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Dear Madam, dear Sir,

Exposure Draft ED/2009/12 Financial Instruments: Amortised Cost and Impairment

The Committee of European Banking Supervisors (CEBS), comprised of high level representatives from banking supervisory authorities and central banks of the European Union, welcomes the opportunity to comment on the IASB's Exposure Draft ED/2009/12 Financial Instruments: Amortised Cost and Impairment.

Banking supervisory authorities and central banks have a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline.

CEBS welcomes the ongoing efforts of the IASB to improve financial reporting for financial instruments and in particular the accounting for assets that are measured at amortised cost and related impairment. As regards these proposals, CEBS broadly supports the direction of the IASB's move towards an impairment approach that is based on the concept of expected loss and considers this to be an improvement over the incurred loss approach used in the current IAS 39. An important factor underlying our support is that we consider that the proposed impairment model better reflects the economic substance of bank lending activities, and in particular allows for earlier recognition of credit risk.

Despite CEBS's support for the broad direction of the approach, the ED gives rise to a number of issues, the most important of which are briefly outlined in this cover letter.

CEBS supports the objective of amortised cost measurement as put forward in the ED, albeit with one qualification. It is felt that the objective should not only be to provide information about the effective return on a financial instrument by allocating interest revenue or expense over the expected life of a loan but also cover - in the case of assets – the recognition of impairment. Consequently, the ED could state the position regarding impairments more explicitly.

While the IASB model provides up-to-date estimates of credit losses at a given time – which change frequently over time, thus potentially giving rise to pro-cyclical effects if the revisions are substantial – CEBS has a strong preference for an approach that would incorporate management's previous experience on credit risk encompassing (ideally) a full economic

cycle. Through-the-cycle (TTC) estimates are more consistent with the way banks manage their credit risk.

In addition, the IASB model presents significant operational complexities and accordingly some simplifications should be introduced so that the model can be implemented effectively.

One of the main ways to reduce operational complexity that the IASB should take into consideration is to allow entities to determine expected cash flows also on the basis of open portfolios, not least to achieve further alignment between accounting treatment and credit risk management practices.

Similarly, complexity is introduced by the fact that the proposed approach requires estimates of the amounts and timings of expected cash flows to be probability-weighted possible outcomes. To simplify, entities should be enabled to use average loss rates, estimated on the basis of loss experience experienced "through the cycle". In addition to achieving greater reliability for the inputs used it would also help banks to apply the expected cash flow method to open portfolios and to bring their accounting systems into closer alignment with their risk management systems and thus also with the prudential framework.

CEBS suggests that the IASB attempts to overcome these issues together with stakeholders and external experts, including prudential regulators.

CEBS also recommends that the final standard includes enough guidance to avoid a position in which a shortfall of allowances could occur as a consequence of transferring financial assets from a portfolio to a different one after a default. CEBS notes that such a shortfall would occur if losses took place at an early stage of a loan's life, even if that was expected at inception.

Other issues which should be addressed in the guidance include what information or event may lead to a change of original estimation of expected losses; how provisions built up for expected losses are used when actual losses arise; and under what conditions provisions can (or must) be released to the income statement when related loans are derecognised.

Closely connected to the issue of complexity is the question of the implementation and lead time. CEBS considers it essential that, prior to any decision on the implementation date of the final standard, the IASB carries out extensive field testing on the new requirements. Given the potential complexity of such field testing, complementary approaches such as simulations could be considered.

Another key aspect will be to obtain high-quality disclosures, to allow users of financial information to understand and properly assess an entity's situation. We consider that the current proposal could be improved in some areas to achieve this objective, in particular regarding those related to losses for non-performing loans.

Finally, given our overall support for the broad direction the IASB has taken in the ED, CEBS - from a convergence perspective – is concerned about the fact that the FASB, in its ED, is moving into a different direction. As impairment has a significant effect on an entity's capital and

profitability, differences in that respect between IFRS and US GAAP raise significant concerns in terms of ensuring a level playing field. The IASB should endeavour – in close coordination with the FASB - to avoid such a scenario, although convergence should not be achieved at the expense of the quality of the final IFRS standard.

