

Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2008:9

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

Dear Sirs,

Re: Discussion Paper – Reducing Complexity in Reporting Financial Instruments

The Swedish Financial Reporting Board (Board) is responding to your invitation to comment on the above Discussion Paper (DP).

General Comments

We appreciate the opportunity to respond to the exposure draft and that the IASB has issued a discussion paper regarding the complexity in reporting financial instruments. Our detailed comments are found as answers to the specific questions. Further comments on important specific paragraphs for which no questions have been asked are found in appendix 1. The answers could be summarized as follows:

- We agree that the present standards for reporting financial instruments are too complex and that the complexity has been caused by the rule based approach used.
- We fail to see that the Discussion paper have focused on identifying the reasons for the complexity; standards that have failed to describe the cash generating process of financial institutions and others who uses financial instruments and adapt the standards to those processes.
- We believe that the discussion paper have pre-empted the conclusion that a single measurement basis would decrease complexity. Our view is that it will be a continued need for a mixed models approach to properly describe the business intent of the entities and therefore also the cash generating process of the different entities.
- We also see a continued need for hedge accounting. As a quick fix, the hedge accounting rules should be relaxed and replaced with some general principles instead.

We question the basis for the document and propose that the conclusions should be rejected. We believe that the DP may have had a completely different outcome if two essential requisites for the work with the DP had not been introduced. The two important requisites are:

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1. Not reconsidering the unit of account
2. Changes have to be in line with the long term goal: "full fair value for all financial instruments".

Using these two requisites as foundation for the discussions in the DP has made it impossible to reach other conclusions than the ones in the DP. If the work had been performed in a more exploring and free environment, we believe that other fruitful solutions than the one presented in the DP might have been reached. We believe that the two requisites for the work done with the DP have narrowed the scope and made it impossible to reach any new conclusion that might have had the possibility of getting around some of the perceived tension between the preparers and the Board. A more exploratory approach would have had the possibility of deleting some of the rules in the present standards for financial instruments which hinder a choice of accounting principles that are more in line with the business practices of today without being more in contradiction to the present framework than the present standards are. We believe that the starting point for both a proper choice of unit of account and the choice of measurement principles should be the business intent. The reason for that is that the business intent is fundamental when analysing the future expected cash flows that a single transaction is expected to generate. Thereafter other factors have to be analysed before the choice of measurement principles are made. It is not obvious for us that an increased use of fair value will be the outcome of such a process.

Section 1 Problems related to measurement

Question 1

Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and their auditors and the needs of users of financial statements? If not, how should the IASB respond to assertions that the current requirements are too complex?

Our perception is that the standards regarding financial instruments today carries high degree of complexity. We welcome efforts to bring those down. However The DP does not reach the goal of reducing the complexity. Instead we believe that the DP should have in an open minded manner analysed the comments for improvements that have been received during the years. When doing that it would have been important not to restrict the analysis of the current situation based on the following restrictions:

1. Not reconsidering the unit of account
2. Changes have to be in line with the long term goal: "full fair value for all financial instruments".

Reviewing the measurement principles for financial instruments without the above mentioned restrictions may create possibilities to facilitating the accounting requirements for financial instruments as well as to increase the users' understanding of the financial statements.

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Section 2 Intermediate approaches to measurement and related problems

Question 2

(a) Should the IASB consider intermediate approaches to address complexity arising from measurement and hedge accounting? Why or why not? If you believe that the IASB should not make any intermediate changes, please answer questions 5 and 6, and the questions set out in Section 3.

Yes, we believe that there are good reasons for addressing the complexity for preparers arising from the present measurement and hedge accounting requirements. The present regulations are too rule based and too burdensome to apply. Instead we believe that some of the detailed rules could be replaced with general principles.

(b) Do you agree with the criteria set out in paragraph 2.2? If not, what criteria would you use and why?

No, we do not agree with all the criteria set out in paragraph 2.2.

We agree with criteria (a) and (d).

Criteria (b) is fundamentally incorrect. By introducing a requisite that the end result should be an increased use of fair value in a DP with the objective to explore difficulties and analyse the reasons for complexity, good solutions that might be identified and that could solve the difficulties identified, might be disregarded.

