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Group Accounting Policy

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1 April 2011

Supplement to ED/2009/12, *Financial Instruments: Amortised Cost and Impairment*

Dear Ms. Lloyd:

UBS AG appreciates the opportunity to comment on Supplement to ED/2009/12, *Financial Instruments: Amortised Cost and Impairment* (the Supplement). UBS is a global financial institution that prepares its consolidated group financial statements in accordance with International Financial Reporting Standards. UBS also has several subsidiaries that report standalone US GAAP financials. For this reason, UBS is supportive of the efforts of the IASB and FASB (the Boards) to converge IFRS and US GAAP. Additionally, UBS supports the work of the IASB to simplify and improve IAS 39, *Financial Instruments: Recognition and Measurement* (IAS 39).

UBS was critical in its response to the ED due its operational complexity and the fact that it did not reflect banks' internal loan management processes for payment collection and credit risk analysis. While we acknowledged the theoretical appeal of the ED, the implementation and operational concerns were insurmountable. The Supplement has addressed those concerns and appears to be a much improved and more implementable proposal.

With regard to the Supplement, we are wholly supportive of the split book approach, which distinguishes between a portfolio of healthy performing loans and a book of loans for which concerns about repayment have triggered a change in management, e.g. closer scrutiny and possible recovery actions, as this reflects the way loans are often managed in practice.

The comments above notwithstanding, UBS has a number of concerns related to the work on improving impairment accounting under both IFRS and US GAAP. Those concerns are:

1) it is imperative to develop a converged impairment standard;
2) a single impairment model for all financial instruments should be developed to facilitate understanding by users and simplify current accounting;
3) the concept of an impairment "floor" within the good book is inconsistent with the relationship between the recognition of interest income and credit losses;
4) adequate field-testing, and the requisite time to perform, is necessary in order to address operational issues and provide meaningful feedback on the end result of the Boards re-deliberations; and

5) transition relief should be provided in order to address concerns about having to build prior period data for disclosure purposes.

Convergence
UBS supports the efforts of the IASB and FASB to jointly engage in this project. A converged approach to accounting for impairments is important as it affects all banks that report under IFRS and US GAAP and it would facilitate the interpretation of financial statements by a large community of interested parties. Further convergence will also benefit the adoption of IFRS globally and IFRS preparers that currently maintain parallel books in order to report under the US GAAP regime. As the Boards started off with different objectives, we understand the challenges of reaching convergence. However, we believe that impairment is such a fundamental issue that convergence is imperative. As a result, we believe that compromises may be necessary in order to reach convergence, particularly as it relates to the concept of a loss "floor" in the good book.

Single model
Current IFRS contains multiple impairment models within IAS 39 addressing the impairment of available-for-sale equity assets, available-for-sale debt assets, and amortized cost investments. US GAAP contains even more impairment models, such as those for purchased loans and debt (SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*), securitized debt (EITF 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*), collective loan impairments (FAS 5, *Accounting for Contingencies*), individual loan impairments (FAS 114, *Accounting by Creditors for Impairment of a Loan*), and accounting specific to troubled-debt restructurings (FAS 15, *Accounting by Debtors and Creditors for Troubled-Debt Restructurings*), all of which have been subsequently subsumed in FASB's Accounting Standards Codification. The myriad of impairment models and accounting guidance in this area leads to confusion among users and additional opportunities for interpretation differences between preparers. A single impairment model for all financial instruments, including assets held and managed within both open and closed portfolios, would significantly simplify the accounting in this area and improve consistency in reporting to the benefit of users.

Floor concept
UBS is not supportive of the floor concept for the good book as proposed. The floor concept lacks the theoretical validity of the time proportional method. Additionally, layering on a second impairment approach for the good book increases the complexity of the approach, the cost of compliance, and may raise questions with users about whether one calculation is more appropriate than the other in certain situations. Lastly, if the floor is not carefully limited, it runs the risk of the dominating provision recognition in the good book.

