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Paris, the 30th March 2011

IFRS Foundation / IASB
30 Cannon Street
London, EC4M 6XH
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Re : Supplementary document Financial Instruments: Impairment

Dear Sir or Madam,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned supplementary document (SD).

In our comment on the IASB's ED *amortised cost and impairment*, we expressed our support to an expected loss model to provide for the credit risk of financial assets at amortised cost but raised strong concerns regarding the operability of the ED.

We therefore welcome the development by the IASB of a more operational expected loss model for open portfolios. Namely, we agree with the following:

- The recognition of expected loss (and changes in estimates) in profit or loss on a time proportional basis over the life of the portfolio according to a simplified method. This will resolve, in an operational manner, the current timing mismatch between the recognition (as revenue) of the credit risk premium included in the interest charged to the borrower and the recognition of the related credit loss;
- The distinction made between good book and bad book;
- The better alignment with the internal credit risk management of the entity regarding the portfolio segmentation and the definition of the good book and bad book;
- The improvements of the operability of the impairment method through a decoupled approach to recognize interest revenue separately from depreciations instead of an integrated EIR (which was quite impossible to implement);
- The introduction of flexibility, notably regarding the optional use of a discount rate and the expected loss estimates

However, we disagree with the floor mechanism on the good book added to the IASB approach (i.e. upfront provision of 100% of the EL on the foreseeable future). This method would lead to the recognition of a day-one credit loss which is not consistent with the economics of the lending activity (at market rate). This issue will be exacerbated in a business combination or purchase of loans. In our comment letter to the IASB's ED on amortised cost and impairment, we called for a floor "to make sure that the expected loss provision is sufficient to cover incurred losses on the existing loans". We consider that the good book/bad book mechanism is quite similar to our request and results in an appropriate floor on the whole impairment model. Thus, an additional floor on the good book is not necessary since the bad book will, in practice, cope with the credit risk of portfolio with early loss pattern.

Moreover, the concept of "foreseeable future" is not clearly defined and potentially broad and uncertain. This ill-defined concept results from the Boards' attempt to reconcile two incompatible approaches resulting in a mere overlap of two different models in order to present a common solution. We are not convinced that this process is the best way to achieve the development of a high quality converged standard. This floor estimated on a foreseeable horizon could undermine the benefit of the IASB's impairment method by driving the allowance amount in most cases. As a consequence, if the Board were to maintain the floor on the good book in spite of our concerns, we would request the Board to cap the floor at a twelve month horizon.

With respect to the functioning of the model, a question arises as to whether the good book allowance may be reversed in practice during an economic downturn. There may be a need for clarification on how the Boards perceive the allowance will be used over the credit cycle, for instance by clarifying that the revision of EL estimates on the good book should take into account the credit losses of the bad book.

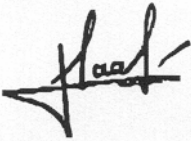
Overall, we consider that the model proposed in the SD (without the floor) may suit closed portfolios as well as open portfolios and would improve the representation of the economic effect of credit risk on financial assets measured at amortised cost (including loan commitments and financial guarantees accounted for under IAS 39). Nevertheless, we reiterate that the proposed approach is not appropriate for short term trade receivables and debt securities.

Last but not least, as already expressed in other comment letters, the ANC requests that the Board undertake a sufficient and effective field-testing when the new proposals are finalised in order to ensure their robustness, relevance and feasibility and to ensure that they provide decision-useful financial statements.

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

If you have any questions concerning our comments, we would be pleased to discuss them.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Haas", with a stylized flourish extending to the left.

Jérôme Haas

Appendix I

Detailed comments

General

Question 1

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

We globally believe that the impairment approach proposed in this SD deals with the weakness of the current incurred loss model and with some of the weaknesses of the original ED 2009/12 *Financial instruments: amortised cost and impairment*.

Namely, we support the Boards' decisions to :

- allow the use of open portfolios instead of closed portfolios only;
- require the use of expected losses estimated over the expected life of the portfolio, notably by using long-term average loss rates;
- align the definition of the portfolios with the way entities manage their financial assets in practice for internal credit risk management purposes;
- allocate the expected credit loss over the average life of the portfolio instead of using the EIR mechanism (see also Q14Z);
- recognise the effect of changes in estimates under a “partial catch up” method (i.e. a time proportional basis);
- allow for flexibility regarding the use of a discount rate and the determination of this rate (see also Q11).

However, we have strong concerns regarding the floor on the good book (see Q9). A question also arises as to whether the good book allowance may be reversed in practice during an economic downturn (see Q19Z).

Scope – Open portfolio

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.

