Bundesverband Öffentlicher Banken Deutschlands





via email

Mr Adam Van Eperen Financial Crisis Advisory Group c/o Financial Accounting Standards Board

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Financial Crisis Advisory Group (FCAG) - Comments to the seven questions

Dear Mr. Van Eperen

Please find enclosed our comments to the questions put forward by the FCAG.

 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 unnecessary concerns? Please be as specific as possible in your answers.

Answer:

The financial crisis has shown plainly that general purpose financial reporting for financial instruments has many problems.

- a. According to IAS/IFRS a financial instrument has to be categorised at initial recognition and is principally prohibited from reclassification even when the business intention changes significantly
- b. Through the premises that every derivative has to be recorded and subsequently measured at fair value all hedge items that are hedged through a derivative also have to be valued at fair value. However, in principle the valuation of the hedge instrument i.e. the derivative should follow the valuation of the hedge item.

- c. Fair Value Measurement has shown its limits in inactive markets. Procyclicality is existent and increases the downward spiral of valuation losses without actual losses being realised. The usage of valuation models is generally and wrongly associated with earnings management and there is a deep mistrust of the third level of the fair value hierarchy. We support activities of the FASB to increase the usage of Level 3 valuations.
- 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.

Answer:

We support the start of a discussion about dynamic provisioning in IFRS and US-GAAP. However, it should be noted that the definition of the term is unclear and thus the desired degree of the provision and detailed practical questions concerning recognition, measurement and disclosures need to be examined with great care.

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?

Answer:

In our opinion such a differentiation cannot be observed. One should await the revision of the consolidation requirements of off balance sheet items in ED 10 of the IASB before drawing any further conclusions.

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,

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what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

Answer:

We are of the opinion that the mixed measurement model is imperative and we reject the full fair value measurement approach. The measurement at fair value or accumulated cost should be determined by management intent and not by the type of financial instrument. We emphatically support simplifycations to the mixed measurement model especially with less complex solutions in the area of hedge accounting. Please also consider our response to the discussion paper "Reducing complexities in reporting financial instruments" of the IASB.

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?

Answer:

in concern of IAS 39 we want to point out two aspects as follows:

- a. Management intention determines the categorisation at inception. An enduring change in management intention goes along with a reclassification.
- b. In hedge relationships the valuation principle of the hedged item should determine the valuation of the hedging instrument.
- 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?

Answer:

We refer to the letter of the European Commission to the IASB from 27 October 2008. The direct involvement of the European Commission is urgently needed as the observer status of CESR is not sufficient.

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

Answer:

In the short run we need an intensive discussion about the possibility to reclassify out of the Fair Value Option. Also embedded derivatives as well as financial liabilities have to be treated equally under IFRS and US-GAAP.

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The newest changes to US-GAAP that will most probably take effect already for the first quarter 2009 have to be introduced to IFRS as well. The usage of level 3 valuation measures is limited also in Europe because of the premise of market price over valuation models.

In the long run a key improvement could be made by introducing a component approach to the present fair value option. The basic principle of this approach is to break down a financial instrument into its individual risk components and measure these separately. Risks which are clearly separable and reliably measurable at fair value should then be measured at fair value.

The breakdown should be based on the intended purpose of the instrument and on its internal management. If it were made part of the existing mixed model approach in IAS 39, the proposed component approach would forge a link between fair value and historical cost accounting. Greater alignment of financial reporting and internal risk management would be possible. We believe that this differentiated approach would help to provide investors with decision-useful information.

If you should have any further questions please do not hesitate to contact us.

(har Jerzembek)

Yours sincerely,

Bundesverband Öffentlicher Banken Deutschlands

(Karl Heinz Boos)

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