DAIMLER

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

United Kingdom

April 1st, 2011

Supplement to ED/2009/12 'Financial Instruments: Impairment'

Dear Sir David,

We are writing to comment on the IASB Supplement to ED/2009/12 'Financial Instruments: Impairment' (herein referred to as 'the Supplement'). We highly appreciate the opportunity to comment on the Supplement.

Our detailed comments on the questions raised in the Supplement are included in the appendix to this letter.

First of all, we very much welcome the IASB's efforts to improve the accounting for impairments and find better accounting solutions and we highly appreciate the IASB's effort to find operational solutions for the difficulties identified in the comment letters to the ED 'Financial Instruments: Amortised Cost and Impairment' (herein referred to as 'the Exposure Draft'). In our opinion the application of an expected cash flow approach to financial assets in an open portfolio is extremely difficult. Therefore we support the development of a simplified approach that addresses operational difficulties while it retains the advantages of an expected loss model at the same time. In this respect we also recommend further simplifications for entities with retail activities.

However, we would like to express our concerns that we are not in favour of any piecemeal solution that does not fit into an overall impairment model. We believe that similar economic situations should be accounted for consistently Therefore we believe that all financial assets carried at amortised cost should be measured using a consistent impairment model.

Yours sincerely,
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IASB and FASB questions
Impairment

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?

As already explained in our comment letter to the 2009 Exposure Draft, we believe that the approach for the recognition of impairment described in this supplement can contribute to the reduction of the weakness of delayed recognition of credit losses attributed to the current impairment models under IFRS and FASB. In our opinion major market upturns or downfalls will affect the statement of income under the expected loss model, when estimates have to be adjusted. In comparison to the incurred loss model the difference would be that the recognition of losses may occur earlier.

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?

In principle, we believe that a consistent accounting model should be applied to similar economic situations. In order to reduce complexity, we are of the opinion that all financial assets carried at amortised cost should be measured using a consistent impairment approach. A situation where different impairment approaches have to be applied to different kinds of financial assets - all of them measured at amortised cost, however - does not entail a simplification of the accounting guidance. Moreover different models are more complicated to implement and maintain. We also would like to point out, that different accounting models might be difficult to understand by users of financial statements.

We highly appreciate the development of simplified rules to improve the operationality of the expected loss model. In our opinion the impairment model proposed in the supplement for open portfolios can also be applied in a similar way to individual assets. The differentiation between 'good book' and 'bad book' and the time-proportional approach will work for individual assets as well.
For trade receivables without a stated interest rate simplified rules should be applied on the basis of the expected loss model. Pro-rata recognition of life time losses is not appropriate for this case. Typically, these trade receivables have a front-loaded impairment pattern. We favour the separate presentation of gross revenue without expected credit losses and the allowance account in the statement of income.

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?

Question 4

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

Question 5

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

We support the efforts of the IASB and the FASB to develop an operable and simplified approach for impairment accounting, based on the separate allocation of interest revenue using the effective interest rate as currently defined by IAS 39 on the one hand and initial and revised expected credit losses on the other hand. Obviously feedback from comment letters and the Expert Advisory Panel with regard to the operational difficulties anticipated from the proposals in the Exposure Draft have been taken into account when developing the joint proposal by the IASB and the FASB.

The proposed impairment approach of the Supplement reflects better the current methods to determine the credit risks and is therefore much more operational.

Nevertheless, we recommend to further simplify impairment accounting for preparers that deal with a great number of retail contracts (contracts with relatively short duration and on average, small amounts on an individual basis).

The proposed impairment model requires the calculation of the whole amount of lifetime expected losses at initial recognition of the financial assets in the portfolio. In our opinion estimating lifetime expected losses is very difficult for retail receivables with relative short maturity. Our experiences shows that the retail business with short maturities receivables is characterised by early losses. This means that during short-term contracts loss events typically take place at an early point of time. Therefore only losses expected in the foreseeable future can be estimated fairly reliably and we propose to recognise only expected losses for the foreseeable future, because this is easier to adopt. Thus the accounting for expected credit losses could be aligned with the Basel II one-year expected loss approach. For further information on this suggested simplifications please refer to the comments on question 9.

