STAFF PAPER

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IASB Meeting

Project	Financial Instruments: Impairment		
Paper topic	Outreach Feedback Summary—Fieldwork		
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Introduction

1. In March 2013, the International Accounting Standards Board (IASB) issued the Exposure Draft (ED) *Financial Instruments: Expected Credit Losses*, which proposed a new model for the recognition, measurement, presentation and disclosure of expected credit losses. The comment period for the ED ended on 5 July 2013.

2. During the comment period we have, in addition to outreach meetings, undertaken detailed fieldwork. The purpose of this paper is to summarise some of the main observations made and some of the information gathered to date in the fieldwork. The fieldwork is not yet finalised.

3. We believe the benefits of the fieldwork undertaken, *which included simulations using real economic data*, were:

   (a) it allowed these participants to actively engage with us to better understand the proposals and to provide us with enriched and valuable feedback based on their experience, as they had to consider in detail how they will operationalise our proposals (and alternative models);

   (b) it allowed us to better understand the impact of our proposals (and alternative models) and identify areas for improvement and clarification; and

(c) by working with participants the staff have obtained a more thorough understanding of the mechanics of measuring expected losses (both 12 month and lifetime), techniques to adjust for forward looking information, potential approach to assess credit deterioration and the effects and relevance of discounting.

Overview of the fieldwork

4. The IASB invited a small number of preparers who represented the major geographical regions across the world and who were at different levels of sophistication to participate in the fieldwork to test and discuss the proposals. In total 15 participants were involved in the fieldwork. We did the fieldwork with only a small group of entities because we asked for detailed numbers to be provided to us. To undertake the fieldwork in full required a significant investment of resources.

5. The participants in the fieldwork included:

   (a) both financial and non-financial (lessor) entities;

   (b) multi-national and regional (or country) based businesses;

   (c) Basel-regulated and non-Basel-regulated entities; and

   (d) entities with various levels of sophistication in credit risk management systems.

6. The primary objective of the fieldwork was to determine how the proposed impairment model responds to changing economic circumstances over time. It was also designed to provide an understanding of the operational challenges for the implementation of the proposals and to provide some directional information about the magnitude of the allowance balance. The original instructions, additional instructions and economic data provided to participants are included as Appendices A–C of this Staff Paper for reference.

7. The fieldwork involved participants applying the proposed impairment model to a representative selection of their portfolios, ie based on real portfolio information,

using a hypothetical scenario of changes in macro-economic environment[1]. The hypothetical scenario set out information about economic conditions, industry-specific facts and key assumptions covering a number of hypothetical reporting periods, and we asked participants to apply the proposed model to their selected portfolios over time.

8. We have asked participants to assess what the allowances would be over a period of five years and asked them to:

   (a) apply current IAS 39 *Financial Instruments: Measurement* impairment requirements;

   (b) apply the proposals as per the ED;

   (c) determine full lifetime expected credit losses for all financial assets in the respective portfolio;

   (d) determine the 12 month loss allowance for all financial assets in the respective proposals; and

   (e) apply the proposals as per the 2011 Supplementary Document *Financial Instruments: Impairment*.

9. The portfolios selected by participants comprised the following, which in aggregate have a total carrying amount in excess of US$500 billion:

   (a) retail mortgages, which comprised amortised loans, equity-line type loans and others;

   (b) wholesale/corporate loans;

   (c) revolving credit products, for example credit cards;

   (d) other unsecured lending, for example personal loans; and

   (e) lease receivables, for example vehicle finance.

10. The main feedback received is consistent with the messages we have already summarised in the outreach summary—refer to Staff Paper 5A.

[1] It was not practical or realistic to ask participants to apply the proposals to all of their financial instruments that would be subject to the proposals.

11. We are currently still receiving and analysing the final results. Paragraphs 12-26 summarise the specific points observed from the fieldwork to date.

Feedback about the ED and operational challenges for implementation

12. Some participants were initially concerned that the assessment of significant deterioration is based on the change in the credit risk of individual instruments and not on the changes in the counterparty credit risk (ie an obligor's credit risk could deteriorate but, depending on when an instrument was initially recognised, an individual instrument may or may not have deteriorated). However, over the course of the fieldwork, a number of participants found ways to deal with the difference between the change in the counterparty credit risk and the change in the credit risk of the instrument since origination. Ultimately, they applied the proposed model at an instrument level and no longer stated this as an area of concern.

13. Participants support the objective of including forward-looking data because it is relevant in determining the allowance in an expected loss model. However, they made the following observations:

    (a) macro-economic factors need to have explanatory power. The factors need to show an effect on, or correlation with, the probability of default to assess when the assets should move to lifetime expected credit losses.

    (b) during the fieldwork, participants noted that obtaining data or finding factors with explanatory power and determining the effect thereof was difficult. The longer the forward-looking period (and considering the effect of extrapolation), the more difficult the calculation was. Ultimately, participants felt it was possible to apply and determine the effect for our proposals.

    (c) some participants indicated that it was difficult to incorporate macro-economic data at a level that enables them to identify specific financial assets to move to lifetime expected credit losses. This is especially the case for retail products. These participants adjusted the

allowance amounts for the macro-economic conditions, but only moved loans to lifetime expected credit losses based on delinquency information or sometimes also on other borrower-specific information (for example, on delinquency information and restructurings). Because those participants were not able to identify which individual loans had a significant increase in credit risk that was due to significant macro-economic changes, some suggested recognising lifetime expected losses for a percentage of their portfolio that would otherwise be measured at the 12 month allowance (ie a type of management overlay). They believe that this might be a way to capture deterioration of credit quality in the portfolio that cannot be individually allocated to specific loans yet.

