

# Financial Instruments: Expected credit losses

# Field-test

**This field-test is carried out by EFRAG with ANC, ASCG, FRC and the OIC (National Standard Setters). The following European associations will encourage their members to participate: EBF, ESBG, EACB, Leaseurope and BusinessEurope.**

**EFRAG staff will aggregate the results of all the questionnaires received on an anonymous basis and only a list of companies who participated in the study will be provided as an appendix. If you explicitly request it, the name of your company will not be included.**

**EFRAG and your National Standard Setter, if applicable, will have access to the information that you provide in response to this questionnaire. Your response will be also shared with other national standard setters participating in the exercise, the IASB and the European Commission on an anonymous basis (i.e. participants’ identity will remain confidential).**

**More detailed information is available on EFRAG’s website (www.efrag.org).**

## Background

1. On 7 March 2013, the IASB published the Exposure Draft *Financial Instruments: Expected Credit Losses*. The objective of the Exposure Draft is to establish principles for the recognition, measurement, presentation and disclosure of expected credit losses that will provide useful information for users of financial statements for their assessment of the amount, timing and uncertainty of future cash flows.
2. The Exposure Draft introduces a consistent measurement approach for all financial assets that are measured at amortised cost and FV-OCI, including trade receivables and lease receivables. The proposed expected credit losses model aims to reflect the credit deterioration of financial assets that are subject to the proposals. The proposals will require entities to incorporate a broader range of information and apply judgment in order to determine their forward looking estimates and will likely affect financial and non-financial entities.
3. EFRAG and National Standard Setters are performing a joint field-test on whether the new requirements are operational, what their impact would be and the costs associated with introducing them. This exercise is focused on the practical application of the new requirements and is not intended to gather any opinions, but solely facts and objective data.
4. The field-test is intended to serve as input to the European Commission’s endorsement process and to EFRAG and National Standard Setters to help them formulate their views on the impacts of the application of the new impairment requirements in IFRS 9.
5. However, EFRAG is also interested in your views and opinions on the ED; therefore we encourage you to submit separately a response to EFRAG’s draft comment letter on the ED. Similarly, National Standard Setters also encourage participants to submit to them separately any views and opinions as part of their due processes on their comment letters to the IASB.

## Objective of this field-test

1. The purpose of the exercise is to identify whether or not the proposals for the expected credit losses model address the weaknesses of the existing incurred loss impairment model in IAS 39. Additionally, the exercise addresses the operationality and the impact and costs related to the expected credit losses model. In particular, the field-test asks questions on:
   1. How the expected credit losses model reflects the amount, timing and uncertainty of future cash flows;
   2. Whether the requirements are clear and operational;
   3. The impact of the proposed expected credit losses model; and
   4. The costs and benefits of the proposed expected credit losses model.
2. All companies that expect to be significantly impacted by the new requirements are invited to participate in the field test. In particular, EFRAG and the National Standard Setters would expect banks, insurers and other financial institutions to participate as they are most likely to be affected by the new proposals.

## What you are invited to do

1. EFRAG staff and National Standard Setters have developed this questionnaire to facilitate the data collection effort and processing of the findings. The questionnaire asks you to report on the tentative results and conclusions of your internal assessment regarding the implementation of the new requirements.
2. Please document your observations and findings in English in the sections specified. If you have any questions about how to document in this questionnaire, please contact your designated point of contact. Participants are encouraged to contact their own national standard setter (as per the table below) as their designated point of contact.
3. Participants are asked to submit the questionnaire by 2 June 2013 to their designated point of contact.

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| --- | --- | --- | --- | --- |
| ***Country*** | ***Organisation*** | ***Contact name*** | ***Phone number*** | ***E-mail address*** |
| Italia | OIC | Roberta Luly | +39-06-6976681 | rluly@fondazioneoic.it |
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## Outline of the questionnaire

1. This questionnaire has been structured as follows:
   * Part 1: General questions about the participating company and contact details
   * Part 2: Application to trade receivables and lease receivables
   * Part 3: Application to financial instruments not covered by the simplified approach
   * Part 4: Other questions applicable to all financial instruments in part 2 and 3
   * Part 5: Modifications and write-offs
   * Part 6: Assessing the impact and costs of the proposed impairment model
2. We appreciate that it might be difficult to respond to some of the questions, as you may not have collected all the necessary information. We ask you to respond only to those parts in the questionnaire that are applicable in your circumstances and for which you have the information, and indicate whether a question is not applicable (‘NA’) or whether it is applicable but the relevant information is not available (‘Information not available’).
3. The purpose of this field test is to gain an understanding of the impact of IFRS 9 on the measurement of expected credit losses of financial assets. We believe that our analysis and conclusions of the field tests will be improved if substantiated with facts. Consequently we would ask that responses are substantiated with facts.

