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Group Finance/Accounting Policy

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Subject: Preliminary comments to draft letter on Discussion paper Fair Value Measurement

Thank you for forwarding your draft comment letter on the Discussion Paper “Fair Value Measurement”. Overall, we are supportive of EFRAG’s comment letter however, we would also like to make the following observations. In the coming period we will further study the Discussion Paper and will provide you with any further comments we may have. Where we have not addressed a particular question or issue it can be assumed that we are broadly in agreement with the views as expressed in EFRAG’s comment letter.

Comments on EFRAG introduction/general remarks

- We support the view that the measurement basis be tagged as "market-based exit value" rather than fair value, since we agree this is prone to misinterpretation. We concur that it is difficult to understand the full ramifications of fair value measurement if we do not understand the scope of use. Here, we believe the “objectives” of management has a part to play. For instance, there is an argument that would indicate that a different valuation should be used on those assets/liabilities that management intends to hold, i.e. for investment or use in production purposes, as opposed to those they intend to sell - the example used, i.e. whether a liability should be held at settlement or transfer value is a good example of how valuations might differ.
- We too, would support the promotion of principles based standards and not the detailed rules indicated by the pages of guidance (albeit well written guidance) and would therefore advocate a distinction between principles in a standard and application and implementation guidance.
- We further agree with EFRAG’s comments regarding application of the guidance where no liquid market exists and, even when liquid markets do exist we believe valuations may differ between entities. A good example of this potential difference would be an FX transaction between a European entity and a US Entity. The European entity would use the close price of the European market for valuation whereas the US entity would use the American close price. Therefore even in highly liquid markets variations in valuation may occur.
- We concur with EFRAG that a transfer notion should not be applied to all liabilities. Here, we believe management objectives as supported by the business use of a transaction needs to be taken into account as transfer or settlement will not provide the most relevant information in all cases. For example, notes issued by an entity would most appropriately be valued on a settlement basis, whereas a traded liability would be most appropriately valued on a transfer basis. We also believe that the same approach should be applied to both assets and liabilities.

- We think that the sentence in paragraph (i) should read “In our view, changes in own credit risk should not be reflected in the measurement used in the primary financial statements, but the resulting information is useful”. Further, if we were to use a transfer basis of valuation for liabilities then we believe that own credit risk should be included, whereas we believe that own credit risk is inappropriate for items valued on a settlement basis.
- We do not support the idea of a hierarchy *per se* since this provides an indication that one basis is "better" than another which is not necessarily the case - while 3 categories of valuation basis appear appropriate for classification - there should not be an assumption that information is per se "better" if it is one category rather than another.

Comments on Appendix 2 to EFRAG letter - comments on individual questions on the invitation to comment from IASB

We are in general agreement with EFRAG’s comments in Appendix 2 however we make the following additional comments/observations:

Question 3:
a) Exit Value Notion
We have concerns with using the exit value in all instances. Exit value will typically not be the same as entry value. Even more so, in most cases we do not believe that the two parties in an identical transaction would assign the same value, even when they sit as the opposing counterparties. For example, if transaction costs are included it is likely that exit values would not agree between entities. Exit value should reflect the likely value that the entity will achieve from a particular transaction, and as a result is affected by method of exit. In addition, there is a danger of overriding the assumption of going concern, and effectively forcing entities to apply what is in effect a break up value.

b) Market Participant
We thought the discussion paper of the FASB was reasonably clear, and thought that the EFRAG argument regarding the existence of a market participant was technical rather than practical. However, the assumption that "principal advantageous market" is one that the entity actually has access to, which begins to bring us back to the question of intent or management’s objective for the transaction, and whether the focus should be on the actual market that the entity is likely to use as opposed to one that it might theoretically have access to but has no intention of using.

Question 4:
Overall we agree with EFRAG’s analysis. We do not believe that entry and exit prices will always equate, even for the same product between the counterparties of that product. While some of this will undoubtedly be attributable to transaction costs, it can also be caused by other factors. For example, consider a simple swap transaction - the two parties may use slightly different models. Equally, we have the case illustrated above with FOREX transactions in different time zones.

Question 6:
We are at odds with EFRAGs comments on financial instruments. We believe that, apart from the requirements of day one, fair value measurement guidance is based on notion of "exit".

Question 7:
We believe that the FAS 157 notion is relatively straight forward. That said, we understand where EFRAG is coming from, re lack of liquid markets making a purist approach difficult, but we believe that the idea that a market participant exists is supportable, and largely consistent with the IAS 39 concept of ‘knowledgeable and willing’ parties.

Question 9:
We disagree that the value concept for a liability should be purely settlement focused; rather, it should depend on whether the entity would intend to transfer (such as traded position) or settle (as in issued debt).

Question 11:
We disagree with EFRAG's comment in para A2.44(c)(ii) given that the comment provided is in our view a US rather than IFRS interpretation. Even for IFRS we understand that some organisations will apply stress testing to determine what level of reserving is required. If day one profit reserving did not exist, we expect organisations would consider other reserve methodologies.

Question 12:
We see two issues. EFRAG is right to point to the merits of looking at applying values on a "full product" rather than a component approach. In addition, there is also an issue as to whether value should be based on the full portfolio of individual products held or each individual product (such as mortgage or credit card product). Here, we believe there are merits in looking at a portfolio approach, which will typically reflect the purposes of the entity with the transaction (and would also reflect most advantageous market), but would be different to unit price x volume.

Question 15:
We believe transaction costs should be included, even though we recognize that this will create differences what is shown as exit value.

Question 16:
If transfer value is used then we believe own credit risk should be measured, if using settlement then own credit risk should not be included.

Question 18:
We agree with the split, but we do not agree it should be a hierarchy, simply a means of attributing the derivation of fair value used.

Question 20:
If the aim is to present an exit price concept of fair value, then a portfolio holding should be priced on basis of exit, and this would include a blockage discount. Since there is more subjectivity around blockage, it is preferable to use a valuation basis of exit that excludes blockage. However, for instruments that are not traded in liquid/active markets, we would support the use of liquidity adjustments as appropriate to reflect actual exit price that can be achieved.

Question 21:
We believe that caution is needed here, since even for a market maker, to exit a long position will incur a bid cost - even though if the organisation is able to hold the position and someone approaches about purchasing, they would be able to dispose at offer (and hence achieve a premium). On the whole, the existing IFRS concept of pricing at bid or offer based on asset or liability appears most appropriate rather than allowing a subjective approach within the bid-offer spectrum. Equally the bid-offer approach represents the transaction cost of exit, and will not necessarily be standard for all entities - hence valued position reflects actual exit price achieved.

Question 22:
As above.

Question 24:
We consider the disclosure requirements in FAS157 useful as additional information

Yours sincerely,

ABN AMRO

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