

8 September 2010

Financial Accounting Standards Board  
Technical Director, File Reference No. 1810-100  
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## **Comment Letter on Proposed Accounting Standards Update – Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities**

Dear Sir / Madam

SwissHoldings, the Swiss Federation of Industrial and Services Groups in Switzerland represents 47 Swiss groups, including most of the country's major industrial and commercial enterprises. We very much welcome the opportunity to comment on the above-mentioned Proposed Accounting Standards Update, and our response below has been prepared in conjunction with our member companies.

Most of our member firms are applying IFRS and some of our member firms are also FPI filers with the SEC. SwissHoldings's member firms are very much interested in a global level playing-field, and as such are closely following the developments of both accounting standards.

### **General comments**

SwissHoldings appreciates the Boards' efforts to reduce complexity in the accounting of financial instruments and to provide users of financial statements more comprehensive information on an entity's involvement in financial instruments.

SwissHoldings supports the following proposals made in the Accounting Standards Update:

- (a) The intention to reduce hedge accounting requirements;
- (b) The discontinuance of an incurred loss model; and
- (c) The introduction of a more prudent impairment methodology.

However, we have several concerns regarding the proposals of the Accounting Standards Update. The proposals are too much focused on one single measurement methodology rather than on the characteristics of the different financial instruments in order to determine the appropriate measurement principle. Especially we are of the opinion that financial instruments for lending purposes should be measured at amortized cost. This measurement approach best

reflects the characteristics of these financial instruments by considering the contractual cash flows of the financial instruments as well as the intention to hold them until maturity. Valuing these financial instruments at fair value would not correctly represent their utilisation and an entity's business activities as the measurement at fair value assumes a short-dated maturity of the investments and also implies the sale or liquidation of the financial instrument in the near future. We therefore support the alternative views of the two dissenting Board members concerning non-marketable, plain-vanilla debt instruments that an entity holds as part of a long-term business strategy to be carried at amortized cost. However, we disagree with their preferred framework to carry marketable securities at fair value since we are in favour of IFRS 9 which permits cost accounting if certain conditions are met.

On this note, SwissHoldings favours the IASB mixed measurement model, specifically for the general principles below:

- (a) The measurement of a financial instrument should be determined by its characteristics and deployment;
- (b) A greater emphasis on the business model of an entity to better reflect and address its business activities in the financial statements;
- (c) An impairment methodology that is future-oriented by taking all available credit loss related information into consideration including future business and economic developments or events; and
- (d) The flexibility to measure an entity's changes in its own credit risk through profit or loss for the purpose of reducing accounting mismatches but also through equity in order not to misrepresent total comprehensive income.

As a consequence, in focusing on entities' business models, we believe that the proposal for the prohibition of reclassification of financial instruments should not be pursued, in other words the existing rules should be retained.

We understand the Board's objective and efforts to review the appropriateness of the incurred loss impairment model in respect of its adequate reflection of economic events in the financial statements. We also recognize the need to develop a model that anticipates economic developments as the current impairment models simply lack future-oriented aspects. However we believe, that the IASB expected loss model more comprehensively introduces forward looking information by considering business and economic forecasts for the assessment of credit losses. In addition, we favour the IASB methodology which requires the allocation of the expected credit losses over the life of the financial instrument different from the proposal of this Update.

In respect of the measurement of financial liabilities and in particular the measurement of own debt instruments including changes in the entity's own credit risk, we are convinced that their measurement at fair value is not representative in all circumstances and could be potentially misleading if recorded in profit or loss.

Most of the proposed disclosure requirements are necessary to analyze the credit business of financial institutions. We believe that these requirements are excessive for non-financial services industry preparers where the credit business is not core to their operations. We expect the Board to differentiate more the level and detail of disclosures depending on business activities and other considerations like relevance, materiality etc.

We would also like to highlight that there will be significant operational issues with the implementation of the standard, especially in the area of collection of historical data to support an entity-specific expected loss model. Most likely many non-financial services industry preparers will be dependent on publicly available statistics. Furthermore we are concerned about the implementation costs as we also expect extensive system and process changes.

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As a general remark and with all due respect, please allow us to point out that SwissHoldings is disappointed that a majority of the Board members could not agree on convergence by issuing this Accounting Standard Update diverging from the respective IASB project.

