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IASB (iasb@iasb.org)
Comment Letters
30 Cannon Street
London, EC4M 6XH
United Kingdom

Dear Sir David Tweedie,

Subject: Supplement to Exposure Draft ED/2009/12 “Financial Instruments: Amortised Cost and Impairment”

Westpac is one of the four major Australian retail trading banks. At 30 September 2010 we had total assets of A\$618 billion of which loans represented A\$478 billion. Our current market capitalisation is A\$74 billion.

We welcome the opportunity to respond to the Board in relation to the supplementary document (including Appendix Z) of January 2011 issued in respect of the impairment Exposure Draft ED/2009/12.

We would also like to thank the Board for addressing some of the concerns raised in our previous comment letter in respect of the original ED. However we would like to highlight for the Boards consideration the matters outlined below. These matters are discussed in more detail under the relevant questions posed by the Board in the supplementary document (including Appendix Z).

Executive summary of key concerns

Overall we believe the proposals outlined in the supplementary ED are a significant improvement over those in the initial ED. From an operational view point we are supportive of the key changes as the new methodology is substantially less complex.

However, we still doubt whether the remaining complexity caused by requiring the impairment allowance to be the higher of two separately calculated quantities is justified. Despite approaching the allowance question from different perspectives, the ‘time- proportional expected credit losses’ (IASB) approach and the ‘credit losses expected to occur within the foreseeable future’ (FASB) approach are both ‘balance sheet’ style calculations that effectively estimate the allowance required for losses over some proportion of the remaining life of the portfolio. In this sense they are similar, and they differ only in what proportion of the remaining life is used for the expected loss calculation. This will undoubtedly vary from portfolio to portfolio. We feel that there is room for further harmonisation between the two approaches that would obviate the need to perform two calculations by choosing the approach that looks at expected loss for the foreseeable future and we do not see a strong case for retaining both calculations in their current form.

In relation to disclosures, whilst we support the tentative decision made by the Board in February 2011 to remove the vintage and stress testing disclosure requirements from the initial ED, we remain concerned with the extent and usefulness of some of the disclosure requirements in Appendix Z. These requirements, in conjunction with the existing disclosure requirements in IFRS 7, will significantly increase the number of dimensions under which impairment information is reported and disclosed. The quantity of disclosures will significantly reduce the useability and comparability of financial statements for users.

We have addressed these and other issues in greater detail in our responses to the IASB questions below:

General

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 believe the approach for recognising impairment as described in the supplementary document is a positive step towards addressing the issues of delayed recognition of expected credit losses and achieving a convergent approach on impairment between the IASB and FASB. However our concerns with certain aspects of the proposed impairment model are outlined in our response to Question 3.

Scope – Open Portfolios

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 the impairment model as proposed in the supplementary document will be as operational for closed portfolios as it is for open portfolios. Irrespective of whether a portfolio is considered open or closed they are managed in the same way. On a similar basis, we anticipate the model will also be operational for other single assets provided they are managed under the same credit risk system. We note the definition of what constitutes a closed portfolio may vary between entities.

A single impairment methodology for all relevant financial assets whether in an open or closed portfolio is the preferred approach not only for consistency and comparability across entities but also to reduce the operational complexities and costs involved in redesigning systems to calculate the impairment allowance under multiple impairment methodologies.

Differentiation of credit loss recognition

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?

We believe that the two calculations as described in Paragraph 2(a) (i) and (ii) are both operational, but we feel that further harmonisation should be possible. The stated intention of the time-proportional approach to 'recognise expected credit losses over the time periods in which interest revenue is recognised' (IE9) implies a cash flow based methodology. In fact, the implementation of this approach in the ED is balance sheet based, in that the calculation always addresses the adequacy of the balance sheet 'stock' of provisions, and does not simply deal in cash flows. This is in contrast to a pure cash flow based approach, where provisions are strictly annuitised over the life of exposures and losses are charged to the allowance account, without special regard to the stock of provisions. Similarly, the approach that looks at expected credit losses for the foreseeable future is also balance sheet based. The only real distinction here seems to be what proportion of the remaining life is used for the expected loss calculation. This would vary from portfolio to portfolio.

It seems likely therefore that a methodology which looks at expected loss over some suitable future period could harmonise the two approaches in the ED. We feel that the approach that looks at credit losses for the

foreseeable future is preferable, since this approach attempts to explicitly address that time period, whereas the time-proportional approach does not. Also, our preliminary modelling using both the time-proportional and the foreseeable future approaches suggests that the foreseeable future floor would be more likely to exceed the amount calculated under the time-proportional approach on average and hence the floor would be applicable in more cases.

Question 5

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

Providing information on 'expected credit losses' is useful for decision-making. However we highlight that the various interpretations of expected loss are currently calculated in a number of different ways for internal management purposes and as required by the various regulatory bodies governing financial institutions in Australia (e.g. General Reserve for Credit Losses, Basel EL). This has resulted in multiple credit loss amounts being reported which has limited the user's ability to compare this information across entities and consequently affected the usefulness of the information. We believe the proposed requirement to calculate the impairment allowance using both the time-proportional and floor methodology will add to this confusion as we introduce new methodologies for calculating expected loss, in addition to the existing amounts already being calculated and disclosed.

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, the requirement to differentiate between the two groups is clearly described.

Yes, we believe the requirement to differentiate between the two groups is operational and auditable.

Yes, we agree with the proposed requirement to differentiate between the two groups. This is part of our existing practice and is useful for internal credit risk management purposes and the readers of the accounts.

