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CANADIAN
BANKERS
ASSOCIATION

Box 348, Commerce Court West
199 Bay Street, 30th Floor
Toronto, Ontario, Canada M5L 1G2
www.cba.ca

Nancy Fung
Vice-President, Banking Operations
Tel: (416) 362-6093 Ext. 335
Fax: (416) 362-8288
nfung@cba.ca

April 1, 2011

International Accounting Standards Board
30 Cannon Street, 1st Floor
London EC4M 6XH
United Kingdom

Dear Board Members:

Re: Response to the IASB re Financial Instruments: Impairment – supplement

The Canadian Bankers Association[1] (CBA) would like to thank the International Accounting
Standards Board (IASB or the Board) for the opportunity to comment on Financial Instruments:
Impairment (suppED); a supplement to the IASB's exposure draft Financial Instruments:
Amortised Cost and Impairment issued in 2009 (ED).

We greatly appreciate the opportunity to participate in the development of accounting standards
that are critical to the Canadian banking industry. Accounting standards affecting the treatment of
loan impairment are critical to our industry. Our views expressed in this letter affirm our tentative
views discussed with IASB and FASB staff on February 28, 2011.

We believe that the suppED is a significant step towards the IASB and FASB adopting a
common approach towards credit impairment. We are also pleased to note that you have
addressed the operational issues with the ED's expected cash flow approach (ECF). We are
very supportive of the suppED's concept of a good and bad book, the decoupling of the expected
credit loss from interest revenue recognition. We believe these concepts should remain in the
final standard.

We are very supportive of the suppED's concept of dividing loans and related credit impairment
allowances based on credit characteristics into 'good' book and 'bad' book categories This is
consistent with how banks manage risk provides critical metrics that are used by management,
bank analysts and other primary users of bank financial statements. We are also appreciative of
the suppED's time-proportional approach to determine the point-in-time measurement of a loan
portfolio's credit allowance. This is a welcomed and practical solution to address the operational
concerns associated with predicting the amount and timing of future cash flows, net of credit

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[1] The Canadian Bankers Association (CBA) works on behalf of 51 domestic banks, foreign bank subsidiaries and foreign bank
branches operating in Canada and their 260,000 employees. The CBA advocates for effective public policies that contribute to a
sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy
to help Canadians make informed financial decisions.

losses, and allocating those losses via the effective interest rate. The time-proportional approach provides a reasonable approximation of the credit impairment that the ECF model would have yielded, while improving transparency and simplicity.

We encourage the IASB and FASB to consider the use of only one approach to measure credit impairment. However, we will accept the inclusion of a secondary approach if the two boards consider it necessary to achieve convergence. Our primary concern lies in the impact to financial statement users and their ability to understand and interpret the application of two approaches in determining credit impairment. This impact is dependent on understanding the parameters or triggers that would result in the allowance derived from credit losses expected to occur within the foreseeable future period (the 'floor') exceeding the time-proportional approach, and the relative sensitivity to switching from one approach to the other within a given portfolio. In the absence of performing detailed modeling and stress testing (which we have not yet had the opportunity to complete) we are unable to predict the outcome of the interplay between the two different approaches. Accordingly, our response letter can only address the suppED's proposals from a conceptual basis.

We are concerned that the suppED's has provided limited guidance on the definition of foreseeable future. Financial statement preparers are likely to interpret this concept differently, and the resulting differences in application will reduce the comparability between companies. There is also the risk that regulators in different jurisdictions could impose different "rules" on how to define "foreseeable future" in the absence of detailed guidance. We believe additional guidance on the foreseeable future is necessary in order to manage the risk of incomparability between entities and limit geographic misalignment.

We believe the floor should behave as its name suggests whereby the amount of credit impairment determined under this approach would seldom exceed the time-proportional approach. The term foreseeable future should have prescribed limits in terms of the time period and/or application of restrictions to only certain portfolios that are likely to incur losses earlier in the life of the portfolio as determined by management, recognizing that portfolios may also exist where losses are incurred later in the life of the portfolio. In our view there are complexities for management and financial statement users and operational burdens associated with calculating two expected loss approaches. However prescribed limits or application of restrictions would moderate these impacts.

