DZ BANK

European Financial Reporting Advisory Group
Square de Meeûs 35
B-1000 Brussels

DZ BANK AG

Extension: -
Fax -

Dear Sir or Madam,

On behalf of DZ BANK I am writing to comment on EFRAG's Draft Comment Letter (DCL) on the IASB's Discussion Paper Credit Risk in Liability Measurement (DP).

We agree with the statement in EFRAG's DCL that own credit risk should only be taken into account in the initial measurement of a liability if own credit risk is priced into the transaction that gave rise to the initial recognition of a liability and that In all other circumstances it should not be included. However, we do not agree with the further statement in the letter that Changes in own credit risk should not be taken into account in subsequent measurements of liabilities. We advocate the present regulation under IFRS that subsequent fair value measurements of financial liabilities should include changes in the debtor's own credit risk to remain unchanged.

Conceptually, it would be contrary to the principle ideas of fair value accounting to set aside any amounts from full fair value and account for them separately. Thus we do not support any of the alternatives mentioned in the Discussion Paper.
Particularly, concerning the argument supported by the DCL that gains should not be reported when the credit standing of an entity deteriorates, we want to point out that under a full fair value measurement the opposite applies as well. A loss is shown whenever an entities credit standing improves. Such effects seem to be counter intuitive in deed. However, they are inherent in the notion of fair value. Counter intuitive effects might be a

good reason not to use fair value. They seem however no good reason to manipulate the concept of fair value as such.

We perfectly understand that from a prudential point of view it seems undesirable for the capital base to widen when the credit standing of a bank gets worse. However, we recommend prudential regulations to be taken to deal with that issue and leave established accounting principles unchanged.

As we understand, EFRAG has reached its tentative views considering arguments brought forward by users, whereas the preparers perspective has seemingly not received much attention yet. For example, paragraph 32 of EFRAG's DCL says that EFRAG is aware that some entities take own credit risk into account when measuring liabilities held at fair value in their trading book. Because of the short-term nature of such items, EFRAG believes that the effect of taking this into account in the measurement will be negligible and does not need to be adjusted for."

Banks have designated many liabilities with a significant combined volume into the fair value through profit or loss category using the fair value option. The effects of changes in own credit risk of these liabilities might be of a long-term nature and material amount. We are not sure if EFRAG is aware of the extent of the use of the fair value option in practise. We also wonder whether EFRAG would hold that banks should be allowed to make no adjustments for possible changes of own credit risk for such designations as well.
We consider it essential to treat liabilities, which are designated as at fair value through profit or loss in the same way as trading liabilities. Such designated liabilities are naturally managed on a full fair value basis. It would probably create accounting mismatches not to full fair value them anymore. There would effectively be an additional valuation category for liabilities at fair value excluding own credit risk. This would by no means contribute to reducing complexity at all. In practise we expect a lot of extra cost and technical effort in order to implement any of the presented alternative treatments.

Furthermore, we are uneasy about the possible factors that could be required to be taken into account by the IASB in order to arrive at the amount which has to be deducted from fair value and accounted for separately (see paragraph 19 of the DP). If anything more than observable information would be compulsory, preparing the numbers would be rather burdensome, if not impossible. Also comparability between financial statements would suffer

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immensely, for it were unclear which exact method was used in order to compute the separated amounts for own credit risk.

Finally, EFRAG's DCL on the Exposure Draft Fair Value Measurement, paragraph 70, states that EFRAG accepts that, when an issuer of a liability can readily settle the liability by purchasing it from the holder in an active market, the settlement value of the instrument as a liability and its fair value as an asset might be the same, and that that value would again include non-performance risk.
In practise, we regularly can readily settle liabilities, which we have issued our self by purchasing them from the holder in an active market. Therefore we recommend that EFRAG clearly says in a prominent paragraph of its final comment letter that under such circumstances changes in own credit risk of the issuer can and should be included in the subsequent fair value measurement of a liability.

If you wish to discuss any of our comments further, please do not hesitate to contact us.

Yours sincerely,
Rainer Krauser
DZ BANK AG