Our general and detailed comments on the Exposure Draft (ED) – provided in the appendix of this letter - discuss these issues as well as the specific questions raised by the IASB in more detail.

The comments put forward in this letter and in the related appendix have been coordinated by CEBS's Expert Group on Financial Information (EGFI) chaired by Mr. Didier Elbaum (Deputy Secretary General, Autorite de Contrôle Prudentiel) - in charge of monitoring any developments in the accounting area and of preparing related CEBS positions - and in particular by its Task Force on Procyclicality and Accounting under the direction of Mr. Ian Michael of the UK FSA. If you have any questions regarding our comments, please feel free to contact Mr. Elbaum (+33.1.4292.5801) or Mr. Michael (+ 44.20.7066.7098).

Yours sincerely,

Giovanni Carosio
Chair, Committee of European Banking Supervisors

Appendix

General Comments

i) Overall view

As already mentioned in our covering letter CEBS supports the broad direction the IASB has taken in the ED as concerns the amortised cost measurement of financial assets and the related treatment for impairment. In particular we welcome the fact that the IASB has decided to adopt an expected loss approach.

CEBS is of the view that an approach based on the concept of expected loss is an improvement over the incurred loss approach used in the current IAS 39, mainly because an expected loss approach better reflects the economic reality of banks' lending activities than the incurred loss approach in that it requires an earlier recognition of credit losses which are in fact usually latent in loan portfolios.

ii) Main concerns

Notwithstanding our overall support for the approach from a conceptual point of view, CEBS nonetheless has a number of concerns about the proposal (or aspects thereof) which the IASB should take into account when finalising this phase of the revision of the financial instruments standard.

Objective of amortised cost measurement

CEBS supports the objective of amortised cost measurement as put forward in the ED, although it is felt that the specification of the objective could be further improved by explicitly referring to impairment. Although it is implicit in the objective, a reference – in the case of assets – to the recognition of impairment, as is the case in the current definition of amortised cost in IAS 39, would be preferable.

This could be addressed by modifying the objective to say that it is to provide information about the effective return on a financial instrument by allocating interest revenue or expense (including impairment in the case of financial assets) over the expected life of the financial instrument.

Excessive complexity / need for simplification

The expected cash flow approach that the ED proposes for the determination of amortised cost, and the related updates that entities need to perform to reflect changes in estimates and expectations, may be too complex from an operational point of view.

While part of the complexity is related to the effective interest rate method, additional complications are due to the determination of expected cash flows and the determination of estimates. The establishment of the Expert Advisory Panel (EAP) - which CEBS very much welcomes - and its work programme bears witness to these difficulties.

In this perspective, to avoid excessive complexity, CEBS encourages the IASB to explore ways of simplifying the effective interest rate method. It also strongly advocates that the final standard provides for entities to have the possibility to determine expected cash flows on a collective basis

and also on the basis of open portfolios. The latter portfolios (as distinct from closed portfolios) contain credits granted in different years that change over time as individual credits mature and new ones are added – but all the while comprising assets with similar characteristics. The use of open portfolios would not only allow banks to limit the number of portfolios they would have to identify but also to achieve greater alignment with credit risk management practices.

Additional complexity is also introduced by the fact that estimates of the amounts of expected cash flows should be probability-weighted possible outcomes. To simplify, the final approach adopted by the IASB should ensure that entities use average loss rates, estimated on the basis of loss experience "through the cycle", rather than point-in-time. This would not only achieve greater reliability of the estimates, especially for inputs used, but would also enable banks (in particular) to achieve a closer alignment between on one side their accounting systems and on the other risk management systems and prudential frameworks. In the same vein the IASB should ensure that any required determination of the timing of the expected cash flows is practicable.

CEBS would also recommend that the IASB – bearing in mind and acting according to its due process – work together with all stakeholders and external experts, including prudential regulators to reduce complexity / increase simplification of the expected cash flow approach and to achieve a closer alignment with credit risk management systems and prudential framework.

