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Deloitte Financial Reporting Conference

Rising to the challenge

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Convention Centre Dublin

IFRS 9
Financial Instruments

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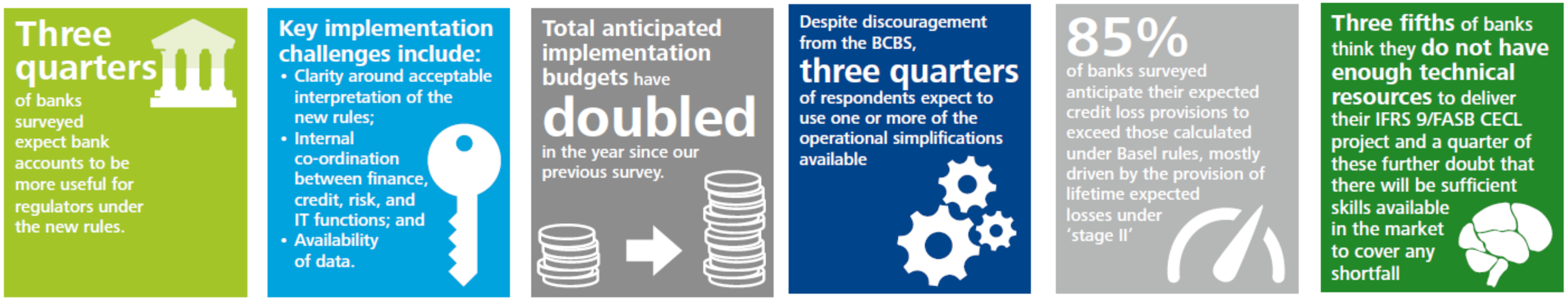
Background

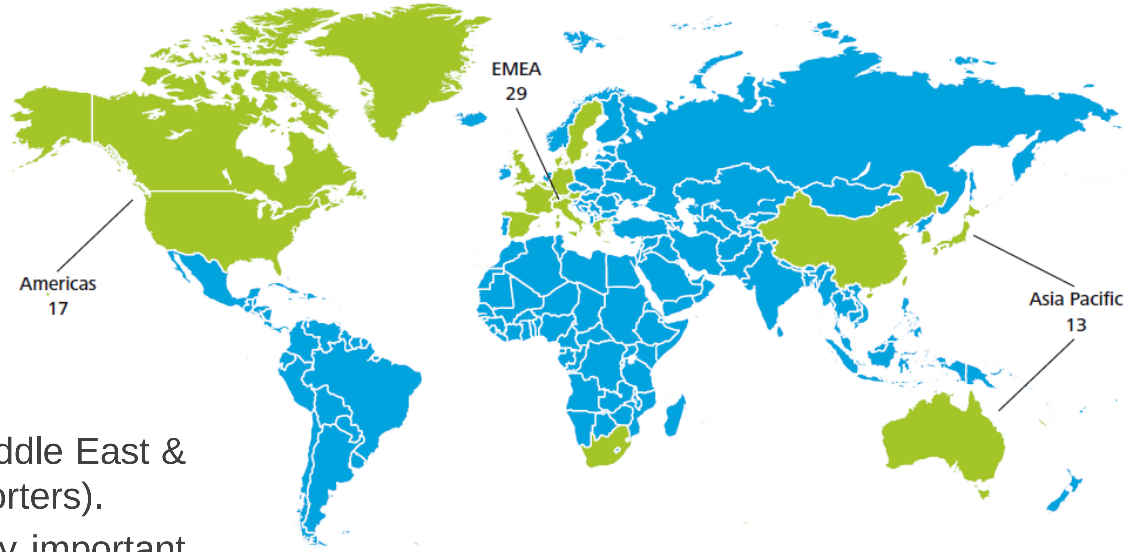
Hans Hoogervorst

- ✓ Closes the accounting chapter of the financial crisis
- ✓ Provides a more forward-looking impairment model for loan loss provisions
- ✓ Fixes the so called ‘own-credit’-problem
- ✓ Did not succeed in the area of convergence in the IASB’s and the FASB’s Standard for financial instruments
- ✓ Losses need to be expected to be reflected in the financial statements. As we approached the financial crisis the market was not expecting the losses that were about to hit.

