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IASB

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The IASB's Supplementary Document on the Exposure Draft *Financial Instruments: Amortised Cost and Impairment*

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as by enhancing investor protection.

ESMA has considered through its Standing Committee on Corporate Reporting the IASB's Supplementary Document (SD) to the Exposure Draft *Financial Instruments: Amortised Cost and Impairment*. We thank you for this opportunity to contribute to the IASB's due process. We are pleased to provide you with the following comments aimed at improving the decision-usefulness of financial statements and the transparency and enforceability of IFRSs.

ESMA noted that the IASB, in its report *Work Plan* to the February 2011 meeting of the IFRS Advisory Council, concluded that it could have finalised the requirements without re-exposure and that the Board is publishing this document primarily to benefit from additional operational feedback but considers this additional consultation to be beyond that required by its due process. Our understanding is that this conclusion was reached on the basis that the simplified approach included in the SD is an expected loss model. ESMA strongly disagrees with this conclusion. We do not agree that the simple fact that the simplified approach is an expected loss approach similar to that contained in the original ED provides sufficient justification for not re-exposing it for comment. Indeed, we believe that there are a number of fundamental differences between the two publications such as the decoupling of the rate of interest and the time-proportionality of the expected losses, flexibility regarding discounting and the 'floor' concept. ESMA believes that these changes are significant and deserve re-exposure. Hence, we would have welcomed a longer comment period.

ESMA acknowledges and commends the progress that the IASB and the FASB have made in arriving at a common approach to impairment as set out in the SD. ESMA also notes that this effort is also consistent with the recommendation from the G20 for both boards to complete their work on a single set of improved high quality global accounting standards[1].

ESMA also recognises that the approach set out in the SD will achieve more forward-looking provisioning, incorporate a broader range of credit information, draw from banks' risk management framework and achieve greater transparency. ESMA believes that all of these elements are helpful in providing more useful and relevant information for investors.

ESMA regards the objectives set out by the IASB (that the income statement should reflect the economic reality of lending) and the FASB (the building up of adequate provisions to absorb loan losses) to be complementary in nature and thus agrees that they need to be jointly and equally emphasised. In particular, the notion of the 'floor' is an acceptable solution to allow for adequate provisioning levels where time-proportional allowances are inadequate to cover early losses. The proposal should however be redrafted to avoid that losses in a foreseeable future means an up-front allowance at initial recognition for profitable contracts.

In our comment letter[2] to the ED *Financial Instruments: Amortised Cost and* Impairment, ESMA (at that time CESR) was generally supportive of the IASB's proposals, including the suggested impairment approach as it was based on discounted cash flows but using expected losses. We also welcomed the way the effective rate of interest (used as the discount factor) was calculated.

There are however operational challenges that this approach might pose amongst others to preparers with complex open portfolios. ESMA therefore accepts the simplified model proposed in the SD as a practical expedient, provided that it gives a good approximation to the calculation based on discounted cash flows using the original model. We believe that it is essential for the IASB to provide convincing evidence that the simplified approach provides this good approximation, for example by carrying out field testing. Field-testing becomes even more important if the simplified model would become eligible for closed portfolios and individually assessed assets. In that context, we believe that if the Board would consider making the simplified approach available outside open portfolios, a re-exposure of the standard is necessary.

If in the final standard the simplified approach is extended beyond open portfolios, ESMA would conclude that it is important that this approach is only an option. It is important that preparers are still allowed to

[1] *G20 Seoul Summit Declaration, November 2010.*
http://www.g20.org/Documents2010/11/seoulsummit_declaration.pdf
[2] Available at http://www.esma.europa.eu/popup2.php?id=6963

use the conceptually more sound expected cash flow model in the original ED. ESMA thinks that it is likely that entities would possibly apply the original approach at least on individual assets.

ESMA expects a widespread use of the simplified model not least of all in the banking industry, where portfolios typically are open. It is therefore necessary for the IASB to address a number of concerns to which the SD gives rise:

— It is a prerequisite for ESMA's acceptance of the simplified approach that it is accompanied with robust disclosure requirements in the final standard (see also our response to question 18Z); in particular we would welcome more granularity in the disclosure required regarding the amount of the financial assets, the total amount of expected losses and the amount of the impairment losses. In addition, ESMA thinks it important that there are robust and high quality disclosure requirements on how the estimation is performed;

— We strongly disagree with the proposed flexibility regarding discounting, be it in the option whether to discount or not, or the freedom of choice regarding the discount rate. ESMA finds that the final standard should require the use of the effective rate of interest as the discount rate; and

— We see a need to clarify the distinction between groups (a) and (b) in paragraph 2 of the SD (see our response to question 8). ESMA would also urge the IASB to provide clear definitions for terms such as "non-performing" and "write off".

