CFA Institute

560 Ray C. Hunt Drive
Charlottesville, VA
22903-2981 USA

+1 (434) 951 5499 tel
+1 (434) 951 5262 fax
info@cfainstitute.org
www.cfainstitute.org

June 17, 2013

Ms. Leslie Seidman
Chair
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856
United States

Mr. Hans Hoogervorst
Chair
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Re: Comment Letter on Classification & Measurement of Financial Instruments

Dear Ms. Seidman and Mr. Hoogervorst,

CFA Institute,[1] in consultation with its Corporate Disclosure Policy Council ("CDPC"),[2] appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB") Proposed Accounting Standards Update ("Proposed Update"), *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* and the International Accounting Standards Board's ("IASB") Exposure Draft ("ED"), *Classification and Measurement: Limited Amendments to International Financial Reporting Standards (IFRS) 9*. The FASB Proposed Update and IASB ED are collectively referred to as the Proposals. The FASB and the IASB are collectively referred to as the Boards.

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

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1 With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 116,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 137 countries, of whom more than 108,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 138 member societies in 60 countries and territories.

2 The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

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Overview

In 2010 CFA Institute issued an extensive comment letter on the FASB's Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*.[3] In that letter we comprehensively demonstrated – through surveys of users, reference to empirical academic research and our consideration of alternative measurements – users' preference for fair value measurements and the relevance of fair value as the primary measurement basis for financial instruments. The letter also addressed the common arguments against fair value.

In our comment letters responding to the IASB and FASB's prior proposals on financial instruments we have studied and commented on the detailed aspects of each proposal. In doing so, we have expressed our view that fair value represents the most appropriate measurement basis for all financial instruments. As we have previously articulated and supported our views with respect to the most appropriate basis for classifying and measuring financial instruments, we will not comment in the same level of detail to the current Proposals put forth by the IASB and FASB. In this letter, we consider – at a very high level – whether the Proposals meet the Boards' originally stated objectives.

We have reviewed the stated objectives of the projects[4] related to classification and measurement and have synthesized them into the following three elements:

1) Reduce complexity;
2) Improve depiction of economic reality and greater comparability between organizations; and
3) Increase global comparability.

We consider each objective in turn and evaluate whether the Proposals represent a sufficient improvement to merit the effort and cost involved in changing standards.

Complexity: Likely Increased Rather Than Reduced

Being principles-based approaches centered on the business model governing the management of the instruments, both the FASB and IASB Proposals claim to be simplifications in the accounting for financial instruments. In reality, the Proposals are a complex set of rules regarding both the entity's business model and the contractual cash flow characteristics of the financial instrument, and their intricate interplay, which are used to determine the classification, and ultimately the measurement, of the instrument. The complexity is only exacerbated when one considers the rules that govern the classification and measurement of hybrid financial instruments and the use of the fair value option. The differences between the complex rules of the FASB and IASB models – that are accounting constructs, rather than criteria based upon underlying economics – have a compounding effect on complexity.

An important element in simplifying the accounting for financial instruments should be to reduce the number of classification and measurement categories where those are accounting rather than economic distinctions and they utilize other comprehensive income (OCI), which doesn't have a conceptual foundation. Neither of the Proposals has accomplished this. While the IASB initially

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[3] CFA Institute also issued a comment letter on the IASB's ED *Financial Instruments: Classification and Measurement* which led to IASB 9 *Financial Instruments* in 2009.

[4] See **Appendix I** that provides a recap of the IASB and FASB's previously stated project objectives.

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reduced the number of classification and measurement categories to two – fair value through net income (FV NI) and amortized cost – it is now proposing to re-introduce the fair value through other comprehensive income (FV OCI) measurement category. The FASB, in its May 2010 exposure draft, proposed requiring much greater use of FV NI measurements and permitted the use of amortized cost in only limited situations. In redeliberations, however, the FASB moved backwards eliminating FV NI as the default category and making FV OCI the likely default category.

