German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Hans Hoogervorst
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Comments by the German Banking Industry Committee on ED/2013/3 Financial Instruments: Expected Credit Losses

4 July 2013

Dear Mr Hoogervorst,

The German Banking Industry Committee welcomes the proposed expected credit loss approach submitted by the IASB which fundamentally addresses the widely criticised shortcomings of the incurred loss model. In this regard, we support the IASB's credit deterioration approach, which differentiates between high quality loans and loans of lower and worsening credit quality ("good book" *versus* "bad book" assets).

We particularly welcome the current exposure draft for the following reasons:

- It constitutes a significant improvement on the 2009 ED; especially in terms of the model's operational feasibility
- It remedies the shortcomings of the IAS 39 model ("too little too late") and addresses the G20 revision mandate
- Compared to FASB's proposal, it takes greater account of existing risk management practices and of the economics of lending
- It sets out principle-based requirements

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Overall, we thus subscribe to the IASB proposals. Please find our comments on operational details and a number of suggestions below. On the whole, we are of the opinion that these issues can be resolved in a constructive dialogue to the mutual satisfaction of all parties involved.

We warmly welcome the principle-based approach of the IASB's ED. From our point of view, principle based rules are vital in ensuring that banks' respective risk management practices can be implemented and are adequately reflected in credit loss provisions. We find that some of the examples listed in the ED leave room for misinterpretation and potential enforcement of quantitative criteria, where the principle-based spirit of the document rightfully allows parallel application of qualitative assessments (this especially applies to assessments of migration from stage 1 to stage 2). We would welcome if such examples (specified further in our comment letter) would be deleted.

Furthermore, we are in favour of assessing the existence of a "significant" deterioration on the basis of the 12-month PD provided there is no indication that the results would differ from those achieved using the lifetime PD. Over time, an assessment on the basis of the lifetime PD would generate enormous complexity which, moreover, would be virtually impossible to make clear to external parties, either.

The disclosure requirements proposed by the IASB are highly detailed and complex. A reduction of the requirements should be considered in the interest of greater transparency and a better balance between the costs and benefits of providing information to users of financial statements. In our view, it is not constructive to require the disclosure of information which, at present, is not even being captured for the purposes of internal risk management.

In order to facilitate a true and fair view of the loans extended in previous years, entities should have the right to opt for pragmatic solutions when it comes to the transitional requirements.

As regards the overall implementation, we would like to point out that the timely publication of a final and complete IFRS 9 standard is of vital importance. Given that implementation is likely to be highly complex, it is difficult to predict precisely how long the process will take as things stand.

On a separate note, the German Banking Industry Committee firmly rejects the current expected credit loss (CECL) impairment model proposed by the FASB. From an economic point of view, it is not obvious why "healthy" loans require immediate recognition of lifetime loss provision (Day 1). Furthermore, the implementation of the US model would lead to a discrimination of the long-term lending business.[1]

The FASB proposal in essence leads to creation of capital buffers. We would like to point out that those should not be regulated by accounting standards. This should be left to regulatory frameworks.

We regret that as a result of the FASB's decisions, convergence will not be possible. In principle, the German Banking Industry Committee is still fundamentally in favour of a convergence between IFRS and US-GAAP. However, the only viable foundation for convergence in this case is the IASB proposal.

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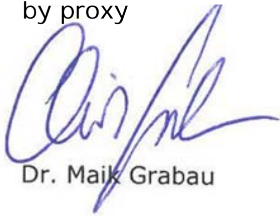
[1] Please cf. the GBIC Comment Letter sent to the FASB on 30 May 2013.

Please find our detailed comments on the exposure draft on the next pages.

Yours sincerely,
on behalf of the German Banking Industry Committee
German Savings Banks Association

by proxy



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German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on ED/2013/3 "Financial Instruments: Expected Credit losses"

The German Banking Industry Committee is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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Comments on ED/2013/3 Financial Instruments: Expected Credit Losses

Question 1

(a) Do you agree that an approach that recognises a loss allowance (or provision) at an amount equal to a portion of expected credit losses initially, and lifetime expected credit losses only after significant deterioration in credit quality, will reflect:

(i) the economic link between the pricing of financial instruments and the credit quality at initial recognition; and
(ii) the effects of changes in the credit quality subsequent to initial recognition?

If not, why not and how do you believe the proposed model should be revised?

