ASC
ACCOUNTING STANDARDS COUNCIL

31 March 2011

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

(By email: director@fasb.org)

Dear Sirs

RESPONSE TO SUPPLEMENT ON FINANCIAL INSTRUMENTS: IMPAIRMENT

The Accounting Standards Council appreciates the opportunity to comment on the Supplement to ED/2009/12 Financial Instruments: Amortised Cost and Impairment (the Supplementary Document) issued by the International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB) (collectively the Boards) in January 2011.

General

We strongly support the Boards' decision to introduce a more forward looking "expected loss" impairment model. We also welcome the Boards' efforts to develop a single converged high quality impairment approach that is built on strong conceptual bases and is operationally feasible taking into consideration cost-benefit balance. However, we are disappointed that the common approach that the Boards had proposed in this Supplementary Document did not achieve these two fundamental objectives. In particular, we disagree with the inclusion of the "foreseeable future period loss" component in the common approach.

We are of the view that the IASB separate impairment approach detailed in the Supplementary Document is conceptually more superior and is more closely align to an entity's risk management activities and policies. We also applaud the IASB's efforts to simplify its original impairment model by providing significant operational relief. That said, we are of the view that the proposals could be further improved in respect of the differentiation requirement between the "good book" and the "bad book" to enable consistent interpretation and application. In addition, the IASB approach could be further modified to

Address: The Secretariat, Accounting Standards Council,
c/o Ministry of Finance, 100 High Street, #10-01, The Treasury, Singapore 179434.
Website: www.asc.gov.sg Email: MOF_Feedback_ASC@mof.gov.sg Fax: (65) 6332 7435

address concerns about the adequacy of the impairment allowance when there is evidence of early loss patterns for assets in the "good book".

Also, we are concerned that the IASB is increasingly adopting a piecemeal and fragmented approach in developing its standards without providing a comprehensive exposure of all aspects of the proposals. Given the importance of this project, we believe it is critical that sufficient time be provided for a robust review and field-testing of the full proposals. In addition, we encourage the Boards to work closely with the Basel Committee and, as far as possible, to align the impairment approach without compromising the fundamental accounting principles.

Our views on the specific questions set out in the Supplementary Document are as follows:

Question 1
Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (ie delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

Yes, we believe the expected loss impairment model as proposed in the Supplementary Document, which eliminates the requirement for a "trigger event" for recognition of impairment loss under the current IAS 39, would enable entities to consider a broader range of credit-related forward looking information and, where appropriate, recognise impairment losses on financial assets earlier in the cycle.

Despite the above, we do not agree with the impairment approach proposed in the Supplementary Document. Please refer to our comments under question 3 for further details.

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.

Yes, we think the impairment model proposed in the Supplementary Document is at least as operational for closed portfolios and other instruments as it is for open portfolios.

We understand that the IASB will use the feedback received on this Supplementary Document to deliberate whether the proposed model should be applied to all financial assets measured at amortised cost or whether different impairment model for each type of financial

asset measured at amortised cost is justified. We are concerned about the potential confusion, inconsistency and costs of having multiple impairment models for different types of financial assets and urge the IASB to develop a single, principle-base impairment model that can be applied to open and closed portfolios and all other instruments. That said, we believe that the proposed approaches in both ED/2009/12 (the ED) and the Supplementary Document are not appropriate and relevant for trade receivables as credit risks are generally not explicitly factored into the price of goods or services sold. Subjecting trade receivables to the same impairment approach would conflict with the IASB's fundamental objective of building the impairment model based on entities' business models. Nonetheless, we believe that the impairment approach for trade receivables should also be improved from the current incurred loss model under IAS 39 to allow entities to consider a broader range of credit-related forward looking information in estimating the impairment allowance.

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?

