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14th September 2009

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David,

Re: Exposure Draft 2009/7 Financial Instruments: Classification and Measurement

We appreciate the opportunity to comment on the exposure draft mentioned above.

General Remarks

We acknowledge IASB's attempt to reduce the complexity of IAS 39. However it is our firm conviction that the essential problems of fair value accounting will not be resolved even by the extended guidance in ED Fair Value Measurement. We oppose IASB's intension to expand the procyclical effects of fair value accounting. Just the experience of the financial crisis has shown that fair value measurement produces useful information only under perfect market conditions. In the past the majority of fair values has been determined by using highly judgemental model based valuations rather than transaction prices in liquid and efficient markets. Thus in our mind fair value should only be applied in narrow situations rather than as the default category for financial instruments.

We recommend restricting the mandatory use of fair value for trading activities in efficient active markets and for derivative instruments without hedging purposes.

Furthermore our proposal to limit fair value measurement on trading activities in efficient active markets would support the two category approach by making it depend more on the entity`s business model rather than the characteristics of the individual instruments.

In our mind the objective and structure of the whole IAS 39 project is still too vague and lacks coordination with parallel regulatory reforms. We demand more efforts to address the overall objective of financial system stability according to the calls of the G 20 and the Financial Stability Board.

We urge the Board to respect the Guiding principles for the revision of accounting standards for financial instruments issued by the Basel Committee on 27. August

2009. Fair value accounting should not be extended. Accounting standards and regulatory requirements should be aligned as far as possible. However, as a minimum, we encourage the IASB to perform impact studies in this regard.

We consider the three-part division of the project as inappropriate, as the implications of many regulations can only be assessed together with the rules for impairment and for hedge accounting. The time frame for implementation should be extended by far.

Answers to IASB's questionnaire

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?

Yes, in line with the Board we believe that amortised cost provides decision-useful information for a financial asset or financial liability. For the traditional lending business amortised cost measurement provides reliable, comparable and understandable information, especially regarding cost-benefit aspects. Regarding the proposed criteria for amortised cost classification please note our comment on question 2.

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?

No, we consider the proposed criteria 'basic loan features' and 'managed on a contractual yield basis' as impractical and too restrictive. The terms are vague in content and need further practical guidance. Moreover, for traditional loan businesses, which are internally often managed and reported on a present value basis, we see the danger of extension fair value accounting on those activities.

We also reject a categorisation methodology depending on the contractual characteristics of the instrument and the type of internal monitoring. Our proposal to restrict fair value accounting only to trading activities in efficient active markets would focus more on the entity's business model and the allocation of instruments to the business segment of 'trading'.

We complain that under current IAS 39 model-based estimation of fair values has became a prevalent valuation method for financial instruments. Thus we disagree with the IASB proposal to extend fair value classification and encourage a default classification at "amortised cost" with a very narrow defined exemption for the fair value category. The fair value category should be permitted only for trading activities, as well as for derivatives without a hedging purpose. Precondition would be a short-term trading intention in an efficient active market.

In the past the majority of fair values has been determined by using highly judgemental model based valuations rather than transaction prices in liquid and efficient

markets. Model-based fair value accounting leads to unacceptable reliability with remote usefulness of the amounts presented, but extensive use of judgement by the preparers of financial statements. We plead to stop this negative development in IFRS accounting.

Question 3

Do you believe that other conditions would be more appropriate to identify which financial assets 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?

We refer to our answer to question 2. According to our proposal the amortised cost categorisation should be the default category and fair value classification should be the exemption, limited to trading activities in efficient active markets and derivatives without hedging purpose.

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 and explain how it simplifies the accounting requirements and how it would improve the decision-usefulness of information about hybrid contracts.

No, we do not agree that the elimination of the current separation requirement will resolve the existing problems. In the case of ‘plain vanilla’ embedded derivatives the separation provides reliable results. For more complex structured products a fair value can only be determined using model based valuation techniques. The financial crisis has shown that model based valuations are not decision-useful and highly judgemental.

However the problematic definition of hybrid instruments will remain. We complain the retention of the current separation requirements for non-financial transactions.

(b) Do you agree with the proposed application of the proposed classification approach to contractually subordinated interests (ie 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 decisionusefulness of information about contractually subordinated interests?

