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Erste Group Bank AG comments to “Consultation paper on amendments to the Guidelines on Financial Reporting (FINREP 10 March 2009)”

Ladies and Gentlemen,

Erste Group Bank AG thanks you for the opportunity to comment on the new proposal of Finrep. We welcome the intention to create uniform reporting format without national discretions to change the templates.

Below you can find our comments which are focused on bringing more clarity, removing the information which we think is not IFRS compliant and difficult to prepare from practical point of view. If you have any questions we stand ready to answer them.

We appreciate your considerations of comments and look forward to hearing from you.

Yours sincerely,

Mgr. Renata Harvankova
Head of Group Financial Statements

1) Comment to
Part 15 of Guidelines for implementation of FINREP

The table for collective impairment assessment process is not IAS 39 compliant in the step 1B because collective impairment is not allowed for individually impaired loans no matter if significant or not.

IAS 39.AG88 says

“Impairment losses recognised on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.”

The table probably refers to the fact that for practical reasons individually insignificant loans which are impaired are not treated based on individual cash flow estimates but based on statistics collected on portfolio basis (like LGD). But if this was the intention some other wording is necessary. Maybe just name “individually insignificant impaired loans” would be sufficient.

2) Comment to
Part 19 of Guidelines for implementation of FINREP
- Table 15 Gains and losses recognised in the income statement

The name “gains and losses” is not correct here because the table 15A under this heading breaks down the interest income and expenses. Gains and losses can never refer to interest income and expenses because the Framework in paragraphs 74-80 defines that gains / losses are subtype of income and expenses and may or may not arise in the course of ordinary activities. Interest income and expenses are always connected with ordinary activities of the banks so they always fall under revenue and expenses which are by nature different from gains / losses. Although borderlines here are not quite clear, IFRS never refer to interest items as gains / losses.

3) Comment to
Part 19 of Guidelines for implementation of FINREP
- Table 2 Consolidated income statement
- Table 15A Interest income and expenses on derivatives

The possibility to recognise interest income and expenses on derivatives should be described further in the part 19 of Guidelines for implementation of FINREP.

The Table 2 Income statement contains line items

- interest income – derivatives – hedge accounting, interest rate risk
- interest expenses – derivatives – hedge accounting, interest rate risk

The table 15A splits interest from derivatives held for trading into income and expenses.

The hedge accounting interest income and expenses in the Income statement should be further described - for example “amounts transferred into interest income and expenses when cash flow hedge accounting is applied”, “settlement payments from interest derivatives when fair value hedge accounting is applied”.

The table 15A contains for derivatives held for trading wrong reference to IAS 18.35 (b). This paragraph requires to disclose the amount of interest revenue. IAS 18 requires in paragraph 30

that revenue from interest shall be recognised using the effective interest rate (EIR) as set out in IAS 39. However EIR cannot be calculated for derivatives using IAS 39 rules because derivatives like interest / FX swaps, forwards have no initial net carrying amount. If CEBS wants to bring clarity into this area it should define what can be considered as interest income or expenses from interest derivatives or FX (or also other derivatives?)

- are these just settlement payments or can also the whole fair value revaluation be reported here?
- can interest income and expenses flow also from open and matched positions (as defined in point 14 i, ii of the guidelines for implementation) or only from hedging derivatives (as defined in point 14 iii)?

Clarification is needed because IFRS do not contain any guidance what interest income and expenses are in relation to derivatives.

4) Comment to

- Table 1 Consolidated balance sheet, 1.1 Assets

The issue that debt securities and loans and advances have references to IAS 39.9 has been discussed already. But we have to keep on saying that these references are wrong. Debt securities and loans and advances are not defined in IAS 39.9.

In this new version of FINREP proposal we welcome the improvement that “debt instruments” were renamed to “debt securities”. Now it is easier to derive that loans and advances are financial assets which are neither equity instruments nor debt securities. However in order to be quite clear it would be worth to write this explicitly in the Guidelines for implementation of FINREP and to cancel the wrong references.

