

4 April 2011

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
UNITED KINGDOM

Dear Sir David

ED/2009/12 FINANCIAL INSTRUMENTS: IMPAIRMENT

The Group of 100 (G100) is an organization of chief financial officers from Australia's largest business enterprises with the purpose of advancing Australia's financial competitiveness. We are pleased to provide comments on the Exposure Draft.

The G100 supports the efforts of the IASB and FASB to develop a common approach to the impairment of financial assets and supports an approach which is principles-based rather than rules driven as it enables a better alignment of accounting requirements with how entities manage and measure expected credit losses on their portfolios.

Q1. 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?

The G100 believes that delayed recognition of expected credit losses has not been a significant issue in Australia and as such weaknesses in the current impairment models may have more to do with the way in which it has been interpreted and applied in various jurisdictions. The current proposals may suffer the same fate in the absence of greater clarity about the 'good book' 'bad book' classification, discounting and the meaning of foreseeable future.

Q2. 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 proposal is meant for open portfolios our members consider that the approach can be applied to closed portfolios and specific assets. The G100 supports the development of a single impairment model rather than separate models for open and closed portfolios which make implementation and consistency of approach more difficult.

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Q3. *Do you agree that for financial assets in the 'good book' it is appropriate to recognize the impairment allowance using the approach described above? Why or why not?*

The G100 agrees with the proposed approach.

Q4. *Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?*

Yes. While the proposed approach is operational it is inconsistent with achieving an approximation to the credit adjusted effective interest rate which is one of the desired outcomes of the model. However, this approach will involve significant additional costs to be implemented.

Q5. *Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?*

We do not believe that information about the calculation of the time proportional provision will be useful as the approach does not reflect the timing or amount of the loan.

Q6. *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?*

The G100 considers that the differentiation between the 'good' book and 'bad' book is a reasonable basis on which to proceed as it aligns with the current approach of estimating a collective provision with a specific provision for the 'bad' book.

Q7. *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?*

The G100 considers that the description of the differences between the 'good book' and 'bad book' is clear and is generally consistent with the way in which credit risk is managed.

Q8. *Do you agree with the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?*

The G100 suggests that guidance on how to distinguish between the two classifications would assist in the implementation and contribute towards achieving improved comparability between entities.

Q9. *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?

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- 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 circumstance 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 recognized 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.*

The G100 considers that 12 months is a reasonable minimum period to be regarded as the foreseeable future in calculating the 'floor' for the good book and that the upper limit should be the expected life of the portfolio. However further clarification and guidance on what constitutes the foreseeable future including the factors to be considered would contribute to achieving more consistent practice.

Members advise that operationally it is challenging to perform the required calculation – taking the higher of the time proportionate amount and the 'floor' of losses in the foreseeable future. The existence of the floor serves as a mechanism to ensure that sufficient provision is built up to address early loss scenarios.

Q10. *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.*

G100 members indicate that the level of the floor will vary depending on the nature of the portfolio, the time to maturity and its expected behaviour.

Q11. *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?*

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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?

While the G100 believes that there should be sufficient flexibility to enable management to determine the discount rate which best incorporates the facts and circumstances of the entity we acknowledge that this may impact on comparability between entities.

Q12. *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 prefer this specific IASB approach, do you prefer the general concept of the IASB approach (i.e. to recognize expected credit losses over the life of the assets)? Why or why not?*

See response to Q 13.

Q13. *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 recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?*

The G100 considers that expected credit losses should be recognized over the expected life of an asset. We believe that the pattern of loss recognition should reflect the economics of the banking transactions to which they relate. Accordingly, the recognition of expected losses at inception of loans as occurs under the FASB approach is not consistent with the economics of banking or the principles upon which other provisions are recognized and measured.

ADDITIONAL IASB QUESTIONS

Q14Z. *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. We agree that the determination of the effective interest rate should be separate from the consideration of expected losses because the previously proposed methodology was overly complex and was neither operational nor consistent with the way in which the business is managed.

Q15Z. *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?*

The G100 supports a single approach to impairment of financial assets.

Q16Z. *Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?*

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The G100 believes that in a principles-based regime the methodology for closed portfolio and off-balance sheet exposures should be the same as that for open portfolios.

Q17Z. *Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?*

The G100 supports the presentation of impairment expense separately from interest revenue and disagrees with the presentation of expected credit loss expense as part of Net Interest Income.

Net Interest Income is a key metric for retail banks which is well understood by users of the financial statements. The proposed treatment of a credit loss adjustment as part of net interest revenue will lead to confusion amongst users and the presentation of further non-GAAP measures by entities in order to explain the underlying performance of the entity.

The G100 believes that credit losses should be presented as a single number (encompassing expected credit loss and gain/loss due to changes in expectations) on the face of the income statement in order that they and other key line items can continue to be clearly identified and understood by users.

Q18Z. *(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 G100 is concerned about the extent and detail of, and cost of compliance with, the proposed disclosures. As indicated in our submissions on a number of other topics including the recommendations in our "Less is More" project provided to the IASB the G100 strongly believes that the content of disclosures should be based on the application of principles by management and that any list of disclosures should be provided as indicative of matters which would be considered in applying the principles.

As articulated in paragraph 11 of ED/2009/12 disclosures should enable users of the financial statements to fully understand the credit quality of financial instruments and the effect of these on the results of an entity. The disclosures proposed in this supplement are extensive and we question their benefit to users. The G100 believes that the volume of proposed disclosures will add to the disclosure overload, confuse users and reduce the decision-usefulness and comparability of financial statements.

Q19Z. *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?*

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We do not agree with the proposal. Whilst the proposal could be seen to assist in ease of understanding and the comparability of disclosures, it would be difficult to calculate and track operationally. Therefore, as it does not impact measurement or presentation, we consider that no amount should be transferred upon transfer of the asset and a new provision should be raised.

Yours sincerely
Group of 100 Inc

Peter Lewis
President