(d) other participants investigated statistical approaches to identify individual financial assets affected (or most affected) by the changes in macro-economic factors. Although this would be more complex, these preparers argued that identifying further individual financial assets that should move to lifetime expected credit losses provides more accurate and relevant information than using only delinquency information.

Responsiveness of the proposed model compared to IAS 39

14. By asking respondents to estimate anticipated allowance balances under IAS 39 and allowance balances under the ED, they were able to assess the anticipated responsiveness of the model.

15. Entities used some data provided in the fieldwork to estimate forward-looking information in the measurement of the allowance balance and, in many cases, in the assessment of significant deterioration (particularly for non-retail products). They found the proposed model was more responsive to changing economic conditions than the current IAS 39 model. Participants were provided a series of economic information so their proxy forecasting was more perfect than would be in reality. The staff acknowledge that this assessment has imperfections. However, it provided an estimate of the responsiveness of the model.

16. Participants made the following general observations relating to responsiveness of the model:

    (a) the better an entity is able to incorporate forward-looking and macro-economic data into its models, the more responsive the allowance amounts are; and

    (b) the model is responsive in both downturn and upturns:

        (a) during a downturn in the economic forecast allowances start to rapidly build and generally reach their peak the year before the lowest point in the economy (this was because data was used to forecast for a 12-month period); and

        (b) during the upturn in economic forecasts the allowances also recover faster than those under IAS 39, which often still had a lagging effect from the downturn in the economic cycle.

Directional impact on allowance balances

17. Almost all preparers observed a noticeable increase in the allowance balances on transition and throughout the entire economic cycle compared to the current IAS 39.

18. We asked preparers to calculate the allowance balance both on the basis of our proposals and also on the basis of lifetime expected credit losses for all financial assets (ie including those that would be measured at a 12-month allowance in our model). By asking participants to calculate both these allowance balances, participants were able to draw comparisons and consider the differences in operationality between the two approaches.

19. In performing these calculations, a number of factors affect the extent of change to the preparers' reports compared to the IAS 39 allowance today. These factors are:

    (a) the calculation of the incurred but not reported (IBNR) allowance today. For participants with higher IBNR allowances due to the use of

longer emergence periods today, the impact on the allowance tends to be less. The pattern of emergence periods showed geographic trends.

(b) the timing of recognition of impairment losses on an individual financial asset. Participants that identify and recognise impairment losses on an individual item in a timelier manner under IAS 39 have a smaller impact. This is because more assets already have allowances recognised at lifetime expected credit losses under IAS 39.

(c) jurisdictional differences. Different jurisdictions have different factors that affect their allowance balances. Some of the differences observed were:

  (a) house price inflation. In jurisdictions with high house price growth, loan to value tends to be low and loss given default is extremely low; and

  (b) the difference between contractual and expected (behavioural) life, in particular for mortgage portfolios. In some jurisdictions borrowers do not have incentives to prepay mortgage loans. In these jurisdictions the expected life tends to be close to the contractual life. In particular, the expected life for mortgage products tend to be more than 10 years compared to a shorter expected life in other jurisdictions. This has a magnifying effect when calculating lifetime expected losses.

20. In summarising directional information below, we note:

(a) some participants' fieldwork is still in progress and the results in this Staff Paper do not reflect their impact;

(b) due to commercial/price sensitive data, some have not provided us with final results for our records (participants did however communicate orally an overview of these results to us) and accordingly are not included below;

(c) one participant was able to only provide qualitative feedback due to timing requirements of the fieldwork;

(d) one participant applied the simplified approach (ie measured lifetime expected credit losses on all financial assets) and one participant

applied a more absolute approach to assess credit deterioration. These participants were excluded from the information below for comparability reasons; and

(e) excluding participants in (c)–(d), the results in paragraphs 21-26 still reflect the majority of the respondents in the fieldwork.

Portfolios other than mortgage portfolios

21. On transition:

(a) the allowance measured in accordance with the ED is between 25 per cent and 60 per cent higher compared to IAS 39;[2]

(b) the allowance measured equal to lifetime expected credit losses on all of the financial assets is between 50 per cent and 140 per cent higher compared to IAS 39.[2]

22. At the point in the cycle where the allowances are the highest, ie where the economic forecast is the worst:

(a) the allowance measured in accordance with the ED is between 50 per cent and 150 per cent higher in the same period compared to IAS 39;[2]

(b) the allowance measured equal to lifetime expected credit losses on all the financial assets is between 110 per cent and 210 per cent higher in the same period compared to IAS 39.[2]

Mortgage portfolios

23. On transition:

(a) the allowance measured in accordance with the ED is between 30 per cent and 250 per cent higher compared to IAS 39;[2]

(b) the allowance measured equal to lifetime expected credit losses on all of the financial assets is between 130 per cent and 730 per cent higher compared to IAS 39;[2]

[2] The difference in percentages reflect the extreme effects of differences in expected lives jurisdictionally.

24. At the point in the cycle where the allowances are the highest, ie where the economic forecast is the worst:

    (a) the allowance measured in accordance with the ED is between 80 per cent and 400 per cent higher in the same period compared to IAS 39;[2]

    (b) the allowance measured equal to lifetime expected credit losses on all the financial assets is between 450 per cent and 540 per cent higher in the same period than compared to IAS 39.[2]

25. During the redeliberations period leading up to the ED, the IASB and FASB discussed the difference between having a 12 month allowance and full lifetime expected credit losses at origination. In addition to the differences noted in paragraphs 21-24, participants observed that the allowance balance increased by at least 100 per cent between our proposals and calculating full lifetime expected losses for both their mortgage and other portfolios.

