Financial Instruments: Impairment

Potential credit impairment disclosures

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

Why a project on impairment?

Problems in financial crisis

- Incurred loss model resulted in lagging recognition of impairment losses (“too little, too late”)
- By not incorporating expected credit losses into the effective interest rate, there is front-loading of interest revenue

Convergence

- Joint project with FASB to align general framework of the impairment models in IFRSs and US GAAP

Incurred loss model

IAS 39 requires an *incurred loss* approach for financial assets

- What does that mean?
  - Impairment loss only recognised when:
    - Trigger (loss) event occurs
    - Impact can be reliably estimated
  - Consequence = expected losses not recognised before trigger events

Proposed expected loss model

Bucket 1: 12 months expected loss allowance

All financial assets are initially categorised in this bucket*

Bucket 2: Lifetime expected loss allowance

Evaluation performed on *groups* of financial assets

Bucket 3: Lifetime expected loss allowance

Evaluation performed on *individual* financial assets

Financial assets move out of Bucket 1 when:

There has been a *more than insignificant* deterioration in credit quality since initial recognition

AND

The likelihood that all or some of the contractual cash flows may not be collected is at least *reasonably possible*

* Except for assets purchased at a deep discount because of incurred credit losses, which are initially categorised within Bucket 2 or Bucket 3. For those assets, expected credit losses will be incorporated into the determination of the effective interest rate. Also, some trade and lease receivables can be initially categorised outside Bucket 1 with full lifetime losses recognised immediately.

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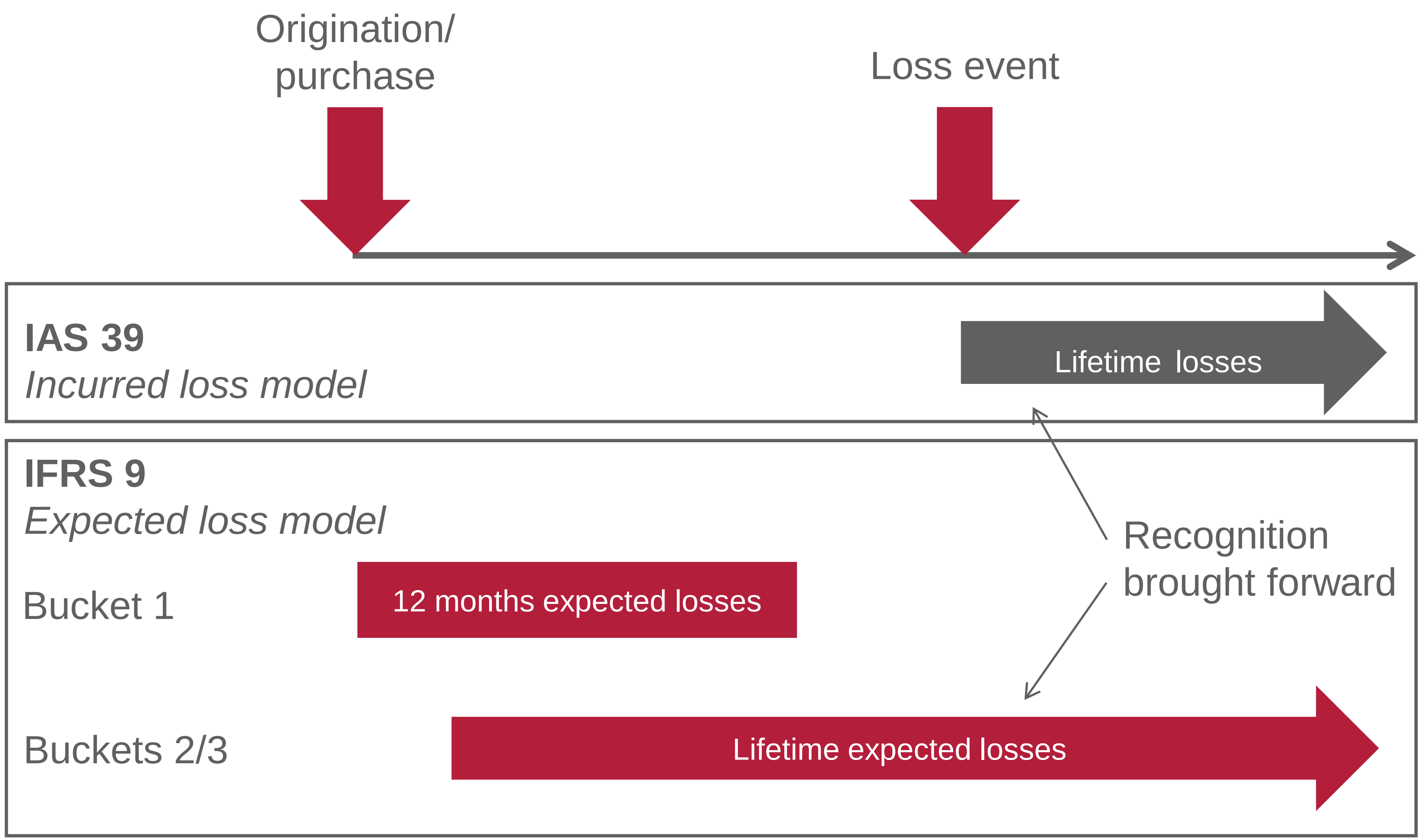
Proposed expected loss model continued

