provides sufficient information to influence decision-making, nor does it consider financial statements including all financial instruments at fair value provide a better communication framework. We would therefore like to bring to your attention the position paper of the International Banking Federation. The document "Accounting for Financial Instruments" assesses full fair value measurement against the objectives of financial reporting and considers whether the objectives are better met by moving to the full fair value as oppose to the current mixed measurement model. Conclusions reached in the document are the outcome of a long-term in-depth debate within the banking industry worldwide and are fully shared by the European banks *(see enclosed).*

We do not question the appropriateness of fair value measurement for financial instruments held for trading purposes or otherwise managed on a fair value basis. In a business model where the underlying strategy is to draw a benefit from short-term variations in the value of the instruments and where the entity is actively engaging in opening and closing market risk positions, it is appropriate for the entity to fair value such instruments and it is also relevant information for primary financial statements users.

However, when an entity does not manage instruments on a fair value basis, amortised cost including impairment is the most appropriate way to estimate future cash flows. If the instrument is held for use in the business to generate cash flows and there is no current or future intention to sell, the aim is to achieve a stable income flow earned on an ongoing basis over a certain period. In this case, there is no intention to profit from the expected short-term market movements. The asset will be held until maturity (or at least until prepayment without change of the terms), and this means that the future cash flows are readily identifiable.

Relevant performance reporting will never be achieved if the framework for financial reporting sticks rigidly to either an amortised cost model or a fair value model. A mixed measurement model provides investors with better information for evaluating financial institutions. It requires fair value measurement for assets and liabilities which are managed on a fair value basis and recognizes that not all financial instruments are managed on a fair value basis or are even capable of reliable fair value measurement.

Instead of determining that one approach offers a superior model to that of others, the IASB should rather try to accommodate accounting standards to the various business models and circumstances in which financial instruments are used.

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A single measurement basis does not reduce complexity

In our view, a single measurement basis is likely to increase rather than reduce complexity.

If all financial instruments were measured at fair value, similar categories to those that already exist would be required to differentiate gains and losses on instruments that are used in the business in different ways in order to create meaningful performance reporting. Users may also find they need the total fair value movement in a period analysed into different components to be able to understand the business performance. Therefore, while it may be possible to argue that full fair value results in better reporting (although we do not agree), we do not think it is credible to argue that it will reduce complexity.

At best it would just move the complexity from classifications and hedge accounting to measurement, presentation and disclosure. A full fair value approach would lead to greater need to explain how the fair values were determined, including the underlying assumptions, and provide information necessary for users to understand the potential variability and uncertainty of measurement for a wider variety of financial instruments than is currently the case. Where these financial instruments are not managed on a fair value basis, the complexities in providing sufficient and understandable information should not be underestimated. In addition, fair value movements may need to be disaggregated into component parts such as interest, credit, liquidity, etc to provide meaningful information that users need to understand the underlying transactions and business performance. Once again, the complexities in making and presenting this disaggregated information, which could be fairly arbitrary, are likely to be great.

The above-mentioned complexities do not include those arising from determining fair values for instruments which are not held for trading or otherwise managed on a fair value basis. Even if it would be possible to determine fair values in certain cases, the difficulties of doing that should not be underestimated. Different bases of accounting have all their own issues and areas of judgment. The aim must be to use a basis that maximises the usefulness of information and minimises the cost and effort in providing it, or at least ensure that the cost and effort are a worthwhile trade off for superior information. The proposal for measuring all financial instruments at fair value does not succeed in meeting this test.

Suggestions for possible improvements

It is unfortunate that the IASB's long-term objective has somewhat stifled the discussion around options available for improvements to the existing standards. In our view, improvements to existing standards should be driven by the need to provide relevant, reliable and understandable information rather than be driven by a long-term measurement objective that does not have widespread consensus. In addition, changes should not be made without meeting clear cost/benefit objectives. Therefore, we do not agree that improvements to IAS 39 are intermediate changes. The primary sources of complexity identified in the DP are the financial instrument categories and the hedge accounting rules. We think that there is likely to be more improvements that can be made to the hedge accounting rules than to the financial instrument categories. We also think that complexity could be reduced by considering issues such as unit of account and some of the anti-abuse provisions in IAS 39 such as the documentation and effectiveness testing requirements and the rules surrounding HTM.

