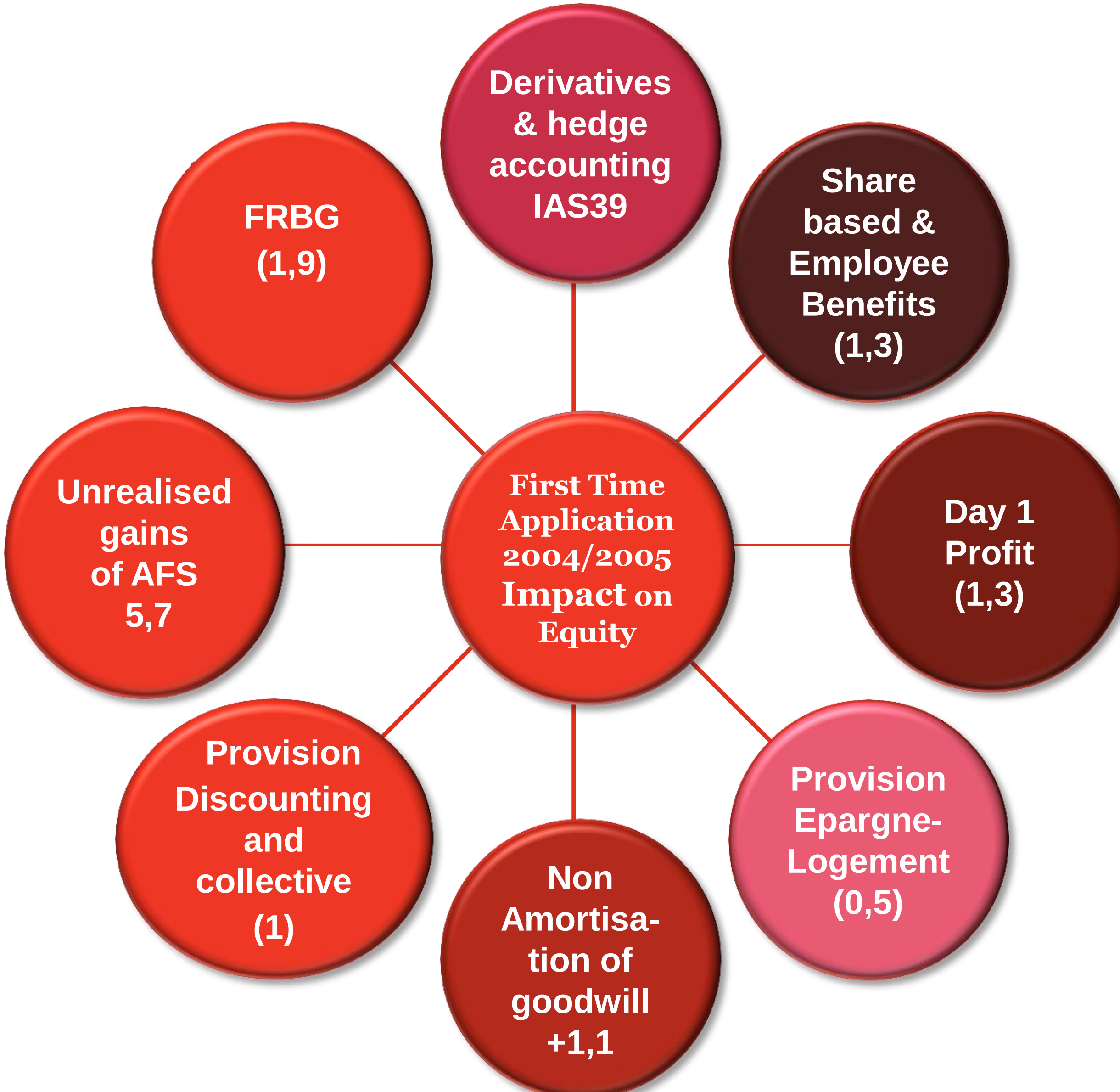
Actuarial techniques in IFRS

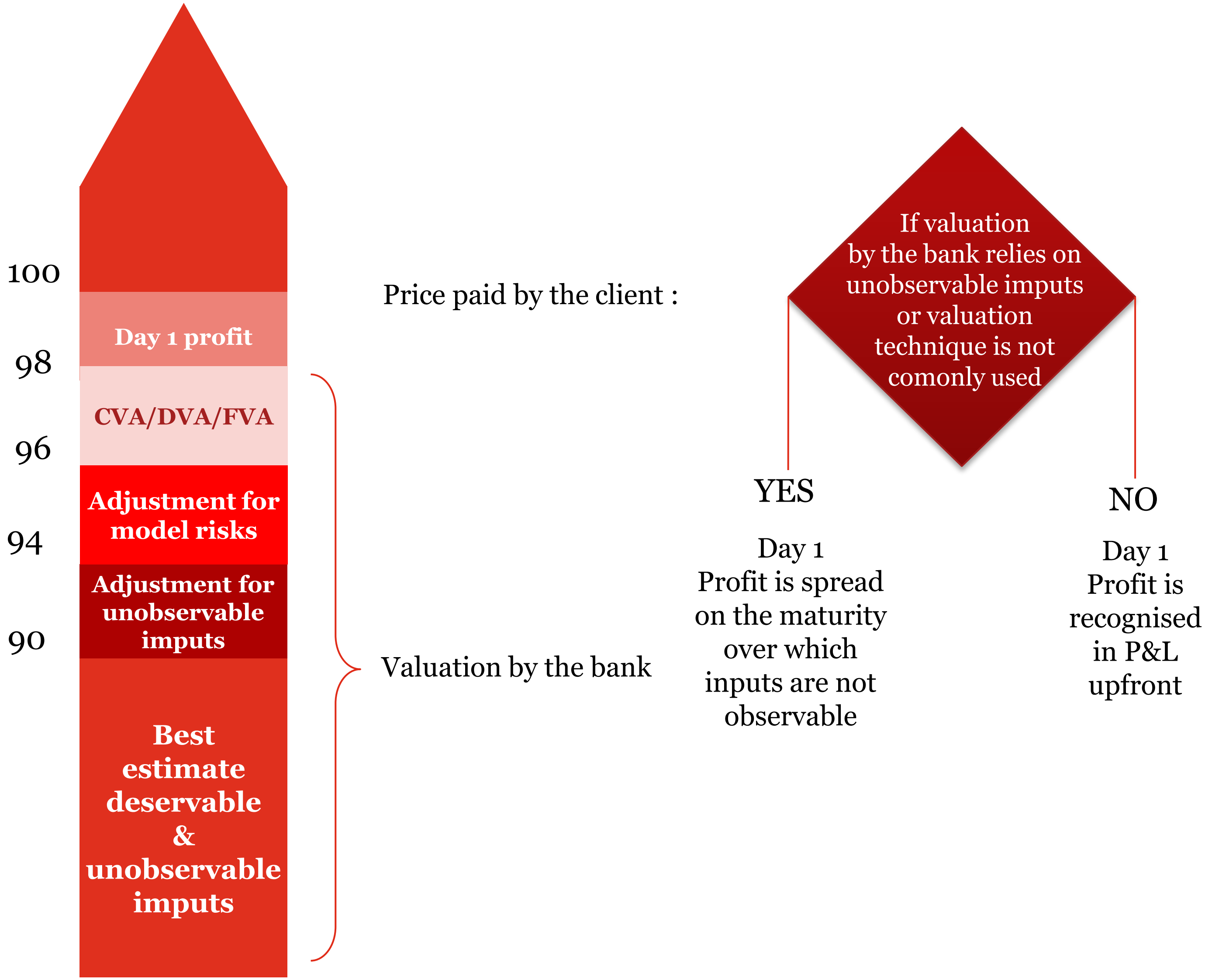
EEE – ESSEC February 16th, 2016

pwc

Impact of IFRS on Bank Equity in 2004/2005



Day one profit : complex structured issued note



IAS 39 2008 amendment: Reclassifications as a result of the financial crisis

Out of « Trading »