26. In observing the directional information on the lifetime expected credit losses, participants made the following observations:

    (a) some participants stated that lifetime expected credit losses create more volatility than our proposal. This is because assets with a 12-month allowance measure under our proposals would be calculated at lifetime expected credit losses. Participants indicated that changes in macro-economic factors result in big differences in future periods beyond the near term (because of extrapolation effects), leading to volatility because macro-economic forecasts are updated annually.

    (b) in a worsened economic period the lifetime expected credit losses tend to be excessive, in particular where new loans are originated at prices taking into consideration the counterparty risk.

Next steps

27. We intend to present a full analysis of the results from the fieldwork during the September 2013 IASB meeting.

Appendix A

Instructions given to participants to perform the fieldwork

Introduction

Thank you for taking part in field work for the proposals in the Exposure Draft *Expected Credit Losses*. Field work is an important part of the IASB's due process, and will supplement the information received by the IASB through its other outreach activities and formal comment letter process.

The IASB published the Exposure Draft with a 120-day comment period, which ends on 5 July 2013. The ED proposes a revised set of requirements to recognise and measure financial instruments by taking into consideration expected credit losses and the deterioration in credit quality since initial recognition. The model builds upon previous proposals and seeks to approximate the economic relationship between expected credit losses and the pricing of financial instruments in a cost-effective way.

The field work is being conducted worldwide with selected representatives from the major regions across the world. The objective of the field work is to determine how the proposed approach responds to changing economic circumstances over time. It is also designed to provide an understanding of how the proposals may be implemented and to provide some information about the magnitude of potential allowance balances. The field work will assist the IASB to better assess:

(a) whether the proposals faithfully represent expected credit losses;

(b) how responsive the proposals are to changes in economic conditions;

(c) the cost and operational challenges associated with the proposals; and

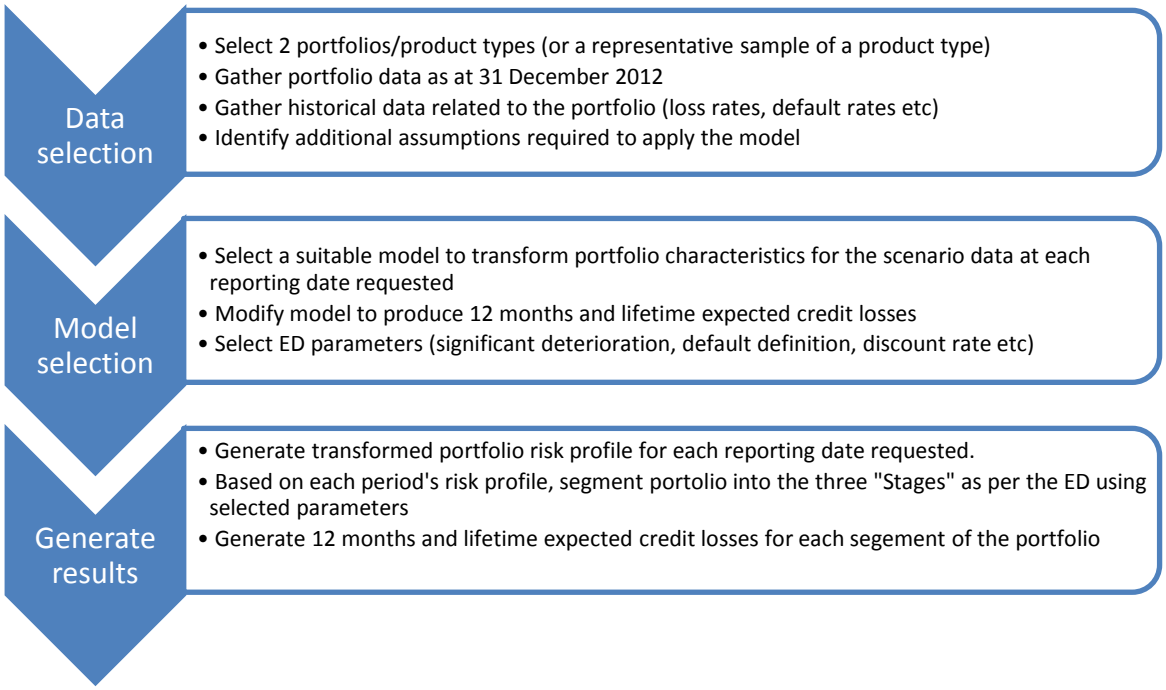
(d) the directional impact on allowance balances compared with IAS 39 today.

Inherent limitations of the field work

The IASB is aware that participants are in varying stages of preparedness to implement or test the proposed impairment model and that some participants may have progressed further than others in terms of gathering data and developing systems and models to estimate expected credit losses. We are also aware that participants will be constrained by the resources and time available. By way of comparison, the field work is not intended to be as resource intensive or as precise as a regulatory stress test. Participants

may therefore need to make use of approximations or simplifications to the proposed model and data in order to conduct the field work. This may include adjusting or modifying existing data and processes to estimate the results of applying the model. **We will consider the results of the field work and the responses to the questions on the application of the model in the light of these limitations**. Notwithstanding these limitations, the preliminary feedback that will result from the field work exercise will be a valuable resource to the IASB during its redeliberations on the proposals.

Field work diagram



Resources

The scenarios that participants should use for the field work are included in *please refer to data sheet at the end*. We request that maximum possible use be made of the information provided to you to enhance comparability and to assist in summarising the results for the purposes of reporting back to the IASB.

