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Mr. Russell Golden, Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, Connecticut 06856-5116

Mr. Hans Hoogervorst, Chairman  
International Accounting Standards Board  
30 Cannon Street, First Floor  
London, EC4M 6XH  
United Kingdom

Re: Financial Instruments – Effective date

Dear Messrs. Golden and Hoogervorst:

As already stated in the IIF SAG comment letters on the IASB Exposure Draft – ED /2013/3 *Financial Instruments: Expected Credit Losses* (March 2013) and ED/2012/4 (ED): *Financial Instruments: Classification and Measurement; Limited Amendments to IFRS 9* (April 2013), the IIF SAG asks the IASB to consider providing a mandatory effective date of IFRS 9, *Financial Instruments* not less than three years after the date of issuance of the final version of IFRS 9. A similar request applies to FASB - *Financial Instruments - Credit Losses (subtopic 825-15) and Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10) - (ASU)*. The IIF SAG thinks that the effects of the proposed standards for financial instruments would be at least as significant as the effects of the revenue recognition project would be. As a result, the Boards should make an implementation decision similar to their tentative decision for the revenue recognition project.¹

While the IIF SAG recognises the importance of finalising and implementing new impairment requirements as soon as possible, and the pressure on the IASB and the

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¹ The boards tentatively decided to require an entity to apply the revenue Standard for reporting periods beginning on or after 1 January 2017. The boards noted that the period of time from the expected issue of the Standard until its effective date is longer than usual. However, in this case the boards decided that a delayed effective date is appropriate because of the unique attributes of the Revenue Recognition project, including the scope of the entities that will be affected and the potentially significant effect that a change in revenue recognition has on other financial statement line items.
FASB to deliver this given the time that has elapsed since the projects started, it is essential that enough time be provided for any final standards to be implemented in the high quality and consistent manner expected by regulators.

The planning work performed by the industry has highlighted the challenges in implementing the impairment proposals as set out in the ED, and has reinforced the view that banks will require at least three years from the issuance of any final standard to implement IFRS 9 in a robust manner. Primarily this is a result of the extensive design, build and test requirements for the new systems and processes that will be needed as well as the multiple competing regulatory projects, the guidance that will need to be developed on the interaction with regulatory capital requirements and the need to inform market expectations of both the accounting and regulatory capital impact in advance of any standard coming into force. These are set out in more detail below.

Another consideration in setting an effective date is that the revised IFRS 4 - Insurance Contracts as well as the FASB - Insurance Contracts (Topic 834) accounting standard update may need additional transitional provisions to allow asset classifications to be revisited.

**Time required to implement the impairment proposals**

Many references are made in the ED or in the ASU to risk management and risk procedures. Despite some ability to leverage existing processes, the implementation of both standards and the impairment proposals in particular will require a large and complex project, involving the development of either new risk models or adjustments to existing risk models for all portfolios within the scope of the requirements. Furthermore, impairment models extend far beyond simply building risk models. They require the implementation of entirely new processes and large-scale system changes, including accounting and reporting systems. Significant time will be necessary for the required systems changes as a result of the design, build and testing required. Another constraint to take into account is that work on systems can often only be performed at certain points in a year because of the live reporting obligations of entities.

Given the magnitude of the changes and the probable extent of the external disclosure requirements, a one-year parallel run period is considered essential. This period is necessary to perform systems and process dry runs, meet the requirements of sound data governance, and provide management information for a period prior to adoption to enable senior management to understand impairment allowances under the new accounting standards and their sensitivities. In addition, there will be demand from investors to understand the financial reporting and capital effects of the new way of provisioning before the effective date (see later comments). It is vital that sufficient time be allowed to implement and to communicate such fundamental changes in a high quality manner.
The implementation of the impairment models will require a significant number of specialist resources and the shorter the time allowed for implementation, the greater the number of incremental resources that are likely to be required. The need to run current impairment systems whilst performing the development necessary to implement the new requirements will place significant pressure on resources, as will the need for a period of parallel running and testing. Finding, recruiting and on-boarding the necessary level of specialist resources to support implementation will in itself take a considerable time. All banks will be looking for the same resources from a small and competitive pool and there are many other competing regulatory projects also requiring similar resource.

**Interaction with other accounting projects**

Furthermore, there are obvious interactions between the insurance projects and the financial instruments projects. The implementation of the new insurance requirements would certainly need to review the asset portfolios that are related to the insurance liabilities. The IIF SAG is of the view that the assessment for classification and measurement should be done simultaneously with the liability assessment to ensure symmetry and consistency in the balance sheet and in particular in other comprehensive income. If the assessment were to be made separately, it would not ensure consistency and would not be cost efficient.

This is the reason why some IIF members also think that IFRS 4 and IFRS 9 (and similarly for the FASB accounting standard updates) should be made applicable concurrently. If this were the case, the effective date of both IFRS 4 and IFRS 9 would have to be three years after the later of the two standards to be issued. At least, a transition period could be allowed for insurance firms, including for insurance subsidiaries of banking groups.

**Interaction with regulatory capital**

Changes to accounting impairment rules would probably affect determination of the regulatory capital banks are required to hold and banks will need time to understand and plan for any commercial implications resulting from such interactions. Regulatory impacts of the new standards would also be a main area of investor focus.

