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21 April 2017

TO: ALL AUTHORISED DEPOSIT-TAKING INSTITUTIONS

PRESCRIBED PROVISIONING AND AASB 9 FINANCIAL INSTRUMENTS

All authorised deposit-taking institutions (ADIs) are required to apply *AASB 9 Financial Instruments* (AASB 9) for annual reporting periods beginning on or after 1 January 2018. Under this accounting standard, the move to an expected credit loss impairment approach for loans and other exposures represents an area of significant change.

APRA confirms that ADIs using the prescribed provisioning approach under *Prudential Standard APS 220 Credit Quality* (APS 220) may continue to do so for APRA reporting purposes. It is APRA's understanding that for financial reporting purposes ADIs may continue to use their current prescribed provisioning approach as a basis for determining AASB 9 provisions subject to adjustments and signoffs by their external auditors (refer to the annexure that provides background to APRA's prudential approach with AASB 9).

If you have any queries regarding the guidance in this letter or require further information, please contact your responsible supervisor.

Yours sincerely

Pat Brennan
Executive General Manager
Policy and Advice Division

Annexure – APRA's prudential approach under *AASB 9 Financial Instruments* (AASB 9) for ADIs using the prescribed approach to provisioning

All ADIs will be required to apply AASB 9 for annual reporting periods beginning on or after 1 January 2018. AASB 9 introduces a forward looking expected credit loss model for loan loss provisioning, resulting in more timely recognition of expected credit losses. Under AASB 9, ADIs will need to monitor the change in credit risk over the life of a financial instrument and compare this to the credit risk at initial recognition to determine the amount of provisions recognised.

AASB 9 does not prescribe a particular approach for measuring expected credit losses or assessing changes in credit risk. The appropriate approach will vary, taking into account the differing levels of sophistication of entities, the nature of the financial instrument and the availability of data (AASB 9, paragraph BC5.157). The regulatory (or prescribed) provisioning approach in Attachment C of APS 220 may continue to be used for reporting to APRA.

APRA expects that AASB 9 will present a number of challenges for smaller ADIs. These challenges include assessing changes in credit risk and using forward looking information to calculate provisions. AASB 9 does not preclude the use of a regulatory provisioning based approach provided this regulatory provisioning approach complies with the accounting impairment measurement requirements (AASB 9, BC5.283). APRA therefore expects ADIs currently using prescribed provisioning may continue to do so. The accounting provisions would, however, be subject to appropriate adjustments for AASB 9 purposes and auditor signoff.[1]

Certain aspects relating to provisioning, such as the prudential treatment of problem assets and the capital treatment of accounting provisions, are evolving internationally. Consequently, APRA intends to update the existing prudential requirements in APS 220 and the regulatory data collections relating to credit quality once these initiatives are further progressed. APRA has also commenced a broader review of APS 220 to update and streamline concepts and guidance. This process will likely extend beyond 1 January 2018, the commencement date for AASB 9.

[1] For example, the appropriate adjustments includes an adjustment for the time value of money if necessary.