No, we do not agree with the proposed common approach to recognise impairment loss for financial assets in the "good book" based on the higher of the time-proportional loss amount and the foreseeable future loss amount. Whilst we appreciate the Boards' effort to converge the impairment approach, we think the common impairment approach that takes on the features of both the IASB's and FASB's separately developed approaches introduces inconsistent recognition principles given the two approaches are premised on entirely different concepts. Under the foreseeable future approach, credit losses expected in the foreseeable future period are recognised immediately in profit or loss. This is at odds with the primary objective of the time-proportional approach, which is to recognise expected losses over the life of a financial asset in order to reflect the link between the pricing of the financial asset and the expected losses. Furthermore, the common approach appears to suggest that estimates that are "more specific" should be recognised immediately in profit or loss while estimates that are "less specific" should be recognised over the life of the asset. This, in our view, lacks conceptual basis as recognition principle should not be premised on the degree of precision of an estimate.

In addition, unlike the "higher of" test introduced in other IFRSs where the basis of measurement for each component is clearly defined and distinguished (e.g. the recoverable amount of an investment property is the higher of its fair value less cost to sell and its value in use), we note that the two components (i.e. lifetime loss and foreseeable future period loss) are related and could be a subset of each other. Accordingly, we do not think the "higher of" test is used appropriately in this context.

Furthermore, we believe it would be operationally complex and costly for entities to calculate two sets of losses at each reporting date for purpose of determining the appropriate allowance amount. In addition, it would also be challenging for entities to distinguish information which is required to support specific projections of events and conditions for purpose of

determining the foreseeable future period loss from information which is used to determine the lifetime expected loss. In our view, the Supplementary Document has not sufficiently explained the difference between the two sets of information/data to make the proposed common model operational.

We also have a number of other concerns on the inclusion of the "foreseeable future period loss" component in the common model. These concerns are detailed in our comments under question 9.

As highlighted in our comment letter to the ED, we support the conceptual principle proposed in the ED that an impairment model should reflect the relationship between the pricing of financial assets and expected credit losses as this is consistent with credit risk management practices. Hence, we believe that the IASB's proposed impairment approach as outlined in paragraphs BC30 to BC55 of the Supplementary Document, which seeks to approximate the credit-adjusted effective interest rate (EIR), is conceptually more superior as compared to either the common approach or the FASB approach **although further refinements to the approach are required**. Please refer to our comments under questions 6, 7, 8 and 12 for further details.

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

We laud the IASB's efforts to simplify its original proposed approach by decoupling expected credit losses from EIR. Compared to the original proposed approach, we believe the time-proportional approach would be more feasible operationally although it would not exactly replicate the outcomes of the original proposed approach and some operational complexity would still exist, including the need to determine the weighted average age and life of the portfolios.

To provide operational relief, the IASB proposes to allow entities to choose between using discounted or undiscounted amounts under the straight-line time-proportional approach. We welcome the flexibility given as we understand it would be challenging in practice for entities to estimate the timing of occurrence of expected losses for purpose of determining the discounted amounts.

In addition, we also welcome the application guidance provided in paragraph B7 of the Supplementary Document where a long-term average loss rate can be used, as this would allow for a simpler method for developing loss estimates.

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

No, we are of the view that the proposed common impairment approach for the "good book" assets would not provide useful information for decision-making as the approach produces mixed results since it alternates between two different bases of recognition of expected credit losses across reporting periods (i.e. time-proportional lifetime expected loss for some period and foreseeable future period loss for other period, depending on which amount is higher).

Furthermore, the foreseeable future approach recognises credit losses expected in the foreseeable future period immediately in profit or loss yet ignores credit losses expected beyond the foreseeable future period, as opposed to the time-proportional approach where lifetime expected losses are considered. It therefore conveys a distorted picture of the profitability and the pricing of a financial asset.

We believe that the information provided under the standalone time-proportional approach (i.e. the IASB separate model) with further refinement to allow acceleration of credit loss recognition in situations where there is evidence of early loss patterns would be more useful for decision-making as it more closely reflects the underlying economics of lending transactions as well as the overall performance of the "good book" assets.

Question 6
Is the requirement to differentiate between the two groups (ie '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 (ie '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 (ie '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 proposal to differentiate the two books based on an entity's internal credit risk management policies as it would not be possible to prescribe a bright line for such differentiation in view of the diversity in risk management policies across different entities, asset types and jurisdictions.