We welcome the credit deterioration model which differentiates between the credit quality of financial instruments. Recognition of loss allowances on the basis of 12-month PD in Stage 1 is both acceptable and operationally feasible. It constitutes a significant operationalization improvement in comparison to the 2009 ED while maintaining its philosophical gist. It is important that assessment of "significant" deterioration in credit quality is consistent with the current practice, relying on quantitative and qualitative risk management information. As a side note, we would like to highlight that recognising loss allowances on the basis of 12-month PD already results in significantly higher provisions in comparison to IAS 39.

(b) Do you agree that recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses, discounted using the original effective interest rate, does not faithfully represent the underlying economics of financial instruments? If not, why not?

Yes, we do agree. From the point of view of the German banking industry, impairment rules should distinguish between high-quality (performing loans) and low-quality (non-performing / impaired) loans. This is also an adequate representation of the underlying economics of lending. More specifically, this means that the level of the required loss allowances should be based on the degree of the credit quality. Also, such a differentiation is consistent with banks' risk management practices. It is counterintuitive from an economic point of view that allowances for potential lifetime credit losses are recognised on day one, at origination of a "healthy" loan (i.e. FASB model). This does not provide readers of financial disclosures with any adequate information. Furthermore, (at least in the event of open portfolios) a blanket requirement of lifetime loss allowances leads to substantial build-up of provisions which would never be used. As a consequence, these reserves have the character of a capital buffer and should be dealt with under a regulatory framework, not in an accounting standard.

Comments on ED/2013/3 Financial Instruments: Expected Credit Losses

Question 2

(a) Do you agree that recognising a loss allowance (or provision) at an amount equal to 12-month expected credit losses and at an amount equal to lifetime expected credit losses after significant deterioration in credit quality achieves an appropriate balance between the faithful representation of the underlying economics and the costs of implementation? If not, why not? What alternative would you prefer and why?

From our point of view, the proposed credit deterioration approach is essentially a balanced model for recognising a loss allowance. We welcome the proposed regime for low-risk financial instruments.

At this juncture, we would also like to point out that there is indeed a sound underlying rationale for the 12-month EL in stage 1. In a nutshell, this is during a loan's lifetime and due to an appropriate calculation of interest margins, the 12-month EL corresponds to the risk premium (as a part of the effective interest rate) that is received annually. Basically, the recognition of the 12-month EL is a corrective entry to the risk premium that is included in interest income shown in the income statement. This corrective entry leads to a better illustration of the economic results of the particular transaction.

Irrespective of this point, it must be borne in mind that (given the required follow-up and data storage at individual level) the implementation of the relative approach will be highly complex. Hence, it is vital that the standard be principle-based allowing financial institutions to align impairment classification to the current risk management practice. In this regard we suggest that any examples which are inconsistent with the principle-based spirit be excluded from the standard to avoid their misinterpretation and unintended usage.

Specifically, the ED purposefully avoids giving a rigid definition of "significant" credit deterioration. However, **paragraph B15** deviates by providing an example which could be interpreted as a precise rule. We therefore suggest deleting the numerical example in paragraph B15.

Along the same line, ED **paragraph 6** could be interpreted as mandating an automated transfer to stage 2 for investment grade rated loans once they shift into a non-investment grade. Other sections of the ED intend to state that the transfer to stage 2 can only happen in case of "significant" deterioration.

Additionally, for the sake of consistency, we suggest to amend paragraph B20e as follows: *"an actual or expected **significant** internal credit rating downgrade..."* For the purposes of consistency, we also recommend revising the entire paragraph B20 in order to include the term "significant" wherever appropriate.

Regarding the IASB's proposed rebuttable presumption that a significant deterioration has occurred if a payment is more than 30 days past due, we consider it necessary to clarify that this presumption can also be rebutted using risk management experience based on alternative thresholds if these have proved effective in internal risk management processes.

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(b) Do you agree that the approach for accounting for expected credit losses proposed in this Exposure Draft achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than the approaches in the 2009 ED and the SD (without the foreseeable future floor)?

Yes, we do agree.

(c) Do you think that recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition, discounted using the original effective interest rate, achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than this Exposure Draft?

No, we do not think so (cf. also our response to question 1(b)).

Question 3

(a) Do you agree with the proposed scope of this Exposure Draft? If not, why not?

We agree with the proposed scope of this Exposure Draft.

(b) Do you agree that, for financial assets that are mandatorily measured at FVOCI in accordance with the Classification and Measurement ED, the accounting for expected credit losses should be as proposed in this Exposure Draft? Why or why not?

