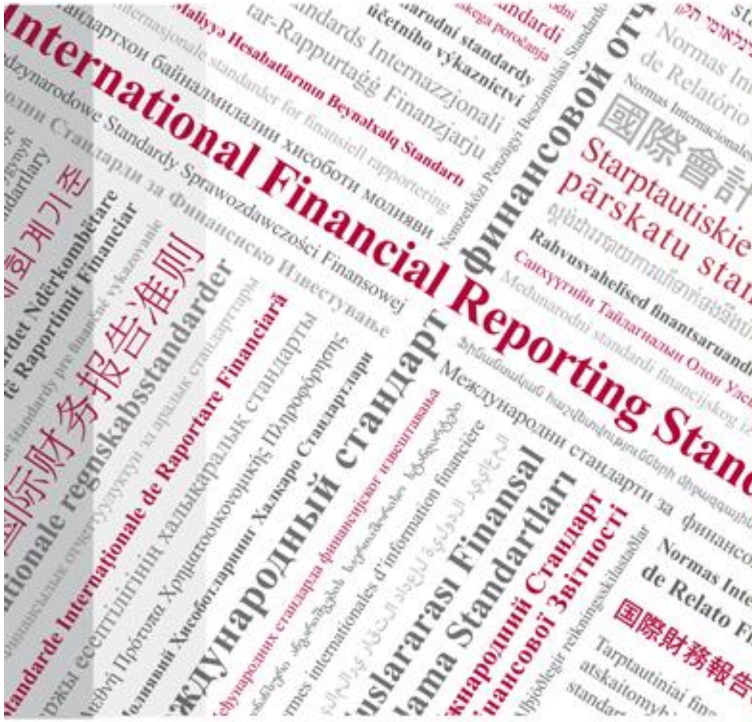
International Financial Reporting Standards



IFRS 9
Financial Instruments
Moving to expected credit losses

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

What problems needed to be solved?

The Financial Crisis highlighted shortcomings in incurred loss accounting:

- Impairment was recognised ‘too late’
- The amounts recognised were considered to be ‘too little’
- The impairment losses booked on identical financial assets varied simply because of different accounting classification
- Application varied hugely by jurisdiction

How has IFRS 9 sought to address these issues?

- **Expected credit losses are always accounted for** since initial recognition
  - (no trigger is required to begin recognition)
- **Full (lifetime) expected credit losses** are recognised **when credit risk has increased significantly** since initial recognition (assumption that this is no later than 30 days past due)
- **All available information must be used** – historical, current and forward looking information.
  - (As long as it is reasonable and supportable and available without undue cost and effort)
- **Same impairment amounts are recognised for all financial assets** subject to impairment accounting regardless of accounting classification

Overview of the impairment model

IFRS 9 Impairment: Expected Credit Loss Model

3-Stage model	Stage 1: performing	Stage 2: Under-performing	Stage 3: Non-performing
Balance Sheet Allowance	12-month ECL	Lifetime ECL	Lifetime ECL
Criterion	No significant increase in credit risk	Credit risk increased significantly.	Credit risk increased significantly & objective evidence of impairment
Interest Revenue based on:	Gross Carrying Amount	Gross Carrying Amount	Net Carrying Amount

Change in Credit Risk

Key concepts in IFRS 9

- 12-month expected credit losses recognised unless there has been a **significant increase in credit risk**

- Significant increase in credit risk based on the **change in the risk of a default occurring**

- Ideally forward looking information should be used but as a 'back stop' it is assumed that this occurs no later than when 30 days past due

- Measurement of expected credit losses shall reflect:
- Time value of money
- Probability weighted amount
- All reasonable and supportable information available

without undue cost or effort

Why this form of expected credit losses?

- The Board differentiated between credit losses anticipated when lending (priced into the instrument) and changes over time
- The simple act of lending does not in itself cause economic losses – changes in credit risk do
- Information content is provided by differentiating financial assets that have increased significantly in credit risk
- Built on credit risk management concepts – can used to determine changes in risk and also to measure expected credit losses
- Some links to regulatory capital concepts

What we expect - and what we don’t

- We expect
  - Allowance balances and impairment in P&L to be more responsive to changes in credit risk
  - Allowance balances to typically increase (mainly due to stage 2)
  - Implementation especially for banks to be an intensive exercise that requires time and systems changes

- We don’t expect
  - To predict the next financial crisis
  - To identify UNEXPECTED credit losses

What else is needed

Improvements won't come solely from a change in accounting standard

- We need preparers to:
  - assist users of financial statements by providing good quality disclosure and explanations
  - establish good governance including approaches that ensure that there is linkage to credit risk management and consistency of assumptions internally
- There is also an important role for:
  - Prudential regulators
  - Securities regulators
  - Audit firms and their regulators
  - Market discipline (investors and analysts)
- A collective effort is required to take the opportunity of the new impairment model to truly improve financial reporting

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Questions and comments