Our detailed comments on the SD are set out in the Appendix to this letter.

I would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Fernando Restoy
Chairman of ESMA's Corporate Reporting Standing Committee

APPENDIX – ESMA's detailed answers to the questions in the IASB's Supplementary Document to the Exposure Draft *Financial Instruments: Amortised Cost and Impairment*

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?

1. The SD is an important part of the replacement of IAS 39. In our comment letter on the original ED, we stated that we believe that the ED represented a clear improvement to the present (IAS 39) requirements as it is based on an expected loss principle instead of an incurred loss principle. The approach in the SD is also based on expected losses. It will therefore likely promote more forward-looking provisioning and provide more decision-useful information about the effective return on financial instruments by allocating revenue over the expected life using discounted cash flows. ESMA notes that the approach deviates significantly from the approach in the original ED. We understand that the main reasons for that are linked to operational problems faced by preparers.

2. ESMA accepts the simplified model proposed in the SD as a practical expedient, provided that it gives a good approximation to the calculation based on the discounted cash flows using the original model. We believe that it is essential for the IASB to provide convincing evidence that the simplified approach provides that good approximation, for example by carrying out field testing, especially if the simplified model is to become eligible for use with closed portfolios and individually assessed assets.

3. Provided it represents a good approximation to the original model, ESMA can support the simplified approach as a practical expedient. However, as set out in our response to question 11, we have some practical concerns with the suggested simplified approach.

4. In our comment letter on the ED we raised concerns about the distinction between short term trade receivables and other short term loans. ESMA understands that short term receivables without a stated interest rate have been scoped out of the SD and are to be dealt with as part of the IASB's project on revenue recognition (IN15 of the SD). In addition, we believe that the IASB has found an appropriate solution on how to draw a line by relating it to the characteristics of the receivable (i.e. it is without a stated interest), and that how it was originated ("trade") is not relevant for the scope exclusion).

5. ESMA notes that scoping out short term receivables is also based on the assessment of what short term means. According to the SD a receivable is short term if the effect of discounting for the time

value of money is immaterial. It is our understanding that the short term definition will vary with the discount rate and that the higher the discount rate the shorter the life of the receivables which are excluded. This means that the trade receivables that are scoped out in one period (because the time value of money is low) may be scoped in in another period (where the time value of money is higher). In addition, what is immaterial for one company can in the same period be material for another based on the facts and circumstances, meaning that companies shall treat alike receivables differently. ESMA urges the IASB to consider whether this is an acceptable consequence.

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.

6. It is not clear to ESMA at this stage what the implications would be if this model were also to be used for closed portfolios and single assets. It is therefore difficult reach a final position on this question.

7. It is ESMA's expectation that the simplified approach will be widely used, especially in the banking industry where complex open portfolios are rather common. We understand that the IASB considers the simplified model to be a good approximation of the model exposed in the original ED. As set out in our response to question 1 we believe that it is essential for the IASB to provide convincing evidence that the simplified approach provides a good approximation, for example by carrying out field testing. This becomes even more important if the IASB were to consider that the simplified model should become eligible for closed portfolios and individually assessed assets. If that were to be the case, we believe that the Board should re-expose the proposals.

8. ESMA continues to support the approach chosen in the ED (a discounted cash flow model using the effective interest rate including expected losses as the discount factor) and supports the simplified approach as a good approximation to that model. We therefore think that the possibility should remain for preparers of financial statements to use the full model. It seems inappropriate to us not to allow the use of a model that is conceptually more sound than the simplified approach.

Question 3

Do you agree that for financial assets in the 'good book' it is appropriate to recognise the impairment allowance using the approach described above? Why or why not?

Question 4

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

Question 5

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

9. According to paragraph B2 of the SD an entity should distinguish between the two groups on the basis of its internal risk management. The paragraph explains that some entities have different objectives for the two groups: for the first group the objective is receiving regular payments from the debtor while the objective for the second group is the recovery of the asset. The dividing line is the degree of uncertainty about the collectability of the financial asset. ESMA believes that there is a need for clearer principles on how to make this distinction.

