



April 1st 2011

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

Re: Supplementary Document to the ED Financial Instruments : Impairment

Dear Sir David,

On behalf of Société Générale, one of the largest financial services groups in the euro zone, we are pleased to provide our comments on the above Supplementary Document to the ED *Financial Instruments : Impairment* (SD).

In our comment letter on the IASB's ED *Financial Instruments : amortised cost and impairment*, we expressed our support to an expected loss model but raised strong concerns relating to the resulting application that was proposed by the ED.

We welcome the improvements made to the original ED when they are based on a principle-based approach and notably the fact that some items rely on the management risk practices.

We also welcome other improvements introduced in the proposed model as they meet the main principles on which an alternative model should be based, as described in our answer to the previous ED :

- the operational introduction of a decoupled approach to recognize interest revenue separately from depreciations instead of an integrated EIR (which was quite impossible to implement),
- the upholding of the current definition of amortised cost and of the EIR calculation,
- the better alignment with the internal credit risk management of the entity regarding the portfolio segmentation and the definition of the good book and bad book,
- the recognition of expected loss (and changes in estimates) in profit or loss on a time proportional basis over the life of the portfolio according to a simplified method. This will resolve, in an operational manner, the current timing mismatch between the recognition (as revenue) of the credit risk premium included in the interest charged to the borrower and the recognition of the related credit loss,
- the treatment of impaired loans which remains as under the current IAS 39.

Regarding the scope of the expected loss model, we advocate to apply a single impairment model to all financial instruments at amortized cost, including financial guarantees and loan commitments. We also advocate not limiting this model to financial assets managed on an

Comments on the Supplementary Document : Impairment

open portfolio basis but extending it to closed portfolios and individual assets as similar operational issues for such financial assets would remain without a decoupling approach.

However, we have a major concern on the new concept of the “floor” introduced by the SD. It is not clear whereas the interaction of the currently proposed time-proportional and floor impairment allowances for the good book has any conceptual basis. We do not support this floor mechanism that will lead to the recognition of a day-one credit loss which is not consistent with the economics of the lending activity (at market rate). Moreover, it is based on the mistaken assumption that credit losses are more reliably estimate over the near term. And we believe that the concept of “foreseeable future” is not clearly defined and potentially broad and uncertain. Therefore, it compromises the time-proportionate approach. Indeed, our first simulations demonstrate that a foreseeable future period above the level of 18 or 24 months will be the only determinative factor of the expected credit allowance. Accordingly this would mean that we would have a single model of impairment corresponding to the FASB model.

We understand that this ill-defined concept results from the Boards’ attempt to reconcile two incompatible approaches resulting in a mere overlap of two different models in order to present a common solution. We do not believe that this process is the best way to achieve the development of a high quality converged standard.

With respect to the functioning of the model, a question arises also as to whether the good book allowance may be reversed in practice during an economic downturn. There may be a need for clarification on how the Boards perceive the allowance will be used over the credit cycle.

Regarding the consultation process, we believe that an adequate comment period should have been retained. The comment period of 60 days for the SD is too short due to the important and complex matter of impairment, the large scope of the questions and the fact that the SD was published in a period when European entities focus all their resources on preparation of their financial statements. We could not be convinced with the reasons given by the IASB’s Board of a limited scope of the SD and the fact that the concepts on which it is built might be already known. Moreover, successive and separate consultations (ED in November 2009 and SD in January 2011) and matters not yet re-deliberated (§IN20) lead to a fragmentary view of interrelated matters. We strongly suggest that all the draft proposals should be re-exposed in order to have an overall view of the impairment model and to properly consider all the issues in their full context.

Our comments to the SD are detailed in the Appendix to this letter.

If you have any queries regarding our comments, please do not hesitate to contact me or Pierre-Henri Damotte, Head of Group Accounting Policies Department of Société Générale.

Yours sincerely,

Marie DOUCET
Group Chief Accountant

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 proposed model addresses the weakness of the existing incurred loss impairment model as it provides more timely recognition of expected credit losses for financial assets in open portfolios.

We welcome the proposed model as it meets the following principles that we find suitable to an alternative model :

- The new impairment model does not change the current definition of amortised cost or the EIR calculation,
- Expected losses is determined on a portfolio level aligned with the credit risk management practices of the reporting entity,
- The expected loss provision is calculated over the life of the portfolio,
- Expected loss provision at initial recognition and subsequent revisions of estimates are spread over the life of the portfolio,
- Impaired loans are treated as in the current IAS 39.

However, the proposed model would hardly meet the principle of usability of the expected loss allowance. Indeed, incurred losses are the crystallisation of the expected losses, so the expected loss allowances are built up to be used. None of the alternatives in the SD fully meets this key principle, because, although the proposed model implies a transfer of allowance between the good book and the bad book, it requires immediately the build-in of an allowance for the good book.

