



Project **Financial Instruments: Impairment**

Topic **Comment letter summary**

Purpose of this paper

1. In January 2011, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) issued the joint supplementary document *Financial Instruments: Impairment (SD)* – a supplement to their original exposure drafts (original EDs) which addressed the impairment of financial assets¹. The comment period for the SD ended 1 April 2011. This paper provides a summary of the 180 comment letters that were received by that deadline.
2. We continue to receive letters. In total, 199 responses have been received as of the date of the posting of this paper. If we identify additional issues in the letters received after the comment deadline, we will provide an update to the Board at a later meeting.
3. In addition to responding to the questions in the ED, many respondents provided general comments. In this paper, we have summarised those general comments first and then addressed the responses to the questions in the SD. This paper provides a high-level summary. During re-deliberations, we will include a more detailed analysis of each issue in the relevant agenda paper.

¹ The original IASB ED *Financial Instruments: Amortised Cost and Impairment* (IASB's original ED), was issued in November 2009. The FASB Proposed Accounting Standard Update *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (FASB's original ED) was issued in May 2010, and included proposals for the impairment of financial assets.

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

4. During the comment letter period for the SD, the staff undertook extensive outreach activities with preparers, regulators, auditors, users and other interested parties. The results of those outreach efforts are presented in IASB agenda paper 4E/FASB memo 87. As mentioned in that paper, the feedback received during outreach was generally consistent with the feedback received from the comment letters.. As is usual we received very few comment letters from users. However, we spoke to users during our outreach and their feedback will be specifically addressed in the outreach summary paper.

Respondent demographics

5. The ‘International’ description below organisations representing an international constituency. Other corporate responses were allocated to the geographic region of their headquarters.

Geographic Region	Number
Africa	3
Asia	20
Europe	57
North America (68 from United States)	74
Oceania	10
South America	2
International	13
Unsure	1
TOTAL	180

6. The ‘Accountancy Body’ description includes associations or institutions made up of accountants in different capacities (eg auditor, preparer, etc).

Respondent type	Number
Academic	2
Accountancy Body	13

Auditor	12
Individual	6
Preparer - Financial Institution	
Company	50
Representative Bodies	29
Preparer - Insurance	
Company	12
Representative Bodies	5
Preparer - Other	
Company	7
Representative Bodies	12
Regulator	11
Standard Setters	13
User	2
Other Professional Services	6
TOTAL	180

Overview of proposals

7. The scope of the proposals differed for the IASB and the FASB. For the IASB, the proposals applied to financial assets that are measured at amortised cost that are managed in an open portfolio, excluding short-term receivables. For the FASB, the proposals would be applied to open portfolios of loans and debt instruments that are not measured at fair value with changes in value recognized in net income. For convenience, this paper will refer to instruments in the scope of the standard as ‘loans’.
8. The proposals addressed the timing of the recognition of expected credit losses. During the comment period for the SD, the boards used feedback from the original EDs to discuss the measurement of expected losses.
9. The SD proposed that loans be divided into two groups: those for which it is appropriate to recognise expected credit losses over a time period, referred to as the ‘good book’ and other loans, referred to as the ‘bad book’. For loans in the ‘good book’, an entity would recognise an impairment allowance at the higher of (i) the time-proportional expected losses or (ii) the expected losses expected to occur within the foreseeable future period, which should be no less than twelve months (referred to as the ‘floor’). For loans in the ‘bad book’, an entity would recognise an impairment allowance for the lifetime expected losses.

10. In developing this model, the boards had differing primary objectives. The IASB stressed the importance of reflecting the relationship between the pricing of financial assets and expected credit losses. The FASB placed primary importance on ensuring that the amount of the allowance for credit losses is adequate to cover expected credit losses before they occur. The common proposal has features that partly satisfy each of the boards' primary objectives. The time-proportional approach addresses the IASB's primary objective while the floor addresses the FASB's primary objective.
11. In the SD, the boards asked questions regarding the 'good' and 'bad books', the time-proportional allocation (TPA), the floor using the foreseeable future period (FFP) and whether constituents prefer one of the boards' primary objectives. In addition, the IASB published a separate IASB-only appendix to the SD containing proposals and questions regarding presentation and disclosure for this model. That feedback will be discussed separately later in the paper.

General comments

12. Many respondents made general comments about the project, including:
 - (a) convergence between the IASB and the FASB;
 - (b) concerns regarding due process;
 - (c) the interaction between the SD and the boards' original EDs; and
 - (d) the effect of the proposals on non-financial and smaller institutions.

