bankenverband
BUNDESVERBAND DEUTSCHER BANKEN

Sir David Tweedie
Chairman
International Accounting
Standards Board
30 Cannon Street
EC4M 6XH LONDON
GROSSBRITANNIEN

Ref. H 3.9
Contact Ingmar Wulfert
Tel. +49 30 16 63 21 20
Fax +49 30 16 63 21 99
E-mail Ingmar.wulfert@bdb.de

20 April 2009

Request for views on FASB staff positions

Dear Sir David,

Thank you for the opportunity to comment on the FASB staff positions, published on 9 April 2009: FSP FAS 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions That Are Not Orderly", and FSP FAS 115-2 and FAS 124-2 "Recognition and Presentation of Other-than-temporary Impairments".

A key problem in the current environment is how to value assets in an illiquid or inactive market. Since IFRS provide no exact definition of when a market may be deemed inactive, it is extremely difficult, if not sometimes impossible, for banks to demonstrate – especially to their auditors – that such a market exists. Against this background, autumn 2008 saw the IASB published a set of guidelines based on the findings of its Expert Advisory Panel. These guidelines were welcomed by the German private banks (cf. our comment letter to the IASB of 6 October 2008). We believe they contain an appropriate summary of possible approaches to measuring the fair value of financial instruments in inactive markets and are a useful addition to the previously issued guidelines and valuation requirements. The FASB guidance takes up certain aspects of the Expert Advisory Panel's findings and presents them in a shortened form.

The IASB guidelines make it clear that various fair values of a financial instrument may exist and not just a single "true" value. We strongly support this view. We consequently also expressly welcome the statement in the guidelines that the choice of method for measuring fair value should continue to be at the discretion of each individual entity as long as existing standards are complied with. This discretion covers selecting a suitable valuation model, specifying the associated assumptions and adjusting them, if necessary, to new market conditions, and evaluating the reliability of available information.

It is essential to avoid a divergence of IFRS and US GAAP or of interpretations of the standards. The boards should continue to promote the convergence of the two accounting regimes.

Our specific comments are as follows:

1) FSP FAS 157-4: Determining whether a market is not active and a transaction is not distressed

This guidance, now adopted by the FASB, first requires the use of various factors (e.g. lack of sufficient recent transactions, substantial price variations) to determine whether or not the market for a financial instrument is active. If it is established that the market is not active, fair value should not necessarily be determined by transactions or quoted prices. Under FAS 157-4, further analysis and certain adjustments are required in order to arrive at a fair value. At the same time, it cannot be concluded solely from a significant reduction in trading volumes or market activity that a transaction is not orderly. Paragraph 16 mentions examples of criteria which may indicate that a transaction is not orderly. Nevertheless, an entity is not compelled to make every conceivable endeavour to obtain the relevant information. Data that may be accessed without excessive time and effort must not be ignored, however.

FAS 157-4 does not prescribe any particular model for measuring fair values. It nevertheless points out that their calculation should incorporate risk premiums which other market participants would also take into account. These risk premiums should take account of an orderly transaction (i.e. no distressed sales) between market participants on the measurement date at current market conditions.

In our view, the IASB guidelines "Using judgment to measure the fair value of financial instruments when markets are not longer active – an IASB staff summary", together with the findings of the IASB Expert Advisory Panel, cover much of the same ground as the FASB proposals and, moreover, are more helpful. Decisions should be based on management judgement – a principle already firmly enshrined in the IASB guidelines ("An active market is one in which transactions are taking place regularly on an arm's length basis. What is 'regularly' is a matter of judgement and depends upon the facts and circumstances of the market for the instrument being measured at fair value."). Nevertheless, given that it is sometimes extremely difficult to demonstrate the existence of an inactive market to auditors, in particular, it might be beneficial to enable entities to determine that markets are inactive with a more reasonable amount of time and effort and on a more factual basis than at present.

In addition, the IASB guidelines clarify that a transaction price in an inactive market will not necessarily indicate a fair value ("Transaction prices in inactive markets might be inputs when measuring fair value, but may not be determinative.").The same also applies to broker quotes.

All in all, we take the view that any changes to guidelines should aim at enhancing the credibility of fair value accounting. It is essential to avoid a situation in which the confidence of investors in financial reporting is undermined.

Irrespective of the above arguments, we firmly believe that there should be no discrepancy between IFRS and US GAAP with respect to the definition of "fair value" and application guidelines since this could place European banks at a competitive disadvantage compared to their US counterparts. We continue to support the objective of establishing globally uniform accounting standards. We would like to draw attention in this context to the Boards press statement of 24 March 2009, which announces further cooperation against the backdrop of the financial crisis.

2) FSP FAS 115-2 and FAS 124-2

Unlike IFRS, US GAAP make a distinction between impairments of loans and impairments of securities. FASB's adopted proposals all relate to the impairment of securities. Under US GAAP, a security is impaired if its market value is less than its cost. The impairment only has to be recognised as a loss, however, if it is not merely of a temporary nature ("other-than-temporary impairment", OTTI). When FASB's proposals are implemented, entities will be required in this case to state that they do not intend to sell the securities in question and that it is unlikely that they will be forced to sell them before their cost basis has been recovered (change of demonstration methodology).

This change only affects preparers of US GAAP accounts, so we will not go into it further.

The second change relates to the treatment of impaired debt securities. Up to now, the entire impairment has had to be recognised as a loss. In future, only the amount related to a credit loss will have to be recognised in the profit and loss account while the remaining portion will be included in other comprehensive income.

We believe this could be used as a basis for harmonising impairment rules for financial instruments in the available-for-sale and loans and receivable categories. We therefore welcome the Boards' announcement on 24 March 2009 that they wish to pursue this approach further. Efforts to move forward with the convergence of accounting standards should also cover standards concerning impairment. Care should nevertheless be taken to ensure that such standards are principles-based and that IFRS avoid adopting any rules-based requirements from US GAAP.

Yours sincerely,

Hans-Joachim Massenberg   Dirk Jäger