Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

4 July 2013

Dear Mr Hoogervorst,

**Exposure Draft: Financial Instruments: Expected Credit Losses**

We are taking this opportunity to comment on the exposure draft "Financial Instruments: Expected Credit Losses". This letter has been drafted by the European Insurance CFO Forum, a body representing the views of 21 of Europe's largest insurance companies and Insurance Europe, representing 95% of the premium income of the European insurance market. Accordingly, it represents the consensus view of a significant element of the European Insurance industry.

**We support the IASB's expected credit loss model but believe some further improvements are necessary**

We support the IASB's efforts to improve the accounting for impairments and believe it is important that a high-quality standard is developed. We support the introduction of the general principles of an expected credit loss model that is applied consistently to all assets measured at amortised cost and fair value through OCI. We appreciate the changes that have been introduced to make the approach more operational and address some of the concerns raised previously by preparers. However, some further amendments to the proposed approach are still needed to simplify the application of the model and ensure that the standard is principles based.

**We accept the proposals in the ED to recognise 12 month expected credit losses in stage 1 as a compromise solution which can be made operational**

We believe the principles outlined in the ED achieve an adequate balance between reaching a conceptually sound approach whilst creating a model that is not overly complex for preparers to adopt. We do not think there is a true economic rationale for the recognition of 12 month expected credit losses for financial assets in stage 1, especially for bonds of high credit quality. However, we understand the practical challenge the IASB has faced in establishing a principle to draw the line between the recognition of lifetime expected credit losses versus recognition of no expected credit losses. On that basis the proposal can be accepted as a compromise, although the cost of implementing the proposals should not be underestimated.

While we accept the current proposal as a compromise, recognising anything more than 12 month expected credit losses in stage 1 would not be an acceptable proxy.

**Convergence is important but not at the expense of quality**

Overall we are supportive of convergence efforts between the IASB and FASB and think the objective of convergence resulting in a single high quality global standard should remain as an ultimate goal for the Boards. We believe that developments in recent years have indicated that impairment is a critical area for convergence between the IASB and the FASB; in addition, divergence creates practical difficulties for companies with US operations as they will need to maintain different models for the same assets. However, whilst convergence is important, it should not be at the cost of quality.

We do not support the model being proposed by the FASB which is based on full recognition of expected lifetime losses on initial recognition. Recognising lifetime losses at initial recognition would clearly result in excessive provisioning and, therefore, would not be a true representation of the underlying economics.

As such, we would not support the IASB aligning towards the FASB proposals in this area.

**We support the use of management judgement in applying the principles based expected credit loss model; management judgement should not be overridden by any "bright lines".**

We agree with the proposed principle that lifetime expected credit losses are recognised when there is a significant increase in credit risk since initial recognition. The determination of when a significant increase in credit risk has occurred should be principles based and be underpinned by the application of management judgement based on existing credit management practices and taking into account both forward-looking information and historical evidence. On this basis the guidance in the ED on the type of information that may be assessed in making a judgement about a change in credit risk is sufficient and in order to ensure that the standard is principles based, we recommend against introducing additional application guidance.

It is important that the guidance and examples within the standard are not misinterpreted as setting "bright line" thresholds (such as the reference to 'investment grade' instruments in paragraph 6 of the ED and the '30 day past due' rebuttable presumption in paragraph 9). Therefore, it should be emphasised and made clear in the final standard that the examples are for illustration purposes and are not intended to override the application of management judgement based on existing credit management practices. Introducing an overly mechanical determination with such "bright lines" could result in an inappropriate level of credit provision and also create undue volatility.

**The determination of interest income for assets where there is objective evidence of impairment should be simplified**

The ED proposes that interest income is recognised in full for assets in Stages 1 and 2 (i.e. for which there is no objective evidence of impairment) and that interest is recognised over the net amount (principal amount less credit loss provision) for assets in Stage 3 (i.e. for which there is objective evidence of impairment). Although we understand the conceptual basis for this proposal, recognising interest income over the net amount can be complex. As a practical expedient, we would propose that (similar to the methodology proposed by the FASB for US GAAP) assets for which there is objective evidence of impairment are put on a non-accrual status and interest income is recognised on a cash basis.

