German Banking Industry Committee

Die Deutsche Kreditwirtschaft

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Comments by the German Banking Industry Committee on EFRAG's Draft Comment Letter on the IASB's ED / 2013 / 3 Financial Instruments: Expected Credit Losses

19 June 2013

Dear Ms Flores,

The German Banking Industry Committee welcomes the proposed expected credit loss approach submitted by the IASB which fundamentally remedies the widely criticised shortcomings of the incurred loss model. In this regard, we welcome the credit deterioration approach prepared by the IASB which differentiates between high quality loans and loans of a lower quality ("good book" *versus* "bad book" assets).

More specifically, we particularly welcome the present exposure draft for the following reasons:

- It constitutes a significant improvement over the 2009 ED; this especially applies to the model's operational feasibility
- It remedies the shortcomings of the IAS 39 model and addresses the G20 requirement ("too little too late")
- It offers an enhanced consideration (compared to the FASB proposal) of existing risk management practices as well as the consideration of the economics of lending
- It sets out principle-based requirements

On the whole, we thus subscribe to the IASB proposals. Please find our comments on pending issues pertaining to operational details and a number of suggestions below. On the whole, we are of the opinion that these issues can be resolved in a constructive dialogue to the mutual satisfaction of all parties involved.

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On the other hand, the German Banking Industry Committee clearly rejects the current expected credit loss (CECL) impairment model proposed by the FASB. From an economic point of view, it is not immediately obvious why "healthy" loans already require the recognition of loss allowances (or provisions) over the entire term to maturity already on the closure date of the credit. Furthermore, the implementation of the US model would lead to a discrimination of the long-term lending business.[1]

At this juncture, from a general point of view, we would like to point out that the creation of e.g. capital buffers should not be regulated by accounting standards. Instead, this should remain the exclusive prerogative of regulatory frameworks.

We would like to reiterate our endorsement of the IASB ED’s principle-based approach. From our point of view, principle based rules are vital in ensuring that banks' respective risk management practices can be implemented / captured in an adequate manner. For this reason, we perceive no need for more guidelines / examples. Instead, we would welcome it if the principle based approach were applied to a greater extent thus deleting a number of the examples listed in the ED. Having said this, also the usage of qualitative criteria in the assessment of the migration from stage 1 in stage 2 should not be ignored.

On a different note and provided there is no indication that the results thus achieved would differ from the ones achieved when using the lifetime PD, we advocate in favour of a solution where the assessment of a "significant” deterioration should generally take place on the basis of the 12-month PD. Over time, an assessment on the basis of the lifetime PD incurs an enormous complexity which can hardly be explained to external parties, either.

The disclosure requirements proposed by the IASB are highly complex and comprehensive. A potential reduction of the requirements should be considered in order to facilitate greater transparency so as to optimise the cost benefit ratio of the information which is being made available to readers of financial statements. In our view it is not constructive to require the disclosure of information which, at present, is not even being captured for the purposes of internal risk management.

In order to facilitate a true and fair view of the loans extended in previous years, entities should have the right to opt for pragmatic solutions when it comes to the transitional requirements.

As regards the overall implementation, we would like to point out that the timely publication of a final and comprehensive IFRS 9 standard is of vital importance. Compliance with the first-time application date scheduled for 1 January 2016 will only be feasible if the implementation on the basis of a final standard can be initialised as early as this year.

Given the FASB’s decision we regret that a convergence will not be possible. In principle, the German Banking Industry Committee is still fundamentally in favour of a potential convergence between IFRS and US-GAAP. However, the only viable foundation for such a convergent solution consists in the IASB proposal.

Please find our detailed comments on the exposure draft on the next pages. At this juncture, we would like to point out that our comments are of a preliminary nature since, at the present point in time, we

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[1] Please cf. the GBIC Comment Letter sent to the FASB on 30 May 2013.

cannot comment on all questions contained in the draft standard. It is also possible, that some of our views could change until the end of the comment period to the IASB.