We are concerned that the Update will impact and change the accounting for associated companies. We object that this revision of the accounting for financial instruments should change the application of the equity method for investments in associated companies. We therefore reject the proposed changes in this area and we believe that such changes in accounting principles should be discussed separately and addressed in an individual project on the accounting for associated companies.

There are also questions addressed in this Update which either relate to specific U.S. GAAP provisions or to implementation issues and matters rather than accounting principles (Questions 12, 19, 20, 21, 51, 63-64, 68-71). As a result, we do not address all these questions presented by the Board. Below we further develop our views in our answers to your specific questions on the Accounting Standards Update focussing our attention on points of principle. Moreover our answers are established from a preparers' point of view, consequently we also do not answer the questions specifically addressed to users (Questions 5-7, 22-27, 35-36, 43-45, 52-55, 59-60 and 66-67).

In the annexe below, we further develop our views in our answers to your specific questions in invitation to comment.

We thank you for the opportunity to submit our comments on your proposals.

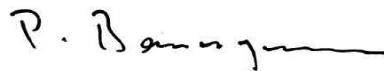
Yours sincerely,

**SwissHoldings**

Federation of Industrial and Service Groups in Switzerland



Dr. Gottlieb A. Keller  
Current Chair of SwissHoldings,  
(General Counsel Roche Holding AG)



Dr. Peter Baumgartner  
Chair Executive Committee

cc SH Board

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## ANNEXE

### ANSWERS TO SPECIFIC QUESTIONS IN INVITATION TO COMMENT

#### Scope – Questions for All Respondents

##### Question 1

*Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments do you believe should be excluded or which financial instruments should be included that are proposed to be excluded? Why?*

Although this question relates partly to U.S. GAAP specific guidance, in particular to various Topic provisions, we agree with the scope of financial instruments included. However we believe that the measurement of some instruments could be addressed more pragmatically. We propose that the Board should evaluate a more practical approach to value short-term accounts receivable as this has been proposed through practical expedients by the IFRS Exposure Draft on “*Financial Instruments: Amortised Cost and Impairment*”. We agree with the IFRS proposal and believe that short-term receivables should be measured by calculating a simplified amortised cost approach and by not imputing interest and determining an effective interest rate, hence not recognising any interest revenue as the effect of discounting is immaterial. These financial instruments should simply be measured at their invoice amount less undiscounted expected credit losses using a provision matrix of experienced losses with trade receivables. We see difficulties in applying the proposed amortised cost concept for trade receivables, the most significant financial instrument balance sheet item for many industrial preparers, for several reasons:

- The interest element is not explicitly known for these instruments, and they are also not perceived as instruments with contractual interest cash flows originated from the principal of the instrument;
- Trade receivables are not held as a revenue originating asset. So to provide information about the effective return is not meaningful;
- The instrument is not intended to provide extended payment terms in order to earn interest;
- Trade receivables are the product of an already concluded revenue earning process and as such the return from goods sold or services provided has materialized. The time lag between the sale or the work fulfilled and the payment is part of the selling process or the rendering of services;
- In many jurisdictions one can only legally claim interest on trade receivables when these are overdue. Consequently, interest components cannot be implied at the date of the origination or conclusion of providing the goods and services; and
- For many industries product prices are determined or regulated by authorities or agencies, which will not accept that interest is embedded in them as consumers would argue that manufacturers or service providers should finance themselves.

For non-financial service industry preparers the question arises on the relevance of having trade receivables treated similarly to financial instruments of the financial services industry. We would therefore urge the Board to reconsider the application to short-term trade receivables and other operating financial assets such as short-term loans to suppliers and/or employees.

##### Question 2

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*The proposed guidance would require loan commitments, other than loan commitments related to a revolving line of credit issued under a credit card arrangement, to be measured at fair value. Do you agree that loan commitments related to a revolving line of credit issued under a credit card arrangement should be excluded from the scope of this proposed Update? If not, why?*

The proposed guidance will only partially require loan commitments to be measured at fair value with the exception for loan commitments related to credit card lines. Although, we agree, that for practical reasons such credit card arrangements could be excluded from the fair value measurement, we wonder whether the proposed simplified accounting treatment could also be applicable to other loan commitments with similar characteristics. Therefore we would recommend that the proposed accounting treatment should be applicable to all loan commitments with the same modularities like credit card arrangements rather than for these specific credit arrangements only.