5) Comment to

- Table 1 Consolidated balance sheet, 1.1. Assets. 1.2 Liabilities

The line items “Fair value hedge of interest rate risk” and “Cash flow hedge interest rate risk” both on asset and liability side refer to the IAS 39 paragraphs dealing with portfolio hedges. To avoid possible confusions such reference given directly in their names may be suitable – “Portfolio fair value hedge of interest rate risk”, “Portfolio cash flow hedge of interest rate risk”.

6) Comment to

- Table 1 Consolidated balance sheet 1.2 Liabilities

The line item “Share capital repayable on demand (e.g. cooperative shares)” has to be updated in the light of the IAS 32 amendment effective from 1st January 2009. It is very likely that most of such instruments will now meet the condition of equity instruments. If CEBS wants to keep this line item then you should include the reference to IAS32.16A,16B. These paragraphs define when capital repayable on demand (puttable instrument) is treated as equity and not liability.

7) Comment to

**- Table 1 Consolidated balance sheet 1.2 Liabilities,
- Table 12 Provisions**

Split of provisions in the balance sheet and in the table 12 contains item "Pensions and other post retirement benefit obligations" with reference to IAS 1.78(d) which requires to show separately provisions for employee benefits.

If the intention of this item was to include all employee benefits provisions it should be renamed. Current name has much narrower meaning.

If the intention was that only post-employment defined benefit plans are covered here, then it should be specified that other employee benefit provisions should be disclosed under "other provisions".

It also has to be mentioned that the table 12 which shows movements in provisions is not suitable for post-employment defined benefit obligations and for other long-term employee benefits because they contain specific movements like interest cost, current service cost, expected return on plan assets, actuarial gains and losses... These movements are analysed in the table 19 (see also our comment No 19). Defined benefit liabilities from post-employment benefits and liabilities for other long-term employee benefits are specific kinds of provisions which can have also negative (asset) balance (when plan assets exist). Therefore FINREP should specify where they should be reported in the balance sheet and they should be excluded from the Table 12.

8) Comment to

-Table 2 Consolidated income statement

Line items for "Interest income - other assets" and "Interest expenses - other liabilities" should be explained.

As regards interest income from other assets – interest income items above this one cover all financial assets. Was the intention to report here interest income from non-financial assets? What cases should fall here?

As regards interest expense from other liabilities – interest expense items above cover all financial liabilities except for financial liabilities that arise when transfer does not qualify for derecognition or when continuing involvement approach applies. It means that this item may be relevant for interest expense from these financial liabilities. But do you also consider it to be relevant for interest expenses from non-financial liabilities like interest expenses from provisions or interest cost from post-employment defined benefit plans and long-term employee benefit plans or for other?

9) Comment to

- Table 2 Consolidated income statement

Referring to the line item „Gains (losses) on financial assets and financial liabilities held for trading, net“ do securities coming from securitisation of loans fall

- under interest rate instruments and related derivatives or
- under credit risk instruments and related derivatives?

The line item “Other (including hybrid derivatives)” should be renamed to “Other (including hybrid instruments)”.

10) Comment to

- **Table 3 Derivatives held for trading**
- **Table 8 Derivatives – hedge accounting**
- **Part 14 of Guidelines for implementation of FINREP**

We strongly object to the requirement that notional amount of derivatives is split into separate columns based on whether derivative has positive or negative fair value. IFRS do not require any disclosure about derivatives except for their fair values. However the notional amount is easy to obtain and this Finrep requirement has not caused practical difficulties so far.

The issue of split of notional amounts based on positive or negative fair values of derivatives was discussed in the January meeting at CEBS. Banking sector opposed it and no convincing reason was given from the side of supervisors why it was needed.

