
Dear Sir David,

We thank you for inviting us to comment on the supplement to your exposure draft Impairment. We welcome that the IASB proposes a new approach to be applied to open portfolios to solve the operational issues connected with the original ED. However, we would have favoured a consistent approach substituting the ED/2009/12 to be applied to all financial instruments.

With respect to the allocation of expected losses we generally agree with a time-proportional and “decoupled” approach similar to that proposed by the IASB. However, we disagree with the “partial catch-up approach” because in cases of defaults it will always affects the P&L even when the defaults are in line with former expectations. Moreover, according to our estimation, economic cycles will have a disproportionate impact on profit or loss because of jumping provisions in times of excessive rating downgrades.

Furthermore, the proposed model is not aligned with risk management. Expected losses are a probability-based measure of default-risks. An actual default can be seen as the crystallisation of former expected losses. Therefore an actual loss in case of a default should be recognised through the allowance account and not affect the P&L (insurance principal).

For these reasons we favour a model to build up an allowance to be used in cases of defaults. Only when actual losses exceed formerly expected losses they should be recognised through P&L to avoid a negative allowance account.
This model would better reflect the risk management strategy of the entity. Beyond that, the user will get a better information on the quality of measurement of expected losses. Entities that are predicting precisely future losses can reduce their P&L Volatility considerably. On the other hand, a bad estimation of future losses will however be reflected by a significant P&L volatility.

Our detailed responses to the questions in the ED are set out in the following:

**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?*

The proposed model will have as effect an increased basic allowance particularly affecting retained earnings at the date of initial application. In future periods, according to our estimation, the proposed model will not deviate considerably from the current incurred loss model because individual actual losses will still be recognised on the basis of their lifetime expected loss without to be compensated by the formerly expected losses of the relevant portfolio.

In the proposed "partial catch up" approach the allowance will form a stable component of equity instead of providing for actual future losses.

Hence, the weakness of a delayed recognition of expected losses in the current incurred loss model is not solved by the proposed model because the major part of losses will still be recognised at the date when losses incur. This is a result of a lack of synchronisation between expected and actual losses. In the proposed approach an actual loss (represented by a reclassification from the good book to the bad book) will have a considerable effect on P&L even though on portfolio basis the loss expectation was precise.

We propose instead a model in which actual losses do not affect the income statement as long as they reflect formerly expected losses of the relevant portfolio. This could be achieved by a model to recognise a loan loss provision based on a forward looking time-proportional allocation of the ELL (no catch up approach). With this method an allowance will be build up based on periodic additions to be used in cases of incurred losses. This allowance account should be subject to a ceiling (equal to the life time expected loss) and a floor (equal to zero or the one-year expected loss).
In such a model, if actual losses equal the formerly estimated EL, there is no volatility in P&L which makes sense because we build the allowance as a provision for future losses. If the expected losses predict precisely the actual losses the impairment should not create additional P&L volatility.

**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.

In order to reduce complexity we support a consistent model to be applied to all financial instruments without to differentiate between single items, open and closed portfolios. The proposed approach, in our opinion, is applicable to closed portfolios as well as to open portfolios and single items. However there may be different results applying it on a single items basis in comparison to applying it on a portfolio basis.

The allowance in the proposed model is not really a portfolio based allowance because any item incurring a loss can only use its individual provision even though its individual loss can be considered as a crystallisation of the loss expectation for the entire portfolio. In the light of this relationship between the portfolio allowance and its use in case of an incurred loss the proposed model is easily applicable on a single items basis.

However, we favour a different model which aligns impairment with risk management. For risk management purposes expected losses are typically calculated on a single items basis. But the expected loss is a probability weighted measure that is never materialised on a single items basis but only on a portfolio basis. Therefore in an appropriate model the expected loss should be measurable on a single items basis to be aggregated in the allowance account and to be used on a portfolio basis.
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 generally agree to apply a time-proportional approach to allocate the lifetime EL to relevant (future) periods. However, we do not support the overall concept of the proposed model to partially allocate expected losses to past periods (partial catch up) for the following reasons:

1. Expected losses for past periods are always zero because they have been materialised through actual losses. Expected losses are economically always related to future periods and hence should be allocated to future periods (no catch up)
2. By allocating expected losses to past periods there is a double accounting of losses because in past periods incurred losses have already been recognised in full. Therefore there is no need to build any further provisions for past periods
3. With the partial catch up approach a synchronisation between expected losses and incurred losses is not possible. In contrast, the proposed model will always overstate loss provisions because it recognises incurred losses in the bad book and additionally it allocates expected losses to past periods

Given these reasons we clearly favour a no catch up approach to allocate expected losses in the good book and to build an allowance to be used in cases of actual losses.

Beside the above mentioned concerns we have some doubts that the concept of an EL to occur within a foreseeable future period is consistently understood throughout the market. It needs more precision in order to allow a consistent application among the different entities.

Question 4

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

We consider the method to allocate the expected loss to time periods as being operational.

Concerning the rationale of the proposed method we have some doubts whether it is in line with the risk management strategy to calculate a risk premium based on a probability based measure to compensate future losses. (see question 3)
Question 5

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

Based on our analysis we came to the conclusion that the proposed model does not provide useful information on the quality of risk management because it does not reflect the economic relationship between expected and actual losses.