### **Question 3**

*The proposed guidance would require deposit-type and investment contracts of insurance and other entities to be measured at fair value. Do you agree that deposit-type and investment contracts should be included in the scope? If not, why?*

Although SwissHoldings members as non-financial service industry preparers are not involved in the life insurance business and directly exposed to these types of financial instruments, we believe that such insurance contracts should not be in the scope of this Accounting Standards Update but be addressed in the project on insurance. In general, the accounting for items involving insurance risk should be stipulated in the insurance standard and accounted for as insurance contracts. If these contracts do not include insurance risk, we agree that such financial instruments should be part of the financial instruments standard.

### **Question 4**

*The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting? If not, why?*

We do not agree with this change to determine the scope of consolidation for equity method investments and joint ventures. SwissHoldings is of the opinion that proposals for the accounting of financial instruments should not influence the criteria the for equity method of accounting. Moreover we fail to understand why there should be a change required to the application of the equity method of accounting. We also believe that this change would significantly influence the accounting of many entities. Such an accounting change should be addressed in a new separate project.

## **Initial Measurement – Questions for All Respondents**

### **Question 8**

*Do you agree with the initial measurement principles for financial instruments? If not, why?*  
We agree with the initial measurement principles that for financial instruments measured at fair value with subsequent changes in fair value recognized in profit or loss, the related fees and costs of the transaction should be expensed. We also agree that in case of financial instruments not measured at fair value through profit or loss, the transaction costs should be part of the initial recognition and should be deferred and amortized through profit or loss as an adjustment of the yield over the related life of the financial instrument.

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**Question 9**

*For financial instruments for which qualifying changes in fair value are recognized in other comprehensive income, do you agree that a significant difference between the transaction price and the fair value on the transaction date should be recognized in net income if the significant difference relates to something other than fees or costs or because the market in which the transaction occurs is different from the market in which the reporting entity would transact? If not, why?*

We are of the opinion that a significant difference between the fair value and the transaction price at initial recognition should be recognized in profit or loss either on a straight line basis or on another rational basis that reflects the nature of the financial instrument. But we would like to emphasize that we consider that the fair value should only be used instead of the transaction price in cases where the fair value is supported by using valuation techniques either by observable quoted market prices or by observable market data input.

**Question 10**

*Do you believe that there should be a single initial measurement principle regardless of whether changes in fair value of a financial instrument are recognized in net income or other comprehensive income? If yes, should that principle require initial measurement at the transaction price or fair value? Why?*

We believe that the transaction price will generally approximate the fair value. In the absence of recent market transactions, the fair value could be derived using valuation techniques. However, as mentioned above, the data input for such valuations should be based on observable market data.

**Question 11**

*Do you agree that transaction fees and costs should be (1) expensed immediately for financial instruments measured at fair value with all changes in fair value recognized in net income and (2) deferred and amortized as an adjustment of the yield for financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income? If not, why?*

This question has been addressed in our answer to your question 8.

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## Subsequent Measurement – Questions for All Respondents

### Question 13

*The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholder's equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?*

SwissHoldings is convinced that a mixed measurement model based on the business intention of the entity best represents its financial position and result. If financial instruments are managed on a fair value basis, the fair value information and the fair value movements provide sufficient information on expected future cash flows. However, if financial instruments are not managed on a fair value basis, we are not convinced that the same conclusion should be reached. For instance, a finance company, which focuses on trading, purchases a debt instrument in order to gain profit from interest rate volatilities, whereas an industrial company could acquire the same marketable security in order to receive a stable inflow of interest revenue. The business strategy of both companies would be different and the use of different measurement criteria for the same security would not diminish comparability of the two entities. On the contrary, it allows each preparer to adequately present its financial results using the objectives with which the instruments were entered into. One company would value the security through profit or loss as it has a short-term focus on possible trading gains, and the other company would measure it at amortized cost as the investment is of a long-term nature to achieve constant revenue streams. Both presentations of financial instruments would allow users and recipients of financial reporting to understand how the entity operates and employs its financial resources as well as how performance is achieved. Such an approach could not be achieved by the use of only a full fair value basis.

Consequently, we strongly support a measurement model that allows both fair value and amortized cost measurement based on the business model adopted by the entity as well as the characteristics of the utilized financial instrument. We therefore agree with the alternative views expressed by the two dissenting Board members concerning non-marketable, plain-vanilla debt instruments that an entity holds as part of a long-term business strategy to be carried at amortised cost.

