Hong Kong Institute of
Certified Public Accountants
香港會計師公會

2011-150
Comment Letter No. 190

Our Ref.: C/FRSC

Sent electronically through email (director@fasb.org)

1 April 2011

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

Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Dear Sirs,

IASB Supplement to Exposure Draft of *Financial Instruments: Impairment*
(File Reference No. 2011-150)

The Hong Kong Institute of Certified Public Accountants ('the Institute') is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned Supplementary Document (SD). Our responses to the questions raised in your SD are set out in the Appendix for your consideration.

We welcome the IASB's effort to find operational solutions for the difficulties identified in respect of the model proposed in the November 2009 Exposure Draft (ED) and to work jointly with the FASB in developing a joint approach to the accounting for the impairment of financial assets. Although the proposed joint approach as set out in the SD is a compromise between IASB and FASB, which has no clear rationale of its conceptual basis for the superimposition of a ‘floor’ on a ‘good book’, we agree that this model should address the most significant concern raised by regulators about existing provisioning for impairment being 'too little, too late'. However, we note that no expected loss model will ever ensure that sufficient provisioning has been made where losses occur as a result of unexpected events such as the recent global financial crisis.

We believe that the proposed joint approach addresses many of the concerns with the original proposals of the Boards. For the IASB, this includes the operational challenge for open portfolios, application of a credit risk-adjusted effective interest rate, and immediate 'catch-up adjustments' arising from changes in estimated cash flows. With respect to the FASB, the proposed joint approach addresses the concerns raised about the immediate recognition of lifetime expected credit losses and the prohibition on using reasonable and supportable forecasts of future events and economic conditions when estimating expected impairment losses.

We support an approach that is based on two groups (i.e. a ‘good book’ and a ‘bad book’), as it is intended to be aligned with the way financial institutions manage their loan portfolios. This new approach is directionally consistent with the other phases of the project to replace IAS 39, for example, classification of financial instruments and

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hedge accounting, which are, or are proposed to be, reflective of an entity's business models and risk management strategies and policies.

We consider that the proposed joint approach should be operationally more feasible than the approach in the original IASB ED, but the complex nature of the new proposal results in a greater need for definitions and guidance around key concepts including:

- *Definition of 'foreseeable future period'* – the concept of the foreseeable future is subjective such that it would be difficult for entities to apply it consistently if no further guidance is provided in the Standard. Different entities are likely to have different views on the length of time over which they can make specific projections. Furthermore, the use of the term 'foreseeable future' in a number of different areas in accounting literature with different meanings will add to the confusion. Consequently, we have concerns that there will be significant diversity in application in practice if there is not a consistent interpretation across entities in different jurisdictions.

- *Determination of weighted average expected age/life* – The proposals do not provide guidance on calculating a weighted average age/life of a portfolio. This is particularly difficult for loans granted for customers in new industry or emerging countries with little historical data. Additional complexity may arise for financial assets without defined maturities, such as credit card receivables and overdrafts.

- *Distinction between 'good book' and 'bad book'* – The lack of robust criteria for the distinction between a good book and a bad book may lead to varying views as to when such a transfer should occur. We consider that indicators for a transfer between the 'books' based on established industry practices for managing different categories and types of financial assets should be developed in the final Standard.

We are concerned that unless the above requirements are made clearer, there will be considerable diversity in application and that this may lead to the development of varying local guidance in different jusrisdictions to fill this void. This would lead to local applications of the Standard, making it more difficult to make comparison between entities in respect of the impairment provisioning.

Moreover, we would like to ask the IASB to engage in field-testing with constituents to determine the degree to which the proposals are operational, and to determine the extent to which the proposed model meets the objective of the proposals. This is particularly important as the Boards have yet to consider, and have not requested additional input on, a number of significant and challenging issues such as: the method of measuring expected lifetime credit losses, the recognition of interest income with respect of financial assets in a 'bad book', the integration of 'credit losses' into the amortised cost model and the application of the model to purchased loans, including those acquired through a business combination. Whether the proposed joint approach is a workable solution may ultimately depend on how these other issues are addressed. It would also be useful for the Boards to reconvene the Expert Advisory Panel to develop practical guidance that can address the above concerns for preparers.