Yours sincerely,
on behalf of the German Banking Industry Committee
German Savings Banks Association

by proxy | by proxy

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Dr. Ralf Goebel | Eric Eispert

German Banking Industry Committee

Die Deutsche
Kreditwirtschaft

Comments

on EFRAG's Draft Comment Letter on the IASB's ED/2013/3 Financial Instruments: Expected Credit Losses

Register of Interest Representatives
Identification number in the register: 52646912360-95

The German Banking Industry Committee is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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Comments on EFRAG's Draft Comment Letter on the IASB's ED/2013/3 Financial Instruments: Expected Credit Losses

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?

We welcome the credit deterioration model which differentiates between the credit quality of financial instruments. From our point of view, at this juncture, the approach for recognising loss allowances on the basis of the 12-month PD in stage 1 is a solution that is both acceptable and also operationally feasible. On aggregate, it can also be seen as a significant improvement over the 2009 ED whilst simultaneously maintaining the gist of the latter's underlying philosophy. At this juncture, we would like to highlight that recognising loss allowances on the basis of the 12-month PD already results in the recognition of loss allowances that are clearly higher than under IAS 39. On the whole, the IASB model is an acceptable approach. This especially holds true when comparing the IASB model to the FASB model and also to the 2009 ED/2011 SD. At this juncture, however, it is important that the interpretation of a "significant" deterioration in the credit quality is consistent with existing practices and that information related to the risk management (both of a quantitative and qualitative nature) will be taken into account during the assessment.

(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?

Yes, we do agree. From the point of view of the German Banking Industry, an impairment approach should distinguish between high-quality (performing loans) and low-quality (non-performing / impaired) loans. This is also an adequate representation of the underlying economics of lending. More specifically, this means that the level of the required loss allowances should be based on the degree of the credit quality. Such a differentiation is also consistent with banks' risk management practices. From an economic point of view, it is counterintuitive why loss allowances for potential losses over the entire lifetime have to be recognised already on day one of the loan accommodation of "healthy" loans (cf. FASB proposal). Also, this would not provide readers of financial reporting data with any adequate information. Furthermore, (at least in the event of open portfolios) a general requirement on loss allowances for lifetime losses also requires the creation of major reserves which, however, could never be used. These reserves have the character of a capital buffer. Hence, they should rather be covered in the regulatory frameworks. They appear out of place in an accounting standard.

At this juncture, we would also like to point out that there is indeed a sound underlying rationale for the 12-month EL on stage 1. In a nutshell, this is motivated by the understanding that, during a loan's lifetime and due to an appropriate calculation of interest margins, the 12-month EL corresponds to the risk premium (as a part of the effective interest rate) that is received annually. Basically, the recognition of the 12-month EL is a corrective entry to the risk premium that is included in interest income shown in the income statement. This corrective entry leads to a better illustration of the economic results of the particular transaction.

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?**

From our point of view, the proposed credit deterioration approach essentially presents a balanced model for recognising a loss allowance. We welcome the proposed regime for low risk financial instruments.

However, in this context it is worth noting that (given the required follow-up and in view of the necessary data storage) the implementation of the relative approach incurs an enormous degree of complexity on the level of the individual loan. Hence, it is vital that the standard be principle-based and that any presentations / examples which are inconsistent with the principle-based nature be deleted. Consequently, the IASB does not seek to promulgate any requirements / interpretations concerning the point in time as of which a credit quality deterioration shall be deemed “significant”. However, this is for instance inconsistent with the language under paragraph B15 which does precisely this. Paragraph B15 lists an example (involving various facts and figures) which gives rise to the impression that a “significant“ deterioration of extremely high-quality credits will be triggered fairly quickly, notwithstanding the fact that these credits, on the whole, still possess a good rating (e.g. if there is a change in the PD from 0.4 % to 0.7 %, which – in terms of percentage figures - translates into a 75 % deterioration). Yet, on the other hand, loans of a lower quality will feature a “significant“ deterioration only at a substantially later point in time. However, such an interpretation would lead to a situation where the majority of loans would migrate to stage 2 thus incurring recognition of lifetime losses in the absence of any economic justification for this. Hence, the consideration of qualitative criteria is of paramount importance during the assessment of the significance and this is already shown by this one example. We therefore suggest deleting the figure-based example provided under paragraph B15.