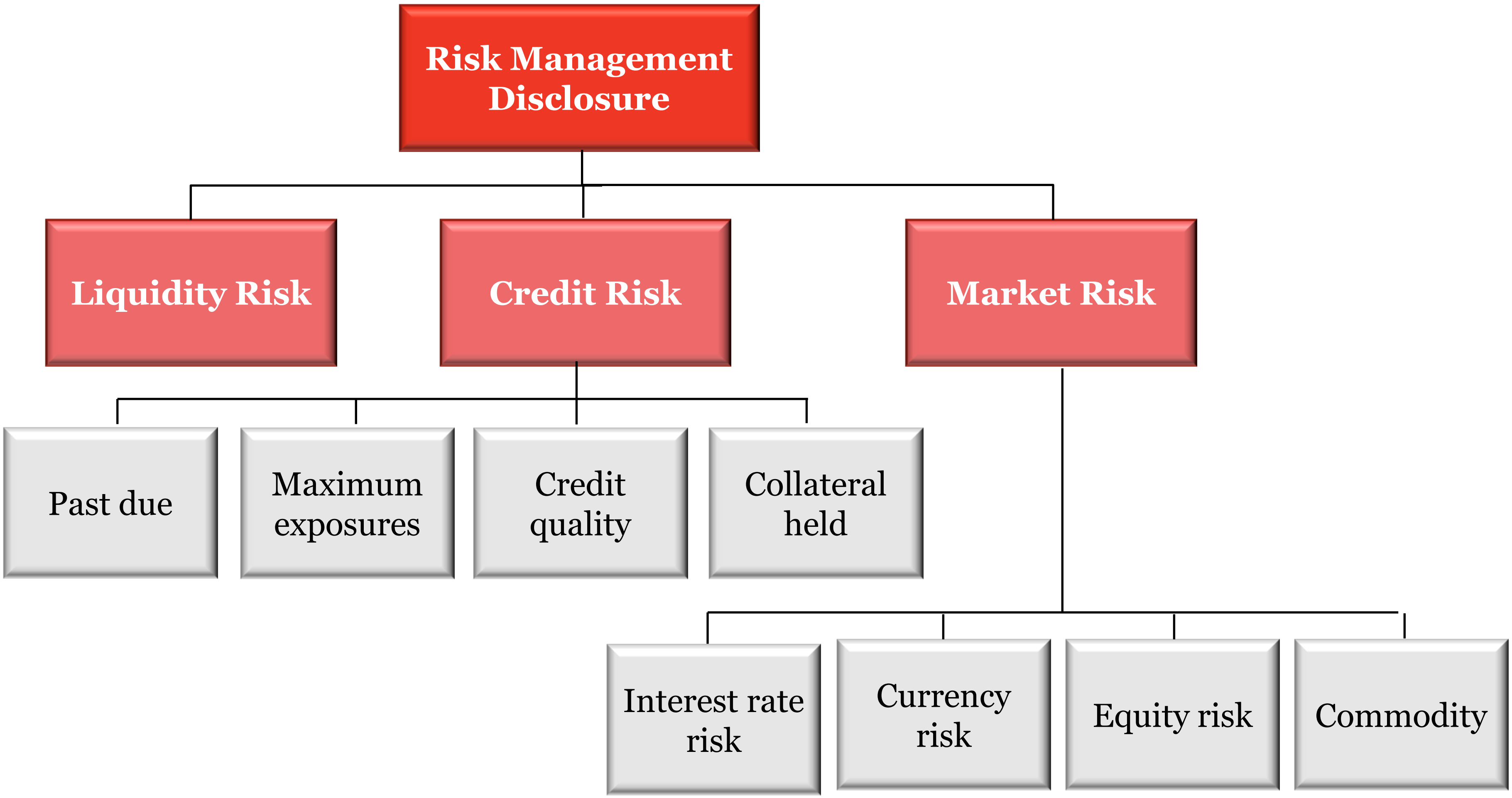
Out of « AFS»

