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Project	**Financial Instruments: Impairment**		
Paper topic	Comment Letter Summary		
CONTACT(S)	Jana Streckenbach	jstreckenbach@ifrs.org	+44(0)20 7246 6473
	Riana Wiesner	rwiesner@ifrs.org	+44(0)20 7246 6926
	Giel Pieterse	gpieterse@ifrs.org	+44(0)20 7246 6543
	Tiernan Ketchum	tketchum@ifrs.org	+44(0)20 7246 6937

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Purpose of this paper

1. On 7 March 2013 the IASB published the Exposure Draft ED/2013/3 *Financial Instruments: Expected Credit Losses* ('the ED'). The comment period ended on 5 July 2013, and to date the IASB has received 175 comment letters, including 8 comment letters from users of financial statements (or their representative groups). This paper summarises the **main messages** received in the comment letters on the ED.

2. An analysis of the comment letters by respondent type and region is included as Appendix A.

3. The staff will provide a more detailed analysis of specific issues during redeliberations.

Overview of proposals

4.   According to the ED's proposals, expected credit losses on financial instruments would always be accounted for. The amount of expected credit losses recognised would depend on the deterioration and improvement in financial instruments' credit quality from initial recognition. The ED's proposals would apply to all financial assets measured at amortised cost or fair value through other comprehensive income (FVOCI), trade receivables, lease receivables, loan commitments and financial guarantee contracts.

5.   There would be three stages to reflect deterioration and improvement of financial instruments' credit quality:

(a)   **Stage 1**: financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have a low credit risk (eg investment grade) at the reporting date. For these financial instruments an entity:

(i)   recognises a 12-month expected credit loss (ECL) allowance; and

(ii)   calculates interest revenue on the gross carrying amount of the asset (ie without reduction for expected credit losses).

(b)   **Stage 2**: financial instruments that have deteriorated significantly in credit quality since initial recognition (unless they have low credit risk at the reporting date) but that do not have objective evidence of impairment at the reporting date. For these financial instruments an entity:

(i)   recognises lifetime ECL; and

(ii)   still calculates interest revenue on the gross carrying amount of the asset.

(c)   **Stage 3**: financial assets that have objective evidence of impairment at the reporting date. For these financial assets an entity:

(i)   continues to recognise full lifetime ECL; but

     (ii)   calculates interest revenue on the net carrying amount of the asset (ie gross carrying amount reduced for expected credit losses).

6.   Throughout this project, the IASB has observed that, conceptually, initial credit loss expectations are priced into financial instruments both when they are originated and when they are purchased. The IASB therefore considers it is inconsistent with the economics of lending to recognise a loss that is equal to lifetime ECL on the initial recognition of the financial instrument. To strike a balance between the operational complexity of an expected loss model and the faithful representation of the economics, the IASB proposed to recognise lifetime ECL only for instruments that are not in Stage 1. Thus, the proposed model distinguishes between instruments that have deteriorated in credit quality and those that have not.

7.   The IASB acknowledged that the requirement to recognise an allowance balance equal to an amount of 12-month ECL in Stage 1 has no conceptual justification; however, it is a proxy to adjust interest revenue (as a counterbalancing effect to recognising the full interest) and to recognise expected credit losses resulting from insignificant deterioration. It was a consequence of operationalising previous proposals and efforts to balance the benefits of faithful representation with the costs of application.

Overview of the feedback

8.   The vast majority of respondents support the proposals in the ED as an appropriate balance between faithful representation of credit losses on financial instruments, and the costs of producing that information. Most specified that they agree with the IASB that initial credit loss expectations are priced into assets when originated or purchased, and continue to support an approach that considers deterioration in credit quality in deciding the extent to which expected credit losses should be recognised.

9. In addition to their comments on the ED's proposals, many respondents also commented on the convergence efforts with the FASB. All of those respondents welcome the boards' efforts to align their models; however, they were split on how important this objective was. Many believe that while convergence was important, the IASB should focus on refining the ED and completing the project on a timely basis.

10. Many also raised application questions or concerns, which are discussed in the rest of this paper.

11. The following summarises briefly the feedback received from comment letters:

   (a) **12-month expected credit loss:** most accept the 12-month ECL and welcome the ability to use different methods to calculate it. However, some are concerned that a probability of default (PD) approach is implicitly required and request clarification that other methods could be used.

   (b) **Significant deterioration in credit quality:** the vast majority of respondents support this criterion for recognising lifetime expected credit losses on a financial instrument. However, respondents did raise a number of detailed questions and concerns.

   (c) **Expected credit losses on financial assets mandatorily measured at FVOCI:** irrespective of their views on the proposed introduction of a mandatory FVOCI measurement category[1], most support a single impairment model for all financial instruments.

   (d) **Low credit risk simplification:** respondents had mixed views on the exception that a financial instrument is not considered to have significant deterioration if it has low credit risk (eg, is equivalent to investment grade) at the reporting date. Most—including insurers and non-financial entities that hold primarily debt investments—strongly support it as a practical way to help them apply the model. However

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[1] Proposed in ED 2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)).

many respondents raised a number of questions and concerns, including that an investment-grade exception could in some cases conflict with the principle of significant deterioration.

(e) **30 days rebuttable presumption:** the majority agree with the rebuttable presumption in the ED that financial instruments have experienced significant deterioration if they are more than 30 days past due. However, some are concerned that it would be applied as a bright line and would in some cases be inconsistent with the principle of significant deterioration.

(f) **Discount rate:** although there was no specific question on this in the ED, many commented on this issue. Most of those respondents believe that the effective interest rate (EIR) on financial instruments should be used to discount the loss allowance, rather than any rate between, and including, the risk-free rate and the EIR.

