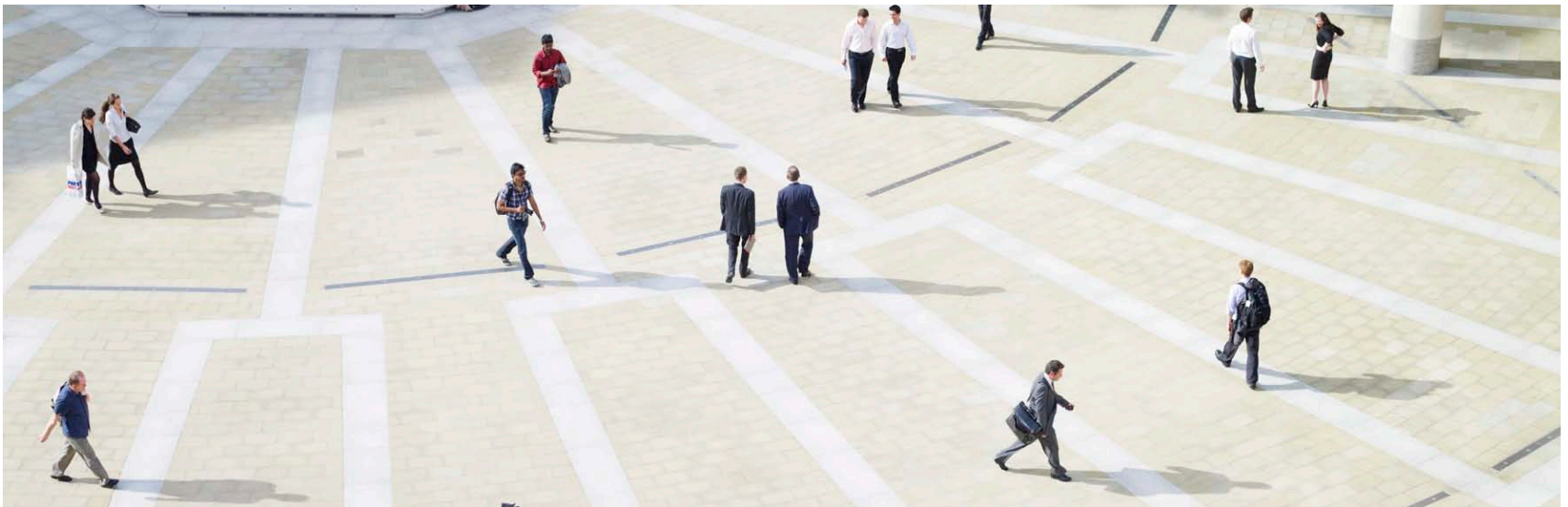


Banking & Capital Markets

Chand Kohli & John Bligh

Agenda

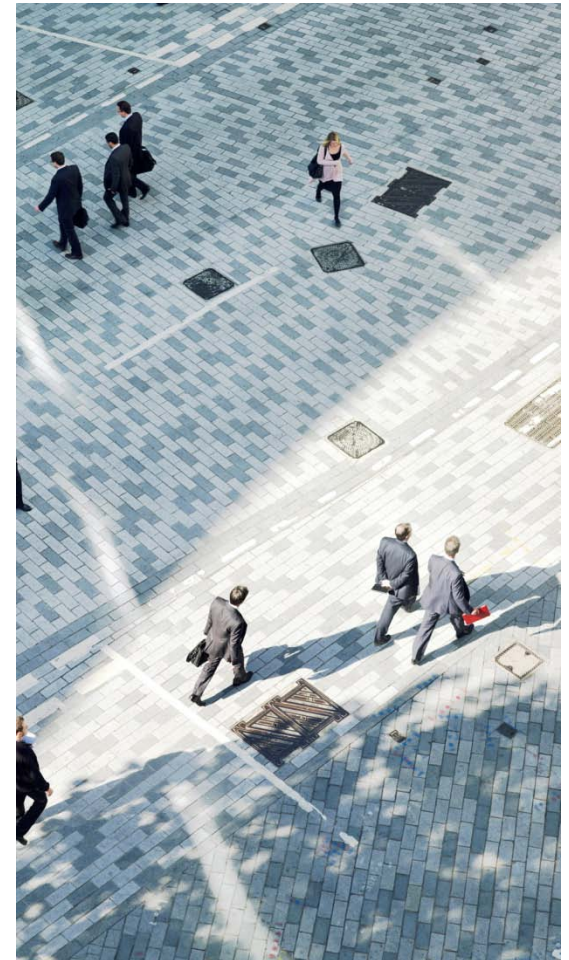
- *Financial Instruments – IFRS 9*
- *Disclosure – IFRS 7*
- *Regulatory Capital and Liquidity*



Financial Instruments

Where do things stand with IFRS 9?

