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

Comments on the Supplement to ED/2009/12 Financial Instruments: Amortised Cost and Impairment

We are pleased to comment on the Supplement Document ("SD") to ED/2009/12 Financial Instruments: Amortised Cost and Impairment.

We welcome the efforts of the IASB to simplify some aspects of the initial ED to make the approach more operational for open portfolios, in particular the proposal to separate calculations and recognition of interest revenues and expected credit losses (i.e. "decoupled" instead of "integrated" interest effective rate), which we advocated for in our comment letter to the initial ED.

However, we have some concerns regarding the common IASB/FASB approach proposed in the ED.

While we acknowledge that convergence is an objective, we believe that it should not override the objective to reach a consistent and meaningful impairment approach. In our view, the common approach proposed in this SD does not reach this objective insofar as the two boards have not defined a single principle that should drive the common approach. It is more a layering of proposals with different objectives: the IASB aims to maintain a relationship between the pricing of loans and expected credit losses while the FASB's objective is to reflect on the balance sheet all credit losses expected to occur in the foreseeable future.

The common approach thus combines these two views by requiring as an allowance for the "good book" (performing loans), to book the higher of the time proportional amount of expected losses and the losses expected to occur in a foreseeable future of at least one year. Especially for short and medium term loans, this approach would lead to immediate recognition of all expected losses, as a day one loss. We are concerned that by ignoring that future interest revenues are priced to cover expected credit losses such an approach will distort the profitability of the lending activities. Further, the usefulness in terms of information to the market will be highly questionable given the lack of clarity of the notion of "foreseeable future", the diversity in practice between banks and geographies and the potential switch from one principle to the other at different reporting dates, without any sound rationale: this will inevitably impair comparability.

Beyond this lack of conceptual justification, we oppose the common proposal due to its potential operational complexity. This approach would indeed require different sets of assessments and calculations at each reporting date (i.e. each quarter for banks reporting quarterly) which could be burdensome and costly without any benefit.

We remain supportive of the fundamental principle that, to the extent that cost of risk is embedded in the pricing of a loan, expected credit losses should align, as much as possible, with interest



revenues. Therefore, we favour the "IASB only" proposal which we believe would better approximate this objective. In our view, this approach based on a time-proportional model for the good book does not need any additional overlay such as the "foreseeable future floor". The only floor should be the allowance needed to fully cover incurred losses on the bad book.

Still, regarding the transfer mechanism between the good book and the bad book, we encourage the IASB to clearly state that the available provision for the good book should be used to cover incurred credit losses. When determining the expected loss on the good book, the effects on the portfolio from the bad book should be taken into consideration.

Finally, we would like to draw the attention on the fact that the "piecemeal" due process does not allow for an overall view of the proposals and a clear understanding of the interaction between the supplementary document and the initial ED, especially regarding disclosures. We call for a single model of impairment for all financial assets (including loan commitments and financial guarantees) and we do believe that it is critical that constituents are given the opportunity to assess and comment on the whole proposal before it is completed by the IASB.

Our detailed answers to the questions are included below. Should you have any questions regarding our comments, please do not hesitate to contact us.

Sincerely,

Gerard Gil

Deputy CFO



# **DETAILED ANSWERS TO QUESTIONS**

#### **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,

Broadly, we agree that the proposed impairment approach for open portfolios would allow for earlier recognition of credit losses than the current IAS 39 incurred loss model. As stated in our comment letter to the *Amortised Cost and Impairment* ED, we are supportive of a forward-looking approach.

However, as detailed in the following questions below, we have concerns about some aspects of the common approach proposed as a compromise between the IASB and the FASB. The lack of a single general objective as a driver for this compromise indeed leads to a common proposal without any robust conceptual basis and with operational complexities.

We agree with the "IASB only" approach based on the principle that the recognition of expected credit losses should be aligned as much as possible with interest income. In our view, such an approach would also allow for an earlier recognition of expected losses as compared to the incurred loss model under IAS 39.