We also have concern with the concept of “foreseeable future” or floor introduced in the proposed expected loss model as explained in question 9. Briefly said, we consider that the floor prevents from meeting the objective of the expected loss model to link the expected losses with the interest revenue recognition. Moreover, in most cases, the floor would be the determinant of the provision and thus would not differ from the model proposed by the FASB.

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 would strongly recommend a single impairment model for all assets accounted for at amortised cost.

We would expect that the part of the impairment model related to the “good book” would be at least as operational for closed portfolios and individual assets as it is for open portfolios. The decoupling approach applied to the good book should not be limited to the open portfolios but it should be applied as well to closed portfolios and individual assets.

Should the requirements of the original ED remain for closed portfolios or individual assets of the good book, the same concerns of complexity related to the EIR (adjusted to include credit risk adjustment) would remain for such financial assets. The original ED is based on the fundamental presumption that it is possible to accurately estimate the timing of future losses over several years. But then, the predicting of timing of future cash flows is far from being accurately possible. So it does not make sense to incorporate the loss rate in the EIR calculus.

The scope to the impairment model should be expanded as well to loan commitments and financial guarantees as answered to questions 15Z and 16Z.

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?

The approach proposed in the SD is based on the distinction of good book and bad book which we support.

But the approach proposed in the SD is also the combination of two concepts: the time-proportional approach and the floor, and we disagree with this last one.

The concept of the “foreseeable future” or floor is a different concept from the expected loss concept notably as it has no link between the interest revenue recognition and the expected losses. Moreover, it is based on the assumption that losses would be predicted more accurately over 2 to 3 years than over the life of the portfolio. This will never be the case. For these reasons and those developed under Question 9, we do not agree with the concept of the “foreseeable future” or floor.

Regarding the time-proportional approach excluding any consideration for the floor mechanism, we have still some question about the possibility to use impairment allowances on good book through the economic cycle. When the amount of impairment allowance is transferred from the good book to the bad book, the time-proportionate mechanism implies, for a stable good book, an immediate build up of the allowance balance. Therefore, such mechanism creates a reserve that can hardly be used when credit conditions deteriorate.

If a reserve should be capable to be used in case of need, loss parameters would have to be increased in good times to anticipate a changing environment and decreased in the reverse situation. However, this would be often difficult, as exact timing and duration of an economic cycle is quite hard to predict. Only if management applies a positive outlook (when justified) in estimating future expected losses (at the height of the crisis) will a meaningful reduction to the good book provision be possible. Such a positive outlook

would then need to be justified using all reasonable and supportable information on forecasts of future events and conditions

Question 4

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

The proposed approach to determining the impairment allowance on a time-proportional basis remains operational as it allows a decoupling approach for interest revenues and expected credit losses. Thus, it should be easier to apply than the approach proposed in the IASB's ED where under the cash-flows approach, the timing of losses needed to be assessed which is impossible.

However, the approach still remains complex and would add compliance burden to entities as it requires developing two separate expected loss estimates in order to recognize the higher amount of the time-proportional amount and the floor amount as the impairment allowance for the good book.

Moreover, given that the foreseeable future or floor would be the determinant factor of the level of provisions in most of the cases, the implementation of the proposed approach would not provide different results from the FASB model. In such a case, we do not believe that the relationship between the pricing of financial assets and expected credit losses would be maintained.

Question 5

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

We are not convinced that the proposed approach would provide useful information, due to the introduction of the floor mechanism which is not consistent with the time proportional approach. The double calculus required for the recognition of the good book impairment allowance raises several concerns. We question the interpretation to give to changes to allowance accounts when the impairment allowance for the good book can shift between a time-proportional amount and a floor amount.

It will not help users to understand financial statements and it will rise difficulties for preparers to comment.

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 welcome the principle-based approach adopted to differentiate between the two groups. We believe that the definitions of "good book" and "bad book" are clearly described and will lead to a distinction which will remain consistent with the current practice under IAS 39 for identification of impaired financial assets.

We do not anticipate difficulties to apply the proposed definitions as they will allow to accurately portray the classification between the two groups in accordance with banks' credit risk management practices.

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 it reflects the way financial services institutions manage their credit risks in practice, the requirement to differentiate between the two groups is operational and auditable. A well-documented policy illustrating the determination of the distinction between good and bad books is still needed for internal control purpose and will facilitate their audit as well.

Question 8

Do you agree with the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

As stated in BC49 it would not have been appropriate to define a bright-line for transferring a financial asset between the two groups as it depends on the risk management practices of each entity. Therefore, we agree with the proposed requirements for differentiation between the two groups.