## Timetable

1. Respondents will have seven weeks to carry out the field-test exercise. However, EFRAG staff will endeavour to include in the analysis as many questionnaires received subsequently as possible. In doing so EFRAG staff needs to take into account the timely submission of the results of the exercise to Boards of the national standard setters and EFRAG TEG, on average three weeks after the end of the field-test exercise.
2. For consistency purposes, EFRAG staff will perform the analysis of the questionnaires which should be finalised within two weeks after the end of the field-testing period.

## Workshops

1. In addition to this questionnaire, EFRAG and the National Standard Setters will organise workshops to discuss the written case studies and examples provided by participants in the field-test. These workshops will be organised in cooperation with the IASB. The workshops will be organised on an industry basis, provided that there are a sufficient number of participants. The case studies are to summarise the participants’ findings from applying the Exposure Draft to real-life situations. The workshops will offer the possibility to discuss the findings with peers in the same industry and the IASB and to improve the understanding of the proposals.
2. If you are interested in participating to these workshops, please contact your designated point of contact as mentioned in paragraph 10 and provide us with the written case studies you would like to see addressed.

## Coordination with the IASB outreach

1. In setting up this field-test exercise, EFRAG and the National Standard Setters have coordinated with IASB-staff in order to avoid creating overlap in their respective outreach activities. The IASB will organise a separate field-test with participants world-wide.
2. The IASB’s field-test exercise will take as a starting point a number of predefined economic scenarios that participants should take into account in applying the requirements of the ED. This is similar to, but more detailed than, the questions 18 and 19 in this field-test. There is no other overlap between both field-test exercises.
3. Respondents to this field-test who will also participate to the field-test exercise organised by the IASB are invited to send the results of the simulation performed for that exercise to their designated point of contact as mentioned in paragraph 10.

**Questionnaire**

**PART 1: GENERAL QUESTIONS AND CONTACT INFORMATION**

1. Please provide the following details about your company:
   * Name of the group with IFRS consolidated financial statements
   * Country where the parent company is located.
   * Size of the company: total balance sheet, total sales, total net income, net interest income, number of employees (please indicate the date of reference)
   * Main activities carried out by the company

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1. Contact details including email address:

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1. Please indicate the relative importance of the gross carrying amounts of the following portfolios in terms of total assets at the date the assessment was done.

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| *Notes:*   * + 1. *The breakdown specified below is to be used accordingly in answering the questions 14, 16, 17, 24, 25 and 32.*     2. *The categories (a) to (e) listed below have been based on the exposure classes defined in the Capital Requirements Directive (Directive 2006/48 of 14 June 2006) relating to the taking up of the business and the pursuit of the business of credit institutions. These exposure classes also include contingent claims. However, for the purpose of this field-test, the contingent claims are to be reflected in category (j) below.*     3. *Not all of the exposure classes as defined in the Capital Requirements Directive have been reflected. Those exposure classes should be reported in category (f) below. Category (g) reflects the total of all loans. This total excludes financial instruments reported in categories (h) to (m).*     4. *The categories (h) to (m) have been based on the Exposure Draft.*     5. *In category (h) those debt securities are to be reported where use is made of external ratings to estimate the shortfall in expected cash flows. In category (i) those debt securities are to be reported where use is made of internal ratings to estimate the shortfall in expected cash flows.*     6. *In answering the questions, participants are asked to apply the requirements proposed in the impairment ED only to financial assets that are to be measured at amortised cost or FV-OCI in accordance with IFRS 9.* |

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| *Type of portfolio* | *Relative importance (%)* |
| a) Loans to local, regional and central governments |  |
| b) Loans to corporates |  |
| c) Loans secured on real estate property |  |
| d) Retail loans (loans to individual persons or small and medium sized companies with a total exposure lower than €1 million) |  |
| e) Loans to credit institutions and investment firms |  |
| f) Other loans |  |
| g) Total loans |  |
| h) Investment (making use of external ratings) |  |
| i) Investment ( making use of internal ratings) |  |
| j) Financial guarantees and loan commitments |  |
| k) Purchased or originated credit impaired assets |  |
| l) Lease receivables |  |
| m) Trade receivables |  |

1. Please indicate the current status of your internal assessment on the new requirements on impairment in IFRS 9.

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**PART 2: APPLICATION TO TRADE RECEIVABLES AND LEASE RECEIVABLES**

1. Are the requirements in the Exposure Draft regarding the application of the simplified approach clear? If not, please explain why.

