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Supplementary Document Financial Instruments: Impairment

Dear Sir David,

Deutsche Bank would like to thank the IASB/FASB (“the Boards”) for the opportunity to comment on the Supplementary Document Financial Instruments: Impairment (“the SD”). As we stated in our previous comment letter on ED 2009/12 we share the concerns that the IASB has about the existing incurred loss model and we continue to see merit in moving to an approach that incorporates expected losses.

The Bank continues to support the development of a single set of high-quality globally accepted financial reporting standards and we support the efforts of the IASB to achieve this aim. We believe that consistency is essential in creating investor confidence in the financial services industry. Still, we are concerned that the SD as issued combines into one model two conflicting impairment concepts to achieve a converged solution.

In addition, we acknowledge that an expected loss impairment model introduces a significant level of judgement in the interpretation and application of the model. Therefore, the disclosures developed will need to be both qualitative and quantitative in nature and adequately explain the policies and assumptions applied and the impact of those choices and subsequent changes. As we outlined in our previous comment letter, we believe that any approach to impairment should:

1. Ensure earlier recognition of expected credit portfolio losses
2. Ensure that provisions for financial instruments held at amortised cost reflect realised credit losses immediately and unrealised but expected losses appropriately (i.e., in line with interest income recognition)

3. Adopt an approach for assessing credit losses consistently with internal risk management policies and practices of financial institutions
4. Adopt a measurement basis for financial instruments at amortised cost which is consistent with the entity's underlying business model
5. Require disclosures that enhance transparency for financial statement users

We welcome the efforts made by the Boards in the intervening period to incorporate and adopt many of the recommendations of the Expert Advisory Panel into the revised model outlined in the SD. This has resulted in a model which is less operationally complex when compared to the previous ED and is better aligned to credit risk management policies and practices, which we believe provides users with more useful financial information.

In particular we support:

- the decoupling of the impairment expenses from the effective interest rate;
- the acceptance of a model for use on open portfolios; and
- the alignment to credit risk management procedures by segregating portfolios into performing “good books” and non-performing “bad books.”

As the SD only addressed open portfolios, we would support extending this approach to all financial assets held at amortised cost, including loan commitments not held at fair value through P&L, (irrespective of whether they are managed individually, or in open or closed portfolios), as this promotes consistency and reduces complexity.

Build up of provisions for Good book and its Usage

A key question which remains between the two approaches in the SD, time proportion allocation (“TPA”) and foreseeable future (“FF”) is the principles regarding the build up and usage of the provisions for the Good book. Whilst the original ED had a very clear conceptual answer to this question, the SD needs to address this question after having accepted the need for an open portfolio approach for operational reasons. In this context we recognise that there is no conceptually perfect answer to the question any longer but as stated in our previous comment letter, we continue to have a strong preference for an approach which allows for a time proportion rebuilding of the “Good Book” Allowance on a going forward basis, following loan transfers to the “Bad Book” (i.e. a “*transfer and rebuild model*”, similar to that advocated by the European Banking Federation). We believe this ensures the best alignment between interest recognition and the recognition of credit losses, thereby also creating an allowance that can be utilised better than under a fully time proportional approach or the foreseeable future concept laid out in the SD. We acknowledge that this forward looking model also has conceptual issues attached to it, in

particular whether the allowance would always be sufficient in an extended crisis period where part of the allowance is used up early as a result of significant crystallization of losses.

The approach favoured by the IASB is to build an allowance over time with immediate rebuilding of the allowance for “Bad Book” transfers (i.e. the time proportionate “IASB only” model). This model attempts to build the allowance over the life of the loan portfolio in line with loan pricing, while ensuring full recognition of losses on non performing loans. Additionally, this model aligns to credit risk management segregations of loans into performing “Good Books” and non performing “Bad Books”. It suffers however, from linking the requirement for the “Good Book” allowance to the time a loan has performed without credit loss, i.e. a (partial) historical backward looking approach to losses. This differs with the credit risk management view of expected loss estimates which is a point in time only looking forward. For example, under the proposed model two loans with the same remaining lifetime and with identical future loss expectations would require a different level of allowance in case they have been originated at different dates in the past, notwithstanding the fact that all past payments have been made in full and past performance has no impact on future credit losses.

