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1 April 2011

Dear Sir/Madam

<u>Supplemental document - Financial Instruments: Impairment</u>

We are pleased to respond to your supplemental document, Financial Instruments: Impairment.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of the member firms that commented on this supplemental document. "PricewaterhouseCoopers" refers to a network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We recognise the significant efforts that the Boards are making to respond to the accounting concerns raised by constituents following the recent financial crisis. The financial crisis has highlighted the importance of having a consistent approach to the accounting for financial instruments, particularly with respect to the impairment of financial assets. We therefore strongly support the development of a single converged model for impairment under both IFRS and US GAAP and urge both the IASB and the FASB to continue to work together during the re-deliberation process to achieve this goal.

Consistent with our comment letters on the original IASB exposure draft, Financial Instruments: Amortised Cost and Impairment, and the FASB proposed accounting standards update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities (the 'proposed ASU'), we support an expected loss approach to accounting for the impairment of financial assets carried at amortised cost. We believe the impairment model should: (i) measure credit losses consistent with current market expectations regarding collectability, and (ii) recognise the expected losses over the life of the instrument in a manner consistent with its pricing. We believe this better reflects the economics of lending transactions than recognising lifetime expected losses immediately. While preferring the conceptual merits of such a model, we acknowledge the operational and pragmatic concerns that exist and are therefore supportive of the Boards pursuing a modified approach.

¹ Embankment Place, London WC2N 6RH. PricewaterhouseCoopers LLP is authorised and regulated by the Financial Services Authority for designated investment business.



The common proposal

We support a differentiated approach to recognition of expected credit losses on a "good book" and a "bad book" basis. We believe that the allocation of expected credit losses on a good book using a time-proportional method reasonably reflects the economics of lending transactions and the pricing of the instruments. When however the focus of the internal credit risk management changes from earning a return to recovery of a financial asset, and that asset is moved into a bad book, we accept the view that it is no longer appropriate to recognise expected credit losses over time. In these circumstances, a balance sheet approach that focuses on the allowance balance and reflects the recoverable amount of the financial asset is appropriate.

We do not believe that there is a conceptual basis for a floor on a good book, as it is inconsistent with the view that the lender is compensated for the expected losses over time through the credit spread on the portfolio. Furthermore, a floor could result in the recognition of Day 1 losses for some financial assets, which is inconsistent with the initial recognition of financial instruments at fair value. This issue is likely to be most pronounced in a business combination or purchase of a portfolio of loans.

At the same time, we recognise that convergence in this area is critical, and we would therefore accept a floor on a good book, if a floor is a necessary requirement to achieve a converged impairment model. In accepting a floor, we weighed the use of a twelve-month bright line against the foreseeable future concept. Our preferred approach is a twelve-month floor, as it would promote more consistent application and result in greater global comparability. However, we would accept a foreseeable future floor subject to additional application guidance, if it was a means of achieving a converged model.

Foreseeable future

The supplemental document states that the foreseeable future is the period over which specific projections of events and conditions are possible and credit losses can be reasonably estimated based on those specific projections. We are concerned that this description of the foreseeable future is too loosely defined to result in a converged application. It appears to be largely dependent on an entity's judgement over what period it is capable of forecasting and will likely be influenced to varying degrees by local regulator views on loss forecasting. We believe some entities will only forecast over the required minimum twelve-month period, while others may undertake the necessary analysis to forecast over two, three, or more years depending on the nature of their financial assets, availability of reliable information and analytical capability. Furthermore, the use of the term foreseeable future in a number of different areas in the current accounting literature with different meanings will potentially add to the confusion.

The IASB's proposed requirement to disclose the time period used as the foreseeable future and how that determination was made should mitigate some of our concern over the diversity in practice in this area. However, if the proposed foreseeable future floor is to be retained, we urge the Boards to better define the term and provide sufficient guidance to ensure a more consistent application in practice. Additionally, we strongly recommend that the Boards field test the interaction of the foreseeable future floor with the time-proportional allocation method to understand the practical consequences and viability of the common proposal.