The IASB seeks to allow practical simplifications for low credit risk loans. We welcome this approach. Based on the foregoing, at this juncture it is our understanding that the presentations under section 6 of the ED mean that investment grade rated loans shall not see an automatic transfer to stage 2 if they shift into the non-investment grade range; instead, such transfer shall exclusively be predicated on a “significant deterioration”.

In this context, we would like to add that for reasons of consistency, paragraph B20e should be amended as follows: *”an actual or expected* ***significant*** *internal credit rating downgrade…“* For the purposes of consistency, we also recommend revising the entire paragraph B20 in order to include the term “significant” wherever appropriate.

Comments on EFRAG's Draft Comment Letter on the IASB's ED/2013/3 Financial Instruments: Expected Credit Losses

(a) 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)?

Yes, we do agree.

(b) 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?

No, we do not think so (cf. also our response to question 1(b))

Question 3

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

We agree with the proposed scope of this Exposure Draft.

(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?

<u>Questions to EFRAG's constituents</u>

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.

We feel that it would be appropriate to apply a consistent impairment model for AC and FVOCI assets.

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?

Yes, we do agree. The proposal is operationally feasible. This is especially true in view of the existing Basel II requirements. However, the corresponding adjustments (in terms of the downturn PD, TTC vs. PIT etc.) incur considerable costs and are linked to a considerable degree of uncertainty whenever they are based on forecasts. We recommend a solution where the identification of the 12-month EL in stage 1 should be possible in line with the Basel requirements without having to make additional adjustments. Already today, the Basel requirements are taken into account during banks' internal management. Hence, the aforementioned recommendation would firstly offer the benefit of a more user friendly implementation. Secondly, it would offer readers improved transparency and comparability between financial reports prepared for accounting purposes on the one hand and those prepared for supervisory purposes, on the other hand. This also holds true for a potential admissibility of Basel parameters during the calculation of the expected loss over lifetime. Such an approach would facilitate a timely implementation of stages 1 and 2 in line with IFRS9 impairment.

In this context we also recommend deleting BC 193. After all, this paragraph implies that it will not be possible to use the Basel PDs due to the fact that the determination of PDs fails to consider current information. At this juncture, it is worth noting the following: The rating systems are being calibrated on the basis of historic data. However, the individual rating has to be based on current data indeed or, moreover, on the borrowers' latest financial statements thus seeking to provide an assessment of the PD that is as up-to-date as possible even when using the Basel rating approach. In this regard, we would like to point out that Annex VII Part 4 para. 18 of the Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (Banking Directive) clearly requests that the rating be based on "current information". If the rating is based on mathematical-statistical models, Annex VII Part 4 para. 30 of the Banking Directive sets out that the model result will still have to be complemented by means of individual assessments. Essentially, this also involves answering the qualitative questions. Also overrides shall be subsumed under this. After all, this is the only way in which all relevant information will be adequately reflected in the rating grade. The rather formal rules on handling overrides are laid down in the provisions under Annex VII Part 4 para. 25 of the Banking Directive and under the 2006 CEBS guideline (point 460 - 461).

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?

We agree with the credit deterioration approach proposed by the IASB. In this respect please cf. also our answers to question 2.

At this juncture, *in lieu* of an assessment on the basis of the lifetime PD, we would like to strongly recommend that the assessment of a "significant" deterioration on the basis of the 12-month PD become a mandatory default method (unless there are any reasons to believe that this will lead to different results than the use of the lifetime PD). Whilst in principle, this is an option granted by the IASB (in exceptional cases), we are still under the impression that – whenever they use the 12-month PD – entities are under the obligation to prove beyond reasonable doubt that the results thus achieved will not be any different. This means that, whilst the IASB essentially grants derogations, such derogations do not ease the (operational) burden for entities. This is due to the fact that entities usually have to provide conclusive evidence for the potential immateriality (comparison lifetime PD versus 12-month PD) which is similarly requested by the auditors. A respective comparison of the lifetime PDs may theoretically be correct. However, for instance due to the need for annual recalibrations (new PD assumptions, mere time elapsed) this still ties up an extreme amount of resources without yielding any benefit that would justify these expenses. Operationally the use of lifetime PDs will require entities to retain large libraries of PD curves and lead to different trigger points for credit deterioration between loans, not just based on credit quality but maturity.

