Verband der Industrie- und Dienstleistungskonzerne in der Schweiz Fédération des groupes industriels et de services en Suisse Federation of Industrial and Service Groups in Switzerland

31 March 2011

International Accounting Standards Board 30 Cannon Street London EC4M 6 United Kingdom

Comment Letter on Supplement to Exposure Draft (ED) / 2009 / 12 – Financial Instruments: Impairment

Dear Sir / Madam,

Swiss Holdings, the Swiss Federation of Industrial and Services Groups in Switzerland represents 53 Swiss groups, including most of the country's major industrial and commercial enterprises. We thank you for the opportunity to comment on the above mentioned exposure draft (the ED). Our response below has been prepared in conjunction with our member companies. We outline some general comments below and answer the specific questions of the ED in the annex.

### **GENERAL COMMENTS**

SwissHoldings welcomes the Boards' initiative to align the different proposals made by standard setters on the impairment methodology for financial instruments measured at amortised cost. As non-financial service industry preparers we support the facilitation of the impairment approach for financial instruments measured at amortised cost. However, we are convinced that an even more simplified impairment approach would be desirable for preparers in non-financial service industries.

In particular, we agree with the following proposals made in the ED:

- a) The impairment approach based on expected loss estimates;
- b) The separation of the interest revenue determination and credit risk provisioning, i.e. the exclusion of expected credit loss estimates in the effective interest rate calculation; and
- c) The simplifications in respect of the determination of the impairment allowance.

As industrial and service industry preparers, our business activities are only to a certain extent affected by lending and borrowing transactions. Therefore, we do not express a distinct opinion and are not able to provide data of credit portfolios to support responses, in particular on your questions on the adequacy of minimum impairment allowance amounts.

We have concerns on the introduction of additional complexity and would suggest that the Boards reconsider the proposals in the area of:

- a) The application of a single impairment methodology for all financial assets valued at amortised cost;
- b) Making the management of credit risk dependent on the existence of a sophisticated credit risk monitoring and management; and
- c) The flexibility to tailor disclosures on credit risks in line with an entity's lending and borrowing activities.

We noticed that short-term trade receivables are not within the scope of the ED. We would like to confirm our reservations on the same treatment of short-term trade receivables and other operating financial assets such as short-term loans to suppliers and/or employees as for financial instruments used for credit and lending activities. We already highlighted in our comment letters to the IASB on the EDs on 'Financial Instruments: Classification and Measurement' and 'Financial Instruments: Amortised Cost and Impairment' difficulties commercial and industrial companies have in applying the same principles to short-term trade receivables as for other financial instruments. We are extremely concerned about the application, practicality and usefulness of the expected loss model to short-term trade receivables. We strongly believe that the characteristics, purpose and source of short-term trade receivables are different from other financial instruments with 'basic loan features' and thus the proposed impairment model would be of no relevance to them. Therefore we expect the Boards to bear this in mind as they continue to address the treatment of short-term trade receivables in conjunction with the discussions on the revenue recognition project.

Furthermore, we would like to affirm our view that impairments or provisioning for trade receivables should be part of operating expense and not shown as a reduction of revenue (i.e. net sales). It is the common practice and policy of industrial or commercial preparers that revenue deductions are closely linked to sales and represent the difference between gross and net sales, i.e. part of the reconciliation from gross to net sales, such as cash or customer discounts, chargebacks etc. We understand that users focus on the gross to net revenue streams to develop possible future cash flows that entities may achieve or generate and to analyze market shares and market penetrations as well as sales growth. Therefore we believe that the allocation and presentation of credit losses on trade receivables using the same methodology as for 'credit products' as a reduction in revenue would reduce decision useful information in the financial statements of non-financial service institutions.

Below we further develop our views in our answers to your specific questions on the ED.

Yours sincerely

### **SwissHoldings**

Federation of Industrial and Service Groups in Switzerland

Dr. Gottlieb A. Keller

Current Chair of SwissHoldings

A. Keller

(General Counsel Roche Holding AG)

cc SH Board

11-04-01-CL-ED-Impairment

Dr. Peter Baumgartner Chair Executive Committee

P. Bannya

**SwissHoldings** 

### ANNEXE

## **QUESTIONS FOR RESPONDENTS - INVITATION TO COMMENT**

### General

### **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 approach for recognition of impairment outlined in the supplementary document to the ED *Financial Instruments: Amortised Cost and Impairments* still focuses on an expected loss model. Thus the proposed approach for the recognition of credit losses will no longer be dependent on an 'incurred or triggering event' and the model still requires the anticipation of economic developments for recognising credit losses. SwissHoldings considers generally expected loss models as an improvement compared to the current impairment models which simply lack future-oriented aspects.