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?

We disagree with the proposal to require a floor.

The concept of the floor is unclear and conceptually unjustified in the frame of the IASB objectives. Moreover, we think that the Basis for Conclusions are far from being clear about the benefits of the common approach to users and preparers.

Introducing a floor compromises the time-proportional approach as it will not meet the objective of a relationship between the expected credit losses and the pricing of the related assets. It will not accurately reflect the economic substance of an expected impairment model.

The concept of floor is based on the premise that it is possible to predict losses more accurately over 2 or 3 years than it is over the life of the portfolio. This is far from being true. We expect that the foreseeable future period would shorten during downturns and be longer during a stable economic period. This would lead to unintended consequences of reduction of impairment allowances while needed.

Moreover, above a level of a provision of 18 to 24 months, the floor will often prevail over the time proportionate provision. Indeed, as most of the standard loan portfolios are expected to have an average life of 8 years, the time proportionate provision will be less than 2 years' expected losses. Consequently, in most circumstances, the floor will be the only determinant of the level of the good book provision. This would result in having a single model of impairment corresponding to the FASB approach only.

The floor implies the recognition of a day-one-loss as an immediate credit impairment is accounted for in the net income, which is far from the concept of the expected model based on the time-proportional approach.

Added to the time proportionate recognition, a floor would add operational complexity as two sets of expected losses should be calculated and compared at each reporting date before recognizing expected loss allowance.

(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?

The "evidence of an early loss pattern" is not a clear concept. Would an early loss pattern be identified under certain circumstances, it should be taken into consideration when determining the allocation of the expected losses over the residual maturity of the portfolio.

(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 disagree with the concept of the proposed minimum allowance for the reasons developed in a).

However, we understand the concern of the IASB that a sufficient allowance amount should be recognised as far as financial assets are concerned.

In an expected loss model, financial assets are differentiated into two groups: good book and bad book according to the different timing recognition of credit losses. Within this model, the provisioning of credit losses is recognized through a consistent accounting treatment related to each of the two groups which is a time-proportionate approach for the good book and an immediate recognition of credit losses for the bad book. Therefore, a minimum level of provisioning is already built as the allowance balance is at least always equal to the credit losses recognized in the bad book.

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

Contrary to what B14 states, the foreseeable future would not be a 'fairly constant period for particular portfolio'. It varies according to economic conditions. We would expect that the foreseeable future period would shorten during highly volatile and uncertain times whereas it would be longer in good times.

Required to be a fairly constant period, it would become a concept close to a regulatory requirement.

(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 explained in Q3 and Q9a), we disagree with the concept of the foreseeable future period or floor. We believe that it is generally difficult to issue reasonable and supportable economic forecasts beyond twelve months, as shown by the recent financial crisis.

(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 previously mentioned, we disagree with the concept of the floor.

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.

As explained in our answer to Q9, above of a level of provision of 18 to 24 months, the floor would prevail over the provision to build. In practice, this would lead to the application of a single model corresponding to the FASB model.

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?

We agree with the flexibility permitted to use either a discounted or undiscounted estimate.

(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 agree permitting flexibility in the selection of a discount rate when using a discounted expected loss amount.

This will enable financial services institutions to implement an impairment method that is aligned with the refinement of their internal risk management practices. Indeed, financial services institutions may have different views on the most appropriate and reasonable

discount rate that best suits their activity. Stating arbitrarily a standardized discount rate might undermine the relevance of the information provided.

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?

As we disagree with a floor approach, we would prefer the IASB approach over the other alternatives proposed in the SD.

We believe that the general concept underlying the IASB approach meets the main principles on which an alternative model should be based, as described in our answer to the previous ED :

- the recognition of expected loss (and changes in estimates) in profit or loss on a time proportional basis over the life of the portfolio according to a simplified method. This resolves, in an operational manner, the current timing mismatch between the recognition (as revenue) of the credit risk premium included in the interest charged to the borrower and the recognition of the related credit loss,
- the recognition of the losses incurred as in the current IAS 39,
- the determination of expected losses on a portfolio basis, aligned with the internal credit risk management of the entity regarding the portfolio segmentation and the definition of the good book and bad book,
- the decoupling approach, to recognize interest revenue separately from depreciations instead of an integrated EIR
- the upholding of the current definition of amortised cost and EIR calculation.

However regarding the principle so that expected loss allowance is built to be used, provisions built up over time would hardly be available for use when credit conditions deteriorate. We believe further clarifications should be provided related to the usability of the provisions.

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 model because it does not reflect the economics of lending transactions. In addition, we have concerns about the application of the concept of “foreseeable future”.