(g) **Interest revenue:** the vast majority of respondents agree that conceptually interest revenue should be calculated on the net basis for financial assets in Stage 3 and that this would be consistent with IAS 39 *Financial Instruments: Recognition and Measurement* today. However, most prefer the non-accrual of interest revenue which would be similar to regulatory requirements in some jurisdictions, or the gross presentation of interest revenue in all circumstances.

(h) **Effective date:** a range of estimates are provided, however most respondents indicated they would need a three-year lead time for implementation of the ED's proposals.

(i) **Transition:** the majority of respondents agree with the transition proposals overall, but requested some additional clarifications.

(j) **Disclosures:** the majority of respondents are concerned about the proposed disclosure requirements and encourage the IASB to consider making the disclosures more consistent with credit risk management practices, and more focused on the judgements and assumptions made by management.

Preferred approach

General deterioration model (IASB ED)

12. The vast majority of respondents, including the majority of users, support a deterioration model that distinguishes the measurement of expected credit losses for financial instruments that have experienced credit deterioration from those that have not, as proposed in the ED.

13. Many respondents, including users of financial statements acknowledge that the model proposed in the IASB's 2009 Exposure Draft *Financial Instruments: Amortised Cost and Impairment* was conceptually more pure and therefore superior to the proposed model, but they also acknowledge that the operational complexities of that model would have resulted in the costs of implementation outweighing the benefits of the information provided.

14. Most respondents consider the proposed model to reflect the underlying economics of a lending transaction in a pragmatic way, while easing the operational complexities that would have arisen from the application of the 2009 ED. Although most consider the proposed model to lack conceptual justification, especially the 12-month expected credit loss (ECL) allowance, they do not think that there is a better alternative available that will achieve the same balance of benefits versus cost. The vast majority of users find the distinction between financial instruments that have deteriorated and those that have not, relevant and useful as this reflects the change in credit quality over the lifetime of the financial instruments.

15. Reasons provided for supporting the proposed model included:

   (a)   it results in more timely recognition of expected credit losses, thereby addressing the delayed recognition criticism of IAS 39;

   (b)   it reflects the economic loss that arises from changes in the initial expectations of credit losses by recognising lifetime ECL when there has been significant credit deterioration;

(c)   it is closely aligned to credit risk management practices and prudential regulatory processes for establishing expected credit loss capital reserves, thereby leveraging from existing processes, models and data sets;

(d)   it is more forward-looking and therefore more responsive to changes in macroeconomic conditions compared to IAS 39; and

(e)   it avoids the excessive front-loading of expected credit losses.

16.   Although the vast majority of respondents support a deterioration model as proposed in the ED, not all support the measurement objective (12-month ECL) for financial instruments that have not experienced significant credit deterioration. This is discussed in more detail in paragraphs 25-30 below.

17.   A few respondents, including some regulators, preparers and users of financial statements, do not support the proposed model and cited the following reasons for their disagreement:

(a)   The proposed model does not achieve the objective of providing information about the effective return on financial instruments in the way that the 2009 ED did.

(b)   It is more judgemental than the current IAS 39 incurred loss model because of the incorporation of forward-looking estimates and the assessment of significant deterioration and is therefore more subjective.

(c)   The need to assess whether there has been significant deterioration since initial recognition adds another layer of complexity to the model.

(d)   Because of the extent of judgement involved, it might be difficult for management and auditors alike to verify that the information is reliable and supportable.

It should be noted that these respondents also did not support a model that always recognises lifetime expected credit losses (ECL) from initial recognition.

Lifetime expected credit loss model

18.   Only a few respondents supported a model that recognises lifetime ECL from initial recognition regardless of credit quality. These respondents welcome the simplicity of a model based on a single measurement objective (ie lifetime ECL on all financial instruments). Furthermore, they believe that reflecting the full loss content of financial instruments provides relevant and useful information for users of financial statements.

19.   The vast majority of respondents, however, do not support a lifetime expected credit loss model. Even though they acknowledge that such a model might be simpler to understand, they consider the operational complexities of estimating lifetime ECL for all financial instruments (including those that are performing in accordance with initial expectations), to exceed those of the proposed model. This is because estimates of lifetime ECL on all financial instruments since initial recognition are likely to be highly subjective, because there could be little or no asset-specific data on which to base forecast lifetime ECL for performing financial instruments that are of high quality and have not significantly deteriorated in credit quality. Such forecasts will be primarily driven by macroeconomic forecasts over the forecast time period rather than by asset-specific data. Because of the subjectivity of these estimates, these respondents observed that lifetime ECL on performing financial instruments are also very sensitive to changes in assumptions, which could cause undue volatility in profit or loss. Some users also questioned the reliability of estimating lifetime expected credit losses.

20.   Most respondents consider a lifetime ECL model to totally disregard the economic link between the pricing of a financial instrument and its credit quality, thereby diminishing the relevance of financial reporting. The majority of users of financial statements stated that it is important to maintain the economic link between pricing and credit quality at initial recognition. They are concerned that the FASB model distorts this economic link by exacerbating the double-counting of expected credit losses incorporated in the pricing of financial instruments compared to the IASB model.

21. Other reasons cited for not supporting a lifetime ECL model included:

    (a) The excessive front-loading of credit losses without any regard to the credit quality (and the economic loss that arise from significant credit deterioration). This distorts the entity's performance during a reporting period and results in a model that does not reflect the economics.

    (b) It is not aligned to credit risk management practices, which distinguish performing financial instruments and those that are not performing as initially expected and will therefore be less reliable and more complex to implement than the proposed model.

    (c) Credit deterioration (and improvement) on existing financial instruments are masked by the lifetime ECL recognised for newly originated or purchased financial instruments.

    (d) It deviates significantly from the measurement of financial instruments at fair value on initial recognition.

    (e) It is likely to constrain lending activities, particularly for longer-dated credits and those with higher credit risk.