**The disclosure requirements should be simplified and addressed within IFRS 7**

The disclosure requirements on expected credit losses and credit risk would be better addressed within IFRS 7 so that the disclosure requirements for financial instruments can be considered as a whole instead of on a piecemeal basis. Disclosures relating to expected credit losses and credit risk would be better addressed as part of a separate exposure draft on IFRS 7 to develop financial instrument disclosure requirements based on all of IFRS 9. This would also eliminate duplication between the requirements outlined in the ED and those disclosures already required by IFRS 7.

In addition, the proposed disclosure requirements should be simplified. The ED proposals would introduce a high volume of detailed rules-based disclosure requirements. We accept that disclosure of information about amounts that arise from expected credit losses and the effect of deterioration or improvement in credit risk will provide relevant information to users. However, we think disclosure requirements should be more principles based and focused on relevant entity specific information rather than a prescriptive requirement which has to be provided in all circumstances even where not relevant.

**The interaction of the expected credit loss model with the proposals in IFRS 4 needs consideration**

The treatment of expected credit losses on assets measured at amortised cost and FVOCI has a linkage with the measurement of certain insurance contract liabilities under IFRS 4. As the IFRS 4 ED has only just become available, further work will be needed to ensure the requirements of the expected credit loss model do not create any unintended consequences for the valuation of insurance contract liabilities in IFRS 4 and for the inter-linkage between IFRS 4 and IFRS 9.

**Sufficient time is needed to implement IFRS 9 in its entirety and the mandatory effective date of IFRS 9 must be aligned with IFRS 4 for insurers**

As we have highlighted in our recent letters to you, insurers should not be required (but be permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise it may put into question the usefulness of financial reporting for users in the period between IFRS 9 and IFRS 4 adoption, as users will experience two major changes in an insurer's financial statements in short succession. A staggered adoption would not result in improved financial reporting for insurers in the period between adoption of IFRS 9 and IFRS 4 due to the fundamental interaction of financial assets and insurance liabilities for insurers.

Notwithstanding the above, we note that the current IFRS 9 standard has an effective date of 2015. The impact of implementing IFRS 9 overall is expected to be significant as it will require substantial changes to internal processes and systems. Sufficient time will be needed to properly implement all of IFRS 9 once IFRS 9 in its entirety is available; hence, irrespective of the interaction with the IFRS 4 effective date, we consider the current IFRS 9 mandatory effective date of 2015 to be no longer achievable. We would like the IASB to clarify the effective date of IFRS 9 as a whole as soon as possible.

We would like to thank the IASB for the efforts it has taken in developing the revised exposure draft and for this opportunity to comment on the exposure draft.

The appendix to this letter sets out our views on the detailed questions posed in the exposure draft.

Please feel free to contact us to discuss any matters raised in this letter.

Yours sincerely

Gerald Harlin
Chair, European Insurance CFO Forum

Olav Jones
Deputy Director General
Director Economics & Finance, Insurance Europe

## APPENDIX

### Question 1 – Objective of an expected credit loss impairment model

(a) *Do you agree that an approach that recognises a loss allowance (or provision) at an amount equal to a portion of expected credit losses initially, and lifetime expected credit losses only after significant deterioration in credit quality, will reflect:*

*(i) the economic link between the pricing of financial instruments and the credit quality at initial recognition; and*

*(ii) the effects of changes in the credit quality subsequent to initial recognition?*

*If not, why not and how do you believe the proposed model should be revised?*

(b) *Do you agree that recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses, discounted using the original effective interest rate, does not faithfully represent the underlying economics of financial instruments? If not, why not?*

(a) We support the introduction of an expected credit loss model that applies consistently to all assets at amortised cost and fair value through OCI. As set out in our covering letter, we do not think there is a true economic rationale for the recognition of 12 month expected credit losses for financial assets in stage 1, especially for bonds of high credit quality. However, we understand the practical challenge the IASB has faced in establishing a principle to draw the line between the recognition of lifetime expected credit losses versus recognition of no expected credit losses. On that basis the proposals for recognising 12 months expected credit losses in stage 1 can be accepted as a compromise solution. While we accept the current proposal as a compromise, recognising anything more than 12 month expected credit losses in stage 1 would not be an acceptable proxy.