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1. The Exposure Draft permits a simplified approach for lease receivables and trade receivables with a significant financing component. For these assets the loss allowance will always be measured at lifetime expected credit losses, so an entity would not need to assess changes in credit quality. Is the simplified approach necessary to apply the expected credit losses model to those assets? Please explain.

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1. Do the requirements for trade receivables and lease receivables reflect in an appropriate way how you manage these receivables for credit risk management purposes? Please explain why.

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1. Did you identify any operational or other difficulties you would encounter in estimating the lifetime or the ‘12-month expected credit loss’ where applicable? If so, please explain.

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1. Could you please describe for the following receivables what other indicators and information you intend to use to assess whether the recognition of lifetime expected credit losses is justified?

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| Lease receivables |
|  |
| Trade receivables |
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1. As an accounting policy choice, the ED allows entities to elect at initial recognition, any reasonable rate that is between (and including) the risk free rate and the effective interest rate in adjusting expected credit losses to reflect the time value of money. Could you please indicate how you would determine the discount rate to be used for lease receivables and trade receivables and the reason for that election? Insofar you would not use the effective interest rate, please describe what the difficulties are in doing so.

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**PART 3: APPLICATION TO FINANCIAL INSTRUMENTS NOT COVERED BY THE SIMPLIFIED APPROACH**

**General credit deterioration approach**

1. Are the requirements in the Exposure Draft regarding the general model including when to measure the ‘12-month expected credit loss’ and the ‘lifetime expected credit loss’ clear when applied to financial assets other than those covered by the simplified approach? If not, please explain why.

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1. Does an approach that recognises a loss allowance at an amount equal to a portion of expected credit losses initially, and lifetime expected credit losses only after significant deterioration in credit quality, reflects how you manage your portfolios of financial assets? Please explain.

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1. Did you identify any operational difficulty (for example is the information related to the credit risk at initial recognition available) to track the credit quality of the following portfolios in assessing whether the probability of default has increased significantly since initial recognition? If so, please explain.

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| *Type of portfolio* |
| a) Loans to local, regional and central governments |
|  |
| b) Loans to corporates |
|  |
| c) Loans secured on real estate property |
|  |
| d) Retail loans (loans to individual persons or small and medium sized companies with a total exposure lower than €1 million) |
|  |
| e) Loans to credit institutions and investment firms |
|  |
| f) Other loans |
|  |
| g) Total loans |
|  |
| h) Investment ( making use of external ratings) |
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| i) Investment ( making use of internal ratings) |
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| j) Financial guarantees and loan commitments |
|  |
| k) Purchased or originated credit impaired assets |

1. The Exposure Draft defines a ‘12-month expected credit loss’ and a ‘lifetime expected credit loss’ measurement objective. Did you identify any operational difficulty you would encounter in applying the above definitions? If so, please explain why.

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1. The ED requires that irrespective of the change in the probability of default since initial recognition, a lifetime expected credit loss is not recognised when that probability is low. A financial asset has a low probability of default occurring (i.e. low credit risk) if default is not imminent but adverse economic conditions or changing circumstances may lead to weakened capacity of the borrower to meet its contractual cash flow obligations on the financial asset. For example, if the credit quality is equivalent to ‘investment grade’. Could you please explain:
   * 1. Whether or not the above definition is clear and operational?
     2. Whether or not the above definition is applicable for all types of portfolios under the general model?
     3. The level of credit risk according to your credit risk management that justifies the recognition of lifetime expected credit losses for the following portfolios?

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| *Type of portfolio* |
| a) Loans to local, regional and central governments |
|  |
| b) Loans to corporates |
|  |
| c) Loans secured on real estate property |
|  |
| d) Retail loans (loans to individual persons or small and medium sized companies with a total exposure lower than €1 million) |
|  |
| e) Loans to credit institutions and investment firms |
|  |
| f) Other loans |
|  |
| g) Total loans |
|  |
| h) Investment (making use of external ratings) |
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| i) Investment ( making use of internal ratings) |
|  |
| j) Financial guarantees and loan commitments |
|  |
| k) Purchased or originated credit impaired assets |

1. The Exposure Draft describes the information and factors entities may consider to assess whether lifetime expected credit losses should be recognised. Could you please describe for the following portfolios the indicators you intend to use in making the above assessment?