Convergence

22. For many respondents convergence is still preferable, however it should not be at all costs. Very few are demanding convergence at the cost of finalising the requirements in a timely manner. Many respondents urged the IASB to finalise the proposed model as soon as possible, with or without convergence.

23. For many respondents (including some that want convergence at all costs), their preference for a converged impairment model is subject to it being similar to the model proposed in the ED. Only a very limited number of respondents preferred convergence to the FASB's model.

24. However, many respondents commented that they would be opposed to the boards attempting to achieve convergence through disclosure. They noted that if the boards cannot reach a converged solution, preparers should not be forced to effectively implement two expected credit loss models to satisfy such a disclosure requirement.

12-month expected credit losses

Measurement objective

25. Most respondents, including users of financial statements accept the 12-month ECL as a pragmatic solution to achieve an appropriate balance between faithfully representing the underlying economics and the cost of implementation. Most users consider 12 months a reliable period to estimate expected credit losses for financial instruments that have not significantly deteriorated and some explicitly stated that they do not support concepts such as 'foreseeable future' (see paragraph 105) as a measurement objective. Additionally one user representative group considered that a 12 month expected credit loss allowance provides them with useful information, as they believe that on a portfolio level some expected credit losses may arise during the reporting period that was not adequately priced in.

26. However, some respondents do not agree with recognising any expected credit loss allowance for financial instruments that have not experienced significant credit deterioration since initial recognition. These respondents consider initial expectations of credit losses to be included in the pricing of a financial instrument and they are conceptually opposed to the recognition of a loss allowance on initial recognition ('Day 1 losses'). A few others are only opposed to recognising 12-month ECL on financial assets such as high quality debt securities that will be measured at fair value through other comprehensive income (FVOCI) in accordance with the Classification and Measurement ED.

27. A small number of respondents, in particular some regulators and users of financial statements, are concerned that the 12-month ECL will not adequately reflect the expected credit losses inherent in some financial instruments such as

interest-only mortgages or bullet repayment loans (instruments that require payment only at maturity) In some cases these concerns were related to a misconception about when such financial instruments would move to a lifetime ECL measure (ie that deterioration should be assessed over the life the instrument).

28. Jurisdictional differences and/or preferences have also emerged, whereby preparers in some jurisdictions are concerned that the 12-month ECL will result in a reduction of overall allowance balances. This is because entities in these jurisdictions have applied current accounting requirements (including IAS 39) more broadly.

29. These respondents requested improvements to, and/or clarification of, the proposed requirements, for example:

    (a)   requiring a period that is longer than the 12-month outlook period; or

    (b)   requiring a 12-month outlook period as a minimum but allowing entities to use a longer period that is deemed reasonable.

30. However, some respondents commented that they are strongly opposed to extending the loss allowance for financial instruments that have not significantly deteriorated beyond 12 months.

Operability

31. Although most respondents consider the 12-month ECL to be without conceptual justification, many accept it as a pragmatic solution to achieve the objectives of the proposed model.

32. Most respondents, including some who do not support the 12-month ECL as the measurement attribute, consider it to be operational. This is because entities will be able to leverage existing credit risk management systems and data, including regulatory models, as the basis from which to apply the proposed approach.

33. Among the respondents that consider the 12-month ECL as operable are insurance entities and corporate entities, as well as financial institutions that are using less

sophisticated credit risk management systems. These respondents did however request additional guidance and examples on how to implement the proposals.

34. Some respondents have commented that for Basel-regulated entities, the operational complexity would be further reduced if the 12-month ECL were fully aligned to the expected credit loss measure applied for prudential regulatory purposes.

Notion of default

35. A few respondents commented that the notion of default is fundamental to the assessment of the probability of default occurring. This is in particular relevant for the measurement of 12-month ECL, because the point at which default is considered to occur will determine the probability of that happening during the next 12 months.[2] A number of potential approaches have been suggested, including aligning it to the regulatory definition of default (ie 90 or 180 days). Other respondents specifically welcome the fact that default has not been defined because they consider the point of default to be different for different products and jurisdictions. These respondents only recommend additional guidance on what would constitute a default event within the context of the proposals.

Significant deterioration

36. The vast majority of respondents agree that significant deterioration is the appropriate point at which to start recognising lifetime ECL. Respondents also agree that an assessment of when to recognise lifetime ECL should only consider the changes in credit risk (ie the probability of a default occurring) rather than changes in expected credit losses (ie the severity of the loss).

37. Many respondents supported the principle-based approach taken in the ED by providing indicators of significant deterioration rather than prescriptive rules and 'bright lines' about what constitutes significant deterioration. This is because they believe the assessment of significant deterioration should consider:

    (a) the credit risk at initial recognition;

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[2] For example, if default is considered to occur when a loan is 360 days past due, no 12-month ECL would be recognised, because it is not possible for a default to occur in the next 12 months.

(b)   the type of financial instrument;

(c)   the remaining maturity of the financial instrument; and

(d)   expected economic conditions.

However, some respondents asked the Board to clarify that a mechanistic approach to assess significant deterioration is not required (refer to Paper 5A par 55(b)).

38.   According to these respondents, significant deterioration should be assessed within the context of an entity's specific financial instruments and it would be inappropriate (if not impossible) to include any prescriptive requirements.

39.   However, some respondents, most notably some regulators and standard-setters, are concerned that allowing entities to use their internal risk management processes may lead to the assessment becoming too judgemental and open to manipulation. They are concerned that this could harm comparability and lead to diversity in practice. These respondents urge the IASB to provide more specific guidance on the criteria to be used to determine when a significant increase in credit risk occurs. Some of their suggestions to improve the guidance included:

(a)   being more explicit that all available information, including changes in macroeconomic factors reflecting changes in credit risk should be considered;

(b)   providing a definition of key terms such as 'default' (refer to paragraph 35);

(c)   being more explicit that significant deterioration is earlier than non-performance or default; and

(d)   incorporating additional guidance on how to assess significant deterioration for revolving financial instruments.