The proposed 'good book' / 'bad book' approach is operational even for entities that do not have sophisticated systems to estimate expected losses. Entities that have historical experience with credit losses or other sources of information, are allowed using either a discounted credit loss amount or applying the annuity method to better reflect their more specific estimates. At least we urge the IASB to provide entities with the flexibility to use expected losses that can be estimated reliably and which are used for internal and other external reporting purposes as well. Thus an entity should be able to choose the approach that best fits its internal risk management systems and thus assures most reliable data.

Nevertheless, we would like to point out the fact, that contract management systems are based on single contracts, not on groups of assets. Even contracts that can be allocated to portfolios have different parameters and comprise a whole variety of different data. Therefore any information necessary for the calculation of allowance accounts has to be collected on the level of the individual contract, not on a group level. Usually the allowance account of a portfolio of financial assets cannot be calculated on the portfolio level but is nothing else than an aggregation of data calculated on contract level. Thus changes affecting only individual contracts can also be tracked as well as changes affecting all of the contracts in a portfolio.

Besides we would like to point your attention to a question that is not resolved in the Supplement. If an entity acquires a financial asset that is already impaired at a discounted price, it is unclear whether the entity has to allocate the financial asset measured at acquisition cost to the 'good book' or whether the financial asset has to be allocated to the 'bad book' together with the full allowance account. We ask for clarification of this issue.

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?

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?

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 requirements would you propose and why?

Basically we agree with the requirement to differentiate between the two groups for the purpose of determining the impairment allowance. This differentiation is aligned with the way many entities manage their portfolios of financial assets. With respect to the proposals in the Supplement we support the approach that an entity shall differentiate between the 'good book' and the 'bad book' on the basis of its internal credit risk management. Thus it is ensured that the accounting reflects the internal management systems in place.

Nevertheless we would like to point to the fact, that from the perspective of a preparer that operates in numerous countries and jurisdictions we realize that there might be different definitions of 'good book' and 'bad book' within one group. Therefore it is our understanding that the accounting shall reflect the different risk management systems that might be in place within one single group. The differentiation in 'good book' and 'bad book' on the basis of credit risk objectives is applied for the purpose of determining the credit loss allowance. The definition of 'good book' and 'bad book' is based on the internal credit risk management. Therefore it is likely that the definition differs between companies.

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 o flosses 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 with 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 that three years after an entity's reporting date)? If so, please provide data an/or reasons to support your response.

The introduction of the requirement to recognise the higher of the time-proportional expected life-time credit losses and the losses expected to occur in the foreseeable future creates significant additional accounting complexity. We suggest the following simplifications: The first simplification refers to the fact that entities with retail business and receivables with short durations should be allowed to use the estimation of expected losses using the12-month forecasting time horizon. The second simplification refers to the immediate recognition of losses related to the 12-month time horizon. Short-term retail business entities with amortizing loan structures typically feature average effective durations between 1 and 2 years. Thus, expected losses being calibrated by using a 12-month forecasting time horizon should adequately assess the expected losses occurring in a typical short-term retail financing portfolio.

Moreover, we believe that estimates for expected credit losses featuring a forecasting time-horizon exceeding 12 months will not become neither more accurate nor more reliable. Defaults occurring in the first 12 months can be assessed by using well-known concepts widely spread in financial institutions, i.e. by using Basel II Probabilities of Default (PDs) and Loss Given Defaults (LGDs) and the resulting Expected Loss as a product of PD and LGD. However, for time horizons exceeding 12 months, entities then would be submitted to resort to migration matrixes and other highly theoretical concepts in order to assess PDs for i.e. 2, 3

and more years. The longer the forecasting horizon is chosen, the more inaccurate and arbitrary the result. We therefore strongly favour a time horizon of not more than 12 months in order to assess future credit losses as a simplification for retail business entities.