We anticipate that participants may need to supplement the data provided with additional information relevant to their portfolios and/or environment in order to conduct the field work. Participants are requested to include in the submission of the field work results an explanation of additional assumptions or information used and an explanation of any approximations or simplifications used, along with the reasons for selecting the chosen alternatives.

The proposals for the expected credit loss approach are set out in the Exposure Draft, which is available on the IASB's website and should be used as the main reference document for the requirements to be applied during the field work.

Recordings of the live webcast presentations and the recorded question and answer session addressing some of the most frequently asked questions on the proposals, are also available on the website. These resources can be accessed here: http//go.ifrs.org/Financial-Instruments-Impairment.

Contact details

If you have any questions or experience any problems during the performance of the field work, please contact **Riana Wiesner** on +44 (0)207 246 6926 or at rwiesner@ifrs.org.

Section A: Features of the field work

This section is intended to assist participants in applying the proposed expected credit losses model to the selected products/portfolios and preparing their submissions to the IASB.

1. General features of the field work and hypothetical scenario

The field work involves participants applying the proposed impairment approach to their selected portfolios using the hypothetical scenario provided in *please refer to data sheet at the end*. This hypothetical scenario sets out information about changes in macro-economic variables. The hypothetical scenario has been generated based on a historical time series in a specific region (the US) and has not been generated using an economic model. In order to enhance comparability, the information has been converted to percentages to enable all participants to use the same scenario while commencing with characteristics relevant to the economic environment for the analysed portfolios as at the reference date.

The field work is not intended to be as resource intensive, or as precise, as a regulatory stress test. Furthermore, the hypothetical scenario is not intended to be either a "normal" (baseline) scenario or a "stress test", however both upswings and downswings have been included to see how the model will react to changing economic circumstances. Because an economic model has not been used to generate the scenario, the hypothetical scenario provided may not be representative of the particular characteristics of the economy of a participant, or of a realistic projection of how the actual economy may perform given the initial conditions at the reference date. Instead, it is a stylised scenario designed to provide a stylised result, and not an accurate projection of performance of a participant.

If the hypothetical scenario would not be appropriate in a given economy of a participant, and thus would not result in useful information if it were to be applied as is, a participant may request to adjust the scenario to better reflect the characteristics

of that economy while maintaining consistency with the overall economic cycle in the scenario[3].

In order to model their selected portfolios, participants will need to collect sufficient data to arrive at a reasonable estimate of expected credit losses. This may include both a 'snapshot' of the current portfolio as well as sufficient historical data to generate the term structures and transition matrices for lifetime credit loss estimates. The IASB acknowledges that the data selection may be more time intensive than the actual modelling for the field test and that participants may need to make simplifications to the process. Where this is the case, participants are requested to provide information on any simplifications that have been made.

2. Scope of the field work

Participants can select the number of portfolios/products they want to include in the field work and can choose to include either the whole portfolio or a representative portion of a portfolio.

Financial institutions are requested to select at least two product types, such as:

- Retail mortgages
- Credit cards/overdrafts
- Corporate lending products (ie single-name high value loans)
- Investments in bonds or other debt securities
- Financial guarantees/loan commitments[4]

Corporates are requested to select at least one of the following:

- Lease receivables
- Trade receivables

Due to the limited time available to conduct the field work and to ensure that coverage of as many products/portfolios is achieved during this time, the IASB will

[3] For example, the correlation between some data points may need to be adjusted to better reflect the characteristics of a particular economy.

[4] Loan commitments may be managed together with other products above, so may form part of the analysis of that given product.

consult with each participant on the type of portfolios they would like participants to analyse.

The IASB would like to understand how the pattern of expected losses affects the timing and amounts recognised, therefore, and to the extent possible, it would be helpful if at least one of the products selected includes either an early loss pattern or a late loss pattern.

Participants may be able to perform an assessment on additional portfolios using a very simplified set of assumptions, such as assumed default rates to provide an indication of the magnitude of the change at the reference date.

3. Time horizon and reference date

For consistency, we ask participants to extract portfolio data as at 31 December 2012 (the 'reference date') and then model this portfolio using the economic data provided over a period of 5 years. The hypothetical macro-economic indicators provided in *please refer to data sheet at the end* cover a number of hypothetical quarterly reporting periods that includes both upswings and downswings in macro-economic factors.

Participants are not required to make use of all the data points provided but are requested to submit information for at least 5 annual periods. The objective of the field work is to understand how various entities intend to interpret and apply the proposed approach. Participants can therefore select those data points and the frequency of the data points that correspond to their existing credit risk management practices, ie annual or bi-annual review.

4. Assumptions and variables

The aim of the field work is to determine how responsive the proposed model is to changing economic conditions. In order to achieve some level of comparability between participants, business mix and model (geographical and product strategies and operation) and the maturity profile of the selected portfolios should be kept

constant throughout the time horizon[5]. To the extent that time and cost constraints allow, some participants may be requested to apply the model under a portfolio growth assumption.

Participants may use additional assumptions to assess credit quality for the selected portfolios. Those additional assumptions should be consistent as much as possible with the reference data provided. However, in that case details of additional assumptions used should be provided with the results.

5. Forecasts at each period

The proposed impairment approach requires entities to incorporate reasonable and supportable forward-looking information when estimating expected credit losses. For the purpose of this field work, participants should avoid the use of foresight and not base their expectations about the future at each point in time on the data points provided in the hypothetical scenario for future reporting periods. Instead, participants should develop forward-looking information using their existing methodologies to forecast economic conditions. Such methods might include a forecast reversion to 'normal' conditions after a number of years.