Such split will cause significant burden for accounting practice. So far the notional amount was posted once at the inception of the contract and did not change after. This new requirement would cause repostings from one account to another based on how fair value of the (non-option) derivative develops. Banks usually have huge amounts of derivative contracts and such change could not be handled manually. Therefore accounting system changes would be necessary. An all these difficulties would be caused by requirement

- which is not IFRS compliant and
- whose informatory value is more than questionable, probably useless.

11) Comment to

- **Table 4 Financial Assets designated at fair value through profit or loss: credit risk information**
- **Table 5C Counterparty breakdown for financial assets held for trading and financial assets designated at fair value through profit or loss**

- a) The table 4 should be renamed into “Loans and receivables designated at fair value through profit or loss” because IFRS 7.9 requires these disclosures only for loans and receivables category.
- b) The column “Amount of cumulative change in the fair values attributable to changes in the credit risk” in the table 5C should be specified that it relates only to loans and receivables which were designated at fair value through profit or loss. IFRS 7.9 is valid only for such types of assets.

12) Comment to

- **Table 7 Information on impairment and past due**
- **Table 16B „Allowances movements for credit losses“**

- a) the column “specific allowances for collectively assessed financial assets” should be renamed to reflect the facts which we mentioned in the comment No 1. Correct alternative might be “Specific allowances for individually insignificant financial assets”.

- b) equity instruments which may be impaired can belong only to available for sale (AFS) category or measured at cost category. Paragraphs IAS 39.67-70 specific for impairment of AFS financial assets and paragraph IAS 39.66 specific for financial assets carried at cost do not allow

- to distinguish individual and portfolio impairment and
- to use separate allowance account for showing impairment.

Such split into portfolio and individual impairment and using allowance account is allowed only for financial assets carried at amortised cost (IAS 39.63-65 and the whole AG part dealing with impairment AG84-AG92).

Therefore for equity instruments in the Table 7 only the columns “net carrying amount of the impaired assets” and “accumulated value adjustments recorded directly to the income statement (accumulated write-offs)” are relevant.

For the same reason the Table 16B cannot be relevant for equity instruments. IFRS 7.16 requires reconciliation of changes in separate allowance account only when it is really used for recording the impairment. However for equity instruments impairment must never use separate account. Impairment is always recorded directly against the asset account.

- c) the column “collateral and other credit enhancements received as security for the related impaired and past due assets (reference to IFRS 7.37 (c))” in the Table 7 should not be required as mandatory, because IFRS 7.37(c) does not require to give disclosures of collateral fair values when impracticable.

13) Comment to

-Table 14 Fee and commission income and expenses

What does the line item “Commissions to agents (acquisition costs)” include? Transaction costs connected with acquisitions of financial assets and incurrence of financial liabilities are part of the initial carrying amount and are not reported in P&L. IAS 39.13 explicitly says that commissions paid to agents are transaction costs.

14) Comment to

- Table 15B Breakdown of gains and losses

For better understandability the line items under “Gains and losses from hedge accounting” should be specified to what types of hedges they relate. Currently this results from the references but including such information directly in the names would be better.

- Fair value changes of the hedged item attributable to the hedged risk – *fair value hedges* (IFRS 7.24 (a) (ii))
- Fair value changes of the hedging derivatives (including discontinuation) – *fair value hedges* (IFRS 7.24 (a) (i))
- Fair value changes of the hedging derivatives – *cash flow hedges* (IFRS 7.24 (b))

Currently the third type of hedge – hedge of net investment in foreign operation is missing.

The line items names say only about hedging derivatives. But also non-derivative financial assets or liabilities can be in the position of hedging instruments for hedging the FX risk. Therefore hedging derivatives should be renamed into „hedging instruments“.

15) Comment to

- **Table 15B Breakdown of gains and losses**
- **Table 25B Information on unrealised gains and losses**

These tables require to show separately gains and losses. For the banks this is especially relevant for gains and losses from financial instruments. We have to stress that such split is not required by IFRS 7, because

- IFRS 7.20 requires to disclose net gains or net losses for financial instruments and
- IFRS 7.24 requires to disclose gains or losses from fair value hedges and ineffectiveness recognised in profit or loss for cash flow hedges and net investment hedges.