- Three key parts
 - Classification and measurement
 - Impairment
 - Hedge accounting
- EU endorsement – only when package complete



IFRS 9 timelines

2015 projects	2009	2010	2011	2012	2013	2014	2015
Classification & measurement	◆ Standard issued						◆ Effective date - 1 Jan 2015
Impairment		Supplementary document issued	◆	◆ ED expected			◆ + Effective date TBC
Hedge Accounting			General standard expected	◆	◆ Macro ED expected		◆ + Effective date TBC

Key

IFRS comparatives

SEC comparatives – selected data

+ *Uncertainty around effective date, which may be post 2015*

Impairment

Reasons for change

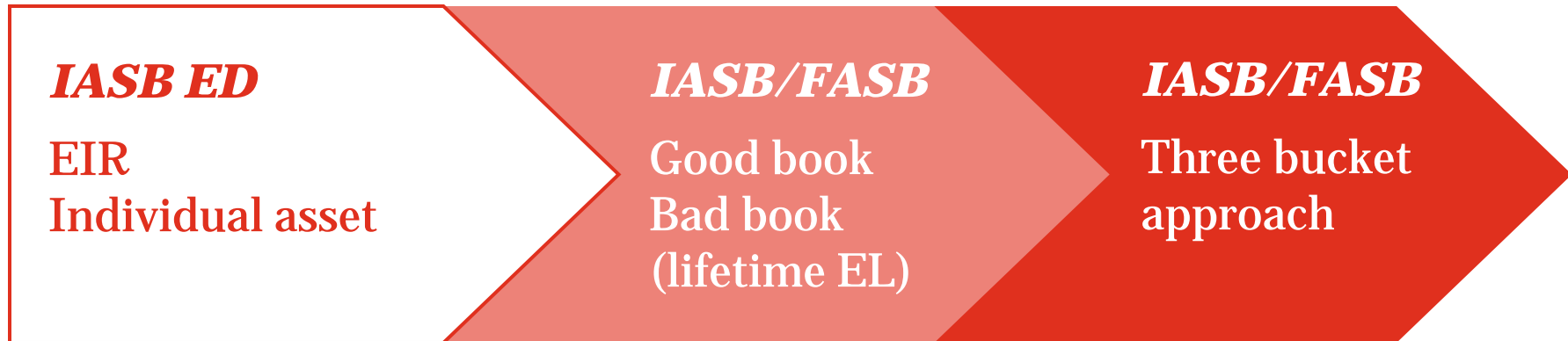
- IAS 39 incurred losses basis exacerbated financial crisis problems
- G20 recommendations in April 2009 – incorporate “broader range of credit information”
- Key issue – no consideration of expected losses (EL)
- Basel II regulatory capital basis – mandates consideration of EL over next 12 months

Key players

- IASB and FASB
- Expert Advisory Group
 - Bank finance teams / bank credit risk experts / regulators / standard setters

Impairment

Evolving approach



Drivers

- Full provision for future EL at B/S date versus rateably over life of loans
- Accounting theory versus operational practicality
- Need to increase absolute level of provisions!

Impairment

‘Three-bucket’ approach

Guiding principles:

“Reflect the general pattern of deterioration of credit quality of financial assets”

- Pattern of deterioration of credit quality is captured through a three-bucket approach
- Based on expected credit losses (EL)
- Responsive to changes in information impacting credit expectations
- Timing of recognition of EL depends on credit quality deterioration/level