## **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 have a strong preference for a single impairment model for all financial assets and for financial guarantees and loan commitments. Several models for different instruments would add complexity.

In our view, the time-proportional approach proposed by the IASB for the good book would be operational for other types of financial assets, either managed in open portfolios, closed portfolios or on an individual basis. The IASB model which also requires a full coverage of expected losses when the loans turn bad would be sufficient, without any additional layer.

Regarding loan commitments and financial guarantees please refer to the dedicated question below (16Z).



## **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 respect to the good book, we agree with the time-proportional approach only, without any "foreseeable future" floor due to the potential complexity and lack of consistency and usefulness of the common approach implying different methods for estimates, calculations and comparisons at each reporting date (ref question 9).

#### **Question 4**

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

We believe that the proposed approach to determining the impairment allowance on a time proportional basis is operationally feasible. However, sufficient lead time and specific investments will be needed to implement a consistent approach throughout our whole group.

#### **Question 5**

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

No, we believe that the combined approach of a time-proportional and a foreseeable future model would not provide decision-useful information, in particular for the reasons expressed below in question 9. Moreover, the flexibility included in the foreseeable period definition could even provide misleading information such as an increase in allowance due to a more stable economic environment (and therefore supposed to be "more foreseeable").

## **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 requirement to differentiate between the good book and the bad book for the purpose of determining the impairment allowance is clearly stated. In our view, the broad principle defined would be consistent with internal credit risk management.

However, even if the two books are operationally different, expected loss estimates should not be made separately (refer to question 19Z).



#### **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 answered in the previous question, the requirement to differentiate between the good book and the bad book for the purpose of determining the impairment allowance is broadly consistent with internal practice regarding credit risk management. Therefore from our perspective, the requirement would be operational and also auditable to the extent that it would be based on documented criteria and procedures.

#### **Question 8**

Do you agree with that 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?

Yes, we agree.

#### **Ouestion 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?

No, we do not agree with the proposal to require a floor for the impairment allowance related to the good book, in particular for the following reasons:

- the IASB and the FASB did not reach any consensus for a single principle that should drive the impairment methodology, each of the boards stuck to its own initial objective. Therefore the proposed common approach is an overlay of two different sets of proposals with two different principles which at some point may be conflicting: the IASB is deemed more focused on the relationship to be maintained between interest revenues and expected credit losses while the FASB's objective is based on the immediate recognition of all credit losses expected to occur in the foreseeable future;
- in our view, there is no clear conceptual justification for the floor to be integrated in the time proportionate approach proposed by the IASB;
- as stated in our previous comment letter to the *Amortised Cost and Impairment* ED, we are supportive of the IASB objective and thus of the time-proportionate approach which approximates the principle of the initial ED while ensuring operational feasibility. We believe that there is no need for an additional floor on the good book, the full coverage of the expected losses of the bad book is a sufficient complement to the time proportional amount of allowance on the good book;



- the foreseeable future floor proposed under the common approach would lead to the recognition of day one losses. This approach ignores that part of the interest revenues that will be accounted for during the life of the loans aims to cover future credit losses and we are concerned that such day one losses would distort the profitability and the performance of the activity;
- we also believe that the common approach bears in itself a confusion due to the lack of clarity of the foreseeable future notion and the fact that it is supposed to rely on "reasonable and supportable information" and "specific projections", which means that in contrast, the estimates for the time-proportional amount are not based on such "reasonable and supportable information" and "specific projections". If the latter are, it means that the overall estimates of credit losses over the remaining life should be immediately recognised. Such a hierarchy between approaches seems overly conceptual and may not reflect the reality;
- in addition, the very definition of what is foreseeable and what is not is conceptually difficult to establish: what is the starting point where the confidence interval for the foreseeable future is no longer foreseeable? The lack of clarity of this notion would lead to the lack of its auditability;
- beyond the lack of conceptual justification and a clear principle, the introduction of the foreseeable future floor in the IASB approach, in practice it would add operational complexity by requiring different sets of estimates and calculations;
- finally, given this lack of a conceptual basis and operational complexities embedded in the common approach, we are not persuaded that the foreseeable floor would provide useful information to users. The interaction of the floor and the time proportional amount of allowance and the potential switch from one method to another at different reporting dates would be difficult for preparers to rationalise and for users to understand.
- b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance amount related to the 'good book' only in circumstances in which there is evidence of an early loss pattern?