We believe that the model proposed in the SD is far more operational for open portfolios than the original impairment model proposed in ED 2009/12 (see Q1). Moreover, we consider that there is no reason to develop two different models for closed or open portfolios. Therefore, we recommend that the Board extends the model proposed in the SD to closed portfolios.

However, we consider that a single impairment approach is not suitable for all financial assets, i.e. one size does not fit all. A distinction should be made between homogeneous portfolios and single assets. An impairment method based on expected loss is relevant for homogenous portfolios since the entity may use the law of large numbers. In other cases, an expected loss approach may be less relevant. Thus:

- As already explained in our comment letter to the IASB's ED 2009/12, "short term trade receivables should be exempted from the expected loss approach and the current incurred loss model should be maintained" since "the distinction between incurred and expected loss is very thin for very short term financial assets such as trade receivables held by corporate entities". This concern was also mentioned in our comment letter to the IASB's ED *Revenue from Contracts with Customers*: "we consider that in most circumstances, the existing accounting treatment should be maintained for corporate entities e.g. the customer's credit risk should continue to affect only whether revenue is recognised and not how much revenue is recognised ; the customer's credit risk credit should continue to be presented as a component of costs and not as a reduction of revenue when the customer's credit risk is not priced in the transaction price or when the contract does not include a material financing component". We therefore acknowledge that this issue will be redeliberated later and that short term trade receivables are appropriately excluded from the scope of the SD.
- As already explained in our comment letter to the IASB's ED 2009/12, "debt securities (typically held by insurance companies), which suffer from very rare defaults, are not well represented with the proposed approach", both in the original ED and in the SD. We also take the opportunity to remind that "in addition, the fact that most of these debt securities are quoted on active markets should not lead to determine the expected losses by referring to credit premiums as valued by the markets"

Differentiation of credit loss recognition

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?

The ANC considers that the principles underlying an expected loss approach can improve the representation of the economic effect of credit risk on revenues generated over the life of a financial asset measured at amortised cost. Therefore, we agree with the time-proportional method to allocate the expected losses over the life of the portfolio. It would resolve the current timing mismatch between the recognition (as revenue) of the credit risk premium included in the interest charged to the borrower and the recognition of the related credit losses.

However, we are concerned by the floor mechanism (see Q9).

Question 4

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

As explained in our comment letter to the IASB's ED 2009/11, we consider that "it is virtually impossible to assess the timing of losses", which is a prerequisite for any cash-flow approach (such as the ECF approach proposed in the original ED). Therefore, we consider that the proposed approach is far more operational than the initial approach.

Moreover, we welcome the IASB's decision to adopt a "decoupled" approach instead of an integrated EIR approach. This decision will solve one of the most significant operational difficulties raised by the initial impairment model.

Question 5

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

We consider that the proposed approach would provide useful information (through the time proportional mechanism) since it properly reflects the economics of credit activity. The proposed approach (except for the floor mechanism) will be able to reflect the inherent credit risk of debt instruments in a timely manner by reserving the risk premiums covering credit losses as they are earned (i.e. on an accrued basis).

Conversely, the floor mechanism leads to day-one loss recognition which is not consistent with the economics of loan origination (see Q9). If loans are priced according to market conditions, the risk premiums included in the contractual interest rate is calibrated to cover future credit losses and there is no reason to recognise in net income a credit loss at inception.

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 consider that the principle underlying the differentiation between the good book and the bad book is clearly described. We note that the distinction between the "good book" and the "bad book" is consistent with the way many entities manage credit risk in practice.

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?

We agree with the aim of the SD to better align the impairment model with the way many entities usually manage credit risk. The definition of the two books introduced by the SD is operational since it will ease the implementation of the impairment model for small and basic entities as well as more sophisticated entities. Nevertheless, some additional guidance might be useful to ensure consistent approaches in the determination of the portfolios.

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?

We agree that a good book/bad book notion is consistent with the way many financial entities manage their credit risk. Moreover, we welcome the link made between the accounting requirements and internal risk management.

Minimum impairment allowance amount

Question 9

The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this model. Specifically, on the following issues:

(a) Do you agree with the proposal to require a floor for the impairment allowance related to the 'good book'? Why or why not?

(b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the 'good book' only in circumstances in which there is evidence of an early loss pattern?

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

(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 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.

(a) We disagree with the floor proposed for the impairment on the good book. This mechanism may lead to the recognition of "day-one" or "quarter-one" losses, which is not appropriate for sound financial assets. Recognising a credit loss at inception is not consistent with the recognition of loans (originated at market rate) in the statement of financial position at their initial fair value. The floor on the good book will therefore create day 1 losses since this floor is inconsistent with a fair value measurement technique. This issue will be exacerbated in a business combination or purchase of loans.

