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Correspondant	Our references	Your references	Date
Ignace Bogaert	C 2013/046		03.07.2013

Dear Sir, Madam,

Invitation to comment – IASB ED *Financial instruments: Expected Credit Losses*

The scientific secretary of the Belgian Accounting Standards Board (BASB) is pleased to respond to the Exposure Draft on *Financial Instrument: Expected Credit Losses* issued by the IASB (the "Boards") in March 2013 (hereinafter the "ED").

Question 1

(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?

Answer to question 1

To recognise any day one loss is difficult to support on technical grounds, as, in theory at least, credit risk is considered into the specific transaction. The scientific secretary of the Belgian Accounting Standards Board agrees and accepts that for financial assets in the "good

book" the recognition of lifetime expected credit losses over time would be appropriate. A provision for expected credit losses from initial recognition provides a reasonably pragmatic way of building up an appropriate provision for impairment.

Delaying the lifetime loss recognition until there has been a significant decline does, to a degree, recognize that when financial instruments are first advanced there is an economic link between their pricing and their credit quality, which breaks down by the time there has been a significant deterioration. We therefore agree with the proposal.

Question 2

(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?

Answer to question 2

The scientific secretary of the Belgian Accounting Standards Board agrees that it is a practical solution; whether or not 12-month is the right number, is debatable. The term is clearly linked to Basel II regulatory requirements. However, it is probably the easiest term to justify as it links to what is expected in the next annual reporting cycle.

The scientific secretary of the Belgian Accounting Standards Board questioned the practical applicability of the previous ED & SD, as we had concerns as to how to apply the concept of *foreseeable future* in the previous version. Hence we support the change in the current ED.

Question 3

(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?

Answer to question 3

The scientific secretary of the Belgian Accounting Standards Board agrees with the proposed scope of the ED but we have mixed views on the treatment for financial assets mandatorily measured at FVOCI.

It does appear logical to have the same model for assets measured at amortised cost and at FVOCI, especially as the current IFRS impairment model for AFS securities has fallen apart.

Nevertheless, the application of a day one loss does give rise to information that will be difficult to explain and is arguably unnecessary, given that changes in credit risk are already reflected in fair values.

For high quality debt securities, the impact is likely to be insignificant as the probability of default would be rather low.

Question 4

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?

Answer to question 4

As per appendix A, the scientific secretary of the Belgian Accounting Standards Board believes that the interpretation and application of *default events* is unclear. The wording of *events* makes it unambiguous. It is not clear whether the Board intended to have a looser definition of default which includes causes of default (e.g. unemployment), rather than default itself (e.g. non-payment) for the definition of 12-month expected credit losses (ECL).

Secondly, the amount of provisions in the 12-month category may differ significantly depending on how default is defined. Also, the ECL allowances between the 12-month and the lifetime category could be misaligned if an entity uses delinquency as the only indicator for the transfer between these categories and when defining *default*.

For example, if more than 30 days past due (DPD) is used as a transfer criterion to Bucket 2, then how default is defined for Bucket 1 would make a difference on the amount of allowance provided.

Should default equate to 30 DPD as in the Bucket 2 trigger, or nearer to 90 DPD, which might be a Bucket 3 indicator? If *default* is defined:

- Between 1 – 30 DPD, then a 12 month calculation will identify expected losses that will arise in the next year.

- At 60 DPD, then (as no loans that are already 30DPD are present in the Bucket 1 population) a *default* cannot arise until month 2. Hence, the calculated loss will be approximately 11/12 of that using a 30 DPD definition.

- At 180 DPD, a *default* cannot arise until month 6, hence the calculated loss will be approximately 7/12 of that using a 30 DPD definition.

- At 365 DPD, the calculation will only be 1/12 of the amount.

Although we have illustrated this assuming that 30 DPD is used as the Bucket 2 transfer criterion, the same general issue arises for whatever criterion is used. This all points to the need for the Board to be more prescriptive as to what it means by *default*.

Question 5

(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?