However, UBS is supportive of the floor concept if included as a practical expedient in cases where a particular portfolio is shorter-lived. In these situations, a time-proportional recognition scheme may provide less meaningful information due to the shorter timeframe over which credit losses develop in shorter-lived assets under this model. It also alleviates some of the complexity of applying a time-proportional method to a shorter-lived portfolio, e.g. credit card loans, receivables, etc.

Re-exposure and field testing
Given that the final standard would likely source concepts and requirements from the Supplement and the ED that have not been considered in totality previously, we encourage the Boards to re-expose the final product for consideration and comment. While we acknowledge that this will delay the issuance of a final standard, given the importance of this issue and the significant improvement it potentially offers, we believe the emphasis of the Boards should be on getting it right rather than getting it done quickly.

Due to the limited comment period, the banking industry (and the user community, most likely) has had insufficient time to fully assess the new standard. Field testing of a near-final standard is imperative prior to the issuance of a final standard to ensure that it is operational for all instruments within its scope and at the institutions that must apply it. Extensive field testing will result in constructive feedback for the

Boards to consider in refining the model. It also gives the Boards the opportunity to understand if the proposals provide the information they seek.

Transition
While UBS is supportive of the model proposed in the Supplement, we are concerned that attempting to apply this model on a fully retrospective basis, along with the accompanying prior period disclosures, may prove to be impossible and will not result in better decision-useful information for users. The impracticality of full retrospective adoption is exacerbated for SEC registrants that are required to prepare comparative information for four prior periods. We encourage the Boards to consider the inclusion of specific transition relief related to the retrospective application of the accounting and disclosure requirements at adoption.

We have provided responses to the specific questions raised in the ED in the appendix to this letter. If you would like to discuss any comments that we have made, please do not hesitate to contact Urs Bluemli at +41 44 234 6974 or John Gallagher at +1 203 719 4212.

Regards,

UBS AG

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Appendix

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?

UBS supports the development of an improved impairment accounting model based on a forward-looking estimate of expected losses recognized on a time-proportional basis. We believe that a forward-looking estimate of expected losses will help address the concern of the delay in recognizing impairment losses too late. However, it should be acknowledged that any forward looking impairment recognition scheme is likely to exacerbate pro-cyclicality to a degree. It must be expected that large realized losses and an upwards re-estimation of expected losses for the good book will occur around the same time (the opposite can be expected as well, however with a time lag as conservatism will result in slower adjustments in an improving environment).

While the time-proportional approach will not lead to a fair valuing of loan assets, the mere existence of a forward looking provision will lead to more volatile accounts. The expected losses from large corporate loans may be anticipated by taking certain market information into account. If credit spreads widen considerably in the market, not only the value of securities will be affected but also – to a lesser degree due to the partial catch-up with respect to elapsed portfolio life and the application of the amortisation scheme for the balance – the reserve requirement for loans.

We believe the Supplement represents a significant improvement to the approach detailed in the ED as it would more appropriately reflect the way in which we manage the assets subject to impairment and also the function of the processes that we employ to monitor credit loss and interest recognition.

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.

The approach outlined in the Supplement would be at least as operational for closed portfolios as for open portfolios because closed portfolios can be viewed as subsets of open portfolios. The model in the Supplement is designed to accommodate the complexities of an open portfolio where the assets constantly evolve with originations / purchases and transfer / repayments. This model can be applied equally to closed portfolios as it is designed to handle the additional complexities of open portfolios and can be applied to the simpler factors in a closed portfolio. The proposal in the ED was designed for application to a closed portfolio and its mechanisms could not be applied to an open portfolio due to the constant changes in the open portfolio. As the model proposed in the Supplement is equally operational for both open and closed portfolios, UBS supports the further development of this single impairment model in order to improve on to the current multiple–model approaches in US GAAP and IFRS.

