Chris Dalton, Chief Executive Officer
Australian Securitisation Forum, Inc.
Suite 605, 3 Spring Street
SYDNEY NSW 2000

(t) + 61 (0)2 8243 3906
(f) + 61 (0)2 8243 3939
(e) cdalton@securitisation.com.au

01 April 2011

Sir David Tweedie
Chairman
International Accounting Standards Board
33 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David,

SUPPLEMENT TO ED/2009/12 *FINANCIAL INSTRUMENTS: IMPAIRMENT*

The Australian Securitisation Forum (ASF) welcomes the opportunity to comment on the Supplement to the Exposure Draft 2009/12 *Financial Instruments: Impairment* (the Supplement). The ASF is the peak body representing a constituency of both bank and non-bank lenders that participate in the securitisation industry in Australia.

The ASF continues to support the International Accounting Standards Board's (IASB) concept of amending the existing model of amortised cost and impairment, particularly the intention to remove some of the 'pro-cyclical' bias of the existing model.

In this letter, we especially highlight certain practical issues and challenges that may arise when adopting the proposed approach.

Please do not hesitate to contact me or the chairman of our Accounting & Tax Sub-committee, Mr Graham Mott (+61 2 9322 7970).

Yours sincerely,

CHRIS DALTON
Chief Executive Officer
The Australian Securitisation Forum

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?

We agree that the proposed model will ensure that expected credit losses are recognised earlier in the lifecycle of an instrument measured at amortised cost. We have outlined our concerns with certain specific details of the proposed impairment model in our responses elsewhere in this letter.

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?

Subject to our concerns outlined in our responses elsewhere in this letter, we believe the impairment model proposed is operational for both open and closed portfolios. The proposed impairment model will in fact be more practicable for a closed portfolio than an open portfolio because the expected loss and run-off of the portfolio will be readily identifiable.

We recommend a single methodology to apply to both open and closed portfolios. Indeed, we believe that a single impairment model is a necessity in order to prevent the difference between open and closed portfolios becoming an arbitrary 'bright line' threshold.

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?

Overall, we believe that the proposed impairment model for financial assets in the 'good book' is appropriate, subject to the concerns outlined below and in our responses to questions 4 to 11.

We would, however, highlight that the proposed impairment model requires entities subject to the Basel III requirements to prepare a minimum of three calculations at each reporting date, which creates an onerous obligation on our constituents, and will cause confusion for investors trying to reconcile the different information.

For example, Basel III requires an entity to calculate the expected credit losses over a 12 month timeframe. The proposed impairment model requires an entity to calculate the time-proportional expected credit losses, and also "the credit losses expected to occur within the foreseeable future (which shall be no less than twelve months after an entity's reporting date)".

We would encourage the IASB to consider refining the proposed impairment approach to be more consistent with the requirements of Basel III, to reduce the burden on entities subject to the Basel III framework.

We note that the Supplement does not define the term 'foreseeable future', other than the "future time period for which specific projections of events and conditions are possible" in paragraph B11 of the Supplement. We believe this definition is open to interpretation and that there could be diversity in application.

Some of our members have noted that the current definition and guidance around 'foreseeable future' could result in a foreseeable future in a difficult market as being a relatively short timeframe due to increased uncertainty, whereas in a good market the timeframe could be longer. We do not believe that this would be a desirable outcome, unless the Boards' intention was for the minimum timeframe of 12 months to address this issue.

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 operational however for our smaller banks and non-bank lender members, the resources to implement complex models and systems solutions will outweigh the perceived benefits. In addition we raise additional concerns identified in questions 5 to 11 below.

Question 5

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

We consider that the most useful information for users will be consistent from period to period, comparable across entities and reasonably simple to understand.

Some of our constituents are concerned that the proposed impairment model permits an entity to:

(a) Choose between a straight-line approach and annuity approach in determining the time-proportional expected credit losses; and
(b) In the case of a straight-line approach, elect whether to use a discounted or undiscounted estimate.

These constituents believe that such a degree of latitude significantly reduces the comparability of information between entities where one entity elects to apply undiscounted straight-line recognition and another entity adopts the annuity approach.

Other constituents recommend taking a principles-based approach, whereby the reporting entity should select the method that most appropriately reflects the characteristics of the portfolio assets.

Our constituents are also divided concerning whether discounting should be optional or required. Some constituents believe that an undiscounted approach would simplify the methodology, while others believe that discounting should be an option if it more appropriately reflects the characteristics of the portfolio assets. Hence on balance we believe flexibility of approach for our members provides a more practical outcome for the smaller entities to reduce the cost of compliance.