We believe that it would be appropriate to apply a consistent impairment model for AC and FVOCI assets.

Question 4

Is measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses operational? If not, why not and how do you believe the portion recognised from initial recognition should be determined?

Yes, we do agree. The proposal is operationally feasible. This is especially true in view of the existing Basel II requirements. However, the corresponding parameter adjustments (historic LGD vs downturn LGD, PIT PD vs TTC PD) will give rise to considerable operational efforts and costs and, as any other forecast, do not fully resolve uncertainty. We recommend allowing 12-month EL in stage 1 to be entirely based on Basel II parameters. Basel II parameters are broadly used in internal risk management - consequently there is a double benefit of faster operational implementation (especially given the tight IFRS 9 timeline) and improved transparency and comparability between accounting and regulatory/supervisory reporting. This also holds true for potential application of Basel parameters in the calculation of a lifetime expected loss.

In this context we also recommend deleting BC 193 which implies that usage of Basel PDs is not permitted, as their determination fails to consider current information. While the rating systems are indeed calibrated on historic data, individual ratings are based on the borrowers latest available financial information. Thus, a rating approach seeks to assign borrowers to the most current PD class. In this regard, we would like to point out that Annex VII Part 4 para. 18 of the Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (Banking Directive) clearly requests that the rating be based on "current information". If the rating is based on mathematical-statistical models, Annex VII Part 4 para. 30 of the Banking Directive sets out that the model result will still have to be complemented by means of individual assessments. Essentially, this also involves answering the qualitative questions. Also overrides have to be subsumed under this. After all, this is the only way in which all relevant information will be adequately reflected in the rating. The more formal rules on handling overrides are laid down in the provisions under Annex VII Part 4 para. 25 of the Banking Directive and under the 2006 CEBS guideline (para 460 - 461).

Question 5

(a) Do you agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk since initial recognition? If not, why not and what alternative would you prefer?

We agree with the credit deterioration approach proposed by the IASB. In this respect please cf. also our answers to question 2.

We would like to strongly recommend that the assessment of a "significant" deterioration should normally be based on the basis of the 12-month PD (unless there are any reasons to believe that this will lead to different results than the use of the lifetime PD). Whilst in principle, this is an option granted by the IASB (in exceptional cases), we are still under the impression that – whenever they use the 12-month PD – entities are under the obligation to prove beyond reasonable doubt that the results thus achieved will not be any different. This means that, whilst the IASB permits exceptions in principle, they will not ease the (operational) burden on entities. This is due to the fact that entities usually will have to provide conclusive evidence of the potential immateriality (comparison lifetime PD versus 12-month PD) and this evidence will also be demanded by auditors. A respective comparison of the lifetime PDs may theoretically be correct. However, for instance due to the need for annual recalibrations (new PD assumptions, mere time elapsed) this still ties up an extreme amount of resources without yielding any benefit that would justify these expenses. Operationally the use of lifetime PDs will require entities to retain large libraries of PD curves and lead to different trigger points for credit deterioration between loans, not just based on credit quality but maturity.

Furthermore, the use of the 12-month PD is compatible with the IASB's underlying rationale. The lifetime PD is comprised of three components: 12-month PD, migration matrixes and maturity effect. Under the provisions of paragraph B14, when assessing the change in the credit quality, the maturity effect will have to be eliminated by means of the PD, anyway. Assuming that the underlying migration matrixes are constant over time, the 12-month PD approach invariably leads to the same results as the lifetime PD. In consequence, the use of the 12-month PD should be permitted as long as there is no evidence to suggest it is no longer appropriate to do so.

Based on the reasons highlighted above, paragraph B11 should therefore be clarified as follows: „However, an entity may use the 12-months probability of default occurring to determine whether credit risk has increased significantly since initial recognition if there is no objective evidence that the outcome would differ.“

(b) Do the proposals provide sufficient guidance on when to recognise lifetime expected credit losses? If not, what additional guidance would you suggest?

We support the principle-based approach emphasized in the ED. To further promote this spirit we suggest excluding any mention of precise PD thresholds etc. that could be misinterpreted as an exact rule. For this reason, there is no need for additional guidelines or examples. In our response to question 2 we provide a number of specific cases where numeric examples are counterproductive (especially paragraph B15) and should not feature in the final standard.