Expected losses assessed on a 12-month forecasting period then should be recognized at the inception of the business in order recognize credit losses at an early stage. This could be achieved by using the floor concept presented in the Supplement. The assessment of expected credit losses based on a forecasting period of 12 months is, according to our opinion, most suitable for the business model of short-term retail business entities. These risk parameters should represent the loss characteristics of such portfolios with sufficient accuracy.

Therefore we recommend to allow entities to decide whether the time-proportional approach provides sufficient allowance or whether another approach is necessary to mitigate the risk of inadequate provision balances. From the perspective of an entity with retail business and rather short-term financial assets we are of the opinion that a simplified approach should be permitted.

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.

In our business of retail automotive financing, the difference between the time-proportional amount of the remaining lifetime expected credit loss and the floor (expected credit losses for the foreseeable future assumed within 12 months) would not be significant. However we believe that the calculation on the basis of a foreseeable future (12 month) horizon is more reliable. Furthermore the estimations methods on the basis of a 12 month horizon (foreseeable future) are well known and widely applied by banks and financial institutions.

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 I 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 fully agree with the proposals that allow entities to choose between discounted and undiscounted estimates and to select the respective discount rate. This flexibility is necessary to make the impairment approach operational and to reflect different risk management approaches in the financial statements.

Besides we are of the opinion that an entity should use the interest rate specific to the respective contract for discounting purposes, if this information is available.

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?

Yes, we prefer the IASB approach, but we strongly recommend to provide simplifications for retail receivables with short durations (immediate recognition of expected credit losses on the basis of a 12 month horizon). For further details we refer to our answer to question 9.

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 (ie to recognise currently credit losses expected to occur in the foreseeable future? Why or why not?

In general we favour the IASB approach however with simplifications as outlined in question-9: Assessment of expected losses for a 12 month horizon and immediate recognition, for retail portfolios which reflect adequate loss pattern (e.g. retail automotive financing)

IASB only questions
Impairment

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 fully agree. In our comment letter to the IASB we emphasized the fact that usually contract management systems and risk management systems work separately. Therefore the integrated calculation of interest revenue after the deduction of expected credit losses will cause severe implementation problems. Therefore we welcome the decoupled approach which states that the determination of the effective interest rate should be separate from the consideration of expected losses

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?

Question 16Z

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

Loan commitments that are not accounted for at fair value through profit or loss should not be in the scope of the supplementary document. In our opinion only recognised financial assets can be impaired. Therefore as long as there is no asset that has to be recognised, there is no room for impairment. Otherwise there would be an accounting mismatch between revenue and cost.

As far as scope questions are concerned, we ask the Boards to confirm that finance lease receivables (IAS 17) and any receivables from leasing contracts accounted for under revised leasing guidance are in the scope of the proposed impairment rules.

Question 17Z

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

Yes, we agree with the proposed presentation requirements, if impairment losses and reversals of impairment losses are presented net in one line item.

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 do not fully agree with all the proposed disclosure requirements. As already mentioned above, we support the idea that the proposed impairment approach is based on an entity's internal credit risk management. Therefore different risk management systems are reflected in the financial statements. Users need information about the specific criteria applied in the risk management of the respective preparer.

Nevertheless we think that some of the disclosure requirements are too detailed to provide decision-useful information. Among them is the requirement to disclose data on the 'good book' allowance account separately from the 'bad book' allowance account. The total of all impairment losses together with the analysis of the age of financial assets that are past due is the decision-useful information for readers of financial statements. Therefore we think that the current guidance in IFRS 7 together with the disclosure of the development of total impairment losses seems to be appropriate. We recommend disclosing only combined data from 'good book' and 'bad book'.

We also do not agree with the requirement to disclose for five annual periods certain information with respect to the 'good book' loss account. This period is much too long and does not contain new information.

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 general we recommend to transfer the amount recorded in the allowance account for the transferred asset in the 'good book' prior to migration to the 'bad book'.