Proposals yet to be deliberated

The scope of the supplemental document is limited to the timing of the recognition of expected credit losses for open portfolios. The Boards have not yet considered, nor requested additional input on, a number of other issues such as: the method of measuring expected credit losses, the recognition of interest income with respect to financial assets in a bad book, and the application of the model to purchased loans, including those acquired through a business combination. These open issues are very significant matters which will likely be challenging to address. Whether the common proposal is a workable solution to the need for a converged impairment model may ultimately depend on the conclusions reached in these areas.

FASB re-exposure

The FASB has tentatively agreed to significant changes to its original guidance in the proposed ASU. Specifically, it has tentatively modified the classification and measurement proposal to include three categories, including amortized cost, fair value with changes reflected in other comprehensive income and fair value with changes reflected in net income. Coupled with the proposed impairment model in the supplemental document, the foundational models of the FASB's original proposed ASU have, based on the FASB's tentative decisions, changed significantly. We understand that the FASB is considering the re-exposure of its revised overall financial instruments model. We strongly believe that re-exposure of the FASB model is appropriate given the magnitude of the proposed changes, the significant complexity of the issues involved, and the interrelated nature of many of the revised conclusions.

IASB transition

In considering the proposed impairment approach in the supplemental document, it is apparent that the transition to the new model will be very challenging. Given the significant judgments and estimates involved in assessing financial assets for impairment under the proposed approach, only a prospective transition requirement would seem to be appropriate. However, this would create an issue for certain financial assets when considering the retrospective transition requirements for the new classification and measurement guidance under IFRS 9. Financial assets at the date of initial application that will be reclassified to amortised cost upon adoption of IFRS 9 will require the application of an impairment model retrospectively in the comparative period. Even if an entity were to try to anticipate the need to make this reclassification in advance and assess impairment for these financial assets during the preceding year, it will still not have identified which assets should be reclassified until the beginning of the year of adoption. This is due to the IFRS 9 transition requirements, which only apply the new classification and measurement guidance to those financial assets present at the date of initial application. In view of this and the overall reconsideration of the effective date for IFRS 9 and certain other projects, we recommend that the IASB comprehensively reconsider all of the transition provisions for the financial instruments projects.

We have expanded on the above and responded to the specific questions raised in the supplemental document in the appendix to this letter.



If you have any questions in relation to the letter please do not hesitate to contact John Hitchins, PwC Global Chief Accountant (+44 207 8042497), Paul Kepple, PwC US Chief Accountant (+1 973 236 5293), John Althoff (+44 207 213 1175) or Greg McGahan (+1 973 236 5250).

Yours faithfully

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PricewaterhouseCoopers LLP



Appendix: Response to Detailed Questions

Question 1

Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (i.e. delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

We support an expected loss approach to accounting for the impairment of financial assets carried at amortised cost. We believe the impairment model should: (i) measure credit losses consistent with current market expectations regarding collectability, and (ii) recognise the expected losses over the life of the instrument in a manner consistent with its pricing. We believe this better reflects the economics of lending transactions than recognising lifetime expected losses immediately. While preferring the conceptual merits of such a model, we acknowledge the operational and pragmatic concerns that exist and are therefore supportive of the Boards pursuing a modified approach. We believe the approach described in this supplemental document addresses the perceived weakness of the current incurred loss model.

Question 2

Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

We believe that a single impairment model should be applied to portfolios of financial assets carried at amortised cost, as well as loan commitments and financial guarantees in the scope of a financial instruments standard. We believe that the impairment model proposed in the supplemental document is suitable for open and closed portfolios, as long as such portfolios contain a sufficiently large and representative population of items. We do not see any additional operational issues arising if the model is applied to closed portfolios.

