7 September 2010

IASB-Exposure Draft “ED/2010/7 Measurement Uncertainty Analysis Disclosure for Fair Value Measurements - Limited re-exposure of proposed disclosure”

FASB-Exposure Draft “Fair Value Measurements and Disclosures (Topic 820) – Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs”

Dear Sir, Madam,

In view of the fact that the FASB and IASB are collaborating on the fair value measurement project and that most of the requirements planned by the two standard-setters are the same, we should like to forward the comments we sent to the IASB on this issue to you as well. These comprise the response by the Zentraler Kreditausschuss (a committee made up of Germany’s five leading banking associations) to the IASB’s exposure draft “ED/2010/7 Measurement Uncertainty Analysis Disclosure for Fair Value Measurements - Limited re-exposure of proposed disclosure” (enclosure 1) and the response by the Association of German Banks in 2009 to the IASB’s exposure draft “ED/2009/5 Fair Value Measurement” (enclosure 2).

Much of our criticism of ED/2009/5 still holds. We continue to take the view that the term “exit price” should only be used if it really reflects an instrument’s fair value (i.e. if an “exit strategy” exists). Under the present requirements and current practice, the fair value of many financial instruments on initial recognition actually corresponds to an entry price. We also continue to be in favour of permitting the application of blockage discounts. Even in extremely active markets, large numbers of an instrument cannot be sold on the assumption...
that the total price obtained will be “value of the individual instrument times number of instruments”. Increased supply, both in economic theory and in practice, leads to falling prices.

On disclosures, we believe that information about the fair value hierarchy should only be mandatory for assets and liabilities which are actually measured at fair value, and not for assets and liabilities whose fair value only has to be indicated in the notes. Details of the fair value hierarchy of such instruments are not relevant for users since these instruments are not managed on a fair value basis and their fair values do not represent the expected income from them. Another problem, as we see it, is the requirement to disclose in the notes day one gains broken down into the three categories of the fair value hierarchy. Our member banks do not consider this information of interest to users; nor do they compile it since the instruments in question are valued on the basis of observable parameters.

Please see the enclosures for more detailed comments.

We would be happy to provide further information on request.

Yours sincerely,

Dirk Jäger
Ingmar Wulfert

Enclosures

Dear Sir David,

We appreciate the opportunity to comment on the Exposure Draft “Measurement Uncertainty Analysis Disclosure for Fair Value Measurements – Limited re-exposure of proposed disclosure (ED/2010/7)“, which was published in June 2010 by the International Accounting Standards Board (IASB).

Our comments are founded on our general agreement with a move towards world-wide consistent accounting standards. However, before addressing ED/2010/7 in detail, we would like to share the following observations:

The IASB Exposure Draft “Fair Value Measurement” was published in May 2009. In the meantime, the IASB and the Financial Accounting Standards Board (FASB) have reached an agreement on issues that were previously contentious. They are now united in their efforts aimed at homogenous requirements. However, whilst a number of the (proposed) requirements have remained unchanged, (now) the IASB no longer tables for discussion aspects that previously already proposed under the 2009 IASB draft, although these issues shall either become subject to a different approach or shall be additionally included under the forthcoming IFRS.

Even if numerous changes are merely of an editorial nature, we have difficulties in comprehending the rationale behind this approach chosen by the IASB. We would have welcomed it if these aspects had been part of the new Exposure Draft. In this context, we would briefly like to address a number of issues already raised by us in the context of the 2009 IASB ED which still remain valid. For instance, in our view the term “exit price” should only be used if the fair value also reflects the exit price/value (basically, there must be an “exit strategy”).
Rather, under the existing provisions as per IAS 39 and standard market practices, at the date of first-time recognition, in various financial instruments the fair value is identical with an entry price. Furthermore, we continue to support the option of applying “blockage discounts”. Even in very active markets selling large volumes of an instrument by strict adherence to the formula >value of an individual instrument * <quantity is not feasible. According to economic theory, too, any supply increase leads to declining prices.

Concerning the disclosures we are of the opinion that disclosures on the fair value hierarchy should only become mandatory for those assets and liabilities which are de facto measured at fair value. It should not be mandatory for those assets that only have to be reported at fair value in the notes. Furthermore, a disclosure of the fair value hierarchy of such financial instruments which would have to take place on a quarterly basis is not relevant for the reader of the financial statement because these instruments are not being managed on a fair value basis and their fair values do not represent the expected yield from these instruments. In addition to this, we view the notes disclosures on the day-1-gains broken down into the three categories of the fair value hierarchy as problematic.

