

2011-150 Comment Letter No. 164

1 April 2011

International Accounting Standards Board 1st Floor 30 Cannon Street London EC4M 6XH United Kingdom

(By email: CommentLetters@iasb.org)

Dear Sir

RESPONSE TO FINANCIAL INSTRUMENTS: IMPAIRMENT

Introduction

06-18-008 (08/2010) AW

Co. Reg. No. 196800306E

DBS Bank is pleased to have the opportunity to comment on the Financial Instruments: Impairment Supplementary Document (SD) issued by the International Accounting Standards Board (IASB) in January 2011. We appreciate the IASB's efforts to re-deliberate and re-expose certain aspects of the original November 2009 exposure draft (ED); specifically, the adoption of a "good book" and "bad book" distinction and the decoupling of expected credit losses (EL) from the effective interest rate are very positive developments.

We set out below, for the IASB's consideration, a proposed modification to the methodology governing the EL charge for the good book termed as the modified time-proportionate approach.

EL charge to closely reflect loss patterns

Paragraphs 2(a)(i) and (ii) of the SD provide for the following:

"At each reporting date, an entity shall recognize an impairment allowance for assets where it is appropriate to recognize expected credit losses over a time period (i.e. the good book), the higher of (i) the time-proportional expected credit losses (TPA); and (ii) the credit losses expected to occur within the foreseeable future (which shall be no less than twelve months after an entity's reporting date)."

An outcome of the joint deliberations of the IASB and FASB, this approach attempts to achieve the twin objectives of (i) reflecting the relationship between expected credit losses and the pricing of financial assets, which is held to be a faithful representation of the underlying economics of lending activities; and (ii) ensuring that a minimum allowance amount is built up, the quantum of which is at least equal to the credit losses when they are expected to occur. While we would agree that Paragraph 2(a)(i) seeks to



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reflect sound accounting principles, we are also partial to the views of certain FASB members outlined in BC83 that, for certain portfolios, "the objective of linking credit losses of financial assets to the original pricing, while conceptually appealing, does not recognize that there is often no direct relationship between the two". Further, "unless recognition of the time-proportional amount of estimated credit losses coincides with the timing of recognition of actual credit losses (and replenishment of the allowance) profit and loss would not be aligned". Accordingly, it is debatable whether a strict adherence to the TPA approach adequately captures the actual EL patterns observed in credit portfolios.

Paragraph 2(a)(ii) accords a higher priority to the adequacy of allowances at a point in time, and is of greater proximity to the viewpoints of constituents such as regulators and rating agencies. In practice, if the loss pattern of a portfolio is observed to be at variance with what was originally envisaged, it is difficult to ascertain upfront whether the overall EL is going to be comparatively higher, or if what has happened is simply an early manifestation of the same originally-estimated EL. In light of this uncertainty, our view is that the TPA has less relevance in such scenarios, considering that the need to establish an adequate allowance balance becomes more paramount. The concept of a "floor" should arguably be applied for such specific situations rather than as a generic requirement for all types of portfolios in all circumstances in the good book.

Modified time-proportionate approach (MTPA)

We propose, for the IASB's consideration, a modified time-proportionate approach (MTPA) which we believe will allow broad objectives to be met without undue operational complexity for practitioners. This method retains the spirit of the TPA while also giving due regard to the need for an adequate allowance balance. Our proposed MTPA approach appears to be congruent with the view expressed by a minority of IASB members in BC74 of the SD. Essentially, practitioners are able to utilise the approaches outlined in Paragraphs 2(a)(i) and (ii) to ascertain the appropriate level of credit losses to recognise. The scope for a reasoned use of judgement in the MTPA is indeed greater; this is, we would venture, a necessary requirement given the nature of loss provisioning - the same IASB members appear to share this view in BC75.

There are two main differences between the MTPA and the approach outlined in the SD:

• The approach outlined in the SD requires entities to recognise the higher of the two amounts in para 2(a)(i) and (ii), which requires maintaining two sets of processes and EL calculations - for the foreseeable future and the expected life - for each and every portfolio in the good book. Under the MTPA, reporting entities will be allowed to depart from the TPA's straight-line or annuity method upon discernible evidence of changes in loss patterns. For affected portfolios, the EL charge will be accelerated to facilitate the build-up of the allowance balance. The MTPA thus takes in both the TPA and



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- allowance adequacy as inputs in determining the appropriate EL charge, permitting greater flexibility for reporting entities.
- Compared to the approach proposed in the SD, the MTPA avoids the clear and perhaps contrived distinction made between foreseeable future and expected life in assessing EL, which adds reporting burden considering that the current proposal envisages the ongoing disclosure of the difference between the EL determined under each of these time-periods as well as the related assumptions.

DBS appreciates that this is an inherently contentious topic and constituents' expectations remain varied and divergent. Efforts at integrating different objectives is a tricky pursuit as the outcome could be too compromised and as such a further departure from actual practice. While the MTPA is susceptible to allegations that a greater degree of judgement has been substituted for arithmetic rigour, this may be a worthwhile trade-off in light of the subject matter being deliberated on.

We hope that the comments provided are useful in assisting with the Board's effort in striking the right balance. Should you require any further clarification, please contact me at sokhui@dbs.com. Thank you.

Yours faithfully

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