- Expected credit losses uses all reasonable and supportable information, including forward-looking information, a range of possible outcomes and incorporates the time value of money
- **Results in earlier recognition of credit losses – more responsive than triggers applied today**
- **Reflects general pattern of deterioration/improvement (credit migration)**
- **There is an allowance balance for all originated assets at all times**
- **P&L reflects favourable and unfavourable changes in credit loss expectations (ie symmetrical model*)**

* Except for FASB troubled-debt-restructurings

Example:
Incurred vs expected losses



Purchased credit-impaired assets

- Scope
  - Assets purchased with an ‘explicit expectation of credit losses’
  - IASB: Same population as IAS 39 today
  - FASB: To consider whether to broaden scope
- Always categorised outside Bucket 1
- Use credit-adjusted effective interest rate
  - No day 1 allowance balance
  - No day 1 impairment loss recognised
- Accrete from purchase price to expected cash flows
- Allowance balance represents *changes* in lifetime loss expectations

Application to trade and lease receivables

Without a significant financing component (eg short term):

- Measure receivable at invoice amount
- Allowance is always lifetime expected losses (ie categorise outside Bucket 1)
- Provision matrix can be used

With a significant financing component (eg long term) and lease receivables:

- Policy election either:
  - apply general ‘three-bucket’ model or
  - always recognise lifetime expected losses

Where will management use judgement?

When determining transfer between buckets

- Deterioration in credit quality
- Likelihood of default
- Whether to evaluate individually or as a group

When estimating expected credit losses

- Timing and amount of losses in event of default
- Range of possible outcomes wider because of earlier recognition

Possible disclosures about impairments

- Disclosure objectives:
  - To enable users of financial statements to understand the level of risk in the overall portfolio and how items have deteriorated in credit quality over time
  - To enable users of financial statements to understand how an entity manages credit risk and the effect on the impairment allowance

Carrying amount rollforward

Provides a rollforward of asset carrying amounts from the beginning to the end of the period (not currently required)

Provides ending carrying amounts and ending allowance for credit losses

These columns are further disaggregated based how they are measured: 12 months and lifetime

	Overall Portfolio														
		Additions			Reductions					Carrying Amount at EOP			Allowance at EOP		
in millions	Carrying Amount at BOP	Originations	Purchases	Draws	Payments	Sales	Charge-offs	Other Net Change*	Carrying Amount at EOP	Financial assets for which 12 months' credit losses are recognised	Financial assets for which lifetime credit losses are recognised	Total	Financial assets for which 12 months' credit losses are recognised	Financial assets for which lifetime credit losses are recognised	Total
20X2															
Commercial	3,693	1,659	15	2	(687)	(55)	(61)	(14)	4,552	4,092	460	4,552	128	32	160
Consumer	6,312	1,239	187	-	(1,564)	(34)	(67)	(16)	6,057	5,445	612	6,057	148	48	196
	10,005	2,898	202	2	(2,251)	(89)	(128)	(30)	10,609	9,537	1,072	10,609	276	80	356
20X1															
Commercial	3,858	860	24	-	(901)	(68)	(62)	(18)	3,693	2,891	802	3,693	114	25	139
Consumer	6,473	2,539	2	-	(2,456)	(8)	(213)	(25)	6,312	5,613	699	6,312	145	36	181
	10,331	3,399	26	-	(3,357)	(76)	(275)	(43)	10,005	8,504	1,501	10,005	259	61	320

* This includes interest accretion changes and discount or premium amortisation changes.

