World Council

July 5, 2013

Filed electronically on www.ifrs.org
International Accounting Standards Board
IFRS Foundation
30 Cannon Street
London, EC4M 6XH
United Kingdom

Re: *Financial Instruments: Expected Credit Losses* Exposure Draft (ED/2013/3)

Dear Sir or Madam:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the International Accounting Standards Board (IASB) exposure draft on *Financial Instruments: Expected Credit Losses*. World Council is the leading trade association and development organization for the international credit union movement.

Worldwide, there are over 51,000 cooperatively owned not-for-profit credit unions in 100 countries with more than US$ 1.5 trillion in total assets. Credit unions range in asset size from as small as a few thousand dollars in assets to as much as US$ 53 billion in assets. The average credit union asset size in 2012 was approximately US$ 30 million in assets with most credit unions have less than US$ 10 million in assets.

Overview of World Council's Comments

World Council opposes the *Financial Instruments: Expected Credit Losses* exposure draft as proposed. We question the utility of moving to an expected loss model, especially in the case of non-stock entities like credit unions that performed well in general during the recent financial crisis under the IAS 39 incurred loss model and similar incurred loss standards established by national generally accepted accounting principles (GAAP).

Credit unions are also concerned that loan loss expenses related to transitioning to an expected loss model could deplete some credit unions' regulatory capital levels to the point where they become subject to mandatory supervisory remedial actions such as "Prompt Corrective Action" rules. Unlike joint-stock company banks, credit unions must rely primarily on earnings retention to build capital and have limited, if any, means of raising additional capital. We are concerned that a significant depletion of credit union regulatory capital could occur as part of a transition to an expected credit loss accounting methodology even though these credit unions' underlying economic credit risk exposures would not have changed and their total amount of reserves and allowances held to protect the institution and its members against losses would not have changed as an economic matter.

We urge the IASB to modify the final version of the *Expected Credit Losses* standard to:

(1) Retain an incurred loss approach, especially with respect to smaller, community financial institutions; and/or

(2) Include practical expedients in the final version of the standard that accommodate the resource constraints faced by credit unions and other small and medium financial institutions, such as:

(a) Allowing a long transitional period for phase-in of the new standard so that credit unions have sufficient time to build up additional loan loss reserves;

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(b) Not requiring the discounting of expected future cash flows at the credit-adjusted effective interest rate; and

(c) Allowing jurisdictional accounting authorities and/or regulators the option to establish simplified credit loss methodologies for small financial institutions, especially those in developing countries and/or those with limited staff resources, for whom full compliance with the proposed expected credit loss model would be an excessively burdensome compliance requirement.

World Council also supports the views expressed by the Credit Union National Association (CUNA) in CUNA's comment letter opposing the Financial Accounting Standards Board (FASB)[1] expected lifetime credit loss proposal under US GAAP that is related to the IASB *Financial Instruments: Expected Credit Losses* proposal. CUNA has also expressed to World Council its support of the views taken in this comment letter. Many of the points raised in CUNA's comment letter are consistent with and relevant to those included in this letter, and vice-versa.

If IASB chooses to proceed with an expected credit loss approach for all entities as proposed, World Council strongly supports the IASB's proposed "Stage 1" (Bucket 1) approach—for loans and other financial instruments without "significant deterioration in credit quality"—that limits expected credit losses on Stage 1 instruments to a 12 months lookout period.

We believe that the IASB's proposed 12 month lookout period for expected credit losses in Stage 1 is a more reasonable approach to valuating loans that do not have any "significant deterioration in credit quality" than the FASB's Current Expected Credit Loss (CECL) proposed model. This is because the FASB's CECL approach would require credit unions and other financial institutions to recognize lifetime losses on loans from virtually the moment of origination and before any signs of credit quality deterioration occur.

World Council's Detailed Comments

- Questions 1(a), 2(a), 3(a), and 4: As noted above, we do not support the IASB's expected loss model for credit unions as currently proposed. We do believe, however, that an approach which recognizes lifetime credit losses only after significant deterioration in credit quality better, such as that proposed by the IASB, reflects the credit quality of a loan or other financial instrument at time of initial recognition than does the FASB CECL method.

- Questions 1(b) and 2(c): We do not support requiring credit unions to recognize credit losses using the discounting of expected future cash flows at the credit-adjusted effective interest rate. We believe that this requirement would increase the standard's compliance costs on smaller institutions without adding commensurate safety and soundness benefits.

- Question 5(d): We believe that the proposed operational simplifications are not sufficient for smaller financial institutions like credit unions. We urge the IASB to include additional practical expedients in the final version of the standard, as outlined above, which accommodate small and medium sized credit unions' resource constraints.

- Question 5(e): We agree that, in an expected loss model, the instrument should be returned to the Stage 1, 12-month expected credit losses treatment if the criteria for recognition of lifetime losses are no longer met. This is because the recognition of lifetime expected losses would have been predicated upon facts that no longer apply.

[1] www.cuna.org/Legislative-And-Regulatory-Advocacy/DownLoads/rcl_052913/

- Question 7(a): We are concerned that the proposed disclosure requirement would be excessively burdensome on small institutions that have relatively less complex financial assets than large banks. We think that credit union disclosures established pursuant to existing regulatory and accounting requirements are sufficient to inform members about their credit union's financial condition.

- Question 7(b): Yes, we foresee myriad operational challenges in terms of adjusting credit unions' accounting systems to the new standard. This transition will require extensive and expensive reworking of most credit unions' back office systems.

- Question 12(a): We urge the IASB to allow a long transitional period for phase-in of the new standard so that credit unions have sufficient time to build up additional loan loss reserves and adjust their back office systems to an expected loss model. We believe that credit unions will need at least three years from the date that the IASB finalizes IFRS 9 to be able to comply with the new standard without presenting risks to credit union safety and soundness. The proposed mandatory effective date of IFRS 9—currently 1 January 2015—should therefore be postponed until at least 1 January 2017, or later if the final IFRS 9 standard is issued after December 31, 2013 so as to ensure an at least three year transition period for credit unions.

- Question 12(b): We do not believe that the proposed transition requirements are sufficient to prevent excessive regulatory burdens on credit unions. As noted above, credit unions should have at least three years to transition to the IFRS 9 standard and, if the transition period is less than three years, it is imperative that the standard be applied prospectively, not retrospectively, vis-à-vis financial assets held by the credit union at the time IFRS 9 become effective.

Thank you for the opportunity to comment on the IASB's *Financial Instruments: Expected Credit Losses* exposure draft. If you have questions about our comments, please feel free to contact me at medwards@woccu.org or +1-202-508-6755.

Sincerely,

Michael S. Edwards
VP and Chief Counsel
World Council of Credit Unions