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International Financial Reporting Standards

Impairment of Financial Assets

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

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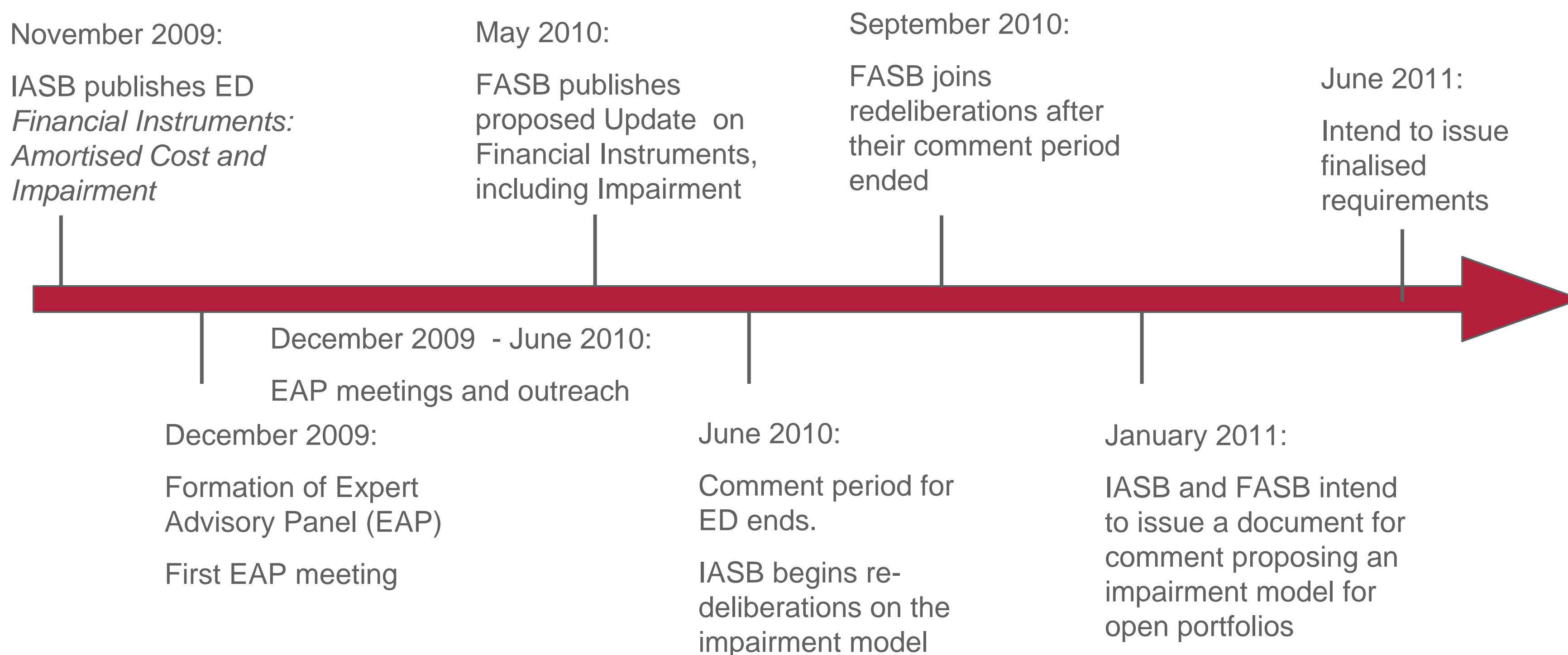
Timeline



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Current state:
Incurred loss impairment

Current guidance 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

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Incurred loss criticisms

Criticisms of the incurred loss approach include:

- Overstates interest revenue before trigger event (front-loading)
- Does not reflect the underlying economics of the transaction
- Triggers inconsistently applied
- Loss recognition too late

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Proposed impairment models in original EDs

IASB – Expected cash flow (ECF)	FASB – Immediate recognition
Initial loss expectations allocated over life using an integrated effective interest rate	Initial loss expectations recognised immediately
Effects of subsequent changes in estimates recognised immediately	Effects of subsequent changes in estimates recognised immediately
Symmetrical in that both increases and decreases in estimates are treated the same	Increases and decreases treated differently in certain circumstances
Uses forward looking information to estimate expected cash flows each period	Hold current information constant to estimate expected cash flows each period

The BIG question: How can we converge and create a more operational model, especially for open portfolios?