The application of an expected value approach to individual instruments, as well as smaller and non-homogenous portfolios, is questionable. A probability-weighted methodology would require entities to make a provision for individual instruments where they do not believe it is highly probable or even likely that a credit loss will occur. The effect of this approach for financial assets that are ultimately collectible would be to defer a portion of the effective interest rate (i.e., the part related to the credit risk of the instrument) in an allowance account until later periods, at which time it would be recognised in profit and loss. The appropriateness, relevance and decision-usefulness of such an approach where there is no significant expectation of loss are doubtful. We believe that a single best estimate approach should be applied in these circumstances.



Question 3

Do you agree that for financial assets in the 'good book' it is appropriate to recognise the impairment allowance using the approach described above? Why or why not?

Question 4

Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

Question 5

Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

We support a differentiated approach to recognition of expected credit losses on a good book and a bad book basis. We believe that the allocation of expected credit losses on a good book using a time-proportional method reasonably reflects the economics of lending transactions and the pricing of the instruments. When however the focus of the internal credit risk management changes from earning a return to recovery of a financial asset, and that asset is moved into a bad book, we accept the view that it is no longer appropriate to recognise expected credit losses over time. In these circumstances, a balance sheet approach that focuses on the allowance balance and reflects the recoverable amount of the financial asset is appropriate.

We believe that the time-proportional method for the recognition of expected credit losses addresses many of the operational issues identified by the Expert Advisory Panel (EAP) with regard to the expected cash flows model proposed in the original IASB exposure draft. In particular, the revised model set out in the supplemental document eliminates the requirement to perform an integrated calculation of interest income net of credit losses expected upon origination of the financial instrument; it removes the requirement to separately track initial credit loss estimates and changes thereto, which is not practicable in the context of open portfolios; and it no longer requires entities to factor the timing of expected credit losses into the estimation process. Given these changes, we believe that the time-proportional method to recognition of credit losses on a good book is more operational than the model proposed in the original IASB exposure draft.

Question 6

Is the requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

Question 7

Is the requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

Question 8

Do you agree with the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

We support a differentiated approach to recognition of expected credit losses on a good book and a bad book basis. We believe that the allocation of expected credit losses on a good book using a timeproportional method reasonably reflects the economics of lending transactions and the pricing of the



instruments. When however the focus of the internal credit risk management changes from earning a return to recovery of a financial asset, and that asset is moved into a bad book, we accept the view that it is no longer appropriate to recognise expected credit losses over time. In these circumstances, a balance sheet approach that focuses on the allowance balance and reflects the recoverable amount of the financial asset is appropriate.

We believe that the principle underlying the distinction between a good and a bad book is clearly described, operational and auditable. We recognise that some entities, particularly those outside of the financial services sector, do not manage financial assets on the basis of a good book and a bad book. However, we believe that the principle described in the supplemental document provides a sufficient basis for entities to implement the proposed approach.

We note that the supplemental document does not address income recognition on financial assets in a bad book. We believe that this is one of a number of significant and complex issues which the Boards should address explicitly.

Question 9

The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this model. Specifically, on the following issues:

- (a) Do you agree with the proposal to require a floor for the impairment allowance related to the 'good book'? Why or why not?
- (b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the 'good book' only in circumstances in which there is evidence of an early loss pattern?
- (c) If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?
- (d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?
- (e) Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.
- (f) If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a 'ceiling' should be established for determining the amount of credit impairment to be recognised under the 'floor' requirement (for example, no more than three years after an entity's reporting date)? If so, please provide data and/or reasons to support your response.

We do not believe that there is a conceptual basis for a floor on a good book, as it is inconsistent with the view that the lender is compensated for the expected losses over time through the credit spread on the portfolio. Furthermore, a floor could result in the recognition of Day 1 losses for some financial



assets, which is inconsistent with the initial recognition of financial instruments at fair value. This issue is likely to be most pronounced in a business combination or purchase of a portfolio of loans.

At the same time, we recognise that convergence in this area is critical, and we would therefore accept a floor on a good book, if a floor is a necessary requirement to achieve a converged impairment model. In accepting a floor, we weighed the use of a twelve-month bright line against the foreseeable future concept. Our preferred approach is a twelve-month floor, as it would promote more consistent application and result in greater global comparability. However, we would accept a foreseeable future floor subject to additional application guidance, if it was a means of achieving a converged model.