6. Techniques to be used

Participants will be required to translate the hypothetical scenario provided into expected credit loss allowances and provision forecasts. These forecasts will differ according to a participant's business model, loan portfolio and internal models. Ideally this will be performed using statistical and simulation techniques that estimate the link between changes in macroeconomic variables and changes in credit risk. However simplifications will be permitted to the extent that they are consistent with the objectives of the proposals and the field work.

The portfolio characteristics will need to be adjusted for the economic conditions experienced at each point based on when the portfolio would have been originated

[5] Ie a static portfolio with no acquisitions or exits and therefore the same origination risk distribution. This risk distribution will then be transformed by the economic conditions that have occurred up to each point in the exercise.

and the economic data from that time to the measurement point. If the credit quality at origination of the portfolio is unknown or costly to obtain, simplifying assumptions are permitted.

7. Comparison to other impairment approaches

In order to assist the IASB in the redeliberations of the proposals, participants are requested to measure the impairment allowance as per IAS 39 for the selected portfolio(s).

In addition to measuring the expected credit losses in accordance with the proposals in the current exposure draft, participants are requested to measure the loss allowance at an amount equal to lifetime expected credit losses and the Time-Proportionate Amount (TPA) for a subset of the portfolios selected for the fieldwork on the following basis:

- Lifetime expected credit losses for financial instruments that have not experienced a significant increase in credit risk (ie those for which a 12-month loss allowance is recognised under the proposed model);
- The TPA but without the foreseeable future floor as proposed in the Supplementary Document (refer later) for those financial instruments that do not have objective evidence of impairment; and
- The 12-month expected credit losses for those financial instruments that have experienced a significant increase in credit risk (ie those for which a lifetime loss allowance is recognised under the proposed model).

A summary table of the data requested has been included in the questions below.

8. Sensitivity assessment

In addition to the hypothetical scenario provided, some participants may also be requested to do a sensitivity assessment by adjusting/flexing some variables or assumptions in order to establish the effect on the estimation of expected credit losses. This will be agreed with each participant individually and may include the following:

- Growth
- Maturity
- Discount rate
- Definition of default
- Different thresholds for 'significant deterioration'

Section B: Practical arrangements

1. Communication

1.1 Kick-off meetings

The project staff will facilitate conference calls with individual participants prior to the commencement of the field work in order to ensure a common understanding of the features of the field work and the submissions required from participants, and to answer any preliminary questions participants may have.

1.2 Regular status updates

The project staff will also schedule regular conference calls with participants individually to gain an understanding of the progress to date and resolve any questions or issues that arose. In order to resolve questions or problems in a timely manner, it is recommended that these be held bi-weekly, however, alternative arrangements can be agreed with the project staff. The project staff are available to answer questions as they arise.

Should participants be interested, the project staff could facilitate conference calls with a group of participants to share experiences or resolve common operational concerns.

In order to ensure the most efficient use of time and resources, each participant is requested to nominate a representative that will serve as the main contact person with whom project staff can liaise to schedule meetings.

1.3 Preliminary results and close out meetings

The project staff will schedule conference calls with participants to discuss the preliminary results and to close out the field work towards the beginning of July.

2. Confidentiality

All field work results will be treated in the strictest confidence and no data from any individual participant will be released to parties other than members and staff of the IASB. However, a summary of the results of the field work will be presented in a staff paper and will be discussed by the IASB in a public meeting. The results will also be discussed with IASB user groups and other selected interested parties. For these purposes all results will remain confidential, and will be summarised on a no-name basis.

3. Timeline

Activity	**Target date**
Selection of participants	12 April 2013
Distribution of detailed instructions and commencement of fieldwork	15 April 2013
Conference call with participants (provisional)	22-26 April 2013
Preliminary results provided to IASB Staff	3-10 June 2013
Final results submitted to IASB	14 June 2013
Feedback on final results	28 June 2013
Comment letter deadline	5 July 2013
Presentation of comment letter analysis and fieldwork results at July Board meeting	22-26 July 2013

Section C: Questions for participants

The questions have been divided as follows:

A. General model – for financial institutions. The main areas of interest are the assessment of deterioration, the measurement of expected credit losses.

B. Trade receivables and lease receivables – for corporates.

C. Comparison of results – for all participants.

D. Costs of implementation and on-going application – for all participants.

E. Additional questions – optional questions for selected participants.

A. General model

1. For each portfolio/product type selected for the field work, please provide a description of the nature and characteristics of the portfolio, ie the general terms of the product, maturity profile and credit quality, to enable us to analyse your submission in the context of the chosen portfolio.

2. For each selected portfolio, please indicate the following as at 31 December 2012 (the reference date) and the end of each subsequent reporting period:

   (a) Expected credit loss allowance:
      (i) 12-month expected credit loss allowance
      (ii) lifetime expected credit loss allowance
   (b) IAS 39 Incurred loss allowance

The remainder of the questions should be answered separately for each selected portfolio where appropriate, based on the results of the field work.

Assessing changes in credit risk

3. Please explain the information that you considered in determining and assessing changes in credit risk. It would be helpful if your explanation includes:

   (a) what information from the reference data was considered in assessing whether lifetime expected credit losses should be recognised and any additional assumptions you made, and why;

   (b) whether the information considered in (a) above was applied at a portfolio or individual level;

   (c) any information in the reference data that was not considered relevant to this assessment and why;

   (d) any additional assumptions and information used; and

   (e) any additional information that you would have liked to use, but which would require undue cost or effort to obtain and why.