Our member banks hold the view that the latter are not relevant for the reader. Furthermore, they do not capture such data because the affected instruments are being measured on the basis of observable inputs.¹

A. General comments on ED/2010/7

Whilst our comments are founded on our general agreement with improved decision-usefulness of financial statements, we have, for a certain period of time, been observing a trend towards increasingly demanding disclosures in the notes that result in the need for sensitivity analyses or similar analyses at points where inputs are being used during the measurement process that vary from company to company and that are unobservable (for instance c.f. also ED/2010/3). In our view, these calls for more stringent disclosure obligations are emblematic of a certain lack of trust with regard to the correct handling of these inputs - despite the fact that these inputs are being validated during the audit of the financial statement.

Yet, measurements are not automatically encumbered by uncertainties just because they are based on unobservable inputs. This point was already underlined during the notes disclosures concerning the estimation uncertainties under IAS 1. From our viewpoint, whenever alternative values are being worked out for disclosure purposes, these alternative figures will erode the credibility of the fair values reported in the financial statement – notwithstanding the fact that these alternative values themselves are equally encumbered by uncertainties. We take the view that the alternative values which have been worked out for the [proposed statutory] disclosure of the analysis are encumbered by the same uncertainties as the values on which the figure reported in the financial statement is based. This point already illustrates the fact that the benefit of these kinds of analyses is extremely limited. The proposed amendment does not deliver any benefit for users of financial statements that would offset the costs for the preparer. After all, the requested figures (primarily) only have to be worked out for disclosure purposes and are hardly ever used for internal corporate management purposes.

¹ For a more detailed view, please c.f. “Comment Letter of the Banking Industry on the IASB Exposure Draft on the Fair Value Measurement” dated 28 September, 2009
Instead, this leads to additional complexity in the presentation of the measurement models. As a result, the disclosure of alternative values generates further confusion on the part of the users of the financial statement concerning the reliability of the fair value shown in the accounts.

At the same time, it seems as if the standard setter were calling into question the meaningfulness of reported fair values. Yet, this would be at odds with previous requests and calls for an extension of fair value accounting (c.f. the current draft of the FASB.)

The ED/2010/7 proposes an analysis of the measurement uncertainties whilst taking into account the interdependencies/correlations between the measurement inputs. On the whole, we do not feel that this would be a suitable approach that would generate more decision-useful information.

Furthermore, we are of the opinion that the requested analysis of the measurement uncertainties is very complex, encumbered by many vagaries and difficult to compare across different companies.

We therefore feel that the traditional sensitivities currently published in the notes under the provisions of IFRS 7 are sufficient. In our view, any further estimation of parameters coming from inactive markets and thus from a market environment that lacks transparency as well as their potential fluctuations does not lead to any meaningful results.

Taking into account the theoretical correlations between inputs simply means expanding the publication scope to include further assumptions pertaining to individual companies. This neither improves the comprehensibility of the measurement model for the readers of the financial statements nor does it increase the acceptance of the audited figures shown in the financial statements. Apart from this, such correlations are difficult to determine because they, too, relate to inputs that cannot be observed. Surveys amongst our members, i.e. the banks, have shown that, in practice, it is not possible to readily identify corresponding correlations. We are concerned that the proposed changes would not result in any improved information but rather lead to misinterpretations by readers of the financial statement as to the multidimensional inputs which are partly closely intermeshed.

What is more, in order to disclose significant effects, financial instruments have to be aggregated into groups. Therefore, in our opinion, arriving at a transparent presentation of the individual adjustments of inputs which, in turn, feature mutual correlations, will hardly be possible, too. Furthermore, we feel that disclosure on the basis of product groups, let alone on the basis of products, is excessively detailed and thereby not useful. Traditionally, reporting takes place at the level of line items. This practice has to remain an option also in future.

On the whole, we hold the opinion that the traditional sensitivity analysis currently stipulated by IFRS 7.27B e) is sufficient and we explicitly object to the proposals contained in ED/2010/7.
B. Individual answers to the questions

Question 1: Are there circumstances in which taking into account the effect of the correlation between unobservable inputs (a) would not be operational (eg for cost-benefit reasons) or (b) would not be appropriate? If so, please describe those circumstances.

