Federation of European Accountants
Fédération des Experts comptables Européens

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Ref.: BAN/HvD/LF/ID

Dear Sir David,

Re: FEE Comments on IASB Exposure Draft Financial Instruments: Classification and Measurement

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the IASB Exposure Draft Financial Instruments: Classification and Measurement (the "ED").

(2) As a founding organisation of EFRAG we have also contributed to the EFRAG consultation process by submitting the FEE comments on EFRAG's Draft Comment Letter issued on 28 July 2009. EFRAG has not yet issued its final comment letter. We have considered the EFRAG Draft Comment Letter in our response and made reference to the EFRAG draft comments where relevant.

(3) We appreciate the efforts the IASB is making to respond to the financial crisis and the requests of G20 and the Financial Stability Board to making the classification and measurement standard already available for the 2009 financial statements.

(4) FEE supports a complete revision of IAS 39 rather than an ad hoc piecemeal approach of small changes to accommodate market participants' requests. We believe that a piecemeal approach would further increase complexity rather than reduce it. We also underline that a comprehensive approach has been advocated by the Monitoring Board which announced in a press release of 8 June 2009 that "the members of the Monitoring Board support the recent commitments by the International Accounting Standard Board (IASB) to undertake a comprehensive review of the International Financial Reporting Standards (IFRS) relating to financial instruments to address the recent statement from G20 Leaders regarding the need for improvements on the accounting standards on valuation and provisioning."

(5) Ideally such a revision should be done as one comprehensive project in which all interrelated aspects of financial instruments accounting are reviewed at the same time. However, we note the political pressure and time constraints put on the IASB and under these circumstances understand the IASB's pragmatic approach to opt for a revision of IAS 39 in three stages, within a tight timeframe, even though such an approach may have some drawbacks.

(6) Financial instruments classification decisions may depend on the resolution of other projects such as the Financial Statements Presentation and Performance Reporting projects and, in particular for the insurance industry, on the IASB's project on Insurance Contracts. Given the close link between financial instruments and insurance contracts, it would be regrettable if entities within this industry were required to make certain decisions in accounting for financial instruments that prove inadequate when a revised standard on insurance contracts is implemented or if they were forced to change their accounting for insurance contracts to avoid accounting-mismatches in an intermediary phase. Consideration should be given as to whether any special reliefs should be provided in the transition provisions for insurers to allow them to present information in a meaningful way that minimises the accounting mismatches between the measurement of financial assets and insurance liabilities.

(7) FEE, like EFRAG, supports the continued application of a mixed measurement model for financial instruments and agrees with the IASB's conclusion that measuring all financial assets and financial liabilities at fair value is not the most appropriate approach to improving financial reporting for financial instruments (as detailed in the Basis for Conclusions 13).

(8) A reduction in the number of categories, based on a clearer rationale for those categories reflecting the economics behind the financial transactions and the way the business is run and managed, makes it easier for users of financial statements to understand the reported information and it improves the decision-usefulness of financial reporting. Thus, FEE is of the opinion that the business model should be the driving factor in determining what constitutes decision-useful information. Accounting for financial instruments should primarily reflect the way the business is managed. We agree with the conclusions in the Basis for Conclusions 32 that the business model is not a free choice but is a matter of fact that can be observed by the way the entity is managed and the information that is provided to management.

(9) Although we welcome the IASB's attempts to simplify the reporting of financial instruments, we question whether the current proposals constitute a sufficient simplification compared to the existing IAS 39, since also the current proposals have substantive and complex rules-based elements.