IFRS 9

In May 2015 Deloitte undertook their fifth global study on the impact of IFRS 9 for financial institutions.





About the survey

The survey includes the views of 59 banks from Europe, the Middle East & Africa, Asia Pacific and the Americas (42 of which are IFRS reporters).

Responses were received from 17 of the 30 global systemically important financial institutions (G-SIFIs)

IASB project on Financial Instruments

The IASB issued the final version of IFRS 9 Financial Instruments on July 24, 2014.

EFRAG Endorsement Advice issued on 15 September 2015.

Classification and Measurement

Impairment

General Hedge Accounting

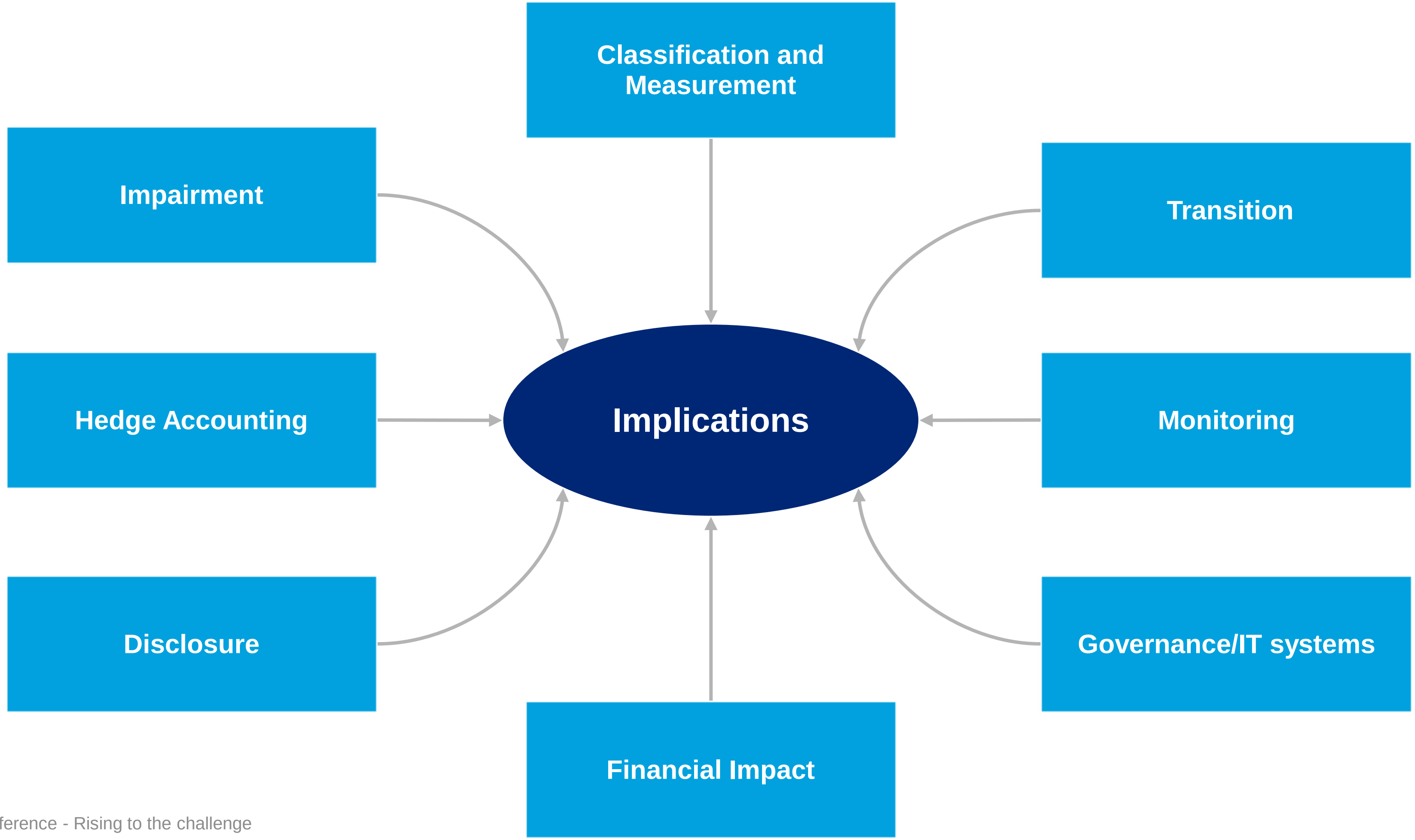
Macro Hedge Accounting

Separate project

Implications

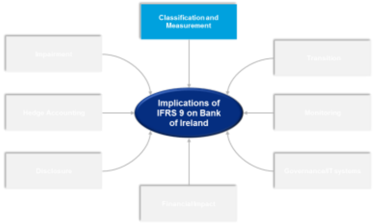
Implications

There are eight elements of IFRS9 that have a direct impact



Implications

Classification & Measurement

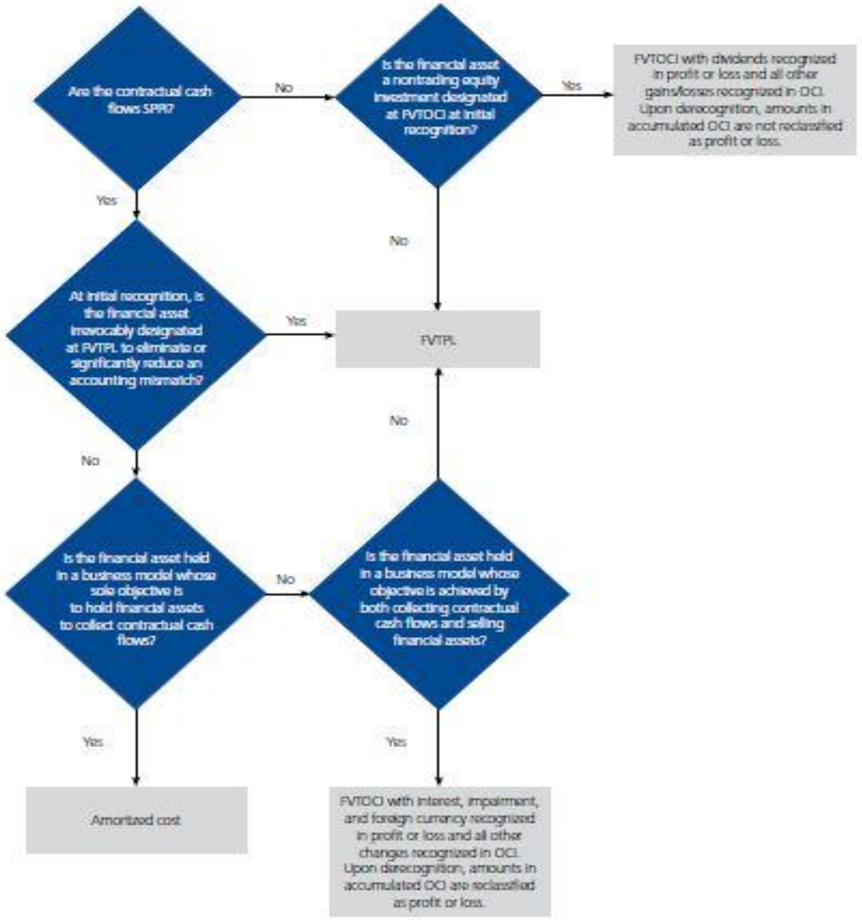


Classification and Measurement

- **Driven by Business model and cash flow characteristics.**
- **The new FVTOCI** classification for business model whose objective is to **collect cash flows and selling financial assets.**
- Alternatively measured at **amortised cost** if the financial asset is held in a business model that **collects** contractual cash flows.
- Entities are required to present gains and losses attributable to the liabilities credit risk in OCI.

Entities will need to assess their business models

In some cases this may require judgment and will need to be tackled early on implementation.



Implications

Impairment

The impairment requirement changes how loss is evaluated.

Impairment (I of II)

IFRS 9 introduces a new **impairment model** for financial assets that is based on **expected loss.**

Single Model Approach; will mean that both debt instruments measured at amortised cost and those measured at FVTOCI will have the same loan loss allowance despite the different measurement basis on the balance sheet.