40.   Others are concerned that basing the assessment on significant deterioration may not result in the timely recognition of lifetime ECL on financial instruments that have terms resulting in expected credit losses towards the end of the contractual term (late loss patterns), for example interest-only mortgages or instruments that require payment only at maturity (bullet loans). These respondents requested

additional application guidance to assess significant deterioration for such products, for example that the assessment should be based on the credit risk over the remaining life of the instrument and not just over the next 12 months.

41.   Although most respondents (mostly preparers) commented that the point of significant deterioration aligns with their credit risk management practices, some provided suggestions to improve the operability of the proposed model, which included assessing significant deterioration:

   (a)   on an absolute basis rather than a relative change; ie once an instrument is rated below the level at which the entity would originate new instruments, it is considered to have significantly deteriorated; and

   (b)   on a counterparty level rather than on a transaction basis.

42.   Some respondents are concerned that the proposed model could result in changes in macroeconomic indicators alone (in the absence of considering the effect on credit risk), which would cause lifetime ECL to be recognised for a segment of, or even a whole, portfolio of instruments. Others, however recommend that the final requirements should be specific about capturing *all* credit deterioration, even where it is not individually identifiable.

Financial assets that are mandatorily measured at FVOCI

43.   Most respondents agree that financial assets in the FVOCI category should be within the scope of the proposals. These respondents state that:

   (a)   a single model for all financial assets reduces the complexity of current IFRS;

   (b)   avoids arbitrage in the classification of the financial asset; and

   (c)   prevents the delayed recognition of expected credit losses in profit or loss.

44.   Many agree with our proposals that for financial assets that are mandatorily measured at FVOCI in accordance with the *Classification and Measurement* ED, the accounting for expected credit losses in profit or loss shall be consistent with the requirements applicable to financial assets measured at amortised cost.

However, a number of respondents propose that we should include practical expedients for these financial assets, such as that:

(a)   12-month ECL should not be recognised on financial assets with low credit rik (eg investment grade financial assets). Rather, no allowance should be recognised;

(b)   the IASB should include a similar practical expedient to the FASB proposals, which does not require an entity to recognise any impairment if the fair value is greater or equal to their amortised cost and if the expected credit losses are insignificant; and

(c)   to apply similar requirements as are today in US GAAP, commonly known as the OTTI model (ie other than temporary impairment). In short, an entity would recognise impairment on securities in profit or loss if the impairment is not temporary.

45.   Respondents propose these practical expedients because they are of the view that:

(a)   it would reduce the operational burden, noting that the instrument is already measured at fair value;

(b)   the amount presented in OCI would not be a meaningful number; and

(c)   it would not be appropriate to recognise expected credit losses in profit or loss for financial instruments purchased in an active market that prices the expected credit losses into the instrument.

46.   Others do not believe that such expedients are necessary. That is because for low credit risk debt instruments, the 12-month ECL amount is likely to be immaterial so may not need to be recognised. They state that it would be helpful if the IASB were to acknowledge this possibility in the Basis for Conclusions to support the practical application of the impairment model.

Loan commitments

47.   The vast majority of respondents agree that loan commitments should be within the scope of the proposals because:

(a)   expected credit losses on loan commitments and financial guarantee contracts are similar to those of loans;

(b)   in practice, loan commitments and financial guarantee contracts are often managed using the same credit risk management approach and information systems; and

(c)   a single impairment model for all credit exposures irrespective of their type (ie whether loans, loan commitments or financial guarantee contracts) removes the complexity currently caused by different impairment models in IFRS.

48.   However, a few respondents support continuing the current accounting prescribed by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* for these loan commitments. These respondents believe today's accounting treatment is sufficient.

49.   Many of the respondents that support including loan commitments within the scope propose that the expected credit losses should be measured over the behavioural life of the product, rather than over the contractual life, as is required by the proposals. Although some of them agree that, conceptually, expected credit losses should be recognised over the contractual period and not over a longer period, the majority of respondents are concerned that using the contractual period:

(a)   will be contrary to credit risk management;

(b)   might result in (or be perceived as resulting in) insufficient allowances for the credit risk exposures arising from these contracts; and

(c)   will result in outcomes for which no actual loss experience exists on which to base the estimates. This is because they do not have information available to support measurement of expected credit losses on a contractual basis which is inconsistent with credit risk management and actual statistical information.

50.   This was of particular concern for revolving credit products, eg credit cards. Some respondents state that in general the contractual cancellation period of these products is one day, but in practice credit is offered for a longer period based on

the entity's business practice (eg conducting an annual limit or facility review). Facilities are generally not immediately withdrawn. Consequently, the respondents propose that the expected credit losses on loan commitments should be estimated over the behavioural life as this would more faithfully represent their exposure.

51. Other comments received on loan commitments and financial guarantee contracts include:

(a) the request of more guidance for revolving credit facilities;

(b) concern about different discount rates for drawn and undrawn facilities; and

(c) the boards should seek convergence so that both loan commitments and financial guarantee contracts are within the scope of both the US and the IFRS impairment proposals.[3]

Low credit risk simplification

52. Most respondents agree with the proposed operational simplifications to measure the allowance (or provision) for a financial instrument that has low credit risk at the reporting date (for example, it is 'investment grade') at an amount equal to 12-month expected credit losses, regardless of whether there has been a significant increase in credit risk. They believe the operational simplifications contribute to an appropriate balance between faithful representation and the cost of implementation of the proposed model.

53. However, many of the respondents who agree with the simplification also request additional clarifications. For example:

(a) Whether an external rating would be required and the interaction between the external rating and the entity's own internal rating or assessment of the instrument's level of credit risk.

