European Banking Authority
European System of Financial Supervision

13 March 2012

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Dear Madam, dear Sir,

Exposure Draft ED/2011/6 Revenue from Contracts with Customers

The European Banking Authority (EBA), which has come into being as of 1 January 2011 as per Regulation (EU) 1093/2010, welcomes the opportunity to comment on the IASB's Exposure Draft ED/2011/6 Revenue from Contracts with Customers.

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.

The EBA is aware of the differences in revenue recognition requirements between US Generally Accepted Accounting Principles (U.S. GAAP) and in International Financial Reporting Standards (IFRS) and therefore welcomes the efforts to achieve consistency of the accounting for revenue recognition that cuts across all industries, aimed at contributing to high quality accounting standards.

As for the previous ED, the EBA expects the most recent proposals to have a limited impact on the banking sector as a whole, as banks derive much of their income from financial instruments which are scoped out of the standard.

For this reason, we have restricted our comments in the appendix to focus on specific issues considered to be the most relevant from a banking supervisory perspective, and we have not commented the proposals more broadly.

If you have any questions regarding our comments, please feel free to contact Mr. Colinet (+ 32.2.220.5247) in his capacity as Chairman of the technical group that coordinated this comment letter.

Yours sincerely,

Andrea Enria

Chair, European Banking Authority

Appendix

Application guidance

On the previous due process document, the EBA's predecessor (CEBS) commented that the treatment of origination fees linked to financial instruments (often accounted for through the effective interest rate, or EIR, method) and underwriting fees would benefit from greater clarity as regards the scope of the Standard. In particular, it was suggested that more detailed application guidance is provided related to such instruments.

We support the IASB's decision to include relevant guidance within IFRS 9, as set out in paragraph D25 of the exposure draft. In addition, we are supportive of the intent set out in paragraph 11 concerning dealing with contracts covered by more than one standard.

Definitions

The proposed IFRS for revenue recognition also adjusts the reference in IAS 39 regarding the definition of the *effective interest method*. We understand that the definitions and application guidance in IAS 39 will be transferred to IFRS 9 when IFRS 9 replaces IAS 39.

We also note that the proposals foresee that addition of a definition of *dividends* in IFRS 9 (appendix A) and in IAS 39 (paragraph 9): "Distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital." We are of the view that the IASB should also provide a clear definition of, and guidance for, other types of distributions to equity instrument holders.

IFRS 9 paragraph 5.7.6 sets out the treatment of dividends for equity instruments accounted for at fair value through OCI, and the proposals amend the criteria for recognising dividends related to such instruments without referring to IAS 18.

However, the removal of the IAS 18 guidance regarding dividends from the proposed standard on revenue recognition could, in case the standard were to be applied before IFRS 9, lead to a lack of accounting guidance for the recognition of dividends (and the related timing). Moreover, the removal of this guidance may also lead to uncertainty around the recognition of dividends on equity investments accounted for at fair value through profit and loss, as this is an area where no clear guidance is currently provided in IFRS 9. We believe that IFRS 9 should be updated to provide clearer guidance on the treatment of dividend income for assets at fair value through profit or loss as well as for those recorded as fair value through OCI.

Constraining the cumulative amount of revenue recognised

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled if the entity has experience with similar types of performance obligations and the entity's experience is predictive. In our opinion the concept of "reasonably assured" based on experience and judgement could lead to a situation of inappropriate recognition of revenues.

Illustrative example IE 13 (example 14) describes how an entity would apply the requirements in paragraphs 81-85. The example deals with the case of insurance policy sold on behalf of an insurance company with a commission received up-front and an additional commission received each year for as long as the policyholder does not cancel the policy. The entity has significant experience with similar types of contracts and customers, and that experience is predictive for the amount of consideration to which the entity will be entitled.

However, we raise the question if it is appropriate to recognise the revenue as proposed in the example; i.e. with reference to the average number of years for customers to renew the policy. We wonder whether other treatments could be more appropriate (e.g. amortising the amount received at the time of the deal pro rata temporis). Irrespective of the treatment, we would suggest including guidance to clarify what constitute similar types of performance obligations to ensure some degree of comparability.

Allocation of stand-alone revenue

The proposal reiterates that allocation of the transaction price to the separate performance obligations is based on stand-alone selling prices. However, we welcome that the proposal clarifies that it may be appropriate to estimate a selling price using a residual approach if the price of a good or service is highly variable or uncertain, see paragraph 73 (c). It is also appreciated that the proposal clarifies when it is appropriate to restrict allocations of discounts, contingent payments and changes in the transaction price to only some promised goods or services, see paragraphs 74-76.

Customer’s credit risk

The EBA welcomes that credit risk is no longer included in the transaction price (paragraph 50). Instead an entity will account for the effects of customer credit risk by applying the requirements of IFRS 9 (or IAS 39 if the entity has not yet adopted IFRS 9). The proposal for separate but adjacent presentation of revenue and corresponding amounts that are not expected to be collected should provide a clear and appropriate treatment of these items.