We continue to be supportive of recognizing impairment losses based on future expectations, rather than being constrained to existing conditions. We understand that the hybrid model may be considered necessary to achieve convergence. However, this has resulted in the unexpected consequence of the introduction of a floor based on the foreseeable future. We kindly request that the Board be open to additional comments, if we and other international banking associations are provided the opportunity to complete detailed quantitative assessments of the impact and interplay of the time-proportional approach and the floor.

This suppED is only a subcomponent of the impairment model such that there are many other issues that are not covered and remain to be deliberated by the Boards. There could be unintended consequences of those issues on the specific matters covered by this suppED. To mitigate this risk we would request the Board consider re-exposing the complete standard on impairment for comments by all the stakeholders.

We look forward to participating in further dialogue on this issue and our industry would be pleased to have a follow-up discussion on the contents of this letter with the Board or its staff.

Sincerely,

[signature]

Attachment: Appendix

Appendix

Question 1

Do you believe the approach for recognition of impairment described in this supplementary document deals with this weakness (i.e. delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

Answer:

We see no reason why the common proposal [reference - 2(a) (i) & (ii)] would not result in the earlier recognition of credit losses relative to an incurred loss approach when applied to the good book. We believe this is likely to be the case under most circumstances if an entity were to apply the common proposal to a conventional open loan portfolio. The recognition of credit losses for a loan within the bad book [reference - 2(b)], based on our interpretation, would generally produce a credit impairment allowance equivalent to current practice, at least for loans that we currently classify as impaired under IAS 39. However, depending on the interpretation of the guidance provided in the suppED, the number of loans within the 'bad' book could lead to an increase from the current 'impaired loans' population under IAS 39, see our response to Question #6 for further discussion. We believe detailed quantitative analysis to stress test various types of loan portfolios under varying assumptions and at different points in a credit cycle would be required to validate our perspective. We have not yet had the opportunity to complete this as of this date.

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.

Answer:

We do not foresee any additional or heightened operational complexities over and above those that we may face in an open portfolio, if we were to apply the common proposal to a closed loan portfolio. Determining weighted averages to calculate expected age and life of the loan portfolio [reference - B9], would likely be simplified in the context of a closed portfolio.

We have not yet had an opportunity to examine the impact if an entity were to apply the common approach to other financial instruments such as debt securities. Given the objectives of various types of portfolios (such as debt securities, purchased impaired loans through acquisition, purchased pools of impaired loans) may be different, the application of one impairment model may not be appropriate.

For example, for debt securities where the bank does not service the underlying loans and bonds measured at amortized cost, it would be difficult to apply the concept of good book vs. bad book as the intentions of its holders do not necessarily fall into the two categories of collection of interest and principal and recovery. Further, the current proposals do not provide guidance on how to measure the good book allowance for these assets, making it difficult to comment if such a model would be appropriate. For

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purchased impaired loans, one way to apply the model is by assuming that management's intention is always recovery, thus all purchased impaired loans would immediately fall into the bad book classification. However, we question if that is the intention of the Boards.

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?

Answer:

Time-proportional expected credit losses [reference - 2(a)(i)]

In principle we are supportive of an expected loss approach that will permit earlier recognition of credit impairment losses. Conceptually we believe the time-proportional method should achieve earlier recognition of losses. In addition, this method addresses several key operational concerns that we had identified in the ECF model. These concerns included the difficulty in determining future expected cash flows in an open loan portfolio, and the associated allocation methodology via the effective interest rate.
We also welcome the interpretative guidance for determining expected losses in distant time periods, which would permit an entity to revert to a long-term average loss rate [reference - B7]. Given our concerns about subjectivity in the use of long term forecasting of economic conditions, we are in support of this guidance.

