bankenverband
BUNDESVERBAND DEUTSCHER BANKEN

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

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Exposure Draft: "Investments in Debt Instruments – Proposed Amendments to IFRS 7"

Dear Sir David,

Thank you for the opportunity to comment on the above exposure draft. The draft is particularly important in view of the current financial turmoil since appropriate and transparent disclosures about financial instruments will go a long way towards restoring confidence in the financial markets.

We welcome the disclosure of high-quality, detailed information in the notes. Care should nevertheless be taken to avoid information overkill. This would actually lead to less transparency because potentially relevant information would be more difficult to identify or would even risk getting lost altogether in the resulting "disclosure jungle". The disclosures proposed by the IASB would not reflect management intent. Furthermore, there is a danger that the disclosure of certain data might paint a distorted picture of the entity's situation and thus mislead the users of financial reporting.

We have very serious reservations about the proposed introduction of additional fair value information for debt instruments which are not recognised at fair value in profit or loss. We reject the proposal to require entities to disclose what the impact on pre-tax results would be if all debt instruments were measured at fair value. This would do nothing to solve the existing problems. The classification and thus the measurement of financial instruments depend on the business models and holding strategies associated with the particular instrument in question (management intent). The fact that financial instruments in the loans and receivables and held-to-maturity categories are not reported at fair value implies that the entity's management does not intend to realise short-term gains resulting from market fluctuations. The proposed additional disclosures would neither provide users with useful information about the entity's situation and performance nor improve their understanding of the financial statements. We would also refer you in this context to the German banking industry's comments of 19 September 2008 on the discussion paper "Reducing Complexity in Reporting Financial Instruments".

Our comments on the questions set out in the exposure draft are as follows:

Disclosure of simulated effects on pre-tax results (Question 1):

The exposure draft proposes in paragraph 30A(a) to require entities to disclose the pre-tax profit or loss as though all investments in debt instruments (other than those classified as at fair value through profit or loss) had been (i) classified as at fair value through profit or loss and (ii) accounted for at amortised cost. Do you agree with that proposal? If not, why? What would you propose instead, and why?

We are highly critical of the proposal in paragraph 30A to require entities to disclose pre-tax profit or loss as though all debt instruments had been measured at fair value. Simulating the influence of the fair value accounting of long-term financial instruments which are not held for trading produces misleading information. This applies especially to non-tradable instruments if the simulated sale on which the market valuation is based does not correspond to the entity's actual business strategy. In cases where a financial instrument is carried at amortised cost to generate sustained cash flow, reporting the hypothetical influence of fair value measurement on the entity's pre-tax results will not provide decision-useful information about its financial situation. As the proposed requirements only comprises investments in debt instruments and includes no liabilities the information on profit or loss can be mis-leading as well as fragmentary. Furthermore, the presentation, in isolation, of the fair values of hedged financial instruments has no information value whatsoever since the singular effect on profit or loss indicated in the notes will not actually be felt by the entity. This gives a distorted view of its real financial situation, which can give rise to misinterpretations on the part of users. Given the number and heterogeneous nature of financial instruments about which little or no market information is available, the question also arises as to whether the "market prices" thus calculated could be realised in practice. Experience during the financial turmoil has shown that this is not always the case in illiquid markets. Measuring all financial instruments at fair value does not, therefore, deliver meaningful and relevant information.

The grounds cited in the exposure draft for introducing the proposed changes are also questionable, in our view. The IASB states that those taking part in the round-table meetings suggested disaggregating impairment losses on available-for-sale debt instruments into credit-related impairments and pure fair value changes. It is not clear why this means that instruments measured at amortised cost, for instance, should have to be reported at full fair value in the notes. Especially where these positions are concerned, it makes sense for only credit-related changes (impairment trigger) to be shown in profit or loss since market price fluctuations tend to even themselves out over time. The exposure draft consequently misses its actual objective.

It would make far more sense, in our view, to recognise the incurred impairment loss portion – determined in the same way as for debt instruments measured at amortised cost using the incurred loss model – in profit or loss. The remainder of the fair value change should then be recognised in other comprehensive income. Before modifying the rules in such a way, however, it is essential to follow due process and allow an adequate period for comment.

Reconciliations (Question 2):

The exposure draft proposes to require disclosing the pre-tax profit or loss amount that would have resulted under two alternative classification assumptions.

Should reconciliations be required between profit or loss and the profit or loss that would have resulted under the two scenarios? If so, why and what level of detail should be required for such reconciliations?

For the reasons mentioned above, we also reject reconciliations between actual and simulated profit or loss. Such reconciliations have no informative value and would serve no useful purpose. After all, no company reconciles its actual results to simulated results based on transactions which might have been executed (or not executed).

Summary of measurement bases (Question 3):

The exposure draft proposes in paragraph 30A(b) to require entities to disclose for all investments in debt instruments (other than those classified as at fair value through profit or loss) a summary of the different measurement bases of these instruments that sets out (i) the measurement as in the statement of financial position, (ii) fair value and (iii) amortised cost.
Do you agree with that proposal? If not, why? What would you propose instead, and why?

IFRS 7.25 ff. already requires entities to disclose a fair value for each class of financial assets and liabilities so that these may be compared with the book values. We consider these existing requirements appropriate and sufficient as things stand. We would welcome further disaggregation as long as it provided users and investors with information which was relevant to their decision-making and gave them a better insight into the entity's financial situation.

Effective date and transition (Questions 5 and 6):

Do you agree with the proposed effective date? If not, why? What would you propose instead, and why?

Are the transition requirements appropriate? If not, why? What would you propose instead, and why?

The proposed effective date (annual periods ending on or after 15 December 2008) is over-ambitious in our view. We do not believe it would be feasible to implement the proposed changes in such a short period of time. It is highly questionable whether information "cobbled together" so hastily – most entities are in the middle of preparing their 2008 accounts – could be of much value.

Yours sincerely,

Dirk Jäger　　　　　　Ingmar Wulfert