We would like to reiterate that we hold the view that disclosure of correlations is inappropriate for the purposes of conveying more decision-useful information. Particularly when it comes to structured financial instruments, correlations can be highly complex. This is especially true for multiply-structured financial instruments. Hence, taking them into account may even reduce their meaningfulness.

In addition to this, we would like to point out that whenever a level 3 instrument (“non-observable inputs”) is e.g. being hedged with a level 2 instrument (“observable inputs”), potential results/analyses may include a distorted presentation.

Furthermore, disclosure of the effects of a potential change in the inputs ties up considerable resources. In addition to this, disclosing figures that constitute – in the final analysis – alternative fair values, calls into question the correctness of the assumed inputs. This suggests a lower degree of reliability (thus also of the fair value itself).

Besides, in practice we could observe but a very limited amount of correlations between the individual inputs from inactive markets. The list of inputs featuring potential correlations equally has to include inputs from inactive markets. Yet, the fluctuations of the latter are also based on estimates. This additionally compromises their meaningfulness.

In addition to this, most readers of financial statements will not benefit since they find it difficult to put information on changes of inputs and their interaction with other inputs into context. This also means that such data will be difficult to comprehend. As a consequence, the cost for disclosure of such information on the part of preparers bears to relation to the potential information benefits for users of financial statements.

Based on the foregoing, we hold the view that the traditional sensitivity analysis currently requested under IFRS 7.27B e) is sufficient and we object to any proposals of the ED/2010/7 that go beyond this.

Question 2: If the effect of correlation between unobservable inputs were not required, would the measurement uncertainty analysis provide meaningful information? Why or why not?

From a theoretical point of view, the desire to disclose information on measurement uncertainties is perfectly understandable. However, we would like to reiterate that the corresponding analyses are extremely complex and that they are encumbered by a high degree of subjective assumptions and uncertainties. This makes an interpretation and comparability of the analysis results more difficult. Hence, we are concerned that even experts and analysts may run the risk of misinterpreting these outcomes. The current Exposure Draft stipulates that correlations, too, have to be taken into account during analyses of changes. This would make such analyses extremely dependent upon the underlying correlation assumptions meaning that
such analyses would even be more open to misinterpretations. The definition and specification of correlation assumptions is the outcome of analytical processes. The disclosure of alternative figures – based on specific experiences and assessments that are typical for the individual company – does not lead to any more decision-useful information. This is due to the fact that the disclosed information cannot be compared across different companies.

The same holds true for disclosures of additional, alternative figures which neither correspond to those figures which are being used for internal purposes nor those which are being audited, certified and reported externally.

*Question 3: Are there alternative disclosures that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorised within Level 3 of the fair value hierarchy that the Board should consider instead? If so, please provide a description of those disclosures and the reasons why you think that information would be more useful and more cost-beneficial.*

In our view, the analysis of the measurement uncertainties proposed in the form of the present ED/2010/7 does not constitute any improvement or, moreover, alternative to the traditional information requirements concerning sensitivities currently requested under IFRS 7.27B e). Neither are the current proposals an option that would be feasible and easily understood by users of financial statements. At this juncture, as far as sensitivity analyses are concerned, we explicitly suggest keeping the current level of disclosure.

Yours sincerely,

For

ZENTRALEN KREDITAUSSCHUSS
Deutscher Sparkassen- und Giroverband
For and on behalf

Pia Jankowski
Exposure Draft ED/2009/5: Fair Value Measurement

Dear Sir David,

Thank you for the opportunity to comment on the exposure draft “Fair Value Measurement”. We welcome the proposed harmonisation of the fair value definition within a standard and the endeavours to converge with US GAAP with the aim of establishing globally consistent accounting standards. We nevertheless have reservations about some of the exposure draft’s proposals.

Although this exposure draft addresses the definition of fair value and not which instruments are to be measured at fair value, the latter issue cannot be totally disregarded in the current circumstances (IASB projects on revising IAS 39). The uncertainty at present concerning the overall form of final standards and the interdependence of current consultations (e.g. the discussion paper “Credit Risk in Liability Measurement”) mean that we are unable to provide any definitive responses at this stage. The comments in this letter are consequently of a preliminary nature.

Our replies to your questions are as follows:
Question 1

The exposure draft proposes defining fair value as ‘the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date’ (an exit price) (see paragraph 1 of the draft IFRS and paragraphs BC15–BC18 of the Basis for Conclusions). This definition is relevant only when fair value is used in IFRSs.