Approach: there is a dual measurement approach for expected credit losses. The standard requires entities to measure expected credit losses by recognizing a loss allowance at an amount equal to one of the following:

The 12 month expected credit loss:

- Where the expected credit losses result from default events on the financial instrument are possible within 12 months
- This is required if the credit risk is considered low at the reporting date.

Dual Measurement approach

Full lifetime expected credit losses:

- Where expected credit losses result from all possible default events over the life of the financial instrument.
- This is required if the credit risk has increased significantly since initial recognition.

Implications

Impairment

The impairment requirement changes how loss is evaluated.

Impairment (II of II)

Measuring expected losses

- The loss allowance will be measured on a probability-weighted basis, discounted by the effective interest rate.
- This will be based on information regarding past events, current conditions, and a reasonable and supportable forecast of future economic conditions.
- Generally when a financial asset is first recognised a 12 month expected loss allowance is recognised.
- For example when the Bank originates or purchases a loan or debt security measured at amortised cost or FVTOCI a day-one provision with a debit to profit or loss will be recognised.
- This day-one loss could have a more significant effect on the performance of the Bank that is growing its loan book since with more loans being recognised than derecognised, the overall loan loss allowance will increase.

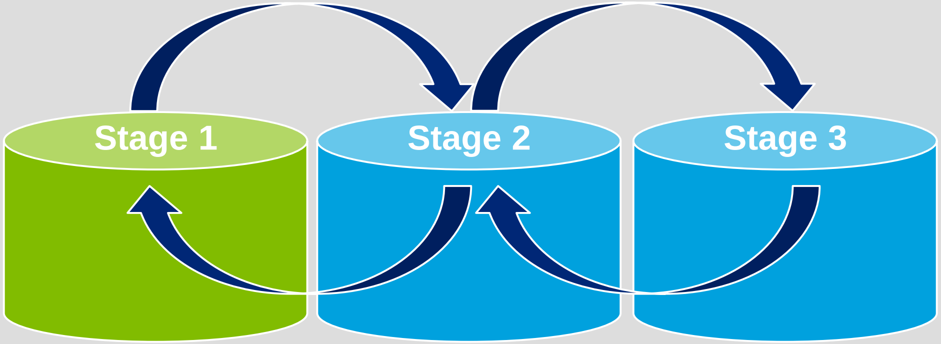
The required information will more than likely exist within the Bank, however, there may be challenges around the accuracy and reliability of this information, given that this would be used for credit risk management and regulatory reporting rather than for accounting purposes.

Exemptions

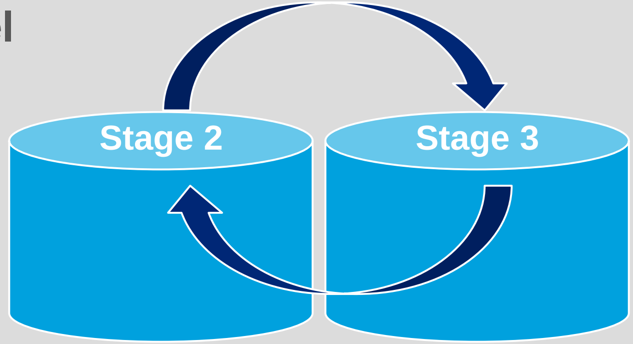
- Lease receivables
- Contract assets with a significant financing component
- Trade receivables with a significant financing component

Policy choice

General model



Simplified model

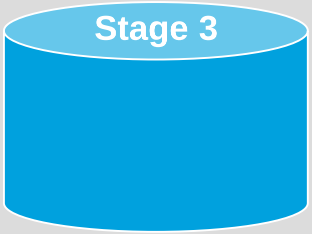


- Contract assets without significant financing component
- Trade receivables without a significant financing component

- Purchased or originated credit-impaired financial assets

Special provisions

- No loss allowance on initial recognition
- Apply a credit-adjusted effective interest rate (based on the expected cash flows at inception including expected credit losses)