We agree with the Boards' view expressed in its Basis of Conclusion (BC), paragraphs BC32 and BC33 that the original objective to recognise credit losses based on expected losses should be unchanged, however that the impairment model needs to be simplified from an operational point of view. We consider that these objectives should be achieved as expressed in paragraph BC33. Moreover, we believe that the adopted impairment approach of the supplementary document responds to the weakness of delayed recognition of expected credit losses. The time-proportional approach may not create in certain circumstances such as early loss pattern scenarios an allowance balance sufficient to cover the expected losses before they occur. However we consider that a minimum impairment allowance amount would only be justified if an early loss pattern will be evidenced.

# Scope - Open portfolios

### 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 understand from the supplementary document that the original impairment methodology would continue to be applicable for closed portfolios and – for us as industrial and service industry preparers more importantly – for single financial assets. We expect operational complexity on the implementation as the model would require the introduction of two different effective interest rates (EIR):

- The EIR for the calculation and the presentation of 'gross interest revenue' which is calculated using the EIR before taking into account the initial estimate of expected credit losses; and
- The EIR considering expected credit loss estimates for the determination and presentation of the portion of allocated initial expected credit losses.

Hence, preparers will have to calculate two EIRs in respect of each financial instrument or portfolio which increases the ongoing burden and cost of implementation. We believe that the

proposed impairment model of this supplementary document would also be operational for closed portfolios and other instruments. We question the adequacy of two models.

Therefore SwissHoldings would like to propose to the Boards to consider the requirement of a single impairment approach in order to avoid the introduction of additional complexity. We would strongly favour the impairment model for open portfolios as proposed in the supplementary document to be the applicable approach for all relevant financial assets.

# Differentiation of credit loss recognition

#### 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?

With the caveat that the differentiation of the two groups for the purpose of determining the impairment methodology and consequently the allowance is based on sound credit risk management practices as outlined in paragraphs 3, B3 and B4 of the ED, we agree that it would be appropriate to recognise the expected credit losses for financial assets of the 'good book' over a time period. However the separation of portfolios in good and bad books is very specific to preparers of the financial service industries. It appears that the concept will not be immediately adaptable for industrial and commercial preparers. We would like the Boards to consider more flexibility for the required approach to management of credit risk of financial assets as entities and industries vary significantly in their applications.

#### Question 4

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

Our member companies in non-financial service industries have relatively limited experience with the lending and credit business and thus have almost no experience with credit loss models and credit loss modelling. However, SwissHoldings considers the proposed approach as less difficult to implement in comparison with the original impairment proposals. As already commented in our answer to question 2 above, we would prefer that the impairment methodology should operate with one single approach. This would further significantly reduce the complexity in determining the necessary credit risk adjustments, i.e. the impairment allowance.

### **Question 5**

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

We assess that the proposed approach will provide decision-useful information to the stakeholders. The impairment approach would assure that the impairment allowance would provide immediately for 'non-performing' financial assets, i.e. where the expectation for receiving entirely the contractual payments is restricted as well as for the expected credit losses which could occur over time in the future.

### **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 proposed principle to separate the two groups in paragraph 3 of the ED, presumes that the entity operates with a credit risk management as required by financial institutions for their lending

business. In general, SwissHoldings believes that one should not assume that all IFRS preparers have the capabilities to monitor their exposure to credit risk in the same way as preparers of the financial services industry. Therefore we propose that the Boards reconsider that the separation should be made dependent on a sophisticated system as proposed in paragraph B4 by referencing to paragraph B3 of the ED, and by just listing other possible criteria to achieve the adequate determination by referencing to examples. In addition, we believe that such a listing should not be meant to be exhaustive.

## **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?

As commented in our answer to question 6 above and as we read paragraphs B3 and B4, we are of the opinion that the management of credit risk should not be made dependent on the existence of a sophisticated credit risk monitoring and management. The respective organisation should be tailored to an entity's exposure to the credit and lending business.

### **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?

As mentioned in our answers to questions 5-7 above, we consider the proposals of the approach to separate two groups as appropriate.

# Minimum impairment allowance amount

### **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?
- 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 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.

