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DIE DEUTSCHEN VERSICHERER

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Date
24.06.2013

Invitation to Comment on the Exposure Draft
"ED/2013/3 Financial Instruments: Expected Credit Losses"

Dear Ms Flores

As the German Insurance Association (GDV) we appreciate the opportunity to comment on the Exposure Draft ED/2013/3 "Financial Instruments: Expected Credit Losses", published by the IASB on 7 March 2013. The proposed expected credit loss model in IFRS 9 for debt instruments being measured at 'amortised cost' or at 'fair value through other comprehensive income' is of high importance for German insurers.

We appreciate the attempts undertaken by the EFRAG Technical Expert Group (TEG) and the involved working groups to reach a common European view on such an important project as 'IFRS 9: Financial Instruments (*replacing IAS 39*)' towards the IASB. We request the TEG to explicitly consider the needs of insurance industry throughout the deliberations.

The GDV supports the new 'impairment' model of the IASB; the dual measurement approach better reflects the needs of long-term invested German insurers than the FASB approach which requires to recognise lifetime expected credit losses at initial recognition. We oppose excessive front-loading of losses as being not in line with the objective of financial reporting in accordance with IFRS. Thus, we support EFRAG's tentative assessment that it is desirable to distinguish between financial assets that have deteriorated in credit quality and those that have not.

Appropriate impairment rules ensure that the value of financial instruments, being measured at amortised cost, is not overestimated. In addition, financial instruments with similar features should be reflected in the income statement in similar way. The amortised cost basis for the income statement treatment of financial assets, being measured at fair value through other comprehensive income, accompanied by recycling at derecognition, thus, a single impairment model is supported by the GDV.

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With regard to the technical and operative level of the IASB's proposal we oppose the recognition of the 12-month expected credit losses at initial recognition. In our assessment, the calculation and recognition of 12-month expected credit losses for performing securities in Stage 1 should start to be recognized only at the subsequent reporting date. In addition, we appreciate the proposed exception for financial instruments with low credit risk (paragraph 6). However, we encourage the Board to clarify more explicitly that the reference to "investment grade" is not intended to demonstrate any preference for external ratings and that internal ratings and management assessment are likewise a suitable basis for categorization of securities as low risk debt instruments.

Although we fully support the convergence efforts of the Boards and strongly encourage further search for a converged solution with FASB, we would request EFRAG to encourage the IASB not to violate the fundamental principle of the dual measurement approach of this Exposure Draft: recognition of lifetime expected credit losses only after a significant deterioration in credit quality.

Attached you will find our arguments and further detailed comments as submitted to the IASB.

We hope our comments are helpful to EFRAG TEG's members in reaching final conclusions on the ED/2013/3. If you would like to discuss our comments in more detail we would be very delighted.

Yours sincerely,

(Dr. von Fürstenwerth) (Dr. Wehling)

Encl.

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

Positions of the German Insurance Association

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General Comments:

We appreciate the opportunity to comment on the revised set of proposals of the IASB issued on 7th March 2013 as Exposure Draft ED/2013/3 Financial Instruments: Expected Credit Losses ('this ED') with the aim to finalise Phase II: *Impairment* of the project 'IFRS 9 Financial Instruments (*replacing IAS 39*)'. With this response the German Insurance Association (GDV) would like to underline the importance of the Board's proposals and reconfirm its positions with regard to the accounting of financial instruments. Furthermore, we will focus on issues which are especially important for German insurers. We are fully supportive of the considerable efforts undertaken by the IASB to finalise the important and ambitious project in the near future. Given the inherent interaction between accounting of investments in debt instruments (e.g. government and corporate bonds) and insurance contracts accounting the suggested proposals in this ED are of great significance for German insurance industry.

In advance of our detailed comments to the questions set out in this ED we would like to highlight some general and some crucial issues for thorough consideration that we have identified from a German insurers' perspective. We'll also highlight the positive aspects of this ED. Especially, although substantial investments in IT-systems will be necessary and the ongoing application of the new framework will be challenging for the entities, the **GDV supports the replacement of the current incurred loss model** by a more forward-looking approach.

We support the 'expected credit loss model' as proposed by the IASB.

In general, we support the expected credit loss model as proposed by the IASB in this ED ('credit deterioration model'); accordingly we oppose the FASB's approach to recognise a loss allowance at an amount equal to the lifetime expected credit losses since initial recognition. The dual measurement approach of the IASB is conceptually more consistent as it more appropriately reflects the economic reality, especially of insurers' financial instruments investments. It is better aligned with how insurers manage credit risk on their debt instruments which are the most significant part of their investments/assets.

