UBS AG
Postfach
CH-8098 Zürich
Tel. +41-1-234 11 11

William Widdowson
Stockerstrasse 64
Zurich
Tel. +411-234-5565
Fax +411-234-2044
william.widdowson@ubs.com

www.ubs.com

Andrea Pryde
Assistant Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

October 22, 2004

ED-7, Financial Instruments: Disclosures

Dear Ms Pryde:

UBS AG welcomes the opportunity to provide comments on ED 7, *Financial Instruments: Disclosures*. We support the IASB's initiative to continually improve financial reporting. UBS acknowledges the need to develop principles for enhanced transparency regarding an entity's exposure to risks and how those risks are managed. We hope you find our comments useful.

UBS supports the IASB's objective to include all financial instrument disclosures in one standard and to remove inconsistencies and duplications. However, we have concerns regarding the volume of qualitative and quantitative risk data that will be included in the financial statements and their general usefulness to understanding the amounts reported on the face of the balance sheet and income statement.

UBS supports the objective of the ED to require entities to provide disclosures that enable users to understand the significance of financial instruments and the nature and extent of risks arising from those instruments. However, the proposed requirement to disclose summary quantitative data based on information provided to key management could be excessive for those entities that have sophisticated risk management systems (i.e. those preparers with the most sophisticated risk reporting systems would appear to be mandated to disclose more detailed data than those with less well developed risk reporting systems). We believe that an entity's management should be able to determine the extent of disclosures necessary to enable readers to assess its risk management policies and position based on the nature and extent of the financial instruments shown in their financial reports and the principles of relevance, understandability, reliability and comparability as set out in the IASB Framework. As a result, we recommend that the ED replace the requirement to disclose summary quantitative data based on information provided to key management, with a general principle that management must disclose sufficient information to enable readers to understand the nature and extent of risks arising from financial instruments. We believe that this objective can be achieved without requiring an entity to disclose the enormous quantity of risk information that is provided internally to key management.

We are also concerned that the ED requires all disclosures related to financial instruments to be included in the primary financial statements. We believe that information about how management manages risk may be better suited to disclosure outside the core financial statements, such as in the Management Discussion and Analysis or in the Operating and Financial Review Document (unaudited). We note that this is the practice of US GAAP preparers and believe that IFRS preparers would be faced with significant additional compliance costs (compared to their US peers) if required to provide this information within their audited financial reports.

We have included responses to the specific questions asked in **Appendix A** of this letter.

We hope you find our comments useful. Should you wish to speak with us on this topic, your contacts are Ralph Odermatt, Managing Director (+41 1 236-8410) and John Gallagher, Executive Director (+1 203 719-4212).

Regards,

UBS AG

William Widdowson
Managing Director
Group Tax and Accounting Policies

Ralph Odermatt
Managing Director
Accounting Policies and Support

Appendix A

Question 1 – Disclosures relating to the significance of financial instruments to financial position and performance

The draft IFRS incorporates disclosures at present contained in IAS 32 *Financial Instruments: Disclosure and Presentation* so that all disclosures about financial instruments are located in one Standard. It also proposes to add the following disclosure requirements:

(a) financial assets and financial liabilities by classification (see paragraphs 10 and BC13).
(b) information about any allowance account (see paragraphs 17 and BC14).
(c) income statement amounts by classification (see paragraphs 21(a), BC15 and BC16).
(d) fee income and expense (see paragraphs 21(d) and BC17).

Are these proposals appropriate? If not, why not? What alternative disclosures would you propose?

We support the IASB's project to incorporate all disclosures about financial instruments into one standard. However we would like to highlight the following issues and concerns with certain proposed disclosures.

Paragraph 31(c) of the exposure draft requires an entity to disclose whether its financial statements include financial instruments whose fair value is measured using a valuation technique based on assumptions not supported by observable market prices or rates. We would like to highlight that this wording is inconsistent with IAS 39 paragraph AG76, which requires use of data from observable markets. The wording of para 31(c) is based upon the proposed fair value hierarchy in the Amendments to the IAS 32/39 Exposure Draft published in June 2002, which is different from the fair value hierarchy in the IAS 39 (Revised) Standard published in December 2003.

Further, we believe that the requirement in paragraph 31(c) to provide an analysis of changes in variables may be misleading for users as it undermines the validity of fair value measurement. In accordance with the IAS 39 fair value hierarchy, fair value determined using a valuation technique should use observable inputs. If observable inputs are not available, the transaction price is the best evidence of fair value. Therefore, the reported fair value of any instrument valued in accordance with the provisions of IAS 39 is by definition the best estimate of fair value and the most relevant number to use. Ignoring any practical problems of conducting this analysis, the requirement contradicts the fair value hierarchy, will confuse users and will undermine the understandability of the numbers reported in the financial statements.

Question 2 – Disclosure of the fair value of collateral and other credit enhancements

For an entity's exposure to credit risk, the draft IFRS proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable (see paragraphs 39, 40, BC27 and BC28). Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?