However, we believe that the credit risk management criteria for determining when an asset should be transferred between the two books as currently worded in paragraph 3 (with further

elaboration in paragraph B2) of the Supplementary Document are likely to lead to varying interpretations. To reduce diversity in application, we suggest that examples of established industry practices for differentiation between the two books be incorporated into the final standard to provide guidance on when a transfer should occur. For instance, some of the examples of objective evidence of impairment under IAS 39 (e.g. where the borrower shows an inability to meet the contractual repayment terms, or where the borrower has sought or is placed in bankruptcy or similar protection) are clear and widely understood and could be incorporated into the final standard. These examples would also be helpful for non-financial institutions as they often do not have established internal credit risk management policies to identify and differentiate the assets between the two books.

We think that the proposed requirement would be operational if it is clearly defined with relevant examples provided. In addition, we believe the disclosure requirements proposed in paragraphs Z13 to Z15 of the Supplementary Document would address some of the issues around the subjectivity of the credit risk management criteria and increase the transparency and comparability of financial reporting in this area.

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?

No, we do not agree with the proposal to require a floor for the impairment allowance related to the "good book" assets for the following reasons:

<u>Immediate recognition of losses expected to occur in the foreseeable future in profit or loss</u>

Conceptually, the requirement for the minimum allowance amount ignores the business practice that lenders usually price in some level of credit risk into the credit spread of the financial assets which would be recovered over the life of the asset. We are therefore concerned that the immediate recognition of foreseeable future period losses in profit or loss would not faithfully portray the underlying economics of lending transactions and would fail to reflect the "overall effective yield" of the "good book" assets as the net interest yield of these assets would fluctuate from period to period depending on the amount of foreseeable future period losses estimated at each reporting date even though the total lifetime expected loss amount for the assets could remain constant. It may also result in the recognition of a "day 1" loss should the foreseeable future period loss exceeds the interest revenue for that period. This is, in our view, counter-intuitive as one would not expect assets in the "good book" to generate negative returns. From a balance sheet perspective, whilst the immediate recognition of expected losses would result in earlier build up of allowance, we are however concerned that the overall net loan receivables could be understated as the "expected" future

interest receivables are not recognised as part of the amortised cost amounts of the loans at the same time.

In addition, the introduction of a floor could potentially blur the line between a "good book" and a "bad book". For example, the floor could result in the immediate recognition of an impairment allowance for a "good book" that has a relatively short life of say 2 to 3 years (i.e. the foreseeable future period coincides with the life of the "good book"). This essentially reduces the "good book" to a "bad book" which is highly misleading.

Determination of foreseeable future period and corresponding loss amount

While we acknowledge the subjectivity inherent in forecasting expected losses over the entire life of an asset (particularly assets with longer life), we believe that the same would apply to foreseeable future period losses. In fact, we think that determining the "foreseeable future period" would be more subjective. Unlike the lifetime expected losses that have been considered and included in the pricing of the financial asset by an entity which provide a basis for estimating the expected loss amount, we believe that significant judgement is required to determine what is the foreseeable future period for which the loss would be recognised immediately. In addition, the length of the foreseeable future period could be changed from time to time. The significant subjectivity involved in determining the foreseeable future period creates the potential for earnings management.

Should the Boards decide to retain this requirement in the final standard, we believe that greater clarity and guidance should be provided on how to determine the foreseeable future period and what is considered reasonable and supportable information for which specific projections of events and conditions are possible for purposes of deriving the foreseeable future period loss. This could be in the form of application guidance or illustrative examples. Without additional guidance, entities are likely to apply different interpretations and this is likely to result in significant divergence in practice which would undermine the comparability of financial information across entities.

Disincentive for entities that could estimate losses over "longer" foreseeable future period

Under this approach, an entity that could estimate credit losses over a longer foreseeable future period (e.g. 3 years) would be subject to a higher floor for its "good book" as compared to another entity that could only make such estimation over a shorter period (e.g. 1 year) for the same book as it does not have the same information or forecasting ability. Entities that are able to project losses over longer foreseeable future period would therefore be unduly penalised and users' assessment of the relative performance amongst peer groups could be significantly impaired.

(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?