The supplemental document states that the foreseeable future is the period over which specific projections of events and conditions are possible and credit losses can be reasonably estimated based on those specific projections. We are concerned that this description of the foreseeable future is too loosely defined to result in a converged application. It appears to be largely dependent on an entity's judgement over what period it is capable of forecasting and will likely be influenced to varying degrees by local regulator views on loss forecasting. We believe some entities will only forecast over the required minimum twelve-month period, while others may undertake the necessary analysis to forecast over two, three, or more years depending on the nature of their financial assets, availability of reliable information and analytical capability.

Furthermore, the term foreseeable future is used in a number of different areas in the accounting literature with different meanings. For example, the term foreseeable future is used in the Framework in the context of going concern discussion and is commonly interpreted as twelve months, whereas under IAS 38, Intangible assets, the term is used in illustrative example 4 and denotes cash flows over an indefinite period. We believe that the inconsistent interpretation of foreseeable future in the existing accounting literature will potentially add to the confusion for both preparers and users. Their prior experience with these other standards could also influence their application/interpretation of the term for purposes of determining/analysing the floor in this model.

The IASB's proposed requirement to disclose the time period used as the foreseeable future and how that determination was made should mitigate some of our concern over the diversity in practice in this area. However, if the proposed foreseeable future floor is to be retained, we urge the Boards to better define the term and provide sufficient guidance to ensure a more consistent application in practice. Additionally, we strongly recommend that the Boards field test the interaction of the foreseeable future floor with the time-proportional allocation method to understand the practical consequences and viability of the common proposal.

We do not see a conceptual basis for a pre-defined minimum or maximum duration of foreseeable future, and we believe that the introduction of such requirements would result in increased complexity. That said, we believe that entities can normally make reliable estimates for a period of twelve months. We therefore can accept a twelve-month floor on foreseeable future from a practical standpoint. Whether the foreseeable future floor could be greater than twelve months will likely be based on the nature of and market for the financial instruments in the portfolio, the amount and quality of the data available for impairment analysis, the entity's forecasting capabilities and potentially, regulatory views on the forecasting period.

We would expect the foreseeable future to be a fairly constant period for a particular portfolio. As a result, we would generally not expect the time period used as foreseeable future to change from period to period, although we recognise that it may vary as a result of significant changes in economic conditions (e.g., during a financial crisis). An entity should assess whether it is appropriate to reconsider the time period used as the foreseeable future for a particular portfolio in accordance with the



relevant guidance in the standard. We strongly agree that the time period used as foreseeable future should be disclosed along with the basis for such determination.

Question 10

Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a)(i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

We believe that the outcome of the 'higher of' test will be driven by a variety of factors, such as the level of granularity at which the assessment is made, the length of the period used as the foreseeable future, the pattern of loss occurrence, the relative weighted-average age and weighted-average life of the portfolio, the dynamics of the portfolio, and the interplay of the various factors. We believe that for some portfolios the expected loss over the foreseeable future will be higher, whereas for other portfolios, the time-proportional expected loss will be higher. We believe that a definitive conclusion as to which amount will typically be higher can only be made on the basis of extensive modelling of actual portfolios.

Question 11

The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

- (a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the approach described in paragraph B8(a)? Why or why not?
- (b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

We support the flexibility in application of the time-proportional method on a good book. We recognise that the annuity approach most closely replicates the outcome of the original IASB exposure draft. However, we believe that operationally simpler approaches (i.e. undiscounted and discounted straight-line approaches) should also be available. On this basis, we also agree with the flexibility in the selection of a discount rate when using a discounted expected loss amount.

We note that the supplemental document is silent on whether the expected credit loss under the undiscounted time-proportional method should reflect a loss of principal only, whereas under a discounted approach, it should reflect a cash flow loss (i.e., a loss of both principal and interest). We believe that such distinction is appropriate and should be set out in the final standard. Furthermore, we believe that the standard should provide a clear definition of expected credit loss. We expand on this point under 'Other matters'.