(b) Yes we agree that an expected credit loss model that recognises lifetime expected credit losses on initial recognition would not represent the underlying economics and it would lead to an overstatement of expected credit losses.

### Question 2 – The main proposals in the Exposure Draft

(a) *Do you agree that recognising a loss allowance (or provision) at an amount equal to 12-month expected credit losses and at an amount equal to lifetime expected credit losses after significant deterioration in credit quality achieves an appropriate balance between the faithful representation of the underlying economics and the costs of implementation? If not, why not? What alternative would you prefer and why?*

(b) *Do you agree that the approach for accounting for expected credit losses proposed in this Exposure Draft achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than the approaches in the 2009 ED and the SD (without the foreseeable future floor)?*

(c) *Do you think that recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition, discounted using the original effective interest rate, achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than this Exposure Draft?*

(a) Yes, the proposal in the ED to recognise 12 months expected credit losses in stage 1 and lifetime expected credit losses after significant deterioration in credit quality is acceptable as a compromise solution between reaching a conceptual sound approach and making the requirements operational.

(b) Whilst we believe that the 2009 ED was conceptually sounder than the current proposal and hence better reflected the underlying economics (as outlined in our original comment letter on the 2009 ED), the cost of implementing that approach would have far outweighed the benefits.

(c) No, we would not support an expected credit loss model that recognises lifetime expected credit losses on initial recognition. Such a model would clearly result in excessive provisioning and, therefore, would

not be a true representation of the underlying economics. As such, we would not support the IASB aligning towards the FASB proposals in this area.

**Question 3 – Scope**

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

(b) *Do you agree that, for financial assets that are mandatorily measured at FVOCI in accordance with the Classification and Measurement ED, the accounting for expected credit losses should be as proposed in this Exposure Draft? Why or why not?*

We support the introduction of one expected credit loss model which applies consistently to all assets measured at amortised cost and fair value through OCI.

For the reasons outlined in our response to Question 10 below, we think insurance receivables, such as premiums to be paid by policyholders, should not be within the scope of the standard.

**Question 4 – 12 month expected credit losses**

*Is measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses operational? If not, why not and how do you believe the portion recognised from initial recognition should be determined?*

Calculating 12 month expected credit losses can be made operational, however, the cost of implementing the proposals should not be underestimated. The impact of implementing IFRS 9 overall is expected to be significant as it will require substantial changes to internal processes and systems. Even where some insurers may currently determine a similar provision for other purposes, any existing model will still need to be adjusted to be suitable for IFRS purposes.

**Question 5 – Assessing when an entity shall recognise lifetime expected credit losses**

(a) *Do you agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk since initial recognition? If not, why not and what alternative would you prefer?*

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

(c) *Do you agree that the assessment of when to recognise lifetime expected credit losses should consider only changes in the probability of a default occurring, rather than changes in expected credit losses (or credit loss given default ('LGD'))? If not, why not and what would you prefer?*

(d) *Do you agree with the proposed operational simplifications, and do they contribute to an appropriate balance between faithful representation and the cost of implementation?*

(e) *Do you agree with the proposal that the model shall allow the re-establishment of a loss allowance (or a provision) at an amount equal to 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met? If not, why not, and what would you prefer?*

(a) Yes, we agree that lifetime expected credit losses should be recognised when there is a significant increase in credit risk since initial recognition.