Credit losses expected to occur within the foreseeable future (the 'floor') [reference - 2(a)(ii)]

In principle we are not adverse to the concept of a floor in an expected loss methodology. However, in the absence of performing detailed modeling and stress testing (which we have not yet had the opportunity to complete) we are unable to assess the consequence of adopting two different approaches. Accordingly, we can only speak to suppED's proposals from a conceptual basis. See our response to Question #9 for a detailed discussion.

Question 4

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

Answer:

The time-proportional expected loss over the life of the portfolio approach permits the measurement of expected losses within an open portfolio through the use of weighted average life and age of the loan portfolio [reference – B8] which will allow an entity to employ a statistical-based approach to estimating expected losses. It is our view that an expected loss methodology is a concept relevant at a portfolio level, in that a lender does not expect to incur a loss on any particular loan at time of origination. However, a lender does expect that within a pool of loans, some of those loans will default. Accordingly, the ability to employ weighted averages for life and age is a practical solution to estimating expected loss over the life of a loan portfolio in contrast to the IASB's original proposal in the ED, which would have made it difficult to employ a statistical-based approach.

There will be operational challenges in the determination of weighted average life and age of loans on a quarterly basis within certain loan portfolios; particularly revolving loan facilities that do not have a fixed end date and the age of the loan are not necessarily determinable on a loan by loan basis. Additional

interpretative guidance and an illustrative example for the application of the time proportional approach on revolving facilities would be helpful. Additionally, determining the correlation of interest rates and defaults on the expected life of a portfolio will make this requirement challenging to apply [reference – B9]. Application of significant management judgement will be necessary in order to develop these estimates, particularly when determining total expected life (through such means at considering prepayments, defaults, etc.).

Question 5

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

Answer:

This will be impacted by management and users' ability to understand and interpret the application of the time-proportional method and floor, and the sensitivity to switching from one approach to the other. Constant switching would likely be confusing for both the preparers and the users and therefore will not be useful for decision making. Regardless of the outcome, significant education will be required for both management and users of financial statements to develop an understanding of an expected loss methodology. The simplification of the time-proportional method relative to the ECF model will reduce some of the concerns of educating management and users on the expected loss methodology. Some element of uncertainty will likely exist until management and users have seen the impact through a full credit cycle.

Please also refer to our comments on Questions #18 and #19 regarding our views on the usefulness of the information contained in the disclosures.

We note that the concept of the good book/bad book will provide better alignment with credit risk management practices and how the relative performance of a loan portfolio is evaluated by management, shareholders, analyst and other users. Ultimately, financial information is most relevant and reliable when it is based on information that management uses to manage its business.

Question 6

Is the requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

Answer:

We are very supportive of maintaining separate good books and bad books that incorporate distinct provisioning approaches. This would better preserve the alignment with current risk management practices and financial statement user needs. Currently, non-performing loans and related impairment allowances, which we believe is similar to the suppED's bad book concept, provide key metrics to analysts and financial regulators on the performance of an entity at different points in the economic cycle.

The measurement and recognition of expected loss is significantly different between the good book and bad book. Accordingly, we are very sensitive to any guidance that leaves a lot of room for interpretation. While we are supportive of the linkage with internal risk management processes [reference B2-B4], it would be beneficial for additional clarifications to be provided on the expectations surrounding the definition of "collectability reaches a degree of uncertainty such that results in the entity's credit risk management objective changing". It is possible that the current definition could favour organizations with weak credit risk management functions. The sooner a loan is identified as being in trouble, the sooner it

will find its way into the bad book, and the expected losses based on bad book designation will result in a higher allowance than if it was designated as a good book loan.

In the absence of the additional clarification we believe preparers will be overly interpretive of the definition and we are sensitive to such over-interpretation. For example, the inclusion of the potential bad book indicator of "making contact with the debtor by mail, telephone, or other methods" is an example [reference – B3]. In many cases, banks make contact with or put borrowers on a watch list in order to be proactive, but it does not necessarily mean that intent has changed. There is often a continuum along which borrowers begin to show more and more signs of financial distress causing banks to monitor them more closely and work with them in different ways. As a result, identifying the exact point at which intent changes will be difficult.