The convergence efforts have to continue.

The GDV is in favour of aligned accounting treatment of expected credit losses on financial instruments between IFRS and US GAAP. Thus, we regret the FASB's decision, taken at a very late stage of the impairment project, to develop a different approach. From the German insurers' perspective, and especially for entities with US operations, it is irritating that especially in the case of debt instruments with low credit risk the impairment conceptions might deviate in the future. We still believe that **convergence is a worthwhile objective**. However, we think that measurement of a loss allowance since initial recognition using lifetime expected credit losses is not appropriate, especially in case of long-term high-quality financial assets. Thus, we advocate that the **convergence argument must not be misused to converge to FASB's unfavourable**

approach. From our perspective it is essential to distinct between debt instruments that have deteriorated in credit quality and those that have not. Thus, the IASB's credit deterioration model is the one we suggest as a valid basis for convergence efforts of the Boards during the coming deliberations.

The level playing field for the insurance industry has to be ensured.

By developing and finalising IFRS 9 *Financial Instruments* it is crucial to consider that IFRS 9 is not solely dedicated to banks. The existing credit risk management systems of the banking industry should be considered, but they should not serve as the sole basis for conclusions for Board's decisions on the designation of impairment rules which will affect all industries. The long-term oriented insurance industry in Germany is a major investor in debt instruments and therefore subject to IFRS 9. This ED will have a significant impact on German insurers. Thus, an appropriate design of impairment provisions for financial instruments is essential. Referring to our preference for consistent two-sided OCI presentation including the use of the **FVOCI measurement category for financial instruments**, the GDV would like to highlight the **essential** importance of the proposed changes for insurers. In this context we request that the IASB recognises the need for conceptual consistency of future provisions in IFRS 9 being suitable for all industries. A proper and transparent reflection of the business model of insurers and a level playing field with other industries is vitally important and has to be ensured by the IASB. For example, the proposed exception in paragraph 6 ("investment grade relief") is a step in the right direction.

The IASB's dual-measurement approach is supported; an excessive front-loading of expected credit losses would misrepresent the economic reality.

This ED is **highly relevant for German insurers** as the overwhelming part of the assets backing (illiquid) insurance liabilities are corporate or sovereign bonds, German covered bonds or loans. The main conceptual change with regard to impairment provisions in IFRS 9 Phase II is the replacement of the 'incurred loss model' by the 'expected credit loss model'. The change has the objective to ensure that losses for financial instruments are recognised on a more timely basis, especially irrespective of a credit loss event. This recognition threshold should be removed. However, **the Board's decision to disallow for excessive front-loading of losses is appreciated**; moreover, the orientation on the significant relative change in credit quality as a basis for recognition of lifetime expected credit losses is the right way to proceed. Especially, the GDV welcomes the Board's explicit acknowledgment that the **long-term instruments should not be disadvantaged** when designing impairment rules (BC72).

Although we **appreciate and support the considerable convergence efforts** undertaken by the Boards, we believe that the German insurers would not be able to appropriately reflect their successful business model when recognition of all potential expected credit losses would have to be recorded immediately at inception. That's why **the GDV is not in favour of the FASB's approach**. Nevertheless, we encourage the Boards to continue their search for converged solutions; but they should not violate the fundamental principles of this ED.

Pragmatic solutions in a principle-based standard reduce operational costs.

We agree that the significant deterioration in credit quality should serve as a **principle-based threshold event** for recognition of lifetime expected credit loss on debt instruments. And we believe that it is consequent that the related credit risk assessment is a matter of management judgment. We appreciate the IASB's acknowledgment that entities might use different information (sources) and techniques for assessing whether they should recognise lifetime expected credit losses (BC115). We understand that this ED permits the use of 12-month probabilities of default when assessing the significance of the change in the credit risk since initial judgment, if appropriate (B11, BC73). We consider it as a pragmatic approach. We support the Board's decision to **not introduce any** further specifications about the amount of the relative change in the probability of default (e.g. 5 per cent as a **bright line**) that would require the recognition of lifetime expected credit losses. We share the Board's rationale (BC74) and support the broad principle-based definition. Finally, we explicitly **support** the clarifications in paragraphs B17 and B25 regarding the use of a **'collective basis' assessment and measurement approach**.

Recognition of 12-month expected credit losses at initial recognition is not appropriate.