(10) A summary of critical comments is presented below, whereas some further observations and the responses to the questions are included in the appendix to this letter:

- The current proposals are in our view product led and the business model is only a secondary consideration resulting in several problems, leading to inconsistencies and creating more rules. We believe that the business model should be the driving principle defining the boundary between the two categories of financial instruments whereas the instrument's characteristics should represent a safeguard for a consistent application of the principle that certain instruments are unsuitable to be managed on a contractual cash-flow basis. The manner in which "managing on a contractual yield basis" is mentioned in the draft could be further clarified in order to prevent abuse or misunderstanding in the practical application. This equally applies as to the level the condition should be applied (business units, portfolios).The proposed guidelines to determine the boundaries of the amortised cost category in combination with the proposed elimination of the embedded derivatives notion for financial instruments could result in profit or loss effects from instruments that are not suitable for fair value measurement. We favour a wider amortised cost category supported by the business model primarily involving holding the instrument to pay or receive cash flows and a reduced fair value category in such a way that only equity instruments and those instruments with contractual fixed cash flows which are leveraged are in the fair value through profit and loss category.

- If classification is based on the business model as discussed by FEE above, it follows that if the entity in rare circumstances decides to change the business model (i.e. the manner in which the entity manages its instruments or certain groups of instruments), reclassification should be required. While this may introduce additional complexity for preparers in making sure any changes are fully disclosed, this seems preferable than continuing to account for instruments in a manner inconsistent with the business model and inconsistent with transactions entered into after the change in business model. Like EFRAG, we do not support the proposed full prohibition of reclassification. We agree with EFRAG that a classification system is at its simplest and most transparent if an instrument is required to be reclassified if it is no longer managed according to the business model that was the basis for its initial classification.

- The "fair value through OCI" option for equity instruments pre-empts the outcome from the performance reporting and financial statements presentation projects. Considering the potential consequences of the proposals and the divergence of opinions of all stakeholders on this sensitive issue, the IASB should consider as an alternative approach in the short term retaining the current AFS category for equities as a third category until the projects on performance reporting and presentation of financial statements have been finalised and agreement on a single performance statement has been reached. The only issue to be considered at this stage is the removal of the prohibition for equity impairment reversal.

- Since the debt securities currently classified as available-for-sale will be mostly reclassified to the amortised cost category and partially to the fair value through profit and loss category, it is our understanding that the proposal solves the critical problems related to the impairment of available-for-sale debt securities raised by the European stakeholders.

(11) The transition provisions of the proposed standard are another critical issue that needs to be considered carefully in particular in the light of early adoption and application by certain industries. The proposals need to be simplified in order to facilitate (early) adoption, and to remove inconsistencies and ambiguities. Early adoption would present a demanding project and early adopters should not be disadvantaged for choices made now. Therefore, we support an approach to transition based on the IFRS 1 requirements for entities that first adopt IAS 39. This would result in the opening balance sheet at, say, 1/1/09 being stated as if the new requirements had always been applied, but would avoid the need to re-create comparatives for earlier periods. See for further details our responses to Question 12 and 13.

(12) The IASB and the FASB should work together in an attempt to reduce any differences and to this effect the IASB should be commended for its intention to expose also the FASB proposals as indicated in the ED. We find it highly unfortunate that at present FASB seems not to be moving at the same pace and in the same direction as the IASB. However, were the FASB to move in a direction that is not meeting the reporting needs of the rest of the world, we believe that IASB should opt for a truly global solution supported by preparers, users and accountants at a global level.

For further information on this letter, please contact Ms. Saskia Slomp, Technical Director.

Yours sincerely,

Hans van Damme
President

Appendix - Responses to the questions in the Invitation to comment of the IASB Exposure Draft Financial Instruments: Classification and Measurement

General comments

(13) The ED appears to put more emphasis on the characteristics of the instrument (basic loan features) than on the business model (contractual yield basis). Like EFRAG, we believe that the approach would be easier to understand and to apply if clear preference was placed on the principles-based business model criterion, with the basic loan features as a second test in determining whether the amortised cost category is allowed.

(14) If the key criterion is the business model (i.e. that the instrument is managed on a contractual yield basis), the test relating to the characteristics of the instrument can focus on eliminating leveraged and other instruments with unpredictable cash flows that clearly do not fit in such a business model. This puts less pressure to define narrowly the characteristics of the instruments that qualify for the amortised cost category.