In order to achieve a single model, the approach promulgated in the final standard must be applicable to any portfolio not carried at fair value. Open portfolios in the Supplement are defined too narrowly as "a grouping of financial assts with similar characteristics that are managed by a reporting entity on a collective basis", whereas in practice a portfolio is an aggregation of individual assets or groups of assets to a higher level, ultimately to all non-fair value assets that a firm carries on its balance sheet. The time-proportional approach (with or without a reasonably set "floor") can be equally well applied to all manner of single assets, static pools of assets ("closed portfolios") or open portfolios. The degree of aggregation will affect the computation of the reserve such that the sum of the reserves calculated at lower-level aggregations will not equal the reserve calculated at a higher-level aggregation. Whilst the aggregation of assets to sub-portfolios and higher-level portfolios is linear in terms of exposure and expected loss, it is not so for the calculation of the time-proportional age ratio and the application of the "floor". Banks will make independent choices of how they manage their books. Some banks will favour an asset-by-asset approach – even for relatively small exposures – and only classify minor parts of their portfolio as an "open portfolio managed on a collective basis". UBS is one of the financial institutions that follow this "bottom up" principle. Other firms may have larger and more homogeneous portfolios and hence apply a "top down" approach for managing the assets on a wider basis. We believe, however, that all firms will have portfolios that are different in nature and will be managed individually or on a collective basis. Different accounting standards for recognising future expected loan losses or a combination thereof, depending on how banks manage their (sub-) portfolios, are therefore neither practical nor transparent.

Moreover, the same provisioning mechanism should also be applied to undrawn amounts under committed credit facilities and off-balance sheet exposures such as financial guarantees, performance guarantees, trade letters of credit, etc. While there may be nuances to these off-balance sheet facilities that introduce some additional complexity in the analysis, these exposures are part of a bank's portfolio of credit exposure and are in many cases also part of a wider range of credit facilities granted to one firm. The estimation of potential drawings under such contracts at the time of impairment needs to be modelled and a "credit conversion factor" applied to their face value. This is similar to the process already in place for the determination of capital requirements under Basel II.

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?

Generally, we support the concept of the distinction between the good book and the bad book. We believe this approach provides useful information for users of financial statements and the differentiation between treatment of the loan exposures in the "good book" and the "bad book" enables firms to align the accounting model with common risk management practices.

However, we disagree with the concept of a "higher of" approach that recognizes losses in the good book based on a "foreseeable future", or a "floor", as defined in the Supplement because the "floor" would introduce the recognition of significant future losses immediately for loans in the good book, which may be asynchronous with the development of those losses over time. This is particularly true for a portfolio of loans that are otherwise healthy and expected, on the whole, to perform. Please refer to Question 9 for further concerns related to the "floor" concept.

As mentioned in our response to Question 2, another critical issue is that the chosen approach must be applicable to any forms of portfolios that financial institutions carry in their books. The definition of an open portfolio in the Supplement is too narrow in its limitation to "a grouping of financial assets with similar characteristics that are managed by a reporting entity on a collective basis".

Question 4
Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

While the approach is still complex, as it requires tracking of the historical data and two sets of calculations (to determine the floor and the time-proportional expected credit losses), it could be made operational with sufficient lead time. However, we question whether the cost of applying a "floor" calculation is justified when it does not reflect the economics of lending activities.

The time-proportional approach has the advantage over the original ED method in that re-estimations of future expected losses in the "good book" are not booked in full immediately but subject to the time-proportional principle, i.e. amortised over the remaining life of the portfolio (or asset; see paragraph 9). This will enforce the symmetry between expected income and costs as the recognition of expected losses will be matched to the recognition of interest income until such a time as the management of the loan changes in response to an increased uncertainty of collection.

