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Organización Internacional de Comisiones de Valores
International Organisation of Securities Commissions
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Organização Internacional das Comissões de Valore

July 19, 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Exposure Draft on *Fair Value Option for Financial Liabilities*

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft on *Fair Value Option for Financial Liabilities* (the Exposure Draft or the ED).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General Observations

Overall Observation

As we communicated in our response to the Board's Discussion Paper, *Credit Risk in Liability Measurement*, we appreciate the difficulty in determining both the appropriate role of credit risk in subsequent measurement of a liability and the best way of communicating to financial statement users all relevant information related to it. We can understand the usefulness of contractual liability amounts to an investor in projecting the issuer's future cash flows and, at the same time, we can appreciate the value of understanding the extent of the opportunity that arises from credit risk effects on the amount at which those obligations could be currently discharged.

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Under the proposals in the Exposure Draft, we note that the proposed determination as to whether the opportunity to currently discharge an obligation at less than its contractual amount due to changes in credit risk of the issuer is reflected in profit or loss depends on whether the liability is held for the purpose of trading and on whether it is a derivative (and, under the alternative proposal, on whether excluding credit risk from profit or loss would create a mismatch). While our members generally prefer the concept behind the Board's proposal over the Board's alternative proposal, some members are concerned that the difficulty in measuring changes in credit risk may result in a loss of comparability between entities because credit risk is inextricably entwined with other inputs to a fair value measurement.

Coherent Reporting of all Financial Instruments

Given the Board's phased approach toward a comprehensive and improved solution to the accounting for financial instruments that will result in IAS 39, *Financial Instruments: Recognition and Measurement*, being replaced by IFRS 9, *Financial Instruments*, (IFRS 9) we believe it is important that the Board fully consider whether the completed standard will result in coherent reporting of all financial instruments. To that end we note that the proposed classification and measurement of financial liabilities would not be based on the same criteria under the proposals as the Board has utilized for financial assets under IFRS 9. We encourage the Board to enhance paragraphs BC8(a) and BC13 in the Exposure Draft to provide further reasoning on its decisions regarding any intended differences between the two.

Evaluation of Embedded Derivatives

We observe that the guidance for evaluation of embedded derivatives in IAS 39 would remain applicable to financial liabilities under the Exposure Draft and that this differs from the guidance in IFRS 9 for determining whether embedded features preclude a financial asset from being measured at amortized cost. Therefore, similar embedded features will be evaluated differently – and have different impacts on the financial statements – simply based on whether the host contract is classified as a financial asset or financial liability. In addition, the explanations for the Board's decisions about embedded features in paragraph BC8(c) of the Exposure Draft are not consistent with the explanations for the Board's decisions about embedded features in IFRS 9 (for example, paragraphs BC54 and BC56). For these reasons, we believe the Board should expand its discussion in paragraph BC8(c) to address the inconsistencies that will remain in the new standard.

Responses to Board's Questions

Question #1: *Do you agree that for all liabilities designated under the fair value option, changes in the credit risk of the liability should not affect profit or loss? If you disagree, why?*

Question #2: *Or alternatively, do you believe that changes in the credit risk of the liability should not affect profit or loss unless such treatment would create a mismatch in profit or loss (in which case, the entire fair value change would be required to be presented in profit or loss)? Why?*

Question #8: *For the purposes of the proposals in this exposure draft, do you agree that the guidance in IFRS 7 should be used for determining the amount of the change in fair value that is attributable to changes in a liability's credit risk? If not, what would you propose instead and why?*

We generally agree that for liabilities designated under the fair value option, changes in credit risk of the liability should not affect profit or loss. Some SC1 members, however, are concerned that the benefits to investors of excluding such changes from profit or loss may be outweighed by a loss of comparability between entities that may result because credit risk is inextricably entwined with other inputs to a fair value measurement, and thus not easily measured and excluded. Thus, quantifying changes in a liability's credit risk such that it can be excluded from profit or loss would be difficult in practice. Should the Board decide to exclude from profit or loss the portion of the fair value change of a liability that is attributable to changes in credit risk, then we believe IFRS 7, *Financial Instruments: Disclosure*, provides appropriate measurement guidance. Considering the complexities involved in determining fair value measurements, we appreciate the need for the flexibility provided by IFRS 7 for quantifying changes in a liability's credit risk component, and we submit that transparency in financial reporting would be improved by augmenting disclosures to provide more specificity regarding the method used.