The interaction of both the ED and the ASU with capital requirements is not straightforward to determine. The impacts would certainly be specific to particular businesses, products and geographies. Furthermore, the regulatory response to any new impairment accounting requirements is currently unknown. Regulators are likely to consider their responses and any new regulatory capital guidance required only once a final standard has been issued. Even if regulatory requirements do not change, there are several areas in which clarity is needed given that the guidance under the Capital Requirements Directive IV (CRD IV) is drafted in the context of an incurred loss model and regulators need enough time to provide this guidance.
following a final standard. U.S. regulations implementing Basel III will of course also be affected.

**Competing regulatory projects**

Banks are currently striving to implement a number of different regulatory projects which involve similar resources across Risk and Finance functions. These projects include Basel III implementation in many jurisdictions, European Banking Authority (EBA) Guidelines on Common Reporting and on Financial Reporting Framework, Enhanced Disclosure Task Force, and the Firm Data Submission Framework. Many other projects will compete with the accounting projects such as the fundamental review of the trading book, the FSB data template, the review of the risk weighted assets approach, EDTF and other new disclosure requirements, and the review of Pillar III disclosure.

**External reporting requirements**

Although restatement of comparatives will not be required under IFRS 9, the mandatory disclosure requirements upon transition (including with respect to periods before transition) in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, mean that banks will need to be able to produce data under the new impairment requirements in advance of the mandatory effective date in order to present well-grounded, auditable prior-period information upon first publication under the new regime. Moreover, communication to the market is likely to drive early need for IFRS 9 results. Banks will be pressed to inform the market as to the probable impact of the changes both from an accounting and a regulatory capital perspective. This will enable the market to form forecasts of banks’ results under IFRS 9. Waiting until adoption to make the first disclosures is unlikely to be acceptable to the market and, furthermore, listing rule requirements may demand disclosure of estimated impact if market expectations are significantly different from internal analysis.

Therefore, the decision on the effective date of IFRS 9 should take into account the systems and data development needs detailed above and allow for sufficient lead time to permit the anticipated preliminary disclosures to be made on a relatively well-grounded basis (i.e. after initial work on systems and procedures has been done, but with sufficient lead time to make the necessary anticipatory disclosures), and to have full data to meet the IAS 8 prior-period comparison requirements.

**Ability to start implementation in advance of final requirements**

Even if both the ED and the ASU, as they currently state, offer the opportunity to leverage existing credit risk systems, there are still too many uncertainties and too many cost implications to permit substantial implementation work in advance of requirements being finalised.
Firstly, it is not possible for banks, and in particular for consolidated groups that include both bank and insurance activities, to finalise the scope of the new impairment proposals until the classification and measurement elements of IFRS 9 (or FASB – financial instruments topic 825-10) and IFRS 4 are completed. The IIF SAG thinks that the final standard should take into account the final standard on insurance to ensure global consistency between insurance contracts and financial instruments. These continue to be discussed, with final guidance only expected along with the final impairment guidance in the second quarter of 2014 for IFRS 9.

Secondly, the impairment proposals themselves are still in draft and under discussion. It is highly probable that the specifications would be subject to change and that the finalised requirements would need to be understood and interpreted before banks can provide information technology (IT) specifications to their (already over-extended) IT development groups. Therefore, it is very difficult to proceed with an implementation project without final requirements, owing to the significant risk of rework and wasted expense. Even an apparently small change in accounting or disclosure requirements can have a large implication for the risk models, data and systems changes needed. For example, until disclosure requirements are finalised and all data attributes are known, it is not possible to start building granular systems interfaces.

**Other considerations**

The FASB is pursuing a different impairment model, with lifetime expected losses to be recognised on all exposures within the scope of the model. The IIF SAG is concerned that, if the final result is inconsistent between IFRS and U.S. GAAP requirements, many international institutions will have to implement two different systems. These systems would be different in at least two aspects: (a) the scope of instruments and (b) the assessment of “lifetime expected losses”. The scope of instruments is currently similar but somewhat different as the FASB is proposing a practical expedient for assessing impairment on debt securities while the IASB requires a single measurement for all debt instruments. The scope might diverge in the future as there is a risk that divergent decisions are made during re-deliberation on classification and measurement. “Lifetime expected losses” in the FASB model is still being defined and it is unclear if this is or can be the same as the IASB definition of “lifetime expected losses”.

For international institutions that are required to implement both the IASB and the FASB model, any implementation project would ideally deal with both sets of requirements concurrently, in particular, given the need to be able to explain differences between them. Furthermore, for S.E.C foreign-private issuers, the interaction with E.U. endorsement is also critical with the potential risk of reporting under both IAS 39 Financial Instruments: Recognition and Measurement, and IFRS 9 if enough time is not allowed for the completion of the E.U. endorsement process prior to the mandatory effective date.
Conclusion

The IIF SAG is convinced that a three-year period is a minimum for implementing the impairment standards as a whole after the final standards are issued. A shorter implementation period is unlikely to result in the consistent application expected by regulators and the market or allow sufficient time the interaction with the regulatory requirements to be resolved.

For members of the group that either have insurance activities or have to follow both IFRS and FASB requirements, implementation may be even more challenging if the standards have different effective dates.

The IIF SAG appreciates your attention on these considerations. Should you have any comments or questions on this letter, please contact the undersigned or Veronique Mathaud (vmathaud@iif.com; +1 202 682 7456).

Very truly yours,