Financial instruments are held both to maturity and for short-term profit making. As concluded above, neither the fair value model nor the amortized cost model can be presented as a universal solution. We believe that a differentiated approach is best suited to achieving the objectives of the framework. There is a need to continue to measure some instruments at amortised cost while others may be measured at fair value in order to reflect the underlying economic substance and business strategy of the company. In order to realign risk management practices with accounting rules, standard setters should focus on the development and improvement of the current mixed measurement model either by a) improving the existing hedge accounting rules or b) the fair value option

a) Relaxation of the hedge accounting rules

Current hedge accounting rules are very complex and burdensome. They require designation of hedging relationships, tracking and analyzing hedge effectiveness and vast formal documentation. The corridor of 80-125% through the life of the hedge discourages entities from applying hedge accounting even when using derivatives and other instruments to reduce risk. As a result, entities are prevented from showing the impact of hedging activities in their financial statements. Relaxation of the overly prescriptive conditions in assessing the hedge effectiveness could provide more flexibility for the use of hedging instruments.

An approach in which the ineffective portion of the hedge relationship is reflected in the income statement, regardless of whether or not the hedge is considered as being highly effective would constitute an approach entirely in tune with the commercial reality. This approach could be put in place for a fair value hedge relationship as well as for a cash flow hedge relationship. As long as the fair value changes can be reliably measured or the hedged cash flows are reasonably probable of taking place and the ineffectiveness can be reliably measured, the hedge accounting could be maintained.

Relaxing the 80-125% corridor while recording the ineffectiveness in the P&L would be self-policing. Regardless of the ineffectiveness, it would not be necessary to terminate and re-designate the hedge relationship. The consequences of having a single bright line to define when to use hedge accounting, is complication that does not help in providing useful information to users or reflect the economics of the hedge.

The recently issued FASB Exposure Draft of FAS 133 proposes on the one hand some changes to hedge accounting requirements which may deserve further consideration and, on the other hand, some changes which we strongly oppose. We suggest that the IASB should consider the suggestions in that paper for modification of the effectiveness threshold necessary for applying hedge accounting from highly effective to reasonably effective at offsetting changes in fair value or variability in cash flows. After inception, an entity would be required to qualitatively rather than quantitatively reassess effectiveness only if circumstances suggest that the hedging relationship may no longer be reasonably effective. Such changes are likely to make hedge accounting easier to apply.

However, we note that the IASB DP in paragraph 2.84 states that allowing more relationships to qualify for hedge accounting will result in less relevant and understandable information.

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In our view, hedge accounting that reflects risk management provides more relevant and understandable information for users; therefore we question the implications of paragraph 2.84. If there is evidence that hedge accounting impairs the relevance and understandability of financial reporting, then this should be fully explained and debated because it is significant to any future debate on hedge accounting.

We strongly oppose other suggestions in the FASB ED such as the removal of the ability to de-designate and to use partial hedges and the requirement to fair value the hedged item for all risks and not just the risks subject to the hedge relationship. We would be greatly concerned if the IASB were to follow such an approach in the interests of convergence.

Macro fair value hedge accounting

The IAS 39 macro fair value hedge accounting approach is rarely used because it is overly complex and does not succeed in reflecting risk management, particularly where liabilities, including demand deposits, exceed assets, or the portfolio contains a mix of issued securities in other currencies combined with derivative portfolios which hedges assets, or the portfolio contains a mix of issued securities in other currencies combined with derivative portfolios which hedges assets. An approach to hedge accounting that would better reflect risk management and the fact that the business is managed based on portfolios of financial assets and liabilities, rather than individual instruments, could be usefully developed. At the very least, the IASB should reconsider the issue of unit of account in relation to hedge accounting. Many accounting estimations, such as effective interest and impairment, are calculated in relation to portfolios of assets rather than individual items and it is not clear why hedge accounting should be required to achieve the same result as if each item had been individually designated.

The IASB should review the application of macro fair value hedge accounting and discuss it with those banks that have tried to use it and failed in using it or those who are managing to use it for particular types of portfolios. There are likely to be lessons to be learned about how to reduce complexity in standards.