We, therefore, question whether these new rules and differing Proposals – that retain three classification and measurement categories – have the effect of reducing complexity. The justification for new and additional classification and measurement rules must be grounded in their ability to provide more decision-useful information to investors.

Economic Relevance & Comparability: Difficult to Demonstrate Improvements

Retention of Mixed Measurement Model Will Not Result In Decision-Useful Information

Both the IASB and FASB Proposals retain a mixed measurement approach. A mixed measurement approach requires the accounting for financial instruments to be based upon the business model governing the management of the instruments. Management intent or the business model,[5] however, does not alter the value of a financial instrument. A financial instrument's "value" is not different because it will be held by one entity and sold by another. An investor who is attempting to determine whether to buy a particular entity's securities would not be willing to pay a different price because of different accounting classifications and measurements of an identical basket of securities held by the entity who intends to hold the basket to maturity and another which intends to hold the basket for sale. Accordingly, accounting principles based on such a model do not provide investors with decision-useful information.

Such reporting flexibility in classification and measurement creates differences in appearance without differences in economics. Further, intent and business model can and do change over time or with management change. Different classification and measurement methods based upon such intent based rationale promote a lack of comparability within and between reporting entities over time as business models differ and as managements change. Further exacerbating the comparability issues are the differences in the IASB and FASB Proposals which result in comparability problems between jurisdictions.

As it relates to the objective of providing an improved depiction of economic reality and greater comparability between organizations, we don't think the Proposals meet this objective.

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5 We use the terms "management intent" and "business model" interchangeably as a business model is predicated upon and intended to capture the idea of management's intent. As we have said on numerous occasions, it seems impracticable for an entity to have a business model that management does not intend to follow, and does not follow. Said differently management's business model is what it intends to do.

See also *Business Model (Intent)-Based Accounting*; James Leisenring, Thomas Linsmeier, Katherine Schipper and Edward Trott; Accounting and Business Research, Volume 42, Issue 3, 2012.

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Retaining OCI: Creates Implicit Options

OCI being a concept that remains undefined, we believe there is no conceptual basis for the inclusion of FV OCI measurements. Splitting gains and losses between net income and OCI increases complexity and reduces understandability for readers of the financial statements.

Furthermore, the use of FV OCI creates implicit options and allows an entity to manage its bottom-line through its choice of business model (i.e. the selective decision to hold certain assets and sell others). Creating such implicit options not only reduces comparability, it enables the use of OCI to portray different economics and manage results.

Reclassification & Tainting: Creates Optionality & Comparability Issues

Both Proposals permit reclassifications of financial instruments. While the Proposals note that reclassifications would occur only in limited (i.e. rare) circumstances, it is difficult to ascertain the nature, or frequency, of such circumstances. Moreover, the rules governing reclassifications differ under the FASB and IASB models compounding the comparability issues. Permissive reclassification provisions in the Proposals create further optionality and comparability issues. The elimination of an explicit tainting notion adds to the problem by allowing greater optionality without anti-abuse measures.

The fundamental issue with allowing reclassification without any tainting provisions is that there is nothing to hold management accountable to their portrayal of the underlying economics in the financial statements when using a mixed measurement model. While we know the underlying economics of financial instruments classified under a mixed measurement model are no different – and hence, why we support fair value – many less sophisticated investors may not appreciate this distinction. For this reason, we neither support reclassifications nor the elimination of tainting.

Fair Value Measurements: Relevant for All Types of Entities under U.S. GAAP & IFRS

The FASB's Proposed Update requires public entities to parenthetically disclose the fair value of financial assets and liabilities that are measured at amortized cost on the face of the financial statements. We support this disclosure requirement – despite the failure to utilize our preferred measurement basis – as it conveys, in a timely manner on the face of the financial statements, an economically relevant measure for all users. Providing this additional information enables investors to adjust to the measurement basis most useful for their analytical purposes. Further, we believe that providing the disclosure on the face of the financial statements, rather than the footnotes, may improve the quality of the information disclosed.