Impairment

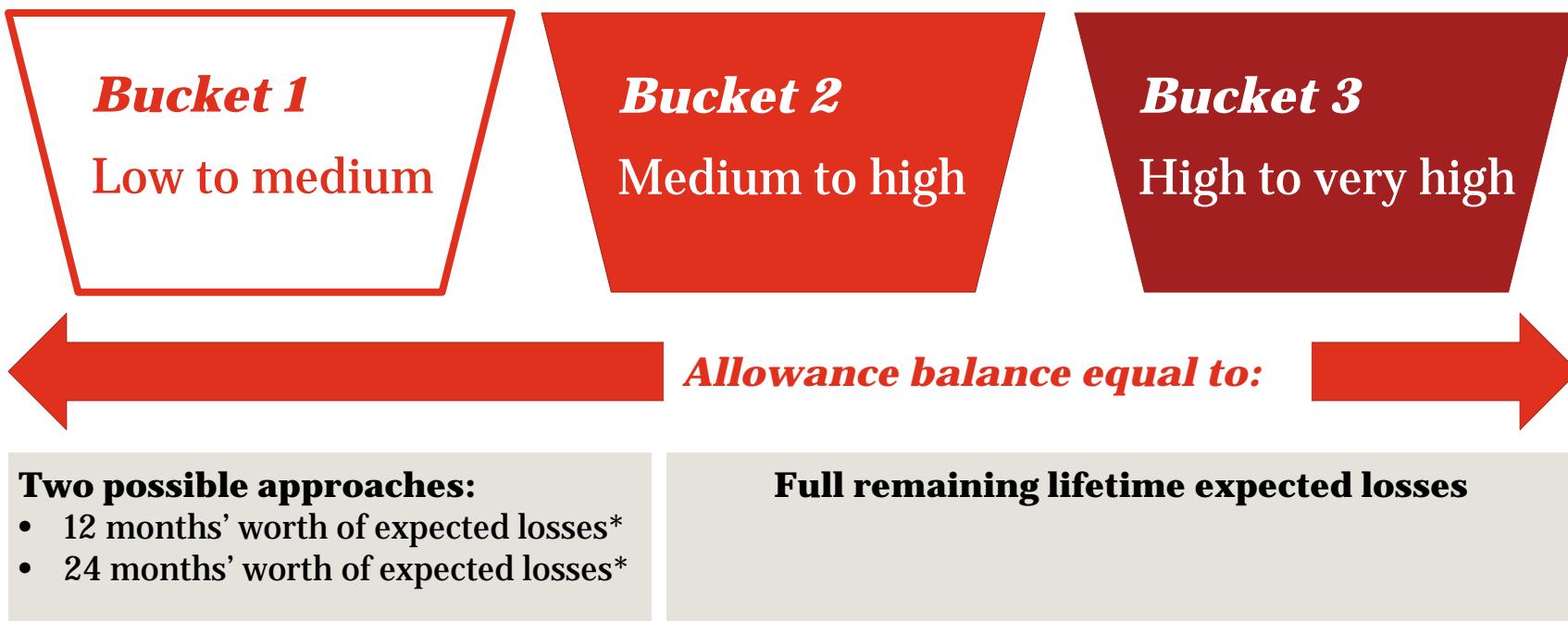
'Three-bucket' approach



- Internal credit categories need to be mapped to buckets
- Loans migrate up or down depending on change in credit quality/rating