Criteria (c) might need to be slightly amended. If complexity is judged to be increased or not is subjective. E.g. for some it might be more difficult to understand cash flow hedging and hypothetical transactions than fair value measurement of the interbank interest components. It depends on the background and the skills of the individual. That said, we believe that some increased complexity could be accepted if the outcome is a significantly increased quality of the financial reports and understanding from the users. We therefore believe that criteria (c) should be rephrased or deleted. Is criteria (c) really necessary if criteria (d) is kept?

Some further criteria that could be used are:

- The evaluation of different solutions to decrease complexity should not be restricted to the present definition of unit of account
- The evaluation of different solutions should not focus solely on the type of financial instrument. Equally important for the measurement basis is the intended use and management of the instrument.

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Question 3

Approach 1 is to amend the existing measurement requirements. How would you suggest existing measurement requirements should be amended? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph 2.2?

See our answer on question 4 below.

Question 4

Approach 2 is to replace the existing measurement requirements with a fair value measurement principle with some optional exceptions.

(a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph 2.2?

Since we believe that the criteria in 2.2 is an incorrect starting point for an evaluation of different solutions, we will not restrict our answer to an analysis based on those restrictions.

We believe that exceptions from accounting at fair value should not primarily be focused on the type of instrument. Instead the focus should be on the business intent of entering into the transaction. Thereafter some further criteria might be added such as:

- (a) If the instrument taken together with other instrument may be subject to a high cash flow volatility
- (b) If the instrument, or parts of the instrument, might be sold before final maturity changing the expected cash flow in criteria (a).

Our position is as follows:

- *Business intent*: If an entity has the business intent to manage an instrument or a part of an instrument at fair value, or if the business intent is to sell the instrument before final maturity, then it might be relevant to measure the instrument at fair value. Contrary; if the business intent is not to manage the instrument at fair value and the business intent is to hold the instrument until final maturity; then it might be relevant to measure the instrument at cost.
- *Volatility in cash flows*: If the instrument, together with other instruments which are linked to each other, create a net position of a locked in cash flow or a cash flow with expected low volatility it might be relevant to measure the group of instruments or group of components at cost. If the business intent is to hold the instrument until final maturity, then it might be relevant to measure the linked instruments at cost. In contrast; Even if the business intent is to hold to maturity, but the instrument and linked transactions might be subject to a high volatility in future cash flows, it might be relevant to measure the transaction and the linked transactions at some kind of current value.

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Please observe that our comments above are in sharp contrast with the argumentation in 2.19. The reason for the sharp contrast is the unit of account. The focus in 2.19 is on single instruments. Since the focus is on single instruments in 2.19 the conclusion in the discussion paper is that fixed rate financial instruments could be measured at cost while instruments variable cash flows should be measured at fair value.

This is one of the fundamental differences in perspective between banks, insurance companies and asset & liability managers and the IASB. While the IASB focus is on single assets and liabilities the preparers in the financial industry focus on packaging assets, liabilities and derivative contracts to create a steady fixed or low volatility margin. Therefore it is utterly important that the unit of account for financial instruments is studied to see if a change in unit of account could reduce the complexity in reporting financial instruments.

Examples on situations where the conclusion in 2.19 may be incorrect are:

- (a) Fixed interest bearing instruments: Stand alone the cash flow is fixed, but the possible change in fair value is high and therefore the business intent with instrument needs to be reconsidered
- (b) Floating rate interest bearing instruments with "normal" credit risk: Stand alone there is variability in cash flows. But since mostly the interest rate risk in such instrument relates to the changes in general interest levels, the risk of large changes in fair value is low compared with fixed rate instruments.
- (c) Derivative contracts like interest rate swaps or other linear instruments: The DP excludes those from the category of instruments for which cost could be an alternative. It is difficult to understand the logic behind such a conclusion (if disregarding 2.2) since e.g. an interest rate swap is not behaving differently than a loan and deposit taken together. Especially if you are considering a package of a loan, a deposit and an interest rate swap you might have created a linked transaction with a fixed or low volatility margin portfolio which might be worthwhile considering if it could fulfil the thoughts in paragraph 2.19.