Minimum Allowance - Floor

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.

- (a) Yes, subject to our response to Question 3, but we would simply see this as an expected loss calculation for a different period by another name.
- (b) No, we do not believe the use of the floor should be restricted to circumstances where there is evidence of an early loss pattern.
- (c) There are many ways that a minimum allowance could be specified. We have no particular issues with the concept of 'foreseeable future'. However, we find the use of a 12 month period somewhat arbitrary and think that shorter periods should be allowed if they can be justified.
- (d) We anticipate that the 'foreseeable future' period is likely to change in response to any significant changes in economic conditions.
- (e) We believe the foreseeable future period will vary from product to product. It is difficult to be specific without considerably more modelling work.
- (f) In light of the proposed standard being principles based, we do not believe that a 'ceiling' needs to be prescribed.

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.

The level of the floor in comparison with the time-proportional expected loss will vary depending on the portfolio. It will depend upon the expected behaviour of the portfolio and the point in the portfolio's life.

Our preliminary modelling using both the time-proportional and the foreseeable future approaches suggest that the foreseeable future floor would be more likely to exceed the amount calculated under the time-proportional approach than be less than it on average.

For this reason we see the time-proportionate amount calculation as potentially redundant under normal circumstances (see further our response to Question 3).

Measurement

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?

(a) We do not strongly object to offering flexibility since the ED is principles based and we do not believe that this issue will result in major inconsistencies relative to other interpretational issues in the Standard. However, we believe that discounting to account for the time value of future cash flows is more consistent with other accounting standards.

(b) We favour the flexibility in the selection of a discount rate provided. A prescribed discount rate is less likely to be appropriate given that the characteristics of each entity will be different. In the spirit of the exposure draft's intention to be principle based, we do not object to allowing each entity to select a discount rate most appropriate for them.

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

For the reasons discussed in our responses to Questions 3 and 10, we would not prefer the IASB approach as opposed to the common approach in the document but we would prefer the FASB 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?

We agree that the determination of the effective interest rate should be separate from the consideration of expected credit losses. The previously proposed methodology was overly complex and not operational.

Banks manage credit risk and losses separately from interest rate risk and related return measures and not on an effective interest basis. Combining estimated credit losses into the effective interest rate will result in the interest margin becoming blurred. This will mean reduced reporting clarity and transparency for users of the financial statements. The interest margin is a key measure used to interpret the short to medium term value prospects of a financial institution. Any ambiguity in this metric will erode the value of analysis and make cross entity comparisons more subjective and less intrinsically useful.

Scope: Off Balance Sheet Exposures

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?

Yes, we favour a single impairment methodology to be applied to all closed portfolios, off-balance sheet exposures (e.g. loan commitments and financial guarantees) and open portfolios. These exposures to customers are managed for credit risk purposes on the same basis and therefore it is appropriate to use the same methodology. Using a single methodology will not only ensure consistency and comparability across entities but also reduce the operational complexities and costs involved in redesigning systems to calculate the impairment allowance under multiple impairment methodologies.

Presentation

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 presentational requirements to separate interest revenue and impairment losses. Net interest income is a key metric for retail banks and is well understood by users of the financial statements. Combining a credit loss adjustment within net interest income will lead to confusion amongst users and further non-GAAP measures.

We do not believe that expected credit loss expense should be presented within the aggregation of items making up net interest income but credit losses should rather be presented as a single item on the face of the income statement so that they can continue to be clearly identified and understood by users.

Disclosures

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?

(a) In relation to disclosures, whilst we support the tentative decision made by the Board in February 2011 to remove the vintage and stress testing disclosure requirements from the initial ED, we remain concerned with the extent and usefulness of some of the disclosure requirements in Appendix Z. As outlined in paragraph BZ19 of the supplementary document, 'it is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation'. We feel the sheer quantity of disclosures will confuse users and significantly reduce the useability and comparability of financial statements.

Financial asset class

The requirements in Appendix Z, in conjunction with the existing disclosure requirements in IFRS 7, will significantly increase the number of dimensions of how impairment information is reported and disclosed. We believe the board should clarify the requirement to disclose by financial asset class in light of the existing IFRS 7 requirements.

Time-proportional calculation disclosure and disclosure of floor amount

See our response to Question 3

Good book - four year comparatives

In light of keeping the financial statements useful and relevant we question the value of disclosing four year comparatives per paragraph Z8. We believe a single year comparative will be sufficient for users and see this as consistent with the general disclosures in other parts of the financial statements.

Back testing

As impairment models are complex and by nature can never be 100% accurate, we feel the quantitative disclosures required by paragraph Z12(a) will simply add to the volume of disclosures without providing any real value to the users. We feel the qualitative disclosures would be more useful to users as they would provide the information needed to understand these models, including their inherent limitations.

Watch list disclosures

We question the usefulness of the disclosure requirements in paragraph Z15(b)(iii) and Z15(d) on watch lists. As the definition and use of 'watch lists' differs significantly across financial institutions these disclosures would be meaningless to users of financial statements due to lack of comparability.

(b) We do not believe there are any additional disclosures required.

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?

In principle, we agree that the related allowance amount of a financial asset should be transferred along with it between the 'good book' and 'bad book'.

We should like to thank the Board for the opportunity to respond to this supplementary document (including Appendix Z) and trust that these comments will prove useful.

If you have any questions related to our response, please contact Ross Goudie at the above address.

Yours sincerely

Ross Goudie
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