We understand that entities could estimate the total amount of lifetime expected losses using statistical techniques at a portfolio level but it would be operationally challenging to predict when the losses would occur. This is also one of the major concerns expressed by various stakeholders on the IASB's original proposed impairment approach which requires entities to estimate both the amount and timing of expected loss in order to determine the credit-adjusted EIR. We are concerned that this proposal would again require entities to periodically identify the timing of occurrence of losses which counteract the Boards' objective to establish an operationally simpler impairment model.

Instead, we propose to address the issue of potential inadequate impairment allowance when there is evidence of an early loss pattern by modifying the IASB separate approach to allow acceleration of recognition of losses. Please refer to our comments under question 12 for further details.

(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?

As indicated in part (a), we do not agree with the proposal to require a minimum allowance amount.

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

Yes, we believe the "foreseeable future period" may change on the basis of changes in economic conditions. In the period where the economy is relatively stable, one would be able to determine the expected loss amount for longer period into the future with greater certainty as compared to the period where the economy is relatively unstable.

(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.

We are of the view that the "foreseeable future period" is dependent on various factors such as the type of financial asset, the availability of data, the sophistication of the system used to estimate the losses, the existing economic conditions, etc. We believe that the period should generally be <u>at least</u> twelve months from the reporting date. This is also broadly consistent with the use of an "at least twelve months" period for the assessment of an entity's ability to continue as a going concern under IAS 1 or for the assessment of whether deferred tax assets or liabilities should be recognised under IAS 12.

(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.

As indicated in part (a), we do not agree with the proposed floor requirement. However, should the Boards decide to proceed with the proposal, we believe that a more principle-base period should be adopted. As such, we do not agree with the introduction of a bright line "ceiling". Whilst a "ceiling" would have the benefit of reducing diversity in practice and improving comparability between entities, it would prevent an entity from considering expected losses that are foreseeable by the entity but are beyond the specified time horizon. In addition, as different financial assets have different loss characteristics and respond differently to changes in economic and market conditions, we believe that it would be challenging to prescribe a "ceiling" that is reasonable and appropriate for all types of assets.

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.

No, we do not believe that the floor will typically be equal to or higher than the time-proportional expected loss amount as it would be dependent on various factors such as the expected loss pattern and age of the portfolio.

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 acknowledge that any deviation from the fundamental principle to consider the time value of money in the measurement of future cash flows would not be conceptually optimal. However, given that estimation of expected credit losses necessarily involved a certain degree of imprecision, we do not think it would be necessary to introduce discounting into the estimates or to prescribe a specific discount rate for that purpose. Therefore, we support the flexibility permitted to use either a discounted or undiscounted estimate as outlined in our comments to question 4. For the same reasons, we also agree with the IASB's proposal of

permitting flexibility in the selection of a discount rate if discounted expected loss amount is used. We believe this would reduce operational complexity and achieve cost-benefit balance.

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 (ie to recognise expected credit losses over the life of the assets)? Why or why not?

We prefer the IASB approach. Please refer to our comments under questions 3, 4, 5 and 8 for details of the rationale for our support for this approach.

However, we note and the IASB has also seemingly acknowledged that in situations where losses are expected to occur early in the life of assets in the "good book", the impairment allowance recognised based on the IASB approach may not be sufficient to cover the losses at the time the losses occur. To mitigate the risk of insufficient impairment allowance for such loan portfolios with evidence of early/front-load loss patterns, we recommend that the IASB approach be modified to require a time-proportional approach based on the expected loss occurrence patterns in order to accelerate the recognition of losses.

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

No, we do not support the FASB approach which requires all expected losses for the foreseeable future period to be recognised immediately in profit or loss regardless of whether the losses relate to "good or bad book" assets. Our concerns with the FASB approach are also expressed in detail under question 9 in response to the minimum allowance amount that would be required under the common approach.

In addition, as highlighted in our comment letter to the ED, we understand that entities such as financial institutions generally manage credit risks by differentiating between a good book and a bad book. As such, the accounting model for impairment should be aligned to reflect how entities manage their credit risks and how the loan portfolio performance is evaluated by management, shareholders, analysts and other users. The FASB approach does not reflect such considerations.

However, we acknowledge that the FASB approach is operationally less complex to apply as compared to either the common approach or the IASB approach.

