

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

1 April 2011

Dear Sir David,

**Supplement to ED/2009/12
Financial Instruments: Impairment**

Standard Chartered PLC (the Group) is an international banking group listed on the London, Hong Kong and Bombay stock exchanges. It operates in more than 70 countries, principally in Asia, Africa and the Middle East.

We welcome the opportunity to comment on the above supplement to the exposure draft (SED) on impairment and are encouraged by the fact that the document is jointly proposed by the IASB and FASB (the Boards) and is better aligned with internal risk management practices. Our detailed responses to the questions are set out in the attached Appendix. We note, however, that we have not fully evaluated the proposals in detail given the curtailed comment period and the limited scope of the document.

We believe the proposals are more operational than those articulated in the original ED although we note that they will add more complexity to the process of determining appropriate impairment provisions than under IAS 39. In addition, given that these proposals are limited in scope and a number of key issues continue to be debated by the Boards, it is not possible for us to fully conclude as to their ability to be operationally implemented without seeing the complete requirements. We note that the Boards do not intend to publish further exposure drafts, but we are concerned that the ability to implement these proposals may be impacted by decisions the Boards make on the remaining key issues.

In terms of the proposals themselves, we observe that, without additional guidance, the extended use of management judgement is likely to reduce rather than increase comparability – in particular, the use and scope of the “floor” could create significant differences between entities depending on how “foreseeable future” is interpreted and applied. We also note that the use of a “floor” deviates from the principle of matching interest revenue and expected losses. We also believe that further guidance is required around how the proposals would be applied to revolving portfolios.

There is also a lack of clear structure as to when a loan is reclassified from the ‘good book’ to the ‘bad book’ and very much relies on management judgement. Under the current IAS 39 requirements, certain parameters are set out for assessing objective evidence of impairment, which at least provides a common analytical starting point for determining ‘bad book’ loans; under these

proposals no such framework exists, which will further drive down comparability. Given the bias towards management judgement, the type and quality of disclosures will be critical and we note that these would need to be disaggregated to a significant degree – reflected in an increase in volume – to enable them to be of any use to the users of the financial statements.

Given the extension of management judgement across so many areas, the end product of these proposals will be distinctly different from one entity to another. For these reasons, together with those set out above, we urge the Boards to perform a period of field-testing of the complete impairment proposals, including the proposed disclosures, before their finalisation to ensure that they are capable of being implemented and generates information that is more decision-useful.

We would be pleased to provide any additional information or clarification of our comments if you so wish.

Yours sincerely,



Chris Innes-Wilson
Head, Group Accounting Policy & Advisory

Appendix

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?

We agree that the documented approach would appear to result in some losses being recorded earlier, although this is largely an enhancement and extension of the existing portfolio impairment provision. It is not clear how the proposed model would work over a full economic cycle or in conjunction with other aspects of the impairment project yet to be finalised and would urge the Board to enable a more detailed analysis of the application of the model to be undertaken (for example, through a period of field testing) before the Board finalises the complete proposals.

In addition, although recognising impairment losses earlier, the proposals do retain a specific impairment “trigger” – that is, when loans will be classified as part of the “bad” book and lifetime expected loss recognised in full – which was one of the criticisms levelled at the existing IAS 39 model. The incurred loss model provides a “framework” to assess impairment against, providing a series of impairment triggers. Whilst it may be true that there is some degree of variation in interpreting those triggers, the fact remains that the current model provides a common basis on which to assess impairment with less scope for different interpretation. Therefore we believe further guidance should be provided in respect of instances in which loans would be transferred from the ‘good book’ to the ‘bad book’ to enhance consistency of application and comparability.

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 that one impairment model should be consistently applied for all financial instruments held at amortised cost. We consider that the proposals are capable of being applied to all types of loan portfolios although we observe that the notion of a “floor” works best for more homogeneous portfolios, such as those found in retail portfolios, rather than a collection of exposures typically found in the corporate book. It is also unclear how this would be applied to revolving loans and amortised cost instruments other than loans. We would also highlight that the proposals detailed are very much focussed on financial institution loan portfolios; we would also expect any proposals developed to also be able to be applied to other amortised cost instruments – such as bonds.