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Major operational issues with IASB original ED

Integrated EIR:

- Includes initial expected losses (EL) in the calculation of EIR to allocate losses over life
  - Potential simplification: 'decoupling' interest revenue from credit loss calculations

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Major operational issues with IASB original ED

Open portfolios:

- Separate treatment for initial EL estimates and effects of subsequent changes
- Not operational to keep track of estimates related to existing versus new loans
  - Potential simplification: Apply same method to all estimates (ie original and updated)

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Redeliberations

IASB perspective:

- Objective: Replicate as closely as possible the outcomes of the original ED in an operational manner for open portfolios
- Maintain link between EL and pricing
- Confirmed EL model
- Confirmed *lifetime* EL using reasonable and supportable information including forward looking
- ‘Good’ book – time-proportionate
- ‘Bad’ book – immediate

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Mechanics of impairment model

- Separate assets into a ‘good’ book and ‘bad’ book
- ‘Good’ book – Time-proportionate approach:

Approach	Allowance balance time-proportionate calculation
Straight-line (undiscounted or discounted)	= EL x (Weighted Average Age / Weighted Average Life)
Annuity	= Annuity x Weighted Average Age (and include notional interest)

- ‘Bad’ book – Immediately recognise all EL
- Allowance for ‘bad’ book equal to full lifetime expected losses

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Redeliberations

IASB-only decisions:

- Non-integrated ('decoupled') EIR. Separately allocate EL.
- Allocation of EL in 'good' book: discounted / undiscounted straight-line or annuity approach
- Discount rate used to discount EL (when applicable) can be between IAS 39 EIR and risk-free rate
- Presentation and disclosure requirements for new proposals
- Distinguishing between 'good' book and 'bad' book (based on internal credit risk management policies)
- Short-term receivables outside scope

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Redeliberations

FASB perspective:

- Objective: Deal with ‘too-little-too-late’ criticism
- Focus on adequacy of allowance balance on day one
- Ensure allowance balance always covered lifetime EL (even if that means immediately recognising a loss)

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New joint proposal – Impairment only

- Queried whether IASB approach would be appropriate for font-loaded loss patterns and related allowance balance

So, to meet primary objectives of both boards:

- Separate assets into two groups: ‘good’ book and ‘bad’ book
  - ‘Good’ book – Time-proportionate approach **WITH a ‘floor’**
    - Floor = EL estimate for foreseeable future (at least 12 months)
  - ‘Bad’ book – Immediately recognise all EL
- Allowance for portfolios with front-loaded loss patterns built up faster but still recognising relationship between pricing and EL

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Joint redeliberations

Other joint decisions:

- Lifetime EL estimates
- Consider all reasonable and supportable information when calculating EL (including forward-looking information)

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Scope of supplemental document

- Only financial assets in open portfolios
- Main focus – allocation of EL
- Does not include short-term receivables
- Single instruments and closed portfolios considered after receiving feedback on open portfolios
- Does NOT describe how to measure expected losses, nor how to calculate interest revenue
- Does NOT address amortised cost measurement

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Items still subject to discussion

- Disclosures not affected by impairment model
- Definitions of ‘write-off’ and ‘non-performing’
- Measurement of EL
- Closed portfolios, single instruments, and off balance sheet items

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Next steps

- January 2011: Joint supplemental document with IASB-only appendix and questions on presentation and disclosure
- Proposing a two-month comment period
- During comment period, continue redeliberations on aspects of original ED not addressed by this document
- Ongoing outreach activities
- June 2011: issue finalised requirements

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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.

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