Negative provisions

The proposed approach permits a financial asset, after a default or addition to a watch list, to be removed from a portfolio and added to a different portfolio, or that the expected cash flows may be estimated individually for that financial asset. CEBS is concerned about the fact that it does not specify how this transfer should be accounted for and what the interrelation is between the allowance account and the expected losses of the transferred financial asset.

In the absence of any guidance on this, CEBS is concerned that the IASB model could lead to a situation where allowances built up are not sufficient to cover the actual losses that can be evidenced (i.e. incurred losses). Moreover, this would occur if losses occurred early in the process, even if that was expected at inception.

Such a situation would be of great concern for CEBS from a supervisory point of view and the IASB is encouraged to consider this issue to avoid a position in which such a shortfall could occur.

Transition

For several reasons, CEBS believes that the transitional provisions need further analysis. Until the new impairment approach is defined, it is not possible to elaborate a transitional regime. This difficulty is reinforced by the practical consideration that an extensive field testing is needed for both purposes. This analysis could also give an idea of how retrospective application of the new model would work and would offer the opportunity to assess whether it would be preferable to adopt a prospective approach.

Implementation and lead time

The questions of the implementation and lead time are directly related to the complexity of the approach. Entities will need sufficient time to prepare and adapt their systems to the new standard. In addition, in some economic sectors entities will need time to collect data for the determination of their estimates.

CEBS therefore is of the view that – before any decision is taken on the implementation date of the final standard – the IASB should carry out extensive field testing on the new requirements. In the light of the potential complexity of such field testing, the IASB may want to consider complementary approaches such as simulations.

Disclosure

CEBS finally considers that high-quality disclosures will be a key aspect of any future impairment approach, to ensure that users of financial statements are in a position in which they can assess an entity's situation.

While we welcome many of the disclosure requirements put forward in the ED, we consider that the current proposal could benefit from further improvements to achieve this objective. In particular the disclosures regarding estimates and expected /actual losses for non-performing loans should be specified more clearly.

iii) Convergence and level-paying field issues

Finally, CEBS is concerned about the latest developments in the FASB regarding impairment. The Exposure Draft the U.S. accounting standard setter issued on 26th of May on accounting for financial instruments includes an approach to the recognition and measurement of loan impairment which is clearly different to that set out in the IASB's Exposure Draft.

Given the significance of impairment accounting for entities' statements of financial position and income statement, different approaches raise significant concerns from a level-playing field perspective. CEBS encourages the IASB – and the FASB – to be mindful of the desirability of avoiding such a scenario, although convergence should not be achieved at the expense of achieving the highest quality of international financial reporting standards.

Detailed comments

Question 1

Is the description of the objective of amortised cost measurement in the exposure draft clear? If not, how would you describe the objective and why?

Question 2

Do you believe that the objective of amortised cost set out in the exposure draft is appropriate for that measurement category? If not, why? What objective would you propose and why?

CEBS considers that the proposed objective of amortised cost, i.e. to provide information about the effective return of a financial asset, is useful and has the potential to reduce volatility of net income and to avoid overstatement of interest income in good times, thus reducing procyclical effects.

Additionally, we agree that the inclusion of initially expected credit losses within cash flows that are allocated over the life of the instrument is in line with the goal to move from an incurred loss to an expected loss model in the recognition of credit losses. However, the current definition of amortised cost in IAS 39 includes any reduction in value due to the asset's impairment. We would therefore propose to include in the final standard the recognition of the asset's impairment as part of the objective of amortised cost measurement.

We have some concerns about how the objective may be applied. Notably the determination of the effective return could raise reliability issues as it could be difficult to estimate precisely the timing of expected losses over the life of the loan.

