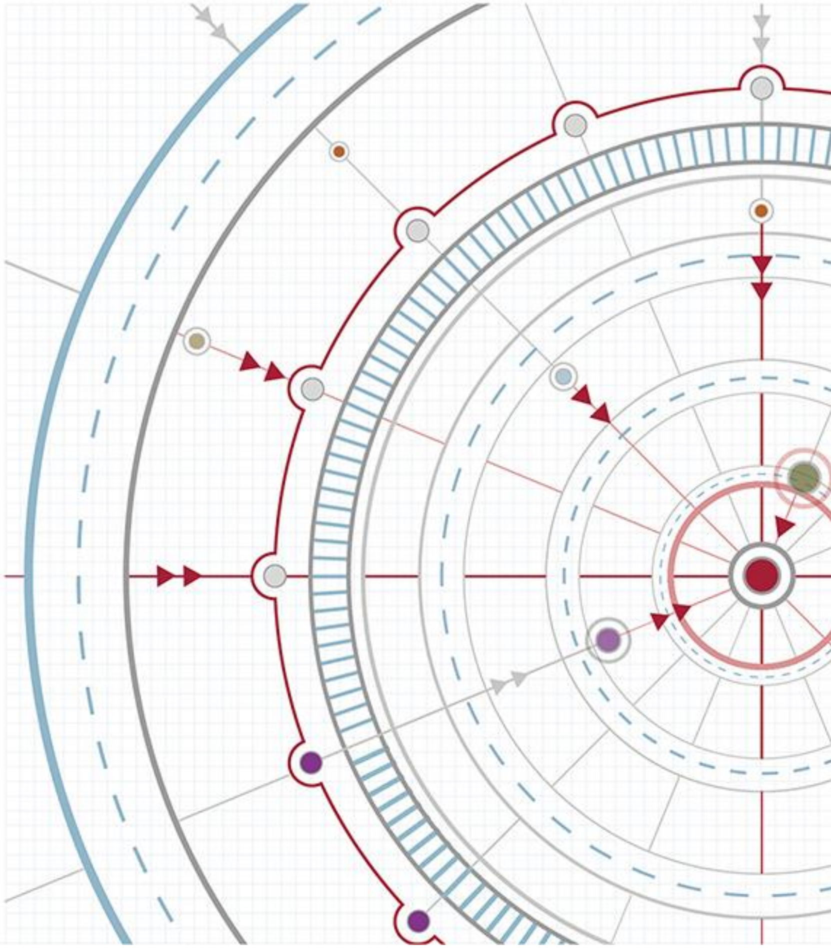
IFRS® Foundation



Financial stability and the IFRS Foundation

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The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.

Why are looking at this?

As we complete the key accounting standards for financial institutions (IFRS9 and IFRS17) there is increased focus on the financial stability implications.

This presentation sets out the Foundation's current position and asks for comments

The advice from the Council will inform the Trustees' discussions at their meeting in May in the context of work on emerging strategic issues

How do IFRS Standards contribute to Financial Stability?

Mission Statement

Our mission is to develop IFRS that brings transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability within the global economy

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Working in the public interest: the IFRS Foundation and the IASB

Key outcomes of IFRS Standards

- **Transparency**

Enhance comparability and quality of financial information. Enable investors and other users to make informed economic decisions

- **Accountability**

Provide information needed to hold management to account

- **Efficiency**

Help with capital allocation, lower the cost of capital and reduce international reporting costs

Long-term financial stability

- Not the primary goal of accounting standards (one for prudential regulators)
- The Foundation's view is that the transparency provided by high quality is indispensable for, and contributes to, long-term financial stability
- Transparency can reveal instability in the short-term, but problems can best be addressed if they are made visible on a timely basis by high-quality accounting

Enhancing financial stability: the role of transparency (views of Donald Kohn, Bank of England FPC member September 2011)

- *Stability of the financial system rests on decisions of private sector participants*
- *Decisions need to be well-informed and based on information that is*
  - *Comprehensive and accurate*
  - *Focuses on important risks and characteristics*
  - *Enables comparisons across institutions and time*
  - *Understandable for market participants to assess and act*

IFRS Standards are intended to meet these criteria

Financial stability for financial institutions

Completion of IFRS 9 *Financial Instruments* and IFRS 17 *Insurance Contracts* increases focus on financial stability. Issues raised

- Expected loss provisioning may increase volatility - if conditions are volatile ECL will be volatile
- Fair values may be volatile and there may be measurement uncertainty
- Concern with interaction with regulatory capital
- Some concerned visible volatility and measurement uncertainty will increase financial instability

Our response

- **Expected loss provisioning**
  - introduced to address criticisms (from G20 and others) of incurred loss provisioning being ‘too little too late’
  - Short-term volatility offset by timely recognition of credit problems and better credit risk information should lead to less violent cliff effects
- Upcoming revisions to the *Conceptual Framework* discuss factors to consider when choosing measurement basis, including when to choose **fair value measurement**. The framework clarifies that any measurement basis should be relevant and faithfully represent what it purports to represent and should only used when it meets that test
- Uncertainty and instability is a function of lack of information. Mitigants are **transparency** and better information to support capital allocation
- We have a **complementary role with prudential regulators** who address the interaction between accounting and regulatory capital

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IFRS 17 and financial stability

IFRS 17 should contribute to financial stability

- Better accounting for insurance liabilities will increase understanding of insurance risks
- Consistent principles for recognition of revenue and profit will increase understanding of insurers' financial performance
- Investors will be better able to identify healthy companies and weaker companies will be incentivised to improve performance
- Industry should benefit from lower cost of capital and greater transparency will improve capital allocation

Next steps

- IFRS 9 expected loss provisioning applies next year. The Foundation, regulators and auditors have worked together to promote consistent application
- IFRS 17 is very near completion, and we are developing similar approaches to foster both a better understanding of the standard and consistent application
- In both cases, transparency and understanding of the causes of volatility are central to promoting long-term financial stability

Questions for the break-out discussion

As explained above there is increased focus on financial stability issues for financial institutions as new accounting standards are finalised. We would like your views and advice on

1. Have we correctly captured the role that IFRS Standards play in promoting financial stability?
2. What could we do to develop that role in the future?
3. Is there more we could do to explain the importance of transparency?
4. What more could we do to overcome concerns?