We encourage the Board to clarify that **12-month expected credit losses should** be recognized **at the reporting date** after the initial recognition, **but not at initial recognition**. The related adjustments of Example 10 would address the most critical part of the Stage 1-design. We question the rationale and oppose the recognition of the 12-month expected credit losses *at initial recognition* of debt instruments, especially with low credit risk. We do not consider it appropriate because any initial credit loss expectations are reflected in the initial measurement (e.g. transaction price, fair value). Thus, only subsequent credit deterioration should lead to impairment recognition. In BC213 the Board confirms that full lifetime expected credit losses should not arise on initial recognition if the financial instruments are priced correctly, even in the case of poor credit-quality financial instruments. In our view, the same rationale should apply in case of 12-month expected credit losses, especially for high-quality debt instruments. The GDV supports the recognition of 12-month expected credit losses on debt instruments *at subsequent reporting dates* as a pragmatic proxy within the favoured decoupled approach until significant credit deterioration occurs.

"Investment grade relief" for financial instruments with low credit risk is supported.

From the conceptual perspective the exception in paragraph 6 ("investment grade relief") is a step in the right direction regarding an appropriate accounting treatment of financial instruments with low credit risk. Irrespective of the change in the credit risk, an entity shall not recognise *lifetime* expected credit losses on financial assets with low credit risk at the reporting date. The Board's pragmatic decision to introduce this explicit exemption for investments in high-quality bonds will significantly reduce the operational costs for insurers. We share the Board's rationale that financial assets with high credit quality should not be the primary focus for the recognition of lifetime expected credit losses (BC76).

Support for consistent accounting treatment of debt instruments and an aligned single impairment model for AC- and FVOCI-category.

The OCI presentation is a transparent way to ensure a proper reflection of the financial performance of long-term oriented entities in the income statement when the short-term current value movements in the balance sheet are taken into account. Thus, the **GDV supports** the introduction and consistent use of the fair value through other comprehensive income (**FVOCI**) category for financial assets in IFRS 9 in alignment with the current fulfilment measurement of insurance liabilities in IFRS 4 Phase II, where effects of current **interest rate changes** are supposed to be presented **in other comprehensive income (OCI)**. The related Board's tentative decisions are appreciated by German insurers. To achieve a consistent accounting treatment of **credit risk related changes** in value of debt instruments **in income statement**, the IASB suggests to include the financial instruments being measured at FVOCI into the scope of the expected credit losses model. Thus, the expected credit losses would be presented in the income statement, irrespective of the use of AC or FVOCI category, in the same way. The GDV supports the **consistent treatment of AC- and FVOCI-category within the expected credit loss model**. Especially, we support the amortised cost basis for the income statement with corresponding records for fair value changes in the other comprehensive income. For further explanations of our position we refer to our response to *Question 3*.

The mandatory effective dates of final IFRS 9 *Financial Instruments* and IFRS 4 *Insurance Contracts* (Phase II) must be aligned.

The completed IFRS 9 *Financial Instruments* is currently scheduled to become effective on the 1th January 2015. The finalised IFRS 4 *Insurance Contracts* (Phase II) is expected to be enacted on the 1th January 2018. Considering the systematic interconnection of both projects we would like to reiterate our fundamental position on the general need for the alignment of the effective dates of both standards (as recently expressed in our comment letter of 19th March 2013). The new accounting principles for financial instruments and for insurance contracts should be implemented and applied by insurers at the same time. However, the possibility of early application should be permitted for both standards. We believe that a pragmatic solution for a question of such importance for all insurers should be feasible.

In addition, any transition period has to be sufficiently long to ensure a proper implementation and application of the fundamentally changed accounting provisions. Even in the case of an isolated mandatory effective date for IFRS 9 we consider that any effective date before 1th January 2017 is operationally not feasible.

Final remarks

Although we are fully supportive of the Boards' convergence efforts we strongly encourage the IASB to maintain the decision that excessive anticipation of expected credit losses is not appropriate. The long-term bonds, loans and any other forms of long-term financing provided by insurers would be potentially disadvantaged under such accounting provisions.

For our arguments and further detailed comments on this ED, please consider our positions enclosed. Please note that our comments are based on the current stage of the insurance contracts project (IFRS 4 Phase II). Given the inherent interaction of IFRS 9 and IFRS 4 our assessment might subsequently change due to the final decisions on the insurance contracts project.

We hope that our comment letter provides a useful contribution to the future IASB's discussions and final decisions on the robust principle-based standard for financial instruments being suitable for all industries.

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?

(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?

(a)
Yes, we agree. The GDV explicitly supports the differentiation between cases in which lifetime expected credit losses have to be recognised and cases in which only the consideration of a portion of expected credit losses is required. The latter is obvious in the case when the financial asset under consideration (e.g. purchased high-quality corporate bond or originated loan) is well performing and the credit quality at the reporting day has not significantly deteriorated since initial recognition.