The IASB approach requires - for the estimation of future cash flows - taking into account all current observable data to reflect the effects of current conditions at the reporting date. This provides relevant and up-to-date estimates of credit losses at a given time. However estimates could change significantly as soon as new information becomes available during the life of the loan or portfolio. Depending on management's ability to forecast accurately changes in credit risk factors, estimates may therefore have to be revised frequently, thus potentially giving rise to pro-cyclical effects if the revisions are substantial.

An approach that would incorporate management's previous experience on credit risk encompassing (ideally) a full economic cycle when estimating future losses could allow management to determine a well-supported average expected loss rate, which is consistent with how loans classified in the banking book are managed (they are held over the longer term to receive cash flows of principal and interest). This average expected loss rate would be applied as a starting point for management estimates, and management would adjust those estimates whenever there is material objective evidence of factors that are likely to cause loan losses to differ from historical loss experience (e.g. a structural shift in the economic cycle, introduction of new products).

We believe that such an approach would increase the extent to which estimates are both reliable and representative of the average rate of return over the life of the loans and portfolios. It would also have less pro-cyclical effects than the approach put forward in the ED and be in line with the business model as characterised by a bank's lending activity and the way credit risk is managed.

Question 3

Do you agree with the way that the exposure draft is drafted, which emphasises measurement principles accompanied by application guidance but which does not include implementation guidance or illustrative examples? If not, why? How would you prefer the standard to be drafted instead, and why?

As already stated in our comment letter on the IASB's request for information, CEBS is in favour of an approach which is principles-based and hence agrees with the way the exposure draft is drafted. It is important to define general measurement principles that could apply to various situations, entities and different types of instrument.

It is also essential that clear and adequate application guidance is provided – as is being developed in the case of fair value measurement - to ensure consistent implementation and comparability across institutions. CEBS believes that some areas may require further specification, e.g. how to determine estimates when there is a lack of historical statistics.

In this regard, CEBS encourages the IASB to establish guidance to mitigate the uncertainty inherent in loan loss estimates. Uncertainty surrounding loan loss estimates may be significant notably in the case of lack/insufficient historical data. In such a situation management will make more assumptions. The objective of such guidance should be to avoid under/over estimations. In developing this guidance, the IASB could draw from other standards and accounting guidance that deal with valuation uncertainty (for example IAS 36 par 30, IAS 37 par 37, EAP guidance on valuation of illiquid instruments -par 99) although CEBS recognizes that those provisions should be adapted to the amortised cost measurement attribute which is used in the expected cash flow model. CEBS also encourages the IASB to draw on existing supervisory literature such as the guidance on sound credit risk assessment and valuation for loans issue by the BCBS in June 2006, which notably deals with policies and procedures which should support experienced credit judgement and states that estimates should be based on reasonable and supportable assumptions and be supported by adequate documentation.

Also, the description of certain technical aspects, such as the use of the allowance account and the definition of the effective interest method (for fixed and variable rate instruments), should be specified more clearly because those techniques do not leave room for interpretation anyway. Although we agree that management should be allowed to decide whether it estimates expected losses on an individual or portfolio basis according to the business model, we believe that it is worthwhile indicating that in some circumstances the evaluation on an individual basis is more

appropriate. For example, an individual assessment should be used for exposures that are large (e.g. loans to buy ships or air planes) and/or loans that require close monitoring (e.g. loans for which actual losses are higher than initially expected). Therefore some guidance may be needed on this issue.

Moreover the methodology for estimating impairment losses on financial assets should take into account that impairment is inherent in any financial asset portfolio and is clearly influenced by business cycles. Therefore the impairment loss calculation models should be part of an appropriate credit risk measurement and management system and, while trying to estimate the through-the-cycle loss rate, take into account default experience and how it changes over business cycles, as well as losses expected and incurred in each homogeneous credit risk category, default experience, counterparty quality, and guarantees and collateral provided (and associated recoverable amounts), based on the information available on the date the estimate was made. The IASB needs to take care to ensure that the application guidance does not inadvertently limit the approaches that entities may have adopted for their internal credit risk assessment systems to fit their business model.