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| *Type of portfolio* |
| a) Loans to local, regional and central governments |
|  |
| b) Loans to corporates |
|  |
| c) Loans secured on real estate property |
|  |
| d) Retail loans (loans to individual persons or small and medium sized companies with a total exposure lower than €1 million) |
|  |
| e) Loans to credit institutions and investment firms |
|  |
| f) Other loans |
|  |
| g) Total loans |
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| h) Investment ( making use of external ratings) |
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| i) Investment ( making use of internal ratings) |
|  |
| j) Financial guarantees and loan commitments |
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| k) Purchased or originated credit impaired assets |

1. The Exposure Draft permits entities to use a rebuttable presumption that the probability of default has increased significantly since initial recognition when payments are more than 30 days past due if no other borrower specific information is available without undue cost or effort prior to delinquency. Could you please explain:
   * 1. Did you identify any potential operational difficulty you would encounter in applying the above requirement?
     2. Whether you manage your portfolios on a delinquency basis? If so, does the 30-day rebuttable presumption appropriately reflect when there is a significant increase in credit risk for these receivables? Do you use different thresholds for different types of loans?

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1. Based on your analysis how would the proposed impairment model behave in a deteriorating economic environment? Please explain the assumptions you make in answering to this question.

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1. Based on your analysis how would the proposed impairment model behave in a positive economic environment with strongly growing portfolios? Please explain the assumptions you make in answering to this question.

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1. Based on your analysis, how does the responsiveness to changes in credit quality of the proposed impairment model compare to IAS 39? Please explain why.

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**PART 4: OTHER QUESTIONS APPLICABLE TO ALL FINANCIAL INSTRUMENTS IN PART 2 AND 3**

1. Are the requirements in the Exposure Draft regarding purchased or originated credit impaired financial assets clear? If not, please explain why?

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1. The Exposure Draft requires an entity to include the lifetime expected credit losses in the estimated cash flows when calculating the effective interest rate for purchased or originated credit impaired financial assets on initial recognition. Did you identify any operational difficulties you would encounter in making the above estimate? If so, please explain.

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**Basis of estimate of expected credit losses**

1. Could you please provide a brief description of the estimation techniques or practical expedients you intend to use to determine expected credit losses for the following portfolios and the reason for that election?

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| *Type of portfolio* |
| a) Loans to local, regional and central governments |
|  |
| b) Loans to corporates |
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| c) Loans secured on real estate property |
|  |
| d) Retail loans (loans to individual persons or small and medium sized companies with a total exposure lower than €1 million) |
|  |
| e) Loans to credit institutions and investment firms |
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| f) Other loans |
|  |
| g) Total loans |
|  |
| h) Investment ( making use of external ratings) |
|  |
| i) Investment ( making use of internal ratings) |
|  |
| j) Financial guarantees and loan commitments |
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| k) Purchased or originated credit impaired assets |
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| l) Lease receivables |
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| m) Trade receivables |
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**Time value of money**

1. As an accounting policy choice, the Exposure Draft allows entities to elect at initial recognition, any reasonable rate that is between (and including) the risk free rate and the effective interest rate in adjusting expected credit losses to reflect the time value of money. Could you please indicate how you would determine the discount rate to be used and the reason for that election for the following portfolios? Insofar you would not use the effective interest rate, please describe what the difficulties are in doing so.

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| *Type of portfolio* |
| a) Loans to local, regional and central governments |
|  |
| b) Loans to corporates |
|  |
| c) Loans secured on real estate property |
|  |
| d) Retail loans (loans to individual persons or small and medium sized companies with a total exposure lower than €1 million) |
|  |
| e) Loans to credit institutions and investment firms |
|  |
| f) Other loans |
|  |
| g) Total loans |
|  |
| h) Investment ( making use of external ratings) |
|  |
| i) Investment ( making use of internal ratings) |
|  |
| j) Financial guarantees and loan commitments |
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| k) Purchased or originated credit impaired assets |

**Disclosures**

1. Do you have any comments or concerns regarding the proposed disclosure requirements in the Exposure Draft? If so, please explain.