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[3] The scope of the FASB proposals includes loan commitments but not financial guarantee contracts, which in US GAAP are accounted for under FASB Statement No. 163.

(b)   How to deal with differences in external ratings between rating agencies or differences between international and domestic external ratings.

(c)   To avoid misinterpretation, clarification that deterioration just below 'investment grade' does not automatically result in the recognition of lifetime ECL. There still needs to be significant deterioration in credit risk to measure the allowance balance at lifetime expected credit losses (ie it is not a hair-trigger change in credit quality that would move an instrument to Stage 2—see also paragraph 59 of Agenda Paper 5A).

(d)   Clarification of the definition 'low credit risk'. For example:

    (i)   some respondents are concerned that the wording implies much higher risk levels than intended, which might introduce a move to lifetime ECL close to an incurred loss model; and

    (ii)   other respondents are unclear whether the scope of the proposed simplification could be interpreted as being capable of being applied separately to each of the entity's businesses and products and thus be different for different business units.

54.   Some note that financial instruments often have a credit risk level that is likely to be higher than the definition of 'low credit risk' and thus, the simplification would apply only in relatively limited circumstances. This is particularly true for banks. However, insurance entities strongly support the simplification because it greatly reduces the complexity of tracking changes in credit risk for most of their instruments.

55.   Those that do not agree with the simplification, notably regulators, mainly think that significant deterioration should be reflected in a consistent way. Regulators are particularly concerned that the exemption does not capture what they regard as significant deterioration, for example a downgrade of an instrument rated AAA to BBB, and would thereby lead to insufficient allowances.

56.   In addition, some of the respondents who disagree with the simplification do not believe the simplification results in a model that is more operational or less costly,

or they are concerned about creating an additional layer of judgement and interpretation.

57.   A few provided alternative suggestions for the scope of the simplification. These suggestions included that the simplification should apply to

(a)   the level of credit risk at which the entity usually originates new financial assets;

(b)   levels of credit risk that are aligned with internal credit risk objectives, which may be different from one business line to another; and

(c)   financial instruments where the expected losses are insignificant (similar to the second criterion of the FASB practical expedient)[4].

30 days rebuttable presumption

58.   In making the assessment of significant deterioration, the ED includes a rebuttable presumption that a financial instrument has significantly deteriorated when the contractual payments are more than 30 days past due.

59.   The majority of respondents consider the inclusion of a delinquency factor to be helpful, particularly when entities do not have other borrower-specific information available to identify significant deterioration. Furthermore, many agree that 30 days past due correlates with a significant increase in the probability of default occurring in future periods. In order to improve the operability of the rebuttable presumption, some respondents propose to further clarify:

(a)   how the 30 days past due presumption interacts with the assessment of other borrower-specific information; and

(b)   that 30 days past due is not a bright line.

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[4] The FASB's proposed current expected credit loss (CECL) model contains a practical expedient that allows entities to not recognise expected credit losses for financial assets measured at FVOCI when both of the following criteria are met: (a) the fair value of the individual financial asset is greater than (or equal to) the amortised cost basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant.

60. A few respondents note that they view more than 30 days past due as too early and propose that the presumption should be later, with some even suggesting 90 days past due to align with current regulatory requirements in a number of jurisdictions. However, the staff note that such a notion is more aligned with default (ie Stage 3 in our proposals), rather than a notion of significant deterioration that aims to capture an increase in credit risk earlier than default.

61. Some respondents, in particular regulators and standard-setters, do not agree with the 30 days past due rebuttable presumption (or longer period) because:

    (a) delinquency is a lagging indicator that would result in capturing financial instruments that are close to default instead of identifying financial instruments that have significantly deteriorated earlier;[5] and

    (b) they are concerned that preparers would rely on the more than 30 days past due concept in isolation as a rule to move items from a 12-month to lifetime ECL.

62. Instead, they propose to eliminate the more than 30 days past due presumption because this will require entities to better identify indicators that can recognise significant deterioration in a timely manner.

63. A few respondents also commented specifically on the fact that the presumption is rebuttable. These respondents note that rebutting the presumption would be difficult because an entity would need to demonstrate that 30 days past due does not lead to an increase in the risk of default in the future.

Discount rate

64. We did not specifically ask respondents to comment on our proposals relating to the discount rate when calculating the expected credit losses for instruments that are not purchased or originated credit-impaired assets. However, a number of respondents did address this point.

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[5] One respondent noted that for financial assets that are 30 days past due Probability of Default could be as much as 50 per cent.

65. Consistently with the proposals in the 2011 Supplementary Document *Financial Instruments: Impairment* (the SD), this ED proposes to allow an entity to discount expected credit losses using the risk free rate, the EIR on the related financial asset, or any rate in between these two rates. On the basis of the feedback received from the SD, the IASB confirmed the flexibility about the discount rate for this ED to help ease preparers' operational challenges in determining and maintaining the discount rate.

66. A few of the respondents who commented about the choice of the discount rate expressed support for operational reasons.

67. However, most of the respondents, including preparers, do not agree with our proposals to allow a range of discount rates (ie a rate between the risk-free rate and the effective interest rate). This is a change from our earlier experience because preparers who replied to the SD had generally agreed with these proposals. The staff believe that the difference in responses reflects the fact that respondents, including some fieldwork participants, have now focussed more closely on the practical implication so the choice.

68. These respondents state that:

    (a) discounting using a risk-free rate is inappropriate because it ignores the fact that there is credit risk associated with the financial instrument; and

    (b) differences in the amount of the allowance using different discount rates are material, in particular for high interest rate environments or high credit risk products, resulting in a lack of consistency and comparability.

69. Instead, these respondents propose to use:

    (a) the effective interest rate (or an approximation thereof); or alternatively

    (b) either the effective interest or the risk-free rate where the effective interest rate is not determinable.