As indicated in our answers to questions 2 and 3, we welcome that the Boards are exploring approaches to facilitate the determination of appropriate credit loss allowances. We agree with the Boards' view expressed in the paragraphs BC74 of the Basis for Conclusions of the ED that the time-proportional approach may not create an allowance balance sufficient to cover the expected losses before they occur. However we also believe that there could be circumstances that early losses would not have been incurred. Consequently, a floor for the impairment allowance related to the 'good book' should only be required when an early loss pattern would be evidenced. Moreover we are of the opinion that the loss estimates should be determined for a medium-term time period that management usually is covering in its strategic planning. That also implies that such a time period would not be less than twelve months. If economic conditions change, we could well imagine that one would change the period considered for the planning and consequently the time period covered to develop estimates including expected loss estimate.

However we are not convinced whether the proposed approach would produce better decision-useful information in respect of operating financial assets for users of industrial and commercial preparers' financial statements. We would like to propose to the Boards to consider retaining the present IAS 39 requirements for these financial assets without any interest revenue element by permitting the use of historical loss and/or peer group experiences for the credit risk assessment.

As industrial and service industry preparers our core business activities do not derive from the credit and lending business as for the financial services industry. Therefore we have almost no statistical data available to support either for which time period the minimum allowance amount should be estimated nor whether a 'ceiling' of the time period to estimate should be established.

### **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.

As commented above in our answer to question 9, our member companies are – unlike preparers in the financial services industry – only to a limited extent affected by lending and borrowing transactions. We do not have data available and we are therefore not in a position to form a view on this question.

## Flexibility related to using discounted amounts

### **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 welcome the Boards proposal to permit flexibility on both the use of discounted or undiscounted estimate as well as the selection of an appropriate discount rate. However, this requires that the approach applied will be disclosed to understand an entity's credit risk management and, in particular, its approach to credit risk provisioning.

## Approaches developed by the IASB and FASB separately

### **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?

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

First of all, we regret that the Boards were developing different methodologies and that they could not agree on a common approach. In general, we are convinced that expected credit losses for financial assets with continuous interest revenues streams should be recognised over time. We consider the recognition of the full amount of expected credit losses at the initial recognition of the financial instrument as too conservative. In addition, we are of the opinion that the application of such principles of conservatism would not be based on and reflect economic development. Moreover, we believe that the developing of expected credit losses and respective impairments would not substantiate the requirement to recognise all expected impairment losses at initial recognition of the financial instrument. Therefore we do not prefer the FASB approach for financial assets in the scope of the ED.

## IASB only Appendix Z

## Impairment of financial assets

### 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?

We welcome the Board's proposal to distinguish expected credit losses from the determination of the effective interest rate. We consider that the proposed approach is less complex to comprehend and operationally less difficult to implement. In particular, our views correspond with the comments of the Expert Advisory Panel (EAP) expressed in paragraphs BC34 and BC35.

# Scope – Loan commitments and financial guarantee contracts

### 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?

and

### **Question 16Z**

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

Industrial preparers have almost no experience with credit loss models and credit loss modelling. In addition, the questions raised are too specific in respect of certain products. Thus we are not in a position to form an opinion. However, we can follow the Board's argumentation expressed in the introduction to these questions on pages 61 and 62 of the ED.

#### Presentation

### **Question 17Z**

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

We agree that the proposed simplified approach also allows for a reduction of line items presented, i.e. gross interest revenue and impairment losses. As the proposed approach does not require the determination of initial estimates of credit losses and changes in those estimates, it is consequently also no longer necessary to present this in separate line items (gross interest revenue, the portion of initial expected credit losses and impairment losses).

### **Disclosure**

#### **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?

As expressed in our comment letter to the IASB on the ED 'Financial Instruments: Amortised Cost and Impairment' the ED has been developed very much from the perspective of the financial services industry. Therefore most of the proposed disclosure requirements are presumed necessary to analyze the credit business of financial institutions. We believe that these requirements are excessive for non-financial services industry preparers where the credit business is not core to their operations. We expect the Boards to differentiate the level and detail of disclosures depending on business activities and other considerations such as relevance, materiality etc. We expect the Boards to consider the introduction of more flexibility in these requirements in order to permit non-financial services industry preparers to tailor their disclosures to their actual involvement in the credit and lending business. This should enable industrial and commercial preparers to minimise excessive disclosures that are considered non-core to their actual business.

## **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?

We agree that when a financial asset is transferred between the two groups the related allowance to be transferred should be determined based on the age of the financial asset.