We also generally agree that for liabilities designated under the fair value option pursuant to paragraph 9(b) of IAS 39, *Financial Instruments: Recognition and Measurement*, attaining the highest degree of alignment between the recognition and reporting of the assets and that of the liabilities is desirable. While the ED presents an alternative approach under which the proposals in the ED would be required unless they would create a mismatch in profit or loss, it is not clear to us the population of scenarios to which the alternative approach would apply. For example, some potential scenarios in which the liability is designated at fair value through profit or loss based on eligibility under paragraph 9(b) of IAS 39 include:

- (a) If the financial liability is designated at fair value due to an "accounting mismatch" as defined in paragraph 9(b), would the alternative approach be applicable whenever a mismatch between counterparties occurs? For example, the credit risk associated with an entity satisfying its own obligations differs from the credit risk of parties to whom the issuer has lent money.
- (b) If the financial liability is designated at fair value due to an "accounting mismatch" as defined in paragraph 9(b), would the alternative method be applicable if the financial liability is a financial liability of a consolidated bankruptcy-remote special purpose entity whose creditors have no recourse to other assets of the reporting entity? Would the result change if market participants priced such liabilities taking into consideration the possibility that the parent may choose to support the credit of the entity for reasons other than contractual requirements to do so?
- (c) If the financial liability is designated at fair value due to an "accounting mismatch" as defined in paragraph 9(b), would the alternative method be applicable if the related asset is an investment in an equity instrument that the reporting entity has irrevocably elected to present in other comprehensive income pursuant to paragraph 5.4.4 of IFRS 9, *Financial Instruments* (i.e., a presentation mismatch rather than a measurement mismatch)?

Some members are concerned that the alternative approach could reduce comparability between entities in certain situations by effectively permitting an entity to choose whether to recognize changes in credit risk either in other comprehensive income or in profit or loss. For example, an entity might meet more than one of the three eligibility criteria for the fair value

option, so if the scope of the alternative proposal were to be based on one of those criteria, an entity may indicate under which criteria its election was made based on its preference to present changes in credit risk either in other comprehensive income or in profit or loss.

Question #3: *Do you agree that the portion of the fair value change that is attributable to changes in the credit risk of the liability should be presented in other comprehensive income? If not, why?*

Question #6: *Do you believe that the effects of changes in the credit risk of the liability should be presented in equity (rather than in other comprehensive income)? If so, why?*

Should the Board decide to exclude the portion of the fair value change that is attributable to changes in the credit risk of the liability from profit or loss, then we agree that such amount should be presented in other comprehensive income. We believe that categories of equity other than the elements of comprehensive income are well-understood by investors as including the effects of transactions with shareholders in their capacity as shareholders; therefore, we believe that investors would find recognition of changes that inform about a non-shareholder transaction in one of those categories to be confusing.

Question #4: *Do you agree that the two-step approach provides useful information to users of the financial statements? If not, what would you propose instead and why?*

Question #5: *Do you believe that the one-step approach is preferable to the two-step approach? If so, why?*

Should the Board decide to exclude from profit or loss the portion of the fair value change that is attributable to changes in the credit risk of the liability, then we agree that the two-step approach provides useful information. Although such information would be available to investors under either approach, the two-step approach increases transparency in financial reporting because it presents on the face of the statement of comprehensive income the entire change in fair value of liabilities. It also increases cohesiveness of the financial statements consistent with the Board's ongoing joint project with the FASB related to Financial Statement Presentation.

Question #7: *Do you agree that gains or losses resulting from changes in a liability's credit risk included in other comprehensive income (or included in equity if you responded 'yes' to Question 6) should not be reclassified to profit or loss? If not, why and in what circumstances should they be reclassified?*

We believe investors generally do not consider gains or losses recognized in other comprehensive income to be equivalent to those recognized in profit or loss. Therefore, we believe that gains or losses resulting from changes in a liability's credit risk should be reclassified from other comprehensive income to profit or loss when those gains or losses are realized through the liability being extinguished prior to its maturity.

Question #9: *Do you agree with the proposals related to early adoption? If not, what would you propose instead and why? How would these proposals address concerns about comparability?*

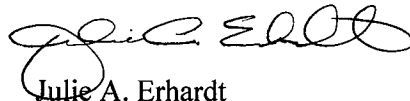
Question #10: *Do you agree with the proposed transition requirements? If not, what transition approach would you propose instead and why?*

We agree with the proposals related to the effective date and transition of the Exposure Draft.

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We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,



Julie A. Erhardt
Chairman
IOSCO Standing Committee No. 1