If the asset meets loan classification at reclassification date → Ability and intention to hold until a forseable future (IAS 39.50 D)

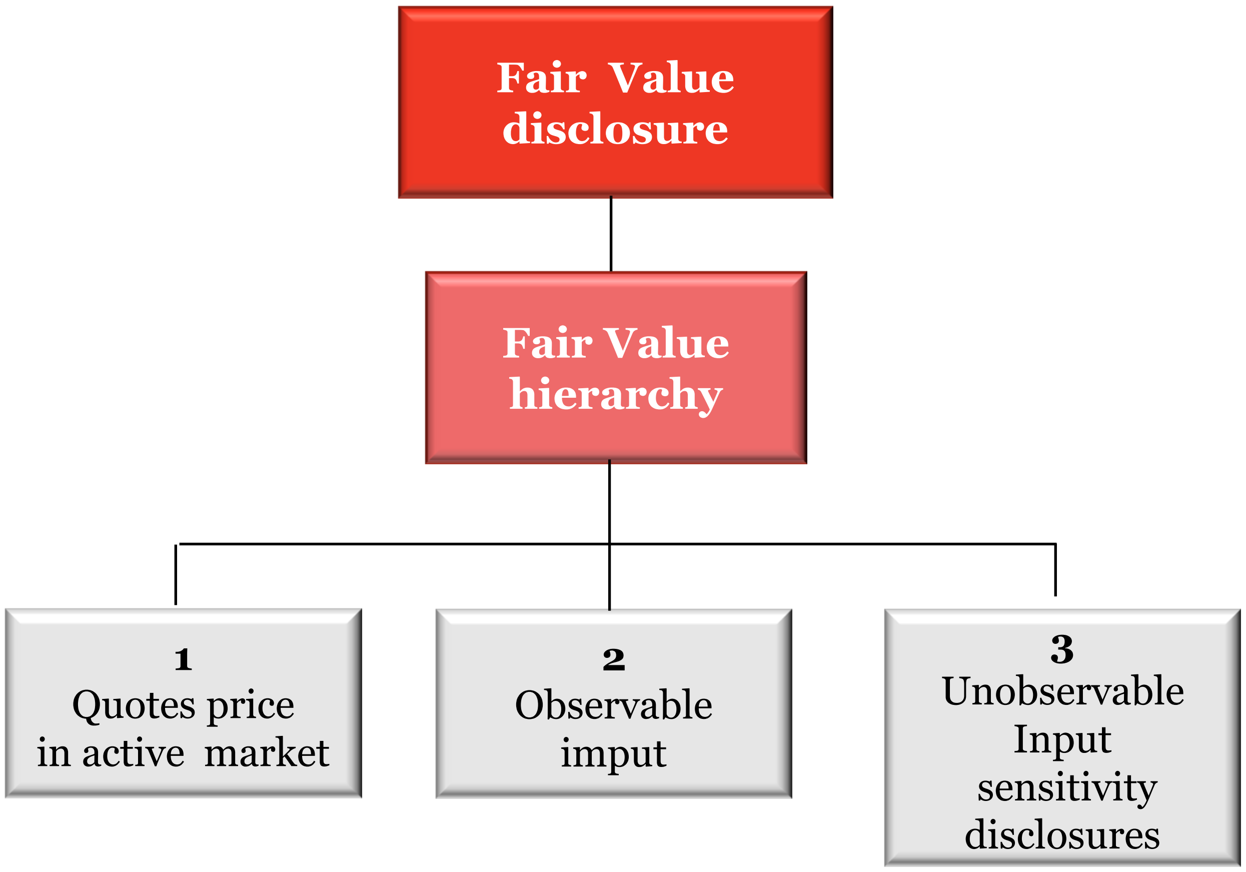
Or if(Other assets) (Equities or liquid assets) → Only in « rare » circumstances (IAS 39.50 B)

➡ More than 400 G€ of assets were reclassified which avoided 28 G€ of negative impact in OCI / P&L

