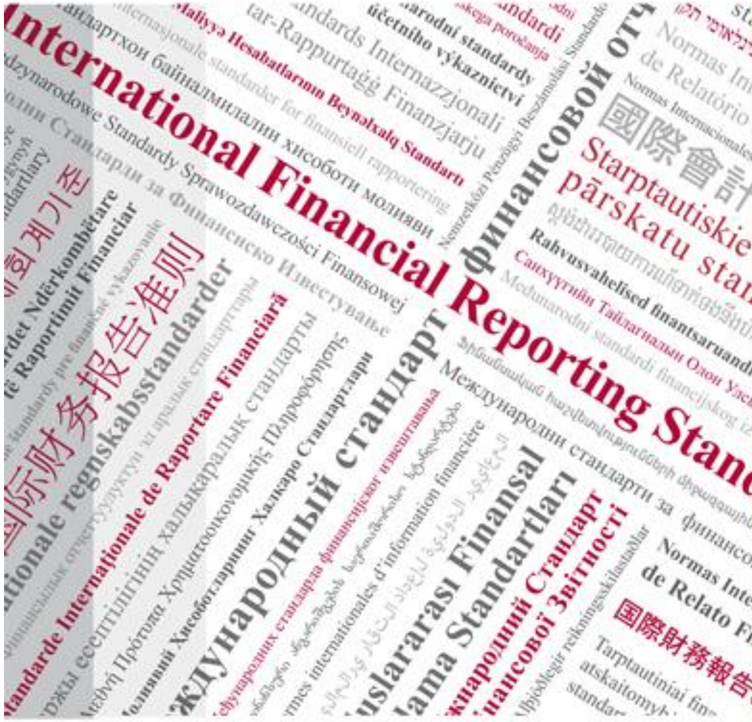
International Financial Reporting Standards



ASAF - 3 July 2013 Feedback to date on ED/2013/3 *Financial Instruments: Expected Credit Losses*

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

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Disclaimer

- The views presented in this presentation are based on:
  - feedback received during our outreach meetings to date
  - selected comment letters received to date (comment deadline is 5 July 2013); and
  - preliminary results from the fieldwork

Main messages received

- Many support a model that distinguishes between financial assets that have deteriorated and those that have not
  - Reflects the economics of a lending transaction
- Model is operational
  - Judgement required to determine when to move to lifetime expected credit losses but considered operational and consistent with credit risk systems
  - Preparer can build on existing information to calculate expected credit losses
- Users – mixed views but many like the distinction provided between financial instruments that have significantly deteriorated and those that have not
- Convergence important

Issue 1: Allowance in stage 1

Measuring allowance at 12-month expected credit losses (ECL) is operational

- General support for 12-month ECL
- Some query conceptual justification
  - But acknowledge balance between the benefits of a faithful representation and the operational cost and complexity
- Participants in the fieldwork consider 12-month ECL operational
- Basel regulated entities have information available
  - More difficult for others to form basis for calculation
- Some concerns:
  - Clarify that all factors that affect credit risk must be considered
  - Limitations of 12-m ECL capturing late loss pattern (but move to stage 2 quickly if loan deteriorates significantly in credit quality)
  - Some (US) concerned may lead to insufficient allowances

Issue 2: Significant deterioration

Support for distinction based on significant deterioration

- Many users find information valuable
  - General concern or scepticism about expected credit loss models because they are based on management estimates
- Operational—align internal credit risk management to financial reporting
  - Some concerned that ED prescribes a mechanistic assessment
- Auditable, but clarifications needed
  - Where significant deterioration occurred but not identified yet
  - Additional guidance for certain products to confirm what information to consider

Issue 2: Significant deterioration (cont’)

‘Low credit risk’ simplification makes model more operational and reduces cost of tracking

- Insurers support ‘low credit risk’ simplification
  - Prefer no allowance for high credit quality assets but agree as proxy
- Clarification needed:
  - What it applies to (ie to instruments that are investment grade equivalent—generally not retail loans)
  - Based on internal vs external rating information?
  - Need to assess deterioration when moving to non-investment grade
- Regulators and some users don’t support ‘low credit risk’ simplification and want information about significant deterioration on all financial assets

Issue 2: Significant deterioration (cont’)

Delinquency rebuttable presumption (more than 30 days) helps to make the model operational for retail loans

- Delinquency information and restructurings provide main evidence of significant deterioration of retail loans
- Changes/clarifications needed that
  - Delinquency lagging indicator and macro-economic factors need to be considered in the assessment of significant deterioration
  - Assessment should include the effect of macro-economic factors that indicate significant deterioration even in the absence of specific information on individual items

Issue 3: Measurement of lifetime expected credit losses

Support lifetime expected credit losses for assets that have deteriorated significantly

- Sufficient data available to measure financial assets at lifetime expected credit losses when assets deteriorated significantly
- Many say measuring lifetime expected credit loss for all assets would be operationally too complex
  - Not sufficient data available
  - Time horizon to consider greater than for deteriorated assets
  - Reliability of the estimate

Other issues

Measuring expected credit losses

- Agree with discounting expected credit losses
- Some are concerned about the choice of the discount rate
  - prefer to require the EIR
- Some disagree with contractual life for loan commitments
- Concerns that default is not defined
  - Varying definitions have an effect on the population of assets captured in stage 1
  - Regulators concerned default focus only on non-payment

Lease receivables & trade receivables (LR &TR)

- Field participants support inclusion of simplified approach for LR&TR

Other issues (cont’)

Users support disclosure proposals

- Additional disclosures recommended:
  - More granular information on carrying amount and loss allowance reconciliations
    - To assess any changes in portfolio over reporting period
    - To assess any changes in allowance balance
  - Information on fair values of collateral
  - Mapping internal rating to external ratings

Transition and effective date

- Some concerned that sufficient relief is not provided and would like more practical approaches to assess deterioration on transition
- Three years for implementation
- Aligning effective date with other projects (ie leases and insurance)

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Fieldwork

Preliminary observations from fieldwork

- Model is operational
- Model more responsive to changes in economic conditions than IAS39
  - Expected credit losses recognised earlier & grow quickly before downturn
- Difficult to calculate lifetime expected credit losses for assets that have <u>not</u> deteriorated significantly
  - No historical trend data to use as a base to determine lifetime ECL
- Identifying relationship between macro factors, financial asset and expected loss/ credit risk is key to any forward looking model
  - For some portfolios more difficult based on limited data
- Generally see increase in overall allowance but effect varies
  - The higher IBNR allowance today the lower the impact

Next steps - Timeline

- Field work planned to be finalised by 5 July
- Comment deadline closes 5 July
- July 2013 Board meeting
  - The boards will jointly discuss feedback received
  - The boards will consider common grounds to move project forward
- Target to finish redeliberations by end of 2013

Thank you


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expressions of
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