30/03/11

FASB/IASB Supplement Document Financial Instruments: Impairment

Dear Sir/Madam,

The Swedish Bankers’ Association appreciates the opportunity to respond to the Financial Accounting Standards Board’s (FASB’s) and the International Accounting Standards Board’s (IASB’s) Supplement Document Financial Instruments: Impairment (SD). This letter represents the views of the Swedish Bankers’ Association (the Association/We/Our).

The Association is of the opinion that the development of a new impairment model is of significant importance for the banking industry. The Association further believes that the complexity of the changes proposed to the original IASB model are significant and sufficient time should be granted to allow entities to review the proposal in details and understand its impact and all possible consequences. For these reasons, we believe that a 60-day comment period is insufficient and believe that entities should be given additional time to assess the proposals. We also urge the IASB to engage in field-testing these new concepts to assess their impact.

The Association supports the FASB’s and the IASB’s efforts to align the approaches for loan loss recognition. We favour moving to an expected loss model that provides a more forward-looking approach to the accounting for credit losses and that better reflects the economics of lending decisions. We also believe that the proposed impairment model for open portfolios of financial assets is a step in the right direction to a more operational solution for financial institutions than the IASB’s original proposal. In particular we welcome the decision to exclude expected losses from the effective interest rate, the introduction of the good-book and the bad-book concept and the flexibility related to the choice of discount rate. However, we are concerned that the introduction of a “floor” for the impairment allowance will deteriorate the
performance measurement and thus decision usefulness of financial information. We support the objective in the original ED to match the recognition of expected losses with the recognition of interest income by allocating the expected losses on a linear basis over the whole life of the portfolio, something we are not yet convinced the model proposed in the SD achieves. The time-proportional model should however take different loss patterns into account when calculating the impairment allowance. The Association believes that convergence between IFRS and US GAAP is a high priority, but it cannot override the goal of issuing high quality standards.

We are in favor of one single impairment model for financial instruments measured at amortized costs why the open portfolio definition should incorporate all financial assets in the good book collectively assessed for impairment i.e. open and closed portfolios as well as large single assets.

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

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 believe that the proposed model for open portfolios also is operational for closed portfolios and single assets. We favor one single impairment approach to be able to perform collective assessment for impairment in the good book rather than apply different impairment models depending on open or closed portfolio, single assets and possibly also short term receivables.

We believe that the exception for short term receivables in paragraph 1 should be optional. For instance, it should be possible to include short term receivables that normally bear no interest as long as payment is made at maturity in the open portfolio model.

We believe that the proposed portfolio definition that is based on assets that are managed in an open portfolio should be changed to include all financial instruments assessed for impairment on a collective basis.
Even though we support the basic concepts proposed for an open portfolio approach. We do have concerns regarding the details in the proposal. See further details below.

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 do not believe that the floor is the right way forward to deal with front-loaded portfolios. Instead, we believe in a principle based approach that takes asymmetrical loss-patterns into account. Furthermore, we believe that the time-proportionate approach as presented in the supplementary document, also without the floor, will result in a pattern for the recognition of expected losses that are different than in the initial ED, badly fulfilling the basic objective in the ED, i.e. will overestimate the expected losses initially and underestimate them at the end of the life of a portfolio. Instead, we favour an approach in which the expected losses normally are allocated on a linear basis over the whole life of the portfolio to the P & L when there is no specific loss pattern. However, when a specific loss pattern could be estimated, that loss pattern should form the basis for the pattern for recognizing the expected losses in the portfolio.

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 believe the introduction of a floor is inconsistent with the matching principle, gives a poor reflection of the performance of the entity and thus, does not provide useful information for decision makers. The credit risk is reflected in the interest rate charged on the loan and in theory the expected credit losses are included in the interest charge. If the credit losses expected to occur in the foreseeable future are to be provided for at inception of the loan, the corresponding interest should also be recognised at inception. This would be an acceptable principle, however difficult to apply in practice.