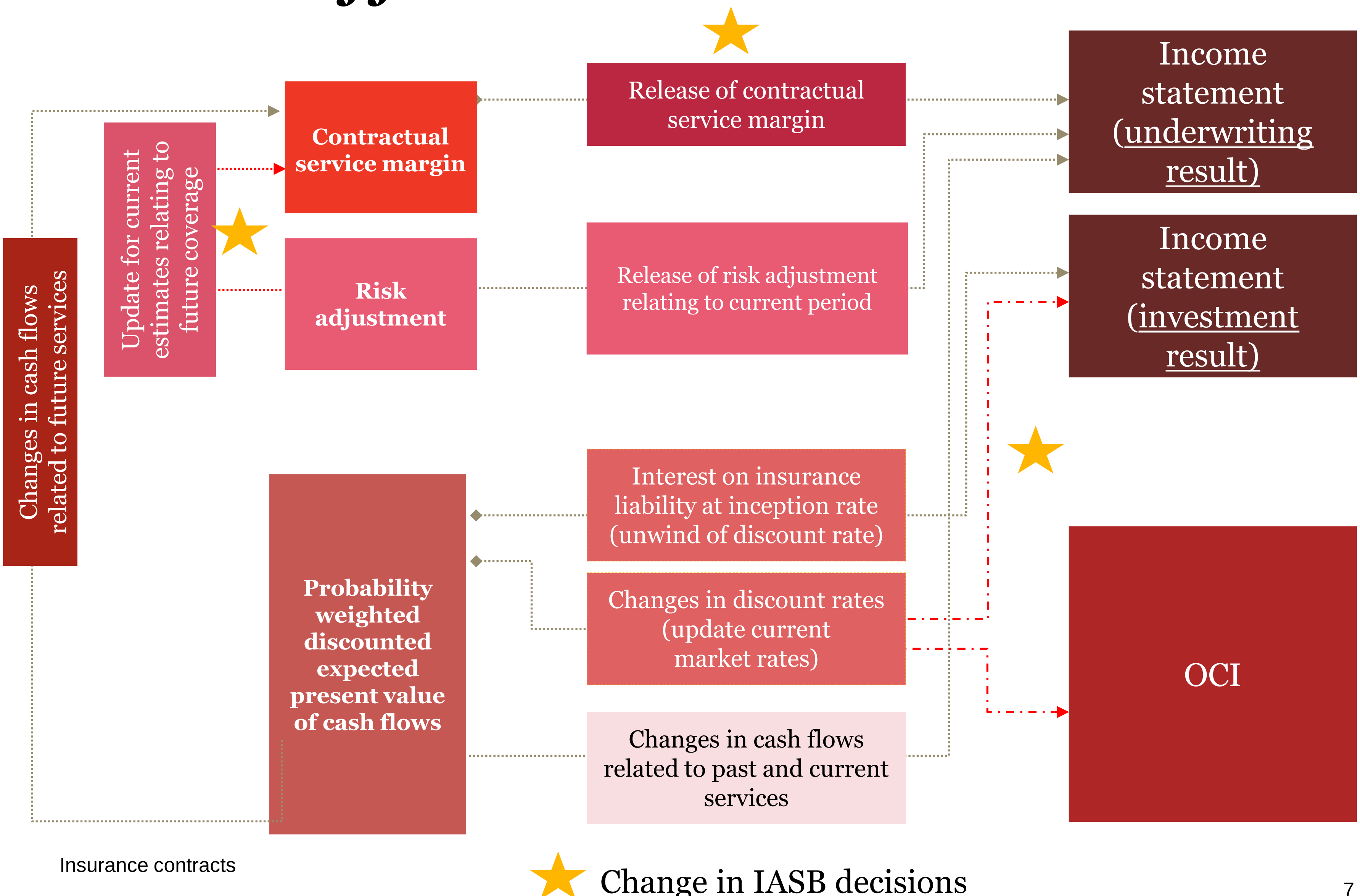
Risk Management disclosures (IFRS 7)