Interest revenue

70.   The ED proposes that interest revenue would usually be calculated using the
effective interest method on the *gross* carrying amount of the financial asset (ie
the carrying amount without deducting the allowance balance). However, interest
revenue would be calculated using the effective interest method on the *net*
carrying amount (ie the carrying amount after deducting the allowance balance) if,
at the reporting date, there is objective evidence of impairment.

71.   Respondents had mixed views about calculating interest revenue using the
effective interest method on the net carrying amount. The vast majority agree
that, conceptually, interest revenue should be calculated on the net amount for
those assets and some state that even credit-impaired assets will generally
generate an economic yield that is not nil or negative. However, most of these
respondents propose alternatives to make the model more operational:

(a)   Some propose that maintaining the gross presentation of interest would
simplify the general model because it would not require a distinction
between Stage 2 (financial instruments that have deteriorated
significantly in credit quality since initial recognition) and Stage 3
(financial instruments with objective evidence of impairment). This
alternative would result in a two-stage model with all interest revenue
being measured on a gross basis.

(b)   Others propose an approach, as included in the FASB proposals, that
interest should not be accrued in certain circumstances (often referred to
as 'non-accrual'). Under the FASB proposals, an entity will cease to
accrue interest on financial instruments for which the entity does not
expect to collect substantially all of the principal or interest. These
respondents consider non-accrual to be operationally simpler and
consistent with the regulatory treatment for these assets.

Modifications

72.   The ED proposes that if the contractual cash flows of a financial asset are renegotiated or otherwise modified, and the modification does not result in a derecognition, then the gross carrying amount of the asset should be adjusted to reflect the revised contractual cash flows. The gross carrying amount should be discounted using the asset's original effective interest rate. To assess whether significant deterioration has occurred, the entity should compare the credit risk at initial recognition under the original contractual terms to the credit risk at the reporting date under the modified terms.

73.   The vast majority of respondents agree with the proposed guidance for modifications. However, many respondents request guidance on when a modification results in derecognition, and note that such guidance does not currently exist in IFRS 9 *Financial Instruments* or IAS 39. There is a concern that this would result in inconsistent practice and difficulty in enforceability. Some indicate that currently some entities use, by way of analogy, guidance for the derecognition of a financial liability. They therefore strongly recommend that the IASB should provide guidance in IFRS 9 on this topic.

74.   Some respondents who disagree with the proposed modifications state that the guidance should be limited to credit-impaired financial assets and modifications that are performed for significant credit risk concerns, and that they would support the proposals if they were made on these bases.[6]

75.   In addition, a few respondents think that tracking the original credit quality of loans on an individual level to assess deterioration for modified assets would be too burdensome, and therefore disagree with comparing the credit risk at initial recognition under the original contract terms to the credit risk at the reporting date under the modified terms.

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[6] Some of these objections relate to disagreeing with the resulting effects on profit and loss or wanted an ability to reset the EIR to avoid an effect on profit and loss despite the fact there is no derecognition for this population. Both of these suggestions are actually inconsistent with amortised cost today (ie these are not changes proposed by the ED).

Disclosures

76.   The ED proposes disclosure requirements to produce information that identifies and explains:

     (a)   amounts arising from expected credit losses, including:

         (i)   a reconciliation of the gross carrying amount and loss allowance for financial instruments; and

         (ii)   the inputs and assumptions used in measuring 12-month and lifetime ECL.

     (b)   the effect of deterioration and improvement in credit risk, including:

         (i)   the gross carrying amount, by credit risk rating grades, of financial assets and the provisions associated with loan commitments and financial guarantee contracts;

         (ii)   the inputs and assumptions used in determining whether a significant increase in credit risk has occurred; and

         (iii)   the gross carrying amount of financial assets and the amount recognised as a provision for financial instruments that are evaluated on an individual basis and whose credit risk has increased significantly since initial recognition.

77.   The ED also proposes to require the disclosure of information about write-offs, financial assets that have not been derecognised but on which contractual cash flows have been modified, financial instruments that have been secured by collateral or other credit enhancements, and significant effects on the loss allowance caused by a particular portfolio or geographical area.

78.   The majority of respondents agree overall with the objective of the proposed disclosures. However, the majority of respondents have a general concern that the disclosure requirements are excessive, burdensome, too prescriptive, complex and inoperable. Many requested that the disclosures should be principle-based, less detailed, and linked more closely with management's credit risk practices. Some respondents, however, support the level of disclosure proposed, and agree that detailed disclosure about inputs and assumptions was particularly important because of the increased judgement involved with the model.

79.   Among the disclosure requirements that respondents disagree with are:

(a)   reconciliation of the gross carrying amount (paragraph 35)—they consider this very difficult and costly to prepare, specifically because it requires the maintenance and tracking of information about movements across stages (12-month and lifetime). Many feel that a reconciliation of the loss allowance was sufficient, and that the reconciliation of the carrying amount would be an excessive level of detail;

(b)   modifications (paragraph 38)—these are viewed as difficult to track and that it is difficult to calculate the re-default rate because it is not captured under existing credit risk practice;

(c)   collateral (paragraph 40)—excessive and onerous to provide information about any changes in the quality of collateral because it is normal for fair value to fluctuate; concern that disclosure of extent to which collateral reduces severity of losses would require lifetime ECL to be computed twice for credit-impaired financial instruments.

(d)   gross carrying amount by credit risk rating grade (paragraph 44)— concern about auditability of internal grades, lack of comparability between internal rating systems of different entities and subjectivity of internal rating systems, the sensitive nature of such information, and difficulty of providing this information for less sophisticated entities. To address this some suggested providing prescriptive guidance of what those grades should be; and

(e)   analyses of positive or negative effects on the loss allowance by portfolio or geographically (paragraph 41)—concern that too prescriptive and is already captured in other disclosures. Respondents stated that such a requirement should be either removed or made broader and more judgemental to capture the types of analyses that management considers.