We note that the Supplement does not clarify whether an entity should apply a consistent approach in determining the time-proportional expected credit losses to each of its portfolios, nor does it restrict an entity from changing the method of calculating the time-proportional expected credit

losses. We believe that entities should be required to apply a consistent approach from each accounting period to the next.

Questions 6, 7 and 8

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?

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?

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?

In principle, we agree with the proposed impairment model's distinction between 'good book' and 'bad book' portfolios, based on an entity's internal credit risk management objectives. This approach is applied throughout the banking sector, but may generate some difficulties for non-bank entities.

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?

In the view of our bank constituents, the use of a floor may be appropriate in portfolios with evidence of an early loss pattern. Based on our constituents' modelling and historical experience, an impairment provision under the time-proportional approach is often lower than the total expected credit losses in the foreseeable future.

Further, as stated in our response to question 3 above, entities subject to Basel III requirements will need to perform three separate calculations in respect of their impairment allowances.

Our non-bank constituents in particular are concerned that the inclusion of a floor in determining the impairment allowance related to the 'good book' may result in an onerous administrative burden for preparers, particularly where the reporting entity has a more straightforward portfolio or

the preparer lacks the complex reporting systems that may be found in larger banking entities. The requirement to calculate a floor in addition to the time-proportional expected credit losses would result in additional costs of preparation without significant benefit to our non-bank constituents.

Therefore we would welcome flexibility to provide a practical expedient to those less sophisticated lending entities

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.

Our constituents' initial modelling indicates that the floor tends to increase where an open portfolio is increasing in size. Where the portfolio has a history of early losses in the lifecycle, expected credit losses in the foreseeable future is typically greater than the amount calculated in accordance with paragraph 2(a)(i) in the early stages of the asset lifecycle.

In an open portfolio of long-dated assets with a high credit quality, our constituents' results indicate that the amount calculated under paragraph 2(a)(i) of the Supplement is greater than expected credit losses in the foreseeable future.

Based on prior performance, for Prime Residential Mortgage portfolios, the peak arrears emerge at about 18 month seasoning with peak losses at 24 months. Accordingly, the floor concept is likely to produce a higher result in the earlier years and reverse in later years when seasoning starts to reduce the expected future losses.

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?

As stated in our response to question 5 above, we believe a flexible approach towards discounting provides a more practical outcome for smaller entities to reduce the cost of compliance.

Some of our constituents believe that, where discounting is applied, the discount rate should be the original effective interest rate, calculated on a weighted average basis over the portfolio, as the introduction of other discount rates would reduce comparability between entities and not reflect the risk in each portfolio.

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?

We agree with the decoupling of the recognition of expected credit losses from the effective interest rate of a portfolio; however, we have some concerns around the floor concept, as detailed in our responses to question 9 above.

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?

We prefer the IASB approach for open portfolios to recognise expected credit losses over the life of the assets, subject to our concerns identified in our responses to questions 3 to 11 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?

As detailed in our response to the original Exposure Draft ED/2009/12 in June 2010, there are a number of practical challenges and issues that would arise from the incorporation of expected credit losses into the calculation of the effective interest rate. We therefore support the decoupling of the impairment calculation from that of the effective interest rate.

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?

We believe that all loan commitments should be subject to the same impairment requirements, on the grounds that banks typically manage the credit risk of their loan commitments on the same basis as their loan portfolios.

Question 18Z

(a) Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why?

We note that the Boards have deliberated on disclosures in relation to stress testing and vintage information separately. We support the tentative decisions of the Board to remove these disclosure requirements, on the grounds set out below.

Vintage information

In the case of the proposal in the original ED to require entities to disclose vintage information by year of origin and year of maturity, our constituents are concerned that many entities would be unable to capture such information, particularly in relation to long-term customers with facilities that tend to roll over on a continuous basis.

Our constituents do not believe that the cost and effort involved in preparing and reporting such disclosures is justified, given the limited value that such disclosures would provide, given the existing wide-ranging disclosures required by IFRS 7.

Stress testing

While our constituents acknowledge the usefulness of stress testing as a forecasting tool, we note that the extent and degree of stress testing differs widely across the industry and mere disclosure of stress testing information in itself may not present decision-useful information to users of the financial statements. For example, banks with comprehensive stress testing throughout the organisation would have very different disclosures from non-bank entities, and we do not believe such disclosure would enable meaningful comparison.