10. It is unclear to us why this shift in focus should be the trigger factor for the creation of two distinct groups and movements between them. The degree of uncertainty is a continuum and it is totally up to the management of an entity to decide when their focus is shifting which means that it could be very difficult to compare financial statements across preparers and as an enforcer it could be hard to challenge any dividing line chosen. Clearer principles are needed. Such principles could be based on what could be considered a "good" credit risk policy which is in cases of growing uncertainty over collectability to intensify the management of the asset or group of assets in order to sustain the objective of receiving regular payments of the financial asset.

11. The IFRS Framework makes clear that IFRSs do not differentiate between types of reporting entities. We therefore regret that the Board uses terms that are specific for a certain industry and which often have their origin outside financial reporting. We believe that industry-specific language should be avoided – including the use of the terms 'good book' and 'bad book'. In addition, if the Board would continue with these terms we believe that clear definitions should be provided.

12. ESMA encourages the Board to provide further explanation and guidance regarding the distinction and transfer from group (a) to (b). ESMA believes that a sound example might be debt restructurings within a portfolio. Indeed, if there are debt restructurings in a portfolio: should the portfolio be transferred systematically to group (b)? If so, at which moment? Are there any specific trigger events to consider? After the restructuring, should the portfolio be retransferred to group (a)? Moreover, ESMA considers that the Board should clarify precisely how to account for a transfer from the group (a) to group (b): how precisely is the amount transferred calculated?

13. ESMA thinks that a good way to address these issues would be to provide some examples over a period of time dealing with transfers from one book to another and also with the recalculation of the time proportional allowances when an amount of amortization was accounted for because of the floor.

14. ESMA believes that in order to achieve consistent application, comparable results and to increase the enforceability of the standards, the IASB should give consideration to:

— the fact that keeping the division on the face of the balance sheet could increase the risk that it is considered to be two degrees of impairment (impairment that is more a hidden reservation of equity rather than "real" impairment). We believe that this could represent an "unhealthy" situation from an accounting point of view and would therefore expect strong disclosure requirements on how an entity distinguishes between the two groups. Robust disclosure requirement on changes in the principles for drawing the line between the two groups (why is the change made and what is the impact of the change) are needed as well; and

— The proposals also lack principles for how lifetime expected losses should be calculated and how, for instance loan prepayments and extensions should be dealt with under the model. Guidance about how to weight external against entity specific data as well as historical data against current economic conditions and supportable forecasts would be helpful.

15. The IASB had not specifically dealt with the measurement of collaterals. ESMA thinks it important that this is dealt with in a way that removes the present ambiguity in IAS 39.AG84. ESMA has in its capacity as enforcers seen divergent interpretations of this paragraph: whilst some preparers use the future (at the time of realisation of the collateral) fair value taking into account expected price increases and discount the amount using the effective interest rate on the loan, others are using the actual fair value without taking into account that the timing of this cash flow is in a future period (no discounting) and still others use the present fair value as the best estimation of the future fair value and discount it. Though the results using one or other of the various interpretations vary substantially enforcers have found it difficult not to accept all three interpretations given the present wording of the paragraph.

Question 6

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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?

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?

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?

16. Paragraph 3 of the SD states that entities often manage financial assets in group (b) on an individual basis and separate them from the financial assets for which the credit risk management objective is receiving the regular payments from the debtor. Maybe this could form the basis for a definition combined with principles such as days past due, or whether the expected return is below the risk-free rate. On the other hand 'doubtful loans' or 'problem loans' do not seem conceptually sound concepts to us either.

17. In its draft comment letter EFRAG is supportive of using the two group approach but thinks that the guidance is designed only for entities which have fairly sophisticated credit risk management activities. Hence EFRAG suggests rewriting paragraphs B3 and B4 in such a way as to make a distinction between the guidance for entities having a risk management strategy which is based upon the uncertainty of collectability and those who do not. As ESMA is asking for more robust principles to draw the line between the two groups we think that the problem should be addressed differently. A minimum requirement must be that the distinction also complies with the entity's risk management policy (which should be disclosed). In the rare circumstance where an entity does not have a risk management policy, ESMA believes it is difficult to see how guidance on how to make a clear distinction between the two groups could be provided.

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 to the impairment allowance related to the 'good book'? Why or why not?

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(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 recognied under the 'floor' requirement (for example, no more than three years after an entity's reporting date)? If so, please provide date and/or reasons to support your response.

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.

18. The IASB suggests in the SD recognising the higher of the time-proportionate expected losses and the losses expected to occur within the foreseeable future. The need for this seems to stem from the fact that the time-proportionate expected losses are not (always) a good reflection of the actual expected loss pattern. Losses are often not time-proportionate but depending on the type of loan there could be early losses or losses only after some years. Patterns could also vary over the economic cycle.

