International Accounting
Standards Board
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By email: director@fasb.org

Supplementary Document Financial Instruments: Impairment

Dear Sir/Madam,

Finance Norway (FNO) welcomes the opportunity to comment on the Supplementary Document Financial Instruments: Impairment that the IASB issued on 31 January 2011. The Supplementary Document is a follow-up of the Exposure Draft Financial Instruments: Amortised Cost and Impairment (ED/2009/12) which was published in November 2009.

The Supplementary Document retains the fundamental concept for loan loss recognition proposed in the original ED. As explained in our letter to the IASB of 26 October 2010, we are of the opinion that the proposal in the ED will have large and complex consequences for banks, the market and the real economy. The consequences will partly be of a technical nature, but will also affect the institutions’ financial position and reporting to the market. The Supplementary Document addresses some of the operational challenges from the ED. However, many of the other shortcomings in the ED have been kept unchanged in the Supplementary Document.

The proposal in the Supplementary Document will, like the original IASB model, lead to a reduction in equity even if business activities do not change. Furthermore, the proposal will introduce more volatility in the income statement and is operationally more complex than the current impairment approach under IAS 39. The proposal is also likely to lead to diversity in application of the regulations and increase the danger of account manipulation. We note that the Supplementary Document introduces new concepts (eg the “floor” and the notions of “good book” and “bad book”) into the debate. We have a number of concerns on the use of the floor and the related concept of “foreseeable future”.

We welcome the decision to exclude expected losses from the effective interest rate.
FNO will urge the IASB to conduct impact studies before new regulations are implemented. Stricter capital adequacy regulations according to Basel III and new accounting rules are closely interrelated. The impact studies should therefore include the effects of both the proposed new approach to accounting for credit losses and the Basel III rules. The overall effect on equity of the two sets of rules must be determined. If new loss reporting rules that lead to a reduction in equity is implemented, this should be taken into account in the calculation of capital adequacy requirements under Basel III, since the new rules for credit loss accounting does not mean that institutions’ actual position has weakened.

Below please find our responses to those questions that are of most concern to us.

**Question 3**
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?

No. As we will explain further below, we disagree with the proposal to set a floor at a level reflecting credit losses expected to occur within the foreseeable future.

**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 operable and/or auditable?

We believe that the requirement to differentiate between the “good book” and the “bad book” is operational. The concept of “good book/bad book” is in line with how credit risk is managed in many financial institutions. To base the split on the management objective is in line with other current developments (IFRS 7 and the ED on hedge accounting). However, as financial institutions have different credit risk management policies, the same instrument could be transferred to the “bad book” at different times by different institutions. The timing of the transfer is important as it has an effect on the income statement. Lifetime expected losses of assets in the “bad book” are fully provided for in the reporting period in which assets are transferred to the “bad book”, whereas expected losses of assets in the “good book” are recognized over the life of the assets. Consequently, the rules would lead to greater diversity in application of the regulations. In our opinion, this is an unfortunate consequence of the proposal. Disclosures about the credit risk management process of institutions, and their credit risk management policies, in particular, will become more important for users of financial statements.

**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?
No. We do not agree with the proposal to require a floor for the impairment allowance related to the “good book”. We believe that the floor is conceptually unjustified and does not provide useful information for decision-makers.

Different entities may project expected losses over different foreseeable future periods, arriving at different floors under the proposal. A lack of a clear definition and understanding of the concept of the foreseeable future could result in a fundamental lack of comparability. The floor will result in two calculations for the impairment allowance and additional operational complexity. Furthermore, switching between the time proportionate approach and the floor over subsequently reporting periods is misleading for users and difficult for preparers to explain.

We underline that requiring a variable time period in which future losses will be estimated provides no incentive to develop new models for estimating the future losses. Such models would increase the foreseeable future and thus require larger reserves for the same portfolio.

Prudential buffers and floors designed to prevent banks from becoming insolvent is a task for the regulators and not for the IASB. We hope the Board continues to issue high quality accounting standards based on the objectives as described in the Framework and leave the prudential aspects of the banking industry to the relevant regulators.

b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the “good book” only in circumstances in which there is evidence of an early loss pattern?

No. We do not agree with the proposal to require a floor for the impairment allowance related to the “good book”.

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?

While FNO does not favour the introduction of the floor, we understand that it was introduced as a result of a compromise to achieve a converged solution. We are of the opinion that if IASB decides to include a floor in the standard, this should be based on expected losses during the coming twelve months. This would create a level playing field for all entities and reduce the subjectivity in estimating how far ahead an entity can reliably estimate credit losses.

Although IFRS is a global standard, a substantial part of entities applying the new impairment standard will be banks applying Basel II rules. These are based on estimating credit losses on a twelve months time horizon and such banks have adapted their credit risk management to this time horizon. For all these banks, a twelve months time horizon would be a reasonable “foreseeable future”.
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?

Yes. For the reasons explained in our response to question 9, we prefer the IASB approach without the floor.

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

No. For the reasons explained in our response to question 9, we reject the FASB proposal.

Question 14 Z
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.

Question 17 Z
Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

Yes. We believe that presenting expected credit losses outside net interest income increase the quality of information. Net interest income is an important part of the total income in the financial industry and adding expected loss will in times of changed expectations add volatility to a normally fairly stable item.

Question 18 Z
a) Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why?

We believe the disclosure requirements are too extensive and too prescriptive. We prefer the more principles based disclosure requirements in IFRS 7, where disclosures are based on management information.
For open portfolios with underlying characteristics that will be dynamic over time, we cannot see the rationale behind disclosing comparative figures concerning the impairment allowance and expected losses for a longer time period than what is usually required (ie one or, in certain cases, two years).

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 do not propose any additional disclosures.

Yours sincerely,
Finance Norway

Erik Johansen
Director

Herborg Horvei
Senior Economist