IASB
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

19 August 2009

Dear Sir or Madam,

RE: DISCUSSION PAPER ON CREDIT RISK IN LIABILITY MEASUREMENT

BUSINESSEUROPE believes that the Discussion Paper (DP) lays out in a fairly balanced fashion the theoretical arguments for and against inclusion of own credit risk in the measurement of liabilities. Our considerations have approached the question from the perspective,'Would inclusion give rise to decision-useful information to the users?'. Based on discussions with users our clear conclusion is that:

- Own credit risk should only be taken into account in the initial measurement of a liability if it is priced into the transaction that gave rise to the initial recognition of a liability.
- In all other circumstances it should not be included in the initial measurement. Where discounting is involved, our preference is for this to be done at (say) the AAA corporate bond rate. (See also our remarks below on discounting.)
- Changes in own credit risk should not be taken into account in subsequent measurement of liabilities.

That the question arises at all reflects in part some rather fundamental cross-cutting issues which the Board has either not tackled or not resolved satisfactorily. We would draw attention to:

- the absence of a clear *principle for discounting*. While it is generally clear – from general principles - that this should adjust for the time-value of money and for the risks of various cash flow outcomes where not considered in the basic data to be discounted, what other factors should influence the discount rate is not. Different standards use different approaches.
- the *perspective* of the financial statements. On the going-concern assumption the possibility of default is in most cases irrelevant as the entity will have the obligation and intention to pay. The financial statements are, however, occasionally looked at from an "external" (e.g. shareholder's) perspective – in our view erroneously, for it is the user's job to translate information about the entity per se into information for the use of the individual supplier of capital. (We say "in most cases irrelevant" as there are of course instances where an entity uses a fall in the market price of its debt to repurchase it where this is believed to be advantageous for the entity. Yet even here, we do not believe that this relatively small number of cases is sufficient to justify requiring all financial liabilities to be measured at amounts that reflect changes in credit

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spreads.) The focus should surely be on financial information which best reflects the entity's expected future cash flows, which credit-risk adjustments will falsify.

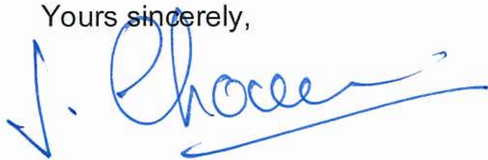
- the assumption of *going concern*. In several recent proposals the Board has appeared to demote the importance of going concern in evaluating appropriate principles, moving financial reporting rather towards liquidation accounts. This is a disservice to users: the cases where they are more interested in liquidation or break-up values for an entity are few and far between.
- *performance*. The Board has so far not seen fit to consider in any practically meaningful way the concept of performance, which is for most participants in the capital markets the most central concept in financial reporting. Hence, we have no generally accepted principle for judging whether any changes in value of liabilities which were recorded would be part of the entity's "performance" or not.

With regard to some of the various theoretical pros and cons presented in the DP, we have the following remarks:

- *consistency*. Looking at many other areas of IFRS, there seems to be no particular reason why there should be consistency between initial and subsequent measurement. Consistency should certainly not take precedence over meaningful, decision-useful information which users appear to understand as excluding changes in own credit risk from subsequent measurement: they would adjust them out.
- *wealth transfer*. Except in the case of an actual transaction such as debt repurchase at a discount, there is here no real transfer of wealth: the shareholder acquires no additional claims on the entity. In any case we doubt whether the argument holds from an entity (rather than shareholder) perspective.
- *accounting mismatch*: We do not see in most cases any necessary automatic link between reductions in the "value" of a liability and a change in that of an asset.
- *"credit risk of the liability"*: The DP talks of "the credit risk of the liability" as something distinct from entity-own credit risk. What types of risk other than own credit standing should be considered? is there, for instance, a generic level of credit risks for all liabilities in a given economy?

Please see the appendix for our answers to the specific questions posed in the DP.

Yours sincerely,



Jérôme P. Chauvin
Director
Legal Affairs Department
Internal Market Department

APPENDIX

RESPONSES TO THE QUESTIONS ASKED IN THE DISCUSSION PAPER

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? and (ii) what should be done with the difference between the computed amount and cash proceeds (if any)?

See our covering letter.

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?

See our covering letter (i.e. exclude effects of *changes* in credit risk.)

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?

An estimate of the change in interest rates attributable to the change in the entity's credit risk could be made by comparing the change in high-quality corporate bond rates with the change in the entity's recent borrowing costs. This would necessarily involve a certain amount of judgement and estimation, but these are normal and essential parts of accounting measurement techniques.

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?

Of the three our preference would be for (c), which is most in line with the overall conclusions of our covering letter. Please note, however, that we would in no way subscribe to the use of a current rate of interest in every circumstance for the subsequent measurement of liabilities as we firmly believe that an amortised cost approach is much more relevant for users in a large number of cases.