The Supplement is not specific as to the calculation method of a time-proportional approach. As the focus of the Supplement is however on open portfolios, we assume that IASB and FASB have a "top-down" approach in mind, where an average age ratio is applied to the cumulative expected loss in a given portfolio. UBS is concerned that this model may be developed with a bias toward a top-down approach and may overlook important factors for institutions that apply a bottom-up analysis of their loan portfolios.

UBS believes that a single accounting model should govern loan impairment irrespective of the way banks form portfolios and manage them (individual assets, versus sub-portfolios, versus homogeneous portfolios etc.). A natural result of differences in institutions' establishment and evaluation of portfolios / assets will be the application of different calculations and aggregation methods.

As banks will have to determine the weighted-average age and life of the assets in a portfolio, a granular analysis of the portfolio will be necessary, which in most cases cannot be easily accomplished with a top-down estimate. If banks perform granular reviews of the age profiles of the assets, a granular calculation of the reserve will, for many institutions, be the next logical step.

With regard to individual assets or homogeneous closed portfolios, an item-by-item calculation would yield the most accurate result as the application of an overall weighted-average age ratio tends to distort the outcome. This is due to the fact that the cumulative expected loss of a loan decreases over time – provided the asset remains in the good book – at the same time the age ratio increases. The two effects offset each other, but will in aggregate generally lead to a lower reserve level. The application of the floor can then be made at the overall portfolio level or for each individual asset. The former would result in a comparatively lower reserve.

In order to minimize the differences, banks applying a top-down approach should be allowed to subdivide their assets into several open portfolios where they can group assets that have similar characteristics (expected loss and age profile).

Question 5
Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

Yes, please refer to Question 3.

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?

Distinguishing between the good book and the bad book and, thereby, transfers from the good book to the bad book, should be based on management practice. UBS believes that the standard should not be overly prescriptive as to what exact criteria will apply for the determination of when an asset should be moved from the good book to the bad book with the immediate recognition of the full value of expected loss. However, some additional guidance would be helpful in order to ensure that there is a clear link to management practice. In order to adhere to a management view of the assets, a possible delineation between good book and bad book may be established at the point that a particular loan is outside the acceptable asset profile for a particular portfolio.

The ability to align the transfer from good book to bad book with the risk management practices will ensure consistent application. If a different line is drawn, then this will require a different set of statistical approaches and increase complexity. Banks that apply the advanced approaches under Basel II already have such definitions in place. UBS also supports the alignment, to the extent possible, of the definition of impairment in the accounting literature with that of parallel frameworks in order to simplify the application of the concept.

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?

Although we believe the requirements are both operational and auditable, we have not completed a detailed analysis. As a result, before a final conclusion can be made on the operational feasibility of the model, we would recommend that a detailed impact study and extensive field testing be conducted.

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?

Yes, we agree with the requirements. The differentiation between treating loan assets in the "good book" and the "bad book" enables firms to align the accounting model with common risk management practices. We think that there should be additional guidance regarding how the good book and bad book approaches should be applied to off-balance sheet assets, such as financial guarantees, performance guarantees, trade letters of credit, etc., and to undrawn amounts under committed credit facilities. We understand that the Boards, in their recent discussions, may be moving in this direction with regard to off-balance sheet exposures and would like to express our support for this approach.

Question 9(a)
Do you agree with the proposal to require a floor for the impairment allowance related to the 'good book'? Why or why not?

We do not agree with the concept of a "floor". If a "floor" is introduced under the general principle of a time-proportional provision, this should be viewed as a practical expedient in dealing with large groups of assets in a bank's portfolio that do not have a fixed balance, have no legal or expected maturity and carry interest at floating rates that are reset at the sole discretion of the bank, often on a daily basis. In other words, a "floor" could provide a simple – but overall non-distortive – mechanism to capture transactions that are not suited to an elaborate calculation of a reserve requirement on a time-proportional basis. Also, a "floor" can be justified on the grounds that banks generally do not review the credit standing of their loan assets more than once annually, with the obvious exceptions for larger commercial or corporate loans, and will also not review the estimation processes for expected loss, more than once per year except at times of severe distortions in the markets.