19. The use of an up-front allowance representing the losses in the foreseeable future has the consequence that an entity may have to recognise day one losses at initial recognition even if these early expected losses are incorporated into the interest rate on the loan. This is especially the case when dealing with acquisitions of loans, where loan portfolios are growing, or where new entities are established. Under more stable situations (the size of the loan portfolios are relatively constant) the problem seems to be less urgent. From an accounting point view these day one losses on profitable

loans seem incompatible with usual principles and seem more to be in accordance with prudential regulators' thinking about capital requirements. As a minimum the proposal should be redrafted to avoid the situation where a loss in a foreseeable future means an up-front allowance at initial recognition for profitable contracts. The IASB may need to consider whether the 'foreseeable future' should be replaced by the 'near future' especially when the average life of the portfolio is the foreseeable future. ESMA also thinks that the term 'foreseeable' or 'near future' should be clarified either in the text itself or in the application guidance in order to ensure consistent application of this principle and to facilitate enforcement.

20. ESMA has difficulty with the IASB's provision that the period should be at least 12 months. ESMA is aware that such a 12 month minimum is used for capital adequacy purposes but prefers a principle based approach for accounting standards and also expects the foreseeable future to vary across portfolios and geographies (hence the reasons why we would not support the use of a ceiling). In addition, continuing with a 12 month period in the standard could invite "lazy accounting" where the entity simply chooses a 12 month horizon because this is the one required by some prudential regulators. Introducing an extra criterion for using this allowance in the form of an early loss pattern, cf. question 9(b), does not seem well founded because if the losses come late in the life of the loan this allowance would typically be less than the time proportionate allowance. If the concept is kept ESMA thinks it crucial to have disclosure requirements about the entities choice of foreseeable futures and if they are changed from one period to another at least details of why they are being changed and the impact of the change.

21. It is crucial for ESMA that the final standard explains the method better and makes it clearer that losses estimated using this proposal are **not the same** as those derived from prudential requirements and more specifically the Basel capital adequacy requirements although similar terminologies are used to a certain extent (such as the probability of default, the loss given default and foreseeable future).

22. In addition, we believe that the standard should make clearer that when disclosing the entity's choice of foreseeable future the entity should describe how it was determined and that if they choose a period of 12 months that it is not sufficient to argue that they have used the time horizon used for capital requirements.

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 discount expected loss amount? Why or why not?

23. ESMA thinks that the proposed flexibility related to using undiscounted cash flows is inappropriate. ESMA finds that the use of undiscounted amounts has no conceptual merit and would result in a net balance sheet item comprising an amortised cost gross amount using the effective interest rate as the discount rate and an undiscounted allowance amount. Giving preparers the option to choose whether to discount or not would also result in non-comparable financial statements because the figures will vary materially from one set of financial statement to another only because of the different choices by one preparer compared to another. If the differences are not material it follows already from IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* that an entity does not have to follow a requirement for discounting.

24. ESMA also disagrees with the flexibility proposed for the choice of discounting rate and does not understand the rationale behind it. According to the SD the flexibility is intended to make discounting operationally feasible. In order to calculate the interest income on a portfolio the entity has to find the effective interest rate on the portfolio, and it is difficult to understand why it cannot use that effective interest rate in the calculation of the losses. ESMA believes that this does not result in decision-useful information and benefits preparers at the cost of users of financial statements. ESMA would prefer that the final standard should require the use of the effective interest rate as the discount rate.

25. ESMA would agree, from a conceptual point of view, with flexibility regarding the use of a straight line approach or annuities. However, we believe that this option could impair comparability and would prefer to limit the proposals to the straight line method.

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?

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 FASAB 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?

26. ESMA prefers to recognise losses over the life of the assets in the same way as interest income is recognised. As set out in our response to questions 9 and 10, this is also why we find the floor approach problematic in its current wording.

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 incorporate expected credit losses in the calculation of the effective interest rate? Why or why not?

27. As mentioned earlier ESMA prefers the determination of the effective interest rate including expected losses as proposed in the ED because it was conceptually better founded and gives a better presentation of the return on the assets concerned. ESMA however acknowledges that the arguments for the decoupling are based on operational aspects.

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 IAS37) 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?

28. ESMA sees conceptual problems in treating loan commitments in the same way as loans and prefers the present treatment in IAS 39 where onerous ones are treated as liabilities using IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* for measurement purposes. As set out in our comment letter to the ED it is difficult to accept recognition of impairment losses for assets not yet on the balance sheet (future loans) because this would not be in line with fundamental accounting principles. Only assets recognised at the reporting date should be included in the impairment calculation.