Convergence between the IASB and the FASB

13. Many respondents acknowledged the boards' efforts at reaching a converged solution for the impairment of financial assets. They recognised the difficulty in trying to converge on this issue when the boards have two differing objectives. Many respondents reinforced the importance of convergence on this topic. A few respondents, however, stated that developing a high-quality standard is more important than convergence and expressed their concern with the compromises reached to publish the SD.

14. Some respondents were concerned that the presentation and disclosure proposals were IASB-only. They requested that the boards strive for convergence not only on the impairment model, but also the associated presentation and disclosure requirements.

Due process

15. Many respondents commented that the length of the comment period was too short to adequately consider the proposal – this was exacerbated by the comment period overlapping with year-end reporting. These respondents often stated that they did not have time to test the proposals in their systems or calculate the effect of the proposal on their financial reporting. Accordingly many respondents stated that their response was ‘conceptual’ and urged the boards to do more testing of the proposals before finalisation.
16. In addition, respondents were concerned about the limited scope of the document and being unable to consider the model as a whole. These respondents requested that the boards re-expose the entire model, once it has been developed including disclosure and presentation proposals, so they may test the model and provide feedback with a view of the ‘big picture’.
17. A number of respondents were concerned that the SD focused on the timing of recognition of expected losses and did not provide guidance or seek feedback on how expected losses should be measured.
18. Many respondents are concerned about the speed of the project, reiterating the importance of developing a high-quality standard. Some respondents expressed a preference to not meet the 30 June 2011 deadline, and take the time necessary to ensure the quality of the final standard.

Interaction with the boards’ original EDs

19. Responses to the proposed approach were mixed as outlined in more detail in this paper; however, most respondents agreed that the proposal (or parts of the proposal) is an improvement over the boards’ respective original EDs. Most IASB constituents acknowledged that the operational issues with the IASB’s original ED had been addressed and were appreciative of those changes. Some

FASB constituents acknowledged that the proposal in the FASB's original ED to recognise the full expected loss in the period of initial recognition was too conservative, and felt that the FFP approach was an improvement.

Effect of the proposals on non-financial and smaller institutions

20. Some respondents asserted that the proposals are focused on financial institutions. The proposals make reference to internal credit risk management methods and procedures regarding the 'good' and 'bad books'. Many non-financial institutions stated that they do not manage their financial assets in the same way as financial institutions and find the proposals burdensome and inconsistent with their current practice.
21. Many non-financial institutions are also concerned about the effect of the proposals on trade receivables, which make up a significant part of their business. They note that the IASB has explicitly excluded these instruments from the scope of the document, but remind the boards that the proposals would be cumbersome and costly to implement if the final standard ultimately is extended to trade receivables. In addition, these respondents said that the information provided about trade receivables would not be useful to users of their financial statements.
22. Many smaller institutions also expressed their concerns with being able to appropriately apply the proposals as drafted. Some of these entities stated that they were not sure how they would calculate a weighted average age and weighted average life appropriately, and were concerned at having the right resources to come up with appropriate estimates of losses.

Responses to questions in the SD

23. This section provides a high-level summary of the responses to the questions in the SD. As noted above, we will provide more detailed analyses of comments relating to these issues in topic-specific agenda papers/memos.

Do the proposals address the issue of delayed recognition of expected credit losses? [Question 1 in the SD]

24. An important weakness that has been identified with respect to the current impairment models under IFRSs and US GAAP is delayed recognition of credit losses associated with financial assets. The SD proposes a model that would recognise losses from initial recognition using all available reasonable and supportable information (including past events and historical data, existing economic conditions and supportable forecasts of future events and economic conditions).
25. Almost all respondents agreed that the proposals would address the delayed recognition of credit losses, even if they disagreed with some aspects of the proposals more generally. However, a few respondents suggested that the proposed expected loss model would not address this issue. These respondents believe that the incurred loss models in force today are still the most appropriate method to recognise credit losses. These respondents believe that the weakness exhibited during the credit crisis is in the measurement of losses and not the incurred loss model. Further, some respondents in the US asserted that the boards should base an improved impairment model based on the current 'incurred' loss model with improved guidance to provide more flexibility for determining losses inherent in financial assets at a given reporting date.
26. Though the boards did not solicit specific feedback on the information set to be used in determining loss estimates, some respondents expressed support for the information set to be used in the proposals, particularly the inclusion of forecast information in determining loss estimates. One respondent commented that the use of forward-looking information could lead to lower loss estimates than an incurred loss model because it would allow an entity to look forward to anticipated improvements.