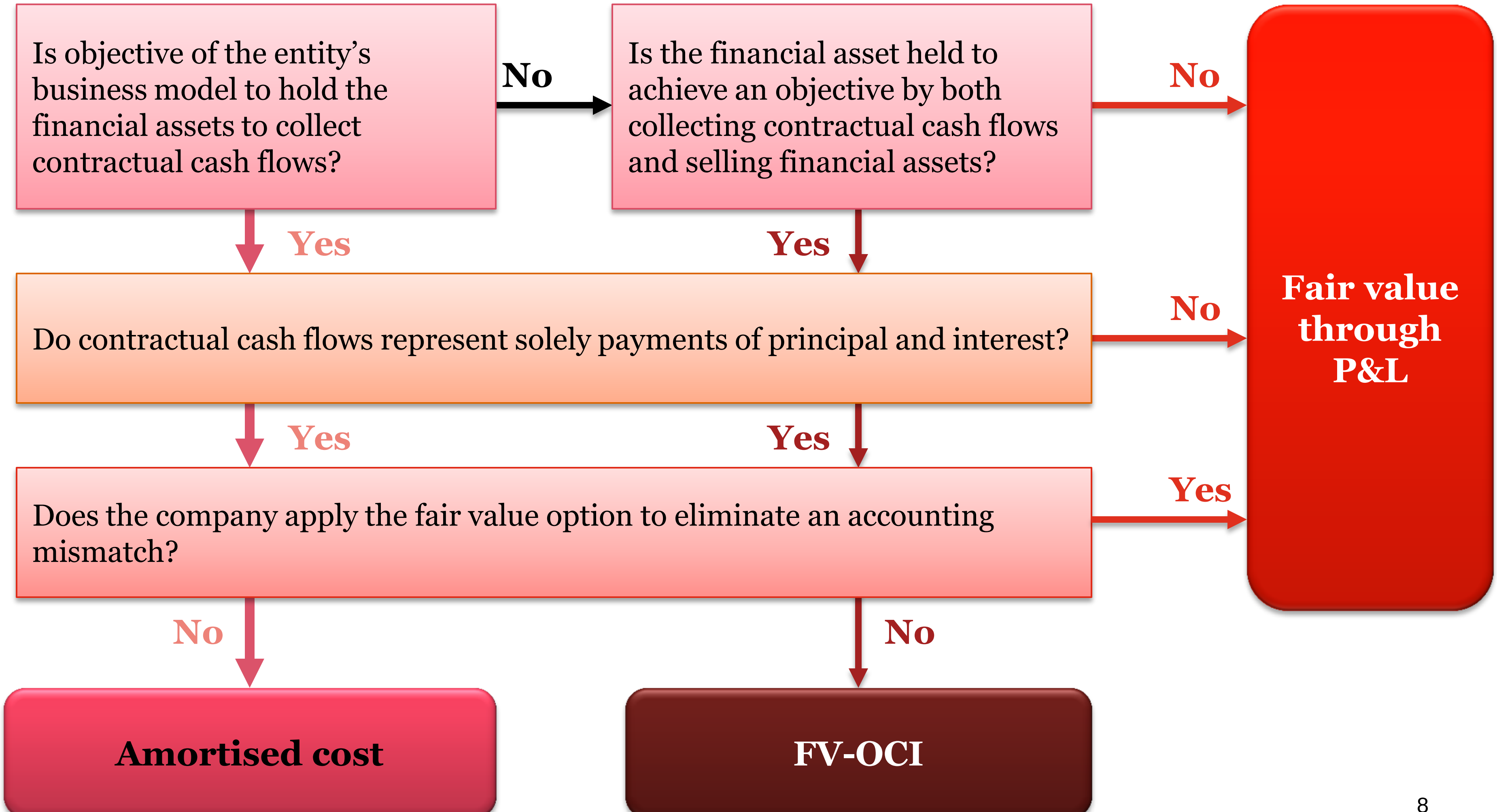
Fair Value disclosures (IFRS 7 & IFRS 13)



Overview of future insurance measurement model



IFRS 9 Classification & Measurement of debt instruments



IFRS 9 Classification & Measurement Equities

Equity instruments measured at FVTPL

Option to elect to measure at FVOCI if not held for trading

No subsequent recycling if measured at FVOCI but can be transferred within equity

Dividends continue to be recognised in P&L

Cost exemption for unquoted equity instruments removed

What it means ?