Macro cash flow hedge accounting

We note that the IASB is considering improvements to macro cash flow hedge accounting, following discussions with the European banks with the objective of removing the EU carve-out.

b) Improvement of the fair value option (FVO)

Financial instruments are often complex and can contain different risks being managed in different ways. Separate measurement of the different components at amortized cost and/or at fair value based on how the component is managed may be seen as a way of achieving a good evaluation of past performance as a basis for predicting future performance.

FVO presupposes that all components of the instrument are fair valued in their entirety even if they are not all managed on a fair value basis.

Therefore, in these circumstances, the FVO does not faithfully represent the economic substance of transactions, which may have components that are not risk managed on a fair value basis or for which a fair value cannot be reliably established - for example, credit risk of retail loans or mortgages. The FVO has to be applied to the whole instrument even if some risks of the instrument are not managed on a fair value basis and cannot be transferred to a separate and specialized area of the company.

Fair value hedging rules allow the management of the interest rate risk component of fair value. This could be extended to the FVO in order to recognize the risk management practices where interest rate risk is managed at fair value. The FVO should be allowed to apply to specific risk or parts of the designated item. This would achieve a similar result to relaxing the 80-125% effectiveness requirements for fair value hedge accounting.

We note that it is not generally possible to achieve effective hedge accounting for economic hedges of credit risk. A relaxation of hedge accounting rules on the corridor or an improvement of the FVO would allow some hedge accounting to be achieved for credit risk, which will increase users' understanding of the risk mitigation techniques undertaken by management.

There may be circumstances (clearly defined) where, in principle, the entity should remove a financial instrument from the fair value option category and cease re-measuring it to fair value.

The hedge accounting rules should be improved either by elimination of additional requirements from fair value hedging rules or extending the FVO in order to adopt an approach which treats different economic risks of financial assets and liabilities differently depending on their relevance to the business.

We note that, after a full long-term debate, the FASB introduced the fair value option in a different way to the fair value option in IAS 39. In our view, FVO in IAS 39 should be modified to apply to the same set of instruments, subject to the same qualifying criteria as FVO under FAS 159.

Yours faithfully;

Guido Ravoet

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EBF answers to the specific questions raised in the Discussion Paper

Section 1 Problems related to measurement

Question 1

Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and their auditors and the needs of users of financial statements?
If not, how should the IASB respond to assertions that the current requirements are too complex?

There is no need to change the measurement model, however there is no doubt that there is room for improvements particularly of the hedge accounting requirements. However as we believe a mixed measurement model is necessary to represent faithfully an entity's business model and the way it generates earnings, we do not believe there is a need for radical change. Complexity may arise from the nature of some financial instruments and financial reporting should faithfully report this complexity within the bounds of understandability and cost/benefit considerations. It is difficult to see how the different categories of financial instruments and the different measurement bases are themselves a source of significant unnecessary complexity to either preparers or users. It is not clear that the disclosure requirements in IFRS 7 have been considered in making the assertion that users do not understand the classifications. It also seems likely that some proposed changes, for example the IASB's preferred long-term approach to measurement, would introduce complexity in the implementation of the standard and the understanding of financial statements than under the current practices.

To some extent, IAS 39 is an easy target for criticism, both from constituents as well as Board members themselves. The standard lacks clearly stated principles, is not well drafted and has been subject to an excessive amount of implementation guidance. Areas such as derecognition and the debt/equity distinction can be difficult to apply and understand but are outside the scope of the DP. However, the requirements have now been in place for several years and there are benefits to the constituency becoming familiar with the requirements which should ease future criticism.

Section 2 Intermediate approaches to measurement and related problems

Question 2

(a) Should the IASB consider intermediate approaches to address complexity arising from measurement and hedge accounting? Why or why not? If you believe that the IASB should not make any intermediate changes, please answer questions 5 and 6, and the questions set out in Section 3.
(b) Do you agree with the criteria set out in paragraph 2.2? If not, what criteria would you use and why?

a) While we are supportive of genuine improvements to IAS 39, we do not support any intermediate approach leading towards a long term solution as proposed in the DP with which we do not agree.

b) No, we only agree with criteria (a) and (d). New standards or improvements to existing standards should have at their heart the qualitative characteristics set out in the framework and should aim to produce relevant, reliable and understandable information. New standards or changes to existing standards should also meet an appropriate cost/benefit test, including avoiding successive changes to the same area in a short time period or changes that do not provide sufficient benefit to be worthwhile. Any changes to the standard need to be principle based and introduced in close cooperation with all interested parties. We believe these criteria alone should be sufficient.