We consider that the bad book specific impairment method is the appropriate floor of the whole impairment model. In the case of effective credit losses arising early in the life of a portfolio, the full expected loss of these doubtful assets will be shortly provided for under the bad book method. Therefore, there is no need for an additional floor mechanism on the good book.

Moreover, we are concerned that in practice this floor may undermine the time-proportional approach (see Q10). It would also make the implementation of costly information systems to manage two impairment mechanisms worthless.

(b) We disagree with the proposed floor mechanism and consider that the good book/bad book concept will address circumstances in which there is evidence of an early loss pattern. However, as an alternative to the proposed floor, the 9b proposal could be further explored by the Board.

(c) We disagree with the proposed floor mechanism. However, should the floor be maintained by the Board, we would recommend to cap the foreseeable future at twelve months (see (e) and (f) below).

(d) We are concerned that the 'foreseeable future' is not clearly defined and potentially broad and uncertain. Moreover, we believe that, in practice, the foreseeable future period is affected by the economic conditions. For instance, under bad economic conditions, the foreseeable future would be very short as this is a time of great uncertainty.

(e) We believe that it is generally not possible to develop reasonable and supportable economic forecasts beyond twelve months, as shown by the recent financial crisis. Therefore we recommend that other than short term expected loss estimates be based on long term average credit losses.

(f) Should the floor be maintained by the Board and consistently with our comment in (e) above, we request that a ceiling at twelve months be established.

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.

According to the first estimates performed by French banks, there is a high risk that the floor would drive the allowance amount in most cases.

Therefore, this demonstrates that the time-proportional approach would rarely be used in practice, unless the floor is only limited to a twelve-month period. Since we consider that the time-proportional approach is more economical than the immediate recognition approach (through the floor mechanism), we are concerned that the former may not be often applied in practice. The floor, as currently proposed, could lead to generalizing an approach which is not appropriate (see also our answer to Q3 and Q9).

Thus we would prefer an impairment model without this floor or an amendment of the floor mechanism (see Q3 and Q9).

Flexibility related to using discounted amounts

Question 11

The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

(a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the approach described in paragraph B8(a)? Why or why not?

(b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

(a) Consistently with our comment to the ED 2009/11 on the difficulty to estimate precisely the timing of expected credit losses, we agree that permitting the use of either discounted or undiscounted loss estimates is welcome. This will enable entities to implement an impairment method that is aligned with the refinement of their internal risk management practices. For instance, small banks or corporates (with open portfolios) may not have developed an advanced internal rating model whereas some large banks may have developed internal models allowing the use of discounted estimates.

(b) We agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount. This will enable entities to implement an impairment method that is aligned with the refinement of their internal risk management practices. Indeed, entities may have different views on the most appropriate and reasonable discount rate that best suits their activity. Stating arbitrarily a standardized discount rate might undermine the relevance of the information provided.

Approaches developed by the IASB and FASB separately

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 (ie to recognise expected credit losses over the life of the assets)? Why or why not?

In accordance with our disagreement on the minimum allowance amount (see Q9), we would prefer the IASB approach for open portfolios to the common proposal in this SD. The underlying principle for allocating the expected credit losses over the life of the portfolio is more economical than the common approach. It will resolve, in an operational manner, the current timing mismatch between the recognition (as revenue) of the credit risk premium included in the interest charged to the borrower and the recognition of the related credit losses.

Question 13

Would you prefer the FASB approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific FASB approach, do you prefer the general concept of this FASB approach (ie to recognise currently credit losses expected to occur in the foreseeable future)? Why or why not?

As explained in our answer to Q10, the floor mechanism will lead in many cases to apply only the FASB specific approach, which is quite similar to the FASB proposal issued last year.

Consistently with our comment letter to the FASB's ASU on accounting for financial instruments published in May 2010, we disagree with the FASB approach. As explained in the above-mentioned comment letter, "the proposed approach may lead to recognizing losses in the first period of reporting which is inconsistent with the timing recognition of the credit risk premium as revenue". The FASB approach exacerbates the timing mismatch between the recognition of the revenues, which are recognized, as part of interest, on an accrual basis over the life of the financial asset and the expense (credit loss) that this revenue aims to offset.

We rather prefer the IASB specific approach which is more economical (see Q12).

IASB only Appendix Z - Presentation and disclosure

Impairment of financial assets

Question 14Z

Do you agree that the determination of the effective interest rate should be separate from the consideration of expected losses, as opposed to the original IASB proposal, which incorporated expected credit losses in the calculation of the effective interest rate? Why or why not?