Finally, we are concerned about the amount and importance of the outstanding issues which need to be dealt with before issuing a final standard. We believe that given the magnitude of the impact of the proposals, the IASB should consider re-exposing them for further comments even if this means delaying the committed deadline. Proper field

testing of the proposed model by both preparers and auditors are prerequisites in publishing the final Standard.

In addition, we believe that entities would need a minimum of 24 to 30 months before the beginning of the comparative period when the changes are first applied to properly prepare for the new standards. With one year of comparative information for IFRS preparers, the mandatory effective date for IFRS 9 could be no earlier than 1 January 2015.

If you have any questions on our comments, please do not hesitate to contact me at ong@hkicpa.org.hk.

Yours faithfully,

Steve Ong, FCPA, FCA
Director, Standard Setting Department

SO/WC/jn

Encl.

APPENDIX

Hong Kong Institute of CPAs

Comments on the IASB Supplement to Exposure Draft of *Financial Instruments: Impairment*

Question 1

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

We understand that the joint approach proposed in the Supplementary Document (SD), which requires use of forward-looking information in determining expected credit losses should generally result in earlier recognition of impairment than the current incurred loss models under IFRS and US GAAP. Entities will not have to delay recognition of credit losses until objective evidence of impairment exists. Therefore, we believe that it helps to address the perceived problem of delayed recognition of expected credit losses for the majority of entities. However, no expected loss model can ensure sufficient provision has been made for the unexpected, such as the recent global financial crisis.

Question 2

Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

We believe that a single, consistent accounting treatment should be applied to portfolios of similar items that are subject to the same economic events. Therefore, we support, in principle, a consistent approach to the measurement of impairment for all financial assets carried at amortised cost. However, in some cases application of a simplified approach is required where a strict application of the guidance would not be practicable. This may well be the case for individual items or for portfolios that do not contain a sufficiently large and representative population of items, where the application of an expected value approach is questionable. For example, a probability-weighted methodology would result in provision being made for an individual item for which it is considered to be highly improbable or unlikely to incur a credit loss. In such a situation, it would seem that this would effectively defer a portion of the item's interest income (that is, the part related to the credit risk of the item) in an allowance account until recognition in profit or loss at maturity. This accounting is questionable and its informational value is doubtful.

We note that much of the focus on the application of the proposed model is on lending portfolios. While we believe that many debt securities have the same risk profiles for investors as large corporate loans. They are not typically managed like a portfolio of loans and they are primarily evaluated individually for impairment. Consequently, the Boards should clarify how the proposal is intended to apply to debt securities. We note that application might be easier for debt securities with the wider variety of available data, including external credit ratings and default histories to estimate expected credit losses.

We strongly urge the IASB to engage in field-testing with preparers to determine the degree to which the proposals are operational. It is considered that the suitability of the proposal depends greatly, amongst other things, on the loan loss patterns and the availability of forward-looking information.

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?

Question 4

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

Question 5

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

We agree that the concept of 'good book' and 'bad book' components aims to capture the way many financial institutions manage their credit risk. The model appropriately links financial reporting to way credit risk is managed and lenders are compensated for such risk. We agree with the IASB that this approach is directionally consistent with the other phases of the project to replace IAS 39, for example, classification of financial instruments and hedge accounting, which are, or are proposed to be, reflective of an entity's business models and risk management strategies and policies.