In general, the IASB's proposal is an acceptable approach to reflect the existing economic linkage between the pricing of a financial instrument and its credit quality. Only the subsequent significant deterioration of the credit quality should lead to the recognition of lifetime expected credit losses at the reporting day. As acknowledged by the IASB (BC61-BC66), the recognition of only a portion of expected credit losses at the reporting date in Stage 1 does not have a sound conceptual basis. Thus, we appreciate the explicit expression of the underlying rationale for this pragmatic decision. However, as already expressed in our General Comments, there is a need for a technical adjustment regarding the recognition of the portion of expected credit losses *at* initial recognition, especially in case of debt instruments with low credit risk. Thus, in consideration of *Example 10* we kindly request the Board to include the following clarification:

Example 10 suggests that a loss allowance has to be calculated and recorded at initial recognition. In our assessment, this approach does not reflect the common understanding of accounting. We believe that the recognition of expected credit losses should remain an integral part of subsequent measurement at the reporting date, as indicated by paragraphs 4, 5, 6 and paragraph 11 of this ED. Thus, *Example 10* which indicates a mandatory recognition of loss allowance already at 1 January 20X0 (paragraph IE63) should be adjusted to demonstrate that the calculation and recognition of the loss allowance is required only at the reporting date subsequent to the initial recognition, and not already at initial recognition. In general, we do not see any reason to violate the **concept of neutrality of initial recognition**. In addition, the calculation and recognition of 12-month expected credit losses at initial recognition might be an operational challenge for preparers, especially in case of portfolio approach application. We consider it also **counterintuitive** when using the fair value as a measurement basis at initial recognition ('double-counting'). Finally, there would be no significant benefit for external users.

(b)

Yes, we fully agree. Recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses would not faithfully represent the underlying economics of financial instruments. It would be counterintuitive, especially in the case of well-performing financial instruments, which are all based on the restrictive cash flow characteristics test as currently suggested in the IFRS 9 *Financial Instruments* Phase I: *Classification and Measurement*. The low credit risk can be usually easily verified (e.g. by observing the fix payments of interest as time passes by). Thus, we support the Board's decision to **not follow the FASB's approach**. The GDV agrees, in general, with the design of the provisions in paragraph 4 and paragraph 5 of this ED: the lifetime expected losses are to be recognised (at the reporting date) only if the credit risk of the financial instrument under consideration has increased significantly since initial recognition.

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?

(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)?

(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?

(a)

In general, we agree that the approach of this ED leads to a faithful presentation. In addition, this ED is also potentially suitable to provide a principle-based expected credit loss model with an acceptable level of one-time and ongoing implementation costs. However, these costs will still be substantial for insurers.

From a <u>conceptual</u> perspective: we think it is not adequate to recognise any loss allowance at initial recognition. For example in case of purchased debt instruments the transaction price at initial recognition closely reflects the fair value and it includes already the assessment of lifetime expected credit losses. In general, we acknowledge that the IASB's approach implicitly and to some extent does already recognise that rationale. Thus, **any additional recognition of lifetime expected credit losses should only take place after a significant deterioration in credit quality since initial recognition,** if the exemption for debt instruments with low credit risk does not apply. Nevertheless, we support the suggested recognition of 12-month expected credit losses *at the reporting date* as a suitable pragmatic proxy in Stage 1 for lifetime expected credit losses.

From the operational perspective: we appreciate the Board's clarification that the estimation of expected credit losses to reflect an unbiased and probability-weighted amount does not require to conduct a complex analysis. However, in cases of performing financial instruments we question the need for any sophisticated analysis to be conducted. This might however be contradicted by the provision of the last sentence in paragraph B28. We would welcome further simplifications to lower the operational costs (e.g. cash-based recognition of interest revenue in Stage 3, incurred loss approach for insurance receivables). Especially, the standard has to be principle-based; the insurers should be able to take advantage of techniques/approaches required for regulatory purposes.

As a matter of fact, the degree of judgment required to estimate the expected credit losses will be higher compared to the incurred loss model. Thus, we welcome the clarification in Application Guidance (paragraph B6) that an **entity is not required to undertake an exhaustive search for information but shall consider all available information** being relevant for the estimation of expected credit losses. It considers the call for a pragmatic approach. Especially, we appreciate that entities which have insufficient sources of data are allowed to refer to peer group experience for comparable financial instruments.

(b)
IFRS 9 is not industry specific. Although we still see a need for some clarifications and improvements, we do agree that the proposed approach in this ED achieves a better balance than the previous approaches; these were mainly driven by the design of loan portfolios. Especially in our response from 4 April 2011 we have suggested differentiating between loan and bond portfolios and considering the needs of banks and of other industries. We acknowledge that the IASB has responded to this request.