We do not believe that this requirement is practical nor do we believe that this is useful information for users of financial statements. Collateral can exist in many forms and may include financial and non-financial instruments. Determining the fair value of each instrument would be impractical, especially for those entities that have mortgage portfolios. For example, in order to determine the fair value of real estate property or non-stationary property (e.g. aircrafts, ships) an entity would have to physically evaluate each property on a continual basis. Current industry practice is to re-value such property only periodically and when the underlying loan becomes impaired. As such, we believe that the fair value of collateral should only be disclosed when there is a possibility it will be drawn on. We note that quantitative disclosure may result in a competitive disadvantage, as entities would give away proprietary information regarding the markets they operate in and the transactions undertaken. It should be sufficient to provide a qualitative overview of the types of collateral held and the general policies for determining collateral requirements.

Further, we believe that the requirement in Implementation Guidance paragraph 13 to disclose credit risk in accordance with IAS 32 offset rules (i.e. gross exposure to assets and liabilities) will not result in a true presentation of credit exposure as it does not consider master netting agreements. This method presents information with a liquidity risk focus, not a credit focus. For example where a Master Netting Agreement is in place assets and liabilities would be offset for credit purposes but would not necessarily meet IAS 32 disclosure requirements. Gross disclosure of these positions would not adequately represent an entity's exposure to risk. As such, we propose that IG 13 be amended to permit the effect of master netting agreements to be disclosed.

Question 3 – Disclosure of a sensitivity analysis

For an entity that has an exposure to market risk arising from financial instruments, the draft IFRS proposes to require disclosure of a sensitivity analysis (see paragraphs 43, 44 and BC36-BC39). Is the proposed disclosure of a sensitivity analysis practicable for all entities? If not, why not and what, if any, alternative disclosures of market risk would you propose to meet the stated objective of enabling users to evaluate the nature and extent of market risk?

UBS believes that it is practical for all entities that have exposure to market risk from financial instruments to produce a sensitivity analysis. Risk management techniques have advanced to a point where it is practical for all entities to produce this information at a reasonable cost. We believe that a sensitivity analysis will improve the transparency and understandability of an entity's financial position. However, the introduction of the requirement to disclose "the effects of reasonable possible changes in the relevant risk variable" introduces an element of subjectivity into the disclosure, which may impair comparability and reliability between entities or reporting periods. Risk is adaptive and needs to change with the economic environment and management views and concerns. It should be noted that some entities are already required by regulators to assess risk (e.g. VaR for Banks). This highlights the comparability problem, as models used tend to be entity specific. Conflicting definitions between regulators and the accounting standards would make reconciliation between risk sensitivity disclosures and the balance sheet difficult. We recognize the importance of disclosing this information however do not agree that this should be included in the core financial statements.

Sensitivity analysis could be misunderstood due to the increased complexity and the presentation of both the accounting view and the risk management view in the same section of the financial statements. Such information will prove to be very difficult to audit as it involves significant assumptions, which are not easily reconciled to financial information prepared in accordance with IFRS. It should also be noted that IFRS preparers would be at a competitive disadvantage to US GAAP preparers who generally disclose this type of information outside the core financial statements. We would recommend that these types of disclosures be produced, but be included in either the MD&A or Operating and Financial Review Document (unaudited). For SEC registrants there is an increasing distinction between disclosure within the core financial statements (being subject to SOX 302 certification etc.) and disclosure elsewhere. We do not support disclosure requirements which would put IFRS preparers at a disadvantage to their US peers.

Question 4 – Capital disclosures

The draft IFRS proposes disclosure of information that enables users of an entity's financial statements to evaluate the nature and extent of its capital. This includes a proposed requirement to disclose qualitative information about the entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance (see paragraphs 46-48 and BC45-BC54). Is this proposal appropriate? If not, why not? Should it be limited to only externally imposed capital requirements? What, if any, alternative disclosures would you propose?

We do not agree that these disclosures should be made, as an entity's own capital is not a financial instrument. We also do not believe that the financial statements are the appropriate place to disclose internal capital targets and the entity's compliance to those targets. Internal capital targets will not be comparable among entities and could lead institutions to change behavior in order not to breach these targets.

We support the disclosure of regulatory minimum requirements but would object to disclosing any regulatory capital requirement that has been imposed. The disclosure of imposed capital requirements and consequences of non-compliance are very sensitive issues, which may be misinterpreted by readers unfamiliar with regulatory capital concepts. A technical breach of a regulatory capital requirement, which may be easily remedied, could cause significant confusion to users of financial statements. Regulators in certain jurisdictions may also prohibit companies from disclosing breaches of regulatory imposed capital.

Question 5 – Effective date and transition

The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged (see paragraphs 49 and BC62-BC67). Entities adopting IFRSs and the draft IFRS for the first time before 1 January 2006 would be exempt from providing comparative disclosures for the draft IFRS in the first year of adoption (see Appendix B, paragraph B9). Are the proposed effective date and transition requirements appropriate? If not, why not? What alternative would you propose?

We agree with the proposed effective date and transition provisions.