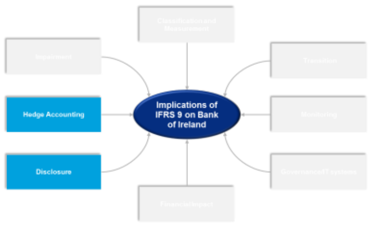


Trade Receivables

Illustrating the disclosure of the credit risk profile via a provision matrix

	Trade receivables past due				
	Current	**> 30 days**	**> 60 days**	**> 90 days**	**Total**
Expected credit loss rate	0.1%	2%	5%	13%	
Estimated total gross carrying amount at default	20 777	1 416	673	235	23 101
Lifetime expected credit losses	21	28	34	31	114

Implications
Hedge Accounting & Disclosure



There are additional impacts in terms of Hedge Accounting and Disclosure.

Hedge Accounting

- IFRS 9 permits entities to designate certain non financial risk components as hedged items.
- Bright line tests under IAS 39 are removed.
- Hedge accounting is optional under IFRS 9
- Findings from the Deloitte Impact survey have discovered that 2/3rds of participants plan to take advantage of the IASB’s election.

Entities need to determine:

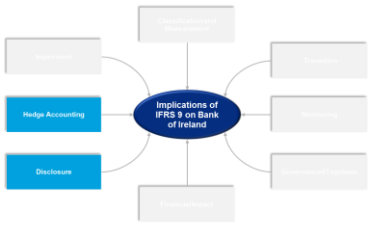
1) **If they want to avail of hedge accounting under IFRS 9; and**
2) **If so, do they qualify under IFRS 9 by meeting the criteria?**

Disclosure

- Extensive disclosures required.
- Disclosures will provide increased transparency
- Needs to enable users of FS to understand the effects of credit risk on the amount, timing and uncertainty of cash flows.
- The appetite for information from banks is large and growing.
- IT systems need to be adapted in order to support the increased public disclosure.

Enhanced disclosures requiring advance consideration.

Must ensure that the structure and systems are in place to meet the requirement.



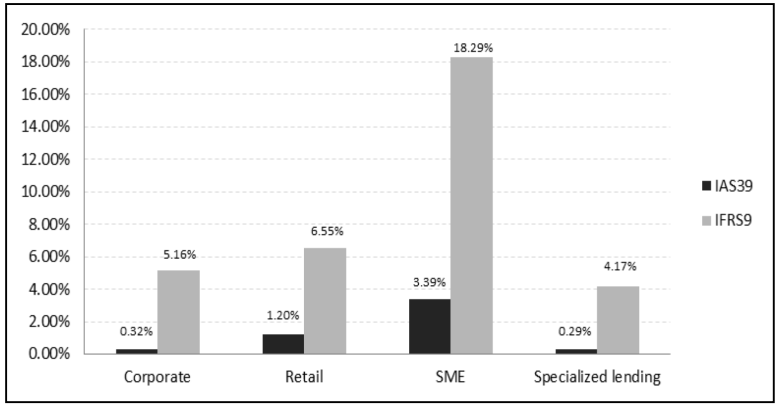
Implications

Financial Impact

The largest financial impact is on Credit Card Portfolios.

Financial Impact

- Financial impact includes change in classification and increased impairment provisions..
- From our research, the transition impact is highest for Credit Cards portfolios (200-260%), followed by Loans (85-120%) and current accounts (25-80%).
- We have found it is most variable for commercial portfolios.
- Volatility however, can be highest for portfolios with longer behavioral lives.
- **Please see graph from Global Impact Survey**



Less profit or loss volatility Impact

- The introduction of the new category- FVTOCI
- Credit risk changes in liabilities through OCI.

This results in potentially Less Profit or Loss volatility for the entity as the gains and losses are now going to Other Comprehensive Income.

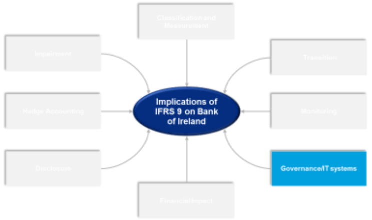
Budget and Cost

- The introduction of IFRS 9 could potentially be a significant cost to the business. This can vary depending on the systems/resources already in place.