From our understanding, the "early loss pattern" concept relates to the marginal default probability (or expected loss) curve as observed from the inception of a loan. If this curve shows a peak in the first years, then we are facing an "early loss pattern" situation. While this situation can indeed takes place, we would like to point out that:

- this concept is only applicable to the cases where the bank has a "product oriented" relationship with its customers. Indeed, in the other cases, a defaulting client will have various products with various origination dates at the time of its default: therefore, some of them will have defaulted early in their life, and some others later.
- this behaviour is opposite to what is observed in most cases. A simple explanation is that when a bank is granting a loan, it obviously tries to make sure the client is able to repay it. It is only when time goes by that unexpected difficulties can occur which can ultimately trigger a default of the client.
- finally, this feature is a second order effect: as demonstrated during the crisis, loss patterns are much more explained by economic cycle and / or change in origination standards, and hence cannot be forecasted at origination.

Therefore, we believe that the model proposed by the IASB only, with the time proportional approach for the good book, combined with the requirement to fully cover the expected losses on the bad book would be sufficient to ensure a reasonable accounting treatment for these portfolios.



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?

We do not agree with the proposed minimum allowance for the good book.

d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

We believe that changes in economic conditions would have an impact on the perception one may have of future events. As a consequence of that perception, the period considered as a "foreseeable future" may change depending on economic conditions. In times of economic downturn, "foreseeable future periods" would presumably be shorter to the extent that the high level of uncertainty would make it difficult to develop predictions.

Still, lessons drawn from the recent crisis demonstrate, if need be, that the foreseeable future is highly judgmental and difficult to predict in practice.

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.

As specified in the previous question, the notion of foreseeable future is highly judgemental and could be interpreted and assessed differently depending on different factors (duration of the portfolio, economic conditions). Therefore, one cannot draw a conclusion on whether the foreseeable future period would typically be a period greater than twelve months or not.

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.

Please refer to the previous question.

We believe that the notion of foreseeable future should not be included in the proposal.

## **Question 10**

Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2.1(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.

This would depend on the way the foreseeable future notion would be interpreted. It is likely the common approach would lead to a switch from the time-proportional amount to the foreseeable future floor depending on the circumstances.



#### **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?

Yes, we agree with the flexibility permitted for the use of a discounted or undiscounted estimate and for the selection of a discount rate.

## **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 would prefer the IASB approach because, we favour the general principle underlying the time proportional approach which is to maintain a link between the recognition of interest revenues and expected losses rather than the approach aiming at booking immediately all credit losses expected to occur in the foreseeable future.

In our view, the IASB approach is more consistent with the objective of the original ED and represents a reasonable trade off between i) reflecting the economics underlying lending transactions, ii) achieving an operational solution without undue complexity and iii) ensuring that an appropriate proportion of expected future losses is provided for. (also refer to Q9a)

## **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 at or after the first reporting date after initial recognition of the financial assets)? Why or why not?

No, even if it may appear as less complex, we do not support the FASB approach due to the concerns expressed in the questions above.

## **Question 14Z**

Do you agree that the determination of the effective interest rate should be separate from the consideration of expected losses, as opposed to the original IASB proposal which incorporated expected credit losses in the calculation of the effective interest rate? Why or why not?

We agree with the decoupling approach of the IASB, which deals with the concern expressed in our comment letter to the 2009 ED.



However, the IASB should clarify that the decoupled approach is applicable to all other instruments subject to credit impairment, not only those included in open portfolios.