The other approach included in the SD focuses on ensuring the balance sheet fully reflects losses expected in the foreseeable future (i.e. the FASB only model). This model has the advantages of being operationally simplistic and due to its focus on the balance sheet treatment, is easily explainable. However, we believe this approach is inappropriate as it creates a day one loss due to the immediate recognition of all losses in the foreseeable future which delinks the impairment allowance with the loan pricing. This model also is not adequately linked to credit risk management practices as it disregards a “Good Book” / “Bad Book” approach, thereby not providing users with useful financial information.

We believe that the boards should be clear as to which conceptual basis any final model is based. At present, the Boards however have settled on a hybrid approach which blends a time proportionate approach with a foreseeable future floor. These concepts we believe are incompatible. However, of the two bases inherent in the combined approach we have a clear preference for a time proportional approach similar to that of the IASB only model. The concern of a potentially insufficient “Good Book” allowance could be addressed by the adoption of a one year expected loss floor, rather than a foreseeable future floor.

Our comments in the remainder of this letter and its appendices do not seek to re-advocate our preferences for a forward looking approach, but instead focus on two basic concepts proposed in the combined approach.

Foreseeable Future Floor

We have a number of concerns in relation to the floor proposed in the SD's combined model. We do not believe that the foreseeable future floor has any conceptual basis in a model based on a time proportional allowance. As stated above, the foreseeable future floor weakens the link to the IASB's original ED objective of aligning the impairment expense with economics of financial assets held at amortised cost. Such a floor would in our opinion effectively lead to day one loan losses, thereby breaking the link between impairment expense and the economics of financial instruments held at amortised cost.

Moreover a foreseeable future floor will lead to reduced comparability between entities, as different entities will apply different foreseeable futures to same/similar loans based on their own unique circumstances and bank specific risk management capabilities which could vary over the economic cycle. This could be mitigated over time as market practice develops to standard foreseeable future floor periods for different asset classes. However, any development of market practice standard could lead to pressure for preparers to adopt the most conservative foreseeable futures as adopted by peers. We believe, in practice this would mean that such a foreseeable future floor would likely outweigh the time proportional allowance for all but the longest dated portfolios. Such a move would further de-link the impairment expense from the interest income profile, conflicting with the original objective of the IASB's ED.

The foreseeable future floor (when combined with a requirement to calculate a time proportional allowance) also places a major operational burden on the entities, as four separate calculations would be needed to arrive at the final allowance balance (i.e. the time proportional allowance, the foreseeable future floor, the relevant "Bad Book" calculations and the regulatory EL). We also believe that a pattern for the allowance expense to be equal to the foreseeable future floor in one period and the time proportional allowance in the next will be difficult to explain to users, potentially confusing, and ultimately reduce comparability between different entities.

We do understand the Boards' stated rationale for the adoption of the foreseeable future floor, i.e. to ensure that the allowance is sufficient to cover portfolios with early loss emergence periods. To meet this objective, while allowing the time proportional features of the model to be mainly preserved, we would suggest that the final standard uses a one year expected loss period floor as a practical expedient. This would ensure that losses in the next reporting period are adequately covered which would enhance consistency for financial statement users, when compared to a foreseeable future floor. It would also ensure that the link to overall financial instrument economic is maintained as far as possible, as the one year expected loss floor will not be expected to outweigh the time proportional allowance to the same extent as that is the case for a foreseeable future floor.

Usage of Good Book Provisions

It is unclear to us how the “Good Book” provision is used in practice, in particular how the Boards perceives the allowance will be used over the credit cycle. The SD only allows the amount of the related allowance reflecting the age of the loan, the TPA amount build, to be transferred from the “Good Book” to “Bad Book”. Once loans have been transferred between the respective books, an entity is required to re-estimate the amount of credit losses for both the “Good Book” and “Bad Book”. Any additional amount required for the “Good Book” and “Bad Book” would be built immediately through a charge to earnings. We believe that this results in an earnings pattern that is similar to the incurred loss model of IAS 39, but which will be exasperated as the economic cycle turns.

As we stated previously, we do not seek to re-advocate an approach, we believe a way to partly mitigate this under the SD is to ensure that there is a meaningful reduction of the “Good Book” provision, when justified, for loans that are transferred to the “Bad Book” during an economic downturn and vice versa during an economic upturn.