Is this definition appropriate? Why or why not? If not, what would be a better definition and why?

We would like to begin with a few general observations.

Business model

In our view, the basis for determining the relevance of a valuation method should be the business model, and not factors such as product-specific details of instruments. This will enable users of financial statements to adequately assess the past and future performance of the entity and forecast future cash flows.

- If the entity intends both to trade financial instruments and to manage the associated risks on a fair value basis, an exit price is appropriate.
- In other cases (e.g. for loans issued by the entity which are not intended for trading), we do not consider the exit price appropriate (see in this connection also our reply to question 2).

We believe that a more precise definition is needed if misunderstandings and ambiguities are to be avoided. The term “exit value/price” should only be used if the exit price really represents the fair value (i.e. if an “exit strategy” generally exists).

Exit price – entry price

We are not of the opinion that the difference between the entry and exit price is due only to transaction costs. Differing perceptions of market participants also play a major role.
A difference between the two prices could consequently result in the immediate recognition of a loss which is not justified from an economic perspective (e.g. in the case of strategic acquisitions). The price for an instrument may also differ from that within a portfolio. For this reason, the blockage factor for assets and liabilities should be taken into account (see also our reply to question 12). Differences between the entry and exit price are likely to be even more marked in illiquid markets.

Transaction costs
Under paragraph 16, transaction costs are not to be considered when determining fair value. Transportation costs, by contrast, are to be taken into account. We consider this distinction too simplistic to apply to financial instruments. Certain costs associated with financial instruments are similar to transportation costs and are relevant to determining the most advantageous market. We find it illogical that such costs should be excluded if the most advantageous market entails higher transaction costs than other markets. It would be appropriate, and also provide more relevant information, to include these costs in such cases.

Question 2
In three contexts, IFRSs use the term ‘fair value’ in a way that does not reflect the Board’s intended measurement objective in those contexts:

(a) In two of those contexts, the exposure draft proposes to replace the term ‘fair value’ (the measurement of share-based payment transactions in IFRS 2 *Share-based Payment* and reacquired rights in IFRS 3 *Business Combinations*) (see paragraph BC29 of the Basis for Conclusions).

(b) The third context is the requirement in paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement* that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid (see paragraph 2 of the draft IFRS and paragraph BC29 of the Basis for Conclusions). The exposure draft proposes not to replace that use of the term ‘fair value’, but instead proposes to exclude that requirement from the scope of the IFRS.
Is the proposed approach to these three issues appropriate? Why or why not?
Should the Board consider similar approaches in any other contexts? If so, in which context and why?

a) We consider it appropriate to replace the term “fair value” in IFRS 2 and IFRS 3 as proposed.

b) One aim of the fair value measurement project was to clearly define the term “fair value”. This term should therefore not be used for something which does not correspond to fair value. The value of a liability with a demand feature pursuant to IAS 39.49 does not constitute a fair value (exit price) because it cannot exceed the nominal value; it should consequently be given a different designation. In addition, the question arises in general as to why the IASB has excluded IAS 39.49 from the scope of this exposure draft.

Furthermore, IFRSs contain other examples where the term “fair value” used so far does not correspond to the exit price. That goes particularly for financial instruments which are recognised initially at fair value pursuant to IAS 39.43 but subsequently measured at amortised cost, such as loans and receivables. In accordance with the existing provisions of IAS 39 and customary practice, the fair value of such instruments when they are initially recognised corresponds to an entry price. Day 1 gains and losses are therefore not recognised. There are differences between the entry and exit price, e.g. in the case of loans issued by an entity, as banks operate on different markets for issuing and selling loans. Initial recognition of these financial instruments at the exit price pursuant to amended IAS 39.43A would lead to reporting of day 1 gains and losses if the inputs used in measurement are observable. This approach would be inconsistent with the guidelines for the recognition of loan origination fees (IAS 18.1E.14.a(i)). In subsequent valuation of the loan, these are deferred at amortised cost and recognised by way of an adjustment to the effective interest rate. We therefore recommend amending IAS 39.43 so that financial instruments which are not subsequently measured at fair value are initially recognised at their entry price.

We also wish to point out that fair value measurement of sight and savings deposits is closely linked to the question of inclusion of such deposits in hedge accounting. For this reason, the issue should be discussed during phase 3 of revision of IAS 39 (hedge accounting).
Question 3

The exposure draft proposes that a fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access (see paragraphs 8–12 of the draft IFRS and paragraphs BC37–BC41 of the Basis for Conclusions). Is this approach appropriate? Why or why not?