80.   Some suggest closer alignment to regulatory disclosures (eg Basel Pillar 3) or to the framework proposed by the Enhanced Disclosure Task Force (EDTF) in its report *Enhancing the Risk Disclosures of Banks*.

81.   Nearly all users of financial statements support the disclosures proposed in the ED. However, some are urging the IASB to guard against requirements that are likely to become boilerplate disclosures.

Simplified approach for trade receivables and lease receivables

82.   The ED proposes a simplified approach for trade and lease receivables, under which an entity would always measure the loss allowance for these assets at an amount equal to lifetime ECL. This would be mandatory for trade receivables that do not constitute a financing transaction in accordance with IAS 18 *Revenue* and an accounting policy election for lease receivables and trade receivables that do constitute a financing transaction. This was proposed to provide operational relief by eliminating

      (a)   the need to calculate 12-month ECL, and

      (b)   the need to determine when to switch to recognising lifetime ECL.

83.   The large majority of respondents agree with the simplified approach, and among them it was noted that it made the model more operational.

84.   A few respondents, however, disagree with all or part of the simplified approach. The main reasons for their views are that they

      (a)   prefer current IAS 39 practice (in particular for short-term trade receivables),

      (b)   think the general model should apply to all instruments for consistency;

      (c)   disagree with extending the simplified approach to lease receivables because those instruments are economically similar to collateralised loans, and it is therefore inconsistent to apply different models for these assets; or

      (d)   are uncertain about the approach's applicability to lease receivables because the forthcoming leases Standard has yet to be finalised.

85.   Several respondents feel that current IAS 39 guidance should be retained for short-term trade receivables because the cost of applying the proposed model

would exceed the benefit of the resulting information. This is because they consider that there would not be a material difference between incurred losses and expected lifetime credit losses, because of the short-term nature of those assets. Some respondents also feel that the expected credit loss proposals are not as relevant for trade receivables because they were not seen as a cause of the financial crisis. This feedback is consistent with the messages received on short-term trade receivables throughout this project.

86.   A few respondents suggested that entities should be allowed to apply the simplified approach to all assets, which would lessen the burden for less sophisticated entities.

Financial assets that are credit-impaired on initial recognition

87.   The ED proposes that when a financial asset has objective evidence of impairment on initial recognition, an entity would be required to include the initial expected credit losses in the estimated cash flows when computing the effective interest rate. In addition, interest revenue would be calculated using the effective interest method on the amortised cost. This approach was thought to represent the underlying economics for these assets more faithfully than the general model.

88.   Most respondents support the proposals for purchased or originated credit-impaired assets. Several note that the proposals better reflect management's objective when acquiring such assets, which is to earn a return after considering expected credit losses. It was also noted that the proposed treatment appropriately reflects the economics of the transaction. Some respondents disagree because they felt it was inconsistent with the general model.

89.   Many respondents indicated they preferred a 'gross-up'[7] approach because:

(a)   it would be simpler (the proposals in the ED imply that assets must be segregated and tracked as closed portfolios, which is burdensome and not aligned with the way assets are managed);

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[7] An approach whereby an allowance for expected credit losses is recognised on initial recognition and the balance sheet amount is grossed up such that the (net) carrying amount reflects the transaction price.

(b)   having all assets follow a model that recognises initial expected credit losses in the form of an allowance balance would be more comparable;

(c)   presentation of expected credit losses would provide more transparent information to users; and

(d)   it would avoid a situation in which a negative credit loss allowance could arise.

90.   Others expressed concern about the effect of business combinations or the purchase of large portfolios and suggested the application of the 'gross-up' approach to all purchased assets.

91.   Some of who disagree with the proposals for originated or purchased credit-impaired financial assets stated that they prefer applying the general model to all instruments because it would provide more consistent information.

Effective date and transition

92.   The ED proposes that the requirements would be applied retrospectively, except when it is not possible to determine without undue cost or effort whether credit risk has increased significantly since initial recognition. In that case, the loss allowance would be determined on the basis of whether credit risk is low at each reporting date until derecognition. In addition, comparative information is not required to be restated. The mandatory effective date of IFRS 9 is currently 1 January 2015. In the ED we noted that the appropriate effective date would depend on the lead time needed to implement the expected credit loss model, so we sought feedback on this issue.

93.   The majority of respondents support the transition requirements. Some, however, requested practical ways to assess deterioration at transition, because the initial credit risk at initial recognition may not be available retrospectively.

94.   Some respondents are concerned that the proposals in the ED could effectively result in all assets below 'investment grade' being measured at lifetime ECL because of the lack of data on transition, which they considered inappropriate. These respondents therefore request that the IASB should clarify that delinquency

and other relevant information can be considered for the assessment of significant deterioration at transition.

95.   Most respondents agree with the transition proposals not to require the restatement of comparative information.

96.   Respondents generally think that a 3-year lead time is necessary to implement the proposed requirements. Many note that even sophisticated entities would need to make significant system changes in order to implement the model, and that specialist resources would need to be sourced. Respondents indicate that such a lead time would enable them to apply the model in parallel for a reporting period to ensure operability and information quality. In contrast, some think 2 years would be sufficient, and a few considered 4 to 5 years would be needed. A few respondents requested that the mandatory effective date of IFRS 4 *Insurance Contracts* and IFRS 9 should be aligned.

Alternative models

97.   Among the respondents many agree that the 2009 ED is the preferred model conceptually, but acknowledge the operational concerns associated with it.

98.   However, a small number suggest going back to the 2009 ED, and believe that the operational concerns surrounding it can be addressed. However, these respondents do not provide specific suggestions on how to overcome the operational difficulties associated with the 2009 ED.