We believe that the starting point between choosing between measuring at fair value or measuring at cost should be the business intent. The reason for this starting point is that the business intent will affect expected future cash flows. Having identified the business intent of holding an asset or liability there is a need to study the characteristics of the asset or liability and thereafter draw a conclusion regarding if the best predictions of future cash flows and the risks inherent in the asset and liabilities are best captured by measuring at cost or at some form of current value.

A simple example may illustrate our thinking.

A bank lends money during 5 years at Stibor + 50 bp to a customer. The bank finances the lending by entering into 5 year floating bond at Stibor flat. To reduce the interest rate risk the bank also enters into a 5 year swap paying 5 year fixed at Stibor flat and receiving floating Stibor at flat.

Given that the customer and the swap counterparty fulfils there contractual obligations the bank has locked in a fixed margin of 50 bp.

The business intent is to service the loan agreement until final maturity



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In our accounting model we will start with the business intent which is to earn a fixed margin of 50 bp yearly during 5 years.

The characteristics of the transaction are:

1. The three transactions taken together will deliver a fixed cash flow during 5 years
2. Changes in credit risk may change the probability of receiving the fixed cash flows
3. The fair value of the loan agreement may change depending on changes in demand and supply in the market; the same applies for the funding cost of the bank and of the fair value of the swap.
4. All the three transactions are exposed to changes in the interbank interest risk, however, taken together, the net exposure to changes in interbank interest rate risk is zero.

The conclusions that may be drawn from analysing the 4 characteristics are the following:

1. The best estimate of future cash flows is the measurement of the margin at cost
2. The best estimate of changes in credit risk is to give note information regarding the changes in Probability of Default, Exposure at Default and Loss given Default. Such information is required to be delivered following Pillar III in the Capital Adequacy Framework.
3. Fair value information will be dependant on several different factors and therefore changes in fair value will be very difficult to use for estimating the change in probability of future cash flows.
4. Cost or fair value is equally good in estimating the variability in future cash flows due to changes in the interbank interest rate since the net exposure to changes in the interbank interest rate is zero. However, in practice there is seldom a one to one relationship between a single loan transaction and a issued debt security wherefore fair value normally is the most advantageous measurement attribute for changes in interbank interest rate risk.

The above example that had its focus on the business intent managed to:

- a) Focus on another unit of account than a single asset or liability
- b) Reached different conclusions for different parts of a single asset or liability regarding the appropriate measurement at the same time as a portfolio view was considered.
- c) Showed how useful it would be to complement the choice of measurement basis with focused note information to make it possible for the users of the financial reports to make separate analysis of future cash flows and probability of those future cash flows.

A measurement model that solely focuses on the type of single asset or liability without considering the intent of holding that single asset or liability would have failed in giving relevant information to estimate the future cash flows and the probability of their occurrence.

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(b) How should instruments that are not measured at fair value be measured?

Instruments or parts of instruments, not measured at fair value could be measured at cost or amortised cost complemented with impairment testing.

(c) When should impairment losses be recognised and how should the amount of impairment losses be measured?

There is no obvious need to reconsider the present rules in IAS 39 for impairment testing.

(d) Where should unrealised gains and losses be recognised on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph 2.2?

The answer on (d) is dependent on the Financial Statement Presentation project. There is always the possibility to choose between the notes and the other financial statements.

(e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph 2.2?

Reclassifications should be made whenever the business intent has changed. Other solutions should only be considered to reduce complexity.

Question 5

Approach 3 sets out possible simplifications of hedge accounting.

(a) Should hedge accounting be eliminated? Why or why not?

Hedge accounting should not be eliminated. Hedge accounting could only be eliminated if other solutions were implemented that gave the same or better information of performance and financial position. E.g. there would still exist a need for fair value hedge accounting for parts of instruments if fair value option was more generally permitted.

If instead the fair value option was:

1. Generally permitted without restrictions and
2. permitted for parts of instruments

there would be no need for fair value hedge accounting.

(b) Should fair value hedge accounting be replaced? Approach 3 sets out three possible approaches to replacing fair value hedge accounting.

(i) Which method(s) should the IASB consider, and why?