With regard to subordinated tranches we do not agree with the Board that these tranches do not have basic loan features. Although subordinated tranches provide credit protection and receive a higher return, they can still have basic features, because the contractual terms of such tranches are representing a claim on cash flows on specified dates that are payments of interest and principal.

Question 5

Do you agree that entities should continue to 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?

In a mixed model (fair value and amortised cost) there is a need for the elimination of accounting mismatches of instruments with a perceived economic relationship. As a solution simplified and practicable hedge accounting rules should be developed. In this connection we consider it to be appropriate that hedging derivatives will not be recognised at fair value. As a consequence no fair value option would be needed.

Question 6

Should the fair value option be allowed under any other circumstances? If so, under what other circumstances should it be allowed and why?

We refer to our answer to question 5. With regard to the fair value measurement of own liabilities, in our view changes in own credit spreads should be eliminated.

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, and why?

No, we do not agree. A reclassification should be mandatory in rare circumstances when active markets become permanently inactive and in case of changes in the business strategy. Substantive evidence should be required to demonstrate these rare circumstances. A change in management intent only is too vague for a reclassification.

Reclassifications should only be permitted from the trading category into the amortised cost category, not vice-versa.

Transfers should be made at the latest reported amount accompanied by appropriate disclosure.

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? If not, why?

We do not agree that a full fair value accounting does provide reliable and useful information for equity instruments.

This proposal lacks feasibility due to not available fair values for unquoted shares. Holders of minority interests typically do not have sufficient information to perform a reliable assessment of fair values. Furthermore we reject IASB's proposal under cost-benefit considerations because it will extremely increase reporting burden for the preparers.

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Most equity instruments are held as long term strategic investments, therefore information needs concerning fair values are rare. Instead at cost measurement has proofed as adequate accounting method.

Question 9

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

We refer to our answer to question 8. An impairment loss can be determined as the difference between the asset's carrying amount and the best estimate of the amount the entity would receive for the asset if it would be sold at the reporting date.

Question 10

Do you believe that presenting fair value changes (and dividends) for particular investments in equity instruments in other comprehensive income would improve financial reporting? If not, why?

No, in our mind the proposed presentation is not justified but would extend management judgement. In general we are opposed to presenting valuation gains and dividends in other comprehensive income because users of the financial statements misunderstand and misinterpret this presentation.

In addition, insurance companies may face in particular problems to map their business model to the financial statements and new accounting mismatches might incur.

Question 11

Do you agree that an entity should be permitted to present in other comprehensive income changes in the fair value (and dividends) of any investment in equity instruments (other than those that are held for trading), only if it elects to do so at initial recognition? If not, (a) how do you propose to identify those investments for which presentation
in other comprehensive income is appropriate? Why? (b) should entities present changes in fair value in other comprehensive income only in the periods in which the investments in equity instruments meet the proposed identification principle in (a)? Why?

We disagree with a presentation in other comprehensive income and would like to refer to our answer to question 10.

Question 12

Do you agree with the additional disclosure requirements proposed for entities that apply the proposed IFRS before its mandated effective date? If not, what would you propose instead and why?

We are opposed to allow the earlier application of the first part of the new IAS 39 ‘Classification and Measurement’ without the implications of the following steps ‘hedging’ and ‘impairment’.

Question 13

Do you agree with applying the proposals retrospectively and the related proposed transition guidance? If not, why? What transition guidance would you propose instead and why?

We believe that a retrospective application is impracticable and too costly.

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?

We do not believe that the alternative approach provides more decision-useful information. As stated in our response to question 2, we reject an extension of fair value accounting.

Question 15

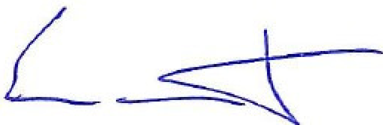
Do you believe that either of the possible variants of the alternative approach provides more decision-useful information than the alternative approach and the approach proposed in the exposure draft? If so, which variant and why?

We do not believe that either of the possible variants of the alternative approach provides more decision-useful information.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact us.

Yours sincerely,

DGRV - Deutscher Genossenschafts- und Raiffeisenverband e.V.



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