European Banking Federation
Secretary General

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Email

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35, Square de Meeûs
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Brussels, 23 September 2010

Subject: ***EBF response to EFRAG´s draft comment letter to the FASB Exposure Draft***

Dear Ms Flores,

The European Banking Federation appreciates the opportunity to comment on EFRAG draft response to the FASB Exposure Draft: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (ED). The EBF response to the FASB is attached to this letter *(see EBF Letter ref. 0276-2010)*; therefore we are limiting our comments to the part of the ED relating to impairment.

The EBF is very much involved in the discussion on the provisioning and has developed its own principle based model for provisioning. This has recently been modified in order to address the concerns that the original EBF model may result in a nil expected loss balance in certain, rather extreme circumstances. The revised model ensures a minimum level of impairment allowances at any point in time, while enabling the provisions to be used when needed.

The revised EBF impairment model is based on the same principles as the original one described in the enclosed EBF letter except the sequence of entries is changed. The opening balance of expected losses allowance is available for incurred losses and any excess is charged directly to profit or loss. The minimum level of provisions at each reporting date would therefore equal the expected losses for the forthcoming reporting period.

The EBF agrees with many comments expressed in the EFRAG's comment letter in response to the FASB and also disagrees with both the FASB and IASB proposal to recognise the effects of changes in estimates in profit or loss in the period of re-estimate. However, the EBF does have concerns with the model which would be supported by EFRAG.

In this model, gains and losses resulting from changes in estimates of future cash flows would be recognised in the period of the re-estimates to the extent that the change relates to the

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current or prior periods. The mechanism proposes also recognition of changes in estimated future cash flows in those future periods allocated over the remaining life of the asset to the extent that the net interest margin is sufficient to absorb the allocation. If the future change in estimates is not compensated by the future net interest margin, that portion should also be recognised directly in profit or loss.

The EBF believes that one of the main principles of any impairment model should be that the impairment allowances are built up to be used. While the mechanics of the model described in the EFRAG letter would allow using the allowances previously created, however, where there are changes in loss estimates it would be necessary to immediately build an incremental provision to the extent that these losses are deemed to relate to the current or prior periods. In certain scenarios the model could lead to high level of allowances that cannot effectively be used and therefore act in a similar way to capital buffers.

The EBF is of the view that in an open portfolio, there is no distinction between initial estimation of losses and subsequent changes. There is only a single estimation of expected losses at each balance sheet date that represent expectations of losses occurring in the future and are distinguished from losses that have been incurred.

In the EBF's view, changes in expectations relate to future events and should be recognized prospectively. The EBF believes that such an approach would provide for a treatment in the income statement consistent with the principles of the revenue recognition over the life of the instruments. It would also avoid introducing artificial income statement volatility resulting from the intrinsic difficulties in estimating expected losses.

The EFRAG's proposal to differentiate expected losses covered by the interest rate margin from those that are not has, in the view of the EBF, sound rational grounds. However, the EBF would like to point out, that in practice, such differentiation will introduce a high degree of complexity and operational challenges in the accounting of financial instruments, making it almost impossible to implement.

We would be very pleased to have an opportunity to discuss EFRAG's views and the EBF concerns with EFRAG in a meeting and also explain the EBF model in more details.

Yours sincerely,

Guido Ravoet
Secretary General

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Enclosure: 1