(ii) Are there any other methods not discussed that should be considered by the IASB? If so, what are they and how are they consistent with the

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criteria set out in paragraph 2.2? If you suggest changing measurement requirements under approach 1 or approach 2, please ensure your comments are consistent with your suggested approach to changing measurement requirements.

In paragraph 2.25 the conclusion is drawn that the need for hedge accounting would decrease if all financial instruments were measured at fair value.

This statement is somewhat hard to comment upon since the conclusion has to be that fair value hedge accounting would be redundant if the instruments already were measured at fair value. The question should instead have been: Does fair value hedge accounting fulfil a need that fair value option can not fulfil? The answer on that question is yes. Measuring at fair value gives rise to artificial volatility in earnings that makes it more difficult for an user to estimate future cash flows if the instruments measured at fair value are to be held until final maturity and if the general market risk has been hedged. Contrary, fair value hedge accounting of portions makes it possible to keep the margin in the contract at cost while the general market risk is measured at fair value. Such solutions combine the two following business intents that normally exist in a single contract in retail and commercial banking:

1. To manage the general interest rate risk (the interbank interest rate risk) at Treasury or the Trading department (the relevant measurement basis is some kind of current value)
2. To manage the credit risk and service the customer during the life of the contract (the relevant measurement basis is cost/amortised cost combined with impairment testing).

We believe that the unit of account should be reconsidered and the hedge accounting rules should be relaxed. We believe that some guiding principles should instead be implemented:

- (a) The business intent with a transaction (or its components) should be documented immediately at initial recognition
- (b) A measurement principle should be applied that is consistent with the business intent of the transaction or components of a transaction
- (c) Only parts of a contract that is clearly separately measurable could be separated and measured at fair value. The remaining part of an interest rate should be measured at cost combined with impairment testing
- (d) If the business intent has changed, the measurement principle should change from that date without recalculating previous periods.

With principles similar to the examples presented above we would have recognition of ineffectiveness immediately in P&L without severe documentation requirements and it would also be possible to present multiple business intents with a single transaction in a way that is consistent with the business model of the entity. By introducing a documentation requirement from initial recognition and if changes in business intent should affect the future measurement of the transaction, the risk of hindsight should be comparable with the present rules.

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Question 6

Section 2 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in the existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required.

(a) What suggestions would you make to the IASB regarding how the existing hedge accounting models could be simplified?

Please see our comments to question 4 and 5.

(b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?

The need to prove efficiency of the hedging relationship is unnecessary if the ineffectiveness immediately affects earnings. Therefore it should be enough to have some general principles as those described in the answer to question 5 (b).

(c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity.

See our answer to questions 4 and 5.

(d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?

See our answer to questions 4 and 5.

Section 3 A long-term solution—a single measurement method for all types of financial instruments

Question 8

To reduce today's measurement-related problems, Section 3 suggests that the long-term solution is to use a single method to measure all types of financial instruments within the scope of a standard for financial instruments.

Do you believe that using a single method to measure all types of financial instruments within the scope of a standard for financial instruments is appropriate? Why or why not? If you do not believe that all types of financial instruments should be measured using only one method in the long term, is there another approach to address measurement-related problems in the long term? If so, what is it?

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No we do not believe that the long term solution is to measure all financial instruments at fair value. Instead, the business intent and the actual risk position (regardless of business intent) should form the basis for financial reporting. Therefore it is more relevant to focus on the actual business model of the entity than focusing on how different instrument should be measured. If the business intent is trading or managing an instrument at fair value, then the relevant measurement basis is fair value. Contrary; if the business intent is to earn a steady income stream while servicing the customer, then the revenue of the contract should be reported during the life of the contract using amortised cost as the measurement basis.

Furthermore we believe that a single asset or liability should be split and measured separately if there is a mixed business intent of holding a single instrument. In such circumstances the natural unit of account is the components of the instrument. The instrument should be separated in units which are managed together. Some parts could thereafter be measured at fair value while others could be measured at cost/amortised cost.

We believe that the reality is more complex than what can be communicated in a fair value model. Relevant performance reporting will never be achieved if the framework for financial reporting of financial instruments is solely focused on fair value or amortised cost. Instead a mixed model should be used, combined with relevant disclosures.

