

Swedish Bankers' Association

Svenska Bankföreningen

POSITION PAPER
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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom
Sent electronically to www.iasb.org

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

Dear Sir/Madam,

We appreciate the opportunity to respond to the International Accounting Standards Board's (IASB) Exposure Draft ED/2009/12 – Financial Instruments: Amortised Cost and Impairment (ED). This letter represents the views of the Swedish Bankers' Association (our/we/the Association). The Swedish Bankers' Association is a member of the European Banking Federation (EBF).

The association agrees with the need for a single impairment model that reduces complexity and mitigates pro-cyclical effects and we believe that moving to an impairment model based on expected rather than incurred losses is a step in the right direction. However, for reasons that will be further explained in our comment letter we do not believe that the highly complex measurement model based on expected cash flows proposed by the IASB is the right way forward. We urge the IASB to find a less complex model that allows for both an open and a closed portfolio approach and that keeps the current definition of the effective interest rate intact. Both EBF and Expert Advisory Panel (EAP) are discussing such solutions. The association essentially supports the model proposed by the EBF that is based on expected losses over the life of the portfolio (ELLP) with a minor correction concerning the recognition of the effects of changes in estimations. This will be described further below.

In the following, the associations' position is summarised as bullet points and thereafter further developed. Finally, we present the association's specific replies to the questions explicitly raised by the IASB in the exposure draft.

1. Our position and general remarks

The association's position can be summarized as follows:

- The proposed model is too complex and will generate large operational challenges as well as substantial implementation costs. Operational aspects for preparers must be more comprehensively considered with a more workable model related to internal risk management practices.

- We do not agree with altering the established principles for measuring amortised cost and presenting interest income, as proposed by the IASB.
- We fear that the proposed model may enhance rather than reduce pro-cyclicality. The IASB should reconsider the proposed approach to recognition of changes in expectations about cash flows.
- Due process should be considered, including field tests and a thorough impact assessment. A single set of high-quality global accounting standards that are well accepted among preparers, users and other stakeholders should be prioritised over political deadlines. It is important that the FASB and the IASB work together to achieve convergence.

2. Development of general remarks

Operational aspects and the link to the Basel II framework

A closed portfolio/single loan model such as the one proposed by the IASB is much too complex and will lead to large operational challenges as well as substantial implementation costs. It can be questioned if the implementing costs are in proportion with the potential benefits of the model.

The association urges the board to consider a more operationally workable solution that is more closely linked to the preparers' business models and the Basel II framework. To become more operational the accounting model must be flexible and possible to align with the well established internal risk management practices of financial institutions. Particularly, the model must allow for both open and closed portfolio approaches. It must also be possible to measure expected losses with the help of statistical information already available for regulatory capital purposes and adjusted for some parameters (such as through-the-cycle to point-in-time PDs and one year horizon to the whole life of the loan).

The alternative model proposed by the EBF (ELLP) is more closely linked to the current business and risk models and would therefore be more operational and cost efficient to implement. We also believe that the required timeframe to implement the EBF model would be substantially shorter than the time it will require to implement the model proposed in the ED.

Reduced comparability and transparency of the financial reporting

We fear that the complexity of the impairment model proposed by the IASB will reduce both comparability and transparency of financial reporting. Furthermore, for financial institutions, the concepts of amortised cost and effective interest are well established concepts among users of financial information. Altering these definitions is both unfortunate and unnecessary and would obstruct the understanding and decision usefulness of financial information. The institutions' exposures to interest rate risk and credit risk are better disclosed if expected losses are not mixed up with the measurement of interest. Therefore, along with the EBF, the association is in favour of presenting expected credit losses on a separate line in the income statement apart from the presentation of net interest income which should be kept as it is.

The issue of pro-cyclicality and recognition of changes in estimates

On a general level, the association believes that impairment rules for the purposes of financial reporting should reflect the nature of the business. Prudential requirements for additional

buffers should be handled as a part of the regulatory capital framework and not be introduced in the IFRS standards. Lending business is to its nature cyclical and as the main objective of the financial reporting is to supply the market with decision useful information we believe that changes in expectations of future cash flows should be reflected in the financial statements. Volatility is natural and should not be hidden in the financial statements.

Having said this, the association is concerned that the model proposed in the ED increases rather than mitigates pro-cyclicality the way the G20 meetings have called for. Evidently, a model based on expected losses will recognise losses earlier than an incurred loss model and thus lead to entities building up reserves during good times. However, preparers of financial reports tend to be more optimistic about the expected cash flows when leaving a recession and vice versa. The impact of such over- and underestimation of the economic trend may give rise to so called "cliff effects" and increased volatility in the financial statements as changes in expected cash flows will have a full and immediate effect on the total portfolio when entering/leaving the business cycle. It can thus be argued that immediate recognition of changes in expected cash flows the way IASB proposes will lead to enhanced rather than reduced pro-cyclicality.