However, the SD does not adequately explain the conceptual basis for a 'floor' on a 'good book' and, in particular, how a user might interpret the carrying value of assets that are accounted for at amortised cost minus a 'floor'-based impairment allowance. Furthermore, we note that a 'floor' on a 'good book' may result in the recognition of Day 1 losses, particularly for growing portfolios, acquisitions of loan portfolios and in business combinations. Such recognition is inconsistent with initial recognition of financial assets at fair value. Nevertheless, for the reasons set out in our comments to Question 9(a) below, we accept the superimposition of a 'floor' on a 'good book'.

We agree that the proposed joint approach appears operationally more feasible than the approach in the original IASB ED as it does not require the tracking of cash flows at individual account level in order to allocate the credit losses and to determine the catch-up adjustments.

We support the proposal of the recognition of expected losses in a time-proportional manner as it appropriately reflects the economic results of lending transactions where lenders are generally compensated for credit risk by earning a credit spread that will be recovered over the life of the asset.

While we agree with the IASB in limiting the degree of prescription in the guidance, we would welcome further guidance or clarification in the following areas:

- Definition of 'foreseeable future period' – the foreseeable future period is defined in the SD as the future time period for which the 'best estimate of credit losses for the period for which specific projections of events and conditions are possible and the amount of credit losses can be reasonably estimated based on those specific projections'. We consider that the concept is so subjective that different entities will have varying views as to what is the foreseeable future. We urge the Boards to provide sufficient guidance to ensure a more consistent application in practice and not lead to jurisdictional differences mandated by local regulators.

- *Determination of weighted average expected age/life* – The proposals do not provide guidance on calculating a weighted average age/life of a portfolio. This is particularly difficult for loans granted for customers in new industry or emerging countries with little historical data. In addition, the weighted average expected life of the portfolio is not as simple as calculating the weighted average life based on contractual maturities. In developing the expected life for a portfolio, entities will need to consider prepayment options, call options, extension options, other options and asset defaults. Therefore, entities may need to consider external factors such as movements in interest rates and other factors correlated to prepayment and call options.

- *Financial assets that will be extended or renewed or are short-term* – The time proportional calculation may be too complex to apply to revolving facilities, such as credit cards, overdrafts and loan commitments as they have no fixed maturity, it would be difficult to accurately forecast the expected life of such assets. Financial assets that are short-term would have amount of losses in the foreseeable future almost the same as the entire amount of losses over the remaining lives which could bring into question whether the performance of the 'higher of' assessment to be cost beneficial to entities.

- *Expected loss estimates* – The guidance in the SD on estimating expected lifetime credit losses is limited. It simply states that entity has to consider all available information including historical data, data on current economic conditions and reasonable and supportable information relating to forecast of future events and conditions that is consistent with currently available information. There is no guidance on what is considered 'supportable and reasonable'. Also, the term 'current' is not sufficiently clear and does not

provide a clear boundary between what would be considered and what would not be considered in forecasting. We believe that the expected loss calculation should be based on historical loss experience but should allow management judgment to take into account expected changes in future economic and credit conditions that are either highly likely or are based upon objective evidence.

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?

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?

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?

As stated earlier, we agree that an approach based on the two groups is appropriate. We support a differentiated approach to recognition of credit losses on a 'good book' and a 'bad book'.

Under the proposals, financial assets would be transferred between the 'good book' and the 'bad book' on the basis of an entity's internal credit risk management. Given that there is diversity in credit risk management policies and practice, there will be different interpretations as to timing of transfers of assets from/to the 'good book' to/from the 'bad book' among different entities. In order to make the principle underlying the distinction between a good book and a bad book more operational and the timing of transfers more comparable, we believe that the criteria to differentiate between the good book and the bad book should be enhanced by providing indicators as to when the collectability becomes uncertain based on established industry practices and additional guidance in the final Standard to help entities apply the credit risk management criteria more consistently. For instance, there is not enough guidance as to how financial assets renegotiated or restructured, in which the objective to receive regular payments from borrowers have not changed, should be classified. Therefore, enough guidance to classify a financial asset managed in accordance with an objective between the two extreme ends should be provided.