### Question 14

*The proposed guidance would require that interest income or expense, credit impairments and reversals (for financial assets) and realized gains and losses be recognized in net income for financial instruments that meet the criteria for qualifying changes in fair value to be recognized in other comprehensive income. Do you believe that any other fair value changes should be recognized in net income for these financial instruments? If yes, which changes in fair value should be separately recognized in net income? Why?*

We are of the opinion that financial instruments held for the purpose of generating constant cash flows and that have certain loan features should be measured at amortized cost as this measurement methodology best represents the value the entity will achieve from the future cash flows of such instruments. However, we agree that income or expense components determined by the amortized cost methodology should be recognized in net income. We disagree to measure at fair value financial instruments that are not held for trading but that an entity manages on a contractual yield basis because the fair value measurement also implies a short-term exit

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strategy for the investment. As such a fair value measurement would not fairly represent the business intention of the entity as it would not divest the financial instrument in the short-term.

In addition, we would like to mention that the recognition of fair value changes of financial instruments held to collect contractual cash flows in other comprehensive income would increase volatility in equity that does not necessarily represent the entity's business model. We believe that a fair value default measurement attribute would not provide decision useful information when the business strategies and models differ from a short-term management approach of these financial instruments.

#### **Question 15**

*Do you believe that the subsequent measurement principles should be the same for financial assets and financial liabilities? If not, why?*

Our major concern relates to the measurement principles for financial liabilities and primarily to own debt issued for financing or funding purposes. We believe that the proposal for measuring all financial liabilities at fair value will not lead to meaningful financial reporting in all aspects. The effects of changes in an entity's own credit risk will have a counter-intuitive and unacceptable impact on the performance of the entity in the case of a weakening of its credit worthiness. The fair value measurement of own financial liabilities does not necessarily reflect the financial position of the entity from an economic point of view. We are therefore opposed to the measurement of all financial liabilities at fair value and believe that the IASB's proposal of a mixed measurement model in combination with the introduction of a fair value option to eliminate the impact of changes in an entity's own credit risk from profit or loss produces a better reflection of an entity's performance.

#### **Question 16**

*The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?*

We are of the opinion that reclassification should remain possible in the revised standard. We strongly believe that accounting should not drive the business or business model but should rather reflect it. The reasons for holding financial instruments may change over time so reclassification to accommodate this change should be allowed. Although business models are of a strategic nature and do not change frequently, they are however reviewed for their appropriateness in the current economic environment. So it is to be expected that entities will change their business orientation from time to time. For financial information and reporting purposes such a change in the business model should permit the reclassification of the entity's deployed resources, e.g. financial assets, in order to properly reflect the revised circumstances the entity operates in. The users would also have more relevant financial statement information for their analysis if business model changes are accompanied by the corresponding reclassifications.

#### **Question 17**

*The proposed guidance would require an entity to measure its core deposit liabilities at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-in-cost-to-service rate over the implied maturity of the deposits. Do you believe that this remeasurement approach is appropriate? If not, why? Do you believe*

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*that the remeasurement amount should be disclosed in the notes to the financial statements rather than presented on the face of the financial statements? Why or why not?*

Although, as non-financial service industry preparers, SwissHoldings member companies will hardly be exposed to such financial instruments, we consider the proposed individual measurement treatment for core deposits as over-complex and unnecessary. This special measurement will introduce additional complexity which should be avoided. We also fail to understand why core deposits should be measured differently from other deposits like time deposits. In addition, the measurement will be based on hypothetical assumptions due to the introduction of an alternative funds rate and will be highly judgemental. This measurement methodology would not reflect the actual cost of funding of the financial institution and consequently would not present decision useful information.

### **Question 18**

*Do you agree that a financial liability should be permitted to be measured at amortized cost if it meets the criteria for recognizing qualifying changes in fair value in other comprehensive income and if measuring the liability at fair value would create or exacerbate a measurement attribute mismatch? If not, why?*

As commented in our answers to questions 13, 14 and 15, we are of the opinion that financial liabilities should be measured at amortized cost, except for derivatives and if they are held for trading purposes or if the fair value option would be elected to avoid an accounting mismatch. Financial liabilities are issued for funding of the entity and usually are repaid at maturity. Therefore amortized cost taking the related cash flows of the debt into account reflects the most appropriate measurement. Moreover, we see the proposed 50% criteria of assets valued at fair value as arbitrary and do not support such a test as the funding of an entity's operations or projects should not be generalized and depend on whether the majority of its assets are measured at fair value or not but should rather be based on the characteristics of the financial instrument.