Are the proposals operational for closed portfolios and other instruments? [Question 2 in the SD]

27. As mentioned in paragraph 7, the scope of the SD was limited to financial assets managed in an open portfolio. The boards asked respondents to consider

whether the proposals would be at least as operational if applied to closed portfolios and other instruments in anticipation of determining whether there should be a single impairment model.

28. Most respondents agreed that the proposals would be as operational for other instruments, including financial assets managed in a closed portfolio. Some respondents, mostly non-financial institutions, requested that the boards provide additional guidance on what constitutes an open and closed portfolio. A few respondents commented that no pool is available for single instruments, so the proposals might yield strange results.
29. Some respondents strongly expressed that the proposals were not appropriate for some types of instruments including trade receivables, insurance portfolios, highly rated instruments and revolving credit.

Trade receivables

30. Even though the IASB explicitly excluded short-term receivables from the scope of the proposals, respondents – mostly corporate preparers – commented that the proposals would be costly to implement, operationally complex and would not provide useful information for trade receivables. They believe that trade receivables are merely a product of a revenue transaction and should have a separate, simplified impairment model.
31. In addition, a few respondents reiterated their views from the IASB's original ED that the net or adjacent presentation of credit loss expectations is not appropriate for trade receivables. They believe that revenue and credit losses should be presented as discrete items on separate parts of the income statement².

Insurance companies

32. Preparers in the insurance industry mentioned that the financial assets within their overall portfolio and subject to the scope of the proposals (including debt securities) are managed on an individual basis, with no consideration of their

² This is being addressed as part of the Revenue project and the interaction between the Revenue and Impairment projects is planned to be discussed in the next few weeks.

collectability for classification in a ‘good’ or ‘bad book’. They use different models and methods than banks for managing credit risk and consider their methods to be more accurate than the proposals. The insurers state that the proposals would be costly to implement, are not consistent with the way they manage their portfolios and would provide less meaningful information because they would have to consider their holdings on a portfolio basis instead of an individual basis.

33. In addition, insurers (and a few other respondents) mentioned that the proposals are overly burdensome to apply to highly rated instruments. Since the losses on these instruments are expected to be insignificant, some respondents don’t find value in applying a complex and costly impairment model to these instruments.

Revolving credit

34. The TPA requires the computation of a weighted average age and a weighted average life of the total portfolio. Some respondents expressed concern about the significant operational difficulty of calculating these weighted averages for a portfolio of revolving credit instruments, such as credit cards. These respondents suggested that, at a minimum, the boards should provide examples or guidance on how to compute the weighted averages for these types of instruments.

***Will the floor typically be equal to or higher than the amount calculated for the TPA?
[Question 10 in the SD]***

35. Respondents acknowledged that this would vary depending on the length of the FFP, the behavior of the portfolio, the point in the portfolio’s life and the expected loss pattern; however, most respondents who responded to the question believe that, as presented in the SD, the floor would typically be higher than the amount calculated for the TPA. With this conclusion, respondents were divided as to whether, as a consequence, the floor should be made the sole basis for establishing the ‘good book’ allowance, whether it should be removed from the model or modified to prevent it from overshadowing the TPA. Some commented that the floor would often be

higher than the TPA calculation with a twelve month FFP, and would almost always be higher with an eighteen to twenty-four month FFP.

36. A number of respondents said they were unsure how to answer the question because it would vary in different scenarios or because they did not have sufficient time to consider the effect of the floor on their loan portfolios.

Is the 'higher of' test appropriate for recognising the impairment allowance in the 'good book'? [Questions 3, 4, 5, 12 and 13 in the SD]

37. For loans in the 'good book', an entity would recognise an impairment allowance at the higher of (i) the TPA of expected losses or (ii) the expected losses expected to occur within the FFP, which should be no less than twelve months (referred to as the 'floor'). The TPA is calculated by multiplying the entire amount of credit losses expected for the remaining life by the ratio of the portfolio's age to its expected life (or converting the expected losses for the remaining life into an annuity and applying that to the age of the portfolio). The FFP is defined as 'the future time period for which specific projections of events and conditions are possible and the amount of credit losses [which] can be reasonably estimated based on those specific projections'. The TPA came from the model being developed separately by the IASB whereas the FFP came from the model being separately developed by the FASB.
38. A few respondents, including some regulators, believed that the proposed approach for recognising the impairment allowance in the 'good book' is appropriate. They see merit in both boards' differing objectives and think the proposals are an appropriate balance or combination between the two. They like that the 'higher of' test ensures an adequate allowance by using the *higher of* the two loss estimates. They also view convergence as especially important and recognise the value of a model both boards agree to, acknowledging the difficulty the boards had in finding a mutually satisfactory model. One respondent suggested that the allowance balance should equal the average of the TPA and the FFP.
39. However, many respondents disagree with the 'higher of' test in the proposals. They state that requiring entities to perform two calculations for the 'good book' is burdensome (especially when a third calculation is performed for

regulatory purposes), difficult to explain to users and leads to a lack of comparability. Preparers feel that the change in method will distract from communicating to users the change in a portfolio's economics. Those who disagree with the approach generally fall into one of three groups:

- (a) those who prefer the TPA;
- (b) those who prefer the TPA but believe it should have a mechanism other than the FFP to address early loss patterns; and
- (c) those who prefer the FFP.