Paragraph B20(e) might give rise to the conclusion that even the mere expectation that there will be an internal credit rating downgrade will warrant a mandatory transfer to stage 2. In our view, such a transfer trigger would be premature. The language should therefore be amended to include a qualifier, e.g. "significant" (as is the case with the other scenarios listed in paragraph B20). Otherwise, a literal interpretation could give the doubtless unintended impression that, unlike external rating downgrades, every deterioration in an internal rating should be considered significant.

The illustrative examples in IE 40, 41 and 52 (which state the use of a lifetime-PD for the entirety or parts of the living portfolio, if an expected increase in defaults due to a deterioration of the economic conditions cannot be assigned to contracts/customers) seem to be inappropriate and should be deleted. By them, risks would be overstated inappropriately and would cause technical volatility of provisions, if this situation is only temporary. If a PD-procedure is to be revised in the next months and if it is to be expected that the revised PD's can be assigned to customers/contracts afterwards, then it should be allowed to reflect the increase in defaults by management adjustment to the best knowledge of the company.

(c) Do you agree that the assessment of when to recognise lifetime expected credit losses should consider only changes in the probability of a default occurring, rather than changes in expected credit losses (or credit loss given default ('LGD'))? If not, why not and what would you prefer?

As a general rule, the assessment of the need to recognise the lifetime EL should be based on the 12 month PD (cf. also our comments on question 5 (a)). However, there should be a further clarification to the effect that under certain conditions in which collateral values (e.g. LGDs or LTVs) have an impact on the probability of default these can similarly be considered during the assessment of a stage transfer. This would also be in line with risk management practices. Along with specific legal provisions in a number of jurisdictions, this particularly also concerns business involving various non-recourse funding transactions and funding transactions through special purpose entities. Whilst paragraph 18 refers to the admissibility of loss rates which implicitly also include an LGD and paragraph B20(j) refers to collateral values, from our point of view this is not sufficient in order to achieve this objective. We believe a clarification should also be included in paragraph 8.

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Furthermore, there should be a clarification that – in exceptional cases - the significance of the credit quality change does not have to be determined merely on the basis of the PD. In the absence of a rating (e.g. for trade receivables or separate trust asset exposures) the assessment should, for instance, also be permissible based on the criterion "own fund ratio reported on the balance sheet > x%" or "(debt carrying amount) / net income for the year < y".

(d) Do you agree with the proposed operational simplifications, and do they contribute to an appropriate balance between faithful representation and the cost of implementation?

We endorse the simplification pursuant to which, in the event of a "low probability of default" (e.g. investment grade) it will be possible to waive the assessment of a significant deterioration of the credit quality and to keep the asset directly in stage 1.

We basically welcome the simplification concerning leasing exposures. The option of using the 3-stage model, like with loans, should definitely be retained, however. This is important for those leasing companies which treat lease receivables as loan receivables for risk management purposes and value these using a rating or score. For simplicity's sake, it ought to be possible to use the 12-month PD for trade receivables since, while trade receivables usually have to be repaid in the short term, they have no specific maturity.

During the expected loss calculation, prepayments, call options and similar options have to be taken into account (Appendix A). We recommend granting banks the right to ignore options whenever the respective influence on the expected loss is insignificant. This would lead to a substantial reduction in the cost of implementation at some banks.

(e) Do you agree with the proposal that the model shall allow the re-establishment of a loss allowance (or a provision) at an amount equal to 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met? If not, why not and what would you prefer?

We agree with the proposal. In order to arrive at a true and fair view of credit quality trends, a switch back to stage 2 or 1 is indispensable.

Question 6

(a) Do you agree that there are circumstances when interest revenue calculated on a net carrying amount (amortised cost) rather than on a gross carrying amount can provide more useful information? If not, why not and what would you prefer?

We welcome IASB's proposal that IFRS 9 keeps the interest revenue recognition approach the same as in IAS 39. However, in view of the fact that apparently this is still not sufficiently clear to parts of the community, we kindly ask the IASB to provide further clarification.

Comments on ED/2013/3 Financial Instruments: Expected Credit Losses

(b) Do you agree with the proposal to change how interest revenue is calculated for assets that have objective evidence of impairment subsequent to initial recognition? Why or why not? If not, for what population of assets should the interest revenue calculation change?

Cf. response to question 6a.

(c) Do you agree with the proposal that the interest revenue approach shall be symmetrical (ie that the calculation can revert back to a calculation on the gross carrying amount)? Why or why not? If not, what approach would you prefer?

Cf. response to question 6a.