Furthermore, the use of the 12-month PD is incompatible with the IASB's underlying rationale. The lifetime PD is comprised of three components: 12-month PD, migration matrixes and maturity effect. Under the provisions of paragraph B14, when assessing the change in the credit quality, the maturity effect will have to be eliminated by means of the PD, anyway. Assuming that the underlying migration matrixes are constant over time, the 12-month PD approach invariably leads to the same results as the lifetime PD. Consequently, the use of the 12-month should be permissible as long as there is no indication that there is a lack of consistency in the migration matrices or, moreover, as long as the change of the 12-month PD is consistent with the lifetime PD.

Based on the reasons highlighted above, paragraph B11 should therefore receive a clarification: „However an entity may use the 12-months probability of default occurring to determine whether credit risk has increased significantly since initial recognition if there is no objective evidence that the outcome would differ."

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

We prefer principle based rules and we are against any fixed threshold values or similar parameters. For this reason, we also feel that there is no need for additional guidelines / examples etc. Consequently, for instance, the figures used as an example under paragraph B15 should be deleted.

Paragraph B20(e) might give rise to the conclusion that even the mere expectation that there will be an internal credit rating downgrade will warrant a mandatory transfer to bucket 2. In our view, such a transfer trigger would be premature. The language should therefore be amended to include a qualifier, e.g. "significant" (cf. also the other scenarios listed under paragraph B20).

(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?

As a general rule, the assessment of the need to recognise the lifetime EL should be based on the 12 month PD (cf. also our respective comments under question 5 (a)). However, there should be a further clarification to the effect that under certain conditions in which collateral values (e.g. LGDs or LTVs) have an impact on the probability of default these can similarly be considered during the assessment of a stage transfer. This would equally be in line with the assessment during risk management. Along with specific legal provisions in a number of jurisdictions, this particularly also concerns business involving various non-recourse funding transactions and funding transactions through special purpose entities. Whilst paragraph 18 refers to the admissibility of loss rates which implicitly also include an LGD and paragraph B20(j) refers to collateral values, from our point of view this is not sufficient in order to achieve this objective; instead, a clarification should also be included under paragraph 8.

Comments on EFRAG's Draft Comment Letter on the IASB's ED/2013/3 Financial Instruments: Expected Credit Losses

Furthermore, there should be a clarification that – in exceptional cases - the significance of the credit quality change shall not have to be determined merely on the basis of the PD. In the absence of a rating (e.g. for trade receivables or separate trust asset exposures) the assessment should, for instance, also be permissible based on the criterion "own fund ratio reported on the balance sheet > x%" or "(debt carrying amount) / net income for the year < y".

(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?

During the expected loss calculation, prepayments, call options and similar options shall be taken into account (Appendix A). We recommend granting banks the right to ignore options whenever the respective influence on the expected loss is insignificant. Partly, this would lead to a substantial reduction in the cost of implementation.

We endorse the simplification pursuant to which, in the event of a "low probability of default" (e.g. investment grade) it will be possible to waive the assessment of a significant deterioration of the credit quality and to keep the asset directly in stage 1.

We basically welcome the simplification concerning leasing exposures. The option of using the 3-stage model, like with loans, should definitely be retained, however. This is important for those leasing companies which treat lease receivables as loan receivables for risk management purposes and value these using a rating or score. For simplicity's sake, it ought to be possible to use the 12-month PD for trade receivables since, while trade receivables usually have to be repaid in the short term, they have no specific maturity.

Questions to EFRAG's constituents

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.

(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?

We agree with the proposal. In order to arrive at a true and fair view of credit quality trends, a switch back to stage 2 or 1 is indispensable.

