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RE: EFRAG's draft comment letter on the IASB's discussion paper on Credit Risk in Liability Measurement

The Committee of European Securities Regulators (CESR) has, through its standing committee on financial reporting (CESR-Fin), considered EFRAG's draft comment letter on the IASB's Discussion Paper (DP) on Credit Risk in Liability Measurement.

We thank you for this opportunity to comment on your draft response to the IASB and are pleased to provide you with our comments.

We welcome the publication of a discussion paper by the IASB dealing with this controversial issue in a more comprehensive way. Changes in the fair value of an entity's liabilities have been put particularly under the spotlight during the current financial and economic crisis, as highlighted in the report of the leaders of the G20.

We note that the feedback from this discussion paper will serve as input for the ED *Fair Value Measurement* which has been published recently. We believe that inviting a discussion on the inclusion of credit risk in liability measurement is not only important in view of that ED, but also in view of other projects that are currently under consideration, e.g. insurance accounting and any revision of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Having carefully considered the different arguments presented in the discussion paper, CESR finds itself agreeing with EFRAG 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 that liability.

We also agree that subsequent measurements of financial liabilities should, in principle, not reflect changes in own credit risk. CESR acknowledges that some market constituents might think it counter-intuitive that an entity reports a gain when the credit quality of its liabilities declines, or conversely reports a loss when its credit quality improves. According to the Framework (paragraph 69), profit is frequently used as a measure of performance or as the basis for other measurements, such as return on investment or earnings per share. Most market participants see profit or loss as a sign of the success or failure of an entity. Indeed, it can be hard to understand that an entity can almost be bankrupt but still report significant profits by reflecting the deterioration of its own credit risk when valuing its liabilities.

However, we could agree that realisation should not be required in all cases for changes in fair value to be recognised, and that changes in the fair value of a liability due to changes in own credit risk, or to a revised risk premium on a particular risk, should, in some cases, be taken into account in the subsequent measurement of that liability. We believe there is such a case to incorporate changes in own credit risk in the subsequent measurement when an entity is able to buy back its own liability and when the liability is in the form of a debt instrument traded in an active market with observable listed prices (level 1 measurement). We have observed that many entities are currently taking advantage of increases in their own credit risk and/or the increasing price on risk in general and realising gains by buying back their liabilities.

We would like to emphasise that no matter what direction the IASB follows on this project, we think appropriate disclosures are necessary in order to provide users with the information necessary to value an entity appropriately and to ensure sufficient market transparency for investors.

As a final comment, we note that this discussion paper has been produced and published on the initiative of the IASB alone and does not form part of the work done under the Memorandum of Understanding. Bearing in mind the importance of this issue for the ongoing and further work of the IASB, we would encourage the IASB to strengthen its liaison with the FASB when discussing the outcome of this project.

I hope you will find these comments helpful. I would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Fernando Restoy

Chair of CESR-Fin