40. These groups have strong geographic leanings. Respondents from the US tend to have a preference for the FFP, while other respondents prefer the TPA. However, the geographic groupings are not as pronounced in the comment letters as in the outreach conducted by staff. Comment letters indicate that some US respondents find merit in the TPA and some international respondents find merit in the FFP approach.

Preference for the TPA alone

41. Those who express a preference for the TPA agree with the IASB's primary objective of reflecting the relationship between the pricing of an asset and the expected credit losses. They believe that establishing an adequate allowance balance is a regulatory concern and that a 'day-one loss' is inconsistent with the economics of lending at market rates. Those who also responded to the IASB's original ED acknowledge that the TPA addresses the operational complexity associated with the originally proposed model, and most believe that it still meets the IASB's objective.
42. Most respondents agree that the TPA is operational, including some who do not express the TPA as their preference. Despite believing that it is operational, some respondents acknowledge that it may still be operationally challenging to implement, especially for smaller banks and insurers. Not all entities believe they have the historical data necessary to implement the TPA. They state that the TPA approach works best for homogenous pools of assets, and will be more challenging for individual assets or smaller pools.

43. A few respondents who preferred the TPA without a floor for the 'good book' stated that they did not view a floor as being necessary with a 'good book', 'bad book' distinction as the 'bad book' itself ensured a minimum allowance balance.
44. While some respondents stated a preference for the TPA relative to either the SD or the FFP in isolation they did so only because of their general preference for a model that has a time allocation component. These respondents had concerns about the mechanics of the TPA. One concern raised was that the TPA was awkward in applying forward-looking expected loss estimates to a period allocation that was backward looking (ie comparing the elapsed life of a portfolio to its total life). They noted that this had the counter-intuitive effect that for loans with the same remaining life and expected losses over that remaining life, a larger allowance balance would be required under the TPA simply because one loan has a longer life overall.

Preference for the TPA with a floor

45. Some respondents express a preference for the TPA because they agree with the IASB's primary objective. They state that the FFP as described will often result in a higher loss estimate than the TPA and would prefer that the FFP was not so 'dominant' in determining loss recognition in the 'good book.' These respondents are split into two groups for their rationale.
46. The first group state that the TPA results in even loss recognition over the instrument's life. These respondents feel that a mechanism should exist to accommodate different loss patterns, specifically including early loss patterns. They present a variety of suggestions for such modification which are explained later in the 'Alternative models' section. They believe that either
 - (a) the TPA should be modified to accommodate early loss patterns or
 - (b) use of a floor is appropriate, but do not agree with using the FFP as the floor.
47. The second group prefers the TPA, but acknowledges the importance of global convergence as an objective. This group is willing to accept having a floor imposed on the TPA model for the sake of convergence, but do not agree with

using the FFP as the floor. A common view among this group is that a twelve month floor should be implemented because this allows the TPA to be used more often to determine loss recognition, would deal with the risk of incomparability in application of the floor and would be consistent with current credit risk management with regards to regulatory reporting³.

Preference for the FFP

48. Many who express a preference for the FFP agree with the FASB's primary objective that an impairment model should ensure the sufficiency of the allowance balance. Some prefer the balance sheet focus of getting the allowance balance to reflect credit losses expected to occur. Some believe that the TPA does not meet the IASB's primary objective and that it is not a good proxy for the IASB's original ED, and prefer FFP as an operationally simpler approach.
49. Many respondents stated that given the proposed approach, the losses recognised using the floor would often be greater than the losses recognised using the TPA, including some who did not express the FFP as their preference. The FFP often results in a more conservative allowance balance that accommodates the existence of early loss patterns in a portfolio. However, many respondents stated that operational difficulties exist with the FFP. They state that the definition of the foreseeable future period in the proposals is vague and will either lead to incomparable results among entities or regulators interpreting the FFP in different ways. Some were concerned that inconsistent global application would make convergence illusory. Some suggested that the determination of the allowance should be based on historical, current and forecasted information that they can confidently predict and, thus, prefer further developing a model that aligns with the 'floor' concept in the SD.