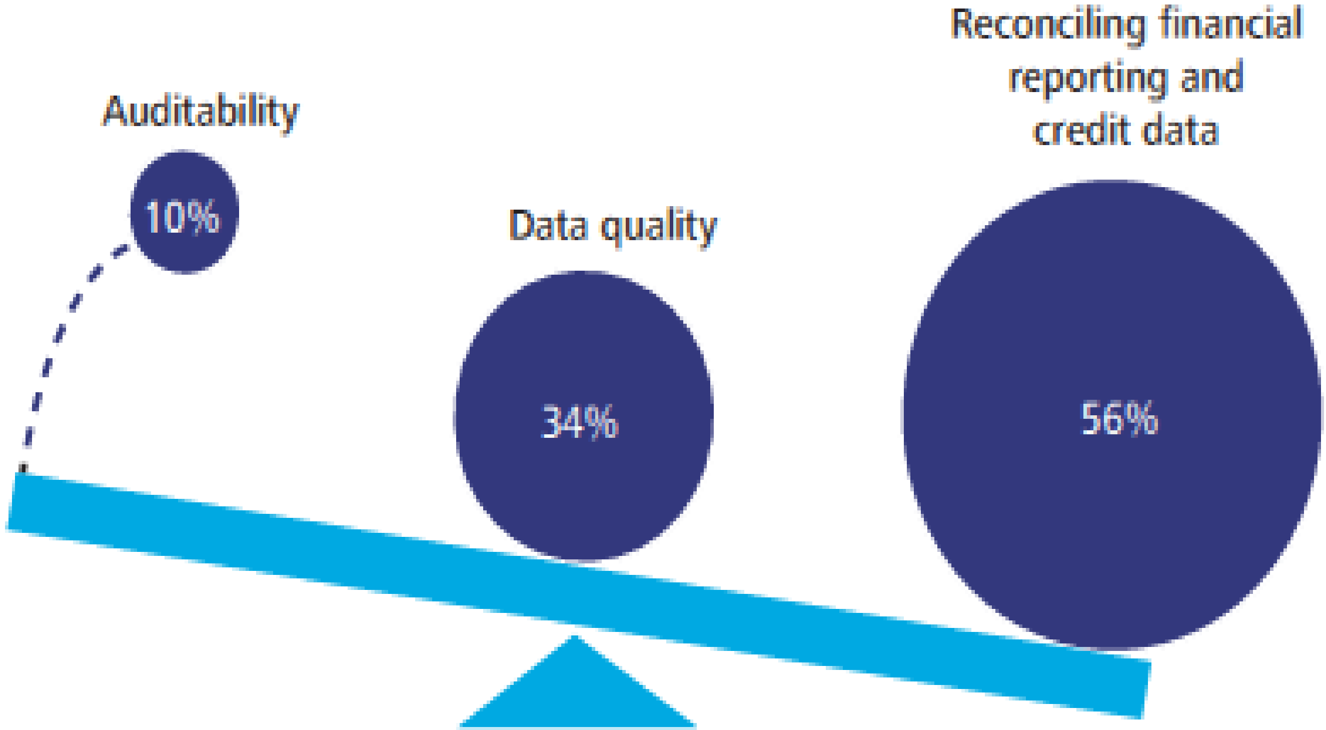
Entities will need to determine the expected cost of IFRS 9 implementation and seek methods to minimise these costs.

Implications

Governance & IT Systems



Data Quality and Credit Risk Management are the forefront of operationalising IFRS9




Are you well placed to account for commitments?
What incurred loss model predictions are you submitting as part of your **ICAAP**? How are you calculating these?
What are you going to disclose between now and 2018 in relation to the impact of IFRS 9 on your business?
What models will need to change?
How long is it going to take you to be fully compliant?
Have you discussed IFRS 9 with the Board and briefed them on your plan?
Do you understand the complexity and volume of data you need for IFRS 9?
Do you know what data you will use in assessing if a “significant increase in credit risk” has occurred?
How long is it going to take you to be fully compliant?
Have you documented your timeline to implementation ?
How are you going to build an audit trail within the credit department that is IFRS 9 compliant?
Who is your IFRS 9 implementation lead? Does the team include Risk, Finance, Reg and IT?
Do you wish you’d started earlier?

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