For entities which operate globally, several markets may exist for a single instrument. Problems will arise in such cases when trying to determine the relevant/most advantageous market. In the first sentence of paragraph 9 it is correctly stated that different reporting entities (and businesses within these reporting entities) may conduct different activities and have access to different markets. It should therefore be made clear also in the second sentence of paragraph 9 that the most advantageous market is something that should be assessed from the perspective of the reporting entity or the business within the reporting entity.

Question 4

The exposure draft proposes that an entity should determine fair value using the assumptions that market participants would use in pricing the asset or liability (see paragraphs 13 and 14 of the draft IFRS and paragraphs BC42–BC45 of the Basis for Conclusions). Is the description of market participants adequately described in the context of the definition? Why or why not?

We basically agree with the description (paragraph 13 of the exposure draft also uses the existing definition of fair value). The report published in autumn 2008 by the IASB Expert Advisory Panel provides corresponding guidance. We nevertheless believe that the entity’s assumptions should take priority if markets are illiquid and the (possible) assumptions of other market participants have no relevance. There are also no clear guidelines on how the (possibly hypothetical) assumptions of other market participants are to be derived. Assumptions about assumptions would not produce meaningful, decision-useful information. In addition, we refer in connection with the measurement of liabilities to our response to the IASB discussion paper “Credit Risk in Liability Measurement”, in which we stated that in our
view full fair value measurement is only appropriate in some cases and should depend on each entity’s individual business model.

**Question 5**

The exposure draft proposes that:

(a) the fair value of an asset should consider a market participant’s ability to generate economic benefit by using the asset or by selling it to another market participant who will use the asset in its highest and best use (see paragraphs 17–19 of the draft IFRS and paragraph BC60 of the Basis for Conclusions).

(b) the highest and best use of an asset establishes the valuation premise, which may be either ‘in use’ or ‘in exchange’ (see paragraphs 22 and 23 of the draft IFRS and paragraphs BC56 and BC57 of the Basis for Conclusions).

(c) the notions of highest and best use and valuation premise are not used for financial assets and are not relevant for liabilities (see paragraph 24 of the draft IFRS and paragraphs BC51 and BC52 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

There are various situations in practice in which the “highest and best use” premise can also be relevant to valuing financial instruments. One example is economic hedges for financial assets. We therefore consider the application of a “value in use” approach generally appropriate for financial instruments as well.

We take an extremely critical view of prohibiting the “highest and best use” premise for financial instruments, as it could be implicitly concluded that valuation adjustments at portfolio level are also no longer allowed. Such portfolio valuation adjustments are permitted as things stand under IAS 39.AG72 (“When an entity has assets and liabilities with offsetting risks, it may use the mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate.”). This concerns, for example, valuation adjustments with regard to counterparty risk in derivative transactions covered by a master netting agreement. If the counterparty defaults, the asset or
liability results from the aggregate net derivatives position, i.e. the entity’s credit risk exposure is based on the net risk position vis-à-vis the counterparty. A valuation adjustment is therefore made on the basis of the net risk position, not on an “instrument-on-instrument” basis. We therefore recommend retaining IAS 39.AG72 or providing for the possibility to apply the “in use” valuation premise (cf. US GAAP).

Even when markets are illiquid, we see no compelling reason to preclude the application of the “in use” approach to financial instruments (including liabilities). “In use” measurement would be more appropriate than an exchange price and would provide more relevant information. We would also like to point out that SFAS 157 does not contain any restriction to one method (“in use” vs. “in exchange” premise).

**Question 6**

When an entity uses an asset together with other assets in a way that differs from the highest and best use of the asset, the exposure draft proposes that the entity should separate the fair value of the asset group into two components: (a) the value of the assets assuming their current use and (b) the amount by which that value differs from the fair value of the assets (i.e. their incremental value). The entity should recognise the incremental value together with the asset to which it relates (see paragraphs 20 and 21 of the draft IFRS and paragraphs BC54 and BC55 of the Basis for Conclusions).

Is the proposed guidance sufficient and appropriate? If not, why?