#### **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?

We think that the time proportional approach by the IASB should be applied to loan commitments and financial guarantees, as banks manage the credit risk of these instruments consistently with other lending activities.

With respect to financial guarantees, we would like to reiterate the position expressed in our comment letter to the *Insurance Contracts* ED to maintain the current option permitted by IAS39:

"Financial guarantees have the attributes of both insurance contracts, transferring risk to another party, and financial instruments, the risk transferred being often credit risk. The proposed principle forces some typical banking business into the scope of the insurance standard, leading to inconsistencies with the underlying business model. Indeed, financial institutions manage financial guarantees issued as part of their credit risk management, consistently with other lending activities.

Therefore, we believe that the final standard should permit an accounting policy choice to classify financial guarantees as insurance contracts or financial instruments, based on the nature of the guarantee and the way it is managed. Such an option would better depict the entity's business model and risk management practices."

In that context, we welcomed the recent tentative decisions of the IASB to maintain the option to account for financial guarantees either as financial instruments or as insurance contracts.

## **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. The separate presentation of gross interest revenue and impairment losses indeed addresses the concern expressed in our initial letter:

"...we do not believe that initial expected credit losses should be presented as part of the effective yield and the additional requirement to separately present gross interest and interest net of initial expected credit losses will be onerous to prepare and meaningless to the users. We believe that credit losses should be presented separately from net interest income in a way that is in line with the entity's current reporting. This is more transparent and provides information that is more relevant for users."



#### **Ouestion 18Z**

- (a) Do you agree with the proposed disclosure requirements? If not, what disclosure requirement 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?

In our comment letter to the initial ED we cautioned about the overload of information and the complexity and the cost to fulfil some of the requirements (e.g. vintage information, sensitivity analyses). The new proposals for disclosures in the Supplementary Document are still rather extensive and in addition to that, the "piecemeal" due process makes it difficult to perform an overall assessment of the disclosures and on their interaction with those included in the initial ED.

Moreover, while the proposals of the new disclosures relate to the common IASB/FASB approach, they are presented as an "IASB only" proposal. Therefore, constituents are required to provide comments on proposals that are supposed to deal with a common approach but for which the FASB's position is not clear.

As already explained in the previous questions above, we are supportive of the IASB time proportional approach, thus we consider that disclosures relating to foreseeable future would not be necessary in the proposal.

Some other specific areas of concern regarding the proposals on disclosures are the following:

- given that a number of disclosures would be required by class of financial assets, the IASB should be clear on how the notion of "class" would fit with the notion of "portfolio" of assets;
- the disclosure on the reconciliation of the good book and the bad book would be overly complex if it aims to include detailed information on transfers between the good book to the bad book and vice versa (example provided in §BZ22). Beyond the substantial investments that this would indeed require for the adapting of systems to track detailed information on flows, it would be very challenging for preparers to rationalise all of these movements and to provide useful information at each reporting date. We encourage the IASB to further consider the cost and benefit of such a disclosure and to simplify this reconciliation;
- the disclosure on the notion of a "watchlist" (§Z15biii) should be further clarified because in many cases there would not exist any objective criteria for such a notion;
- disclosures on credit ratings may represent high volumes of information for large entities (with a significant number of credit rating grades), therefore, disclosures should be limited to the level of information considered meaningful for users;
- Finally, we urge the IASB to ensure consistency with IFRS 7 and the existing requirements regarding credit risk.

# **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?

The Supplementary Document proposes that when an asset is transferred to the bad book, the time-proportional allowance balance of that specific asset should be transferred and then the amount of



expected credit losses is re-estimated for both the good book and the bad book. We believe that this mechanism is unduly complex without any benefit.

We consider that, at each reporting date, the whole amount needed to cover the expected losses of the newly transferred assets from the good book to the bad book should be deducted from the allowance built up on the good book. When determining the expected loss on the good book, the effects on the portfolio from the bad book should be taken into consideration.