At the worst point of an economic cycle many bad loans will be or have been transferred to the “Bad Book”. If management applies a positive outlook (when justified based on reasonable and supportable information on forecasts of future events and conditions) in estimating future expected losses for the “Good Book”, a meaningful reduction to the “Good Book” provision may be possible, which would provide an offset against the immediate additional provisions needed for the incurred losses in the bad book.

However, we are concerned that in practice this might be very difficult to accomplish, as it would require predicting the beginning, the end and also the depth of economic cycles, which is practically very difficult. Importantly, it would also require a positive outlook to be documented at the height of a crisis.

Given the characteristic of the SD model, we believe that it would be helpful if the standard was clarified to better explain the objective of how the model is intended to operate in various parts of the economic cycle and should better explain that the offset as explained above should arise when condition justify so (for example by providing guidance or examples that assists in making judgements in the relevant parts of the economic cycle). Without such guidance, and in lieu of detailed field testing we believe that the income statement profile will be at best no different to that experienced under the existing IAS39 incurred loss model but more likely more volatile in times of crisis, due to the requirement to rebuild immediately the “Good Book” allowance based on heightened expected loss estimates following transfers to the “Bad Book”. This clarification should reduce the problem that the proposals would result in practice in an impairment model that is

similar or equal to the existing incurred loss model with only an additional “buffer” in the balance sheet, the rebuilding of which would lead to further P&L volatility.

Good Book/Bad Book

As stated we are supportive of the “Good Book” and “Bad Book” distinction, as this is consistent with our credit risk management practices and we believe it is appropriate to built “Bad Book” allowances immediately and “Good Book” allowances over time. The SD provides some guidance on when loans should be moved between books; when the entities credit risk management objective changes from receiving payment to recovery. We believe that this approach could result depending, on the portfolio type, in loans being moved „too late or too early“ into the Bad book. Therefore, we recommend that a more standardised definition be developed; as suggested in our previous comment letter we would recommend consistency with the regulatory definition. This would also enhance comparability of financial statements and regulatory disclosures, i.e., Pillar III, for users from both analyst and regulatory communities.

Disclosures

Due to the limited comment period and our desire to focus on the conceptual aspects of the combined approach model we have not have sufficient time to undertake a detailed review of the requirements set out in the SD. Additionally, we note, the limited scope of SD (i.e. assets held in open portfolios only) has not allowed us an opportunity to see the full scope of proposed disclosures and how they link to all assets held at amortised cost. We therefore recommend that the Board re-expose on a limited basis the proposed final standard as it will allow constituents adequate time to review the disclosures requirements for all assets (not only those under the scope of the SD) and how the proposed requirements link to the final model.

Comment Period and Implementation

We would like to draw the Boards’ attention to the short comment period in relation to this SD of sixty days but we recognise the time pressure the Board is facing. This has limited our ability to perform detailed calculations and simulations on the proposals outlined in the SD. We recommend that due to the limited scope nature of this SD, the Boards prior to final issuance of a standard briefly re-expose to ensure that constituents are able to assess the impact of the proposed final model. That being said we believe the Board has heard materially all concerns of the industry as part of its very detailed and time consuming engagement since publication of the ED, including the EAP process, and we believe it is fully appropriate for the Board to take its decision on a revised standard at this point in time.

Our responses to the specific question posed in the SD are attached in the appendices to this letter. We hope you find our comments useful and relevant, and look forward to continuing to work with you in the future. Should you want to discuss the contents of this letter in more detail, please do not hesitate to contact Ralf Leiber at ralf.leiber@db.com or +49 (69) 910 48 717; Cynthia Mustafa at cynthia.mustafa@db.com or 020 754 50978.

Yours sincerely,



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Appendix A

Questions in the Supplementary Document *Financial Instruments: Impairment*

Question 1 - Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (i.e. delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

We support the move towards earlier recognition of expected credit losses. The combined model does allow for earlier recognition of credit losses on the performing “good book” while retaining the requirement to full provide for all expected losses on the non-performing “bad book”. While the inclusion of a floor eliminates removes the possibility of negative allowance balances.

However, as detailed in our answers below, we have concerns regarding the combined model specifically in relation to impact of the foreseeable future floor.