³ For Basel II purposes a 12 month period is used for loss estimation.

What other feedback was received about the floor using the FFP? [Question 9 in the SD]

50. In addition to whether they believed the ‘higher of’ test in the ‘good book’ is the appropriate method for recognising expected losses, respondents were asked the following questions about the floor and the FFP:
- (a) Should an entity invoke the floor only with evidence of an early loss pattern?
 - (b) Would the FFP vary with changes in economic conditions?
 - (c) Is the length of the FFP typically greater than twelve months?
 - (d) Should a ‘ceiling’ be established for the FFP?
51. Most respondents were opposed to using the floor only in the instance of a recognisable early loss pattern. Besides those who disagree with this because they advocate either the TPA or the FFP approaches, some respondents feel that this would increase complexity and decrease comparability because another assessment would have to be made for each portfolio – whether it had evidence of an early loss pattern. Some thought it would be difficult to determine whether there was an early loss pattern to apply the requirements. Conversely, a few believed that this option is a better balance (and appropriate compromise for convergence) between the TPA and the FFP models and would decrease complexity because an entity would only have to perform the two computations for pre-selected portfolios.
52. Most respondents agreed that the FFP would vary depending on economic circumstances and the sophistication of the entity. Some respondents pointed out the counter-intuitive results this causes. In stable economic conditions, entities are able to look further into the future, so the FFP, and consequently the allowance, may be greater during sound economic periods⁴. Also, entities with more sophisticated credit risk management systems may be able to look further into the future, so those entities which are better equipped to mitigate credit losses may consequently have a higher allowance. Some were concerned that this would mean that paradoxically those with weaker credit

⁴ Although there would be some counter effect resulting from increased expected losses.

controls may actually have shorter FFPs and thus smaller allowance balances for like loan books. Respondents supporting the FFP as a starting point for building an impairment model, acknowledging their discomfort of its description in the SD, believed it would allow an entity to build up an allowance in periods of growth which could address the current concern that reserves are too low in periods where economic conditions result in greater actual losses.

53. Responses varied with regard to the length of the FFP. Most respondents either believed that the FFP would be twelve months or eighteen to twenty-four months. A few respondents felt that the twelve month minimum for the FFP is inappropriate for certain types of portfolios as it would be difficult to predict the timing of losses twelve months into the future. Some respondents believed that the FFP should be set at a fixed period to increase comparability among entities. Of these respondents, most suggested twelve months as a fixed period to tie in with regulatory requirements for some regulated entities and because some felt this sat 'naturally' with budget cycles. Of the respondents who felt the FFP would be greater than twelve months, almost all disagreed with the idea of a ceiling on the FFP, with lack of comparability being the primary reason for their views.
54. A few respondents were confused about whether the FFP encompassed loans on which losses were expected to crystallise within the FFP or expected losses on loans that were expected to become 'problematic' within the FFP (even if losses were expected to crystallise later).

Should entities differentiate between a 'good book' and a 'bad book'? [Questions 6, 7 and 8 in the SD]

55. The proposals would require that entities classify loans in two groups for recognising the impairment allowance. Loans for which it is appropriate to recognise expected credit losses over a period of time would be classified in the 'good book'. When the collectability of a loan becomes so uncertain that the entity's credit risk management objective changes from receiving the regular payments to recovery of all or a portion of the loan, it would be moved to the 'bad book'.

56. Most respondents believe that it is appropriate to differentiate between a ‘good book’ and a ‘bad book’ for the purpose of determining the impairment allowance. Most financial institutions confirm that it is consistent with internal credit risk management processes already in place.
57. Some respondents state that the requirements are sufficiently clear and operational/auditable. Of these respondents, some believe that entities will use credit risk management policies in place today to transfer loans between the ‘good’ and ‘bad books’. US respondents stated that they believe the ‘bad book’ will closely align with what is done today under current US GAAP for loans evaluated individually, while international respondents believe they will use the Basel II definition of default (ie 90 days past due) for their ‘bad book’. Staff understands that in the US, banks use the 90 days past due trigger to say loans are impaired for the purpose of capturing them in the scope of FAS 114, so effectively, respondents from both jurisdictions would suggest a 90 days past due criteria to move loans to the ‘bad book’.
58. Other respondents are concerned about the comparability of loans in the ‘good’ and ‘bad books’ as a result of the management judgment involved in defining the two groups. These respondents emphasise that sufficient disclosure of the policy is necessary⁵. Also, they request additional guidance or examples about when a loan should be moved to the ‘bad book’. The definition in the proposals provides a broad spectrum of when a loan may be moved in to the ‘bad book’. At the two extremes, a loan may be moved when an entity makes the first phone call to the creditor to enquire about a payment or when the loan defaults and the collateral is repossessed. Respondents request that the boards provide additional guidance to narrow the spectrum of possibilities and to more clearly express the principle of when a loan should be in the ‘bad book’.
59. However, a few respondents believe it is neither operable nor appropriate to distinguish between the two books for determining the impairment allowance. Insurers and some corporate entities explain that the distinction is not consistent with their internal credit risk management procedures. In addition, some of the US respondents who prefer a pure FFP model to a model that

