Executive Summary – Why Comply and Compete?

- IFRS 9 moves impairment accounting from an incurred to **expected loss basis**
- All accounts will require provisions based on “Expected Credit Losses” over at least the next 12 months – deteriorated accounts over their remaining lifetime
- Compliance with the new standard is usually required by January 2018
- The change will affect the financial impact of daily decision strategies, including but not limited to:
  - Originations / pricing / product structure
  - Customer management (especially line management)
  - Collections / recoveries
- Organisations who can plan for and mitigate these impacts will have an advantage over those who focus only on compliance – “**Comply and Compete**”
### Stage Classification Requirements

All accounts are segmented into “stages” based on credit risk

<table>
<thead>
<tr>
<th>Inclusion criteria</th>
<th>Stage 1</th>
<th>Stage 2</th>
<th>Stage 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>No significant increase in credit risk since initial recognition / low risk</td>
<td></td>
<td>Significant increase in credit risk since initial recognition</td>
<td>Default (credit impaired)</td>
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</tbody>
</table>

#### “Rebuttable presumption”

<table>
<thead>
<tr>
<th>IFRS 9 Basis for Provision</th>
<th>12-month expected credit losses</th>
<th>Lifetime expected credit losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>No provision or minimal general provision</td>
<td>General provision for non-delinquent accounts, else driven by “outcome period”</td>
<td>Outcome period for 90+ non-charged off accounts, else similar to IFRS 9 approach</td>
</tr>
</tbody>
</table>

**Credit risk deterioration since initial recognition**
Numerous models (each with their own useful outputs) combine to produce IFRS 9 provisions.
## Linking Expected Credit Loss drivers to business decision areas

### PD
- Underwriting
- High Risk Account Management
- Collections

### EAD
- Initial line
- Credit line increases / decreases
- Authorisations
- Charge vs credit cards

### LGD
- Recoveries
- Settlements
- Debt sales
- Collateral values

### Lifetime
- Product tenor
- 'Encouraged attrition'

### Stage
- High(er) Risk Account Management
- Collections
- Mitigants to economic conditions

### Expected Credit Loss

<p>| | | | |</p>
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<tr>
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<tr>
<td><strong>Profitability / Returns</strong></td>
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<td><strong>Sensitivity to Stress</strong></td>
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Focus on EAD: Line management

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<th>EAD</th>
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<td>• Underwriting</td>
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<td>• Credit line increases / decreases</td>
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<td>• Collections</td>
<td>• Charge vs credit cards</td>
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Unused credit line bears a cost under IFRS 9

...so card issuers may choose to switch to a “low and grow” strategy

...but this may reduce revenue potential

...and create “adverse selection”

...and a negative customer experience
Focus on Stage: High(er) Risk Account Management

Preventing movement into Stage 2 is key
…but accounts may move before they are even delinquent
…and they may not be your highest risk accounts
…so ‘Pre-Pre-Delinquency’ and ‘High(er) Risk Account Management’ tactics are now needed
Thank You

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