We do not believe it is appropriate to recognise credit losses upfront for any amortised cost assets (as required by paragraph 2(b)), unless those assets are not able to be recovered in line with the principles outlined in paragraph B3.

We also note that the application by individual institutions will depend on how the portfolios would be cut to best enable the requirements to be met – that is, by vintage and/or by product. This may not be aligned to how management views their portfolios – for example, these may currently be managed and analysed by geography or by product.

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 agree, although we note that the proposals would require entities to maintain two models, which will add to the complexity and cost of reporting and configuring systems. However, we have concerns about the floor from a conceptual standpoint as discussed in our response to question 9(a). We also note that the introduction of a floor will likely reduce comparability between companies as there will be differences in how the “foreseeable future” will be interpreted by entities. For example, a company that has reliable projections that extends for 24 months, compared to a company that only has projections up to 12 months, will have a much larger floor – and therefore larger provisions – than the other. We support the comments of some, outlined in BC86, that “the lack of any clear articulation of what the foreseeable future period means is likely to result in significant divergence in practice”. Disclosure will therefore be a significant factor in ensuring users can determine how “foreseeable future” has been interpreted although we also note that this will need to be at a sufficiently disaggregated level (for example, by product, by geography) to be of use to users.

In addition, a financial institution with a 24 month projection period will also have a greater capital adjustment and therefore will be incentivised to interpret “foreseeable future” as 12 months to minimise the capital adjustment (although we note that the regulatory expected loss determination under Basel II differs from these proposals as it is determined at the lowest point in the economic cycle).

Whilst we note that the Boards, in paragraph B16, expects the foreseeable future to be greater than 12 months for many portfolios, we note that B13 states that “development of the estimate relies heavily on an entity’s ability to forecasts events and conditions that will exist in the foreseeable future period”. We believe, as we articulate in later responses, that any floor should be established as a maximum of 12 months as we believe that this represents the most reliable information and prevents the “floor” from being extended in such a way that renders the time-proportional approach irrelevant.

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 this could be applied in practice, although this will require significant efforts in determining the impact at account level for wholesale loan books and in establishing the average tenor in consumer lending portfolios. We are also concerned that for the annuity basis, any reasonable discount rate between the risk-free rate and the effective interest rate can be used as we believe that this will lead to further inconsistencies in application. However, in our view whilst

discounting credit losses would be consistent with how other long-term balances are accounted for under IFRS (other than deferred tax), we do not believe it would represent useful information and that the undiscounted approach articulated by B8(a) is more appropriate.

The time-proportionate approach is impacted by changes and variations in the expected life of a portfolio. For prepayable assets this is likely to vary in accordance with the economic environment rather than in relation to credit risk – for example, mortgage customers are less likely to switch products in times of economic stress, increasing expected lives relative to more benign economic periods.

We note that the IASB intends to expand the level of disclosure in this area; although we do not believe that this is a panacea for comparability, the disclosures required would need to be sufficiently disaggregated to be of use.

Question 5

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

Whilst the underlying principles of the proposals are based on internal risk management practices the application of the concepts may be applied differently across organisations – there may be differences in how the ‘good book’/‘bad book’ delineation is made, how the expected loss buckets are applied and, as previously noted, how “foreseeable future” will be applied – which will not only vary between entities but also may vary within an entity from period to period. From a user’s perspective, as this is based on internal risk management, there will be significant divergence in the market as to how these concepts are applied. This will ultimately impact how useful the information is to users and consequently disclosure will need to be such that the users can easily read across from one entity to another.

However, we consider that due to the level and extent of management judgement and the potential variability in the assumptions and techniques used, the disclosures required will have to be extensive. Whilst the overall concept and principles applied will be consistent across an entity, there will be multiple variations across products and geographies that may result in a significant volume of disclosures, potentially obscuring the primary messages and reducing the decision-usefulness of the information provided.