(15) We believe that amortised cost is the most relevant measurement attribute when the business model followed by the entity is not based on the short-term trading of the instruments but on the creation of predictable long-term cash flows, managed on a contractual yield basis. The use of amortised costs reflects the way in which the business is run and managed and provides the user with information about the likely future cash flows that the reporting entity can anticipate. As such, we welcome the elimination of the held-to-maturity category including its tainting rules and support its replacement with an approach that would result in measurement of financial instruments in a manner that is consistent with the business model accompanied by relevant disclosures.

(16) However, we are concerned that the restrictive characteristics proposed in the ED to define basic loan features will result in recognising financial assets and liabilities at fair value through profit or loss in circumstances where this treatment is neither justified nor relevant. Indeed, the narrow definition of what constitute basic loan features (including the proposals with respect to certain exposures to credit risk such as those in subordinated interests and acquired distressed loans) coupled with the removal of the requirement/ability to bifurcate embedded derivatives will likely result in an increase in the number of instruments that must be recognised at fair value through profit or loss (despite the fact that they are not traded in an active market). When considering financial liabilities, this approach will increase the circumstances where an entity will recognise the impact of changes in its own credit risk in its financial statements.

(17) To address this concern, we suggest the basic loan feature category be extended to include features commonly present in loans to individuals. Examples include extension provisions, payment holidays and indexation to variables (cap or floor or guaranties on capital or interest) to the extent they are not significantly leveraged.

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(18) Where an entity acquires deeply discounted loans as part of its trading strategy, such business model under the proposals of the ED would oblige the entity to apply fair value measurement. However, should that entity acquire a portfolio which includes performing loans and loans which have incurred losses to add to its lending business, we consider these should be measured at amortised cost.

CLASSIFICATION APPROACH

Question 1—Does amortised cost provide decision-useful information for a financial asset or financial liability that has basic loan features and is managed on a contractual yield basis? If not, why?

(19) As noted above in our general comments, we support EFRAG's view that amortised cost provides decision-useful information for a financial asset or liability that has basic loan features and is managed on a contractual yield basis. We believe that amortised cost is the most relevant measurement attribute when the business model followed by the entity is not based on the short-term trading of the instruments but on the creation of long-term cash flows. However, we are concerned that the restrictive characteristics proposed in the ED to define basic loan features will result in recognising financial assets and liabilities at fair value through profit or loss in circumstances where this treatment is neither justified nor relevant.

(20) Like EFRAG, we would like to place clear preference on the business model. However, we believe that it is not simply a matter of reversing the order in which the tests are performed. We believe that the test relating to the characteristics of basic loan features should be developed with the objective in mind of eliminating from the amortised cost category instruments that due to its inherent characteristics cannot be considered to be managed on a contractual yield basis. This is likely to result in a more relevant distinction and in a more principle-based approach than if the model is first developed by trying to establish what constitutes a basic loan feature.

Question 2—Do you believe that the exposure draft proposes sufficient, operational guidance on the application of whether an instrument has 'basic loan features' and 'is managed on a contractual yield basis'? If not, why? What additional guidance would you propose and why?

(21) We agree with EFRAG when it indicates that a key concern is that the manner in which the concepts are developed in the ED is quite rule-based. As indicated before, we are of the opinion that the underlying principles need to be described with more clarity and prominence in order to make the concept operational and to promote consistent and appropriate application.

(22) As presently proposed, the ED does not provide sufficient operational guidance on the application of whether an instrument has "basic loan features" and is "managed on a contractual basis". For example, it is unclear how inflation and instruments with no interest such as receivables are addressed.

(23) We believe that two key aspects on guidance on the application of the above principle need to be addressed: the definition of the basic loan feature; and the role of acquired credit risk in determining whether a loan qualifies for the amortised cost category.

Definition of the basic loan features

(24) We question whether the ED defines loan features broadly enough. We believe that one of the key reasons why the concept is developed in a rule-based manner is that the IASB has attempted to tackle the issue by defining the characteristics of the loans rather than the business model in which such loans would be used. This results in an overly restrictive definition of what constitute a basic loan feature.