Question 9(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?

UBS does not support the requirement of a loss "floor" for the good book; as such we do not believe that evidence of an early loss pattern should trigger the use of a floor calculation. UBS's experience does not reflect concerns about early loss patterns for mortgage portfolios, i.e. the cases where under the ED a negative provision would have resulted and under the time-proportional approach the reserve is for a lower amount compared with "back ended" loss patterns as the reserve is determined with a view to obtaining a true and fair measurement of the balance sheet value of the assets and not to create a "prudent buffer" (which anyway cannot be used freely as noted earlier). In UBS's view, an early loss realization pattern would be indicative of loans that should be transferred to the bad book due to concerns about collectability.

Distinguishing between loss estimation for a "foreseeable future" and the lifetime of an asset (a portfolio) is arbitrary and not grounded in risk management practice. The aim of the standard must be to determine loss expectations for the entire lifetime of an asset or portfolio. As noted in the Supplement, the approaches taken may differ (a) depending on the density of data and other information, (b) for the estimation of future losses in earlier and later years, and (c) in cases where there is specific information on events that may have an impact on the estimation, such as issues that have emerged, but are not in the available data series and therefore not appropriately captured by estimation models.

Question 9(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?

The application of a floor covering at maximum the value of the next twelve months' expected loss would be very similar to the requirements under the Basel II capital standards. A "floor" based on a time period exceeding one year would contradict the general principle of matching the timing of credit loss recognition to interest income recognition through a time-proportionate approach as it would accelerate the recognition of losses far in advance of the associated interest income.

A "floor" that is attenuated to two years, for example, would in many cases render the time-proportional model irrelevant. By way of a very simple illustration of this point, we may assume that a bank has a portfolio of loans with the following characteristics: (a) tenor five years, (b) average age 2 ½ years, (c) even loss pattern so that the cumulative expected loss for the residual life is 2 ½ times the one-year expected loss. The model based reserve would be 1 ¼ [50% of 2 ½ times] times the one-year expected loss and hence much less than a 2-year "floor".

Question 9(d)

For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

The tenor to which a "floor" applies must be uniform and not vary for one institution depending on the nature of the (sub-) portfolio. A "floor" based on the concept of a variable time of a "foreseeable future" could set inappropriate incentives. As it is easier to forecast the loss profile for, say, a regulated utility in a well developed price regime and stable political climate, loans to this sector would be charged with a higher "floor" compared with loans to firms in volatile markets (industries, countries) where forecasting losses even for a rather short time period will be error prone. The risks in the latter portfolio are clearly higher, but the reserve – ceteris paribus – would be lower. Also banks that are more diligent in estimating losses would be penalised; despite a better risk management and control culture, such firms may have to carry higher reserves as their forecasting horizon may be longer.

Question 9(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.

Question 9(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 believe the foreseeable future should not be greater than 12 months in order to avoid a situation in which the floor would be the primary basis for loss recognition in the good book and, therefore, invalidate the matching concept. For portfolios with remaining life under 12 months, a ceiling should be established based on their remaining life.

We disagree with the concept of a "foreseeable future" as defined in the Supplement as this is at odds with the concept of a good book where uncertainty with regard to collection has not been specifically identified. This leads not only to a "day one loss" in published accounts of institutions that have a rapidly growing loan book, but also produces asymmetry with regard to performance measurement at other institutions, where expected income and costs are assessed on individual assets or smaller portfolios (account officer, branch level, business line etc.).

The application of a floor covering at maximum the value of the next twelve months' expected loss would also be very similar in concept to the requirements under the Basel II capital standards. A "floor" based on a longer time period than one year would be farther reaching than a practical expedient and is not supported by us as it is not consistent with the concept of time-proportional loss recognition in a good book.

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.

