

Spanish Banking Asseciation

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—— Secretary General

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IASB Financial Instruments: Impairment. Supplementary Document

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Dear Sir David,

The AEB¹ welcomes the efforts of the IASB with the publication of the supplementary document and the opportunity to comment on the new proposal.

In this sense, we are pleased to express our support for the EBF's position that will be sent to you about this subject. Nevertheless we would like to stress some points relevant for the Spanish Banks we represent. Those points are as follows:

- The AEB firmly favors a single impairment model for all financial instruments at amortized cost, including financial guarantees and loan commitments, and believes the development of separate models is not desirable or justified.
- Although AEB welcomes the principle based standards, there are some aspects where further clarification is deemed necessary to assure consistency in application across different countries, banks, product types and portfolios, comparability and auditability. The clarification could for example be provided by guidance that would assist in making judgements in the following aspects:
 - o The difference between the "good book" and "bad book".
 - The concepts of expected losses and
 - The concept of foreseeable future.

¹ The **Spanish Banking Association (AEB)** is the voice of the Spanish banking sector representing and defending the collective interests of banks operating in Spain (94 member banks: 59 Spanish and 35 credit entities' branches of foreign banks operating in Spain), with total consolidated assets of € 2,114 trillion as of December 2009 and 109,996 employees in Spain.





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Finally, in our view incurred losses are the crystallization of expected losses, so expected loss allowance are built to be used. In this sense, the proposed approach in the Supplement ED does not allow the full absorption of incurred losses using the allowance account that was established for the relevant portfolio in the good book. Only the proportionate share in the allowance account that "belongs" to the transferred loan provides an offset against the new incurred loss provision in the bad book, while all the rest must be recognised immediately as a loss. This results in an incurred loss pattern in the profit and loss account that is similar to the incurred loss model of IAS 39, without any meaningful offset from the allowance on the good book. This contradicts the principle that incurred losses are the crystallisation of expected losses and that expected loss allowances are built to be used if and when losses are incurred.

The only way to mitigate this under the proposed model in the Supplement ED is to ensure that there is a consequential reduction of the allowance for the good book if and when loans are transferred to the bad book and vice versa. This may be best illustrated by the conditions that exist at the worst point of an economic cycle. At this point many bad loans will be or have been transferred to the bad book. If management applies a positive outlook (when justified based on reasonable and supportable information on forecasts of future events and conditions) in estimating future expected losses for the good book, a meaningful reduction to the good book provision will be possible, which would provide an offset against the immediate additional provisions needed for the incurred losses in the bad book.

However, in practice it would be very difficult to accomplish this, as it would require predicting the beginning and the end of economic cycles, and also their depth, which is practically very difficult and, if even possible, would always occur with a significant delay.

The AEB believes that the standard should be clarified to better explain the objective of how the model is intended to operate in various parts of the economic cycle. Also it should be better explained that the offset as described above is intended to arise (for example by providing guidance or examples that assists in making judgements in the relevant parts of the economic cycle).

Such clarification should avoid that the proposals would result in practice in an impairment model that is similar or equal to the current incurred loss model with only an additional "buffer" in the balance sheet. Furthermore, it is not clear how that outcome would address the criticism on the current IAS 39 model.

Yours sincerely,