Question 7

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

When an accounting standard is principle based, it is logical that the investment community would rely on disclosures to get the adequate depth of information covering the expected loss model and its underlying parameters. The requested disclosures are very detailed as well as excessively elaborate. In order to avoid a potential information overload for readers of financial statements, for the sake of transparency and in order to reduce the complexity, the requirements should be revisited and ought to be streamlined.

Whilst not limited to, this particularly applies to the reconciliation statement of the gross carrying amounts (**paragraph 35, 36**) which would require the integration of credit risk control data into financial accounting on the basis of individual business transactions. In order to create meaningful balancing entries which lend themselves to a further analysis, the transfer to a different stage would have to trigger an account entry. Effects due to changes in the consolidation scope and due to currency conversions have to be treated separately. This would affect the entire portfolio of transactions belonging to the categories AC and FVOCI including portfolios featuring low PDs (stage 1). To date, loss allowances could be determined by means of a subledger accounting and could be booked in an aggregated form.

Furthermore, due to the fact that these would incur tremendous implementation costs (e.g. tracking past modifications, calculation of the re-default rate, disclosure of enforcement actions), we also recommend a review of the disclosure requirements on direct write downs and modifications.

The implementation of additional disclosures that are requested e.g. in **paragraphs 37, 38, 44 and 45** is extremely complex and does not generate decision relevant information for readers.

We believe the examples 12 and 13 should be deleted as they are going beyond the principles of paragraphs 35 and 44.

In terms of the disclosures requested under example 12, we would like to point out that it is difficult to differentiate credits extended in previous years from new lendings. This is first and foremost owed to the fact that prolongations cannot be assigned to one of the two categories in an unambiguous manner.

Comments on ED/2013/3 Financial Instruments: Expected Credit Losses

As mentioned above, we welcome the principle-based approach of the IASB's ED and consider it important that banks' internal risk management practices can be appropriately reflected. It is also important in this context that the disclosure requirements now proposed by the IASB are consistent, or are brought into line, with the requirements of IFRS 7 ("through the eyes of management").

To be consistent the disclosure requirements regarding the expected credit loss model proposed in the exposure draft should be included in IFRS 7 which is supposed to comprise the disclosures regarding financial instruments.

(b) Do you foresee any specific operational challenges when implementing the proposed disclosure requirements?If so, please explain.

We have major concerns especially over the complexity inherent in the reconciliation of the gross carrying amounts requested under **paragraph 35a**. This is due to the fact that this requires the aggregation of data on existing holdings and of data on movements. Maintaining these data (e.g. gross exposures which have been transferred from stage 1 to stage 2 during the fiscal year and *vice versa)* requires a comprehensive database thus incurring considerable costs.

In our view, there is no adequate cost/benefit ratio concerning the information provided on write-offs (**paragraph 37**). At present, entities already provide detailed recovery information. In this respect, the ED proposals require historical data as a precondition. Such data are either entirely absent or no longer available (for instance, due to the fact that a loan has already been written down thus meaning that the corresponding information will no longer be available in the system). Furthermore, the ED does not provide a concept clarification of the term "active enforcement".

We have reservations with the requirement in **paragraph 38** to disclose the re-defaulted rate and the reporting of loans which have returned to stage 1 featuring contractual adjustments because this would be burdensome from the operational perspective. The disclosure should therefore be limited to a period of 2 years.

A comprehensive implementation of the disclosure requirements by 2016 will be virtually impossible. It is obvious that there will be challenges or, moreover, high implementation costs. Whilst not limited to, this is particularly owed to the scope and the granularity of the information requested.

(c) What other disclosures do you believe would provide useful information (whether in addition to, or instead of, the proposed disclosures) and why?

In order to avoid information overload for users of annual financial statements, for the sake of transparency and for the purposes of cutting complexity (cf. above), we rather recommend reducing the requirements.

Comments on ED/2013/3 Financial Instruments: Expected Credit Losses

Question 8

Do you agree with the proposed treatment of financial assets on which contractual cash flows are modified, and do you believe that it provides useful information? If not, why not and what alternative would you prefer?

The proposed treatment is at least logical in terms of its underlying philosophy. However, we have concerns over the fact that its scope of application is not entirely unambiguous. We also have reservations over the disclosures on modifications (e.g. the disclosure of the re-default rate and the reporting of loans which have returned to "health" again featuring contractual adjustments).