(c)
We disagree. The concept of recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition does not achieve a better balance between the faithful representation of the underlying economics and the cost of implementation. Especially, this ED allows for a **more suitable representation** of the underlying economics **in case of financial instruments with low credit risk**; the balance with regard to the costs of implementation of this ED are considered to be at an acceptable level.

Question 3

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

(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?

(a)
We agree with the proposed scope of this ED; and especially with the rationale of the proposal for a **single expected credit loss model for both financial assets at amortised cost (AC) and financial assets at FVOCI** (BC55). Thus, also financial assets that are mandatorily measured at FVOCI should be subject to the accounting of expected credit losses as proposed in this ED. As a consequence the income statement would reflect the amortised cost basis information. It might be challenging for users to interpret the recognition of expected credit losses and the offset in the OCI in cases in which the fair value of e.g. tradable bonds exceeds their carrying amount at AC-basis. Nevertheless, we would not be in favour of incorporating any practical expedients to the proposed single model; any modifications might have the unintended consequence of increased operational challenges to insurers.

(b)
As expressed in our detailed comment letter from 19 March 2013 with regard to the Exposure Draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9*, **the GDV supports the introduction of** the additional defined business model in IFRS 9 which should be subject to **FVOCI measurement and presentation category**. Also in context of this ED we would like to highlight the **transparent nature of the OCI presentation** of changes in the fair value of assets being measured at FVOCI. In addition, we refer to our rationale stated in *Question 1* that, from a conceptual point of view, a loss allowance at initial recognition is inappropriate because the initial fair value measurement already considers the lifetime expected credit losses. Thus, we believe that the <u>calculation and recognition</u> of expected credit losses also for debt instruments in the FVOCI category should be required <u>only at the reporting date</u>.

While we support a **consistent accounting treatment of credit risk related changes** in value of debt instruments in the **income statement**, irrespective the category (AC or FVOCI) they are belonging to, we encourage the IASB to more explicitly address the interpretation of the amounts accumulated in OCI and gains/losses at derecognition which are supposed to be recycled from OCI to profit or loss.

In our interpretation, *positive* amounts accumulated in OCI would indicate that the market assessment is such that fair value of the debt instruments under consideration exceeds their amortised cost basis (i.e. including the subjective assessment of loss allowance for expected credit losses in line with this ED). On the opposite, *negative* amounts accumulated in OCI would indicate that the subjective assessment of the loss allowance needed to cover the expected credit losses does not sufficiently decrease the carrying amount of the debt instrument and, thus, additional reduction is needed. Effectively, the amounts accumulated in OCI reflect the difference between the amortised cost bases in the income statement and the consequences of the required use of fair values in the balance sheet. We support this approach.

Nevertheless, we have been advised that the simplified *Example 10* might be confusing with regard to suggested journal entries. We would favour a double step approach for journal entries, whereby the initial recognition is not accompanied by the recognition of 12-month expected credit losses:

Journal entries at initial recognition	**Debit**	**Credit**
Financial asset - FVOCI	CU 1.000	
Cash		CU 1.000

Journal entries at the reporting date	**Debit**	**Credit**
Impairment (profit or loss)	CU 30	
Financial asset - FVOCI		**CU 30**
other comprehensive income (OCI)	CU 20	
Financial asset - FVOCI		**CU 20**

Finally, we support the suggested **recycling** principle: recycling at derecognition. In our view, it **should also apply for equities when measured at FVOCI**.

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?

We believe that the 12-month expected credit losses measurement (Stage 1) can be made operational. Especially, we favour robust financial accounting principles so that also insurers can use regulatory techniques which are already required or which are supposed to be enacted under their regulatory framework in near future.

Nevertheless, we believe that there is no need for recognition of *additional* loss allowance in cases in which a robust assessment indicates that no significant change of default risk occurred. Thus, we encourage the Board to clarify that a probability of default being zero is feasible and should not be treated as a misuse of the model where the 12-month expected credit loss has to be calculated. Such a clarification would correspond with the explicit statement for **disclosure** requirements in paragraph 40 (b) where the possibility of expected credit loss of zero because of collateral is provided. In addition, we understand that appropriate portfolio selection would allow for equal treatment on the collective basis (in accordance to paragraph B25). As insurers usually invest in high-quality debt instruments, the importance of clarification is obvious.

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?

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

(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?

(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?

(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?

