European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

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E-MAIL

EACB Comments on IASB DP on Credit Risk in Liability Measurement

Dear Sir/Madam,

On behalf of the European Association of Cooperative Banks, we appreciate the opportunity to present our views on the Credit Risk in Liability Measurement Discussion Paper of the IASB issued in June 2009 and would like to provide you with the following brief comments.

We feel that a debate on the new approaches and simplifications with regard to accounting of own liabilities is very important and we welcome the publication of a Discussion Paper on this matter. However, the fact that the review of IAS 39 has been broken down into different sub-projects makes it difficult to fully assess the impact; hence, we ask you to consider our answers as only of a preliminary nature.

Please find our answers to the questions of the DP in the paragraphs below.

Kind regards,

Hervé GUIDER
General Manager

Volker HEEGEMANN
Head of Unit

Question 1: When a liability is first recognised, should its measurement (a) always, (b) sometimes or (c) never incorporate the price of credit risk inherent in the liability? Why?

(a) If the answer is "sometimes", in what cases should the initial measurement exclude the price of the credit risk inherent in the liability?

(b) If the answer is "never":
(i) what interest rate should be used in the measurement?
(ii) what should be done with the difference

We feel that during first-time-recognition (issue of the liability) the incorporation of the price of the own credit risk is appropriate. Due to the fact that the contractually agreed interest rate is generally reflecting of the credit standing risk this results in consistency with regard to the contractually agreed interest payment. However, in cases where the liabilities do not incorporate any inherent price for credit risks, a corresponding factor should be taken into account during liability measurement.

Question 2: Should current measurements following initial recognition (a) always, (b) sometimes or (c) never incorporate the price of credit risk inherent in the liability? Why? If the answer is 'sometimes', in what cases should subsequent current measurements exclude the price of the credit risk inherent in the liability?

In our view, the goal that is pursued using the liability is of fundamental importance in this regard:

- When measuring liabilities held for trading, we feel that an incorporation of the "own credit risk" during subsequent periods is meaningful and appropriate. Liabilities held for trading should therefore be discounted at market interest rates which include the borrower's own credit risk.
- Liabilities designated as "to be measured at their fair value" during the application of the fair value option should also be measured in the same way as liabilities held for trading whilst simultaneously incorporating the own credit risk. It is possible only with great difficulties to single out the impact of changes to the own credit risk during the calculation of the applicable fair values; whilst not limited to, this is particularly the case for complex structured liabilities. Accounting mismatches may also result from non-incorporation of the current own credit risk during accounting of financial liabilities. This could be avoided by including the own credit risk during the fair value measurement of the respective liabilities.
- For all other financial liabilities, the inclusion of own credit risk is not appropriate. We think that these liabilities should be measured at amortized cost.

Question 3: How should the amount of a change in market interest rates attributable to the price of the credit risk inherent in the liability be determined?

We feel that the change in the entity's own credit risk should be estimated by using the risk-free rate of interest and the entity's recent borrowing cost. In our point of view this is the only workable procedure. This approach is based on observable market data (e.g. from financial information services companies like Markit or from rating agencies). Although, for instance, estimates are part and parcel of valuation methods for accounting purposes, these results should still be sufficiently reliable and plausible. Otherwise this would also result in non-compliance with the premise of supplying decision-useful information.

Question 4: The paper describes three categories of approaches to liability measurement and credit standing. Which of the approaches do you prefer, and why? Are there other alternatives that have not been identified?

Please cf. our answers under question 1 and 2.

There should be no measurement at fair value of liabilities which are held until their final maturity; we feel that a measurement at amortized cost would be more appropriate.