Criterion (b) is fundamentally incorrect. Without widespread support for the long-term objective, which is unlikely to be engendered through this DP, it is illogical to take the approach of being directionally consistent with the long-term objective. We are also concerned that introducing such a criterion excludes ideas that are consistent with criteria (a) and (d).

c) There is too much focus on complexity. We do not argue against the complexity reduction; however whether the complexity is judged to be increased or not may be subjective. For example, some users may consider it more difficult to understand cash flow hedging and hypothetical transactions than fair value measurement of the interbank interest components. We believe that some complexity increase could be accepted if the outcome leads to a significantly increased quality of the financial reports and understanding from the users and the preparers.

Question 3

Approach 1 is to amend the existing measurement requirements. How would you suggest existing measurement requirements should be amended? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph 2.2?

We are not convinced that the existing measurement methods are a source of significant unnecessary complexity or that material changes to the approach would avoid the introduction of additional complexity in the areas of measurement, presentation and disclosure.

Reducing the number of measurement categories, for example, by eliminating HTM may not make much difference in practice since the category is not widely used and many instruments which entities are holding from the long term are reported as available for sale (AFS).

Eliminating the HTM category and/or AFS would not reduce complexity since similar classifications in the income statement are likely to be necessary to distinguish gains and losses on instruments that are not held for trading from those on instruments that are held for trading in order to reflect the different nature and usefulness of the information to predict future cash flows in performance reporting. Indeed the resulting disconnects between balance sheet classification and income statement presentation could create additional problems in understandability.

Another approach could achieve a merger of the HTM category with "loans and receivables" by allowing quoted assets which are not managed on a fair value basis to be included in loans and receivables thus valued on the basis of discounted value of their cash flows, providing appropriate disclosure around disposals rather than tainting rules. Alternatively, a similar treatment would arise if the anti-abuse provisions of the HTM category were deleted and replaced with disclosure requirements. Such changes may result in reporting which better reflects the business model for many of the instruments being currently reported as AFS, where they are as an example held for long term but could be sold to meet liquidity needs. Transfers between categories should be permitted or required where ability and intent changes provided the transfers are at fair value and fully disclosed.

The DP sets another approach where all instruments traded in active markets are measured at fair value. This approach seems more likely to introduce additional complexity in defining an active market and determining what happens if a market changes status. This is information content in the markets' view of the future cash flows of a financial instrument but there is also important information in a valuation of financial instrument and their reporting through the income statement in a way that reflects how future cash flows are expected to arise through the business model. The virtue of the current mixed measurement model is that fair values are disclosed for all financial instruments but they are reported in the income statement based on how they are used in the business. We cannot, therefore, support an approach that determines measurement based on the nature of the instrument rather than how it is used in the business.

We note that the DP suggests that this alternative may or may not result in a significant change in existing practice. If it would result in significant change we do not think this would be change for the better since it would make financial statements, particularly the income statement less relevant and understandable. If it is merely a restatement of existing practice, the risks and costs of making the change seem to outweigh any benefits.

Question 4

Approach 2 is to replace the existing measurement requirements with a fair value measurement principle with some optional exceptions.
(a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph 2.2?
(b) How should instruments that are not measured at fair value be measured?
(c) When should impairment losses be recognised and how should the amount of impairment losses be measured?

(d) Where should unrealised gains and losses be recognised on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph 2.2?
(e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph 2.2?

As a general comment, we would like to make clear that we do not believe the replacement of the existing measurement requirements with fair value measurement principle is conceptually correct whether or not the principle contains exceptions. It may lead to a situation when more than 50% of the balance sheet of most European banks would be accounted for on the basis of exception. Any proposal focusing on the nature of the instrument rather than how it is used in the business, will result in additional complexities for income statement presentation and disclosure.

a) As already set out in IAS 39, we consider that the business purpose of the financial instrument is key to its categorisation. We also note that, when IAS 39 was first introduced, the standard was often described as requiring fair value which resulted in many misunderstanding the extent to which fair value measurement was required or permitted. While it may be possible to restate the current IAS 39 measurement categories in terms of fair value with exceptions, we think this is likely to overstate the extent to which fair value is relevant and could cause confusion. This is particularly the case where, as indicated in paragraph 2.22, the practical affect may not be significant.