(a)

The GDV supports an approach which distinguishes between performing financial assets (Stage 1) and those which are significantly deteriorated with regard to their credit risk, subsequently to the initial recognition (Stage 2). We support the proposal to require the recognition of 12-month expected credit losses *at the reporting date* in Stage 1 as a suitable pragmatic proxy for lifetime expected credit losses, especially considering debt instruments with low credit risk. In such cases, the operational efforts to calculate the lifetime expected credit losses are not proportionate to the potential benefits. In cases of financial instruments with poor-credit quality, we agree that the benefits of recognising the 12-month expected credit losses overweight the operational efforts. In addition, we explicitly endorse the rationale for the Board's decision not to require the recognition of lifetime expected losses in such cases (BC213).

Furthermore, we agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses after a **significant increase in credit risk** since initial recognition. The suggested **principle-based** ‘recognition threshold’ appears to be sufficiently robust to meet the Board’s objective for more timely recognition of expected credit losses. We share the Board’s general assessment that a significant increase in credit risk occurs before there is an objective evidence of impairment or a subsequent default occurs (paragraph B12, BC212). Thus, the proposed change to rely on the significant increase of credit risk (i.e. significant increase in probability of a default) at the reporting date since initial recognition is **conceptually convincing**. We appreciate the Board’s efforts to align the approach of identifying deteriorated financial instruments with credit risk management approach (BC198). We share the objective of the IASB that only meaningful changes in credit risk should be captured. Moreover, we welcome the exemption for financial instruments with low credit risk (i.e. performing instruments). We appreciate the decision that in such cases no analysis of the change in credit risk since initial recognition of a debt instrument is required (paragraph 6 and paragraph B16 of this ED).

(b)
We believe that **this ED provides sufficient guidance** when to recognise lifetime expected losses (B20-B21). In our assessment the **principal-based approach** fits well into the targeted design of final IFRS 9. It is suitable that this ED provides only a high-level principle which has to be appropriately implemented and applied on a consistent basis. The principle-based requirement allows for flexibility as insurers’ credit risk management systems differ in many ways. Thus, we support the Board’s current proposal.

Especially, we explicitly support the Board’s decision <u>not</u> to define the term ‘default’. We share the Board’s conclusions as expressed in BC97.

(c)
Yes, we agree. In our view it is conceptually appropriate to refer only to relative changes in the credit risk assessment expressed by the probability of a default. In cases in which the changes in expected credit losses are immaterial the general materiality principle remains applicable.

(d)

We agree with the IASB's assessment that the implementation of the expected credit loss model will require 'substantial system changes, time and resources' (BC201). Thus, a sufficient long implementation period is indispensable. Although the **costs of ongoing application** (especially tracking of changes in credit risk assessment since initial recognition) **will** also **be substantial**, they are justified by the benefits of new approach. Nevertheless, some pragmatic simplifications might contribute to significant reduction of operational challenges.

We support the proposed simplifications and appreciate the Board's intention to reduce the operational costs for entities. Especially, we would like to express our explicit **support** for the exception for securities with low credit risk ('**investment grade relief**', paragraph 6). In addition, we endorse the Board's decision to explicitly clarify in the last sentence of paragraph 6 that the existence of 'low credit risk' characteristics can also be proved by the reference to **internal credit risk rating**. Thus, internal credit risk rating is clearly considered to be an adequately valid basis for such qualification. We welcome and support this clarification.

This ED suggests relying on significant <u>relative</u> change in probability of default (since initial recognition) to recognise a loss allowance for lifetime expected credit losses. Thus, we believe that the '**investment grade relief**' (paragraph 6) is not only just a simplification to reduce the operational burden (BC208), but an **essential** part of the suggested expected credit loss approach for debt instruments with low credit risk. The operational costs would not be proportionate given the potentially low benefits of recognition of lifetime expected credit losses on such instruments where the recognition of 12-month expected credit losses is a suitable proxy. Finally, the current consultation might demonstrate a need for **further operational simplifications**, for example when estimating the 12-month expected credit losses in case of securities with low credit risk.

(e)

We support the Board's decision to require the re-establishment of the recognition of only 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met. Otherwise the fair presentation of the financial position would be distorted for long periods of time. Especially the long-term oriented insurers would be negatively affected as they would be forced to present loss allowances although the financial instruments have already recovered.

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?

(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?

(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?

(a)
We support the suggested decoupled approach of this ED (BC98). However, we do not believe that recognising the initial planned interest revenue (calculated using the effective interest method on the gross carrying amount of the debt instrument) is still appropriate when the objective evidence of impairment has occurred (i.e. impaired debt instruments).