Other issues which deserve some further clarification and/or consideration are, for instance:

- What information or event may lead to a change of original estimation of expected losses (factored in the effective interest rate);
- How and to what extent provisions built up for expected losses can be used when actual losses arise;
- In case of full usage of loan loss allowances, how rapidly these allowance should be re-built;
- Under what conditions provisions can (or must) be released to the income statement when related loans are derecognised.

Finally, it is important that any such guidance has authoritative status, so as to have the greatest effect on increasing consistency in interpretation and application. Therefore, we think that application guidance, including outputs from the work of the Expert Advisory Panel, should be included in the standard itself, rather than as a separate document or as staff examples.

Question 4

(a) Do you agree with the measurement principles set out in the exposure draft? If not, which of the measurement principles do you disagree with and why?

(b) Are there any other measurement principles that should be added? If so, what are they and why should they be added?

CEBS supports the implementation of an expected loss model in place of the current incurred loss model as it would provide a timely recognition of credit losses, alongside the recognition of the credit risk premium included

in the interest rate charged to the borrower (as revenue on an accrual basis). Such an accounting mechanism would prevent a timing mismatch between the revenue recognition and the risk taken by the bank that this revenue aims to offset and would improve credit risk related information provided to investors. Therefore CEBS believes that the approach proposed by the IASB is conceptually appealing. However, it raises a number of concerns.

First of all, the focus on the matching between interest revenue and expense recognition has obscured the importance of correctly estimating impairment. In this sense, it could be the case that if actual/incurred losses appear at the initial stage of a loan's life, insufficient provisions would be in place to cover those losses, and therefore loans would be under-provisioned. From a supervisory point of view, this issue would be of great concern for CEBS and the IASB should avoid such a situation.

Additionally, the approach poses operational difficulties and concerns about the reliability of the expected loss calculation and in terms of pro-cyclicality.

The Board clarifies in the exposure draft that entities should use point-in-time estimates of expected loss. If expected losses are estimated using all current observable data reflecting current conditions, this could lead to loan loss allowances that would not reflect conditions expected over the life of the loan or portfolio. Consequently expected losses, and hence net profits, would vary significantly through economic cycles as management expectations fluctuate between optimism and pessimism in line with changes in economic conditions. Catch-up adjustments due to changes of expectations not linked to incurred losses would unduly exacerbate pro-cyclical effects. The extent to which initial estimates of expected losses will be revised will determine the magnitude of these effects.

CEBS believes that the estimate of expected losses should be made using a thorough understanding of how credit losses have previously been realised through an economic cycle.

Making use of "through-the-cycle" information would reduce the potential pro-cyclicality induced by catch-up adjustments, insofar as changes in the estimation of expected losses would become less frequent, being linked to material modifications of the economic environment and/or bank's lending policy. Moreover, the use of TTC estimates does not necessarily imply the recognition of an impairment loss at initial recognition. It is consistent with a progressive building up of the provision. Also, CEBS considers that such an approach does not result in providing for credit losses that relate to future loans as the impairment allowance is determined on the basis of the existing portfolios at the end of the reporting period.

Another possible solution aimed at reducing the pro-cyclicality of the ECF model as designed in the ED could be to allow, only for performing loans, an adjustment of the effective interest – rather than recognising an immediate gain/loss in the income statement – when original estimates of expected losses change.

The length of the observed historical period should not be compared with the time horizon of the estimate. In fact, it is possible to estimate the expected losses looking at a more or less long past period, provided that

observed losses refer to loans with equal or similar characteristics (including maturity) to those which are to be measured. For instance, if the current portfolio is made of 5 years loans, the average historical loss should be calculated considering actual losses observed in the past on the same type of loans.

To determine point in time estimates, an entity needs to assess in which phase of the economic cycle the related loans are granted. This assessment is extremely difficult to do with sufficient accuracy. Therefore, forecasting future losses on the basis of current and foreseeable economic conditions will be challenging and increasingly unreliable as time horizons increase. This may affect the relevance and reliability of the accounts.