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, consistent with our comments to the ED, we agree that the determination of EIR should be separated from the consideration of expected losses. Whilst we agree that the risk of default is inherently embedded in the loan spread at origination of a loan, we believe the use of an integrated EIR approach which incorporates expected credit losses would be operationally challenging, costly and time-consuming to implement as entities typically manage credit and interest rate risks separately using different systems and processes. We are therefore supportive of the IASB's decision to decouple expected credit losses from EIR and to develop an operationally feasible impairment approach that seeks to approximate the credit-adjusted EIR.

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?

We believe that the impairment model for written loan commitments not measured at fair value through profit or loss should be consistent with the impairment model applied to the underlying loans measured at amortised cost since the loan commitments are typically managed using the same business model, processes and systems as the loans. If entities have factored in the expected credit losses in the pricing of the commitment fee, the same impairment requirements should be applied to the loan commitments so as to reflect the economics of such lending transactions.

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

Yes, we believe that the proposed requirements would be operational if applied to loan commitments and financial guarantee contracts.

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

Consistent with our comments under question 14Z, we agree with the proposed presentation approach that requires the separate presentation of interest revenue and impairment 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?

We are generally supportive of the proposed disclosure requirements as we believe a key metric for both management and users is the disclosure of "good book" and "bad book", including the level of allowance associated with each loan book. This, together with the disclosure on how an entity distinguishes and manages assets in the two loan books are critical tools for users to measure relative performance amongst peer groups as well as to predict shifts in the credit cycle. They would also address some of the issues around the subjectivity and significant judgements involved in applying the proposed impairment model and increase the transparency and comparability of financial reporting. However, we have the following concerns with regards to the proposed disclosure requirements:

(i) Paragraph Z7 requires the disclosure of the transfer of allowance between "good" and "bad" books. As the allowances for both "good" and "bad" books require re-estimation at each reporting date, we query the importance of the required disclosure. Under the current practice, there is no transfer needed for a loan migrating from "good book" to "bad book". The specific impairment is computed when the loan becomes "bad" and the computation of collective impairment for "good book" loans would then exclude the loan transferred. Users of financial statements understand this concept very well and therefore, the proposal to transfer an amount of the related allowance reflecting the age of the financial asset that turns "bad" would increase complexity without much added value. For simplicity, we recommend removing such requirement.

(ii) Paragraph Z8 proposes that an entity shall disclose information about the loss allowance account of its "good book" assets for a period of 5 years. We believe this is onerous and would add significant burden to entities, while not providing any significant informational value to users. We are also strongly against the proposed disclosure if the 5-year information is required for transition purpose as we believe many entities would not have kept the relevant 5-year data to meet such disclosure requirement.

(iii) Paragraph BZ17 allows disclosures to be given in the financial statements or incorporated by cross-reference from the financial statements to other statements. In our view, the required disclosures are to assist users to understand and evaluate information presented in the financial statements. As such, the disclosures, which are part of financial reporting, should be placed within the financial statements. It would be confusing and cumbersome for users to refer to and switch between different statements in order to have a complete understanding of the financial position and performance of the entity. We believe such decision with regards to the placement of financial information should be discussed holistically under phase E of the Conceptual Framework project on

Boundaries of Financial Reporting and Presentation and Disclosure and not separately in the individual standard.

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?

As indicated in part (i) of our response to question 18Z, we do not agree with the proposed requirement to disclose the transfer of allowance between the two books.

Other Comments:

Collateralised loans
We would like to highlight that relevant guidance should be provided in the final standard on the assessment of expected credit loss for collateralised loans. We note that the ED issued by the IASB previously requires the estimate of expected cash flows of a collateralised financial asset to reflect the cash flows that may result from foreclosure. It is not clear as to how this requirement would fit into the assessment of expected loss for the "good book" assets. If the collateral value is not taken into consideration when the asset is classified in the "good book" but later factored in when transferred to the "bad book", this could lead to potential reversal of overprovision of impairment upon transfer.

We hope that our comments will contribute to the Boards' deliberation on this Supplementary Document. Should you require any further clarification, please contact me at Soh_Siew_Luie@mof.gov.sg.

Thank you

Yours faithfully

Siew Luie SOH
Secretary, Accounting Standards Council