4. If you have used the 12-month probability of default to determine whether lifetime expected credit losses should be recognised, please explain why you consider this to be appropriate.

5. In assessing changes in credit risk, please explain

   (a) what techniques you used and why;

   (b) how you determined when there has been significant deterioration in credit risk;

6. What are the operational difficulties you encountered in assessing changes in credit risk? Based on this, are there any practical suggestions you would make to assist with implementing the proposals that are consistent with the objectives of the Exposure Draft?

Financial assets with low credit risk

7. Did you find that the requirement that lifetime expected credit losses should not be recognised for financial assets with low credit risk

   (a) is sufficiently clear and can be applied consistently?

   (b) reduces the cost of implementation (and in which cases)?

   If not, please explain why not?

Rebuttable presumption—more than 30 days past due

8. Did you rely primarily on delinquency as a basis for assessing deterioration in credit quality for particular assets? It would be helpful if your explanation includes:

   (a) for which portfolios and circumstances you relied primarily on delinquency;

   (b) whether you rebutted the presumption and on what basis;

   (c) whether the rebuttable presumption reduces the cost of implementation; and

   (d) whether you used factors other than delinquency that still allowed the operational advantages of using delinquency as a basis for the assessment but improved the application of the model? If so, what factors were used?

Measurement of expected credit losses

9. Please explain how you estimated the 12-month and lifetime expected credit losses by portfolio. If you have used existing expect credit loss measures as a starting point, please describe any adjustments you have made to these calculations and assumptions to meet the requirements in the Exposure Draft.

10. What information/factors contributed most significantly to the change in the allowance balance? Was the information applied at a portfolio or individual level and why?

11. Please explain how the pattern of the timing of expected losses (ie early or late loss emergence patterns) was considered in:

   (a) the assessment of changes in credit risk?

   (b) the calculation of expected credit losses for the selected portfolios?

12. Please explain what discount rate you used and why.

B. Trade receivables and lease receivables

13. Did you apply the simplified approach to your trade receivables and/or lease receivables? Please explain the reasons and the factors that influenced your decision to choose that approach.

14. If you have chosen to apply the general model, please describe what indicators and information you have considered to determine whether lifetime expected credit losses should be recognised?

C. Costs of implementation and on-going application

15. What systems changes do you expect will be required to implement the proposals in the Exposure Draft? Why?

16. What would be the required lead time between the publication of the finalised proposals and the effective date for those systems changes to take place?

17. To the extent that you have estimated the resources required for the implementation and on-going management of the proposed approach, please indicate the following separately for the implementation and on-going application of the proposed impairment approach:

    (a) Human resources—FTE/hours
    (b) Infrastructure changes—costs
    (c) Other

D. Comparison to other models

18. To assist the IASB in determining whether it has achieved an appropriate balance between the benefits of the model and the costs of implementation, it would be appreciated if you could provide input, to the extent possible, on the financial statement effect if the loss allowance is measured as being equal to:

    (a) the time-proportionate amount of expected credit losses (refer below for more information) for assets that do not have objective evidence of impairment;

(b) lifetime expected credit losses for all financial instruments.

(c) 12month expected credit losses for all financial instruments.

Summary table of data requested for each portfolio:

2013 IASB ED	**Stage 1**	**Stage 2**	**Stage 3**
Gross carrying amount			
12-month EL			
Lifetime EL			
IAS 39 Incurred loss	**IBNR**		**IAS 39 Incurred loss excl. IBNR**
Loss allowance			Assumed same as for Stage 3 above
IASB SD	**Good book**		**Bad book**
TPA allowance			Assumed same as for Stage 3 above

E. Additional questions (optional)

Sensitivity assessment

19. Please provide a sensitivity analysis of the results of the models as per question 15 for one or more of the following:

    (a) definitions of default (taking into account any resulting changes to LGD)

    (b) the discount rate used

    (c) the assessment of significant deterioration

    (d) if growth or decline in the portfolio was assumed instead of a stable portfolio

    (e) if different maturity assumptions were used.

Determination of the time-proportionate amount (TPA)

20. The time proportionate amount should be calculated either:

    (a) by multiplying the entire amount of credit losses expected for the remaining life of the portfolio by the ratio of the portfolio's age to its expected life (ie a straight-line approach using either a discounted or undiscounted estimate); or

    (b) by converting the entire amount of the credit losses expected for the remaining life of the portfolio into annuities on the basis of the expected life of the portfolio and accumulating these annuities for the portfolio's age (which includes accruing notional interest on the balance of the allowance account) (ie an annuity approach, which by definition, uses a discounted estimate).

21. For the purpose of determining the time-proportional expected credit losses, the age and the total expected life of the portfolio are weighted averages. At each reporting date, those weighted averages need to be updated.

22. The age of a portfolio is based on the time that the financial assets within the portfolio have been outstanding since they were initially recognised by the entity. The total expected life of a portfolio is based on the time that the financial assets within the portfolio are expected to be outstanding from inception to maturity (for example, considering prepayment, call, extension and similar options and defaults).

Appendix B

Updated instructions based on comments received during early stage of fieldwork

Introduction

Thank you for taking part in field work for the proposals in the Exposure Draft *Expected Credit Losses*. The field work is being conducted worldwide with selected participants from the major regions across the world. As explained in the field work instructions distributed previously, the objective of the field work is to determine how the proposed impairment model responds to changing economic circumstances over time. It is also designed to provide an understanding of how the proposals may be implemented and to provide some information about the directional impact on potential allowance balances.

