



International Accounting Standards Board

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United Kingdom

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E-MAIL

EACB Comments on IASB Request for Information on "Expected Loss Model"

Dear Sir/Madam,

On behalf of the European Association of Cooperative Banks, we gladly take the opportunity to respond to the IASB Request for Information on Expected Loss Model, Impairment of Financial Assets: Expected Cash Flow Approach.

In fact, our members consider the IASB Staff paper very high-level. Accordingly, at this stage it seems almost impossible to get a clear cut picture of the approach and to assess all consequences of applying a new approach as the expected Cash Flow Approach. Nevertheless, it is our impression that the proposed approach will not result in a reduction of complexity. As for the next steps we would like to underline the importance of a convergence with any prudential approach, as describes by the Basel Committee in "BCBS Guiding principles for the replacement of IAS 39" (August 2009).

Please find below our comments and responses to the individual questions.

Kind regards,

Hervé GUIDER
General Manager

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Head of Unit

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Question 1: Is the approach defined clearly? If not, what additional guidance is needed, and why?

In our opinion the IASB staff paper is very high-level and lacks some important details at this stage. Therefore, we would appreciate if additional guidance would be considered on the following items:

What happens if credit loss data/ default rates are for whatever reason not available, e.g. for certain types of financial assets?

We highly appreciated that the IASB staff paper included an example. Nonetheless, it is a very basic example. Therefore, it would be very helpful to get more complex/detailed examples, impairment on portfolio basis.

As financial institutions are highly regulated we strongly expect that any new approach should be convergent with Basel II.

Question 2: Is the approach operational (i.e. capable of being applied without undue cost)? Why or why not? If not, how would you make it operational?

In our point of view the implementation of the proposed impairment model is very challenging. A profound evaluation if the approach is operational highly depends on further and more detailed explanations and guidance (see question 1).

But as a matter of fact it can be stated that the calculation of the effective interest rate at inception will be very complicated under the proposed approach when credit losses have to be considered - and further amortised cost adjustments on a continual basis will also be very burdensome.

We would like to point out that from our financial institutions' perspective the proposed approach does not result in a reduction of complexity and does not necessarily result in better loan loss provisioning. Under the current approach single loan loss provisions are considered as soon as trigger events occur. In determining the recoverable amount expected cash flows are defined on a single deal basis and are therefore very accurate. Currently, portfolio loan loss provisions are calculated based on expected losses already, though upon at the occurrence of a trigger event. Those are in accordance with the rules of Basel II; the calculation includes the factors "probability of default" (PD, factor depends on the internal rating of the respective customer), "loss given default" (LGD) and "loss identification period" (LIP). As a result of the incurred loss approach it can be stated that all financial instruments measured at amortised cost are considered when determining loan loss provisions - either as single or portfolio loan loss provisions.

With this concept in place the question arises what are the advantages of the proposed approach would be. In fact, in many cases the most likely scenario is that all contractual payments are settled completely; then it should not be necessary to recalculate the effective interest rate and calculate an impairment loss respectively a later positive adjustment (e.g. reversal of impairment without an earlier impairment!). Only if the most likely scenario is that contractual payments are not settled completely, impairments should be considered. For differentiation purposes impairment triggers would still be required.

Question 3: What magnitude of costs would you incur to apply this approach, both for initial implementation and on an ongoing basis? What is the likely extent of system and other procedural changes that would be required to implement the approach as specified? If proposals are made, what is the required lead time to implement such an approach?



At this early stage and with regard to the remaining open questions it is rather difficult, if impossible, to give a realistic estimate of cost that may occur from implementing the expected cash flow approach.

But applying the new approach would cause immense costs.

(Additionally, it has to be kept in mind that the implementation of the incurred loss model including a solution for single loan loss provisions and portfolio loan loss provisions caused immense costs already).

- It would be necessary to amend the IT systems that the EIR according to the expected cash flow approach is calculated.
- An IT-solution would have to be implemented to generate the required credit loss data/default rates.
- A new IT-solution would be required to calculate the impairment loss (initially and subsequently) according to the expected cash flow approach automatically including generation of booking entries.
- Furthermore, banks will still have to handle contractual data for various reasons, which means that two IT systems will have to be maintained, as already is the case today but with less important volumes of data.

Implementing the current incurred loss approach including the IT-solution took approximately two years. Within this project the existing IT-system was amended extensively. Implementing the new approach would take probably even longer as a complete new IT-system would be required.

Question 4: How would you apply the approach to variable rate instruments, and why? See the Appendix for a discussion of alternative ways in which an entity might apply the expected cash flow approach to variable rate instruments.

On the *amortisation of upfront fees* on variable instruments, we would prefer using effective interest rate calculated upon initial recognition of the instrument (**Approach A described in A4**)

On the *amortisation on impaired variable interest rate loans*, we would support the recalculation of the effective interest rate so that the still expected future interest and principal receipts are discounted to the carrying amount (**Approach A described in A6**).

Question 5 – How would you apply the approach if a portfolio of financial assets was previously assessed for impairment on a collective basis and subsequently a loss is identified on specific assets within that portfolio? In particular, do you believe:

a) changing from a collective to an individual assessment should be required? If so, why and how would you effect that change?

In our opinion a reporting entity should be able to choose whether it removes a financial asset, for which performance has become more doubtful, from a portfolio of performing assets. This choice should reflect the individual circumstances of the reporting entity, e.g. whether under-performing financial assets are managed separately (either individually or as part of a portfolio of similar assets).

b) a collective approach should continue to be used for those assets (for which losses have been identified)? Why or why not?



See comments on a)

Question 6 – What simplifications to the approach should be considered to address implementation issues? What issues would your suggested simplifications address, and how would they be consistent with, or approximate to, the expected cash flow model as described?

In our opinion the approach is not defined clearly yet so that at this stage it is almost impossible to get a clear picture and to assess all consequences and therefore, constitute simplifications to the proposed approach.