⁵ Disclosure was addressed in the IASB-only appendix to the SD.

includes a TPA state that the distinction is not necessary given their preferred model and note that they believe the distinction between the ‘good’ and ‘bad books’ introduces additional complexity.

60. Some respondents commented that the division into a ‘good’ and ‘bad book’ is most appropriate for homogenous pools of loans; however, some respondents commented that the implied granular analysis for distinguishing between the two books may not be consistent with credit risk management for some types of loans (eg mortgage loans). Some respondents also believed that the ‘good’ and ‘bad’ books should focus on the characteristics of the loans rather than how they are managed to improve comparability.

Should flexibility be permitted related to using discounted amounts? [Question 11 in the SD]

61. The proposals permit an entity to use a discounted or undiscounted estimate when calculating the TPA. In addition, when using a discounted expected loss amount, the proposals permit entities to use any discount rate between (and including) the risk-free rate and the effective interest rate. It is noted that the FASB did not deliberate this issue, but it was included in the joint document for comment because it is considered an integral part of the overall proposals.
62. Respondents were divided on the question of whether to permit an entity to use a discounted or undiscounted estimate. General views indicate that a discounted amount is the conceptually correct response because it gives consideration to the effects of the time value of money, but note that discounting is operationally more difficult. Given these general views, respondents generally fall into one of three opinions:
 - (a) Permit flexibility in the approach so entities that wish to discount can do so while still accommodating those entities that are unable to discount.
 - (b) Require all entities to discount because it is more reflective of the economics of lending (unless the effect is immaterial). One respondent commented that less sophisticated entities may have less

sophisticated assets, making discounting more achievable for their holdings.

- (c) Require all entities to use an undiscounted estimate because it is simpler and will be less burdensome for less sophisticated entities.

Advocates of options (b) and (c) cite comparability between entities as one of the main reasons to mandate a method.

- 63. Some respondents requested that, at a minimum, the boards require an entity to use the same method for all portfolios.
- 64. Respondents were also divided on whether flexibility should be permitted in the discount rate that should be used if an entity discounts their estimates. Those who prefer not to permit the flexibility want to maintain greater comparability between entities. Those who prefer flexibility want to ease the operational burden on preparers by allowing them to choose the most appropriate rate. Many prefer that the effective interest rate be used because it is the most sensible discount rate and is more reflective of economic reality than the risk-free rate and is consistent with the notion of the time value of money.
- 65. Where flexibility is permitted for either making estimates or using a discount rate, some respondents request disclosure of the inputs and methods used and any significant assumptions made.

Alternative models

- 66. Many respondents suggested variations on the proposals in the SD or on the TPA or FFP components of the model. Most of those comments were noted above. There were also some alternatives proposed – the main alternatives proposed are set out briefly below. A number of European respondents were concerned about the transfer of allowance balances to the ‘bad book’ and the rebuild of the ‘good book’ allowance. This is discussed in paragraph 87 below.

Revisions to the TPA approach

67. Some respondents suggested a TPA model with a floor other than the FFP. They believe that the FFP overshadows the TPA in the proposals. Two alternatives to the FFP that were suggested by a few respondents were to establish a twelve month 'bright line' as a floor or use incurred losses as a floor. Another suggestion was to require entities to assess the floor at a higher level, such as at the entity level instead of the individual asset level.
68. A few respondents also suggested that an allocation approach be employed, but instead of a smooth allocation, as in the proposals, an allocation approach based on the expected loss profile should be required. They felt that this would be a better way to deal with frontloaded loss patterns in particular.

Incurred loss plus

69. Some respondents demonstrated support for maintaining the current incurred loss models while providing additional guidance about measuring incurred losses to strengthen application. They felt that this would address the primary criticism of the current model – that allowance balances are established 'too little, too late' without imposing such extensive changes on preparers. Respondents had varying suggestions to modify the incurred loss model, including additional measurement guidance (as stated), recognising incurred but not reported losses or establishing an earlier threshold for incurred losses. A number of respondents proposed alternative models such as those models summarised below.