In the ELLP model suggested by the EBF adjustments to the initial estimation of expected losses are amortised over the remaining life of the portfolio. In our opinion, a more appropriate approach is to recognise any gains or losses relating to the current and prior periods immediately in profit or loss in the period of the change in estimate and amortise portions of the change in estimate relating to future cash flows over the remaining life of the financial assets. This approach is also supported by some members of the EFRAG.

Due process, impact assessment and convergence of accounting standards

When altering regulations of this magnitude it is essential that due process is considered. Just like the G20 meetings have called for we are in favour of a single set of high-quality global accounting standards that are well accepted by preparers, users and other stakeholders. The development of such standards should be prioritised over political deadlines. Furthermore, it is of great importance that the FASB and the IASB work together to achieve the objective of convergence.

A thorough impact assessment is needed in order to ensure that the proposed rules are appropriate and proportionate to their purpose. In addition, the assessment is needed to ensure legal certainty for those who are going to apply the amended or new standardisation creating the necessary basis for predictability and transparency. We consider the fragments of an impact assessment contained in the ED to be shallow and not to provide sufficient backing for the proposal.

The impact assessment should particularly consider the efforts within the EU to improve the regulatory environment, reduce the administrative burden for companies and enhance competitiveness.

3. Responses to the specific questions in the ED

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?

We believe that the description of the objective of amortised cost measurement in the ED is clear.

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?

We support the proposed description of the objective of amortised cost measurement in the ED. It provides information about the effective return of a financial asset or financial liability by allocating interest revenue or interest expense over the expected life on the financial instrument. However, having said that we believe that including for a financial asset the initial estimate of expected credit losses is difficult in practice.

For individual financial assets the Swedish Bankers' Association is in favour of keeping the present definition of amortised cost, based on contractual terms and conditions including the expected life of the loan, unchanged. The current definition is well established and accepted amongst preparers and users. Having said that we believe that expected losses in the context of a new impairment model should be determined on a portfolio level. Therefore we essentially support EBF's alternative model (ELLP).

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?

We support an approach whereby the standard should be principles-based. Therefore, we see no reasons for including details and/or rules by application guidance or illustrative examples in the standard itself.

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?**

We believe that the EBF's alternative model (ELLP) is consistent with the objectives and the principles of the IASB's exposure draft as it is based on expected losses. Therefore please see our remarks in the beginning of our response.

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?

We believe that the description of the objective of presentation and disclosure in relation to financial instruments measured at amortised cost is well formulated and clear. However, an alternative model that is based on a portfolio approach will probably not contain all the information for the disclosures that is requested by the ED. These would then have to be adjusted accordingly.

Question 6

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

In principle we broadly agree with the presentation requirements. However, we are concerned that the proposals introduce a new definition of "net interest income". With the new definition we might experience difficulty to communicate the net interest income and its components, due to the increased number of ways to define and possibilities to communicate net interest income (for instance before or after reassessment of expected losses). Furthermore, please see our comments under "Reduced comparability and transparency of the financial reporting", page 2.

Question 7

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

In principle we broadly support the proposed disclosure requirements.

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

We don't prefer any other disclosures.

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?

The Board proposes a transition approach that would determine an adjustment to the effective interest rate previously determined in accordance with IAS 39. For the banks this should be applied to a financial asset or group of financial assets. We believe that the demand for sufficient lead-time for implementing the proposed requirements will be very extensive and the consequences cannot be foreseen at this time. Therefore, we cannot assess a sufficient lead-time to allow for implementing the proposed requirements, but if the entities are required to restate also comparative information we are of the opinion that the entities should be given sufficient time to be able to build up data for that purpose.

As we have already stated we believe that the expected cash flow model should be applicable on a portfolio level to both "closed" and/or "open" portfolios. Given that, we believe that an effective date of about three years after the issue of a new standard will allow sufficient lead-time for implementing the proposed requirements.

Question 9

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

We propose that the preparers are given sufficient time for transition to make it possible to build up data collection dates to be able to make relevant adjustments of the effective interest rates, for instance, in accordance with the implementation of Basel II framework.

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

We don't fully understand how the alternative transition approach would look like. Therefore, we are doubtful to such a system and its objectives.

(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.

If you as a preparer have the historic information then you also have the possibility to restate the information. If the entities are required to restate the comparative information then the entities should also be given sufficient time to be able to build up data for that purpose.

Question 10

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

We support the proposed disclosure requirements in the ED.

Question 11

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

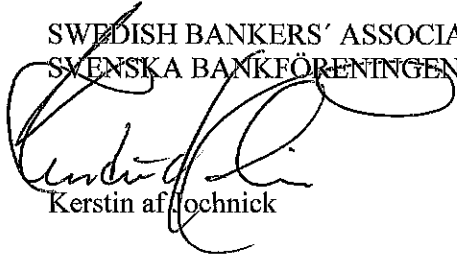
We agree with the proposed guidance on practical expedients in the ED.

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?

We have nothing to add to the question of additional guidance on practical expedients.

SWEDISH BANKERS' ASSOCIATION
SVENSKA BANKFÖRENINGEN



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