CEBS therefore prefers the use of statistical information to forecast future credit losses with a long-run perspective rather than estimating losses period by period. The use of an average loss rate, estimated using loss experience collected "through the cycle", may be more reliable for periods stretching far into the future as it would not require assumptions to be made on the position of the economic cycle. It could also be more neutral in that it provides a baseline for what are highly judgmental estimates.

Moreover if the fungibility of the allowance recognised to provide for the credit losses of a given portfolio is accepted (i.e. the provision covers indistinctively the whole portfolio since future defaulted loans cannot be identified), this principle should also apply to new loans entering the portfolio.

Overall, there should be an assessment to evaluate whether the loan loss allowance covers at least the expected/incurred losses for non-performing loans. Otherwise there could be an under-provisioning for loans where losses appear in the early years of their life.

Question 5

(a) Is the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost in the exposure draft clear? If not, how would you describe the objective and why?

(b) Do you believe that the objective of presentation and disclosure in relation to financial instruments measured at amortised cost set out in the exposure draft is appropriate? If not, why? What objective would you propose and why?

As noted in our response to the IASB's Request for Information in September 2009, CEBS considers that any impairment approach should be subject to appropriate high-quality disclosure requirements (which for quantitative disclosures, should deliver information that is harmonised as much as possible). The proposed objective of presentation and disclosure in relation to financial instruments measured at amortised cost appears to be clear. Also, the elaboration provided in paragraph 12 is helpful in ensuring that information provided on the application of amortised cost measurement (including the impairment approach) is comprehensive, meaningful and "tells a story" about the entity's performance and financial

position, rather than providing individual disclosure items without links being clearly explained. This objective for disclosures aligns with aspects of CEBS' Principles for disclosures in times of stress (published on 26 April 2010).

Question 6

Do you agree with the proposed presentation requirements? If not, why? What presentation would you prefer instead and why?

CEBS agrees with the proposed presentation requirement to show gross interest revenue, expected credit losses and net interest revenue separately on the face of the income statement.

CEBS believes that, in the absence of an impairment trigger, both impairment and reversal of impairment require robust presentation and disclosure to prevent earnings management. The presentation of gains and losses resulting from changes in estimates on the face of the income statement should increase the focus of users on this important adjustment, and thus mitigate (to some extent) the risk of earnings management.

Question 7

(a) Do you agree with the proposed disclosure requirements? If not, what disclosure requirement do you disagree with and why?

(b) What other disclosures would you prefer (whether in addition to or instead of the proposed disclosures) and why?

CEBS notes that it is essential that any impairment model, especially one which relies so critically on management judgements, should be accompanied by high quality disclosure requirements to enable users to understand how the model is being implemented and the entity's key underlying assumptions. We believe that there is merit in making the judgemental nature of these estimates clear and in providing detailed information on the basis on which the estimates were made, including the underlying assumptions made about the future. The disclosure requirements on estimates and changes in estimates (paragraphs 16-19) will be especially important in this regard.

If accounting standards move away from an "incurred loss" model, it is crucial that this does not result in a reduction in the information disclosed about actual credit quality. The exposure draft uses non performing loans and write-offs as a proxy for this.

In that respect CEBS is of the view that the definition of "non-performing loans" is too narrow. It should be possible to classify a financial asset as "non-performing" when the entity considers that the obligor is unlikely to pay the amounts due in full without recourse to actions such as realising the collateralized securities although it is neither past due more than 90 days nor considered uncollectible (i.e. there are no reasonable expectations of recovery). To establish a better "proxy" for actual losses, as suggested above, it will also help to properly segregate "performing"

and "non-performing" financial assets. A 90 days rule could be a good approach to consider (amongst others) for this purpose. However a more principles-based definition could also be appropriate in this regard and there may be some scope for considering how these are defined under the Basel II prudential framework. In any case it is essential to have information on expected / incurred (or actual) losses associated with non-performing loans.