Comments on EFRAG's Draft Comment Letter on the IASB's ED/2013/3 Financial Instruments: Expected Credit Losses

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?

We welcome the presentations in the ED to the effect that under IFRS 9 there shall not be any changes concerning the collection of interest revenue compared to IAS 39. However, in view of the fact that apparently this is still not sufficiently clear to parts of the community, we kindly invite the IASB to provide a corresponding clarification.

(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?

Cf. response to question 6a.

(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?

Cf. response to question 6a.

<u>Question 7</u>

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

<u>Questions to EFRAG's constituents</u>
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?

As regards our endorsement of a principle based standard, for readers of financial reporting information it is important that the disclosures provide them with appropriate information concerning the expected loss model and the respective, underlying parameters. The requested disclosures are very detailed as well as excessively elaborate. In order to avoid a potential information overload for readers of financial statements, for the sake of transparency and in order to reduce the complexity, the requirements should be revisited and ought to be streamlined.

Whilst not limited to, this particularly applies to the reconciliation statement of the gross carrying amounts (paragraph 35, 36) which would require the integration of credit risk control data into financial accounting on the basis of individual business transactions. In order to create meaningful balancing entries which lend themselves to a further analysis, the transfer to a different stage would have to trigger an account entry. Effects due to changes in the consolidation scope and due to currency conversions have to be treated separately. This would affect the entire portfolio of transactions belonging to the categories AC and FVOCI including portfolios featuring low PDs (stage 1). To date, loss allowances could be determined by means of a subledger accounting and could be booked in an aggregated form.

Furthermore, due to the fact that these would incur tremendous implementation costs (e.g. tracking past modifications, calculation of the re-default rate, disclosure of enforcement actions), we also recommend a review of the disclosure requirements on direct write downs and modifications.

The implementation of additional disclosures that are requested (e.g. examples 12 and 13 (see pages 79 ff.), paragraphs 37, 38, 44 and 45) is extremely complex and does not generate decision relevant information for readers.

We therefore recommend keeping the solution where there is a comparison between two assessments made on specific dates. This would also be in line with a principle based standard.

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

<u>Question to EFRAG's constituents</u>

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.

We have major concerns especially over the complexity inherent in the reconciliation of the gross carrying amounts requested under paragraph 35a. This is due to the fact that this requires the aggregation of data on existing holdings and of movements. Maintaining these data (e.g. gross exposures which have been transferred from stage 1 to stage 2 during the fiscal year and *vice versa)* requires a comprehensive database thus incurring considerable costs.

In our view, there is no adequate cost/benefit ratio concerning the information provided on write-offs. At present, entities already provide detailed recovery information. In this respect, the ED proposals require historical data as a precondition. Such data are either entirely absent or no longer available (for instance, due to the fact that a loan has already been written down thus meaning that the corresponding information will no longer be available in the system). Furthermore, the ED does not provide a concept clarification of the term "active enforcement".

In terms of the disclosures requested under example 12, we would like to point out that it is difficult to differentiate credits extended in previous years from new lendings. This is first and foremost owed to the fact that prolongations cannot be assigned to one of the two categories in an unambiguous manner.

A comprehensive implementation of the disclosure requirements by 2016 will be virtually impossible. It is obvious that there will be challenges or, moreover, high implementation costs. Whilst not limited to, this is particularly owed to the scope and the granularity of the information requested.

Question to EFRAG's constituents

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

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

In order to avoid information overload for users of annual financial statements, for the sake of transparency and for the purposes of cutting complexity (cf. above), the requirements should rather see a reduction.

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?

The proposed treatment is at least logical in terms of its underlying philosophy. However, we have concerns over the fact that its scope of application is not entirely unambiguous. We also have reservations over the disclosures on modifications (e.g. the disclosure of the re-default rate and the reporting of loans which have returned to "health" again featuring contractual adjustments). Furthermore, from our point of view, problems result from the relationship to the definition of forbearance by the EBA which, as yet, still remains unclear. In principle, we would welcome congruence between the definitions and disclosure obligations under accounting standards on the one hand and under supervisory rules on the other hand and we would also like to point out that the requirements proposed by the IASB are already sufficiently comprehensive.

