Rådet för **finansiell rapportering**

The Swedish Financial Reporting Board

RFR-rs 2011:07

International Accounting Standards Board
30 Cannon Street
London EC4M 6 XH
United Kingdom

Dear Sirs,

Re: Supplement to ED/2009/12 Financial Instruments: Impairment

This is the Swedish Financial Reporting Board´s response to your invitation to comment on the Supplement to ED/2009/12 Financial Instruments: Impairment.

We note that the proposal only addresses open portfolios. The standard should not be finalised until models for all portfolios have been developed.

We welcome:

- The decision to exclude the expected losses from the calculation of the effective interest rate, which is in line with our previous comment letter on the ED regarding the objectives of measurement at amortised cost
- The introduction of the good-book and the bad-book concept, which, at a higher level, is in line with our comment letter on the ED
- The flexibility in the choice of discount rate. We share the concerns about the unnecessary complexity that the discounting of expected losses might introduce.

We do not support:

- The introduction of a floor. We believe that the introduction of the floor in practice has totally changed the initial objective of the standard, i.e. presenting an effective return on assets measured at amortised cost.
- The practical expedient for short term receivables. Our concern is that the present wording might exclude those credit card receivables that normally bear no interest as long as the customer pays the whole amount at the first contractual maturity date. Those should be included because these normally are managed on an open portfolio basis with regards to expected credit losses.
- The proposed principles for separating financial assets in the good or the bad book. We believe that principles are more complex than necessary by focusing on the management of the financial assets rather than if the financial assets are impaired or not.
- The definition of portfolio. The proposed focus is on the management of the portfolio rather than on the adequate calculation of expected losses.

Below you will find detailed remarks on some of the issues we recommend the IASB to reconsider.

Our position
As a background we reiterate our position expressed in our comment letter on ED/2009/12.

We consider that the methodology for the calculation of amortised cost should be made separately from the measurement of impairment charges.

We believe it is difficult (and sometimes impracticable) to assess and set a timing for probability weighted expected losses on individual loan engagements. We envisage that only in rare circumstances entities would be able to arrive at a reliable estimate of the timing of expected future losses, especially at the inception of the loan engagement. In most cases we consider that entities are predicting estimated losses on a portfolio level, and that the estimate is not of cash flows at given times, but rather of the size of future credit losses. We believe that this is especially true for low risk portfolios.

Provisions for expected losses are different in nature than incurred losses. Expected losses are contingent on a future event. As such they are not related directly to single assets and liabilities. Once the losses materialise, it is natural to exclude them from the calculation of expected losses. The contingent characteristics of the expected losses should also be reflective in their recognition. We therefore consider it natural to allocate the expected losses over the life of the instrument and adjust the calculation (with catch-up's for the past), when the estimates are changed. There are several arguments for that:

- The uncertainty of the credit risk is higher at inception. Therefore the initial estimate is normally exaggerated.
- The initial estimate does not reflect the current estimate of expected losses. Especially, if the objective of an amortised cost estimate is to allocate estimated future cash flows, the estimate of expected losses should be based on the currently estimated cash flows, not historical estimates.
- Several types of loan agreements give the lender the possibility to adjust the contractual interest rate if the credit quality has deteriorated, i.e. using the current estimates of expected losses will better reflect the contractual possibilities to adjust the interest rate.

The effect on the objective of the standard of the introduction of a floor
We welcome the decision of the IASB to exclude expected losses from the calculation of the effective interest rate. This is in line with our comment on the ED. However, introducing a floor on the impairment charges for expected losses has in practice totally changed the initial objective of the standard, i.e. presenting an effective return on assets measured at amortised cost.

We believe that this is a fundamental change in the basic principles, which should be considered to be a cross-cutting issue. The reason for our conclusion is that the supplement actually introduces an impairment model in which impairment allowances

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are required at day-one even though the expected return on the asset is expected to cover the expected losses. If kept unchanged, it should have implications on e.g. the revenue recognition project, the insurance project, on IAS 36 e.t.c.

Besides these conceptual concerns, we believe that the proposed model is a weak reflection on the performance of the entity and thus does not provide decision useful financial information. Instead, we favour a time-proportional model that takes different loss patterns into account when calculating the impairment allowance.

The proposal in the supplementary document will, in normal circumstances, instead overestimate the recognition in profit or loss of the expected losses in a growing portfolio and underestimate the recognition in profit or loss of expected losses both when the entity has an unchanged size of the portfolio and when the portfolio is reduced in size. We understand that one of the basic arguments for the floor is the risk of underestimating the recognition in profit or loss of expected losses for loan portfolios where most of the credit losses occur early in the life of the portfolio (front-loaded portfolios). Our view is that, instead of changing the basic principles, we believe that the principles should be made clear; that using average expected losses is not relevant for those portfolios which are front-loaded.

We believe that our principle based approach is superior to the proposed floors.

Short term receivables
We supported the inclusion of practical expedients in the ED. However, in the supplement, our concern is that the present wording might exclude those credit card receivables that normally bear no interest as long as the customer pays the whole amount at the first contractual maturity date. These should be included because these normally are managed on an open portfolio basis with regards to expected credit losses.

The concept of good and bad books
We are supportive of having different impairment models for the good book and the bad book. However, the supplement to the ED may complicate the concept by focusing on how the exposures are managed rather than focusing on the collectibility of cash flows as a starting point for if the exposure should be moved out of the good book. We believe that the wording in IAS 39.64 slightly rephrased would be an excellent starting point for a principle. The presently proposed focus on the credit risk management could instead be used as supplementary guidance. The banks´ internal rating systems would support such a distinction.

The portfolio definition
The present portfolio definition focuses on the management of the portfolio. The definition is further narrowed by introducing the requirement that the portfolio should be managed on a collective basis.

We support one single impairment model for financial instruments measured at amortised cost why the scope of open portfolios should be wider and incorporate all financial assets in the good book collectively assessed for impairment.

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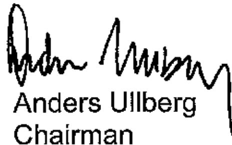
Furthermore, as a basis for the calculation of expected losses, we question if the starting point for the calculation is relevant (i.e. similar characteristics and managed on a collective basis). Instead, we consider that the definition should focus on groupings for the calculation of expected losses more clearly and that the starting point should be that credit risk characteristics should be similar.

If you have any questions concerning our comments please address our Executive member Carl-Eric Bohlin by e-mail to: carl-eric.bohlin@radetforfinansiellrapportering.se

Stockholm, 7 April 2011

Yours sincerely



Anders Ullberg
Chairman

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