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 strongly support a single approach to impairment for financial instruments held at amortised cost. Such an approach reduces complexity for both the user and preparer and ultimately improves financial statement transparency.

We credit risk manage our financial assets held at amortised cost and loan commitments (not held at fair value through P&L) in a consistent manner, irrespective of whether the assets are held in open, closed or single asset portfolios. As the accounting model outlined in the SD for open portfolios is grounded in existing credit risk management procedures, we believe that this approach equally should be used for closed portfolios, single assets and loan commitments not held at fair value through P&L.

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 an approach that allows earlier recognition of expected losses than the existing IAS 39 incurred loss approach. We believe that an approach that allows the accrual over time of the

expected loss estimate, is consistent with the underlying economic of an amortised cost financial instrument, that is to receive contractual cash flows, rather than to achieve short term profit.

We are concerned however, by the inclusion in the SD of the floor based on expectation of losses in the foreseeable future. We understand that the Boards included a floor to ensure that the good book allowance was adequate to cover loan portfolios with early loss emergence periods, without operational complexity calculations of loss emergence profiles. We believe that this simplification could however, have the effect of creating, for many portfolios an artificially high allowance balance, in excess of the time proportional accrual.

Conceptually, the foreseeable future would vary over time, as credit information varies with particular economic cycles. Should the Boards keep the floor based on the foreseeable future, guidance would need to be issued to outline how the foreseeable future should be estimated over the cycle. We also noted that a foreseeable future floor is likely to vary between institutions reducing comparability between entities in the absence of industry standards foreseeable futures.

We support the notion that the good book allowance should align with the underlying economics/loan pricing and an approach using a time proportional approach to “good book” without a foreseeable future floor aligns to this.

Question 4 - Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why, or why not?

We support the concept of a time proportional approach to determining the build up of the “good book” allowance. Although, this approach will take time to implement, involve investment in our systems and processes, we believe it is operational.

Our support for this approach is premised on a revised floor. We believe that the floor as defined in the SD will in practice equal or exceed the time proportional approach for many portfolios. We would ask the Boards to consider carefully the floor as defined in the SD as significant operational effort will be used to derive a time proportional allowance, which may not be used in many situations where the foreseeable future floor will be greater.

As we have noted in our earlier comment letter, we believe that a practical expedient could be the use of a one year expected loss floor. This would align with the regulatory requirements under the existing Basel framework and would also promote consistency between entities, without creating a floor which makes the time proportional allowance redundant.

However, if the definition of the floor is not amended and remains based around the concept of “foreseeable future” we would support an approach which would reduce the operational need to calculate the time proportional approach, i.e. to reduce the need for extra sets of calculations which will not impact the allowance balance. However, such an approach would move this model

away from the objective of the original ED to link the impairment expense to the interest income on financial instruments held at amortised cost.

Question 5 - Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

The “good book”/ “bad book” approach proposed in the SD is grounded in existing credit risk management practices. We believe an approach that aligns credit risk management with accounting will provide users with useful financial information as it allows users to understand how we manage credit risks and the assumptions and quality of our risk management procedures.

As noted above, we prefer a time proportional approach as this aligns with the loan pricing. We do not believe that the addition of a foreseeable future floor provides useful information to users or for internal risk management.

Furthermore, the potential for the allowance expense to be equal to the foreseeable future floor in one period and the time proportional allowance in the next will be difficult to explain to users and potentially be confusing, and reduce comparability between different entities.

Question 6

Is the requirement to differentiate between the two groups (i.e. ‘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 with the broad concept that loans held at amortised cost in the performing “good book” are held to receive regular payment, whereas those in the non-performing “bad book” are managed to recover all or part of the financial asset. However, we believe that Boards should create application guidance to aid consistent application of this concept to improve financial statement comparability.

As we noted in our previous comment letter we recommend that the Boards and regulators work together to ensure there is a standardised definition for non-performing or “bad book” loans. This would help enhance comparability of both financial statements and regulatory disclosures, i.e., Pillar III, for users from both analyst and regulatory communities.

Question 7

Is the requirement to differentiate between the two groups (i.e. ‘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. As noted in answer to Question 6, we believe application guidance should be developed in conjunction with regulators to ensure a consistent application of the “good book” and “bad book” approach.