(25) Rather than expanding the list of examples of basic loan features, we propose that the IASB provides more principles-based guidance on what is (and is not) a basic loan feature. We would expect that the guiding principle focus on whether the feature creates leverage. Indeed, we believe that a basic loan feature is a feature that does not create significant leverage compared to the conditions that existed initially and cannot result in an investor losing its investment (the carrying amount of the loan on an accrued basis). This guiding principle would ensure that certain standard loan features that would not qualify as basic loan features under the ED would appropriately be treated as such. These features include: extension provisions, payment holidays and indexation to variables other than to an interest index (such as inflation, cap or floor or guarantees on capital or interest) to the extent that they are not significantly leveraged.

Role of credit risk in determining whether a loan qualifies for the amortised cost category

(26) We also believe that the IASB should reconsider the impact of exposure to credit risk on determining whether a loan qualifies as a basic loan, more specifically in two respects: the impact of subordination and the acquisition of a loan with incurred losses.

(27) With respect to the impact of subordination, the ED appears very form driven; subordination in an instrument does not disqualify the loan from the amortised cost category but subordination through a waterfall structure in an entity does. Even though we recognise that there are advantages to the proposals of the ED in that it is simpler, we still consider that adopting a look-through approach may be preferable in cases where the preparer holds the required information. Consequently, if the information is not available or not reliable, the fallback option would require to measure the instrument at fair value through profit or loss.

(28) As discussed above, we consider that the concept of substance over form should take precedence over the drive to simplification. If a special purpose vehicle ("SPV") exists merely to hold instruments which, if taken on an individual basis, would be measured at amortised cost, the investor controlling the SPV should account for it at amortised cost – the "look through approach". This principled approach will have the consequential benefit of deterring "artificial" financial engineering.

(29) With respect to financial assets acquired at a discount that reflects incurred credit losses, we do not believe that the deep discount on these loans should be considered as not representing a basic loan feature. This discount reflects only "the time value of money and the credit risk associated with the principal outstanding amount" as indicated in paragraph B1 and as further described in paragraph B3(iv) of the ED. It appears inconsistent to disqualify purchased distressed loans from the amortised cost category but at the same time permit such a classification for loans originated to a subprime borrower or for securities issued by non-investment grade entity.

(30) As noted by EFRAG in paragraph 25 of its draft letter, it appears inconsistent to introduce a distinction between incurred and expected losses in this ED while working on eliminating this difference in the IASB project on the expected loss model.

(31) If the IASB was to maintain its views on distressed loans, it would be useful if the IASB explained whether an entity that acquires distressed loans as part of a business combination would be able to maintain the amortised cost category established by the acquiree prior to the business acquisition.

Additional comments

(32) We believe that the application of the basic loan feature definition needs to be developed considering how they would apply to long-term structured debt instruments that finances the reporting entity. This is also noted by EFRAG in paragraph 30 of its draft letter. As noted above, we believe that what is required is principles-based guidance. In this respect, we also refer to our letter dated 31 August 2009 to EFRAG commenting on the IASB Discussion Paper Credit Risk in Liability Measurement.

Question 3—Do you believe that other conditions would be more appropriate to identify which financial asset or financial liabilities should be measured at amortised cost? If so,

(a) What alternative conditions would you propose? Why are those conditions more appropriate?

(b) If additional financial assets or financial liabilities would be measured at amortised cost using those conditions, what are those additional financial assets or financial liabilities? Why does measurement at amortised cost result in information that is more decision-useful than measurement at fair value?

(c) If financial assets or financial liabilities that the exposure draft would measure at amortised cost do not meet your proposed conditions, do you think that those financial assets or financial liabilities should be measured at fair value? If not, what measurement attribute is appropriate and why?

(33) We believe that the criteria should be improved in three key areas:

- Providing priority to the business model and redefining the basic loan features as a secondary criterion as we further explained in our response to Question 2;
- Reinstatement of the requirement to bifurcate embedded derivative in financial liabilities: this is further explained in our response to Question 4(a);
- Ensuring that similar exposures to credit risk are treated similarly in determining whether the exposure is a “basic loan feature”: this is further explained in our response to Questions 2 and 4(b).