We note that the SD gives examples of activities that are consistent with the objective of recovery of cash flows. These include the creditor taking action such as enforcement

of securities, debt restructuring or attempting to recover cash flows from an uncollateralized asset by making contract with the debtor. We are concerned that the above example of management activities relating to the 'bad book' usually takes place long after the initial identification of credit problems in an asset. In particular, recovery of the collateral is often one of the last steps in the recovery process. We consider that the Boards should consider revising these examples if it is the intention of the Boards that a transfer of financial assets to the 'bad book' should occur earlier than the 'trigger events' under the current incurred loss model. Additional guidance and examples should be developed by the Expert Advisory Panel to help entities apply the credit risk management criteria more consistently.

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 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) We do not consider that there is a conceptual basis for a 'floor' on a 'good book'. However, we can see that under the time-proportional approach, this may mean that for portfolios of assets in which losses occur early in a portfolio's life, such an approach may not create an allowance balance sufficient to cover the expected losses before they occur. The superimposition of a 'floor' can ensure that losses

expected to occur in the near future are fully provided for. While the introduction of a 'floor' may be appropriate in these circumstances, it causes problems for growing portfolios, acquisitions of loan portfolios and in business combinations. In these situations, the 'floor' will cause the recognition of Day 1 losses, which is inconsistent with the initial recognition of financial assets at fair value.

(b) To avoid unnecessary complications in the determination of impairment allowances and for local regulators to define the foreseeable future period leading to jurisdictional differences, we believe that the requirement of a 'floor' should be applied in all circumstances, regardless of whether there is an early loss pattern, subject to re-consideration in respect of growing portfolios, acquisitions of loan portfolios and in business combinations.

(c) As mentioned in Q3 – Q5, we consider that the concept of the foreseeable future is subjective such that it would be difficult for entities to apply it consistently. Different entities are likely to have different views on the length of time over which they can make specific projections. Furthermore, the use of the term 'foreseeable future' in a number of different areas in accounting literature with different meanings will add to the confusion. Consequently, we have concerns that there will be significant diversity in application in practice. It could be that more sophisticated entities would be able to make specific projections over longer periods than less sophisticated ones. This may lead to situations in which entities with more advanced credit risk management systems would carry larger allowances for expected losses than other entities with less sophisticated systems and might lead to a belief that the more sophisticated entities have poorer credit quality loans. We urge the Boards to provide sufficient guidance to ensure a more consistent application in practice. As most of the available internal or external information used in the expected loss estimate is usually of near-term nature (i.e. over a one-year time horizon), we therefore can accept at least a twelve-month floor on foreseeable future from a practical and consistency standpoint. Whether the foreseeable future floor could be greater than twelve months will likely be based on the nature of and market for the financial instruments in the portfolio and the amount and quality of the data available for impairment analysis. We believe that the time period used as foreseeable future if greater than twelve months should be consistently applied and disclosed along with the basis for such determination.

(d) The length of the foreseeable future can change with the phases of a business cycle or reacting to changes in the conditions of the financial markets. An increase in the market volatility might result in higher uncertainty attached to the forecast for the foreseeable future and the length of this period needs to be shortened. As economic conditions worsen, the foreseeable future might be considered shorter with the possible effect of reducing the overall impairment allowance for the 'good book'. This may occur even though the amount of losses expected in the foreseeable future and over the total life of the assets may both increase. Without guidance on the foreseeable future, there would also be significant issues for the auditing profession as to whether it can verify what the foreseeable future is.

(e) We note that many banks will simply not have enough detailed and reliable data to estimate future losses beyond 12 months. This is particularly true for smaller banks and many banks in Asia, who are not currently adopting a model based approach for Basel II.

(f) We do not believe that a 'ceiling' should be established for determining the amount of credit impairment as we do not see a conceptual basis for a pre-defined maximum duration of foreseeable future.

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.