Group of US banks

70. This model presumes that the fundamental principles in the incurred loss model are sound, but some changes are necessary to incorporate the cyclical behaviour of financial instruments. They also would like to expand the incurred loss practices by eliminating the probability threshold, to incorporate expected events into the loss forecast and extend the loss emergence period when determining the losses that they believe exist in their portfolio at a given reporting date.

71. An entity would calculate the incurred loss, or losses inherent in the portfolio, using two components:
- (a) A base component would replace the incurred loss model with an expected loss concept by representing an estimate of reasonably predictable expected losses inherent in the portfolio.
 - (b) A credit risk adjustment component would represent additional credit losses that are not reflected in the base component, but are estimated using macro-level factors and are expected to emerge as the credit cycle unfolds. This component would capture the incurred losses for which there is no currently observable evidence of a loss.

US mortgage security issuer

72. This model segregates financial assets into three separate categories which receive different treatment for the recognition of expected losses:
- (a) Homogenous loans measured collectively – recognise expected losses in the FFP (with enhanced definition of FFP);
 - (b) Non-homogenous loans measured individually – divide into a ‘good’ and ‘bad book’; for loans in the ‘good book’, recognise expected losses in the FFP; for loans in the ‘bad book’, recognise the full expected loss for the remainder of the life; and
 - (c) Investment securities – presume that all securities will be in the ‘bad book’ and recognise the full expected loss for the remainder of the life.

IASB-only appendix

73. As mentioned earlier, the IASB published an appendix to the SD (Appendix Z) containing proposals for the presentation and disclosure of financial assets within the scope of the impairment model. The FASB did not deliberate or seek feedback on these parts of the proposals.

Should the determination of the effective interest rate be separate from the consideration of expected losses? [Question 14Z in the SD]

74. The SD proposes that the credit loss estimate not affect the cash flows used to determine the effective interest rate. This contrasted to the IASB's original ED which proposed an integrated approach whereby the initial estimate of expected credit losses would be included in the cash flows used to determine the effective interest rate. Feedback on the IASB's original ED was generally against that approach due to the operational complexity it introduced and the need for significant systems changes.
75. Respondents almost unanimously agreed that the determination of the effective interest rate should be separate from the consideration of expected credit losses. They stated that this approach is a significant improvement to the IASB's original ED and is more operational.

Should loan commitments and financial guarantee contracts be subject to the impairment proposals? [Questions 15Z and 16Z in the SD]

76. Some loan commitments are not included within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*, but are instead included within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The IASB has been informed that loan commitments and loans are often managed using the same business model and information systems and was asked to align the accounting for these two types of instruments. Respondents were asked whether all loan commitments should be subject to the impairment accounting in IFRS 9.
77. Some financial guarantee contracts are within the scope of IAS 39, though at the time of publishing the SD, there was uncertainty as to whether the contracts would be included within the scope of the ongoing Insurance project. In the light of this uncertainty, respondents were asked to consider the implications of the proposals on financial guarantee contracts in the event they are included in the scope of IFRS 9. During the comment period, the IASB decided in the Insurance project, to maintain current practice which means that some financial guarantee contracts will be within the scope of IFRS 9 and some will be accounted for as insurance contracts.

78. Respondents almost unanimously agreed that loan commitments and financial guarantee contracts should be subject to the same impairment requirements as loans because the credit risk management is the same. No significant issues were addressed regarding the operability of including these contracts within the scope of the proposals.

Should interest revenue and impairment losses be presented separately? [Question 17Z in the SD]

79. The SD proposes that interest revenue (calculated using the effective interest rate that excludes expected credit losses) and impairment losses (including reversals) be presented as separate line items on the income statement. This is in contrast to the IASB's original ED, which required the adjacent presentation of gross interest revenue, the portion of expected credit losses allocated to the period and net interest revenue. Feedback to the IASB's original ED was generally opposed to this presentation as constituents believed that impairment losses should be shown separately from interest revenue.
80. Respondents almost unanimously agreed that interest revenue and impairment losses should be separately presented on the income statement. They stated that this approach is a significant improvement to the IASB's original ED and provides better information to users.