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**Effective date and transition**

1. Do the transition requirements give rise to any operational concerns? If so, please explain.

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**Other issues**

1. Does the Exposure Draft give rise to any other significant operational issues that you would like to comment on?

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**PART 5: MODIFICATIONS AND WRITE-OFFS**

1. The Exposure Draft requires for modified financial assets the recalculation of the gross carrying amount on the basis of the renegotiated or modified contractual cash flows and the recognition of a modification gain or loss in profit or loss. Did you identify any operational difficulties you would encounter in applying these requirements?

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1. The Exposure Draft requires an entity to reduce the gross carrying amount of a financial asset directly when an entity has no reasonable expectations of recovery. The Exposure Draft also specifies that a write-off constitutes a derecognition event. Did you identify any operational difficulties you would encounter in applying these requirements?

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**PART 6: ASSESSING THE IMPACT AND COSTS OF THE PROPOSED IMPAIRMENT MODEL**

1. Do you have access to data to update the historical loss information to reflect current conditions and reasonable and supportable forecasts of future events and economic conditions?

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1. The Exposure Draft requires the recognition of a ‘12-months expected credit loss’ on initial recognition for all financial assets subject to the general deterioration approach which could result in a day-one loss. Please indicate whether this amount is significant compared to your current impairment allowance under IAS 39.

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1. Could you please compare, as of the date of 31 December 2012, the total allowance for your portfolios under the ED to the allowance amount under IAS 39? In doing so, please indicate for each portfolio, whether you have used the relief provided for in the transition requirements.

|  | relief | lower | | higher | | | | |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Type of portfolio | Y/N | >25% | 0-25% | 0-25% | 25-50% | 50-75% | 75-100% | >100% |
| Loans to local, regional and central governments |  |  |  |  |  |  |  |  |
| Loans to corporates |  |  |  |  |  |  |  |  |
| Loans secured on real estate property |  |  |  |  |  |  |  |  |
| Retail loans |  |  |  |  |  |  |  |  |
| Loans to credit institutions and investment firms |  |  |  |  |  |  |  |  |
| Other loans |  |  |  |  |  |  |  |  |
| Total loans |  |  |  |  |  |  |  |  |
| Debt securities ( making use of external ratings) |  |  |  |  |  |  |  |  |
| Debt securities ( making use of internal ratings) |  |  |  |  |  |  |  |  |
| Purchased or originated credit impaired assets |  |  |  |  |  |  |  |  |
| Lease receivables |  |  |  |  |  |  |  |  |
| Trade receivables |  |  |  |  |  |  |  |  |
| Financial guarantees and loan commitments |  |  |  |  |  |  |  |  |

Please provide further comments

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**Overall assessment**

1. To which extent did you rely on the initial credit quality at recognition in doing your analysis? Please explain:

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1. How does the expected credit losses model improve your ability to build an expected credit losses allowance/provision for your portfolios, compared to the Exposure Draft Financial Instruments: Amortised Cost and Impairment (the “2009 ED”). Please provide further comments.

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1. Do the requirements reflect fairly the performance of your lending and investing portfolios over time? If not, please explain why.

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1. In applying the proposed impairment model to your portfolios, did you find the application guidance clear, operational and appropriate for all types of portfolios? If not, please explain why.

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1. Based on the results of your analysis, please indicate the main benefits of the new standard for you, when compared to IAS 39, or if you are applying the IFRS requirements on impairment for the first time:

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1. How would you rate the overall operational difficulty of applying the new requirements to the sample that you tested?

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|  | **Operational difficulty** | | |
|  | **High** | **Moderate** | **Low** |
| **Tracking credit quality** |  |  |  |
| **Estimating expected credit losses** |  |  |  |
| **Estimating probabilities of default and loss rates** |  |  |  |
| **Significant credit deterioration criterion** |  |  |  |
| **30-day past due rebuttable presumption** |  |  |  |
| **Investment grade practical expedient** |  |  |  |
| **Access to sufficient data** |  |  |  |
| **Discounting expected credit losses** |  |  |  |
| **Disclosures** |  |  |  |
| **Transitional provisions** |  |  |  |

Please provide further comments

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1. Could you please provide an overview of the types of costs (and the amount of costs) that you would expect to incur to implement and apply the new requirements?

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| **Type** | **High / moderate / low** | **Explanations** |
| One-off costs |  |  |
| *On-going costs* |  |  |