We do not agree with the IASB’s proposed guidance. The example cited in IE5 ff. is a special case. It would be better to provide a more general illustration which makes the underlying principle clearer. In addition, we believe it would be unhelpful and inappropriate to report assets as envisaged by the IASB (current use vs. fair value) when undertaking a portfolio measurement, as is usual practice for banks.
Question 7

The exposure draft proposes that:

(a) a fair value measurement assumes that the liability is transferred to a market participant at the measurement date (see paragraph 25 of the draft IFRS and paragraphs BC67 and BC68 of the Basis for Conclusions).

(b) if there is an active market for transactions between parties who hold a financial instrument as an asset, the observed price in that market represents the fair value of the issuer’s liability. An entity adjusts the observed price for the asset for features that are present in the asset but not present in the liability or vice versa (see paragraph 27 of the draft IFRS and paragraph BC72 of the Basis for Conclusions).

(c) if there is no corresponding asset for a liability (e.g., for a decommissioning liability assumed in a business combination), an entity estimates the price that market participants would demand to assume the liability using present value techniques or other valuation techniques. One of the main inputs to those techniques is an estimate of the cash flows that the entity would incur in fulfilling the obligation, adjusted for any differences between those cash flows and the cash flows that other market participants would incur (see paragraph 28 of the draft IFRS).

Are these proposals appropriate? Why or why not? Are you aware of any circumstances in which the fair value of a liability held by one party is not represented by the fair value of the financial instrument held as an asset by another party?

a) We agree that the fair value of trading liabilities should be based on the transfer value. If the entity does not intend to transfer the liabilities, however, we believe it would make better sense to value them at amortised cost.

b) In principle, we agree. There may nevertheless sometimes be variations between different markets, for example, or because an asset has certain features that the liability does not.

c) We take the view that the fair value of an asset and a liability should be identical as long as the instrument does not contain an option. In the presence of options, differing
risk profiles may result in differences in value. The holder of an equity option, for instance, has invested only a small amount in the instrument; the associated risk is consequently also only minor. The issuer's risk, by contrast, is unlimited. A difference thus arises (also owing to the different risks and associated incentives) between the value of the asset and that of the liability. It would therefore be inappropriate to assign them the same fair value.

**Question 8**

The exposure draft proposes that:

(a) the fair value of a liability reflects non-performance risk, ie the risk that an entity will not fulfil the obligation (see paragraphs 29 and 30 of the draft IFRS and paragraphs BC73 and BC74 of the Basis for Conclusions).

(b) the fair value of a liability is not affected by a restriction on an entity's ability to transfer the liability (see paragraph 31 of the draft IFRS and paragraph BC75 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

(a) In general, liabilities should only be measured at fair value in the following circumstances:

1. to eliminate artificial volatility in earnings if assets which are directly linked to the liabilities are measured at fair value;
2. if it is intended to repurchase debt instruments before their maturity without replacing them with new debt. This is usually the case with trading or other portfolios managed on a fair value basis.

In all other cases, changes in the entity's own credit risk should not be recognised.

(b) Unlike the IASB, we take the view that the fair value of a liability is most certainly influenced by restrictions on the ability to transfer it.
The issue of measuring liabilities at fair value is also addressed in the IASB’s discussion paper “Credit Risk in Liability Measurement”. We would refer you in this context to our response to this paper dated 1 September 2009.

**Question 9**

The exposure draft lists four cases in which the fair value of an asset or liability at initial recognition might differ from the transaction price. An entity would recognise any resulting gain or loss unless the relevant IFRS for the asset or liability requires otherwise. For example, as already required by IAS 39, on initial recognition of a financial instrument, an entity would recognise the difference between the transaction price and the fair value as a gain or loss only if that fair value is evidenced by observable market prices or, when using a valuation technique, solely by observable market data (see paragraphs 36 and 37 of the draft IFRS, paragraphs D27 and D32 of Appendix D and paragraphs BC76–BC79 of the Basis for Conclusions).

Is this proposal appropriate? In which situation(s) would it not be appropriate and why?

We agree with the IASB that in the cases listed the transaction price does not necessarily correspond to the fair value. However, it should be made clear that these are only examples.

We support retention of the existing rules on recognition of day 1 gains and losses (IAS 39.AG76), although the issue was not discussed further under the project since it is not directly related to fair value measurement. In our opinion, the IASB should consider clarifying the conditions for including day 1 gains and losses in more detail.
**Question 10**

The exposure draft proposes guidance on valuation techniques, including specific guidance on markets that are no longer active (see paragraphs 38–55 of the draft IFRS, paragraphs B5–B18 of Appendix B, paragraphs BC80–BC97 of the Basis for Conclusions and paragraphs IE10–IE21 and IE28–IE38 of the draft illustrative examples).