Recognizing credit losses expected to occur in the foreseeable future period at the reporting date would result in an inappropriate day-one-loss. The proposed approach would lead to immediate recognition of losses and would not be consistent with the timely recognition of

the credit risk premium as it is in an expected loss model. This would not reflect the link between the pricing of financial assets and expected credit losses as would do an expected loss model based on time proportionate recognition and this would not be consistent with the principles of the revenue recognition over the life of the financial assets.

The objective of an expected loss model is not to achieve an earlier recognition of credit losses but to estimate expected credit losses over the life of the related financial assets.

The FASB approach would also lead to unintended consequences. Indeed, it relies on the assumption that credit losses are more reliably estimate over the near term rather than over the entire life of the financial assets. This is far from being true. For long period, long statistical series would allow to have general trend of credit defaults. Expectations for short term periods may be exacerbated by the effects of the economic cycle related to the existing economic conditions.

The foreseeable future period for which losses are observed varies according to the economic cycle. The period is longer during a stable economic cycle than during a downturn. During a stable economic cycle as few losses would be observed, the FASB approach would lead to a low level of impairment allowance. Furthermore, as the economic cycle reverses, the foreseeable future shortens and the expected loss allowance increases. The resulting effect of the conflicting factors is unknown.

Foreseeable future adds a level of unnecessary complexity. Within world wide companies, the interpretation of foreseeable future may be different as it may vary upon the economic cycles that exist in different locations where subsidiaries or branches are set up. Moreover, there is no clear definition of the foreseeable future in the SD which might result in significant divergence in practice.

Finally, we do not believe that the FASB approach would meet objectives defined by the G20 and financial authorities of early identification of credit losses to permit less procyclicality in assessing credit impairment. The FASB approach implies a deep procyclical effect as it is based on the assumption of more reliable estimations over the near term.

IASB only Appendix Z Presentation and disclosure

Impairment 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 agree that the determination of the effective interest rate should be separate from the consideration of expected losses as this would be more operational. Decoupling the effective interest rate and the consideration of expected losses is one of the major improvements we advocated for at both conceptual and operational levels in our responses to the ED proposals.

Additionally, we consider that the “decoupled” approach within the good book should be applied not only to open portfolios but as well to individual assets and closed portfolios.

Scope – Loan commitments and financial guarantee contracts

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?

All loan commitments that are not accounted for at fair value through profit or loss should be subject to the same impairment requirements as loans recognised at amortised costs as they are managed in the same way. Thus, this would be consistent with the bank credit risk management.

Question 16Z

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

The proposed requirements would be operational if applied to loan commitments and financial guarantees contracts as they are managed under the scope of the bank credit risk management. Financial institutions like Société Générale manage the credit risk of balance sheet items (e.g. loans) and off balance sheet items (e.g. loans commitments and financial guarantees) in a consistent manner based on an expected loss approach.

We see no reason to differentiate the treatment of credit risk arising from loans from credit risk arising from loan commitments and financial guarantees and to disconnect accounting principles from credit risk management practices.

Presentation

Question 17Z

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

We support the proposed presentation requirements as they reflect the “decoupling” approach that we welcome. This would be operationally simple to apply and would provide meaningful information for users.

Disclosure

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?

As a general concern, the complexity and volume of disclosure requirements will confuse users of financial reporting from the value and clarity of the financial statements. We would

suggest that the volume and interaction of extensive disclosure requirements should be accurately taken into consideration within the existing disclosure requirements of IFRS 7 or with the disclosures part of the November 2009 proposals. Therefore we believe that an overall reassessment of the disclosure requirements is needed through a re-exposure of the overall impairment project.

More precisely, disclosures should only focus on the information presented on the face of financial statements. So we believe that the difference between the time-proportional amount and the floor amount as stated in paragraph Z7b) should not be required.

Moreover, requiring detailed movements such as write-offs, reversals or disposals for the “good book” allowance account (paragraphs Z7 – BZ22) makes no sense as this information relates to the consideration of financial assets being irrecoverable which concerns financial assets of the bad book.

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?

The SD requires the amount of allowance transferred with an asset becoming doubtful to be the time-proportional amount relating to this specific asset, i.e. considering the age and expected life of this specific asset. This requirement would unnecessarily add complexity into the proposed impairment model.

The amount of impairment allowance which is proposed to be transferred from the good book to the bad book in the SD supposes a specific recalculation of the time proportionate allowance for the transferred financial asset. This is not a straightforward way to transfer financial assets between the two groups. Moreover it is not in line with the concept of recognizing an expected loss allowance on a portfolio basis. As loans recognized as defaulted loans are the crystallization of the expected losses, the bad book impairment allowance will be calculated and adjusted fully against the good book impairment allowance. Therefore, the amount to be transferred should be the total amount required of the bad book allowance on the transfer’s date.