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Sir David Tweedie
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30 Cannon Street
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Dear Sir David,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on the IASB's Supplement to ED/2009/12 Financial Instruments: Amortised Cost and Impairment. Principal authors of this comment letter were Peter Bitzyk, Roman Fabian, David Grünberger, Andreas Gilly, Karl-Helmut Halak-Fogl, Christian Höllerschmid, Ernst Schönhuber and Roland Nessmann.

GENERAL REMARKS

We see it as absolutely essential that amortisation and impairment regulations should be the same everywhere in the world, and therefore wholeheartedly support IASB and FSB in their joint approach to developing a common body of regulations. However, we also consider it to be essential for the new regulations not to be unduly complex, so that their application – especially by non-financial entities – does not result in excessive costs without corresponding additional benefits. For this reason the new regulations should as a matter of principle specify one rule for all financial instruments at amortised cost, irrespective of whether what is involved is a single instrument, or an open or closed portfolio of instruments. We are hence assuming that the regulations presented for discussion in this supplementary document with respect to impairment of open portfolios will be the basis of the generally applicable rules for all impairment.

SPECIFIC REMARKS

Question 1 - Do you believe the approach for recognition of impairment described in this supplementary document deals with its weaknesses (ie delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

We believe that the new regulations will lead to earlier recognition of impairment than was the case under IAS 39. As explained under General Remarks, however, in our view several additional conditions must be fulfilled if the objectives of the proposal – earlier recognition of impairment, reduction in the complexity of the regulations, comparable regulations for all, and an appropriate balance of costs and benefits – are to be achieved.

- Severing the link between interest income and impairment allowances, contrary to the provisions of the original exposure draft of November 2009, applies with respect to expected losses in all cases of impairment in the good book. For impairment in the bad book, the impairment rules in IAS 39 will continue to apply.

- The decision to distinguish between 'good book' exposures, where the only expectation of loss is a statistical one (i.e., no trigger event), and 'bad book' exposures, where there is already an impairment for the purposes of IAS 39, is a principle of which we approve. The distinction requires the objective definition of a 'bright line', which should be based on IAS 39. This preserves the compatibility with Basel II, and reduces complexity.

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?

As we have explained above, we consider it important for there to be uniform rules for impairment. Provided this condition is met, the solution proposed in the supplementary document is at least as feasible operationally as the one proposed in the original Exposure Draft.

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?

In principle, yes (see our answers to Q1 and Q2). It should however be emphasised that there must be specific, practical criteria for allocating financial assets either to the good book or to the bad book.

Question 4 - Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

As noted above, severing the link between interest income and impairment allowances is an essential requirement, and one that must be applied to all the financial assets in the good book. For financial assets forming part of the bad book, the impairment provisions of IAS 39 are to be applied. In theory at least, the application of period-based loss expectations should also be possible for individual portfolios with corresponding loss experience profiles. However we welcome the time-proportional approach with a 'floor' as a general solution, and a good compromise that avoids unnecessary complexity and the additional costs often only dubiously linked to additional benefits.

Question 5 - Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

Yes (see comments above).

Question 6 – Is the requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

We see the distinction as clear provided it is based on the principle we have identified in our answer to Q1(b). We therefore assume that if there is an impairment for the purposes of IAS 39, then the asset must be allocated to the bad book. Otherwise, there is no clear distinction, and the possibility of earnings management cannot be excluded.

Question 7 – Is the requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

See our answers to Q6 and Q1(b): only if, as a matter of principle, the definition of a trigger event in the current version of IAS 39 provides the dividing line for allocation of financial instruments between good and bad books.

Question 8 – Do you agree with the proposed requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

See our answers to Q1(c), Q6 and Q7.

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?

See our answer to Q1(b): a floor can at least ensure that if a transfer from good book to bad book becomes necessary adequate allowances would generally have been made. Particularly in the case of long-term financial assets, it could otherwise be the case that insufficient impairment allowances were recognised. In our view, the need for a floor is not as strong for stable, open portfolios as it is in the case of single instruments, but in the interests of a general solution the floor should be applicable for all financial assets recognised at amortised cost under IFRS 9.

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?

In the interests of consistency and simplicity, we believe that a floor should be a general requirement. There would then be no problems of deciding whether an early loss pattern existed or not.

c) If you agree with a proposed minimum loss allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?

We welcome the proposed approach because it is clear in application, facilitates comparability and is practical in operation. The period of twelve months is also familiar in, e.g., the context of financial regulation. In our view, the period an entity decides to use should in any event be disclosed in the notes to the financial statements.