Is this proposed guidance appropriate and sufficient? Why or why not?

We see no need for further guidance. The IASB Expert Advisory Panel published guidelines on this issue in autumn 2008. These are appropriate and sufficient in our view.

**Question 11**

The exposure draft proposes disclosure requirements to enable users of financial statements to assess the methods and inputs used to develop fair value measurements and, for fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period (see paragraphs 56–61 of the draft IFRS and paragraphs BC98–BC106 of the Basis for Conclusions).

Are these proposals appropriate? Why or why not?

We understand the IASB’s thinking behind the proposed disclosures in the notes to make financial statements more transparent. Implementing these proposals would require enormous time and effort, however. What is more, there is a danger that focusing on Level 3 information in the notes would lead users of financial statements to believe that Level 1 and Level 2 were of less relevance. We nevertheless recognise that it makes good sense to disclose an appropriate amount of Level 3 information, as the financial instruments in this category are the most difficult to measure.

We therefore suggest that the IASB should launch a project to develop a framework for disclosures in the notes, in the course of which such disclosures would be examined, reviewed and consolidated. The framework could be developed jointly with the FASB, which recently decided to undertake such an initiative. Instead of additional disclosures in the notes when-
ever a standard is amended, such a framework could ensure more planning security with regard to computer system changes needed.

Details of assumptions about valuation models are only relevant if the entity holds only a few different classes of assets. If an entity had a large number of asset classes, each with a corresponding set of valuation assumptions, it would be extremely onerous to disclose all the envisaged information about each individual class. For users, moreover, the disclosures would be confusing and thus unhelpful. It would be more useful to focus instead on the main processes on which fair value measurement is based.

Furthermore, information about the fair value hierarchy should only have to be disclosed for assets and liabilities which actually are measured at fair value, and not for assets and liabilities whose fair value only has to be indicated in the notes (paragraph 58). Disclosure of the fair value hierarchy for such financial instruments, which would, moreover, have to be made quarterly, is of no relevance for users of financial statements in cost-benefit terms, as these instruments are not managed on a fair value basis and their fair values do not represent the expected earnings from these instruments.

Preparing additional disclosures for the notes to interim financial statements in the form proposed by the IASB would be highly onerous and impracticable. It would be better in our view to limit disclosures to information which differs substantially from that reported in the entity’s annual accounts. This would enable entities to provide users with decision-useful information in a suitable and transparent manner.

A further problem in our view is the proposed disclosure in the notes under paragraph D12 of day 1 gains broken down by the three fair value hierarchy categories. This information is considered to be of no relevance for users by our member banks and is thus also not collected, as the instruments concerned are measured on the basis of observable inputs. The day 1 gain represents the ability of financial intermediaries to operate in different markets and can only be realised if fair value measurement is robust. US GAAP do not contain this requirement either.

Further examples of new disclosure requirements concerning the notes which would often be extremely difficult to meet, yet would deliver little added value to either the entity or the users of its financial statements, are paragraphs 57(c) and 57(e)(iii).
**Question 12**

The exposure draft differs from Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) in some respects (see paragraph BC110 of the Basis for Conclusions). The Board believes that these differences result in improvements over SFAS 157.

Do you agree that the approach that the exposure draft proposes for those issues is more appropriate than the approach in SFAS 157? Why or why not? Are there other differences that have not been identified and could result in significant differences in practice.

We basically support convergence between IFRS and US GAAP, particularly on an issue such as fair value measurement, and welcome it that the definitions of fair value in IFRS and US GAAP are identical. Most of the differences referred to should not lead to different valuations in practice.

We regard the following differences as problematic:

- As already explained in our reply to question 5, we believe that – like under SFAS 157 – the “in use” valuation premise should also be applicable to financial instruments. This is important particularly for the possibility to perform portfolio-based measurement.
- The requirements of SFAS 157 concerning disclosures in the notes, moreover, are more appropriate than those proposed in the exposure draft (see our reply to question 11).
- We also favour the possibility to apply blockage discounts. Even in extremely active markets, large numbers of an instrument cannot be sold on the assumption that the total price obtained will be “value of the individual instrument x number of instruments”. Increased supply, both in economic theory and in practice, leads to falling prices.
Question 13
Do you have any other comments on the proposals in the exposure draft?

No.

Yours sincerely,

Dirk Jager

Ingmar Wulfert