Some participants have requested simplifications for the field work to enable them to provide meaningful responses before the target date of 14 June 2013. One of the main concerns raised by participants was the use of forward-looking information as specified in point 5 of Section A in the original instructions.

This paper sets out a simplified approach and provides clarification on:

(a) the annual periods to be presented; and

(b) the updated hypothetical data set.

Annual periods to present

Some participants have requested clarification on whether information should be presented quarterly or annually and the number of annual periods that should be reported.

In order to obtain meaningful feedback on the responsiveness of the proposed model, participants are requested to present at least 5 annual periods. Quarterly information is not required. To further improve the consistency of the information and allow all participants to model a complete economic cycle, **we are requesting participants to use data provided for years 3 to 7**.

An added advantage of presenting years 3 to 7 are for those participants that would like to have some historical data, the data for years 1 to 2 can be used as historical data.

Updated data set

Some participants have raised questions on the data provided in hypothetical scenario. We have updated the data as requested and highlighted the areas where changes have been made.

Some participants have also requested the inclusion of data from delinquency indices. After further consultation and considering the varying nature of portfolio's and geographical regions included in the fieldwork, we believe using the own internal data and indices is most beneficial to the fieldwork and most reflective of what happens in an entity's credit risk management. Participants should therefore make use of their own internal delinquency data.

Simplification

The original instructions required participants to incorporate reasonable and supportable forward-looking information in measuring the expected credit losses. However, some participants raised concerns over this approach and indicated that:

- They have limited, if any, forward looking information;
- The data provided in the hypothetical scenario moves in the opposite direction as their respective current economic cycle. This would result in the information having to absorb 'market noise' that could be avoided if all participants were using similar forward-looking estimates.

We understand that many participants have not yet developed their forward-looking data. To assist these participants, we propose the following simplification:

- Participants should use the data provided in the hypothetical scenario as forward looking data *for the next 12 months* only.

> **Illustration**
>
> On 31/12/2012 an entity develops forward-looking estimates of macro-economic indicators. It uses the data provided for the coming year (ie year 3) to develop the forward looking estimates for the next 12 months. The entity uses its own methods to develop forward looking estimates beyond the 12 months (ie does not use data series for year 4 of the hypothetical scenario).
>
> At the end of year (31/12/2013), the entity would use the same data of that year (ie year 3) as the actual results and update its estimates and loss

allowances. It will then use the data of the next year (ie year 4) to develop forward looking estimates for the next 12 months. Again it will use its own methods to develop forward looking estimates beyond the 12 months.

We believe that this approach will assist participants to develop forward-looking estimates, without applying perfect foresight as the forward-looking estimates are limited to only 12 months. Participants can use their own methodology to develop forward looking estimates beyond 12 months.

This approach will result in small, if any, experience adjustments at the end of the year and will accordingly highlight how the loss allowance develops over a period of time.

Contact details

If you have any questions or experience any problems during the performance of the field work, please contact any member of the team.