Impairment

‘Three-bucket’ approach



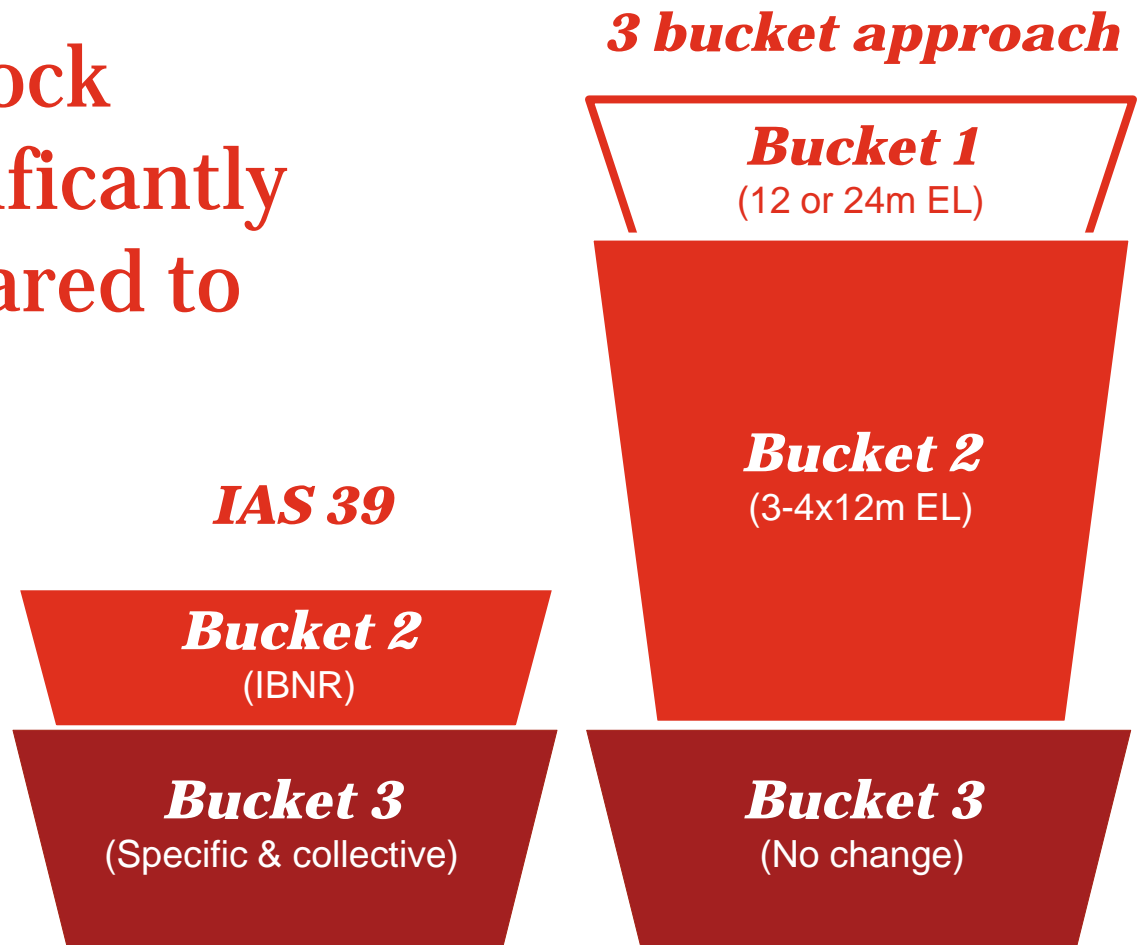
- **IASB / FASB have not yet decided on the measurement of Bucket 1 allowance**

* Can use loss rate basis for calculation

Impairment

‘Three-bucket’ approach

Impairment stock levels will significantly increase compared to today!



Impairment

‘Three-bucket’ approach



Issues / Next steps

- Where to draw the line
 - Bucket 1 versus bucket 2
 - Guidance on indicators
 - Measurement of lifetime EL
- Day 1 losses
 - Business combinations
 - Purchased loans
- Regulatory overlap / inter-action
- Disclosure – critical to transparency and comparability
- Outreach to discuss operational challenges

Impairment

'Three-bucket' approach

**Last chance to input to
debate...have your say!**

Hedge Accounting

Current Concerns

- Too rules based
- Unable to hedge non-financial risk components
- 80-125% hedge effectiveness requirement produces arbitrary results, e.g. 79% versus 81% effective hedges
- Difficult to explain hedging results to users
- P/L volatility from use of options as hedging instruments – time value
- Cannot hedge a net position – macro hedge accounting impractical

Hedge accounting

Key decisions to date

Effectiveness testing

- Remove the 80-125% bright line
- Objective based assessment – pass as long as “other than accidental”
- All ineffectiveness to be measured and reported in income statement
- Prospective assessment can be quantitative or qualitative

Macro hedge accounting

- Discussions ongoing – ED H1 2012

IFRS 7 Disclosures

Credit Risk

Maximum exposure to credit risk

These apply

Not required if carrying amount represents maximum exposure

Disclosure of possessed collateral

year-ends!

Only if held at the reporting date

Renegotiated financial assets that would otherwise be past due or impaired

No longer required

Fair value of collateral

Financial effect of collateral

www.pwc.com/ie

Regulatory Capital and Liquidity

John Bligh

The Credit Crunch

Was Capital the problem?