(b)
From a theoretical point of view, we support the proposal to change the basis for calculation of the interest revenue for impaired debt instruments (Stage 3). We also acknowledge the rationale of the Board's proposal (BC99-BC102). However, the consideration of operational aspects leads us to the conclusion to <u>not favour</u> the Board's approach. We believe that recognition of interest income for impaired securities should be further simplified. We propose to consider the practical expedient and to allow the **cash-based** treatment of interest payments (similar to the methodology suggested by the FASB). In agreement with this request we suggest to investigate if there is a need to maintain Stage 3. The removal of the indicators for the 'objective evidence of impairment' for the transfer between Stage 2 und 3 would significantly contribute to reduced complexity of the proposal.

(c)

From a theoretical point of view, it is a valid approach to revert the calculation basis for interest presentation when the recognised impairment is subject to reversal. However, for the simplicity purposes we suggest to <u>not</u> require the symmetrical approach. The operational efforts are disproportionate to the potential benefits for the users. Thus, we would prefer for interest payments to continue to be recognised on the cash basis once securities are qualified to be impaired.

Question 7

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

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

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

(a)

In an expected credit loss model the recognition of loss allowances (or provisions) is inherently based on management's judgment. Thus, suitable level of disclosure requirements is necessary (BC106). Although we are supportive of transparent and effective notes, **we do not support extensive disclosure requirements which might lead to information overload**. Thus, for example, we appreciate the Board's decision to not require disclosure for back-testing (BC109).

In general, we believe that the current proposal on disclosure requirements does <u>not</u> reflect the cost-benefit-balance. The collection of exhaustive information, as proposed by this ED, would cause considerable operational efforts, where the effective benefit for the users might be limited, especially if disclosures are presented on an aggregated basis on a group level. Especially the required **granularity of the mandatory reconciliations (paragraph 35) is an area of considerable concern for German insurers**. We doubt whether the expected benefit justifies the operational efforts for such a detailed level of disclosure requirements. Thus, we disagree with the tentative conclusion of the IASB (BC112).

Furthermore, we consider that the **disclosure** requirements on the application of the expected credit loss model should be specified **in IFRS 7 *Financial Instruments: Disclosures***. This would also **eliminate duplication** between the requirements outlined in this ED and those disclosures already required by IFRS 7 (paragraph 31). In addition, we believe that the proposed disclosure requirements should be simplified and focussed on entity specific information.

In addition, we suggest the reconsideration of some specific disclosure requirements. Our comments aim to improve the consistency of the disclosure requirements and to lower their burden:

- We do not see any significant added value through the requirement of the last sentence in the paragraph 35 (d). We suggest deleting it.
- The specifications in paragraph 39 are too prescriptive. We suggest deleting the detailed explanations and keeping only the first sentence.
- Paragraph 41 is redundant when considering the provisions of IFRS 8 *Operating segments*. We suggest deleting paragraph 41.
- The specifications in paragraph 42 are too prescriptive. We suggest deleting the detailed explanations and keeping only the first sentence.
- We support the Board's tentative decision to rely on the internal credit risk management. However, we do not believe that it is appropriate or necessary to require an effective change in the internal rating policy if the entity uses less than three credit risk rating grades. Thus, we recommend to adjust the paragraph 44 and to delete the sentence "*except that an entity shall always disaggregate its portfolio across at least three grades, even if that entity uses fewer credit risk rating grades internally*".

(b)
The most burdensome disclosure requirement would be to ensure the required granularity of mandatory reconciliation (paragraph 35). We strongly request the Board to consider major simplifications.

Finally, we suggest a clarification that disclosure requirements for **interim reporting** are solely specified by IAS 34 *Interim financial reporting*. It would be, for example, a significant operational burden to provide for reconciliations in line with paragraph 35 for interim reporting purposes.

(c)
We are not aware of any further disclosures which provide useful information to an extent that would justify a mandatory application.

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?

In general, we agree with the Board's proposal and share the underlying rationale. We do believe that the suggested treatment provides useful information.

In addition, we understand that the exception for financial instruments with low credit risk should also apply to modified financial instruments (BC123).

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?

(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.

(a)
Yes, we agree. In our view it is conceptually sound to consistently apply the same impairment approach to loan commitments and financial guarantee contracts with the present obligation to extend credit (BC132).

(b)
The GDV supports the transparent recognition of off-balance financing agreements. We do not foresee any significant operational challenges which would overweight the benefits of having a transparent picture of financial positions of entities committed to such contractual agreements at the reporting date (BC136).

