



Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Group Chief Accountant's
Level 12
280 Bishopsgate
London EC2M 4RB

Telephone: 020 7672 0202
Facsimile: 020 7672 1424

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Dear Sir David

Supplement to Exposure Draft ED/2009/12 – Financial Instruments: Amortised Cost and Impairment

Following our comments to the Board on the exposure draft last year, we welcome publication of this supplement by the Board jointly with the FASB. We regard convergence in this area of significant importance. We also support the Board's decision to decouple recognition of interest income from impairment loss as well as the requirement to separate the 'good book' from the 'bad book'.

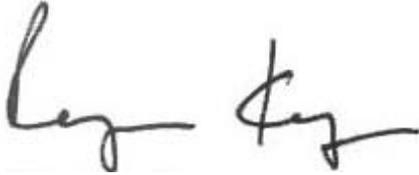
Our answers to the specific questions in the invitation to comment are given in the appendix but it is worthwhile emphasising the following points:

- Whilst the supplement has simplified certain areas, its proposals are part of the picture as they address open portfolios only. There remain fundamental issues for the Board to resolve including how impairments of single instruments, revolving credits, purchased loans, and securities should be recognised and the measurement aspect of credit losses.
- We believe there is a real risk that differences in interpretation will emerge. In particular, we believe the definitions of the bad book and the foreseeable future warrant additional guidance. Further clarification would also be useful around the treatment of transfers between good and bad books. Comparability in these areas is essential since the quality of the loan book and changes to the 'bad book' are key metrics for financial institutions.
- The Board has set itself a challenge in the 30 June 2011 date for publication of a comprehensive standard on impairment of financial instruments. We urge the IASB to ensure that a quality standard is not sacrificed to this self-imposed deadline.

Given the concerns above, we believe a period of field testing of the proposals is required. Without field testing and detailed analysis, including modelling under various economic cycle scenarios, it is difficult to assess objectively whether the model proposed is both conceptually sound and operationally robust.

Please contact me if you have any specific questions on our response.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Rajan Kapoor', written in a cursive style.

Rajan Kapoor
Group Chief Accountant

Appendix

General

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?

The approach in the supplement will generally result in earlier recognition of losses than under current IFRS and should, therefore, address concerns that have been expressed about the delayed recognition of expected losses under the current model.

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.

Yes. We believe the impairment model to be at least as operational for closed portfolios; the difference between an open and closed portfolio is that the closed portfolio relates to a particular cohort. In our view, the calculations set out in the supplement would be easier to manage and more operational in closed portfolios than in open portfolios where multiple cohorts are included in one portfolio.

We do not think the proposed model is operational for single assets. We offer the suggestion that single assets in the good book be grouped into residual portfolios for the calculation of impairment. For some single assets (for example some government securities) it may be appropriate for the provision to be zero. Upon transfer of a single asset to the 'bad book' expected losses should be calculated on an individual basis.

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?

We support the proposal to recognise the impairment allowance on a time-proportional basis over the life of the asset. However, we believe, but in the time available have not been able accurately to model and test the hypothesis, that in many cases the 'foreseeable future' floor amount will be the provision recognised. In our view it is needlessly complex and time consuming to have to compute two methodologies and we urge the Board to develop a single approach to impairment in the good book.

Question 4

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

Although complex, the time-proportional approach could be made operational. In an open portfolio, the expected credit losses over the remaining life and weighted average age will be affected by new loans, transfer to the 'bad book', as well as changes in loss estimates and changes in expected lives. Discounting this and computing annuity factors will add further complications especially when loss assumptions are changed. For long-life portfolios, small changes in assumptions may have material impacts on provisioning.

However, recognising the impairment allowance on a time proportional basis may not be consistent with the portfolio's anticipated loss profile. This will lead to volatility when actual losses crystallise in a different time period to that originally estimated ie when the asset transfers from the good book to the bad book or matures.

Question 5

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

Under the proposals the method for calculating impairment can change from period to period. In our view, this seriously impairs its decision-usefulness. Furthermore, the 'foreseeable future', differing as it will between entities and between asset portfolios, will significantly reduce comparability.

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?

We think that the proposed differentiation ('good book' – receiving regular payments; 'bad book' – managing for recovery of all or portion of the debt) is a helpful principle. However, as risk management practice and regulatory interpretation vary, identification of the boundary between the two books is likely to be inconsistent. There may also be differing practices for assets where action is taken to avoid defaults, for example, renegotiated loans. We believe the impairment triggers currently in IAS 39 might provide a good basis for assessing whether or not an asset should be transferred to the bad book.

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?

Since it is based on an entity's internal risk management policies, we believe that the differentiation between the 'good book' and 'bad book' is operational and auditable, however as mentioned above there may not be comparability between entities due to differing practices and/or regulatory interpretation. The introduction of clear boundaries would be useful or perhaps essential.