We believe that the particular recognition approach adopted by the entity, including a discount rate used, is a matter of accounting policy and as such, should be consistently applied on a portfolio by portfolio basis. We believe that this matter should be explicitly addressed in the final standard. We further believe that the disclosure of the method applied is essential to help users understand the amounts reflected in the financial statements and hence should be required.



Some entities may find it challenging to understand the time-proportional allocation method, and in particular, why credit losses expected for the *remaining life* of the portfolio are allocated based on the ratio of age to the *entire expected life* of the portfolio. We believe that the standard should clarify that credit losses expected for the remaining life of an open portfolio represent a point-in-time estimate of the entire lifetime credit losses expected for those financial assets in a good book.

We note that the supplemental document does not contemplate expected sales of financial assets in determining the weighted-average life of a portfolio. This does not seem consistent with a classification and measurement model which acknowledges that financial assets carried at amortised cost may be sold prior to maturity in certain circumstances, such as where there has been deterioration in the credit risk of the instruments. We encourage the Boards to consider addressing the determination of expected credit losses in situations where financial assets will be sold due to adverse changes in credit risk and their effect, if any, on the expected life of the portfolio. See further discussion of expected credit losses under 'Other matters'.

Ouestion 12

Would you prefer the IASB approach for open portfolios of financial assets measured at amortised cost to the common proposal in this document? Why or why not? If you would not prefer this specific IASB approach, do you prefer the general concept of the IASB approach (i.e., to recognise expected credit losses over the life of the assets)? Why or why not?

Question 13

Would you prefer the FASB approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific FASB approach, do you prefer the general concept of this FASB approach (i.e., to recognise currently credit losses expected to occur in the foreseeable future)? Why or why not?

We support a differentiated approach to recognition of expected credit losses on a good book and a bad book basis. We believe that the allocation of expected credit losses on a good book using a time-proportional method reasonably reflects the economics of lending transactions and the pricing of the instruments. When however the focus of the internal credit risk management changes from earning a return to recovery of a financial asset, and that asset is moved into a bad book, we accept the view that it is no longer appropriate to recognise expected credit losses over time. In these circumstances, a balance sheet approach that focuses on the allowance balance and reflects the recoverable amount of the financial asset is appropriate.

We do not believe that there is a conceptual basis for a floor on a good book, as it is inconsistent with the view that the lender is compensated for the expected losses over time through the credit spread on the portfolio. Furthermore, a floor could result in the recognition of Day 1 losses for some financial assets, which is inconsistent with the initial recognition of financial instruments at fair value. This issue is likely to be most pronounced in a business combination or purchase of a portfolio of loans.

At the same time, we recognise that convergence in this area is critical, and we would therefore accept a floor on a good book, if a floor is a necessary requirement to achieve a converged impairment model. In accepting a floor, we weighed the use of a twelve-month bright line against the foreseeable future concept. Our preferred approach is a twelve-month floor, as it would promote more consistent application and result in greater global comparability. However, we would accept a foreseeable future floor subject to additional application guidance, if it was a means of achieving a converged model.



The supplemental document states that the foreseeable future is the period over which specific projections of events and conditions are possible and credit losses can be reasonably estimated based on those specific projections. We are concerned that this description of the foreseeable future is too loosely defined to result in a converged application. It appears to be largely dependent on an entity's judgement over what period it is capable of forecasting and will likely be influenced to varying degrees by local regulator views on loss forecasting. We believe some entities will only forecast over the required minimum twelve month period, while others may undertake the necessary analysis to forecast over two, three, or more years depending on the nature of their financial assets, availability of reliable information and analytical capability. Furthermore, the use of the term foreseeable future in a number of different areas in the current accounting literature with different meanings will potentially add to the confusion.

The IASB's proposed requirement to disclose the time period used as the foreseeable future and how that determination was made should mitigate some of our concern over the diversity in practice, in this area. However if the proposed foreseeable future floor is to be retained, we urge the Boards to better define the term and provide sufficient guidance to ensure a more consistent application in practice. Additionally, we strongly recommend that the Boards field test the interaction of the foreseeable future floor with the time-proportional allocation method to understand the practical consequences and viability of the common proposal.