We are not in a position to assess fully whether the expected loss over the foreseeable future typically will be equal to or greater than the time-proportional amount. However, we believe for a steady-state portfolio, the time-proportional allowance based on the losses over the remaining lives of the assets will typically be higher than the losses in the upcoming shorter-term period. However, the level of the 'floor' depends greatly on the length of the period defined as the 'foreseeable future' by an entity. The time-proportional amount could be lower than the 'floor' in situations where an entity can develop a longer foreseeable future period or portfolio of assets with early loss patterns. Other factors that will drive the 'higher of' test will include the level of granularity at which the assessment is made and the relative weighted-average age and weighted – average life of the portfolios.

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?

(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?

From a conceptual perspective, we support the use of discounted amounts in determining the allowance as IFRS generally require cash flows that will occur in the future to be discounted based on the presumption that time value of money should be considered in a measurement based on future cash flows. It is particularly important for renegotiated/restructured loans. However, from a practical perspective, we understand that it would be difficult to determine the appropriate discount rate for portfolios. We would recommend the Boards develop guidance that is similar to those in IAS 37 where an entity is required to use discounted rate that only reflect the time value of money but not include the credit risk of future cash flows.

We consider that the choice of recognition approach adopted by an entity, including the choice of discount rate, are matters of accounting policy choice and as such should be applied consistently on a portfolio by portfolio basis. This should be explicitly addressed in the final Standard and a description of the method used should be a disclosure requirement.

We note that the SD does not address whether the expected credit loss calculated on an undiscounted approach should reflect a loss of principal only. A discounted approach would normally include all cash flows, that is, both principal and interest. The final Standard should address whether it is appropriate for there to be this distinction in calculation. In addition, we consider that the Standard should provide a clear definition of lifetime expected credit loss.

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 explained in paragraph BC32 of the SD, the IASB's preferred approach was a 'good/bad book' model without the 'floor' (i.e. allowance equal to the time-proportional amount of the remaining lifetime expected credit losses for 'good' book loans). We generally support the objectives of a time-proportional approach. We understand that, compared to the original conceptual model in the November 2009 ED, this approach is a simplified catch-up approach (i.e. deferral to the future of some of the changes in credit loss estimates that relate to future periods). However, we prefer the joint approach in the SD. Although not ideal, the introduction of the floor ensures adequate impairment allowances for portfolios with front-loaded expected credit losses. However, as noted earlier it can result in Day 1 losses in sme situations, which is inconsistent with the initial recognition of financial assets at fair value.

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?

The approach that was being developed by the FASB would have required an entity to recognize immediately all credit losses expected to occur in the foreseeable future. As mentioned in our comment letter dated 30 September 2010 on the FASB Exposure Draft *Accounting for Financial Instruments*, although the FASB's approach is simpler to operate, we do not support it as it does not appropriately reflect the economic results of all lending transactions where lenders are generally compensated for credit risk by earning a credit spread that will be recovered over the life of the asset. As discussed in Q12, we prefer the joint approach suggested in the SD.

Questions IASB-only

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 except for distress loans (i.e. purchased loans acquired at a discount). Practically, accounting systems that calculate effective interest rates are generally not integrated with the credit loss information within credit risk systems. It is considered that the transaction price of the distress loans already reflected the amount of cash flows the entity expects to collect. It would be confusing if the expected credit losses are separated from the calculation of the effective interest rate for distress loans.

Question 15Z

Should all loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37) be subject to the impairment requirements proposed in the supplementary document? Why or why not?

Question 16Z

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

We generally support the view that the same impairment model should apply for both loans and loan commitments (other than those not accounted for at fair value through profit or loss) whether within the scope of IAS 39 and IFRS 9 or IAS 37, since they are often managed within the same business strategy, as such commitments may eventually become loans carried at amortised cost.

For financial guarantee contract, we consider that only those contacts that are purely financial guarantees issued by banks (excluding credit insurance contracts issued by insurers that are effectively credit derivatives) should apply the proposed impairment model.