Question 8

Do you agree with that 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?

As noted in our previous comment letter, we agree with the proposed requirement as we believe it's operationally easier to use a "performing and non-performing" or "good book/bad book" approach to impairment.

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 amount 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.***
- (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.***

- (a) (b) and (c)*** As noted in our earlier answers, the inclusion of a floor is not conceptually consistent with a time proportional approach and moves the SD away from the objective of the original ED that estimates of expected credit losses should be accrued over time, rather than recognised in full on day one. While we understand that the Boards included a floor to ensure that situations where early loss patterns are experienced the allowance balance is sufficient to cover those losses, we believe the floor as defined in the SD will not be appropriate.

We do not support the adoption of a floor only for portfolios with early loss emergence periods, as this would require detailed guidance as to what is considered to be an early loss emergence period and how loans with that characteristic should be segregated.

As we outlined in our answer to question 4 we believe that a one year expected loss floor would be an appropriate practical expedient. This would ensure that the losses in the next reporting period are covered by the allowance and the floor is aligned to regulatory requirement under Basel II and promoting consistency between reporting entities

- (d) We would expect that the expected loss estimate would change if economic conditions change. The magnitude of change is dependent from the type of portfolio, business, counterparties and loans. The higher the variance/volatility of risks of the portfolio in scope the more difficult it is to predict the expected losses. E.g. If a certain industry is very sensitive re/economic changes (like manufacturing in Germany) the higher the likelihood that the expected loss and thus the foreseeable future will change i.e. it will become shorter. Furthermore, there might be knock-on effects to other industry or other portfolios. Private Individuals are more diversified thus we expect a longer foreseeable future for these portfolios.
- (e) Typically the foreseeable future would be a period of greater than twelve months - but this is dependent on the type of portfolio, business, counterparts and loans as stated above.
- (f) As noted in answer (c) above a better approach would be the floor defined as a one year expected loss floor.

Question 10

Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2.1(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.

While we understand that the Boards included a floor to ensure that situations where early loss patterns are experienced, we would ask the Boards to reconsider the definition of a floor. As we stated in our previous comment letter and in our answer to question 4 above we believe that a one year expected loss period could be used as a floor. This would ensure that the floor would not consistently outweigh (and thereby negate) the time proportional approach, and enable the use of existing data (with appropriate adjustment) for many preparers. It would also ensure consistency of minimum allowance balances across preparers.

We believe the foreseeable future floor will be higher than the amount calculated according to the time-proportional approach in most cases.

By definition the floor will be always the binding constraints for portfolios with:

1. a short weighted average total lifetime that is exceeded by the foreseeable future
2. a very low weighted average age (young portfolio) since the 1-day loss effect of the foreseeable future dominates in those cases
3. a very old weighted average age since the remaining lifetime is exceeded by the foreseeable future (see also 1)

The amount calculated according to the time proportional approach can only exceed the foreseeable future floor if a material amount of expected losses beyond the foreseeable future over-compensates the time-proportional discount factor to be multiplied with the remaining lifetime EL. This is achieved if:

- the remaining lifetime exceeds the foreseeable future
- the loss pattern is sharply increasing beyond the foreseeable future time

This said we believe in principle only for very long-term portfolios (especially commercial/residential mortgages and other construction loans) where the remaining lifetime exceeds the foreseeable future several times, will the time-proportional allowance tend to exceed the foreseeable future floor.

We believe that the loss pattern is mainly determined by the expectation of the economic outlook and the contractual conditions - the age of the portfolio does not play a dominant role in determining the loss pattern.

Taking into account the economic outlook we do not believe that a sharp increase in the loss pattern (due to a fundamental expected change to the existing economic conditions) beyond the foreseeable future can be estimated since this would require the consideration of specific inputs/projections and the resulting event itself lies in the scope of the foreseeable future.

Taking into account the contractual conditions we believe loans repayable at final maturity - without any redemption payments before maturity - tend to reflect a sharp increased loss pattern towards the end of the life. If the maturity is beyond the foreseeable future we believe for portfolios of loans without any redemption payments before maturity the time-proportional amount may tend to exceed the foreseeable future floor (b).

Question 11

The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

- 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?***
- 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 supported the use of an expected loss model, rather than the ED, because we cannot determine the timing of losses. While we agree with providing flexibility, we wonder over what period the discounting in the "good" book would be performed.