29. That said, ESMA asks for clarification by the IASB on whether the assessment of loan commitments under IAS 37 should include expected credit losses (calculated in accordance with the requirements

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set out in the SD). This would mean that loan commitments were still assessed under IAS 37, but that the assessment would be on the basis of their expected cash flows rather than on their contractual cash flows, which ESMA believes is a more appropriate basis.

30. In our comment letter on the ED we also agreed with the IASB that financial guarantee contracts should be assessed on the basis of whether they include insurance risk or not. If so they should fall within the scope of IFRS 4 – *Insurance Contracts*. The very fact that some banks lump them together with loans cannot justify break the overarching principle that assets and liabilities should be treated according to their characteristics independent of on which entity's balance sheet they are recognised.

Question 17Z

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

31. ESMA believes that the proposed presentation requirements are in line with the other proposals set out in the SD. They provide valuable information about the extent to which interest income represents compensation for credit losses. This would be one of the areas that would need further attention if the IASB would continue with the new model as a practical expedient for complex open portfolios.

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 or instead of the proposed disclosures) for the proposed impairment model and why?

32. ESMA sees a need for robust and comprehensive disclosure requirements regarding the operation and results of an expected loss approach. This is essential for the provision of understandable and comparable financial statements and will also be helpful in relation to the enforcement of the standard.

33. ESMA agrees in general with the individual disclosure requirements in paragraphs Z6 to Z15. However, we would welcome more granularity in the disclosures required in paragraph Z8 regarding the amount of the financial assets, the total amount of expected losses and the amount of the impairment losses.

Additional Disclosures necessary for users

34. Given that the outcome of the proposed loan loss provisioning model (the original model as well as the simplified one) is highly dependent on the estimation of future losses and that the estimation of such losses will require significant judgement, ESMA finds it important that there are robust and high quality disclosure requirements around how the estimate is performed (which parameters are taken into account, how the history of losses is used, how actual tendencies are judged, which assumptions on the future are used etc.) In this regard also sensitivity analysis of inputs and assumptions should be required.

35. ESMA also finds that the disclosures required in paragraph Z12 on how previous estimates compare with actual outcomes is crucial for users to gain an understanding of the reliability of the estimates made. ESMA would prefer a requirement for back testing so as to always enable a quantitative analysis to be performed as a qualitative analysis alone is much less transparent for users. ESMA urges the IASB to consider imposing a requirement for loss triangles inspired by the requirements in the ED *Insurance Contracts* to be provided. On top of the quantitative analysis a requirement for a qualitative analysis including a discussion of relevant data is needed.

36. ESMA also believes that disaggregated information on the impairment losses recognised in profit and loss is essential and prefers to see this as a disclosure requirement in the standard itself rather than as application guidance as suggested in the SD.

37. According to paragraph Z14 an entity should disclose by rating grade a number of pieces of information. Some banks may have chosen to segment their borrowers especially corporate ones according to criteria other than credit risk rating grades for instance by industry. ESMA hence suggests that this disclosure requirement is generalised so as not to force on the one hand an entity to use rating grades, and on the other to require similar disclosures if other criteria are used.

Further clarification

38. ESMA finds that good and clear definitions of the terms “non-performing” and “write off” are critical and encourages the IASB to include such definitions in the final standard.

39. The example given in BZ20 for a financial institution could give the impression that “corporate” is normally the right level of granularity. However, this is a very non-homogeneous class and further disaggregation would in most cases be necessary in the same way as is required for retail (though maybe on the basis of other characteristics – the main criterion being dissimilarity).

40. Regarding the allowance reconciliation in paragraph BZ22 the example is not easy to follow and would benefit from an exchange of the x's, y's and z's for figures. ESMA also wonders in what line the allowance effect of transfers from group (b) to group (a) would be included. In addition, an explicit requirement for disclosing an articulated policy for transfers between the two groups is essential given that the timing of such transfers impacts provisioning levels.

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 loss of the financial asset?

41. ESMA would like to invite the IASB to provide more rationale for its proposals regarding transfers between group (a) and (b).

42. We agree with the IASB that all approaches should result in the same impact on profit and loss and the allowance amounts for group (a) and group (b). For transfers from (a) to (b) it is therefore crucial that the allowance amounts for both groups are recalculated, both allowance amounts being adjusted to the appropriate levels.