EMBEDDED DERIVATIVES

Question 4(a)—Do you agree that the embedded derivative requirements for a hybrid contract with a financial host should be eliminated? If not, please describe any alternative proposal, explain how it simplifies the accounting requirements and how it would improve the decision-usefulness of information about hybrid contracts.

(34) We are of the opinion that the long term objective of a principles-based standard should be a single classification approach for hybrid contracts with financial hosts and agree in this respect with the direction of the IASB proposals to eliminate bifurcation of embedded derivatives for both assets and liabilities. This would avoid the complexity surrounding the concept of embedded derivatives.

(35) However, further considerations are needed before a final decision is taken as to whether embedded derivative requirements for a hybrid contract with a financial host are eliminated, for the following reasons: (1) we are concerned that the problematic “closely related” assessment in IAS 39 may merely be replaced with an equally difficult assessment of whether a hybrid contract has a “basic loan features”, and (2) as long as the existing requirements for hybrid contracts with non-financial hosts remain in place, the accounting treatment of like transactions is not consistent, thus impairing comparability and giving rise to structuring opportunities.

(36) Moreover, the subject of embedded derivatives cannot be disassociated from the accounting treatment of own credit risk in liability measurement. The increase of the use of fair value – since the whole instrument is to be fair valued – could result in circumstances in which the results of the reporting entity are affected by changes in its own credit risk. To avoid or minimise such situation until the own credit risk treatment is resolved and to decrease the number of non-tradable financial liabilities at fair value, the bifurcation option could be currently retained for financial liabilities. This will not reduce the complexity in the short term, but it will allow for a more comprehensive debate around the classification and measurement of financial liabilities.

(37) Like EFRAG, we believe that the bifurcation of embedded derivatives should be optional if it were to be retained. We agree with this view as far as it relates to liabilities.

Question 4(b)—Do you agree with the proposed approach regarding the application of the proposed classification approach to contractually subordinated interests (eg tranches)? If not, what approach would you propose for such contractually subordinated interests. How is that approach consistent with the proposed classification approach? How would that approach simplify the accounting requirements and improve the decision-usefulness of information about contractually subordinated interests?

(38) We agree with EFRAG's decision in its draft letter not to support the proposal because it represents an oversimplification that is not principles-based.

(39) As we noted in our response to Question 2, this proposal appears to be very form driven; subordination in an instrument does not disqualify the loan from the amortised cost category but subordination through a waterfall structure in an entity does.

(40) Credit risk is an integral part of loan features. Accordingly, we believe that the credit risk inherent in a multiple tranches structure should be, like other credit risk features, evaluated to assess whether it represents a basic loan feature. We would expect that in some of the structures the credit risk attached to subordinated interest would be considered as a basic loan feature even if the interest does not represent the most senior tranche.

(41) While we recognise that adopting a look-through approach is necessarily more difficult, we believe that the result of such an approach would be superior and more reflective of the substance of an arrangement. Accordingly, to the extent that the required information is available to apply such an approach, we believe that a look-through approach should be adopted.

FAIR VALUE OPTION

Question 5—Do you agree that entities should be permitted to designate any financial asset or financial liability at fair value through profit or loss if such designation eliminates or significantly reduces an accounting mismatch? If not, why?

(42) Like EFRAG, we support the proposal to retain the fair value option to mitigate an accounting mismatch. We believe that in addition to allowing a fair value option to mitigate an accounting mismatch, the fair value option should be retained for instruments with embedded derivatives (to the extent that the IASB reconsiders its decision to prohibit bifurcation). Furthermore, if entities adopt the proposed standard before all final requirements for financial instruments are issued, it may be necessary to allow entities to re-consider their use of the fair value option on transition to the final requirements. A similar reconsideration of the fair value may be needed for insurers when the final standard on insurance contracts is applied.

(43) However in general we support the prohibition of subsequent reclassification of financial instruments measured at fair value following the use of the fair value option unless rare circumstances where such reclassification would be required due to the change in the business model.

Question 6—Should the fair value option be allowed under any other conditions? If so, under what other conditions should it be allowed and why?