As drafted, the proposal is likely to create its own complexities, i.e. what is meant by low variability. It is not clear that the exemption would include instruments with prepayment and credit risk. If not, the proposals could create an unusable exemption like HTM and result in bringing forward at an early stage the IASB's long-term solution. Since the IASB's own view is that the long-term solution cannot be implemented in the short term, this proposal could be unworkable. If the intention is merely to restate similar classification and measurement to that under IAS 39, the costs of the change seem likely to outweigh any benefits.

b) Instruments or parts of instruments, not measured at fair value could be measured at cost, including appropriate impairment. However, it seems likely some AFS-type classification would be necessary to distinguish trading income from other gains and losses in the performance statement. Therefore, we question whether the proposal would reduce complexity.

c) There is no obvious need to reconsider the present rules in IAS 39 for impairment testing for instrument measured at amortised costs.

d) The answer on (d) is dependent on the "presentation project". Indeed, it is our view that any fundamental changes cannot be made to IAS 39 until there is greater clarity in how financial performance should be presented.

e) Arguably, if the criterion for using an exemption from fair value measurement is dependent on low variability in cash flows, the exemption should no longer apply and the item should be reclassified if the variability in cash flows increases to an "unacceptable" level. However, given the difficulties with determining "slightly" variable and the difficulties involved in presenting and disclosing any reclassifications and our lack of support for the proposal in the first place, we do not recommend reclassification if the aim is to create a simple standard (albeit one that is unlikely to faithfully represent business transactions). As reflected above, where the criterion for determining categories is based on how instruments are used in the business, it is logical that transfers should be permitted or required where the intent or ability changes, with full disclosure.

Question 5

Approach 3 sets out possible simplifications of hedge accounting.
(a) Should hedge accounting be eliminated? Why or why not?
(b) Should fair value hedge accounting be replaced? Approach 3 sets out three possible approaches to replacing fair value hedge accounting.
(i) Which method(s) should the IASB consider, and why?
(ii) Are there any other methods not discussed that should be considered by the IASB? If so, what are they and how are they consistent with the criteria set out in paragraph 2.2? If you suggest changing measurement requirements under approach 1 or approach 2, please ensure your comments are consistent with your suggested approach to changing measurement requirements.

The IASB proposal to treat fair value hedge accounting a bit like cash flow hedge accounting seems no less complex than the current situation and potentially less understandable/explainable. It is also hard to see how the proposals are compatible with a single performance statement with no recycling. Once again, until there is greater clarity on the direction of performance reporting, we cannot support such possible approaches to fair value hedge accounting.

a) No, hedge accounting cannot be eliminated. Fair value option cannot be seen as a substitute for hedge accounting because it must be applied to the entire instrument, whereby fair value hedge accounting can be applied to specific risk or parts of a hedged item and can be designated and de-designated at any time to match the risk management practices. Hedge accounting should not be eliminated if no other solutions are implemented that make hedge accounting redundant. Even when the FVO would be applied more generally, there will still be a need for fair value hedge accounting in order to recognize the change in fair value due to changes in the hedged risk.

b) The question to ask should be whether fair value hedge accounting fulfils a need that the fair value option cannot fulfill. If the instrument measured at fair value is to be held until maturity and the general interest rate risk has been hedged, which is a common practice in some markets, measuring at fair value makes it more difficult for users to estimate future cash flows. There might be circumstances with a mixed intent of holding a single instrument where it might be relevant to split the instrument and measure parts of the instrument at fair value and the other part of the instrument at cost

If the benchmark interest rate risk were separated, the fair value option could be applied for the whole risk component and cost could be used to measure the separated margin. Allowing the FVO application to specific risk would enable entities to use fair value measurement in circumstance where its use is particularly suited to the characteristics of the transactions in question. Creating a fair value option that reflects risk management practices to the same extent as fair value hedge accounting would be akin to removing some of the rule based restrictions and anti avoidance provisions form fair value hedge accounting.