We are concerned, however, that the IASB Proposal does not require the parenthetical disclosure of fair value measurements – so necessary for investment decision-making – in a timely fashion. We are also concerned that the FASB's Proposed Update does not require nonpublic companies to disclose fair value information for these financial instruments. Eliminating the current requirement for disclosure of the fair value of these instruments would eliminate extremely relevant information necessary for the users of these financial statements. Of particular concern is that the FASB's Proposed Update would not require nonpublic financial institutions to disclose fair value information for any financial instruments measured at amortized cost. As fair value reflects the underlying risks inherent in these instruments – credit risk, interest rate risk,

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and liquidity risk – excluding such disclosure has the effect of failing to convey important risks to the users of such financial statements.

Both Proposals need to ensure that timely disclosures of fair value measures are provided by both public and nonpublic entities so that investors may adjust to the measurement basis needed for their financial analysis.

Convergence:
Concerned by Perception That Proposals Result in Greater Global Comparability
The FASB and the IASB models may appear generally aligned with three classification and measurement categories under both models; however, there remain key differences between the Proposals. For example, the accounting for equity investments, hybrid financial instruments and the criteria under which financial instruments may be reclassified are different. In addition, the substantive wording differences in the Proposals, such as the description of the hold-to-collect business model, may give rise to differences in interpretation and application of the guidance. Such differences could lead to differences in classification and measurement conclusions for the same financial instruments and fact patterns.

Instead of creating the perception of sameness, we believe, it would be in investor interests for the Proposals to explicitly articulate the differences. This will allow investors to be more directly attuned to the differences and make necessary adjustments. We are concerned that the illusion of comparability can be more harmful than the explicit articulation of differences in the Proposals.

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The Importance of Sustaining & Cultivating Investor Outreach:
Listening & Responding to Investor Concerns

In developing these Proposals, the standard-setters performed outreach activities to investors to obtain their feedback. The majority of CFA Institute members supported the use of fair value as the measurement basis for financial instruments[6]. However, the standard-setters, as expressed in the FASB's outreach summary, concluded that the approximately 150 investors/users they spoke to preferred a mixed measurement model along with disclosure of the cash flow characteristics of financial instruments.

Cultivating feedback from the global investment community is difficult. Investors indicated they wanted the cash flow characteristics of the financial instruments – in the circumstance where they supported a mixed measurement model over fair value. Our concern is that the Proposals – though using a mixed measurement model – fail to provide investors with this second, and possibly most essential, element of their request. Investors we spoke to – who preferred a mixed measurement model – indicated that they wanted this key information because they want to perform their own valuations and sensitivities of such financial instruments. Our concern with excluding this request – which resulted from the FASB's direct outreach – from a final standard on classification and measurement or impairment is that it may have the effect of reducing the desire for investors to engage or participate in the standard-setting outreach process. It is important for investors to recognize that their feedback is fully heard and acted upon if the standard-setters are to demonstrate that they are fulfilling their mission of providing investors with decision-useful information.

Has The Threshold for Change (i.e. Improvement) Been Met?

As articulated above, the FASB and IASB models do not appear to result in classification and measurement criteria that are less complex than existing standards. Further, the Proposals do not represent a converged solution that provide investors with the full range of measurements (e.g. fair value) and disclosures (i.e. the cash flow characteristics of financial instruments) they requested. Accordingly, it is difficult to conclude that the Proposals have met the previously articulated objectives of the threshold for change – that being an improvement in financial reporting.