(44) We would not be in favour of providing a free choice to use the fair value option and we would underline that in general free options are undesirable. There should not be choice between the categories, particularly since it would mean, under the business model approach that items managed at amortised cost are classified at fair value. If the instrument meets the criteria it should be in the category concerned. There could be an exception but not a general option. At this stage, it seems logical that the fair value option is only needed to address accounting mismatches. However, as the requirements in other areas, for example hedge accounting, become clearer, it may become apparent that a wider fair value option is necessary.

RECLASSIFICATION

Question 7—Do you agree that reclassification should be prohibited? If not, in what circumstances do you believe reclassification is appropriate and why do such reclassifications provide understandable and useful information to users of financial statements? How would you account for such reclassifications?

(45) Like EFRAG, we do not support the proposed prohibition on reclassification. If classification is based on the business model, as supported by FEE, it follows that, if the entity in rare circumstances decides to change the manner in which it manages its instruments, reclassification should be required. We agree with EFRAG that a classification system is at its simplest and most transparent if an instrument is required to be prospectively reclassified if the business model basis for its initial classification has changed since its initial recognition. For example, if an entity's business model is to trade certain instruments and the market becomes illiquid, the entity may be forced to change its business model in response to this extraordinary situation. In such a circumstance, it would be appropriate to reclassify the instruments from a fair value category to an amortised cost category (provided all criteria are met).

(46) We believe that the ED prohibition on reclassification represents a contradiction in the ED, since the ED supports the business model for initial classification.

(47) We specifically disagree with the Board's view that prohibiting reclassification will enhance comparability. This could result in two entities with the same business model managing a financial instrument in exactly the same way but required to use different measurement bases. It is difficult to see how this mismatch enhances comparability.

(48) We note that it is the business model that is the determining factor rather than management intent. Accordingly, as noted by EFRAG in paragraph 67 of its draft letter, we believe that reclassification would only occur in rare circumstances. We believe that the circumstances leading to reclassification should be very clearly established (and supported by transparent disclosure) to ensure that (i) users understand the circumstances that led to the reclassification and the accounting consequences of the reclassification, (ii) the reclassification is auditable and (iii) regulators can evaluate the impact of the reclassification.

(49) We note that the IASB proposal to prohibit reclassification seems to contradict the October 2008 amendments. We agree with the analysis provided in paragraph 68 of the EFRAG draft letter of that situation.

INVESTMENTS IN EQUITY INSTRUMENTS THAT DO NOT HAVE A QUOTED MARKET PRICE AND WHOSE FAIR VALUE CANNOT BE RELIABLY MEASURED

Question 8—Do you believe that more decision-useful information about investments in equity instruments (and derivatives on those equity instruments) results if all such investments are measured at fair value?

(50) We agree with the IASB that more decision-useful information about investments in equity instruments can result if all such investments are measured at fair value, provided the fair values can be determined reliably. However, we have concerns whether all entities are able to determine reliable fair values in all circumstances.

(51) In our view the requirement to value all equity instruments at fair value will need to be supported by additional guidance on measurement of private equity investments. The IASB might consider publishing guidance based on the work of the International Valuation Standards Council (akin to the publication by the Expert Advisory Panel).

Question 9—Are there circumstances in which the benefits of improved decision-usefulness do not outweigh the costs of providing this information? In such circumstances, what impairment test would you require and why?

(52) In practice, there may sometimes be difficulties in obtaining the necessary information to be used in models for unquoted equities and significant costs may have to be incurred to determine fair values. However, the benefits for users of the fair value information would be in most if not all circumstances outweigh the efforts required by preparers and therefore the exception should be retained only as a last resort.

INVESTMENTS IN EQUITY INSTRUMENTS THAT ARE MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

Question 10—Do you believe that improved financial reporting results when fair value changes for particular investments in equity instruments are presented in other comprehensive income? If not, why?

(53) The OCI option proposed by the IASB does not appear to have a conceptual basis until it is backed-up by the conclusions in the performance reporting and financial statements presentation projects. We are concerned that the option will be difficult to apply in practice since it may lead to applying different accounting to the same instrument purchased at different times. It would also introduce significant risk of cherry picking.