We are supportive of the principles embedded in IAS 39 on determining when a loan would be included in the bad book (i.e. when it is probable that the contractual principal and interest are not expected to be collected). This would provide clarification on distinguishing loans for purposes of determining credit impairment between good and bad books, and improve comparability across different institutions in various jurisdictions.

Question 7

Is the requirement to differentiate between the two groups (i.e. '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?

Answer:

The practice of differentiating between good and bad loans based on status is consistent with current risk management practices followed by Canadian Banks. However, our response to Question #6 highlights some difficulties in applying the requirements of the suppED which will introduce some operational and audit issues. Subject to additional guidance on distinguishing loans between good and bad books, we have not identified any significant operational concerns based on our understanding of the guidance provided in the suppED.

Question 8

Do you agree with the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

Answer:

We support the requirement to differentiate between the 'good book' and 'bad book' for the purpose of determining the impairment allowance. See answers provided under Questions #6 and #7.

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.

Answer:

We encourage the IASB and FASB to consider the use of only one approach to measure credit impairment. However, we will accept the inclusion of a secondary approach if the two boards consider it necessary to achieve convergence. . Our primary concern lies in the impact to financial statement users and management and their ability to understand and interpret the application of two approaches in determining credit impairment. This impact is dependent on understanding the parameters or triggers by which the credit allowance determined by the floor approach will exceed the time-proportional approach, and the relative sensitivity of moving from one approach to the other. In the absence of performing detailed modeling and stress testing (which we have not yet had the opportunity to complete), we are unable to predict the outcome of adopting the two different approaches. Accordingly, we can only speak to suppED's proposals from a conceptual basis.

We believe additional guidance on foreseeable future would limit the risk of incomparability between entities and limit geographic misalignment. Financial statement preparers can interpret this concept differently. As there is ambiguity surrounding the definition of foreseeable future, the differences in application are likely to reduce the comparability between companies. Furthermore, regulators in different jurisdictions could impose different "rules" on how to define "foreseeable future' in the absence of detailed guidance.

There are various factors that would impact the foreseeable future period, such as the depth of the data available, the stability of the economy, and business models in place to reliably forecast. We believe that the floor, as currently described, could be punitive for institutions with more sophisticated business models and data depth, thus having a longer foreseeable future period which in turn could generate a higher allowance.

We believe that the foreseeable future period should be adjusted as required. Changes in the portfolio or economic outlook could affect an entity's ability to forecast. During an economic downturn, uncertainty regarding the future is at its highest where the range of possible losses would be at its widest. This would require significant use of management judgment. The ability to reliably forecast is reduced, and thus it would be appropriate to shorten the foreseeable future period.

We believe the floor should behave as its name suggests whereby the amount of credit impairment determined under this approach would seldom exceed the time-proportional approach. The term foreseeable future should have prescribed limits in terms of the time period and/or application of restrictions to only certain portfolios that are likely to incur losses earlier in the life of the portfolio as determined by management. In our view there are complexities for management and financial statement users and operational burdens associated with calculating two expected loss approaches. However prescribed limits or application of restrictions would moderate these unfavourable impacts.

We understand that the hybrid model may be considered necessary to achieve convergence. However, this has resulted in the unexpected consequence of the introduction of a floor based on foreseeable future. We kindly request that the Board be open to additional comments, if we and other international banking associations are provided the opportunity to complete detailed quantitative assessments of the impact and interplay of the time-proportional approach and the floor.

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.

Answer:

We believe this analysis to be critical to both our understanding as well as the Board's prior to their finalizing accounting guidelines for credit impairment. See our answer to question #9 for further discussion.

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?