(b) The determination of when a significant increase in credit risk has occurred should be principles based and be underpinned by the application of management judgement, based on existing credit management practices and taking into account both forward-looking information and historical evidence. We believe the guidance on the type of information that may be assessed in making a judgement about credit risk is sufficient. In order to make sure that the standard is principles based, we recommend against introducing additional application guidance. It is also important that the guidance and examples within the standard are not misinterpreted as setting "bright line" thresholds and do not

create an overreliance on external factors (such as the reference to 'investment grade' instruments in paragraph 6 of the ED and the '30 days past due' rebuttable presumption in paragraph 9). Therefore, it should be emphasised and made clear in the final standard that the examples are for illustration purposes and are not intended to override the application of management judgement, based on existing credit management practices. Introducing an overly mechanical determination with such "bright-lines" could result in an inappropriate level of credit provision and also create undue volatility.

(c) Yes, we agree the assessment should consider only changes in the probability of default.

(d) We agree with the operational simplifications proposed in the standard, however, as noted above, care should be taken to ensure that "bright-line" thresholds are not introduced into the standard or an overemphasis on the use of external factors. For example, the "30 days past due" rebuttable presumption in paragraph 9 of the standard is a helpful guide but we recommend including sufficient explanation of this assumption in the final standard so that this is not misinterpreted as setting a "bright line" threshold. The same applies to the example in paragraph 6 which refers to an 'investment grade' financial instruments being considered to have a low credit risk.

(e) Yes, we agree with the proposal to allow the re-establishment of a 12 month loss allowance. However, we note that the proposal in paragraph 10 of the ED is in fact a requirement and not an option.

**Question 6 – Interest revenue**

*(a) Do you agree that there are circumstances when interest revenue calculated on a net carrying amount (amortised cost) rather than on a gross carrying amount can provide more useful information? If not, why not, and what would you prefer?*

*(b) Do you agree with the proposal to change how interest revenue is calculated for assets that have objective evidence of impairment subsequent to initial recognition? Why or why not? If not, for what population of assets should the interest revenue calculation change?*

*(c) Do you agree with the proposal that the interest revenue approach shall be symmetrical (i.e. that the calculation can revert back to a calculation on the gross carrying amount)? Why or why not? If not, what approach would you prefer?*

Although we understand the conceptual basis for requiring interest income to be recognised over the net amount for assets with objective evidence of impairment (i.e. assets in Stage 3), the proposal is overly complex. As a practical expedient we propose that (similar to the methodology proposed by the FASB for US GAAP) assets for which there is objective evidence of impairment are put on a non-accrual status and interest income is recognised on a cash basis.

**Question 7 – Disclosure**

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

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

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

No, we do not agree with the proposed disclosure requirements.

The disclosure requirements on expected credit losses and credit risk would be better dealt with within IFRS 7 so that the disclosure requirements for financial instruments can be considered as a whole instead of on a piecemeal basis. Disclosures relating to expected credit losses and credit risk would be better addressed as part of a separate exposure draft on IFRS 7 to develop financial instrument disclosures requirements based on all of IFRS 9. This would also eliminate duplication between the requirements outlined in the ED and those disclosures already required by IFRS 7.

In addition, the proposed disclosure requirements should be simplified. The ED proposals would introduce a high volume of detailed rules-based disclosure requirements. We accept that disclosure of information about

amounts that arise from expected credit losses and the effect of deterioration or improvement in credit risk will provide relevant information to users. However, we think disclosure requirements should be more principles based and focused on relevant entity specific information rather than a prescriptive requirement which has to be provided in all circumstances even where not relevant.

We have identified a number of examples where we believe the requirements could be simplified or made more principles based:

- The requirement in paragraph 35 to provide a reconciliation of the gross carrying amount and the associated loss allowance will result in an overloaded table disclosure which will include information which is not relevant for understanding credit risk, such as gross purchases and sales. The reconciliation should be simplified to require a reconciliation of only credit related allowances which is the more relevant information in this circumstance.
- The requirement in paragraph 39(d)(ii) to disclosure information about the discount rate percentage used will not provide decision useful information when an entity has elected to use the effective interest rate as this rate differs on an instrument by instrument basis. A qualitative disclosure would be more suitable and hence any quantitative disclosure requirement should be removed.
- The requirements in paragraph 39 and 42 should remain principles based through qualitative disclosure of the credit risk management process. It should not require quantitative disclosure of the mechanical process or formulas used. Instead, the overall disclosure principle should be based on a judgement by management as to what is relevant to disclose in order to meet that disclosure principle, based on the entity's specific circumstances.
- The requirement in paragraph 41 identifies impacts on the loss allowance caused by a particular portfolio or geographical area. We do not think these two areas should be singled out; instead they would be identified under the qualitative disclosure requirements in paragraph 39 where relevant to the entity.