(54) We question the purpose of introducing an option that carries such severe consequences on those that chose to apply the option (i.e. no returns in profit or loss) that is unlikely that many entities will opt for this treatment. The IASB should consider as an alternative approach in the short term retaining the current AFS category with recycling strictly for equities as a third category until the projects on performance reporting and presentation of financial statements have been finalised and agreement on a single performance statement has been reached. The only issue to be considered is at this stage is the removal of the provision for equity impairment reversal.

(55) The Discussion Paper on Presentation did not address OCI in a satisfactorily way and did not address how to deal with fair value changes. It did not clarify what belongs in the profit or loss account and what belongs in OCI. The "fair value through OCI" option for equity instruments should not pre-empt the outcome of the performance reporting and financial statement projects. These projects should articulate the purpose of OCI and types of gains and losses that are appropriate to be presented in that statement, if there would continue to be two separate performance statements.

Question 11—Do you agree that an entity should be permitted to present in other comprehensive income changes in the fair value of any investment in equity instruments (other than those that are held for trading), if it elects to do so only at initial recognition? If not:

(a) What principle do you propose to identify those for which presentation in other comprehensive income is appropriate?
(b) Should entities present changes in fair value in other comprehensive income only in the periods in which the investments in equity instruments meet that principle?

(56) We would not be in favour of providing a free choice and we would underline that in general free options are undesirable. Since we propose that the business model becomes the driving principle defining the classification, we argue that this principle should also be consistently applied for the initial recognition of equity instruments. Consequently, subsequent changes should be allowed and required only under rare circumstances provided the business model changes. Full disclosure of reasons and effects of such change would need to be required.

EFFECTIVE DATE AND TRANSITION

Question 12—Do you agree with the additional disclosure requirements proposed for entities that adopt the proposed IFRS early? If not, what would you propose instead and why?

(57) We do not support the additional disclosure requirements proposed for early adopters. We support a simplification of the transition provisions and related disclosures compared to those currently proposed. We support an approach to transition based on the IFRS 1 requirements for entities when they first adopt IAS 39. In all cases, and not just on early adoption, there should be reconciliation between the closing balance sheet using the existing IAS 39 and the opening, restated balance sheet with explanations for the main changes in classification and measurement.

Question 13—Do you agree with the proposed transition guidance? If not, why? What transition guidance would you propose instead and why?

(58) We are of the opinion that the transition provisions need to be simplified in order to facilitate (early) adoption and to remove inconsistencies and ambiguities. As drafted the transition provisions are not practical and risk to discourage early adopters. As discussed above, we support an approach to transition based on the IFRS 1 requirements for entities that first adopt IAS 39. In all cases, and not just on early adoption, there should be a reconciliation between the closing balance sheet using the existing IAS 39 and the opening, restated balance sheet with explanations for the main changes in classification and measurement. In our view, this reconciliation would provide more useful and understandable information than restated comparatives with the benefit of hindsight.

AN ALTERNATIVE APPROACH

Question 14—Do you believe that this alternative approach provides more-decision useful information than measuring those financial assets at amortised cost, specifically: (a) In the statement of financial position? (b) In the statement of comprehensive income? If so, why?

(59) No, we do not believe that the alternative approach provides more decision-useful information than measuring those financial assets at amortised cost. Under IFRS 7, there is already a requirement to present fair values for financial instruments valued at amortised cost. Hence we do not agree with the requirement to include fair values in the statement of financial position. Recognising fair values in the statement of financial positions when the financial instruments are not held for trading or otherwise managed on a fair value basis results in less meaningful income statement information and additional complexity in dealing with items in the statement of comprehensive income.

Question 15—Do you believe that either of the possible variants of the alternative approach provides more decision-useful information than the alternative approach and the approach proposed in the exposure draft? If so, which variant and why?

(60) We do not support either the alternative approach or possible variants to that approach and do not believe that either of the possible variants of the alternative approach provides more decision-useful information. It is difficult to envisage a variant of the alternative approach that would be consistent with the aim of reducing complexity.

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