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Thank you again for the opportunity to comment on the Proposals. If you or your staff have questions or seek further elaboration of our views, please contact either Mohini Singh, ACA, by

[6] The aforementioned comment letter presents all of CFA Institute's research and survey findings related to the empirical and member support for fair value measurement. The following excerpt, from our previous letter to the FASB, articulates CFA Institute member support for, as an example, fair valuing loans:

During the four business days the survey was open – compared to the two week survey period in November – the number of respondents nearly doubled from approximately 625 to 1,100. The results showed support for fair value of loans increased from 52% to 71% while the support for amortized cost increased only slightly from 26% to 29%. Further, 68% of respondents indicated that CFA Institute should support the FASB proposal regarding measuring loans at fair value. These results – subsequent to the significant public debate on the fair valuing of loans – reaffirm that CFA Institute members continue in their strong support for fair value as the preferred measurement basis for loans.

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phone at +1.434.951.4882, or by e-mail at mohini.singh@cfainstitute.org or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters
Sandra J. Peters, CPA, CFA
Head, Financial Reporting Policy
Standards & Financial Markets Integrity Division
CFA Institute

/s/ Ashwinpaul C. Sondhi
Ashwinpaul C. Sondhi
Chair
Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council

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Appendix I

Project Objectives

Previously stated objectives of the financial instruments projects are recapped as follows:

FASB	IASB
Project Objective ***The main objective in developing this proposal is to provide financial statement users with a more timely and representative depiction of an entity's involvement in financial instruments, while reducing the complexity in accounting for those instruments.*** Currently, a high threshold for recognition of credit impairments impedes timely recognition of losses, while complex hedging requirements produce reported results that lack transparency and consistency. Furthermore, existing U.S. generally accepted accounting principles (GAAP) permit different accounting treatments for similar financial instruments. For example, under existing U.S. GAAP, debt instruments may be measured at amortized cost (for example, loans held for investment or held-to-maturity debt securities), at lower of cost or fair value (for example, loans held for sale), or at fair value (for example, trading securities). ***This proposal simplifies and improves financial reporting for financial instruments by developing a consistent, comprehensive framework for classifying financial instruments,*** removes the threshold for recognizing credit impairments, and makes changes to the requirements to qualify for hedge accounting, the result of which should be more consistent and transparent reporting for hedging activities.[7] ***The objective of the proposed guidance is to provide an improved and consistent financial reporting model for the recognition, measurement, and presentation of financial instruments in an entity's financial statements. The model increases the decision usefulness of the information provided in the financial statements to users by recognizing and measuring many financial instruments at fair value, without eliminating amortized cost information.***[8] Following the issuance of this proposal, the ***FASB and the IASB have jointly committed to continue attempting to reduce differences in the accounting for financial instruments under U.S. GAAP and IFRS***. The strategy calls for both Boards to consider together the comment letters and other feedback received in ***an effort to try to reconcile differences in views in ways that foster convergence while meeting project objectives***. [9]	***Project Objective*** The IASB and the FASB have been urged by many constituents to develop new standards of financial reporting for financial instruments *that are* ***principle-based and less complex than today's requirements.*** Anecdotal evidence suggests that many users of financial statements and other constituents find the requirements in IAS 39 Financial Instruments: Recognition and Measurement and the requirements under US GAAP ***difficult to understand, apply and interpret.*** ***The many ways of measuring financial instruments is one of the main reasons for today's complexity.*** This discussion paper is being published as a basis for future discussion of issues related to measuring financial instruments and hedge accounting. ***The ultimate objective of both boards is the convergence and improvement of the requirements for measuring financial instruments and hedge accounting requirements.*** [10] ***Since 2005, the Board and the US FASB have had a long-term objective to improve and simplify the reporting for financial instruments.*** [11] The objective of this [draft] IFRS is to establish principles for the classification and measurement of financial assets and financial liabilities that will ***present relevant and decision-useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of future cash flows.***[12]

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7 Proposed Accounting Standards Update, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, 2013, pp. 1.

8 Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, 2010, pp. 23.

9 Ibid, pp. 1

10 Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*, 2008, pp. 8.

11 Exposure Draft, *Financial Instruments: Classification and Measurement*, 2009, pp. 4.

12 Ibid, pp.17.