Possible Narrative and Other Disclosures:
- Risk characteristics, changes in the risk characteristics (e.g., an increase in risk in a certain area)
- Carrying amount of assets that are 90 days past due, but still in Bucket 1, and the related allowance
- Carrying amount of purchased-credit impaired (PCI) loans and related allowance
- Carrying amount of collateralised or guaranteed loans, and amount of collateral
- Discussion of the quality of the collateral, changes in the quality, appraisal policies, etc
- Balance of assets with 100% probability of default and reasons why such assets are not yet written off
- Explanation of transfer policy

Allowance rollforward

Provides a rollforward of the allowance for credit losses based on the measurement attribute

20X2 *in millions*	12 months' allowance		Lifetime allowance		Total allowance
	Commericial	Consumer	Commericial	Consumer	
Opening balance	114	145	25	36	320
Add:					
Recoveries	7	9	4	-	20
Add/(Less):					
Provision	44	35	27	38	144
Less:					
Write-offs	37	41	24	26	128
Closing Balance	128	148	32	48	356

Possible Narrative and Other Disclosures:
•Drivers of changes in the allowance balance for 12 months versus lifetime credit losses
•For allowance balance based on 12 months of credit losses, qualitative discussion of the effect of the current-period provision related and unrelated to new loan activity and purchases of non-PCI loans
•Discussion related to reasons for increase or decrease related to provision by measurement (PCI assets should be addressed separately)

Performing assets disaggregation

Provides a disaggregation of financial assets that have 12 months' expected losses

Wide spectrum of credit risk in this category (all assets originated here). Moderate risk could move directly to lifetime losses.

20X2	*in millions*	**Financial assets for which 12 months' credit losses are recognised**			
		Lower Risk	Moderate Risk	Higher Risk	Total
	Commercial	3,397	450	245	4,092
	Consumer	4,247	436	762	5,445
	Total	7,644	886	1,007	9,537

Possible Narrative and Other Disclosures:
• How the allocation of balances by risk level is determined (e.g., how they interact with an entity's internal ratings system for commercial loans, factors such as FICO scores for consumer loans, assignment to regulatory rating categories, etc.)

Purchased credit-impaired (PCI) to other assets comparison

Shows an entity's portfolio disaggregated by assets that are purchased credit-impaired assets and all other assets (purchased non-credit-impaired and originated assets)

20X2 *in millions*	Other assets	Purchased credit-impaired assets	Balance sheet amount
Carrying amount less allowance	9,946	307	10,253
Add:			
Allowance	313	43	356
Gross carrying amount	10,259	350	10,609
Discount		-	
Accretable difference (ie remaining cash flows expected to be collected)		35	
Total cash flows expected to be collected		385	
Non-accretable difference (ie cash flows not expected to be collected)		34	
Total contractual cash flows		419	

20X1 *in millions*	Other assets	Purchased credit-impaired assets	Balance sheet amount
Carrying amount less allowance	9,394	291	9,685
Add:			
Allowance	320	-	320
Gross carrying amount	9,714	291	10,005
Discount		-	
Accretable difference (ie remaining cash flows expected to be collected)		44	
Total cash flows expected to be collected		335	
Non-accretable difference (ie cash flows not expected to be collected)		34	
Total contractual cash flows		369	

Possible Narrative and Other Disclosures:

•The amount of non-accretable yield reclassified during the year and cumulatively, how this amount has affected net income, and to which accounts the amount(s) have been reclassified

•The ending carrying amounts of purchased credit-impaired assets and all other assets

Questions

- *From a user perspective:*
  1. What information provided under IFRSs today is useful in understanding credit quality of an entity?
  2. What information is not very useful and you would remove?
  3. If given a blank sheet of paper, what information would you add?

- *From a preparer perspective:*
  4. What information provided today is costly and difficult to prepare?
  5. Are there alternatives that could meet the disclosure objectives that could be provided with less cost or effort?

Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.