Question 10

Part B of Section 3 sets out concerns about fair value measurement of financial instruments. Are there any significant concerns about fair value measurement of financial instruments other than those identified in Section 3? If so, what are they and why are they matters for concern?

There are numerous arguments that have been presented by all kinds of parties during the years which questions the relevance of fair value for financial instruments other than those listed in the DP. Instead, when answering this question we have chosen to insert specific remarks on single paragraphs in section 3. Those remarks are found in the answer to question 12.

Question 11

Part C of Section 3 identifies four issues that the IASB needs to resolve before proposing fair value measurement as a general requirement for all types of financial instruments within the scope of a standard for financial instruments.

(a) Are there other issues that you believe the IASB should address before proposing a general fair value measurement requirement for financial instruments? If so, what are they? How should the IASB address them?

(b) Are there any issues identified in part C of Section 3 that do not have to be resolved before proposing a general fair value measurement requirement? If so, what are they and why do they not need to be resolved before proposing fair value as a general measurement requirement?

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See our comments on the different questions above. We never see a possibility to just have one measurement basis.

Question 12

Do you have any other comments for the IASB on how it could improve and simplify the accounting for financial instruments?

We have no other comments for the IASB on how it could improve and simplify the accounting for financial instruments. Instead, in appendix 1 we give detailed comments on important specific paragraphs for which no questions have been asked.

Other

We have no comments on question 7.

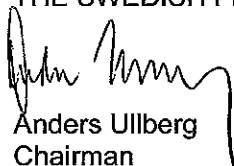
We refer to our answer in question 8 for question 9.

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 10, 2008

Yours sincerely,

THE SWEDISH FINANCIAL REPORTING BOARD



Anders Ullberg
Chairman



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Appendix 1

Paragraph	Comment
2.40—43	<p>In these paragraphs some changes in fair value option is discussed. One point is that it might be possible to allow fair value option for components as an alternative for fair value hedge accounting. The proposal is rejected because it would “defeat the purpose of making a change”. The only “defeat of purpose” we are able to identify is “an increased use of fair value”. Therefore if the DP had not required solutions that increase the use of fair value, an expansion of the fair value option to components would have been an attractive alternative.</p> <p>We believe that an expanded fair value option for components in itself would be an attractive short term solution:</p> <ul style="list-style-type: none"> (a) it decreases the documentation requirements (b) it would immediately recognise ineffective hedges in P&L (c) it would achieve the same presentation as fair value hedge accounting of components (is therefore in accordance with the present standard) (d) it would make it possible to align risk management and business business intent with measurement principles in the financial reports (e) it would make it possible to only measure those components where there are a liquid market at fair value <p>If unit of account was changed for financial instruments, there would be no need for a fair value option for components. Instead the unit of account could be different well defined components (normally benchmark interest rate and other) of a single asset or liability.</p> <p>The DP is stating that a components approach does not increase comparability. We believe that this is not necessarily correct. We believe that the comparability will be the same, or increase, if comparability is combined with relevance. A component approach makes it possible to compare apples with apples. When two entities have the same intent with entering into similar transactions, there should be a higher probability than before that they will use the same accounting principles, since the burden of hedge accounting would no longer prevent the entities from measuring different parts of a financial instrument based on business intent.</p>
2.46 (c)	In this paragraph it is stated that fair value hedges should be reported in the same way as cash flow hedges. The main