Other matters

As noted in the cover letter, there are open issues that are very significant matters which will likely be challenging to address. Whether the common proposal is a workable solution to the need for a converged impairment model may ultimately depend on how these other issues are addressed. Below, we highlight the issues we believe to be the most significant for the Boards' consideration.

Expected credit losses

We recognise that the supplemental document focuses on the timing of recognition of expected credit losses. However, we believe that the final standard will need to define expected credit losses and give guidance on acceptable methods of measuring them for both the good book and the bad book.

We believe that an undiscounted allocation approach is only appropriate where the expected credit loss represents loss of principal only, whereas if the expected credit loss represents a cash flow loss (i.e. loss of principal and interest), a discounted allocation approach should be applied. We believe the standard should address this matter.

The Boards should clarify whether the same measurement approach should be applied in determining the time-proportional and the foreseeable future allowances. We believe that the time-proportional allowance can be based on either principal only or principal and interest as long as the appropriate allocation method is applied. It is not clear how the measurement approaches would apply to the floor.

A question has also arisen concerning what expected credit loss means in the context of a bond portfolio where it is an entity's policy to sell any bonds whose credit rating has fallen below a specified threshold. In our view, if the sale is expected to result in a loss, such a loss does not represent a credit loss that should be provided for in advance of the sale through the impairment model for financial assets.



Purchased assets

We note that a floor could result in the recognition of Day 1 losses for some financial assets, which is inconsistent with the initial recognition of financial instruments at fair value. This issue is likely to be most pronounced in a business combination or purchase of a portfolio of loans. We believe that the Boards need to specifically consider the application of the proposed model to purchased loans including those acquired through a business combination. In this regard, careful consideration needs to be given to the interaction of income recognition, the recognition of expected credit losses over the life of the book and the impact of the floor. We understand the Boards are currently deliberating this matter.

Interest income

The proposal is silent on how entities should recognise interest income for financial assets in a bad book - for example, whether interest recognition should continue upon transfer into a bad book. Also, the proposal is silent on how entities should consider interest income recognition where assets may move between a good book and a bad book, which is further complicated when loans are restructured.

Bond portfolios

Currently, bonds are primarily evaluated individually for impairment. While an entity may be able to pool bonds by certain credit risk characteristics, a portfolio of bonds is not typically managed like a portfolio of loans. We believe the Boards should clarify how the proposal was intended to apply to bond portfolios.



IASB only Appendix Z

Question 14Z

Do you agree that the determination of the effective interest rate should be separate from the consideration of expected losses, as opposed to the original IASB proposal, which incorporated expected credit losses in the calculation of the effective interest rate? Why or why not?

We agree that the determination of the effective interest rate should be separate from the consideration of expected losses. The requirement of the original IASB proposals to incorporate expected credit losses in the calculation of the effective interest presented a major operational challenge. The existing loan accounting and credit systems for most financial institutions are generally not integrated, and therefore, in their current form, cannot determine the EIR, net of credit losses. A 'decoupled' approach to recognition of credit losses appears to mitigate this operational concern.

Question 15Z

Should all loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37) be subject to the impairment requirements proposed in the supplementary document? Why or why not?

Question 16Z

Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

We believe that it is preferable that a single credit impairment model be applied to portfolios of financial assets carried at amortised cost, as well as financial guarantees in the scope of the financial instruments standard and loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37). Many of these commitments will eventually become loans carried at amortised cost, and financial institutions generally consider both loans and loan commitments together when making their credit assessments. Hence we believe that the application of the same credit impairment model to loans and loan commitments that are not accounted for as derivatives would be appropriate and consistent with the way financial institutions manage their business.