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 believe the time-proportional amount should be adjusted to take into consideration the loss patterns. Such an adjustment would eliminate the need for a floor. The current proposal for amortising residual margin in insurance contracts stipulate that the residual margin should be recognised on the basis of the passage of time, unless this pattern does not reflect the economics of the contract. We believe a similar principle should be developed for the time-proportional amount in IFRS 9. Therefore, as mentioned in our answer to question 3, we understand the time-proportional amount methodology proposed in the supplement, also will be a bad reflection of the loss pattern of a good book since it will lead to another pattern for recognition of expected losses than evenly during the life of the portfolio.

(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?

No. If the Board decides to include a minimum allowance, we believe it should be a fixed period for reasons described below in (d) – (e). Having a variable time period for which to estimate future losses gives no incentive to develop new models for estimating the future losses, as such models would increase the foreseeable future and thus require larger reserves for the same portfolio.

(d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

Yes, we believe the foreseeable future changes over the economic cycle. In good times the foreseeable future is longer than in times of economic downturn. The foreseeable future for most portfolios was shorter than twelve months at the peak of the financial crisis. This may lead to the counter intuitive result that the provisions for credit losses could decrease in an economic downturn as the foreseeable future shortens and consequently the expected losses are estimated for a shorter period of time.
(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.

No. As described in the answer to (d) above, the foreseeable future will vary over time, but also between portfolios. As Swedish banks apply the Basel II rules, these are incorporated into the credit management process. The Basel II rules are based on Probabilities of Default (PD) on a twelve months time horizon, this is the time horizon most banks work with. In general, we believe the foreseeable future will not be longer than twelve months for Basel II banks.

(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.

N.A. As explained above, we do not believe the foreseeable future is more than twelve months in general but may vary over time depending on the economic environment.

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?

Yes. We support the flexibility proposed by the Board, both in regards to using discounted or undiscounted estimates and in the choice of discount rate. Although discounted estimates are theoretically more correct and in line with the concept of time value of money, we believe the use of undiscounted estimates is a welcomed practical expedient. Estimating the amount of expected credit losses on a portfolio level is normally based on statistical data on historical defaults why estimating when in time these losses will materialize in the future is operationally very complex.
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 recognize expected credit losses over the life of the assets)? Why or why not?

Yes. For the reasons explained in our response to question 9, we prefer the IASB approach without the floor. For portfolios with a front loaded credit loss pattern, the time-proportional amount can be adjusted to reflect this pattern.

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 the FASB approach (i.e. 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. We do not believe this approach reflects the economics and the pricing of amortised cost assets and would result in an income recognition that would distort the information disclosed in financial statements.

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?

Yes. We believe the link between the pricing of contracts and the recognition of expected losses is important, but this link has not been retained in the supplementary document, even though we appreciate that the operational difficulties in the original proposal have been removed.

We believe that the same basic recognition principles could be proposed also for open portfolios as for single assets. Therefore we believe that the expected losses should normally be allocated linearly during the life of the portfolio with a partial catch-up when the estimated losses changes as proposed in our initial comment on the ED.
Question 15Z
Should all loan commitments that are not accounted for a 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?

Yes. We believe all loan commitments that are not accounted for at fair value through profit or loss should be subject to the impairment requirements in the supplementary document as these are managed and evaluated on the same basis as loans at amortised cost. We further believe financial guarantees should be in the scope of IFRS 9 for guarantees managed in a banking business model. Such guarantees should then be subject to the impairment requirements in the supplementary document as also these guarantees are managed on the same basis as loans and loan commitments.

Question 16Z
Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

Yes as these instruments are often incorporated in the banking book and part of the assessed credit exposure.

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

Yes. The association strongly believes that presenting expected credit losses outside net interest income increase information usefulness. 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 18Z
(a) Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why?

No. We support the tentative decision taken on the February Board meeting to remove the requirements to disclose vintage information and results from stress testing.

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 (i.e. one or, in certain cases, two years) are of inferior value for the users.

(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.

**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?

As the allowances both in the bad book and the good book are based on the situation on the balance sheet date, we believe it is difficult to identify the amount reflecting the age of the asset to transfer and we do not believe this information is of value for the user of the accounts. The requirement to disclose a reconciliation of the changes in the allowance account in paragraph Z7 is an adequate level of disclosure.

**SWEDISH BANKERS’ ASSOCIATION**

Kerstin af Jochnick

Mats Stenhammar