(i) We do not consider any of the methods suggested by the IASB are worth further consideration.

(ii) Suggestions for improvements that can be made to the existing requirements are set out in the answer to the next question.

Question 6

Section 2 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in the existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required.
(a) What suggestions would you make to the IASB regarding how the existing hedge accounting models could be simplified?
(b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?
(c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity.
(d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?

a) The complexity of today's accounting for financial instruments rises from hedge accounting rules. In particular, the main sources of complexity regard documentation and effectiveness testing. Hedge accounting should be based on a number of key principles for designation, documentation and recognition of ineffectiveness that are aligned to management intent and the company's risk management practices. We believe that the strict anti abusive hedge accounting rules should be relaxed and the following guiding principles could be implemented instead:

- The intent with a transaction (or it components) should be documented immediately at initial recognition
- The measurement principle should be applied that is consistent with the intent of the transaction
- Only the parts of a contract that are clearly separately measurable could be separated and measured at fair value

Principles similar to these examples presented above would lead to recognition of ineffectiveness immediately in income without the overly detailed documentation requirement. Recognition of actual ineffectiveness provides relevant information as it informs the users of financial statements of the degree of success of hedging policies followed by the entity. We believe that hedge accounting should be recognised even if the effectiveness is low provided all ineffectiveness is recorded in profit or loss. If the ineffectiveness is recorded in P&L it is not necessary to meet the qualifying quantitative effectiveness test.

In addition, the IASB may wish to consider whether the disclosures in the FASB ED "Accounting for hedging activities" would represent an improvement over IFRS 7. Making such amendments to hedge accounting would reduce complexity for preparers and users without changing the number of financial instruments currently measured at fair value.

b) Restrictions around hedge effectiveness and what can be a hedging instrument are not necessary provided ineffectiveness is taken to income. It may also be possible to remove some of the detailed rules and application guidance although this may not be worth doing as existing practice is unlikely to change.

c) Portion hedging and partial hedging should continue to be permitted if hedge accounting is going to be a proper reflection of the risk management techniques undertaken by the company. Fair value hedge accounting is mostly used when hedging the benchmark interest rate risk. Normally, it is not possible to achieve enough efficiency in the hedging relationship if the whole instrument is classified as the hedged item. Fair value hedge accounting of portions makes it possible to keep the margin in the contract at cost while the general market risk is measured at fair value. Such solutions combine the two business intents that may exist in a single contract; to manage the general market risk at fair value while managing the margin at cost.

Question 7

Do you have any other intermediate approaches for the IASB to consider other than those set out in Section 2? If so, what are they and why should the IASB consider them?

No, except for those described earlier in our comment letter (Please see section: Suggestions for possible improvements)

Question 8

To reduce today's measurement-related problems, Section 3 suggests that the long-term solution is to use a single method to measure all types of financial instruments within the scope of a standard for financial instruments.

Do you believe that using a single method to measure all types of financial instruments within the scope of a standard for financial instruments is appropriate? Why or why not? If you do not believe that all types of financial instruments should be measured using only one method in the long term, is there another approach to address measurement-related problems in the long term? If so, what is it?

No, we do not believe that the long-term solution is to measure all financial instruments at fair value. (Please refer to the previous section "A single measurement bases does not provide more relevant information"). A single measurement method would increase complexity in measurement, presentation and disclosure. These complexities are likely to introduce considerable additional costs for little benefit as fair values of instruments, which are carried at amortised cost, are already required. This seems the more appropriate way of presenting useful fair value information while preserving meaningful performance reporting.

Question 9

Part A of Section 3 suggests that fair value seems to be the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments.
(a) Do you believe that fair value is the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments?
(b) If not, what measurement attribute other than fair value is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Why do you think that measurement attribute is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Does that measurement attribute reduce today's measurement-related complexity and provide users with information that is necessary to assess the cash flow prospects for all types of financial instruments?

a-b) No, see our comments throughout the document. We see no possibility of having just one measurement basis and continue to maintain that the mixed measurement method provides the most relevant information with less complexity than that would be introduced by a full fair value method.