Nevertheless, we would like to reiterate our position against recognition of a loss allowance at an amount equal to 12-month expected credit losses <u>at</u> initial recognition. Per analogy we oppose the recognition of a provision at an amount equal to 12-month expected credit losses at initial recognition (date of commitment) in case of loan commitments. The application of this requirement would be operationally very challenging while the benefit would be very limited (if any), especially in cases in which loan commitments are available only over a limited period of time (an in many cases within one reporting period). For these pragmatic reasons we consistently support the recognition of 12-month expected credit losses only at the reporting date.

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?

(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?

(a)

We agree with the proposed simplified approach for trade receivables and lease receivables. However, we would expect that the rules for treatment of lease receivables would be defined within the standard on leases.

We would like to recommend a clarification with regard to the treatment of **insurance receivables**, such as premiums to be paid by policyholders. We assume that they are not intended to be in the scope of IFRS 9. However, the cost of implementing an expected loss model for insurance receivables, even under a simplified model, might not outweigh the benefits due to the short maturity of these assets. We believe they should be exempted from applying the expected credit loss model and instead an **incurred loss approach** should be applied.

(b)

Yes, we agree with the proposed amendment.

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?

Form a conceptual point of view, we agree with the suggested treatment. We also welcome the clarification in paragraph B9 that for a financial asset to be a 'purchased or originated credit-impaired financial asset', there must be 'objective evidence of impairment' at initial recognition. We share the Board's assessment that the proposed approach for computing the effective interest rate (especially inclusion of the expected credit losses in the estimated cash flows) and for recognition of interest income (based on the amortised cost) faithfully represents the underlying economics for credit-impaired debt instruments. We understand that the subsequent changes in the lifetime expected credit losses lead to recognition of impairment gains or further impairment losses, but they do not lead to change in the effective interest rate calculated initially.

In addition, we do not consider it necessary to disclose the total amount of undiscounted expected credit losses at initial recognition (paragraph 35 (d)) over the whole remaining maturity. The amount is implicitly included in the transaction price at initial recognition (BC141). In addition, the impairment gains or losses on such instruments at the reporting date will be also disclosed. This information is sufficient.

Question 12

(a) What lead time would you require to implement the proposed requirements? Please explain the assumptions that you have used in making this assessment. As a consequence, what do you believe is an appropriate mandatory effective date for IFRS 9? Please explain.

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

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

(a)
A **suitable transition period is indispensable** to achieve a high level of proper implementation and application of the fundamentally new approach. In our assessment the 'expected credit loss model' will require substantial changes to existing internal processes and systems. Thus, sufficient time after the final publication of the completed IFRS 9 should be granted.

In addition, we would like to reiterate our strong position that the mandatory effective dates for the standard on insurance contracts and the standard on financial instruments need to be aligned for insurers. Thus, insurers should not be required to apply the final IFRS 9 before the mandatory effective date of the final standard IFRS 4 Phase II. Nevertheless, an early adoption on a voluntary basis should be permitted. For further comments and our rationale we refer to our General Comments. We encourage the Board to provide a realistic time table for the finalisation and enacting of the complete IFRS 9 in alignment with the insurance contracts standard in the near future.

(b)
We support the IASB's decision to not grandfather current requirements (BC156 (a)) for existing financial instruments and to not allow for prospective application of the proposed requirements for new financial instruments only. However, regardless our general support for the retrospective approach in accordance with IAS 8, the proposed retrospective application of the conceptually new impairment approach is in many cases too costly in relation to the potential benefits. In many

cases the insurers use currently an approach that is solely based on credit quality at the reporting date which is in accordance with the current requirements of the incurred loss model.

For these reasons, we support the proposed relief that the loss allowance measurement shell be determined only on the basis of whether the credit risk is low (i.e. credit risk is equivalent to investment grade) at each reporting date (C2 (a)). However, we disagree that this relief should only apply when obtaining information about credit quality at initial recognition is not feasible without undue costs or efforts. This judgmental constraint might lead to unnecessary uncertainty by auditors if the relief can be utilised.

We also explicitly support the Board's tentative decision that the entities are not required to restate prior periods (C2 (b)).

(c)
Yes, we support the proposed relief from restating comparative information.

Question 13

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

In general, we agree with the IASB's effects assessment. Nevertheless, our suggestions, e.g. to not require the recognition of 12-month expected credit losses at initial recognition, to allow the cash basis for interest revenue presentation in Stage 3 or to reconsider the disclosure requirements would further improve the cost-benefit-balance of the new approach.

Finally, we welcome the explicit clarification that the IASB does not intend to create an approach to recognise loss allowance that will be sufficient enough to cover (all) unexpected credit losses (BC197). That is, indeed, not the primary objective of financial reporting in accordance with IFRS. The suggested clarification might reduce any potential 'expectation gap'.

Berlin, 24th June 2013