Capital Ratios before default* *(minimum requirement 8%)*

Northern Rock (December 2006)	<i>17.5%</i>
Washington Mutual (June 2008)	<i>14.0%</i>
Lehmans (H1 2008)	<i>c.10%</i>
Wachovia (September 2008)	<i>12.2%</i>
Anglo Irish Bank (September 2008)	<i>12.0%</i>

** Last published total capital % ratio before default or government rescue/Basel I basis*

The Regulatory Response

Capital Requirements Directive IV (BASEL III)

Improve

Capital quality

Recalibrate

Risk weighting of assets

Increase

Capital ratios

Introduce

Leverage ratio

Introduce

Liquidity ratios

Improve

Governance & supervision

Capital Quality

Basel II					
	Deferred Tax Assets				
	Negative AFS Reserves				
	Pension Deficit in OCI				
	Minority interests/Invest in Fin Inst				
	Preferred stock				
Basel III					

Available capital decline depends on capital structure

Less **available capital** through stricter definition of capital with greater deductions that emphasize stronger quality

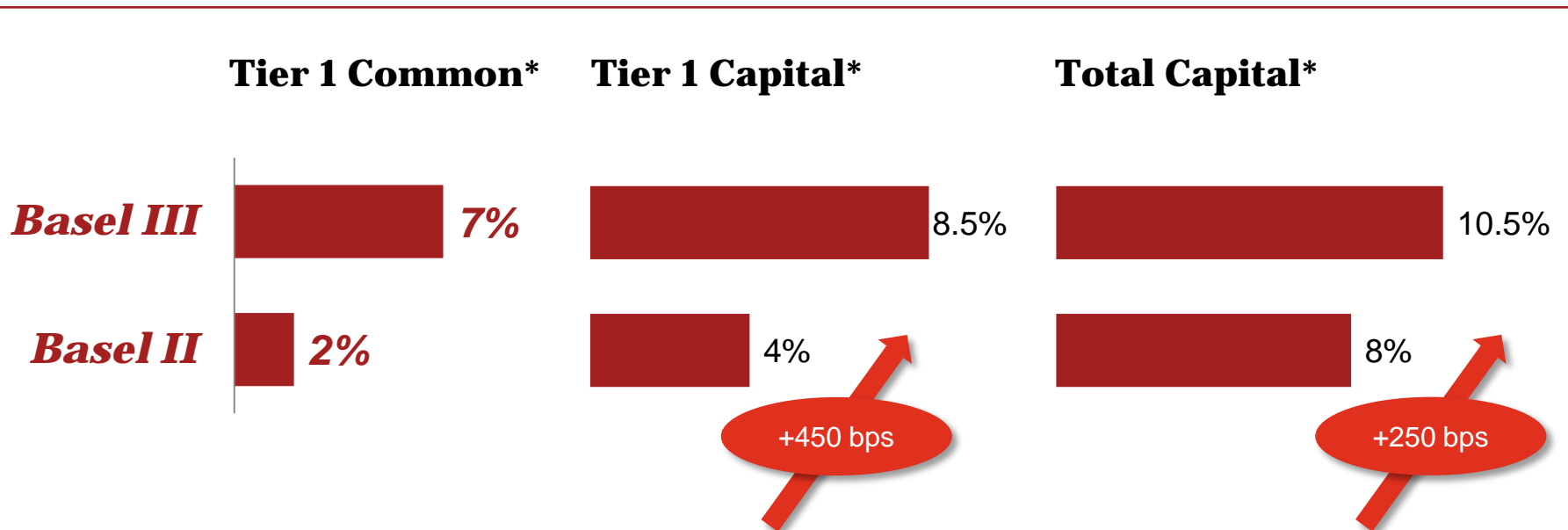
Higher Risk Weighting of Assets



Higher **RWA requirements** to better capture risks related to trading, securitisation, and counterparty exposures

