

Supplement to ED/2009/12

FINANCIAL INSTRUMENTS: AMORTISED COST AND IMPAIRMENT

I - GENERAL COMMENTS:

In the Banco Santander Brasil opinion, the new requirements for recognizing impairment allowance defined in the Supplementary Exposure Draft certainly will solve the operational difficulties that were arisen in the ED-2009/12.

The proposal of splitting open portfolios into "good book" and "bad book" was a suitable solution, since it will simplify operational procedures and facilitate the comprehension of financial statements by its users. Additionally, the decision to allow entities to apply their internal credit risks models to identify expected losses demonstrates Boards's commitment to be complying with a principle oriented accounting pattern.

Despite of above considerations, the Supplementary Exposure Draft brings some accounting criteria that we have some concerns. Basically we are talking about "flat" profit and loss recognition related to "floor allowance", once it seems too much conservative and produces on financial statement an excess of prudence that distanced it from the economic substance (please check our answer on question 9 (c)).

In order to contribute to FASB and IASB to achieve a common approach for an expected loss impairment model for open portfolios of financial assets measured at amortised cost Banco Santander Brasil has answered the questions of the supplementary document which are presented below.

II - RESPONSES TO THE QUESTIONS:

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?

Yes, the recognition of credit loss at the inception date of financial asset will allow the entity to supersede the weakness of expected credit losses delay recognition. The proposed model is more adequated than the current version of IAS 39 because it covers all kind of impairment (expected and incurred losses).

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.

The impairment model proposed should not applicable for closed portfolios and other instruments.







The supplementary document should have a specific section to treat individually significant assets before measuring them on a collective basis. This proposal is necessary since these assets are managed individually by credit risk area and such assessment should also be reflected in the entity's financial statement. In the case of Board's decision is to apply the proposed impairment model for closed portfolios and other instruments, in our opinion it could bring some distortion to the allowance amount.

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?

Yes, due to the approach would represent the economic substance of the portfolio, it means, according to the passage of time the expected loss embedded in the good book probably will materialize either by the portfolio's duration or foreseeable future period whichever is greater.

Question 4

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

Yes, in general terms, the impairment allowance on a time-proportional basis is operational on the standpoint of accounting and credit risk, since the necessary information to implement the proposed model are already produced and used currently by the entity.

Complementary, this approach is complied with IFRS framework of confrontation between revenues and expenses as time goes by, avoiding profit and loss accounting mismatch. In the possibility of impairment allowance to be flat recognized, what we do not agree, an excess of prudence would be observed in the financial statement.

Question 5

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

Yes, once the entity applies such model, the expected credit losses will no more postponed, preventing the delay of credit losses recognition and mitigating the effect of "too little, too late". In summary, as soon as the effective cash flow of a portfolio is known, more useful it will be for entity to make decisions.

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?

Yes, the orientation to segregate financial instruments into "good book" and "bad book" is clear enough.

We support IASB decision to develop a model principle orientated, where according to entities internal credit risk model the financial assets will be classified between the two groups.







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?

Yes, since each entity (i) formalizes its internal credit risk model, (ii) disclosures all the necessary parameters for measuring credit losses and (iii) the model is consistent and verifiable.

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, considering this requirement is feasible in operational terms and in particular for good book, it achieves the original purpose of ED/2009/12 that had the intention to recognize the expected credit losses according to the duration of the portfolio by the adjustment of the effective interest rate.

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?

Yes. A minimum allowance amount (floor) represents the potential future credit losses that the good book is subjected, based on entity's credit experience and internal credit risk model, even the current portfolio demonstrates an excellent performance (payments are perfectly in course).

(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?

No. We understand that such procedure does not respond the Financial Crisis Advisory Group, the Financial Stability Board and others, since it will diverge from *Declaration in Strengthening the Financial System*.

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

Yes. We agree that an assumption of twelve months for a foreseeable future is adequate for the entity to calculate a minimum allowance amount even the portfolio's duration is more than it. On the other hand, for portfolios that presents duration less of twelve months, the entity should have utilize such duration as foreseeable future period on "floor" calculation.

IMPORTANT: Although, we agree with the concept of a minimum allowance amount (floor), we do not agree with its "flat" profit and loss recognition. We strongly recommend that the Board revises such criteria and introduces deferrable profit and loss recognition, based on the period utilized for foreseeable future.







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

No. Despite changes in economic conditions the foreseeable future period should not change. Actually, if changes in economic conditions affect open portfolios, the internal credit risk model must capture such effects.

(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.

We understand that this question is not applicable to the brazilian economic credit environment, due to the fact it is very diversified. Therefore, it is possible to find open portfolios with different durations, it means, less or more than twelve months.

(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.

Despite the comments in question (e), for portfolios that presents duration greater than twelve months, we consider a "ceiling" a good practice to determine the amount of credit impairment (floor) and it will facilitate the comparability among entities.

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.

At this moment, we do not have any rational that could help us in answering this question.

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?

In our point of view, the best approach is to use a discounted estimate. However, the flexibility to use both approaches will simplify the adoption of this supplementary document, especially in operational terms.

(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?

Yes, since each entity has the ability to define the discount rate that better represents its economic reality. Besides it, the discount rate applied will never be higher than the portfolio effective interest rate.







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?

We agree with the model proposed by the IASB for measuring credit loss of open portfolios, which was proposed by this supplementary document. The main reason for choosing this approach is because it is more aligned with Basel II. The only consideration is that all impairment allowance should be recognized in the profit and loss on deferral basis (either to recognize expected credit losses over the life of the assets or according to foreseeable future period).

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 agree with any approach that determines a "flat" profit and loss recognition for expected credit loss, since we understand that such kind of recognition does not represent a principle orientated accounting pattern (i.e the economic substance is not observed). Another concern is to replace market criticism from "too little, too late" to "too soon, too much".

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. To calculate the new effective interest rate considering the expected loss is not feasible on the operational view. If the entity should have to practice such criterion, the observation cost would be significantly incremented and it would not be a guarantee that the information could be useful for decision-making.

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?

Yes. Currently, financial entities already capture all loan commitments, financial guarantee contracts and customers credit limits that are not accounted for at fair value through profit or loss in their internal credit risk models. Therefore, the supplementary document requirements should be extended also to these types of loans. In addition, we would like to recommend that all kind of credit exposure should be treated under an unique IFRS Pronouncement (i.e from IAS 37 to IAS 39/IFRS 9).





Question 16Z

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

Yes. As we have mentioned in the question 15Z, the entities internal credit risk model already consider such kind of credit exposure, consequently, the proposed requirements will be not an operational issue.

Question 17Z

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

Yes. To show the effective interest rate separated from the expected credit loss is the best way to present entities' figures and contribute for a better comprehension of the users.

Question 18Z

- (a) Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why? (b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) for the proposed impairment model and why?
 - a) Yes, we agree with the proposed elements, once we consider them sufficient to the needs of the users of financial statements and market analysts.
 - b) We would like to recommend that Appendix Z (Presentation and Disclosure) should dedicate an item to be comply with Basel Pillar III Disclosure.

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?

No, we understand that each time we have movements between books the credit asset has to assume the requirements of the new book. Actually, the credit age of the financial asset must be an item to be considered and treated by the internal credit risk model of the entity.



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