As explained in our response to question 9(c), we believe that, where the "foreseeable future" period is greater than 18 to 24 months, the floor would exceed the time-proportionate loss. In practice, a "floor" that is set for a minimum of, for example, two years would in many cases make the time-proportional model irrelevant.

Distinguishing between loss estimates for a "foreseeable future" and the lifetime of an asset (a portfolio) is arbitrary and not grounded in risk management practice.

The aim must be to determine loss expectations for the entire lifetime of an asset or portfolio. As noted in the Supplement, the approaches taken may differ (a) depending on the density of data and other information, (b) for the estimation of future losses in earlier and later years, and (c) in cases where there is specific information on events that may have an impact on the estimation, such as issues that have emerged, but are not in the available data series and therefore not appropriately captured by estimation models.

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?

Yes, we agree with the proposed flexibility as particular institutions may apply different management practices, but we expect that most preparers will default to undiscounted estimates due to reduced complexity. Discounting is also far more relevant for some portfolios than others. We note that if flexibility is permitted, this will necessitate further disclosures to explain the impact for users.

Question 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 recognize expected credit losses over the life of the assets)? Why or why not?

We prefer the IASB-only approach over the alternatives in the Supplement for the reasons stated above. However clarification to assist with the judgments around the usability of the provisions should be provided. Additionally, more guidance on the treatment of loan commitments and other off-balance sheet exposures would benefit preparers and users.

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 recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?

As noted in our response to Question 12, UBS prefers the IASB approach in order to more closely match the timing and recognition of credit losses and interest income related to lending activities. However, UBS is open to the inclusion of a limited floor in order to achieve convergence in this area.

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?

Yes. As noted in the cover letter, this is one of the main advantages both conceptually and operationally as the ED was overly complex and did not reflect the management of and systems employed with regard to these assets. For additional consideration of this issue, please see our comment letter from 30 June 2010.

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?

Yes, as all loan commitments should be subject to the impairment requirements in the Supplement as they are managed the same way as loans valued at amortised cost (IFRS 9). This is because all off-balance sheet credit exposures are managed together as part of the general credit exposure. Typically, banks establish credit risk limits at a client-specific level, based on fundamental credit analytics (internal and external ratings, collateral, etc.). A variety of credit-based products (including financial guarantees, loans, commitments and similar instruments) are generally offered to clients, subject to their overall credit limits. These instruments are all risk-managed fungibly by the financial institution, generally using expected loss techniques or fair valuation approaches.

Question 16Z
Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

UBS manages financial guarantee contracts and loan commitments collectively with its other credit exposures. Given our management of these exposures, we do not anticipate any significant operational issues around applying this model to off-balance sheet exposures. For additional discussion, please refer to our response to question 2.

Question 17Z
Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

Yes, we agree with the proposed presentation requirements.

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?

We generally agree with the proposed disclosures for the on-balance sheet exposures. For the off-balance sheet exposures, the disclosures are less meaningful because instead of an allowance, which is a reduction of the carrying value of a claim on the balance sheet, a provision for credit losses has to be recognized.

The Supplement excludes a number of the disclosures that were included in the ED. The disclosures it includes are summarized rather than detailed. As such, and given the limited time for review and assessment, we have not had time or sufficient detail to properly evaluate the disclosure proposals.

As noted in our cover letter, we encourage the Boards to consider the relevance of and difficulty in preparing retrospective disclosures related to the adoption of the new models. Transition relief in this area would be helpful to reduce the cost of implementation without significantly harming the utility of the information for investors as the approach is a conceptually a forward-looking model.

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?

The disclosure requirement suggests that the time proportionate amount of the allowance should be transferred to the bad book, the bad book allowance should be subsequently increased for the remaining amount needed and the good book allowance should be recalculated. While in practice the level of the good book allowance would not be affected, we would prefer a transfer of 100% of the allowance to the bad book. We recommend that the transfer method should be open and prepares have a policy choice as we identify no substantive difference in result.