Question 10

Part B of Section 3 sets out concerns about fair value measurement of financial instruments. Are there any significant concerns about fair value measurement of financial instruments other than those identified in Section 3? If so, what are they and why are they matters for concern?

There are numerous arguments that have been presented by various parties during the years which question the relevance of fair value for financial instruments other than those listed in the DP. *(Please see the enclosed IBFed paper).*

The concerns identified are significant and encompass all aspects of financial reporting, i.e. what fair value is, what would be fair valued, how it would be presented and how it would be disclosed as well as associates issues such as the unit of account to which fair value is applied.

The proposals addressed in the DP do not reduce the overall complexity of reporting financial instruments but simply put more stress on different areas instead (presentation, classification, disclosure). Far from removing complexity, full fair value measurement is likely to result in users being given more complex information that would need supplemental disclosures based on the information about transactional cash flows, which is of interest. In order to enhance users' understanding, the gross movements reported in the income statement would require disaggregating in order to differentiate between changes in contractual cash flows and viable income because of measurement. Inclusion of information based on fair value would result in increased need for highly complex additional disclosures explaining the various estimations being used as well as factors causing the changes in fair value.

We believe that the interests of users are better served through the primary financial statements being presented on the basis that best reflects the flow of earnings. The current accounting model requires footnote disclosures for financial instruments, which presents fair value information. The use of this fair value information by users of financial statements should be assessed before any changes are made to financial instrument measurement accounting.

In our view, the different measurement bases are not the source of complexity, neither are the measurement categories. The complexity rather comes from the drafting of the standard itself and the fact that IAS 39 and application guidance are more rules than principles based in contradiction to the general aim of the IFRS to be of a principles' nature.

Opponents of the existing mixed measurement system often argue that it is not always easy for users to determine which measurement has been applied to which instrument or to understand the implication of the difference. In this regard, we would like to mention that IFRS 7 requirements, which were first applied to 2007 accounts are extensive and an important step towards increasing the transparency in reporting financial instruments.

It is also argued that the quantification of impairment can be complex, based on subjective valuation performed by the entity, not necessarily leading to relevant information. We would argue on the contrary that impairment could be more relevant especially in circumstances when markets are not active. A participant in a non-liquid market cannot be fully knowledgeable and aware of the true price therefore may have no better knowledge than a transacting entity. In addition, while only impaired losses are recognized in the income statement, fair value models allow recognition of both, losses as well as gains. Recognition of gains on fair value, which is not necessarily reliable, could lead to more complex financial reporting with less relevance and much more pressure on preparers for information disaggregating.

Question 11

Part C of Section 3 identifies four issues that the IASB needs to resolve before proposing fair value measurement as a general requirement for all types of financial instruments within the scope of a standard for financial instruments.
(a) Are there other issues that you believe the IASB should address before proposing a general fair value measurement requirement for financial instruments? If so, what are they? How should the IASB address them?
(b) Are there any issues identified in part C of Section 3 that do not have to be resolved before proposing a general fair value measurement requirement?
If so, what are they and why do they not need to be resolved before proposing fair value as a general measurement requirement?

a) Firstly, the IASB has not completed its work on the FAS 157 discussion paper so it is not clear what is meant by fair value. Secondly, it may be possible to require a single measurement basis but there will be many different methods to determine it which may change as circumstances change. This results in significant additional disclosure requirements to explain how the values are determined and how they may change if circumstances change, which introduces additional complexity and may impair the relevance and understandability of the information, particularly where the financial instruments are not held for trading or otherwise managed on a fair value basis. There are issues currently being discussed arising from the application of fair value in illiquid market conditions. The usefulness of fair value rules depends on market efficiency and the issue is particularly relevant to the question of whether fair value should be expanded to cover not only financial instruments which are traded also instruments that are neither traded nor managed on the FV basis. Thirdly, in these circumstances, an income statement recognising a single fair value movement in the period may not provide useful information and there may be demands for the fair value movement to be disaggregated, introducing further complexity.

b) No.

Question 12

Do you have any other comments for the IASB on how it could improve and simplify the accounting for financial instruments?

Paragraph 2.19 suggests that instruments with fixed or slightly variable cash flows might be eligible for cost based measurement. The focus in paragraph 2.19 is on single instruments and this is one of the key differences in perspective between bank's asset and liability managers and the IASB.