### **Subsequent Measurement – Questions for Preparers and Auditors**

We addressed the questions 28, 29, 30 and 31 in our answers to questions 14, 15, 18 and 17 respectively.

### **Presentation – Questions for All Respondents**

We are answering the following questions together.

### **Question 32**

*For financial liabilities measured at fair value with all changes in fair value recognized in net income, do you agree that separate presentation of changes in an entity's credit standing (excluding changes in the price of credit) is appropriate, or do you believe that it is more appropriate to recognize the changes in an entity's credit standing (with or without changes in the price of credit) in other comprehensive income, which would be consistent with the IASB's tentative decisions on financial liabilities measured at fair value under the fair value option? Why?*

### **Question 33**

*Appendix B describes two possible methods for determining the change in fair value of a financial liability attributable to a change in the entity's credit standing (excluding the changes in the price of credit). What are the strengths and weaknesses of each method? Would it be appropriate to use either method as long as it was done consistently, or would it be better to use Method 2 for all entities given that some entities are not rated? Alternatively, are there better methods for determining the change in fair value attributable to a change in the entity's credit standing,*

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*excluding the price of credit? If so, please explain why those methods would better measure that change.*

#### **Question 34**

*The methods described in Appendix B for determining the change in fair value of a financial liability attributable to a change in an entity's credit standing (excluding the changes in the price of credit) assume that the entity would look to the cost of debt of other entities in its industry to estimate the change in credit standing, excluding the change in the price of credit. Is it appropriate to look to other entities within an entity's industry, or should some other index, such as all entities in the market of a similar size or all entities in the industry of a similar size, be used? If so, please explain why another index would better measure the change in the price of credit. ?*

In most cases financial assets and financial liabilities held by an entity have different inherent credit risks. SwissHoldings is of the opinion that the change in fair value of liabilities attributable to changes in an entity's credit risk should not affect profit or loss. We find it counter-intuitive, potentially misleading and unexplainable that an entity might recognize gains from the worsening of its credit standing as a result of its underperformance. We agree with the proposal to recognise the fair value changes due to the changes in an entity's own credit risk in other comprehensive income. Separating the two credit components, i.e. the price of credit in general and the entity's specific price will introduce additional complexity. We would not recommend determining a single methodology, but we believe that an entity should apply consistently a methodology which most comprehensively reflects the changes in fair value of its own credit risk.

#### **Credit Impairment – Questions for All Respondents**

We are answering the following questions together:

#### **Question 37**

*Do you believe that the objective of the credit impairment model in this proposed Update is clear? If not, what objective would you propose and why?*

#### **Question 38**

*The proposed guidance would require an entity to recognize a credit impairment immediately in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s).*

*The IASB Exposure Draft, Financial Instruments: Amortised Cost and Impairment (Exposure Draft on impairment), would require an entity to forecast credit losses upon acquisition and allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using the effective interest rate method. Thus, initially expected credit losses would be recorded over the life of the financial asset as a reduction in interest income. If an entity revises its estimate of cash flows, the entity would adjust the carrying amount (amortized cost) of the financial asset and immediately recognize the amount of the adjustment in net income as an impairment gain or loss.*

*Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?*

We understand from the proposed model that an entity should consider the available information of the credit history and the actual situation of the financial instrument, but will assume that the

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existing conditions would remain unchanged. So possible future events would not be forecasted and introduced in the estimates on expected credit losses. In addition, the estimated credit losses would be recognized within the period when they are estimated and not over the life of the financial asset.

We believe that forward looking information should also be considered for the estimates on credit losses. Consequently, an impairment model based on the expected cash flows from the financial instruments would more comprehensively predict the credit performance over time. The proposed guidance does not take changes of cash flow estimates into account but only the forecast for credit losses upon acquisition or in case of change in expectations. So, an entity would recognize immediately the total credit impairment in profit or loss at that point of time. This could be even the case upon initial origination of the borrowing.