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

Since the key concept is "loss expectations for the foreseeable future", these expectations should in our view be based on management estimates, as is also the practice in risk management. Estimates of expected losses will of course reflect all circumstances that may influence the losses: depending on their importance to the entity and consequently on the quality of the risk management system, different factors may well need to be taken into account.

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.

See our answers to (c) and (d) above. It varies from entity to entity, depending on the nature of the assets and the quality of the risk management system. Especially in the financial sector, the use of 12-month expected loss estimates should be permitted, since these are already required under banking regulatory systems.

f) If you agree that the foreseeable future period is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a 'ceiling' should be established for determining the amount of credit impairment to be recognised under the 'floor' requirement (for example, no more than three years after an entity's reporting date)? If so, please provide data and/or reasons to support your response.

See our answer to (e) above.

<u>Question 10</u> – 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.

In principle it depends on whether the rule is applied to an individual credit or to a whole portfolio. In the case of portfolios, it depends on the structure of the portfolio, and the effects can not be specified a priori. Relevant factors for the relative level of the floor and the expected loss include in particular how long the “foreseeable future” is considered to be, the (average) life of the credi/portfolio or the remaining life of the credit/portfolio.

<u>Question 11</u> – The boards are seeking comments with respect to 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 an undiscounted estimate when applying the approach described in paragraph B8(a)? Why or why not?

Yes: in the good book the time value of money is in any event taken into account through the calculation of the effective loss and the time proportional allowance. The use of discounted values would theoretically be appropriate, but in the interests of simplicity this can in our opinion be ignored. The option of using discounted values should continue to be available, and the relevant information should be disclosed in the notes.

In our view, in the bad book the rules of IAS 39 should in any case be applied.

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?

See our answer to (a) above. To the extent that the use of discounted values is permitted, the use of any appropriate discount rate, such as the one used in risk management, should be allowed. The discount rate used should be disclosed and explained in the notes.

<u>Question 12</u> – Would you prefer the IASB approach for open portfolios of financial assets measured at amortised cost to the common proposal in this document? Why or why not? If you would not prefer this specific IASB approach, do you prefer the general concept of the IASB approach (ie to recognise expected credit losses over the life of the assets)? Why or why not?

The approach including a floor proposed in the supplementary document is a reasonable compromise. Without a floor, there could in certain circumstances be greater problems with time maturities.

<u>Question 13</u> – 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 (i.e. to recognise currently credit losses expected to occur in the foreseeable future)? Why or why not?

No, because we fear that it would jeopardise economic neutrality as between long and short-term financing: as a general rule the financial markets would then choose short-term forms of financing, which would be to the disadvantage of economic activity.

<u>IASB-only Appendix Z: Presentation and Disclosure</u>

<u>Question 14Z</u> – 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?

Yes (see General Remarks and other answers).

<u>Question 15Z</u> – 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?

Yes.

<u>Question 16Z</u> – Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

See answers to Q 14Z and Q9, Q10 and Q11.

<u>Question 17Z</u> – Do you agree with the proposed presentation requirements? If not, what presentation would you prefer instead and why?

As explained in our answers to Q1 and Q4, we strongly support the change in presentation proposed in the supplementary document – that expected losses should not be deducted from the effective interest rate. The reason is that, as stated in our Comment Letter to ED/2009/12, the proposed presentation requirements would result in

- Very burdensome changes in IT systems
- No increased added value as compared with disclosure of movements in allowances in the notes
- An additional new difference between the way risk is managed and the way it is reported
- Additional practical as well as conceptual problems of differentiation, especially for loans managed as part of a portfolio.

<u>Question 18Z</u> – Do you agree with the proposed disclosure requirements? If not, which disclosure requirements do you disagree with and why?

In principle we agree, but in some cases providing information for the last five years can be extremely difficult. In particular if the structure of the group changes, or the business segments, or the Standards, it can become effectively impossible. All risk information should be included under IFRS 7, in order to prevent it being scattered across the financial statements.

What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) for the proposed impairment model and why?

We see no need for additional disclosures.

<u>Question 19Z</u> – Do you agree with the proposal to transfer an amount of the related allowance reflecting the age of the financial asset when transferring financial assets between the two groups? Why or why not? If not, would you instead prefer to transfer all or none of the expected credit loss of the financial asset?

Yes.

Please do not hesitate to contact me if you wish to discuss any aspect of our comment letter in more detail.

Kind regards,

Romuald Bertl

Chairman