A related issue concerns the notion of "write off". A firm's write-off policy may be affected by local company law, tax law or other factors, and in any case is likely to lag behind changes in credit quality. This may lead to inconsistencies in application. We believe that the IASB should explore other proxies for "actual losses" that are more reflective of the change in credit quality of the loans held.

We think that an appropriate definition of "write-off" is essential. A financial asset may be considered uncollectible, for example, immediately after a bankruptcy has been completed, immediately after arrangements with creditors, when debt-collecting has been undertaken without recovery of the full outstanding amount, or in other cases where the entity, after having tried to recover the outstanding amount, finds that there are no reasonable ways of recovering the amount within the foreseeable future. Considering an asset as uncollectible need not prevent an entity from performing further enforcement activities (such as legal action). We understand that the FASB are considering a different definition and would encourage the Boards to work together to achieve a joint solution.

Regarding the proposal of disclosure in paragraph 21.b), it is essential for users to be informed of a quantitative estimate of the interaction between changes in non-performing assets and changes in the allowance account. Paragraph 21.b) only refers to a qualitative analysis, and only if that interaction is significant. This is clearly insufficient to understand the loan loss allowance, and therefore we propose that disclosures clearly specify the expected losses of non-performing loans.

We also believe that entities should be required to disclose accumulated provisions and write-offs during the period. Information on the use of the allowance account could also be helpful.

We have some concerns about whether the stress testing disclosures (paragraph 20) would be applied consistently and would be comparable across entities, particularly as the disclosure requirement only applies to those entities that prepare such information. We assume that the IASB's intention is that the information should cover stress tests conducted as regards credit risk, as the scope of the proposed standard is financial instruments measured at amortised cost. However, this is not clear as currently drafted, and may imply that firms should publish information on stress tests conducted on the bank as a whole, as may often be the case for strategic planning or regulatory purposes. There is also a risk that the requirement as currently drafted could give misleading signals to users of financial statements, given the range of stress tests conducted. For instance, a firm running a very severe stress test could compare unfavourably to another running a less extreme scenario, even if it were

better prepared to manage its risks. For these reasons CEBS suggests that there should not be a requirement to disclose stress tests. This kind of disclosure could be better addressed within the Pillar 3 regime.

If – though CEBS advises against this (see above) - the proposed model is based on probability-weighted estimates of cash flows, we anticipate that all firms would have to carry out some form of sensitivity analysis to assess the effects of reasonably possible alternative assumptions. Information about such sensitivity analyses from all entities would provide more appropriate, relevant and useful information for users of financial statements. CEBS therefore encourages the IASB to refine the scope and drafting of this disclosure requirement instead of disclosure of stress tests.

CEBS also notes that the concept of "class" has caused some issues in the application of IFRS 7, and it appears for some entities to have resulted in disclosures being made only at a high level. CEBS is of the opinion that a more granular disaggregation, for example a breakdown into groups according to credit risk, would be a more appropriate breakdown for the disclosures proposed in paragraph 19. In any case, the term "class" should be defined more clearly.

However, to be meaningful and verifiable, banks' expectations of cash flows could be determined at a very granular level. The same will be true of disclosed information if it is to be informative for users of accounts. For large banks, there is a risk that this could result in disclosure overload. This could be a particular problem for the vintage information proposed in paragraph 22. The IASB should consider whether "average remaining maturity" may be a more appropriate framework for disclosure. In order to reflect the revolving nature of some loan portfolios, it is also important to consider the economic ('behavioural') maturity, where this is significantly different to the contractual term of the loans.

Although CEBS considers that the disclosures proposed in paragraphs 17, 18 and 19 provide transparency into an entity's ability to estimate future cash flows, more disclosures are needed to better understand how management judgement has been applied. CEBS suggest adding in IAS 1 par 126 the example of estimating expected cash flow for impairment purposes as a source of estimation uncertainty. CEBS also considers that the future standard on impairment should contain more detailed provisions as regards the determination of the initial expected losses (e.g. regarding sources of inputs, banks should provide explanations about the length of historical data used (at least for each category of portfolio : retail, corporate...), and on how they estimate expected losses on new products...). CEBS also considers that the sensitivity analysis requirement should be enhanced (for example it could be provided for each category of portfolio, it could be systematically based on several scenarios...) and that some specific qualitative disclosures on back testing could be introduced.