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 agree the requirement is clearly described and is largely in line with internal risk management although it is not clear how the underlying description would be applied to restructured loans and those loans that switch from good to bad to good.

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?

As long as internal policies are documented around the delineation between good and bad, then we believe the process should be auditable. Loss triggers will still have to be applied, however, if say a performing ‘good book’ loan goes “bad” (rather than going past due 90 days say, and falling into the non-performing ‘bad book’) and this therefore does not completely solve the criticisms of the exiting model around judgements around when losses actually occur.

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 this approach as this aligns closely to existing risk management and the determination of impairment provisions. Typically provisions on the ‘good book’ are captured through the existing portfolio impairment provisioning (PIP) models which assess to what extent losses are inherent in the ‘good book’ that have not yet been specifically identified. As such, we therefore see the requirement to recognise lifetime expected losses over a time-apportioned period to be an extension of the existing PIP requirements. However, as noted above, the requirement to recognise losses in full on transition to the ‘bad book’ still requires management judgement in respect of identifying specific loss triggers.

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?**

Under the model proposed, we agree that a ‘floor’ is appropriate – on the basis that earlier recognition of incurred losses could occur – although we note that this does not reflect the link between the pricing of assets and expected credit losses and as a result we believe this may undermine the decision-usefulness of the expected losses presented. In addition the floor creates a conceptual problem as “foreseeable future” may be such that for a number of portfolios, particularly those of shorter durations, losses are recognised in full on day 1 – a position not dissimilar to the standalone FASB proposals.

We believe that the lack of clarity around how foreseeable future is to be applied will either lead to considerable disparity in practice or entities will converge around the 12 months minimum. Entities that assess that they have information on which they use for assessing credit over more than 12 months will be ‘penalised’ for having better information by holding larger provisions than those with a less comprehensive suite of data. As such, we believe the foreseeable future should be set at a maximum of 12 months.

We are also not clear how these proposals would be applied to revolving portfolios – for example, credit card portfolios – and we would request the Boards’ further consider providing guidance in this respect.

(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 do not believe this approach is appropriate as evidence of early loss may change over time depending on the underlying environment. For this to hold, there would have to be a mechanism to reassess portfolios each period to determine whether a floor is appropriate or not. In addition, if there was such evidence of early loss, then this should be reflected in the assessment of expected loss in the first instance.

(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?

We agree with the proposed minimum allowance, and this aligns well with the Basel II requirements (although EL in this instance is determined using the most pessimistic assumptions). As noted in (a), however, the size of the floor will depend on the quality of information an entity has available. We believe that any floor should be established at no more than 12 months as this represents the best available information and will drive more consistency in applying the proposals across entities.

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

We believe that the floor should be retained at a minimum of 12 months although we acknowledge that in times of stress this will shorten. If the floor was determined to be variable in changes in economic conditions, then we believe this would (1) introduce further degree of management judgement and variability into the application of the floor; (2) make the application of the floor more operationally challenging; and (3) could reduce decision-usefulness of the information generated.

(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.

Where a floor is applied, we believe that the foreseeable future should be set at no more than 12 months. Whilst some entities may have information that extends beyond 12 months, the quality and usefulness of that information declines the further out projections of uncertain cash flows are made. We consider that even at the 12 month time horizon, there is a significant degree of estimation required.

- (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 that any floor should be set at a maximum of 12 months, as noted in our responses above and we do not believe that a ‘ceiling’ is conceptually justified. Applying a longer time frame decreases the quality of forecasts and extends management discretion, together with increasing the audit challenge. If any maximum were to be introduced, this would of course be limited by the average life of the portfolio.

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.

For short-term portfolios, as the floor will always be hit despite the book cycling over short tenors, we believe that the floor will be in line with paragraph 2(a)(i) and will therefore require the upfront recognition of all expected losses. We believe this will also be the case for portfolios of revolving portfolios, such as credit cards. For other portfolios, the interplay between the floor and the time-proportionate approach will depend on how widely “foreseeable future” is interpreted – it is possible that in the majority of cases the floor could exceed the time-proportionate approach and generate day 1 losses. In addition, entities that hold similar portfolios may have significant variations in their determination of the “foreseeable future” such that one could always exceed the time-proportionate approach whilst the other may not. As noted earlier, we believe that it would be more beneficial to limit the floor to a maximum of 12 months.