We note that loan commitments and financial guarantees present some unique application questions. For example, should an entity present the credit allowance on loan commitments and financial guarantees as a liability or as a contra-asset in the statement of financial position? There are also questions as to the method for measuring expected losses for these instruments, such as whether the estimated expected losses for a loan commitment should be limited to the life of the commitment or extend through the life of the subsequent loan. We encourage the Board to consider the application of the proposed model to financial guarantees and loan commitments and provide appropriate application guidance in the final standard.



Question 17Z

Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

We agree with the proposed presentation requirements and believe that they are consistent with the 'decoupled' approach to the recognition of credit losses.

Question 18Z

- (a) Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why?
- (b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) for the proposed impairment model and why?

Question 19Z

Do you agree with the proposal to transfer an amount of the related allowance reflecting the age of the financial asset when transferring financial assets between the two groups? Why or why not? If not, would you instead prefer to transfer all or none of the expected credit loss of the financial asset?

We agree with the disclosure objective in the supplemental document, and in particular the proposed disclosures around expected credit loss estimates and internal credit risk management. However, we believe certain of the disclosures will be onerous for many preparers, and we question the usefulness of those requirements. Consistent with our comment letter on the original IASB exposure draft, we encourage the IASB to apply a "through the eyes of management" approach to disclosure. This should help users to understand how management determines the credit quality of their financial assets, how they track this quality over time (i.e. credit migration), how they determine their credit losses and how they assess the accuracy of their estimation process. Our concerns regarding the proposed disclosures are set out below.

We do not agree with the proposed disclosure of a reconciliation of the allowance account on a good book. We do not expect most preparers to track the allowance account for a good book on a "loan-by-loan" basis, the composition of which changes over time. The time-proportional and foreseeable future expected loss will only be determined at a period end, and this determination will be made on a portfolio basis. These approaches do not identify the provision on a loan-by-loan basis and, therefore, do not facilitate the identification of the provision transferred from the good book allowance to the bad book allowance. Hence, a detailed reconciliation of movements on the good book allowance, including the amount transferred to the bad book, is not meaningful and is operationally difficult. Furthermore, we note that the supplemental document proposes that the allowance transferred to the bad book be established on the basis of the time-proportional method. This appears inconsistent with the fact that the allowance on a good book represents the higher of the time-proportional amount and foreseeable future expected loss.

We do not believe that a five-year disclosure of nominal amounts, lifetime expected loss and allowances on a good book by class of financial asset provides useful information. If trend information were to be required, we believe that trend information about the credit quality of financial assets would be more valuable to users. However, as far as a good book is concerned, we believe such disclosures are useful where they are limited to the periods presented in the financial statements. We do not believe that a comparison of time-proportional and foreseeable future allowances on a good book should be



required, as this disclosure would only be meaningful at the level the estimate is made, which is at the portfolio level.

We agree it is important for users to be able to evaluate the quality of the credit loss estimation process. However a comparison of the actual outcomes to an average estimate of credit losses for a portfolio that will change each period for changes in economic circumstances, as well as changes in the composition of the portfolio, does not seem to be very helpful. We encourage the Board to reconsider how this disclosure objective can be better achieved.

Other IASB only matters

In considering the proposed impairment approach in the supplemental document, it is apparent that the transition to the new model will be very challenging. Given the significant judgments and estimates involved in assessing financial assets for impairment under the proposed approach, only a prospective transition requirement would seem to be appropriate. However, this would create an issue for certain financial assets when considering the retrospective transition requirements for the new classification and measurement guidance under IFRS 9. Financial assets at the date of initial application that will be reclassified to amortised cost upon adoption of IFRS 9 will require the application of an impairment model retrospectively in the comparative period. Even if an entity were to try to anticipate the need to make this reclassification in advance and assess impairment for these financial assets during the preceding year, it will still not have identified which assets should be reclassified until the beginning of the year of adoption. This is due to the IFRS 9 transition requirements, which only apply the new classification and measurement guidance to those financial assets present at the date of initial application. In view of this and the overall reconsideration of the effective date for IFRS 9 and certain other projects, we recommend that the IASB comprehensively reconsider all of the transition provisions for the financial instruments projects.