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Our ref: ICAEW Rep 86/13

Mme Françoise Flores
Chair
European Financial Reporting Advisory Group
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Chère Mme Flores

ED/2013/3 *Financial Instruments: Expected Credit Losses*

ICAEW welcomes the opportunity to comment on EFRAG's draft comment letter on the International Accounting Standards Board Exposure Draft ED/2013/3 *Financial Instruments: Expected Credit Losses.* Our responses to the main issues highlighted by EFRAG are set out below. A copy our response to the IASB is attached to this letter. Please refer to this response for our detailed views on the IASB's proposals.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

EFRAG'S DRAFT COMMENT LETTER ON ED/2013/3 FINANCIAL INSTRUMENTS: EXPECTED CREDIT LOSSES

Memorandum of comment submitted in June 2013 by ICAEW, in response to EFRAG's draft comment letter on IASB's exposure draft ED/2013/3 *Financial Instruments: Expected Credit Losses* published in March 2013.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on EFRAG's draft comment letter on the IASB's Exposure Draft ED/2013/3 *Financial Instruments: Expected Credit Losses*.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

MAJOR POINTS

While no impairment model is without conceptual flaws, the IASB's current proposal offers a workable solution

5. We agree with EFRAG that the requirement to recognise all losses expected to result from default events within the 12 months after the reporting date has no conceptual basis. However, in common with EFRAG, we are willing to support the board's latest proposals for pragmatic reasons as they offer a solution that is operationally viable and represents an improvement to existing practice.

6. We also agree that by recognising lifetime expected credit losses when there is a significant deterioration in credit quality, the proposals better match interest income and credit losses and provide a closer link to risk management than previous proposals. This is likely to result in more relevant and understandable information.

7. Impairment is of critical importance and, after four years of examining different options, including attempting converged solutions, the board should move as quickly as possible to finalise a standard based on its latest proposals, including clarifications as determined through its due process. Returning to the drawing board in search of a better solution is no longer an option.

Convergence with US GAAP

8. In an ideal world, we would like to see a converged impairment standard. However, in our view, it is more important for the IASB to focus on finalising a quality solution rather than continuing to attempt to agree a compromise and accept the FASB's proposals. Like EFRAG, we have serious concerns about the FASB's latest model as recognising all expected credit losses upfront does not reflect the economic substance of lending and could have serious unintended commercial and broader economic consequences.

Costs and benefits

9. We agree with EFRAG that the proposed approach strikes an acceptable balance between costs and benefits. However, while the board's latest proposals should be less costly to implement than their predecessors, the costs involved should not be underestimated. It may be that larger banks and other financial sector institutions will be able to leverage regulatory models to help develop systems for implementing the requirements. However, it should not be assumed that this will significantly ease the burdens, not least because there are many differences between the regulatory and accounting requirements and not all the necessary data may be available to meet the latter. Moreover, it is important to note that relatively few banks currently use the 12-month expected loss information for the purposes of prudential regulation and that many smaller banks are therefore likely to incur significant costs in order to implement the proposals as they may have to build systems to estimate 12-month expected losses from scratch. We looking forward to seeing the results of the work that EFRAG is undertaking as this should provide an indication of the complexities and costs of gathering this data in practice.

RESPONSES TO SPECIFIC QUESTIONS RAISED BY EFRAG

Are you comfortable having the same impairment model for both the amortised cost category and the FV-OCI category? Please explain.

If you prefer a different impairment model for the FV-OCI category than for the amortised cost category, please explain how this model would function and how it would reflect changes in credit quality.

10. If a mandatory FVOCI category is introduced, we believe that the same approach to accounting for expected credit losses should be applied as to financial assets measured at amortised cost. This would avoid some of the criticisms levelled at IAS 39 during the financial crisis by ensuring that comparable amounts are recognised in profit or loss for all financial assets and avoiding the complexity that arose from IAS 39's multiple impairment models. We would not want to return to a situation where different financial assets are subject to different impairment methodologies. See our reply to question 3(b) in our response to the IASB for more details.

Do you believe that the '30 days past due' rebuttable presumption appropriately reflects when there is a significant increase in credit risk? If not, please explain why and what alternative period you would recommend.

11. We agree with the proposed rebuttable presumption that there is significant deterioration if payments are more than 30 days past due. See our reply to question 5(d) in our response to the IASB for more details.

Do you believe that any of the proposed disclosures give rise to operational concerns or are unnecessarily burdensome? If so, please specify those disclosures and explain why the concern arises.

Do you believe that the proposed disclosures are appropriate for all types of entities?

12. On the whole we are supportive in principle of the proposed disclosure requirements which we believe could potentially increase transparency and comparability provided the requirements are clear. However, we have some specific concerns about some of the detailed requirements, as discussed in our reply to questions 7(a) and 7(b) in our response to the IASB.

13. Paragraph 29 of the exposure draft allows entities to judge for themselves what level of detail should be disclosed, what the emphasis on each disclosure should be and the amount of aggregation that is appropriate. This should ensure that the proposed disclosures are appropriate for all types of entities. Moreover, entities outside of the financial sector will be able to avoid making some of the more detailed disclosures on the basis of materiality.

Do you believe that a different impairment model should apply to loan commitments? If so, please explain how the model would function and reflect changes in credit quality.

14. No. We believe that the general model should be applied to loan commitments. Many entities in the financial sector manage loan commitments together with other items in open portfolios eg, undrawn credit card commitments are often managed together with credit cards with existing balances. Therefore we believe that it is appropriate for such commitments to be subject to the same impairment requirements as other financial assets. See our reply to question 9(a) in our response to the IASB for more details.

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