- **For banks**
  - *Opportunity to move assets from FVOCI to amortized cost (liquidity buffer)*
  - *Some unknown:*
    - *securitization / originate to distribute,*
    - *how the model will react to another liquidity crisis*

- **For Insurers**
  - Mutual funds & equities will move from FVOCI to FVP&L which will significantly increase P&L volatility
  - Intense lobby to align the effective date of both the financial instrument and the insurance standard

Hedge accounting: Why EU carved out was needed ?

Balance sheet in 2005			
Fixed rate mortgages	800	Equity	50
Flooting rate mortgages	200	Demand deposits	950
Total	1 000	Total	1 000
Fixed rate net position			
Fixed rate	800		
Equity	(50)		
Demand deposits	(950)		
Net position	(200)		
Hedged by swap	200	Received fixed rate	
	200	Pay floating rate	

CFH

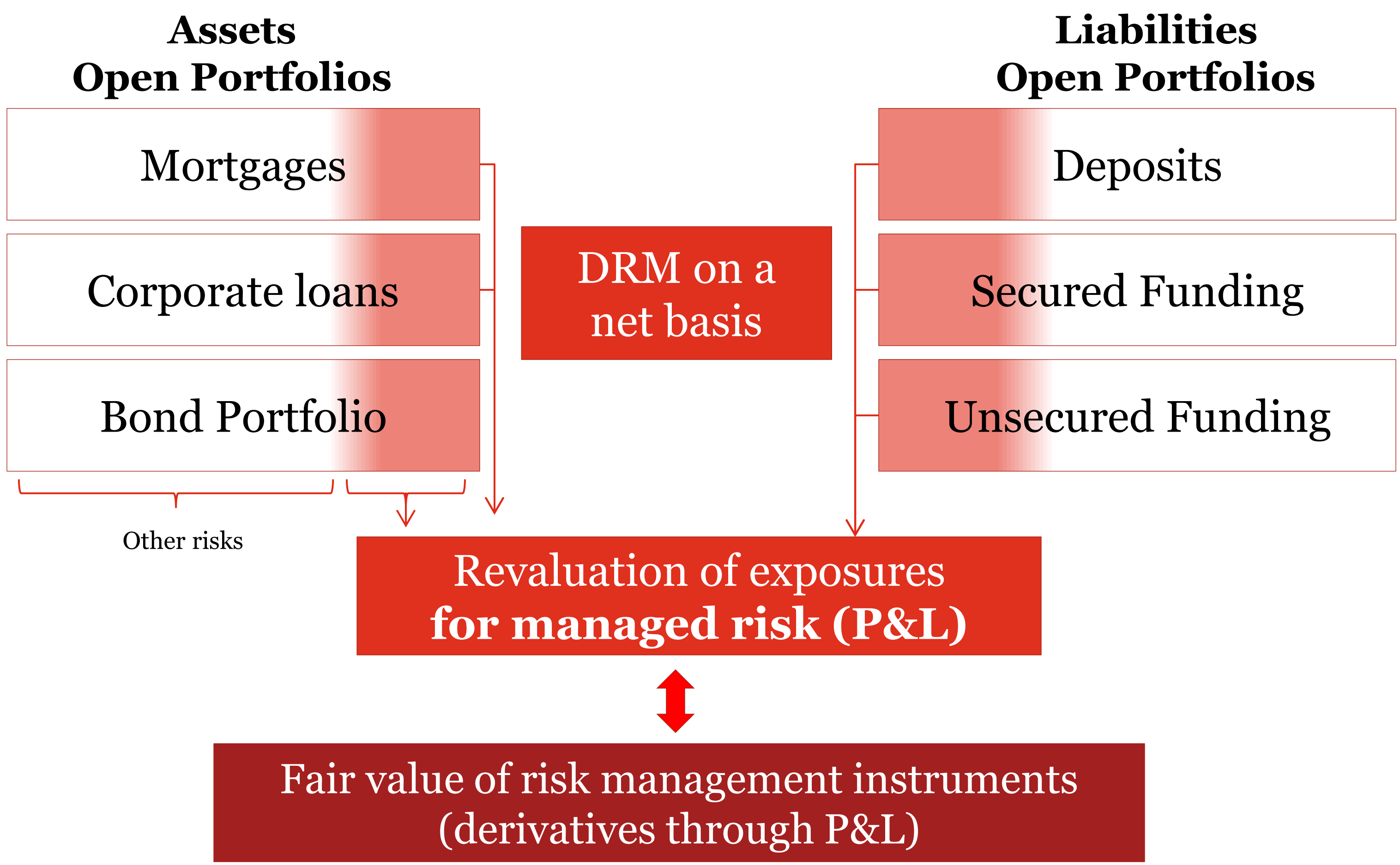
FVH

Precluded under IAS 39 as issued by IASB

Accepted under IAS 39 as endorsed by EU

Portfolio Revaluation Approach : Overview of the methodology… that was finally rejected

The DP explores the use of a Portfolio Revaluation Approach (PRA):



Impairment of assets : where do we come from ?

Current IAS 39 model

IAS 39 Effective yield: Gross EIR

Book value = discount value of contractual cash-flows using gross EIR

Book a loss only where an impairement trigger occurs

Loss
- Loss: discount value of expected future cash-flows using EIR
- AFS : Fair value

« Incurred but not reported »

IFRS 9 initial proposal

IAS 39 effective yield

Book value = discount value of expected cash-flows using net EIR