From the operational perspective, we would like the Boards to provide more guidance on how to determine the weighted average expected life of loan commitments as it would be difficult to perform the time-proportional calculation as the lives of the loan commitments and financial guarantees are not tracked. In addition, we note that questions will arise as to the presentation of allowance accounts in respect of loan commitments and financial guarantees in the statement of financial position since the allowance represents a liability (for an onerous contract) rather than a reduction to the

value of an asset which does not exist. It would be appropriate for the IASB to address whether such impairment allowance should be presented separately from that of loans and receivables or debt securities in the final Standard.

Question 17Z

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

We agree with the new presentation proposals that contain two line items (gross interest revenue and impairment losses) as it is consistent with the business models of most banking entities which focus on the net interest margin.

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?

The proposed model implies application of more judgment than IAS 39. To increase transparency and comparability, we believe that the disclosures should help users to understand the effects of credit risk of financial instruments on an entity's financial position and performance. However, we consider that certain of the proposed disclosures will be onerous for many preparers and we question the usefulness of the information to users.

We support the IASB to adopt a 'through the eyes of management' approach to disclosure of the credit quality of financial assets consistent with IFRS 7. This disclosure should enable users to understand how management determines the credit quality of their financial assets, how they track this quality over time, how they estimate credit losses, and the accuracy of their estimated process.

Having said that, we are concerned about the following proposed requirements:

- Paragraph Z7 – We disagree with the proposed disclosure of reconciliations of the allowance account on a ‘good book’. In reality, there will be no tracking of the allowance account on a ‘good book’ on a loan by loan basis. The time-proportional and foreseeable future expected loss will only be determined at a period end and this determination will be made on a portfolio basis. As such, the provision on a loan by loan basis is not identified and, therefore, the amount transferred from the ‘good book’ allowance account to the ‘bad book’ allowance account. Hence a detailed reconciliation of movements on the ‘good book’ allowance account, including the amount transferred to the ‘bad book’, is not meaningful whilst being operationally difficult to calculate. Furthermore, the SD proposes that the amount transferred to the ‘bad book’ allowance account should be established on the basis of the time-proportional approach. This ignores the fact that the allowance on a ‘good book’ is determined on a ‘higher of’ the time-proportional amount and the foreseeable future ‘floor’.

- Paragraph Z8 – Without the benefit of hindsight, it would be difficult for entities to prepare disclosure of previous four annual periods as comparatives for the first-time implementation of this Standard. We suggest that transitional provision should be provided for this requirement. We do not believe that a 5-year disclosure of nominal amounts, lifetime expected losses and allowances on a good book by class of financial assets provides useful information. A more meaningful disclosure would be trend information about the credit quality of financial assets.

- Paragraph Z12 – It is not clear to us the definition of 'actual outcomes' in the requirement. Actual outcomes could have different interpretations, e.g., write-offs, defaults, transfer to bad book. For open portfolio, it would require keeping sufficiently granular records of expected losses to be able to compare those expected losses to the actual outcome. It is also not clear how such comparison would be performed in practice, i.e. as estimates of expected losses change over time, which of the estimates should be compared with the actual outcome and at what level of aggregation would such comparisons be disclosed.

- Paragraph Z12(a) – We do not support that quantitative analysis is only required if the entity already performs 'back testing'. We suggested that this requirement should only be required if the analysis is crucial to users to understand the credit quality for financial assets.

- Paragraph Z15(d) – The term 'watchlist' might be applied differently depending on each entity's business practice. As such, we consider the IASB should clarify that the term 'watchlist' should be applied according to an entity's internal credit risk framework.

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 suggest that instead of transferring the related allowance every time there is a transfer of financial asset between the good book and the bad book, it would be simpler if the allowances for both books to be re-estimated, i.e. trued-up, at each reporting date.

~ End ~