Appendix C

Hypothetical data series

	Year	1				2				3				4				5				6				7			
	Quarter	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28
Measure	**Expressed as**																												
Real GDP Growth	% quarter on quarter	0.70	0.60	0.70	0.80	1.00	0.40	0.80	0.50	1.30	0.40	0.00	0.70	0.10	0.90	0.70	0.40	-0.40	0.30	-0.90	-2.30	-1.30	-0.10	0.40	1.00	0.60	0.60	0.60	0.60
Unemployment	% quarter on quarter	-1.72	-1.75	-3.57	0.00	-1.85	-3.77	-1.96	0.00	-6.00	-2.13	0.00	-4.35	2.27	0.00	4.44	2.13	4.17	6.00	13.21	15.00	20.29	12.05	3.23	3.13	-1.01	-2.04	-1.04	1.05
Inflation CPI	% quarter on quarter	1.68	1.23	0.11	0.21	1.58	0.62	2.21	-1.01	1.52	1.55	0.00	-0.54	1.76	1.46	0.07	0.74	1.66	2.49	-0.01	-3.91	1.18	1.40	0.13	-0.01	0.78	0.15	0.22	0.34
Purchasing Managers Index	% quarter on quarter	0.83	-0.17	-5.12	-0.35	-3.50	-5.07	8.40	-2.39	-1.45	-4.24	0.38	-1.53	-1.36	3.75	-3.04	-3.32	-1.43	3.11	-10.04	-26.12	8.76	27.22	18.78	1.65	7.23	-5.40	0.71	1.42
Industrial Production Index	% quarter on quarter	0.32	0.34	1.00	1.84	0.98	0.69	-1.97	2.61	0.43	0.66	0.12	0.61	0.71	0.79	0.60	0.10	-0.61	-1.44	-6.17	-3.15	-4.37	-2.21	2.62	1.27	2.21	2.14	1.11	0.91
House Price Index	% quarter on quarter	4.09	4.13	3.71	3.45	4.95	4.37	3.32	2.63	2.46	0.00	-1.10	0.25	-0.81	-2.19	-2.97	-3.06	-3.43	-4.47	-4.14	-4.88	-5.20	-1.25	1.19	0.56	0.48	0.14	-2.20	-1.61
Commercial Real Estate Price Index	% quarter on quarter	3.60	4.36	6.95	2.59	0.67	3.84	2.31	4.61	1.70	4.38	5.60	-1.38	5.52	3.51	6.75	0.93	-2.54	-4.53	1.94	-6.04	-8.93	-16.95	-9.52	-0.44	-2.65	10.29	1.06	5.08
Consumer confidence index	% quarter on quarter	-3.49	16.16	-5.93	6.20	0.29	3.11	-17.61	18.63	3.56	-1.67	0.19	3.87	-1.64	-2.68	-5.51	-8.94	-27.26	-23.52	21.63	-37.13	-30.31	83.27	8.32	0.37	-2.43	3.82	-10.50	30.45
Retail sales	% quarter on quarter	3.12	-0.62	3.07	2.22	0.16	3.14	0.16	1.26	2.46	0.09	0.60	1.91	0.63	-0.04	1.66	0.54	-1.01	1.19	-2.76	-9.14	-0.59	2.50	-0.04	2.55	2.16	-0.36	2.07	2.99
Household debt to GDP	% change in ratio quarter on quarter	0.35	1.61	1.14	1.91	0.00	1.76	1.08	0.96	0.53	1.58	1.66	0.92	-0.10	0.71	0.50	0.60	0.40	-1.39	0.80	-0.10	0.20	-0.10	-0.60	-1.40	-1.83	-1.14	-1.26	-0.53
Commodities Prices																													
Oil	% change in end of quarter USD price quarter on	12.42	5.55	17.19	-6.15	30.29	5.81	14.40	-8.40	7.90	12.08	-9.25	-1.57	-0.66	12.52	12.79	16.28	13.88	29.14	-24.51	-58.17	10.05	47.24	-1.08	9.51	5.30	-5.76	1.85	18.34
Gold	% change in end of quarter USD price quarter on	-0.07	-3.52	3.29	9.08	-1.88	-0.74	5.90	11.85	9.21	7.01	0.34	5.28	3.99	0.12	8.69	12.71	20.57	-8.15	-6.70	-1.67	13.26	2.32	5.38	13.86	-1.88	10.74	3.09	9.41
Commodity Price Index (All)	% change in end of quarter USD price quarter on	10.86	3.36	5.77	-2.43	19.23	2.57	9.40	-3.06	6.88	11.10	-5.24	1.54	1.22	8.51	5.88	11.33	15.71	16.90	-16.29	-44.19	1.83	27.95	-0.49	10.50	5.65	-3.72	4.76	16.31
Commodity Industrial Inputs Price Index	% change in end of quarter USD price quarter on	8.31	-0.61	1.40	0.69	11.34	-2.72	2.91	8.75	3.37	10.98	4.47	5.57	3.48	4.63	-8.75	-4.54	17.03	-4.84	-8.84	-31.22	-3.64	18.60	14.77	14.86	10.49	-4.39	7.87	15.93
Credit Yields																													
US Overnight rate	% change in annualised end of quarter yield qtr on qtr	2.04	3.00	56.31	34.16	21.76	15.53	19.08	14.92	10.34	8.71	5.21	-0.19	0.38	-0.19	-5.90	-14.17	-38.44	-23.37	-9.50	-31.16	12.50	16.67	-28.57	-20.00	33.33	12.50	5.56	-5.26
US Treasury (3 month)	% change in annualised end of quarter yield qtr on qtr	0.00	22.22	36.36	33.33	25.00	16.00	17.24	11.76	15.79	6.82	4.26	0.00	2.04	-6.00	-9.51	-20.93	-38.24	-23.81	-6.25	-80.00	-33.33	0.00	0.00	-50.00	0.00	0.00	100.00	-50.00
US Treasury (10 year)	% change in annualised end of quarter yield qtr on qtr	-6.82	14.63	-6.38	-2.27	2.33	-4.55	2.38	6.38	2.17	10.64	-3.85	-6.00	2.13	2.08	-2.04	-9.33	-11.36	5.13	0.00	-9.76	-10.51	15.63	2.70	-2.63	5.41	-7.69	-19.44	3.45
BBB spread over US Treasury (10 year)	% change in annualised end of quarter spread qtr on	0.00	0.00	0.00	-21.43	-9.09	30.00	-7.69	8.33	0.00	0.00	7.69	0.00	-7.14	7.69	21.43	17.65	30.00	3.85	14.81	83.87	1.75	-22.41	-33.33	-20.00	-20.83	5.26	10.00	-9.09
Default rates (moody's corporate default and recovery rates 1920–2010)																													
Investment grade	% annual default rates				0.00				0.07				0.00				0.00				1.47				0.19				0.07
Speculative grade	% annual default rates				1.88				3.76				1.05				0.60				5.81				16.77				1.64
All rated	% annual default rates				0.33				0.75				0.21				0.12				2.22				2.81				0.33
Investment grade	% change in annual default rates				0.00			n/a				-100.00				n/a				n/a					-87.24				-62.57
Speculative grade	% change in annual default rates				-62.50				100.21			-72.09				-42.67				864.62					1688.86				-90.25
All rated	% change in annual default rates				-61.68				128.35			-71.70				-44.61				1798.29					26.52				-88.19
Equity markets																													
Market index	% change in end of quarter price quarter on quarter	2.22	0.90	-2.19	9.87	-2.78	2.05	3.47	1.86	5.09	-2.33	3.87	6.83	1.06	5.56	0.99	-3.53	-10.04	-1.94	-9.16	-23.48	-10.72	16.17	15.78	5.37	5.77	-11.60	11.14	11.24
Market Volatility Index	% change in end of quarter VIX quarter on quarter	2.37	-7.41	-3.50	-13.98	-12.05	21.23	-19.77	16.20	-11.52	63.01	-37.58	-31.72	54.33	-3.57	62.96	0.97	3.54	-3.73	50.65	73.23	-29.91	-25.40	-26.49	-1.28	-11.07	67.77	-28.17	-28.57