

Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2009:19

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

Dear Sirs,

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

This is the Swedish Financial Reporting Board's response to your invitation to comment on the Exposure Draft (ED) regarding Classification and Measurement of financial instruments.

We appreciate the efforts for simplification of a complex standard. However, as mentioned in our comment letter on Derecognition, simplification should not be made at a significant loss of relevance. Our opinion is that true simplification will never be achieved until a standard for financial instruments makes it possible to align business intent and risk management with the requirements for financial reporting. We believe that true simplification could be achieved if the unit of account could be reconsidered for financial instruments. There are normally multiple purposes with the holding of different risk components in a single contract, some is are held until final maturity while other may be actively traded. In other circumstances a financial liability may be directly linked to several different financial assets as well as to one or several derivative contracts. The ED fails to develop a proposal for a relevant allocation of financial instruments to the two different measurement categories because the focus is on the single instrument. Furthermore, by proposing some simple rules for the allocation into the amortised cost or the fair value categories, incentives for tailor made solutions that achieve the result that an entity strives for is created. To avoid that several rules needs to be developed. Those rules will make the standard equally complicated to apply as is the case today and will fail to achieve a relevant simplification of the standard for financial instruments.

Classification Approach

We believe that the starting point for classification should be the business intent and not, as proposed, the nature of the instrument. Once the business intent has been clarified it should be less complicated to thereafter allocate financial instruments to the amortised cost or to the fair value measurement categories.

Our basic opinion is that financial contracts that are managed on a contractual yield basis normally should be measured at cost while financial assets and liabilities that are part of a trading portfolio normally should be measured at some kind of fair value.



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We believe that the ED in some respect has started to develop an approach in the right direction but the actual proposals are, however, not workable. E.g. there is a move in the wrong direction not to allow/require a separation of the host contract from an embedded derivative contract. As the ED is presently written there will be a totally different classification result depending on if an entity has made one derivative contract and one loan agreement compared with if the entity has put in the derivative contract directly into the loan agreement. We fail to see how such classification rules will make IAS 39 less complicated to understand for the users of the financial statements.

Instead a business intent approach should be proposed complemented with a change in the unit of account based on the business intent. This would result in the same kind of risk positions being measured in the same way regardless of how the legal documents and the transactions had been structured. We believe that such solutions would achieve an actual simplification for the users of the financial statements.

Fair value option

As long as there is a mixed measurement approach and as long as the present complicated hedge accounting rules still exist, there is a need to keep the fair value option.

However, as stated in the beginning of this comment letter, there is normally a mixed purpose of holding single financial instruments. Therefore, the fair value option should also be allowed to be used for components of financial instruments. A reduction of measurement mismatches are normally best achieved for e.g. interest bearing instruments by measuring the interbank interest rate risk component at fair value. Seldom there is a market for the credit risk component and therefore the requisite "reducing measurement mismatch" is normally not met for the credit risk component of a financial asset.

Consequently, if the unit of account were components of financial instruments that met a certain business intent objective, that could be accounted for at fair value, the need for complex hedge accounting would be significantly decreased, since such measurement methodology would achieve an alignment of the accounting with the risk management procedures..

Reclassification

We believe that it was the right approach to increase the possibilities for reclassification last year. The intent of holding a single asset or liability may change. Our opinion is that the financial reporting framework should aim at reflecting the present purpose of holding a financial instrument. Therefore, we believe that reclassification should be possible when the business intent has changed. This should apply for all kinds of holdings of financial instruments, including loans and receivables and Fair value option classified instruments. We consequently, do not support prohibiting reclassifications of financial instruments.

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Investments in Equity Instruments

Our view is that there are sound reasons for having a possibility to treat some strategic equity holdings differently from other holdings of equity instruments. However, we believe that the proposed solution will give an irrelevant presentation of the actual performance of holding the strategic equity holding. There are two basic flaws in the approach proposed:

1. The funding cost of holding the strategic equity holding will not be classified into OCI, instead that funding cost will affect the net profit before OCI while the dividend received on the strategic equity holding will affect OCI.
2. There will be no recycling once/if the strategic equity holding is realised.

We understand that this approach has been developed to handle the imperfections in the present impairment rules for equity instruments classified as Available for Sale. We believe that it would be better to align the impairment rules for Available for Sale equity instruments with those for loans and receivables. We believe further consideration should be given to when and how to measure impairment and that impairment should be reversed if there are indications that the causes of the impairment have been cured. A way of addressing impairment of equity securities may be to look for indications of actual default, for example, the failure of the investee to make payments on its debt. Then the impairment should be the difference between the present value of the expected cash flows and the acquisition value of the equity instrument instead of market price for an entity in distress.

Investments in unquoted equity instruments

We believe that there are continued good reasons to continue to have the possibility not to fair value some unquoted equity investments. Our view is that this possibility should continue to be an alternative when there are no possibilities to calculate a reliable fair value.

Effective Date and Transition

If implemented, the implementation date should be put long in the future. There are a lot of changes taking place, including some in standards that may be related to that for financial instruments. Furthermore, the proposal as presently written is very complicated to interpret. It will take time to understand all the implications. Once those are understood there might be a need to change some of the proposed wording. We presently see some areas where the result of classification will be that some "traditional plain vanilla loan agreements" may be forced into the fair value category.

We believe that retrospective application of a standard with a mixed measurement approach when the actual transactions previously have been structured to consider the standards historically applied will result in figures that are not comparable. Furthermore, retrospective application may create incentive to "fair value in hindsight". The Board considers that a standard for the measurement of financial instruments should be applied prospectively as was the case when IAS 39 first was implemented, with recalculation of the opening balance.

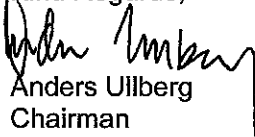


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If you have any questions concerning our comments please address our Executive member Carl-Eric Bohlin by e-mail to: carl-eric.bohlin@radetforfinansiellrapportering.se.

Stockholm, September 14, 2009

Kind Regards,


Anders Ullberg
Chairman