Answer:

It is our preference that flexibility be removed in favour of comparability. While smaller institutions may not have as sophisticated systems, their loan portfolios may not have the same level of complexities as a larger institution such that the application of a discounted estimate would not necessarily be a constraint. We also note that the suppED does not specify whether a discounting approach should be consistently applied to all of an entity's portfolios or whether it can select different methods for different portfolios. At a minimum we believe an entity should be required to apply one method consistently across all its portfolios.

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 recognise expected credit losses over the life of the assets)? Why or why not?

Answer:

We strongly support convergence and also support the concept of good book and bad book, the decoupling of the expected credit loss concept from interest revenue recognition and the operational relief associated with the recognition of expected credit losses on a time-proportional basis through the use of weighted average age and weighted average life of the portfolio introduced in the suppED.

Our concern with the common proposal is the complexity of employing two approaches (time-proportional and the floor), and its impact on management and users, as well as the related operational burdens.

Our preference would be dependent on a better understanding both approaches both from an operational perspective as well as quantitatively.

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?

Answer:

Our preference would be dependent on a better understanding of the floor or FASB approach both from an operational perspective as well as quantitatively. Also, see answer provided to Question #12.

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?

Answer:

We strongly support the concept that the effective interest rate should be separate from the consideration of expected losses, which is consistent with how banks manage their business, i.e. banks manage interest rate and margins separately from credit risk. Aligning the accounting of credit impairment with credit risk management practices will result in information that is relevant to users. While risk of default is inherently embedded in a loan spread at time of origination, subsequent to loan origination the risk of default and actual defaults are managed separately from interest rate risk and margins. And consistent with how these risks are managed, banks typically store and manage interest rate data and credit risk based data on different systems. We believe that the definition of the effective interest rate under IAS 39 should not be changed to incorporate credit losses and expected losses should be accounted for separately. Management will always be better able to provide more meaningful disclosure to users if that disclosure is aligned with how the business is managed.

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?

Answer:

We would support the requirement that loan commitments be subject to the same impairment requirements as loans for the reason that the risks of the exposures for loan commitments are measured in the same way as loans, i.e. it is the same borrower and typically the same collateral backing it. Therefore, as management monitors and measures the risk for off balance sheet exposures the same way as for on balance sheet, then both should be subject to the same requirements.

Question 16Z

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

Answer:

Based on our preliminary review we have not identified any additional operational concerns over and above what has been previously noted in the context of loans.

Question 17Z

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

Answer:

We have no concern with the presentation of the credit allowances as proposed.

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?

Answer:

We are concerned with the extent of the disclosure that is being proposed. Users will be saturated with information and be faced with having to learn and understand two fundamentally new methods to measure credit impairment – the time-proportional and the floor.

Information that we do not believe to be particularly useful to users of financial statements include expected loss by credit grade, along with information by credit grade such as amount expected to be impaired given a default, exposure at default, and probability of default. Although credit grades are input into calculating expected losses, credit allowances are calculated at the portfolio level, not at a credit grade level, accordingly this disclosure is not aligned with current risk management practices, nor is it information that is currently collected.
Under the expected loss methodology we would continue with the practice of determining credit allowances at the individual portfolio level. Therefore, any allocation of the allowance to credit grades would be somewhat arbitrary.

Financial institutions already have robust disclosure related to loans and credit impairment which would continue under an expected loss approach. Additionally, we disagree with the disclosures around the transfers between the good and bad books, as discussed in our response to Question 19Z.

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?

Answer:

In our view, the disclosure of transfers between good and bad books is neither relevant nor practical. The good book loan allowance is a statistical concept, while bad book allowances are more likely be determined on a loan by loan basis for individually significant loans. Accordingly, disclosing the transfer between the two books is of little value. Under existing IFRS guidelines the collective impairment allowance is a statistical concept while the individually assessed credit allowance is typically on a loan by loan. While theoretically there is a transfer from the collective to the individually assessed as credit losses emerge, the two balances are point-in-time measures and hence the transfer concept is not useful in today's practice.