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Paragraph	Comment
	<p>argument is that it would lead to “fewer ongoing effects on earnings” because the entity would not need to recalculate the effective interest rate if the entity closes the hedging relationship. This is not a completely relevant argumentation. If an entity closes the hedging relationship in a cash flow hedge, then it will affect earnings during the remaining maturity of the hedged transaction. The net effect on earnings will be the same.</p>
2.67	<p>In the DP it is stated that it is difficult to understand hedges of parts of an instrument. We do not believe that this statement is correct. If the partial hedge is focusing on parts that are easily separable for which there is a liquid market, the financial reporting of parts of instruments would be easy to understand, it would be transparent and it would be objective. . As a consequence it would be easier for users to understand those hedges than the fair value measurement of instruments for which there is no secondary market and where the business intent is to hold the instrument to maturity.</p>
3.11	<p>In this paragraph it is stated that cost or accreted cost for derivative contracts would not give information about future cash flows. This is not correct as a general remark. There are a lot of derivative contracts with linear behaviour where it is as ease to estimate future cash flows as for on balance sheet instruments. Furthermore the unit of account has to be considered. If several contracts are combined (including derivative contracts) the net effect could be a fixed future cash flow.</p> <p>Therefore other arguments are needed to motivate why all derivative contracts should be measured at fair value.</p>
3.13	<p>In this paragraph arguments are presented for requiring derivative instruments to be measured at fair value. We do not believe that the argumentation is completely correct. There is a need to consider the business intent when evaluating the relevant measurement basis for all financial instruments, including derivative contracts. If such evaluation is made, the conclusion might be (as for some on balance sheet contracts), that there are good arguments for measuring some derivative contracts at cost. As mentioned when commenting on paragraph 3.11, other convincing arguments are needed since future cash flows for a lot of derivative contracts are more easily predictable than some on-balance sheet instruments.</p> <p>Examples of such argumentation might be the one given above in our answer to 5 (b), that the business intent normally is to manage the inherent risks in derivative contracts at fair value. But that measurement attribute can not be used for the derivative</p>

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Paragraph	Comment
	<p>contracts stand alone, there is a need to first consider why the entity has entered into the derivative contract and what other assets and liabilities, or more precisely risk components that the derivative contracts are linked to, and thereafter the natural conclusion might be that the derivative contract, together with the linked components of other instruments should be measured at fair value.</p> <p>If that change in unit of account is not implemented it might be more relevant to let some linear derivative contracts be measured at cost, using the measurement principle for the instruments that they are linked to, given that the link is well documented from the inception of the derivative transactions.</p> <p>Our reasoning for the above argumentation is to highlight the oversimplification that has been made in the present IAS 39 and to highlight that the unit of account for financial instruments does not correspond well with traditional retail and commercial banking activities. We are however not in favour of accounting standards where open market risk positions are not measured at fair value, when those open risk positions may alter the expected future cash flows of the entity.</p>
3.17	<p>It is stated that "it is not useful in assessing future cash flow prospects for instruments with variable cash flows" by measuring those instruments at cost. This is a strange comment since the alternative would be to measure those at fair value. Normally, measuring a floating rate instrument at fair value will equal cost while there might be larger differences between fair value and cost for fixed rate instruments.</p>
3.19—3.30	<p>These paragraphs give a lot of comments for fixed or semi-fixed cash flows, but exclude interest rate derivative contracts without any proper argumentation. If the basis for this DP were reconsidered, there might be a need to include linear derivative contracts in the analysis. Please see our comments on paragraph 3.13.</p>
3.43	<p>The paragraph describes when there is artificial volatility in the financial statements. The DP have excluded some relevant arguments:</p> <p>(a) Artificial volatility also exists when linked financial instruments with fixed cash flows are measured at fair value even though they are intended to be held until final maturity. The swings in fair value might give rise to high volatility due to changes in supply and demand without any other relevant changes in risk factors.</p>

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Paragraph	Comment
	(b) Other instruments which taken together have created fixed cash flows but who are traded on different markets with different liquidity wherefore there might be a low correlation between them with regards to temporary changes in fair value.
3.52	In this paragraph it is stated that fair value is objective because it contains the view of the market. That might be true for highly liquid instruments for which there is a secondary market. The statement is not at all true for instruments which are seldom or never traded.
3.57	It is stated that entity specific values is "clearly more subjective and less reliable" for non-traded or illiquid instruments. We question this argumentation. Entity specific values might be superior to external data due to the fact that the entity might have a superior access to information.
3.66	It is argued that "the range of possible differences in judgement is not especially wide if the credit risk is not especially high and changeable". This statement is not correct. There exists an old Federal Reserve study that compared highly rated instruments in the bond market with the syndication market that concluded that the differences in spread was not constant and that the spread difference might be up to 50 bp. 50 bp. is a very high difference, especially for highly rated instruments. Furthermore, the recent market turmoil has shown how vulnerable the market is and how significant the spread differences might be for similar instruments.