When the expected loss is estimated precisely future incurred losses should have no further P&L effect because they have already been recognised through the EL based provision. Deviations of actual losses from formerly expected losses should result in the respective P&L effect. The partial catch up approach is not appropriate to provide a realistic view on the quality of the entity’s risk management approach.

Furthermore we expect that the effects of the proposed model are not very far from those of the current model. The current model is criticised to provide to little to late. In the proposed model the provision might be higher but it is still not used in the case of incurred losses. In other words, the major P&L effect will still occur when the loss will be classified as incurred which is still to late.

The only appropriate method to recognise a loan loss provision on the basis of the expected losses is a forward looking time-proportional allocation of the lifetime EL (no catch up approach). With this method an allowance will be build up to be used in cases of incurred losses. When actual losses will be less than expected the allowance balance will rise. To prevent a long term rising trend a maximum allowance should be defined (e.g. at the lifetime EL of the portfolio (ceiling)) the minimum allowance should be set at zero or the 1-year EL of the portfolio.

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?

The criteria to differentiate between good book and bad book are clear.
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?

The criteria to differentiate between good book and bad book are operational and auditable as they are already used for internal controlling purposes.

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?

We generally agree with the requirement to differentiate between the two groups for the purpose of determining the impairment allowance. In particular we agree with the requirement to provide for loans attributed to the bad book with their entire lifetime EL. However we do not agree with the method to determining the impairment allowance for loans attributed to the good book (see above Question 1 to 5)

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?
(d) 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.

(e) 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.

Generally speaking, we agree with a minimum allowance for the instruments attributed to the good book. In the context of the proposed model it has as effect that the allowance in the good book may be higher than without a floor. However, given that the allowance is not used on a portfolio basis the floor has only a limited impact to the additional provision needed in the case of incurred losses. In other words, the floor will increase a basic allowance which is never used. The usefulness of the floor is limited even though for portfolios with an early loss pattern it is greater than for other portfolios.

Nevertheless, when applying the concept of a foreseeable future period it needs some more precision in order to be understood consistently. We suggest to consider the internal credit risk management and reporting time range as sound foreseeable future period, which will typically not be longer than 12 months. Furthermore, internal models for expected loss measurement and their statistical validation are usually based on the same time period. Therefore, we do not believe that the typical foreseeable future period will be longer than 12 months.

**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.

The time proportion used to allocate the lifetime expected loss of a steady state portfolio is expected to be 0.5. The foreseeable future period we expect to be generally below 1 year. As our main portfolios consists of long term investments we expect that in practice only in few cases the
floor will be effective. Nevertheless for some specific portfolios with early loss pattern or short term assets it could be effective.

**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?

We agree with a certain flexibility related to the method to be used to determine the periodic EL amounts. An EL is always an estimation based on several assumptions. It will be impossible and inappropriate to standardise each detail of the model. In our opinion to allow alternative methods to use discounted or undiscounted amounts is acceptable.

**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?

The common proposal is a mixture of different approaches that do not match with each other. The effects of this mixed model are not foreseeable. We consider neither of both approaches as appropriate. As explained under Question 1-5 the only method to align impairment with risk management and to adequately reflect in P&L the net yield of lending activities is to allocate the ELL to future periods (no catch up approach) and to build up an allowance which is used in cases of incurred losses.
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)? Why or why not?

We would favour the FASB approach in comparison to the common mixed model because of the following reason: In contrast to the partial catch up approach, there is no differentiation between good book and bad book needed any more. With no differentiation there will be no “jump” affecting the P&L at the date of reclassification between the two groups.

However, we have concerns that a lack in clarity related to the definition of the foreseeable future period will result in financial statements that are not comparable. Furthermore this approach will lead to considerable day-one losses, that is in our opinion not appropriate. Therefore our preferred model is the no catch up model described above.

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?

The original coupled approach to include expected losses in the original effective interest rate is not operational on an open portfolio basis. To implement it on a single items basis means to integrate risk management and accounting systems. This would involve a completely new systems architecture and hence an implementation effort that is not justifiable with the effect of the new model.
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?*

At least the loan commitments that will result in assets recognised at amortised cost should be subject to the impairment requirements. This would reduce complexity because there would be no need to apply different methods to the same issues. Furthermore it would align accounting methods with the methods applied to regulatory reporting.

Question 16Z

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

Already today loan commitments are included in the EL for the purpose of regulatory reporting. We do not expect any obstacles to include loan commitments and financial guarantee contracts in the impairment process as designed in the ED supplement.

Question 17Z

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

We agree with the proposed presentation requirements.

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?*

We agree with the proposed disclosure requirements.
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?

In the proposed model in the bottom line the amount to be transferred between the good book and the bad book does make no difference. This is one reason we do not support the proposed model (see questions 1-5). In an appropriate model the entire ELL of a single item should be transferred from the good book to the bad book. As long as the transferred amount does not exceed the allowance in the good book the latter one should be reduced by the same amount so that here will be no additional P&L effect caused by the reclassification.

We remain of course available should you wish further clarification on our opinion.

Best regards,