While the IASB focuses on single assets and liabilities, the preparers in the financial industry focus on packaging assets, liabilities and derivative contracts in order to create a steady fixed or low volatility margin (portfolio approach). Therefore, it would be useful to consider whether changes in the unit of account could reduce the complexity in reporting financial instruments.

Finally, we include comments on some paragraphs in the DP

Paragraph	Comment
2.40—43	In these paragraphs, some changes in fair value option are discussed. One point is that it might be possible to allow fair value option for components which could be introduced as a complement to fair value hedge accounting. The proposal is rejected by the IASB because it would "defeat the purpose of making a change". The only "defeat of purpose" we are able to identify is "an increased use of fair value". Therefore, if the DP had not required solutions that increase the use of fair value, an expansion of the fair value option to components could have been explored. The benefits of the fair value option for components would be: • the decrease in the documentation requirements • it would immediately recognise ineffective hedges in P&L • it would achieve the same presentation as fair value hedge accounting of components • it would make it possible to align risk ,management and business intent with measurement in financial reporting • it would make it possible to only measure those components where there are a liquid market at fair value The DP is stating that a components approach does not increase comparability. We believe that this is not necessarily true. We believe that the comparability will be the same, or increased. When two entities have the same intent with entering into similar transactions, there should be a higher probability that they choose the same accounting principles, since the burden of hedge accounting would no longer prevent the entities from measuring different parts of a financial instrument based on the business intent.
2.46 (c)	In this paragraph, it is stated that fair value hedges should be reported in the same way as cash flow hedges. The main argument is that it would lead to "fewer ongoing effects on earnings" because the entity would not need to recalculate the effective interest rate if the entity closes the hedging relationship. This is not a completely relevant argument. If an entity closes the hedging relationship in a cash flow hedge, then it will affect earnings during the remaining maturity of the hedged transactions. The net effect on earnings will be the same.
2.67	In the DP, it is stated that it is difficult to understand hedges of parts of an instrument. We do not believe that this statement is true. If the partial hedge is focusing on parts that are easily separable, for which there is a liquid market, the financial reporting of parts of instruments would be easy to understand. It would also be transparent and objective. It should be more possible to understand those hedges than the fair value measurement of instruments for which there are no secondary market and where the business intent is to hold the

Paragraph	Comment
	instrument to maturity. We would also like to underline the fact that users of financial statements have expressed their interest in seeing total change in fair value disaggregated in major components. Depending on how major the component is intended, this seems in contradiction with the IASB proposal to eliminate partial hedges. In fact, even though partial hedges are eliminated and full fair value is required there would always be the need to separate the total change in fair value in its components.
3.43	The paragraph describes when there is an artificial volatility in financial statements. The DP has excluded some relevant arguments: Artificial volatility also exists when two linked financial instruments with fixed cash flows are measured at fair value even though they are intended to be held until final maturity. The swings in fair value might give rise to high volatility due to changes in supply and demand without any other relevant changes in risk factors.
3.52	In this paragraph, it is stated that fair value is objective because it contains the view of the market. That might be true for highly liquid instruments for which there is a secondary market. The statement is not at all true for instruments, which are seldom or never traded.
3.57	It is stated that entity specific values are "clearly more subjective and less reliable" for non-traded or illiquid instruments. We question this argumentation. Entity specific values might be superior to external data because the entity might have superior access to information.
3.66 3.67	It is argued, *"the range of possible differences in judgement is not especially wide if the credit risk is not especially high and changeable"*. This statement is not true. There exist a Federal Reserve study that compared highly rated instruments in the bond market with the syndication market concluding that the difference in spread was not constant and that the spread difference might be up to 50 bp. 50 bp. is a very high difference, especially for highly rated instruments. Furthermore, the recent market turmoil has shown how vulnerable the market is and how significant the spread differences might be for similar instruments. Similarly, we do not agree with the comments in paragraph 3.67 that fair value is not significantly more subjective than cost based measures. There is long history and experience in determining, explaining and understanding loan impairment concepts and little or no experience in determining fair value in these situations. This fact, coupled with views on the reliability of fair values determined in current market conditions, lead to the conclusion that the view in the paper is naive at best.

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