Question 8

Would a mandatory effective date of about three years after the date of issue of the IFRS allow sufficient lead-time for

implementing the proposed requirements? If not, what would be an appropriate lead-time and why?

In the new model, provisions will be built up progressively. Therefore, sufficient time will be needed before implementing the new accounting framework. The phasing in of such model should take into account the economic cycle to avoid procyclical effects.

CEBS believes that "field testing" (as part of the due process) should be carried out before the new standard becomes effective as this would help to understand the consequences of the new standard and would make clear if the primary intention is achieved. Such testing could be accompanied by complementary approaches such as simulations. Furthermore, such a field test could give an indication regarding the practicability of the new provisioning approach.

CEBS notes that the banking sector remains subject to significant challenges, and that the implementation of this standard would coincide with many other substantial changes in both accounting standards and the regulatory framework. Given the importance of banks developing reliable and effective systems to implement the ECF and the significance of lending within banks' business models, we believe that at least three years would be required from the date of issue of an IFRS.

Question 9

(a) Do you agree with the proposed transition requirements? If not, why? What transition approach would you propose instead and why?

(b) Would you prefer the alternative transition approach (described above in the summary of the transition requirements)? If so, why?

(c) Do you agree that comparative information should be restated to reflect the proposed requirements? If not, what would you prefer instead and why? If you believe that the requirement to restate comparative information would affect the lead-time (see Question 8) please describe why and to what extent.

The proposed transition methods need further analysis. In particular, until the new impairment approach is defined, it is not possible to elaborate a transitional regime. This difficulty is reinforced by the practical consideration that an extensive field testing is needed for both purposes. This analysis could also give an idea of how retrospective application of the new model would work, and would offer the opportunity to assess whether it is preferable to adopt a prospective approach.

Question 10

Do you agree with the proposed disclosure requirements in relation to transition? If not, what would you propose instead and why?

We agree with the proposed disclosure requirements in relation to transition, and we believe that they are sufficient to provide decision useful information to the users of financial information.

Question 11

Do you agree that the proposed guidance on practical expedients is appropriate? If not, why? What would you propose instead and why?

Question 12

Do you believe additional guidance on practical expedients should be provided? If so, what guidance would you propose and why? How closely do you think any additional practical expedients would approximate the outcome that would result from the proposed requirements, and what is the basis for your assessment?

CEBS agrees with the proposal that entities should be able to resort to practical expedients for calculating amortised cost. The possibility of resorting to such measures seems particularly important for smaller entities for which the calculation of amortised cost could otherwise be a difficult task.

At the same time the fact that the ED allows the use of such practical expedients only if their overall effect is immaterial effectively limits their use in practice. CEBS notes that materiality is a qualitative characteristic applying to all aspects of financial statements, in line with the IASB's conceptual framework. An additional reference to materiality in this standard could be misleading in suggesting that there is a higher threshold for determining materiality than in other standards.

In particular, the introduction of such a clause may ultimately further complicate an entity's situation as one interpretation of the clause as currently drafted would imply that an entity would have to determine amortised cost using the approach put forward in the ED in order to be able to say whether or not the overall effect of the practical expedient is immaterial.

CEBS believes that the intention of principle (c) in paragraph B15 is to ensure that using a practical expedient does not give rise to a situation where a financial instrument is not measured at fair value at initial recognition, or that using a practical expedient gives rise to a gain or loss on day 1. If this is the IASB's intention, we suggest that it makes this clear in the drafting of the principle. Otherwise, we believe that this principle is not expressed clearly and could potentially be a very burdensome requirement for use of a practical expedient.

CEBS is therefore of the view that the IASB should ensure that the practical expedients simplify the calculation of the amortised cost without introducing undue lenience or level-playing field issues. Guidance might be important in that respect.