99.   A few respondents, including one user, considered that the SD (without the floor) was a better reflection of the economics of lending than the proposed ED, while still reducing some of the operational complexity of the original ED and encourage the IASB to revisit the SD.

100. Others, including some users, support the gross-up approach[8] (ie the alternative view in the ED) or a variation thereof (amortisation of the initial expected credit losses over a period and in a manner in which the credit losses are expected to be realised). They think that it would provide useful information on lifetime ECL, while still more faithfully representing the economics of lending. Among those who support the gross-up approach, it was acknowledged that recognising lifetime ECL on Day one was conceptually inappropriate, but they noted that they considered that lifetime loss information is useful and believed that the gross-up approach would address concerns about double-counting. However, a respondent who performed its own outreach ultimately do not recommend this alternative, because that outreach indicated that there was minimal support because of operational complexity and concern about the nature of the debit that offsets the allowance balance.

101. Some respondents prefer the current IAS 39 model because they believed that expected credit loss models are too judgemental and arbitrary. Others suggest improvements to IAS 39, making it more forward-looking (ie including factors such as management estimates of future events and aligning the incurred loss trigger with indicators used in credit risk management).

102. Some other respondents suggest a variation of the IASB's proposals. They suggest recognising lifetime ECL based on an absolute level of credit risk rather than based on a change in in credit risk since initial recognition. Respondents suggested this approach because it would be less complex and align closely align with credit risk management and would avoid situations in which anomalies could arise when assets have a similar level of credit risk at the reporting date but are measured differently.

103. A small number of US respondents suggested a model in which the expected loss measurement period would be the greater of 12 months or the period that is

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[8] The gross-up method would require an entity to recognise a loss allowance for the lifetime ECL at initial recognition, but increase the gross carrying amount of the asset by the same amount, and thus eliminate the effect of double-counting the lifetime ECL.

reliably estimable and predictable. However, some specifically addressed this alternative and disagree with it because it would

(a)   be more likely to create diversity in practice and reduce comparability;

(b)   be very judgemental and it would also be difficult to define the period that is reliably estimable and predictable;

(c)   not be aligned with current credit risk systems; and

(d)   it would inappropriately extend the expected credit loss period beyond 12 months for assets that have not deteriorated significantly (eg it would be too conservative and conceptually there should not be a Day 1 loss to start with).
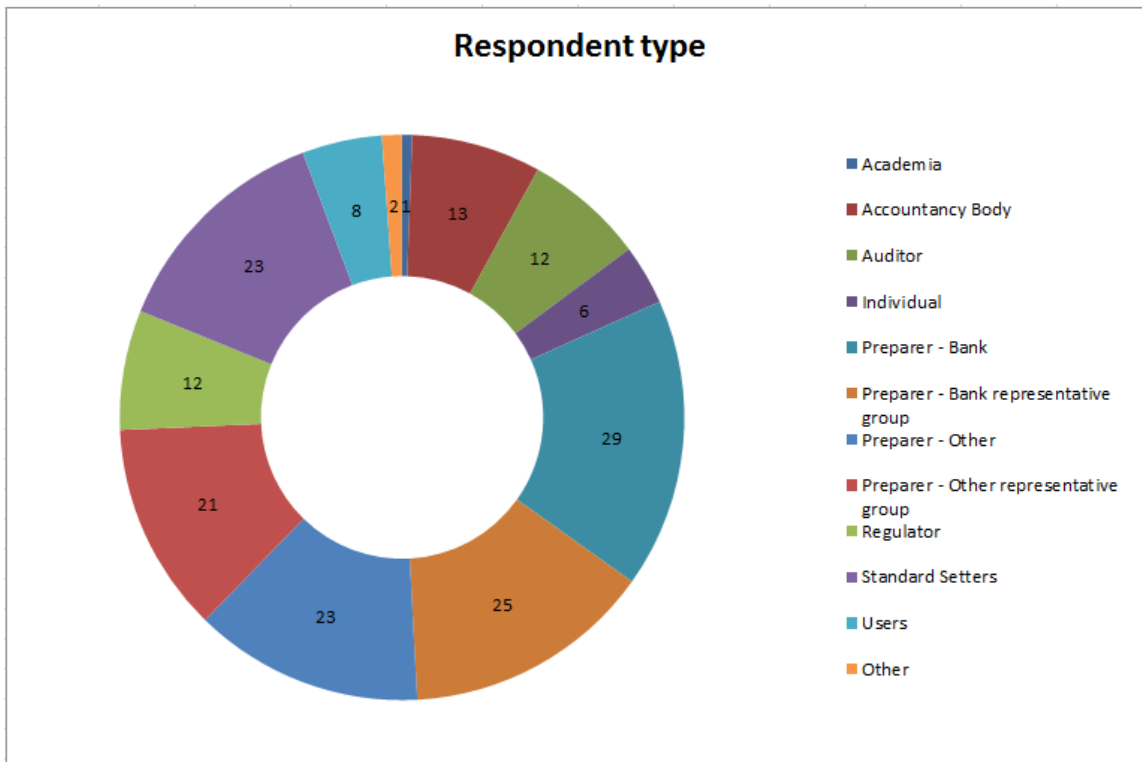
104.   These respondents noted that 12-months ECL for Stage 1 was superior because it is clearly understood and would provide more consistent results.

105.   One user representative group specifically do not support the 'foreseeable future' as an alternative measurement objective for financial instruments that have not significantly deteriorated since initial recognition because they consider it open to interpretation, which could lead to diversity in implementation and potential earnings management.

Appendix A

A1.   This Staff Paper summarises the feedback from 175 comment letters received.

Breakdown of comment letters

Geographical representation

Regional representation

Legend:
- Africa
- Asia
- Europe
- North America
- Oceania
- Latin America
- Global

Values shown: 5, 24, 38, 5, 10, 28, 65