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 (i.e. to recognise expected credit losses over the life of the assets)? Why or why not?

As noted above in our answer to question 2, we strongly support an approach to impairment of financial instruments held at amortised cost which attempts to align interest income with the impairment expense and thereby recognises credit losses over the life of the assets.

However we believe the inclusion of a floor is not conceptually consistent with the time proportional approach and moves the SD away from the objective of the original ED that estimates of expected credit losses should be accrued over time, rather than recognised in full on day one.

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 (i.e. to recognise currently credit losses expected to occur in the foreseeable future at or after the first reporting date after initial recognition of the financial assets)? Why or why not?

In many respects the FASB approach is similar to the common proposal, due to the inclusion of a foreseeable future floor. The FASB approach has however the advantage of being operationally more simplistic as it does not require the retention of time proportional information. We do not support the FASB approach as it results in an impairment expense for performing loans that is divorced from the loan pricing, as it compels preparers to reflect all losses in the foreseeable future immediately in the income statement, leading in effect to a day one loss at loan inception.

Two of the key aspects of the IASB only model that we prefer are that it: uses a time proportional approach to “good book” allowance build up which aligns to the loan pricing, and is based how credit risk is managed, i.e. in the use of “good book” / “bad book.” The FASB approach in contrast does not use this split. As the approach outlined in the SD aligns with credit risk management we believe that it provides users with more useful financial information.

As noted in response to earlier questions, our preference would be for the concept of the floor to be reassessed and redefined to a shorter period, aligned to the Basel II twelve month period as a practical expedient.

Appendix B

Questions IASB only re-deliberations

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 support the retention of the current IAS 39 effective interest rate concepts and the presentation of provisioning in a separate line of the income statement including the retention of the current IAS 39 guidance for variable rate instruments.

Retaining separate methodologies for the recognition and presentation of interest income and expected losses improves transparency and better aligns the accounting and risk management practices.

We believe that the different nature of contractual cash flows and expected losses justifies separate methodologies for the recognition and presentation of interest income and expected losses.

While there is a link between the yields charged for an amortised cost instrument, as the yield incorporates an amount to cover expected losses, there does not need to be a link between interest revenue recognition and allocation of expected losses. Decoupling is appropriate and required to reduce the operational complexity and it also reflects how management views and manages interest and credit risk.

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?

We believe all loan commitments that are not accounted for at fair value through P&L should be subject to the impairment requirements of the SD. These loan commitments are managed in a manner consistent with the drawn loan facilities. Therefore application of the SD to these commitments would ensure alignment between the financial accounting and credit risk management and enhance the relevance for users of financial information.

Question 16Z

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

Loan commitments that are not accounted for at fair value through P&L are managed in a manner consistent with the drawn loan facilities and as such the general requirements of the SD would be operational.

Question 17Z

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

We broadly support the proposed presentation requirements.

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?

We support the recent Board decisions to eliminate the requirements for some of the disclosures as proposed in the original ED in particular those relating to loss triangles and stress testing. Due to the limited comment period and our desire to focus on the conceptual aspects of the combined approach model we have not have sufficient time to undertake a detailed review of the requirements set out in the SD and how they link to all assets held at amortised cost. We therefore recommend that the Board re-expose on a limited basis the proposed final standard as it will allow constituents adequate time to review the disclosures requirements for all assets (not only those under the scope of the SD) and how the proposed requirements link to the final model.

We do not support the requirement for the “Good Book” allowance to be based on the higher of the time proportional allowance and the foreseeable future floor and therefore do not support the disclosure linked to it. We believe it will lead to a lack of comparability between entities and potential across different reporting periods which, we believe is difficult to explain to users. As noted above, we support replacing the foreseeable future floor with a fixed one year floor. Such a floor, due to its fixed nature is unlikely to be used in one period and then not used in the next, which will enhance the ability to explain the build up of the “good book” allowance to users over time. We would recommend the disclosure of where such a one year expected loss floor is used, be added to the final standard.

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 would prefer an approach where following a transfer of a loan from “good book” to “bad book” the entire estimate of lifetime expected losses is transferred as well. We believe this is operationally simpler and ensures that the allowance is used.