During lending transactions, it is paramount for banks that they are capable of responding to the borrower's latest economical circumstances. The more stringent disclosure requirements as well as the resulting implementation costs would severely impair this very capacity to respond on the part of banks.

In many business models, contractual changes are a standard practice. The requisite differentiation between credit quality driven changes and other contractual changes incurs considerable additional implementation costs.

Comments on EFRAG's Draft Comment Letter on the IASB's ED/2013/3 Financial Instruments: Expected Credit Losses

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?

Question to EFRAG's constituents

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.

Although this may incur costs for the technical implementation that are considerably higher, we agree with the proposal on the application of the "general model" to financial guarantees and loan commitments.

(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.

No, we do not foresee any such challenges. This is due to the fact that, already today, it is presented as a provision.

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?

In principle, we welcome the exemption rule. On the one hand, waiving the set up of 12-month EL in stage 1 translates into low costs for monitoring and assigning contracts / portfolios in stage 1 or, moreover, stage 2. However, in the decision on exercising the right to chose, the impact on the regulatory own funds shall and must be taken into account.

(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?

Yes, we do agree (although this is of subsidiary relevance).

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?

On principle, we agree with the proposals. However, in this context it is not sufficiently clear how loans should be treated which are initially classified in stage 3 after a modification (i.e. derecognition and recognition modified loan). Even if the assumption is that, following the modification, the loan can subsequently be serviced in a regular manner, banks’ risk management policies and guidelines stipulate that a stage 3 classification (impaired) will be adequate at least for the first year. Provided there are no renewed payment difficulties etc., we hold the view that, also afterwards, it should be possible to transfer such loans again into stages 1 and 2 (the purpose of the modification being to avoid said payment difficulties in future). We would like to ask the IASB to provide a clarification in this respect.

Furthermore, we would like to draw attention to a potential problem in the context of phase 1 under IFRS 9. Pursuant to the rules on classification / measurement proposed by the IASB, financial instruments shall be recognised at fair value if the cash flows fail to pass the SPPI test (e.g. high leverage etc.). To us, it is not sufficiently clear whether this rule also covers (purchased) PCI assets, i.e. assets featuring a high discount. This is due to the fact that, at least in theory, it is possible to preserve the initial nominal value (100%) even if this cannot be taken for granted at the point in time where these assets are being purchased. Yet, such an approach – provided there is a rigorous interpretation of IFRS 9 phase 1 – would subsequently lead to a FV measurement of PCI assets. We feel that this is not sufficiently clear and invite the IASB to elaborate this further.

Question 12

(a) What lead time would you require to implement the proposed requirements?

At the present point in time, forecasts are extremely difficult due to the forthcoming complex implementation stage. Upon finalisation of the standard, the implementation will require at least 3 years. Should the IASB insist on its disclosure requirements in their entirety, this lead time would expand even further.

For the leasing industry, it would be a good idea if the amended IAS 17 was implemented at an earlier date or at least at the same time as IFRS 9. Otherwise, there will be increased implementation costs. We would therefore like to advocate a synchronisation of the timetable for introducing IFRS 9 and the amended IAS 17.

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

Also in light of the previous discussions with the IASB, we hold the view that the ED presentations mean that pragmatic approaches may be applied during the transitional period. Whilst not limited to, such pragmatic approaches would, for instance include a corresponding approximation of the initial credit quality without thus calling into question the retrospective application.
In the absence of any (initial) PD for a loan, we advocate e.g. for the possibility of assuming the first available and quality assured PD.

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

We do agree with the proposed relief.

Comments on EFRAG's Draft Comment Letter on the IASB's ED / 2013 / 3 Financial Instruments: Expected Credit Losses

Question 13

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

As has been pointed out in paragraph BC166 by the IASB, the impact for the individual user depends on the nature and scope of the individual users' existing financial instrument holdings. We also expect an increase in loss allowances and an earlier recognition of expected losses.