Are the proposed disclosures appropriate? [Question 18Z in the SD]

81. The proposals included disclosure of financial assets *by class* to permit reconciliation to the balance sheet of the following:
- (a) the balance of the mandatory allowance account including:
 - (i) reconciliation of the change in allowance balance for the 'good' and 'bad books', including transfers;
 - (ii) reconciliation of nominal amounts in the 'bad book';
 - (iii) for the 'good book', five years of comparative data, including:
 - (1) total nominal amount;
 - (2) total expected credit losses for the remaining life;
 - (3) impairment allowance; and

- (4) the difference between the floor and the TPA, if the floor is used for the 'good book';
 - (b) an explanation of the estimates and changes in estimates used to determine the allowance, including:
 - (i) the length of the FFP and inputs and assumptions used in that determination;
 - (ii) significant positive or negative effects on the allowance caused by a particular portfolio or geographic area; and
 - (iii) quantitative or qualitative comparison of expected loss estimates and actual outcomes (ie back testing) depending on whether the analysis is performed for credit risk management purposes;
 - (c) a description of internal credit risk management processes, including:
 - (i) information about internal credit rating grades, how grades are assigned and, if an entity uses a watchlist, how that criteria relates to the 'good' and 'bad books';
 - (ii) disclosure by credit risk rating grade of:
 - (1) the nominal amount of financial assets; and
 - (2) expected losses over the remaining life and the FFP; and
 - (iii) the criteria for differentiating between the 'good' and 'bad books'.
82. A number of respondents did not comment on the proposed disclosures noting that they had had insufficient time to do so and felt that it would be necessary to comment on disclosure when a complete package representing the final model is available.
83. For those that did respond, they generally believe that aspects of the proposals where management judgment is required had sufficient disclosure of the assumptions and methods used. However, some respondents cautioned the IASB to limit disclosures to those that are necessary and provide useful information to users of financial statements. They are concerned about the burden of excessive disclosures, especially because many entities are also required to prepare disclosures for regulatory purposes which may overlap

with those proposed. Some respondents specifically requested that the IASB give consideration to the Basel disclosure requirements to align them more closely where possible.

84. Many respondents disagreed with the proposal to require entities to disclose five years of comparative data for the allowance account including the nominal amount, the expected losses, the impairment allowance and the difference between the TPA and the floor (if applicable). They believe that five years is overly burdensome for preparers to provide this information.
85. In addition, some respondents were concerned about:
 - (a) the feasibility of providing information about back-testing - they were uncertain about the availability of the information and how useful it would be;
 - (b) The disclosure to provide credit rating information because it is burdensome and some consider it proprietary;
 - (c) the watch-list disclosures; and
 - (d) the disclosure to provide information by class, believing it to be overly burdensome and the definition of 'class' to be vague.
86. Regarding disclosures, two general comments – not addressing specific questions in the SD – were made by a number of respondents:
 - (a) Preparers were in support of the IASB's tentative decision during the comment period to eliminate the disclosures on stress testing, the loss triangle and vintage information that were proposed in the IASB's original ED.
 - (b) The impairment disclosures should be considered in tandem with IFRS 7 *Financial Instruments: Disclosures*. Respondents suggest there may be some overlap between the existing disclosures and the proposals which can be streamlined.

When transferring from the ‘good’ to the ‘bad book’, should a portion of the related allowance also be transferred? [Question 19Z in the SD]

87. The SD proposes that when a loan is transferred from the ‘good book’ to the ‘bad book’, an amount of the related allowance reflecting the age of the financial asset would be transferred together with that financial asset. The ‘bad book’ and ‘good book’ allowances would then be required to be re-established at the appropriate levels.
88. Most respondents did not agree with the proposals. Some had a broader concern than simply the way in which the transfer occurs and were concerned about the requirement to re-establish the ‘good book’ allowance after a transfer to the ‘bad book’ based on the loans remaining in the ‘good book’. These respondents, most of whom were European, believe that this does not permit an entity to use or ‘draw on’ the allowance when the credit quality of loans begins to deteriorate. They are particularly concerned that in a deteriorating credit environment it would be very difficult to make a case that the expected losses in the remaining ‘good book’ are improved as a result of the transfer of the bad loans and that this would inevitably result in the ‘good book’ allowance in effect not being used. These respondents believe that:
- ...the full amount needed to cover the new bad loans’ life time expected losses should be transferred out of the good book allowance to the bad book along with the transferred asset and that the good book allowance not be required to be replenished immediately or that it should only be rebuilt over time in order to better reflect the interaction between pricing and credit losses. (CL 168)
89. Other respondents noted that there was no difference in the resulting effect on the income statement of how the transfer occurred (if the allowance balances always need to be reestablished). Because of this they felt that being required to determine and transfer a time-proportional allowance for bad loans was unnecessarily complex and burdensome. Some of these respondents preferred that no allowance should be transferred from the ‘good book’ to the ‘bad book’ and the allowance for both books should be adjusted at the end of each period according to their current holdings.