European Banking Federation

Chief Executive

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Ms Leslie F. SEIDMAN
Chairman
Financial Accounting Standards Board
Email: lfseidman@fasb.org

Brussels, 30 May 2013

***Subject*: EBF comment letter on FASB Exposure Document Financial Instruments: Credit losses**

Dear Ms Seidman,

Thank you very much for the opportunity to comment on the Exposure Document Financial Instruments: Credit losses.

The EBF is supportive of the objective to achieve a sound expected loss provisioning approach promoting more forward looking provisioning through timely identification and recognition of credit losses. The EBF believes the new model should be principle-based, differentiating between performing assets and those which no longer perform or have suffered significant credit deterioration, and applicable to open portfolios.

In this respect, unfortunately, the EBF cannot support the proposed FASB approach. The recognition of life time losses at initial recognition of a financial asset is not consistent with the objectives of financial reporting since it does not faithfully represent the underlying economics. Financial statements should portray the economic substance of transactions to provide information useful for economic decisions. This general purpose information can then be adjusted by regulators to meet their different objectives.

The EBF notes that life time expected loss is the appropriate measurement for loans which have suffered significant deterioration and that in some circumstances, particularly for short term and revolving loans, there may be little or no difference between life time expected loss and 12 month expected loss.

However, for performing loans with a longer maturity there is likely to be a very significant difference, and given that the measurement of life time loss is inherently uncertain, the range of possible outcomes is so great that the information is unlikely to meet the objectives of financial reporting.

We believe that the proposed approach is also in conflict with the revenue recognition principle in particular where the pricing of financial instruments at initial recognition is already reflective of their prevailing credit quality. The provisions recognized under the FASB model are seen mainly as a prudential buffer because the majority of loans will never default in most conditions.

Furthermore, the EBF is concerned that this model would not provide for a level playing field as it seems to disadvantage loan portfolios with longer maturities and may even discourage long term lending, particularly at the bottom of economic cycles and in emerging economies. As long term lending would become more expensive, the business lending structure may be forced to change, resulting in shortening the maturities of the loans. The model seems also more favorable where securitisation practices result in derecognition of loans shortly after origination.

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The EBF believes that the IASB model, with its concept of credit deterioration is more reflective of the way banks manage their risk and it is believed it will provide users of financial statements with better information. The EBF therefore regrets that the Financial Accounting Standards Board (FASB) has abandoned a joint project with the IASB and developed its own expected loss model.

The EBF understand the concerns expressed in US with the operational challenges of the IASB model. However, the operational challenges of the FASB model, particularly with determining life time losses for longer term performing loans, should not be under estimated.

The EBF believes that the IASB model better matches risk management practices It could be simplified in practice to address the operational issues and remain faithful to its underlying principles. The link with risk management practices makes the IASB model not only more operational than the FASB model, but also more likely to provide meaningful information to users.

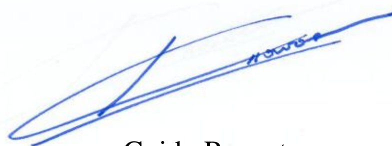
While the EBF is committed to a single set of high quality accounting standards, particularly given the growing importance of comparability of financial statements and a level playing field at global level, it is essential that the converged standards are of high quality, workable and reflective of the way the business is managed. The EBF does not believe the FASB model could provide users with useful information and does not believes it would meet the objectives of the financial reporting.

Although there are some common features between the IASB and the FASB model there are also important differences which mean that the measurement of life time expected loss are unlikely to be comparable. For example, the approach to discounting is different between the two models; it is doubtful whether discounting that may be implicit in certain methodologies would achieve a comparable result to the IASB model which requires explicit discounting.

While regrettable, it may not be possible for the Boards to reach a converged solution from such different starting points. In this case all the differences need to be clearly articulated in the standard to avoid any confusion and help users of the financial statements to draw the right conclusions. For example, if the same terms used do not have the same meaning or the outcomes are not comparable, this should be clearly identified in the standards.

In addition, the EBF would strongly reject the notion that disclosure could address the lack of convergence, using the precedent set in the offsetting project. As set out above, the EBF believes that, in some cases the measurement of life time loss is so inherently uncertain and the range of possible outcomes is so great that the information is unlikely to meet the objectives of financial reporting, whether the loss is recognised as impairment or whether it is disclosed. This, coupled with the inherent differences in acceptable methodologies between the IASB and FASB models, makes it impossible for disclosure to be used to bridge the gap. We appreciate your consideration of our comments and remain at your disposal to elaborate further on our views should you wish so.

Yours faithfully,



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