SwissHoldings questions whether it is appropriate that credit losses should be required on initial acquisition or on the origination of the lending. We prefer a credit impairment methodology which will be based on forecasted cash flows over the life of the financial instruments taking possible future scenarios into account. In addition, we do not support the recognition of gains and losses due to changes in estimates of future credit losses within the period when the change happens. If forward-looking information produces a more favourable outcome, then a one-time gain could be recognized immediately in the period when the appraisal changed, although no credit losses were incurred in prior periods. In our opinion, such fluctuations in the income statement will be difficult to explain and to justify. Although economically a change happened, does the respective one-time effect really only relate to the period when the improvement materializes or becomes obvious? One approach could be to first reverse provisions established in prior periods and then spread the remaining portion over the anticipated time of the revised estimation as it would relate to future periods.

#### **Question 39**

*Do you agree that a credit impairment should not result from a decline in cash flows expected to be collected due to changes in foreign exchange rates, changes in expected prepayments, or changes in a variable interest rate? If not, why?*

We believe that changes in foreign exchange rates should not result in a credit impairment, but that such changes should be recognised in accordance with the relevant standard on effects of changes in foreign exchange rates. However, if a debtor would encounter significant difficulties to fulfil its credit obligation due to foreign currency rates movements which would affect its operations, we believe that such developments should be part of the analysis to estimate the expected credit losses. As regard to changes in expected prepayments or changes in variable interest rates we agree that these changes should not trigger credit impairments. However, if contractually agreed prepayments cannot be met by the debtor, this should be factored into the respective credit loss estimates. Following the IASB proposal on expected credit losses derived from expected cash flows, we believe that the above circumstances and events would already be covered by this measurement model through the continuous inclusion of any kind of revision for the expected cash flows from the financial instrument.

We are answering the following questions together:

#### **Question 40**

*For a financial asset evaluated in a pool, the proposed guidance does not specify a particular methodology to be applied by individual entities for determining historical loss rates. Should a specific method be prescribed for determining historical loss rates? If yes, what specific method would you recommend and why?*

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**Question 41**

*Do you agree that if an entity subsequently expects to collect more cash flows than originally expected to be collected for a purchased financial asset, the entity should recognize no immediate gain in net income but should adjust the effective interest rate so that the additional cash flows are recognized as an increase in interest income over the remaining life of the financial asset? If not, why?*

**Question 42**

*If a financial asset that is evaluated for impairment on an individual basis has no indicators of being individually impaired, the proposed guidance would require an entity to determine whether assessing the financial asset together with other financial assets that have similar characteristics indicates that a credit impairment exists. The amount of the credit impairment, if any, would be measured by applying the historical loss rate (adjusted for existing economic factors and conditions) applicable to the group of similar financial assets to the individual financial asset. Do you agree with this requirement? If not, why?*

We agree that the standard should not stipulate a specific methodology to determine historical loss rates. Similarly as commented in our answer to question 34, we believe that an entity should be able to determine consistently historical loss rates which reflect its business or industry environment.

But we would like to mention at this point that although we recognize the need to develop a more future-oriented impairment model we are concerned about the complexities that such a model will involve. Especially we fear that for many non-financial service institutions there might be a lack of historical data and statistics to build on for the development of an expected loss model. Whilst historical data collected from various business cycles should, to a certain extent, provide the basis for determining historical loss rates, related estimates of future cash flows (in case of the IASB methodology) and the related impairments required.

We consider that it will be difficult in many cases to achieve the required data granularity to support the model. This may be the case for the data collection for certain customer segments or geographical and market segmentation. We also expect difficulties in gathering data for long time series. We would expect more guidance on this issue for non-financial service industry preparers. The guidance should include pragmatic and practical approaches for database requirements. We further agree that no immediate gain should be recognized in case of a higher than expected cash flow collection and that the additional cash flows should be spread as interest income by adjusting the effective interest rate over the remaining life of the financial asset.

**Credit Impairment – Questions for Preparers and Auditors**

We addressed the questions 46 and 47 in our answers to questions 38 and 42 respectively.

**Interest Income – Questions for All Respondents****Question 48**

*The proposed guidance would require interest income to be calculated for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income by applying the effective interest rate to the amortized cost balance net of any allowance for credit losses. Do you believe that the recognition of interest income should be affected by the recognition or reversal of credit impairments? If not, why?*

This question has been addressed in our answer to your question 34.