We agree that impairment must be determined at a portfolio level, apart from the EIR calculation as currently existing in IAS 39. This is indeed more consistent with the way credit risks are managed in practice. The use of an integrated EIR mechanism as proposed in the original ED raised burdensome implementation difficulties and did not take into account the fact that it is very difficult to estimate precisely the amount and timing of expected credit losses.

This proposed "decoupled" approach is therefore more operational and makes an appropriate distinction between revenue recognition and impairment recognition in profit or losses.

Scope – Loan commitments and financial guarantee contracts

Question 15Z

Should all loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37) be subject to the impairment requirements proposed in the supplementary document? Why or why not?

For risk management purposes, financial entities usually manage the credit risk from loans on the same basis, either drawn or undrawn.

Therefore, we consider that the proposed approach which is better aligned with credit risk management should also be applied to loan commitments (not accounted for at FVTPL).

Question 16Z

Would the proposed requirements be operational if applied to loan commitments and financial guarantee contracts? Why or why not?

We consider that the proposed requirements would be operational if applied to loan commitments (see Q15Z).

Regarding financial guarantees, as explained in our comment letter to the IASB's ED insurance contracts, "we note that the current IFRS 4 requirements for financial guarantees work well in practice and are well understood. Therefore, we recommend that the IASB continue to provide entities with this accounting policy choice to account for financial guarantee contracts in compliance with the business model of the entity.

Should the IASB pursue with its decision to review the existing accounting requirements in this area, we recommend the IASB to explore the following alternative so as to appropriately reflect in the accounting treatment the economics of these contracts and the business model of their issuers:

- trade credit insurance contracts issued by entities that cover the policyholder against a risk of default to pay of a customer of this policyholder, should be brought into the scope of this ED [insurance contracts] consistently with the business model of the entity;
- financial guarantees contracts issued by entities, such as those commonly issued by banks on request of their customers (for example, performance bonds or guarantees in favour of tax authorities) that cover third parties against a risk of default to pay of the customers of the entity, should be accounted for under IAS 39/IFRS 9 using an expected loss accounting model consistently with the business model of the entity."

We therefore believe that the model proposed in the SD would be operational if applied to financial guarantees currently accounted for under IAS 39. Besides, we welcome the IASB's tentative decision at the 1-2 March 2011 meeting to retain the existing approach in IFRS in order to determine which standard would apply to financial guarantee contracts.

Presentation

Question 17Z

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

In our comment letter to the IASB's ED 2009/12, we mentioned that "the ANC considers that the effect of changes in expected losses estimates must be isolated from gross revenue on a separate line". Therefore, we agree with the proposed presentation that clearly requires to separate revenue recognition (resulting from the EIR as currently defined in IAS 39) from variations of impairment allowances.

This will provide more useful information to users.

Disclosure

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

We support the principle of full and transparent disclosures to help users properly understand the outputs of the model and assess the amount of judgement that is inherent to them, as well as to contribute to help promoting convergence of impairment practices.

However, we regret the lack of clarity regarding the whole disclosure requirements of the final standard on impairment. We are therefore not in position to fully assess the disclosures proposed in the SD and their consistencies with other disclosures related to credit risk that are not re-exposed by the Board. Moreover, we wonder how these disclosure requirements will interact with the current disclosures related to credit risk in IFRS 7.

The disclosures proposed in the SD seem very extensive. More precisely, we are concerned by the following disclosure requirements :

- comparing the actual credit losses with previous estimates: as estimates of expected losses change over time, which of the estimates should be compared with the actual outcome and at what level of aggregation would such comparisons be disclosed ?

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 credit loss of the financial asset?

The SD requires the amount of allowance transferred with an asset becoming doubtful to be the time-proportional amount relating to this specific asset, i.e. considering the age and expected life of this specific asset. This requirement would unnecessarily add complexity into the proposed impairment model.

By definition, the expected loss allowances on the good book are supposed to cover effective losses on financial assets becoming doubtful. Since the expected loss method is based on a concept of portfolio loss mutualisation, it seems conceptually logical to use this allowance when an asset is transferred into the bad book using a full depletion approach (i.e. the entire amount of provision required for the bad book is transferred from the good book).

The SD requires that the good book allowance be updated after the transfer, which seems logical. A question arises as to whether the good book allowance may be used or reversed in practice during an economic downturn. In a steady state, this update may indeed generate a systematic recognition of new expected losses on the good book (especially through the floor mechanism) after a transfer of doubtful assets since the remaining sound portfolio may still theoretically suffer from expected credit losses, unless the entity massively decreases the loss parameters for the residual life of the portfolio. A mere way to address this issue in practice would be to revise EL estimates by taking into account (deducting) the credit losses of the bad book.