There is no requirement to use separate disclosures for gains and for losses.

When a bank accounts for the gains and losses from revaluation of financial instruments continuously it may use the system of postings from which such separate information about gains and losses cannot be tracked. This would be the case when

- for same financial asset it posts for example gain 100 (when fair value went up by 100) for one month on one account and loss 20 for another month (when fair value decreased by 20) on another account. There are two separate accounts for gains and losses but they show the month-to-month +100 and -20 and not year-to-date information +80. Moreover in practice each asset does not have its own account for gains and losses and therefore such year-to-date information cannot be obtained simply by merging the gain and loss account; or
- One account both for gains and losses is used which shows the year-to-date gain or loss on individual asset level. But again postings on it merge many financial assets of the same or similar kind (like described above) and gain and loss balances are offset in this way.

To track such information the bank would have to handle each financial asset separately or would have to change the system of month-to-month (or day-to-date) postings of gains and losses. It might require significant system changes for the banks. Moreover banks which do not have this information do not even use it for internal purposes. Internal reporting based on net presentation of gains /losses is sufficient for them. Only information about financial instruments which are of particular interest for them is then searched individually.

The question is why should Finrep require information

- which is not required by IFRS,
- may not be tracked from accounting systems and
- when unavailable it is not even relevant for management decision making.

16) Comment to

- **Table 17 Repurchase agreements, reverse repurchase agreements and related agreements**

To be more understandable it should be specified to what values the particular tables relate

- Table A – carrying amount (of financial assets which were transferred but not derecognised)
- Table B – carrying amount of liability
- Table C – fair value of collateral when sold
- Table D – the carrying amount of assets (financing granted).

The reference to IFRS 7.15(a) is confusing here because this paragraph is about fair value of collateral held. If this table is about carrying amount of the assets (financing granted) then separate column for fair value of collateral held should be added.

17) Comment to

- Table 19 Defined benefit plans and employee benefits

Disclosures in this table are relevant for

- post employment defined benefit plans and
- other long-term employee benefits (although some line items are not relevant here like unrecognised actuarial gains/losses, unrecognised past service cost).

The scope of this table should be clearly defined because its current name is confusing.

18) Comment to

- Table 20 Loan commitments, financial guarantees and other commitments

The “doubtful” loan commitments and financial guarantees have to be defined. The possible definition might be that these are loan commitments and financial guarantees “for which provision on individual basis was created in accordance to IAS 37”.

19) Comment to

- Table 22 Statements of changes in equity

According to new IAS 1 statement of changes in equity is focused on owner changes in equity. This is reflected in the table. But the logical order of the line items would be that the comprehensive income for the year is the last line item just before closing balance. Currently it is placed in the middle of owner changes in equity.

20) Comment to

- Table 25A Information on fair value of financial instruments

- a) the columns for “Gross (before taxes) unrealised gains and losses (accumulated)” and further split into level 1, 2, 3 is not required by IFRS 7
- b) The table contains line items requiring to disclose fair value hierarchy for
 - loans and receivables,
 - held-to-maturity investments and
 - financial liabilities measured at amortised cost (with further subitems),
 i.e for those financial instruments which are not recognised at fair value in the financial statements.
 IFRS 7.27B requires to disclose fair value hierarchy only for fair value measurements recognised in the statement of financial position.

We strongly oppose that Finrep requires information that is outside the scope of IFRS. Preparing such information would be very burdensome for banks. If CEBS wants to collect such information anyway it should not use the heading Finrep which refers to IFRS.

21) Comment to

- Table 25D Hybrid financial instruments not designated at fair value through profit or loss

The column "Held for trading" is not relevant because under IAS 39.11 (c) if the hybrid instruments is measured at fair value through profit or loss (not only designated, but also when held for trading) the embedded derivative is not separated and no "rest of separable hybrid contracts" exists.