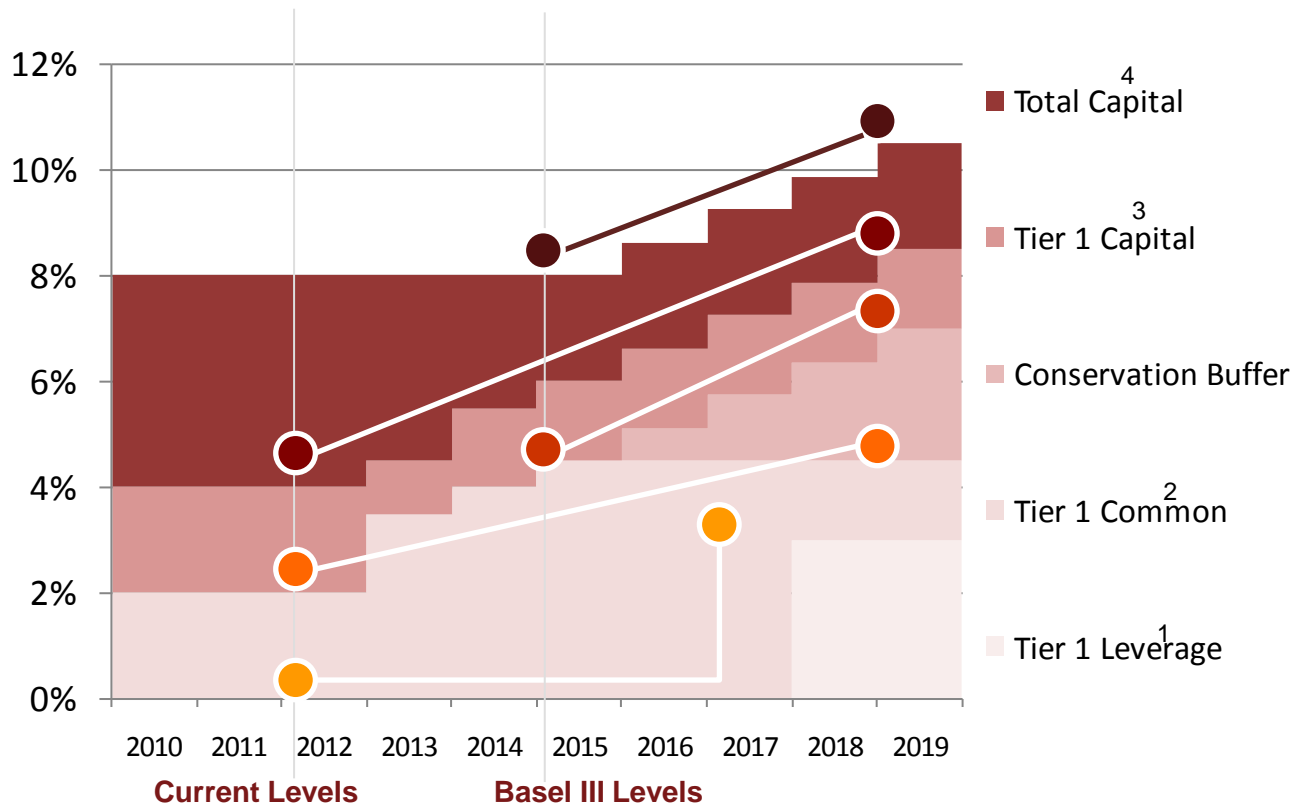
Higher capital ratio requirements

Significant increases in minimum required capital ratios



* Includes conservation buffer, but does not include a 0%–2.5% countercyclical buffer.

Capital Ratios and Targets



Minimum Ratios		Transition Period
Current	Basel III*	
8%	10.5%	2016-2019
4%	8.5%	2013-2019
NA	2.5%	2016-2019
2%	7%	2013-2019
NA	3%	2013-2018

* Does include conservation buffer, but does not include countercyclical buffer of 0 to 2.5%

Capital Strategies



The Regulatory Response

Capital Requirements Directive IV (BASEL III)

Improve

Capital quality

Recalibrate

Risk weighting of assets

Increase

Capital ratios

Introduce

Leverage ratio

Introduce

Liquidity ratios

Improve

Governance & supervision

Liquidity

For many institutions, the liquidity challenge is likely to be greater than the capital challenge.