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**Question 49**

*Do you agree that the difference in the amount of interest contractually due that exceeds interest accrued on the basis of an entity's current estimate of cash flows expected to be collected for financial assets should be recognized as an increase to the allowance for credit losses? If not, why?*

We have concerns with the proposed approach as the allowance for credit losses would not effectively represent the accumulated amount of impairments recognized through the income statement. We prefer to present interest income based on interest revenue less the expected credit loss expenses as well as impairments which would represent the allowance for credit losses.

**Question 50**

*The proposed guidance would permit, but would not require, separate presentation of interest income on the statement of comprehensive income for financial assets measured at fair value with all changes in fair value recognized in net income. If an entity chooses to present separately interest income for those financial assets, the proposed guidance does not specify a particular method for determining the amount of interest income to be recognized on the face of the statement of comprehensive income. Do you believe that the interest income recognition guidance should be the same for all financial assets?*

We believe that the fair value changes of financial instruments measured at fair value through profit or loss should be presented in their entirety as business practice has shown that the fair value changes of financial instruments held for trading should comprise the entire change in value and that such information is sufficient for this category. Moreover, the proposed additional separation will add complexity to the presentation of comprehensive income from financial instruments.

**Hedge Accounting – Questions for All Respondents****Question 56**

*Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?*

SwissHoldings definitely supports the simplification of hedge accounting and thus the reduction of complexity in the accounting for financial instruments. The hedge effectiveness requirements have been considered as burdensome and in many cases prevented companies from establishing hedge accounting in the way their actual risk management is conducted. The demonstration of reasonable effectiveness by a qualitative assessment will allow entities to better realize hedge accounting for their actual risk management strategies and as a result, the risk management activities of an entity would be better presented in its respective financial statements. We therefore agree with the proposed modification to change the effectiveness threshold from highly effective to reasonably effective which would be generally demonstrated by a qualitative (rather than quantitative) assessment. We are answering the following questions together:

**Question 57**

*Should no effectiveness evaluation be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected term? Why or why not?*

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**Question 58**

*Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? Why or why not?*

As commented above SwissHoldings is very much in favour of simplifying the effectiveness test requirements for hedge accounting. We understand that ineffectiveness would still be required to be recognized in profit or loss. Therefore, an entity would continue to calculate effectiveness at its financial statements reporting dates. We doubt whether no effectiveness evaluation could be required after the inception of a hedging relationship. So in principle, we foresee that processes and hedging operations in respect of effectiveness requirements would remain. In addition, we believe that additional guidance would be required to determine circumstances that would suggest that a hedging relationship should be reassessed. However, we estimate that the number of discontinued hedging relationships due to the existing effectiveness thresholds could decrease.

In cases where the critical terms of the hedging instrument and the hedged item exactly match, e.g. interest rate swaps, the changes in fair value attributable to the risk being hedged will most likely offset each other in full, both when the hedge is entered into and afterwards. Therefore, we would appreciate if in such cases a method of effectiveness testing would be available that consists for example of comparing the principal terms of the hedging instrument with those of the hedged item (e.g. a short-cut method). However, such a method may only be used in limited circumstances.

**Hedge Accounting – Questions for Preparers and Auditors**

We addressed the questions 61 and 62 in our answer to questions 57 and 58.

**Disclosures – Questions for All Respondents****Question 65**

*Do you agree with the proposed disclosure requirements? If not, which disclosure requirement do you believe should not be required and why?*

The Update is very much written from the angle of financial service institutions. Consequently the required disclosures support the analyses of the credit business of these preparers. We understand that the proposed set of disclosures needs to be comprehensive in order to allow and support these business assessments. However we miss the application of materiality consideration in respect of the application of the proposed disclosure requirements for non-financial service institutions. We consider that the volume of disclosures that non-financial service industry preparers would have to produce will be excessive and non-core to their actual business. Users of financial statement information might even be distracted by largely irrelevant disclosed business information which may cloud core business activities. The disclosure requirements need to be more differentiated by taking the preparer's business activities and their relevance to the credit business into consideration. The disclosure requirements should include provisions to address flexibly the level of detail depending on the relevance and materiality of the credit business to a preparer's core operations rather than requiring equivalent disclosures from non-financial service companies which – in fact – are necessary and designed for financial service institutions. We expect the Board to reduce or allow simplification, in particular for allowances for credit losses, of the disclosure requirements for non-financial service institutions.