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 requirement to differentiate between the two books as the risk management approach is different and the quality of the loan book is something that the analysts and investors focus on. We agree that once an asset is transferred to the 'bad book', all losses relating to that asset should be recognised immediately.

Minimum impairment allowance amount

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.

As noted above, we do not agree with the proposal to calculate both the time-proportional amount and the losses expected over the foreseeable future for all portfolios. In our view, applying the foreseeable future amount to certain portfolios and the time-proportional amount to others will be confusing to users and burdensome to preparers. The impairment allowance is after all an estimate and our view is that only one methodology should be used when calculating the impairment allowance. However, for some portfolios, where there is no fixed repayment schedule, such as short term receivables and revolving facilities, the concept of losses expected over the life becomes somewhat meaningless.

If the Board decides to retain the foreseeable future concept, we believe the term needs to be more precisely defined. Some entities may have (or at least believe they have) better forecasting techniques than others. Under the proposals, such an entity would have to look further ahead and book higher impairment allowances than those entities with relatively less sophisticated forecasting. Furthermore, the period any entity can 'foresee' the future is likely to change as result of macro economic conditions. In times of financial stress, the forecasting period is likely to be shorter than twelve months. Finally, the foreseeable future might differ between portfolios. To improve comparability, we see some merit in a defined period say twelve months.

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.

In a steady state, the amount expected to arise within twelve months will typically be higher than the time-proportional amount for portfolios that have an expected life of around four years or less. There has been insufficient time to model the effect of the proposals on real-life portfolios.

Flexibility related to using discounted amounts

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 have a number of concerns over the lack of clarity in the proposals regarding discounting. First, it is unclear what definition of losses is being used. Is it the loss compared to carrying value? Is it future cash losses i.e. principal and interest? Or is it something else? Secondly, although we appreciate the Board's wish to simplify its proposals by permitting flexibility in discounting, this must be coupled with a consideration of the treatment of interest.

Approaches developed by the IASB and FASB separately

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?

Whilst we support the time-proportional approach, it would be extremely complicated to apply to open portfolios and therefore the use of a foreseeable future amount for the good book has superficial attractions. A 12 month foreseeable future would align with the regulatory requirements and reduce operational complexity by simplifying the calculations and reconciliations required.

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?

We are not supportive of the FASB approach. It has little conceptual merit, simply a desire for the earlier recognition of losses. There is little guidance defining the 'foreseeable future' so there is a danger of divergence in practice. Impairments will

depend on the period of an entity's projections; the further into the future these are the higher the impairment charge. Further, the FASB model makes no distinction between the good book and the bad book disconnecting impairment provisions and the management of financial assets.

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 strongly support the decoupling of the effective interest rate calculation from the calculation of credit losses.

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?

Loan commitments - we support the application of the proposals to loan commitments that are accounted for at amortised cost as these are managed together with loans. Expected losses will reflect the likelihood of drawdown of such loan commitments. The proposed disclosure requirements would require amendment to incorporate loan commitments taking into account the likelihood of drawdown and the amount of drawdown.

Financial guarantee contracts - we are not convinced that the proposals should apply to financial guarantee contracts. For the issuer of a financial guarantee contract, we prefer the current approach in IAS 39. For the beneficiary, we believe that they should be reflected in the calculation of the expected loss in the same way as other collateral.

Question 17Z

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

We agree with the proposal that interest revenue (excluding credit losses) and impairment losses are presented separately.

Question 18Z

- (a) *Do you agree with the proposed disclosure requirements? If not, what disclosure requirement 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?*

The disclosure requirements are extensive and in the time available we have been unable to determine whether the required data will be easily sourced. Some of the proposed disclosure requirements in the original exposure draft relating to stress testing, origination, maturity vintage and the credit quality of financial assets are yet

to be re-deliberated by the IASB; we remain concerned that the volume of required disclosure will be excessive. It is also unclear how these proposals will interact with the existing IFRS 7 disclosure requirements.

We are concerned about the operational complexity of performing back testing on open portfolios, particularly in the good book. The supplement would require comparisons of actual outcomes with previous estimates but it is unclear how this applies to assets that have been transferred from the good book to the bad book. Write offs would only occur in the bad book; at what point does the Board envisage that the actual outcome would be known?

We believe that the IASB should address disclosure issues only once it has finalised its impairment model for all portfolios.

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?

This proposal facilitates preparation of a 'good book' and 'bad book' impairment movements table. However a systems solution would be required that identifies the date each asset is added to the portfolio, and the amount of loss relating to that vintage. It would be administratively simpler to recalculate the loss for the 'good book' and 'bad book' at each balance sheet date separately, despite the consequent loss of visibility over changes to those estimates from period to period.