During lending transactions, it is paramount for banks that they are capable of responding to the borrower's latest economical circumstances. The more stringent disclosure requirements as well as the resulting implementation costs would severely impair this very capacity to respond on the part of banks.

In many business models, contractual changes are a standard practice. The requisite differentiation between credit quality driven changes and other contractual changes incurs considerable additional implementation costs.

Question 9

(a) Do you agree with the proposals on the application of the general model to loan commitment and financial guarantee contracts? Why or why not? If not, what approach would you prefer?

Although this may incur costs for the technical implementation that are considerably higher, we agree with the proposal on the application of the "general model" to financial guarantees and loan commitments.

(b) Do you foresee any significant operational challenges that may arise from the proposal to present expected credit losses on financial guarantee contracts or loan commitments as a provision in the statement of financial position? If yes, please explain.

No, we do not foresee any such challenges. This is due to the fact that, already today, it is presented as a provision.

Question 10

(a) Do you agree with the proposed simplified approach for trade receivables and lease receivables? Why or why not? If not, what changes do you recommend and why?

In principle, we welcome the exemption rule. The option of using the 3-stage model should definitely be retained, however. This is important for those leasing companies which treat lease receivables as loan receivables for risk management purposes and value these using a rating or score. For simplicity's sake, it

ought to be possible to use the 12-month PD for trade receivables since, while trade receivables usually have to be repaid in the short term, they have no specific maturity.

(b) Do you agree with the proposed amendments to the measurement on initial recognition of trade receivables with no significant financing component? If not, why not and what would you propose instead?

Yes, we do agree (although this is of subsidiary relevance).

Question 11

Do you agree with the proposals for financial assets that are credit-impaired on initial recognition? Why or why not? If not, what approach would you prefer?

On principle, we agree with the proposals. However, in this context it is not sufficiently clear how loans should be treated which are initially classified in stage 3 after a modification (i.e. derecognition and recognition modified loan). Even if the assumption is that, following the modification, the loan can subsequently be serviced in a regular manner, banks' risk management policies and guidelines stipulate that a stage 3 classification (impaired) will be adequate at least for the first year. Provided there are no renewed payment difficulties etc., we hold the view that, also afterwards, it should be possible to transfer such loans again into stages 1 and 2 (the purpose of the modification being to avoid said payment difficulties in future). We would like to ask the IASB to provide a clarification in this respect.

Furthermore, we would like to draw attention to a potential problem in the context of phase 1 under IFRS 9. Pursuant to the rules on classification / measurement proposed by the IASB, financial instruments shall be recognised at fair value if the cash flows fail to pass the SPPI test (e.g. high leverage etc.). To us, it is not sufficiently clear whether this rule also covers (purchased) PCI assets, i.e. assets featuring a high discount. This is due to the fact that, at least in theory, it is possible to preserve the initial nominal value (100%) even if this cannot be taken for granted at the point in time where these assets are being purchased. Yet, such an approach – provided there is a rigorous interpretation of IFRS 9 phase 1 – would subsequently lead to a FV measurement of PCI assets. We feel that this is not sufficiently clear and invite the IASB to elaborate this further.

Question 12

(a) What lead time would you require to implement the proposed requirements?

At the present point in time, forecasts are extremely difficult due to the forthcoming complex implementation stage. Upon finalisation of the standard, the implementation will require at least 3 years. An earlier implementation might be possible if our proposals for a less complex implementation of the proposed rules are taken into account.

For the leasing industry, it would be a good idea if the amended IAS 17 was implemented at an earlier date or at least at the same time as IFRS 9. Otherwise, there will be increased implementation costs. We

would therefore like to advocate a synchronisation of the timetable for introducing IFRS 9 and the amended IAS 17.

(b) Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

Also in light of the previous discussions with the IASB, we hold the view that the ED presentations mean that pragmatic approaches may be applied during the transitional period. Whilst not limited to, such pragmatic approaches would, for instance include a corresponding approximation of the initial credit quality without thus calling into question the retrospective application.

In the absence of any (initial) PD for a loan, we advocate e.g. for the possibility of assuming the first available and quality assured PD.

(c) Do you agree with the proposed relief from restating comparative information on transition? If not, why?

We do agree with the proposed relief.

Question 13

Do you agree with the IASB's assessment of the effects of the proposals? Why or why not?

As has been pointed out in paragraph BC166 by the IASB, the impact for the individual user depends on the nature and scope of the individual users' existing financial instrument holdings. We also expect an increase in loss allowances and an earlier recognition of expected losses.