Question 6 – Location of disclosures of risks arising from financial instruments

The disclosure of risks arising from financial instruments proposed by the draft IFRS would be part of the financial statements prepared in accordance with International Financial Reporting Standards (see paragraph BC41). Some believe that disclosures about risks should not be part of financial statements prepared in accordance with IFRSs; rather they should be part of the information provided by management outside the financial statements. Do you agree that the disclosures proposed by the draft IFRS should be part of the financial statements? If not, why not?

We are concerned about the inclusion of such voluminous and detailed information in the audited portion of the financial statements. UBS currently prepares a substantial management discussion and analysis (MD&A) which is included as part of our financial report, but is outside the audited financial statements. Although the IASB framework does not currently define where this information should be disclosed, best practice has been to disclose this outside the financial statements. If the Exposure Draft is approved, a significant quantity of information will be moved to the audited report. UBS does not believe that the IASB should mandate inclusion of this information in the audited report. We believe that the minimum disclosures in the Exposure Draft are reasonable, but also believe that it is unreasonable to include them in the primary financial statements. This would put IFRS preparers at a disadvantage relative to their US peers who include this information in the MD&A section. We are also concerned about the additional time and resources that would be needed to produce the significantly increased level of information.

Question 7 – Consequential amendments to IFRS 4 (paragraph B10 of Appendix B)

Paragraph B10 of Appendix B proposes amendments to the risk disclosures in IFRS 4 *Insurance Contracts* to make them consistent with the requirements proposed in the draft IFRS. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by the draft IFRS. The Board's reasons for proposing these amendments are set out in paragraphs BC57-BC61.

Do you agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS? If not, why not and what amendments would you make pending the outcome of phase II of the Board's Insurance project?

We agree that the risk disclosures for insurance contracts should be consistent with the requirements for financial instruments.

Question 8 – Implementation Guidance

The draft Implementation Guidance accompanying the draft IFRS suggests possible ways to apply the risk disclosure requirements in paragraphs 32-45 (see paragraphs BC19, BC20 and BC42-BC44). Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

We believe that the implementation guidance is sufficient.

Question 9 – Differences from the Exposure Draft of Proposed Statement of Financial Accounting Standards *Fair Value Measurements* published by the US Financial Accounting Standards Board (FASB).

The FASB's Proposed Statement of Financial Accounting Standards *Fair Value Measurements*, which is open for public comment at the same time as this Exposure Draft, proposes guidance on how to measure fair value that would apply broadly to financial and non-financial assets and liabilities that are measured at fair value in accordance with other FASB pronouncements. That Exposure Draft proposes disclosure of information about the use of fair value in measuring assets and liabilities as follows:

(a) For assets and liabilities that are remeasured at fair value on a recurring (or ongoing) basis during the period (for example, trading securities)
   (i) the fair value amounts at the end of the period, in total and as a percentage of total assets and liabilities,
   (ii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and
   (iii) the effect of the remeasurements on earnings for the period (unrealised gains or losses) relating to those assets and liabilities still held at the reporting date.

(b) For assets and liabilities that are remeasured at fair value on a non-recurring (or periodic) basis during the period (for example, impaired assets), a description of

(i) the reason for remeasurements,
(ii) the fair value amounts,
(iii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and
(iv) the effect of the remeasurements on earnings for the period relating to those assets and liabilities still held at the reporting date.

Disclosures similar to (a)(ii) above are proposed in paragraph 31 of the draft IFRS (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a).

Do you agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to the draft IFRS would you propose?

We agree that the disclosures proposed in the Exposure Draft provide adequate fair value information and do not believe that it s necessary to include additional disclosures at this time.

Question 10 – Other comments
Do you have any other comments on the draft IFRS, Implementation Guidance and Illustrative Examples?

As stated in the main response letter, we have reservations with the extent of quantitative disclosures that may be interpreted to be required under the ED. We believe that the requirement to disclose summary quantitative data based on information provided to key management should be replaced with a general principle that management must disclose sufficient information to enable readers to understand the nature and extent of risks arising from financial instruments. We believe that this is necessary due to the enormous quantity of risk information that is provided internally to key management.

Data provided to management are generally proprietary and includes strategic business information. Disclosing this information will put entities with a strong risk management function at a competitive disadvantage to those with a less robust function and to those that are not required or not permitted to provide such disclosures such as US GAAP reporting entities.

Information provided to management may not be based on IAS accounting rules. Risk assessment systems are generally different from accounting systems. It may be difficult to reconcile certain risk disclosures to the amounts reported on the balance sheet. Users may have difficulty understanding why the figures disclosed in the risk section do not easily reconcile to the figures presented on the face of the balance sheet.

Information provided to management is generally forward looking. Assumptions and scenarios are generally used to quantify certain risks for management, and much of that information is based on future forecasts. Financial statements report the position of an entity at a specific point in time and are not intended to be forward-looking. For that reason, the US Securities and Exchange Commission (SEC) prohibits the inclusion of forward-looking statements in the audited financial statements.