Answer to question 5

(a) The scientific secretary of the Belgian Accounting Standards Board agrees with the proposed requirement.

(b) The scientific secretary of the Belgian Accounting Standards Board is of the opinion that preparers would prefer more guidance to those already in paragraphs B11 – B21. However, the practical expedients proposed in the ED help and we believe that an Expert Advisory Panel (EAP) is in a better position to explore this further rather than the IASB.

(c) The scientific secretary of the Belgian Accounting Standards Board agrees that the assessment for the recognition of lifetime expected credit losses should be based on changes in the probability of default.

(d) The scientific secretary of the Belgian Accounting Standards Board agrees, but we would recommend that the *investment / non-investment grade simplification* should be a rebuttable presumption in order not to prohibit entities from recognising lifetime ECL if there has been significant credit risk deterioration, but the asset is still deemed to be of investment grade quality (e.g. deterioration from AAA to BBB+).

(e) The scientific secretary of the Belgian Accounting Standards Board also agrees as one of the practical difficulties in the impairment of AFS securities under IAS 39 is that entities are reluctant to recognise any allowance if there is no subsequent way of releasing that amount.

Question 6

(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?

Answer to question 6

The scientific secretary of the Belgian Accounting Standards Board agrees that interest revenue should be calculated on a net basis when there is objective evidence of impairment.

In addition, in relation to the discount rate, we noted that the ECL should be discounted at the EIR for assets in Bucket 1 and Bucket 2. However, once an asset is in Bucket 3, interest revenue that is calculated based on the EIR would be irrelevant and the cost of capital may be more appropriate.

Question 7

(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?

Answer to question 7

(a) The scientific secretary of the Belgian Accounting Standards Board supports the disclosures as they will provide relevant information about the credit quality of an entity's financial assets.

(b) Potentially, the scientific secretary of the Belgian Accounting Standards Board believes, it will be operationally difficult for entities to disclose all the quantitative reconciliation disclosures that are required under paragraph 35.

(c) Additional disclosures on how the inputs and assumptions are used in an entity's estimation technique when calculating the ECL allowance would be more helpful for users of the financial statements. In particular, two entities using the same inputs and assumptions (e.g. unemployment, macroeconomic indicators) are likely to have different ECL allowances depending on how these assumptions are used in the way the ECLs are calculated. Therefore, additional disclosures would be helpful, such as the effect of using forward looking estimates compared to historical loss rates.

Question 8

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?

Answer to question 8

The scientific secretary of the Belgian Accounting Standards Board agrees with the proposed treatment of financial assets on which contractual cash flows are modified.

Question 9

(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.

Answer to question 9

The scientific secretary of the Belgian Accounting Standards Board would like to refer to findings of the field-test that is being executed by EFRAG as the BASB cannot provide relevant comments on this question as it mainly relates to financial institutions.

Question 10

(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?

Answer to question 10

The scientific secretary of the Belgian Accounting Standards Board strongly supports this simplification as this will ensure a more consistent treatment in the impairment model of trade receivables.

Question 11

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?

Answer to question 11

The scientific secretary of the Belgian Accounting Standards Board agrees as this will result in no change in the current treatment of credit-impaired assets under IAS 39 today. Also, we noted that it will be rare to have originated assets that are credit-impaired; however, it is possible given the current economic climate (e.g. Greek Government Bonds).

Question 12

(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?

Answer to question 12

The scientific secretary of the Belgian Accounting Standards Board would like to refer to our answer to question 9.

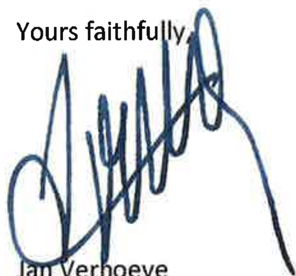
Question 13

Answer to question 13

The scientific secretary of the Belgian Accounting Standards Board does not have any further comments at this stage.

Should you wish to discuss the content of this letter with us, please contact Jan Verhoeye at jan.verhoeye@cnc-cbn.be.

Yours faithfully,



Jan Verhoeye
Chairman BASB