New net effective yield

Any subsequent changes to lifetime expected losses will go to P&L

IFRS 9 Impairment of financial assets

Change in credit quality since initial recognition

Stage 1	**Stage 2**	**Stage 3**
Performing (Initial recognition*)	*Underperforming* (Assets with significant increase in credit risk since initial recognition*)	*Non-performing* (Credit impaired assets)

Recognition of ECL

12 month ECL	Lifetime ECL	Lifetime ECL

Interest revenue

Effective interest on gross carrying amount	Effective interest on gross carrying amount	Effective interest on amortised cost carrying amount (i.e. net of credit allowance)

*except for purchased or originated credit impaired assets

$$EL\ \text{à maturité} = \int_0^M EAD(t) * dd(t) * LGD(t) * \frac{1}{(1+r)^t}\, dt$$

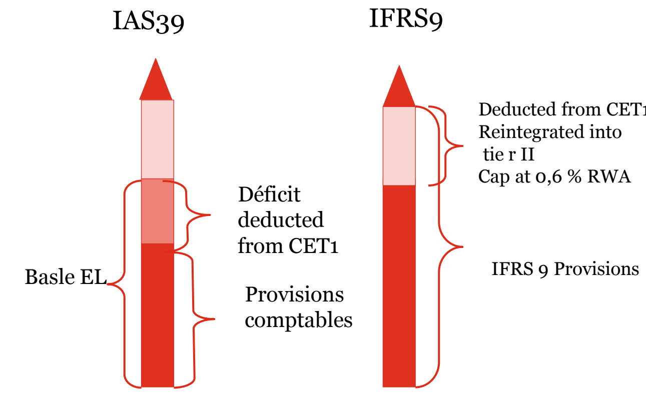
What it means ?

❑ *For banks*

Increase in provisioning *affecting solvency*

- FSB / G20 calls : *« Too little, too late »*

Provisions + Volatility



Decrease in CET1

Methodological Complexity

- ≠ Basle EL *(PIT parameters+ no conservatism+ prepayment+ behavior collateral+ forward looking)*

complexity

Need of specialists in credit modling

Disclosures

- Increase in transparent information

Move from a balance sheet exercice to a cash-flow exercise

High implementation costs

❑ *For Insurers*

- ❑ No impact on solvency ratios and no significant increase in provisioning
- ❑ … But significant implementation costs

Does it worth it ?

Thank You

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