New liquidity ratios:

Liquidity Coverage Ratio

Net Stable Funding Ratio

Liquidity Coverage Ratio

Objective: Maintain enough liquid assets for 30 days under stress scenario specified by supervisor

Liquid Assets
(less haircut)

Net Cash Outflow over next 30 days
(Based on assumptions regarding outflows of deposits and other liabilities)

> 100%

A diagram illustrating the Liquidity Coverage Ratio. It features two dark red rectangular boxes. The top box contains the text 'Liquid Assets (less haircut)'. The bottom box contains the text 'Net Cash Outflow over next 30 days (Based on assumptions regarding outflows of deposits and other liabilities)'. A red line connects the right side of the top box to the right side of the bottom box, forming a U-shape. In the center of this U-shape is a red oval containing the text '> 100%'. The line ends in arrowheads pointing towards the bottom box.

Net Stable Funding Ratio

Objective: maintain stable sources of funding relative to illiquid assets and off-balance-sheet contingent calls over 1-year horizon

Required Stable Funding
(assets requiring longer term funding)

Available Stable Funding
(capital, long term funding and assumed stable deposits)

> 100%



Timeline for Liquidity Ratios

	2011	2012	2013	2014	2015	2016	2017	2018	As of 1 Jan 2019
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Liquidity coverage ratio	Observation period				Introduce min standard				
Net stable funding ratio					Observation period			Introduce min standard	

Liquidity and Funding Strategies

Raise

- Liquidity of investments
- Retail deposits
- Long-term debt and capital

Reduce

- Businesses with unfavourable liquidity treatment
- Committed credit and liquidity facilities
- Wholesale credit

Adjust

- Pricing to compensate for higher cost of funding

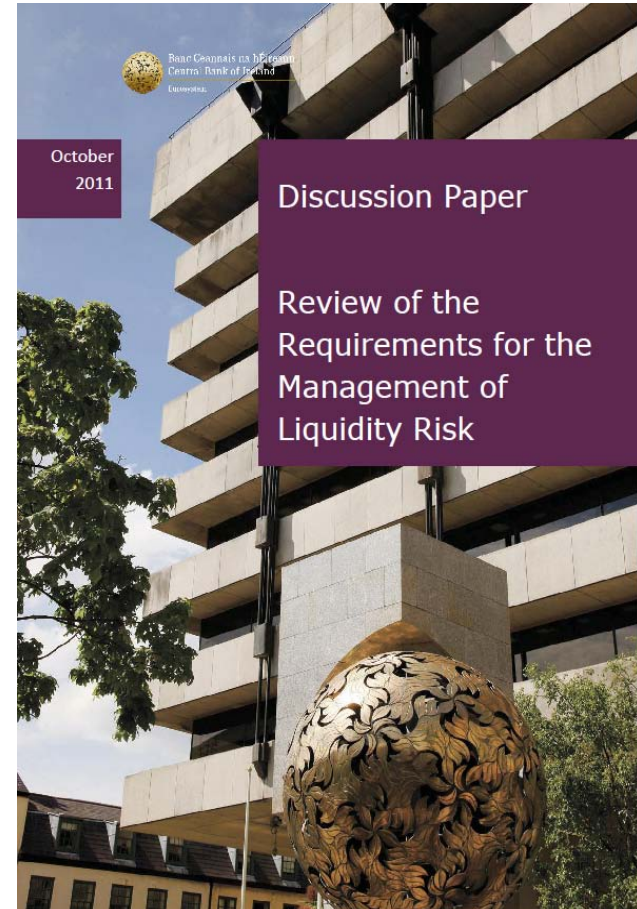
Central Bank

Liquidity Discussion Paper

Key Principle

A credit institution shall ... as a minimum standard maintain adequate liquidity resources, both in terms of quantity and quality, to ensure that **in a normal and stressed environment there is no significant risk that liabilities cannot be met as they fall due.**

Targeting ... requirements that deliver benefits such as **reduced systemic liquidity risk** which exceed the inevitable costs should be an objective that both industry and regulator can share



Central Bank Liquidity Discussion Paper

October 2011

Issues and questions - respond by 31 December : -

- Governance: greater prescription at board/ALCO level
- Setting liquidity risk appetite?
- Liquidity cost allocation?
- Intraday liquidity
- Liquidity Stress Testing – how prescriptive
- Liquidity Limits – extend 100% coverage requirement to 30 days?

Preparing for the post 2015 world

IFRS 9 project will result in:

- Higher impairments
- Lower net assets

Capital Requirements Directive IV will result in:

- Higher capital requirements
- More difficult funding environment

No easy solutions

Thank you...

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