

Ms. Sue Llyod  
Director of Capital Markets  
The International Accounting Standards Board  
30 Cannon Street  
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United Kingdom

April 1, 2011

Dear Ms. Llyod

In order to facilitate smoother convergence to IFRS, a Working Group on IFRS Implementation has been set up the Reserve Bank of India(RBI). Under the aegis of this Working Group, six sub groups have been formed to deliberate on specific issues, with one of these sub groups focussing on impairment. Based on the deliberations of the Sub-Group on Impairment, comments in response to the specific questions raised in the Supplementary Draft on Impairment are enclosed. We would like to clarify that the comments here are based on the views of the members of the sub-group and do not represent those of the RBI.

Yours faithfully

P R Ravi Mohan  
Chief General Manager  
Department of Banking Operations and Development  
Reserve Bank of India

## **Appendix A: Responses to specific questions**

### **Question 1**

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

Although we are in principle supportive of this approach, we believe there are several issues that need to improved/ refined in areas such as definition of bad book, transfer between good book and bad book, etc. These have been further elaborated in our responses to specific questions later. We are also supportive of IASB's decision to exclude expected credit losses when computing effective interest rate on account of the operational complexities involved.

### **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 are supportive of a distinction between a good book and a bad book in respect of open portfolios. However, in the case of the bad book, we believe there should be a provision to compute impairment on a basis other than a portfolio basis. It is not uncommon for financial institutions to evaluate and manage significant exposures on

a stand alone basis as per their risk management policy. Therefore, it would be possible to provide impairment on a basis other than on a portfolio basis consistent with the principles outlined in the document.

### **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?

We do agree that there should be provision amount recognised on the ‘good book’ to reflect the potential credit losses that will arise in future from such portfolios. Using an expected loss model in this regard does address the issue of ‘too little too late’. However, although such an approach in theory addresses the issue, the measurement of future credit losses can present a number of challenges in practice, especially in jurisdictions which for the first time are considering such impairment methodologies. The implementation of the above model does present significant challenges not only in terms of resources but also availability of reliable data. In view of the above, although we are supportive of the overall approach, we believe the IASB should consider certain practical expedients specifically targeted towards those jurisdictions which face the above challenges especially lack of available data to implement and calibrate such models. In our view, in the absence of such a practical expedient it will become incredibly difficult, if not impossible, for such jurisdictions to apply the model. We would recommend that the IASB consider providing certain practical expedients targeted towards those jurisdictions who are in the above scenario.

### **Question 4**

Would the proposed approach to determining the impairment allowance on a

time-proportional basis be operational? Why or why not?

In order to reduce operational complexity and enhance comparability, IASB may consider prescribing a single approach. The time proportional approach is considered preferable to the annuity approach as it reduces the amount of management judgement involved in aspects such as a discount rate.

### **Question 5**

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

Please refer to our comments under Question 3.

### **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?

One of the pre-requisites for the proposal in the supplementary document to be put into operation is a very clear definition of good book and bad book. In paragraph B4, IASB also recognises that entities may not be managing credit risk on the basis of uncertainty regarding collectability and suggests that entities may use alternate criteria such as return below risk free rate, management identifying a loan as doubtful,

etc. We agree with the proposals contained in paragraph B4 as there are a number of methodologies that are used by financial institutions for making the above distinction and represent valid risk management strategies and procedures. In determining the distinction between the bad and the good book, in our view, it is essential to give cognisance to such risk management practices that are used across different jurisdictions.

However, while the definition is fairly clear, it may present some operational issues in practice. In many jurisdictions regulators have prescribed prudential norms for classification and the IASB may consider providing that regulatory norms may be used as uniform basis for classification between good and bad books.

### **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?

We agree with the proposed requirement of differentiating between the two groups.

### **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.

#### **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 inclusion of a floor on the basis explained in the standard would entail additional computation and sophisticated expected loss modelling in some cases for it to be meaningful. In some jurisdictions, regulatory authorities may also desire to prescribe a prudential floor based on their assessment of systemic issues.

In some cases where countries have adopted Basel principles, expected losses are computed for a time period of one year. However, in the exposure draft while there is a minimum period specified for foreseeable future, there is no maximum period specified. Therefore, in such cases there would three computations for expected loss which apart from increasing compliance costs for entities may also lead to inconsistencies.

### **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?

Using a discount rate may complicate the computation and the choice of discount rate will reduce comparability across banks. There is also a doubt that entities may use the discount rate to manipulate the results.

### **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?

### **Question 17Z**

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

### **Question 18Z**

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

**Question 19Z**

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

In respect of the IASB only Annexure on Presentation and Disclosure we have no specific comments at this stage. However, our view is that the benefits derived from the information should exceed the cost of providing it. Perhaps the IASB would like to review the disclosure requirements in light of this principle.