The proposals are likely to be easier to apply for diversified, universal banks as they will likely have such granular data but where banks operate on a smaller scale or more narrowly focused, then unlikely granular detail will be available.

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?**

No – we believe that this will introduce further inconsistency in the application of the proposals. Although IFRS generally tends to prefer discounting, we believe that an undiscounted approach will be simpler to apply, would be more prudent (as it would result in higher provisions) and would also involve less scope for variability between entities. Discounting would introduce further complexity by requiring the timing of individual cash flows to be scheduled.

(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?

To the extent that discounting is permitted, we believe that entities should not have a choice of a range of discount rates to apply as to do so would again introduce the potential for significant variability in application. We believe that entities should choose either the risk-free rate or the effective interest rate (although we note the latter is operationally more complex). It is also not clear whether the option to apply the discounted or undiscounted approach is across all portfolios or could be different for each portfolio.

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?

Although we are supportive of the common approach set out in the SED, as we noted in our response to the initial Exposure Draft, we are more supportive of the IASB's concept of spreading expected credit losses over the life of the assets rather than operating a hybrid model.

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 do not support the FASB approach in isolation – that is, we do not support the upfront recognition of expected losses and believe that credit losses should either be spread (to provide appropriate matching of revenue and risk) and/or recognised in full when an actual loss has been incurred (that is, the transfer to the 'bad book').

Appendix Z – Scope of IAS 39 and IFRS 9 (IASB)

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 we articulated in our original response, we believe that expected losses should be presented separately from effective interest. We consider that it is more appropriate to accrue expected credit losses through a separate reserve. This would be less complex, would avoid the need for multiple effective interest rates – which may confuse rather than enlighten the majority of investors – and facilitates easier understanding – especially if losses occur before expected or do not occur at all.

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 believe that it is appropriate to account for loan commitment similarly, and aligns with risk management practices of assessing “exposure at default” which include loan commitments.

However, we believe that the application in practice is likely to be quite difficult – compounded by the fact that entities would have to also assess the probability of there being an exposure at all. In addition, the proposed requirements would also have to be applied at a more granular, individual level rather than by portfolio.

Question 17Z

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

Yes – as noted above, we believe that interest and impairment should be separately presented.

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 disclosure requirements although we believe that there should be a focus on what the disclosures will actually tell the user of the accounts – too aggregated and the disclosures become less useful tools in being able to compare across entities and too detailed and the underlying message the disclosures are trying to convey is lost. As we have noted in our earlier responses, there may be a number of instances where the volume of disclosures could be significant

to ensure appropriate information is provided to users to enable them to draw appropriate comparisons between entities. In addition, we question the need to disclose the tables required by paragraph Z8 for five years as we are unclear what the basis of choosing five years is and also what users can really divine from this information, without it being presented at a significant level of disaggregation.

In some instances the proposed disclosures have been vaguely drafted which is likely to lead to inconsistencies in interpretation and application. For example, paragraph Z12(a) states that entities shall “disclose a quantitative analysis that compares the actual outcomes and the previous estimate of credit losses” but with no guidance as to how that disclosure may actually be achieved.

We also note that the example disclosures proposed for expected loss combine accounting and regulatory type disclosures – for example, exposure at default includes both on-balance sheet and off-balance sheet exposures and could either be before or after collateral.

Given the significant reliance by the Boards on disclosure to bridge the gap between consistent application and comparability, we believe that this is a key area that the Boards should focus on in field-testing the proposals to determine the nature and extent of disclosures required to make them useful to users.

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?

We agree with the proposal but we question whether this is actually workable and would encourage the Boards to undertake a period of field testing to determine how this would be applied in practice. This is another area in which a degree of management judgement and subjectivity is required, which would have to be compensated by enhanced disclosure.