**Question 8 – Application of the model to assets that have been modified but not derecognised**

*Do you agree with the proposed treatment of financial assets on which contractual cash flows are modified, and do you believe that it provides useful information? If not, why not and what alternative would you prefer?*

Yes, we agree with the proposed treatment of financial assets which are modified but not derecognised.

**Question 9 – Application of the model to loan commitments and financial guarantee contracts**

(a) *Do you agree with the proposals on the application of the general model to loan commitment and financial guarantee contracts? Why or why not? If not, what approach would you prefer?*

(b) *Do you foresee any significant operational challenges that may arise from the proposal to present expected credit losses on financial guarantee contracts or loan commitments as a provision in the statement of financial position? If yes, please explain.*

(a) Yes, we agree with the proposals for the application of the model to loan commitments and financial guarantee contracts. We also think the provision arising from financial guarantee contracts and loan commitments can be presented with the impairment provision for other financial assets and does not need to be shown separately in the balance sheet.

(b) The application of this requirement could be operationally challenging where companies have a high volume of loan commitments which in many cases are available only over a limited period of time.

**Question 10 – Exceptions to the general model**

(a) *Do you agree with the proposed simplified approach for trade receivables and lease receivables? Why or why not? If not, what changes do you recommend and why?*

(b) *Do you agree with the proposed amendments to the measurement on initial recognition of trade receivables with no significant financing component? If not, why not and what would you propose instead?*

Yes, we agree with the simplification for trade and lease receivables and with the proposed amendment for measurement on initial recognition of trade receivables.

Insurance receivables, such as premiums to be paid by policyholders, should not be within the scope of IFRS 9 but in the scope of IFRS 4. Hence, they should be exempted from applying the expected credit loss model and instead an incurred loss model should be applied. The cost of implementing an expected credit loss model for such receivables, even under a simplified model, does not outweigh the benefits due to the short maturity of these assets.

**Question 11 – Financial assets that are credit-impaired on initial recognition**

*Do you agree with the proposals for financial assets that are credit-impaired on initial recognition? Why or why not? If not, what approach would you prefer?*

Yes, we agree with the proposals for financial assets that are credit-impaired on initial recognition.

**Question 12 – Effective date and transition**

(a) *What lead time would you require to implement the proposed requirements? Please explain the assumptions that you have used in making this assessment. As a consequence, what do you believe is an appropriate mandatory effective date for IFRS 9? Please explain.*

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

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

(a) As set out in our covering letter, insurers should not be required (but be permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise it may put into question the usefulness of financial reporting for users in the period between IFRS 9 and IFRS 4 adoption, as users will experience two major changes in an insurer's financial statements in short succession. A staggered adoption would not result in improved financial reporting for insurers in the period between adoption of IFRS 9 and IFRS 4 due to the fundamental interaction of financial assets and insurance liabilities for insurers.

Notwithstanding the above, we note that the current IFRS 9 standard has an effective date of 2015. The impact of implementing IFRS 9 overall is expected to be significant as it will require substantial changes to internal processes and systems. Sufficient time will be needed to properly implement all of IFRS 9 once IFRS 9 in its entirety is available; hence, irrespective of the interaction with the IFRS 4 effective date, we consider the current IFRS 9 mandatory effective date of 2015 to be no longer achievable. We would like the IASB to clarify the effective date of IFRS 9 as a whole as soon as possible.

(b) Yes, we agree with the proposed transition requirements.

(c) Yes, we agree with the proposed relief from restating comparative information.

**Question 13 – Effects analysis**

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

The implementation efforts to adopt the proposals could be more significant than the effects analysis suggests, for example due to the volume of disclosure requirements included in the proposed standard.