HONG KONG BANKS' HKFRS 9 BENCHMARK STUDY

NOVEMBER 2019

MAZARS

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INTRODUCTION

The HKFRS 9 standard on financial instruments has been applicable in Hong Kong starting from 1st January 2018.

We felt it would be informative to have an overview of the HKFRS 9 reporting practice after almost 2 years since the First Time Application ("FTA").

As a reminder, the standard introduced numerous changes with regards to the classification, impairment recognition and the performance of hedge accounting. As for all new HKFRS, financial disclosures have been significantly amended both for the first time adoption and for the ongoing reporting.

In this Hong Kong Banks' HKFRS 9 Benchmark Study we chose to study the 2018 year-end financial reports of 22 banks incorporated in Hong Kong to get a comprehensive overview of the impact on the financial statements and identify opportunities or trends offered by the standard when first applying HKFRS 9 as at 1 January 2018.

This study was also an opportunity to assess the quality of the disclosures for the first year of application as of the end of December 2018 and to better understand the risk management practice of banks incorporated in Hong Kong.

Although the information is public, we chose to discuss the information without mentioning the bank's name, subject to some focus on good practice that we noticed.

Our study shows that there are significant variations in reporting practices, some of them being very comprehensive but others not fully addressing financial disclosure requirements of HKFRS 7 as amended by HKFRS 9.

Implementing the standard for the first time was a complex exercise but the journey is not ended with HKFRS 9 FTA. Banks will need to continue to refine their risk and finance processes in the coming years to ensure full compliance with the standard and reduce the cost in the preparation of their financial statements.

We hope you appreciate our benchmark study on the banking sector in Hong Kong, and we would welcome the opportunity to discuss it.

Pierre Latrobe
Director - Financial Services

Columnists of the Hong Kong Banks' HKFRS 9 Benchmark Study: Amanda Yeung and Pierre Latrobe

EXECUTIVE SUMMARY

KEY HIGHLIGHTS OF THE SURVEY

A sample that includes locally incorporated Banks in Hong Kong as at 31 December 2018

22 banks

A negative change in value of total financial assets at the First Time Application

15

banks out of 22 reported a negative impact.

High asset quality of financial assets held by banks in Hong Kong

96%

of credit exposure is classified as stage 1

14

banks reports the use of 3 scenarios model to assess the significant increase in credit risk and compute expected losses

Application of the 30 days past due presumption to assess the significant increase in credit risk by most of the banks, among other criteria

18

12

Only half of the banks present the **linkage between the HKMA loan classification system and the impairment phasing under HKFRS 9.**

A wide diversity in the definition of default and its relationship with the stage 3 impairment classification

22

banks refer to the 90 days past due as a back-stop for S3

No change in measurement categories or **carrying amounts in respect of financial liabilities reported by most of the banks**

16

8 banks

Explicitly mentioned the application of HKFRS 9 for hedge accounting, while 7 continue to use HKAS 39.

SAMPLE OF BANKS

CONSTITUTION OF OUR PANEL

22 — Locally incorporated Banks in Hong Kong with Financial Statements as of 31 December 2018.

8 — Banks are Systemically Important Authorized Institutions, either Domestically or Globally (group level) or both, as of 31 December 2018.

SIZE

Size of Banks covered as measured by total balance sheet assets as of **end of 31 December 2018** ranging from less than HKD 100 billion to over HKD 1,000 billion.

4 — **> 1,200 billion**

- Industrial and Commercial Bank of China (Asia) Ltd
- The Hongkong and Shanghai Banking Corporation Ltd
- Hang Seng Bank Ltd
- Bank of China (Hong Kong) Ltd

2 — **801 – 1,200 billion**

- Standard Chartered Bank (Hong Kong) Ltd
- The Bank of East Asia Ltd

3 — **401 – 800 billion**

- China Construction Bank (Asia) Corporation Ltd
- DBS Bank (Hong Kong) Ltd
- Nanyang Commercial Bank Ltd

10 — **101 – 400 billion**

- Citibank (Hong Kong) Ltd
- China CITIC Bank International Ltd
- Dah Sing Bank Ltd
- Chiyu Banking Corporation Ltd
- Chong Hing Bank Ltd
- Bank of Communications (Hong Kong) Ltd
- Fubon Bank (Hong Kong) Ltd
- OCBC Wing Hang Bank Limited
- Shanghai Commercial Bank Limited
- CMB Wing Lung Bank Limited

3 — **< 100 billion**

- Public Bank (Hong Kong) Ltd
- Tai Sang Bank Ltd
- Tai Yau Bank Ltd

SOURCE OF INFORMATION

The main sources used were the published Financial Statements as of 31 December 2018 and the HKFRS 9 standard.

Systematically Important Authorized Institutions ("SIBs") are banks that could cause significant disruption to the financial system and the broader economy if they are subject to distress or failure. Hence, they have to apply to specific regulations and supervision, including higher loss absorbency ("HLA") capital buffer.

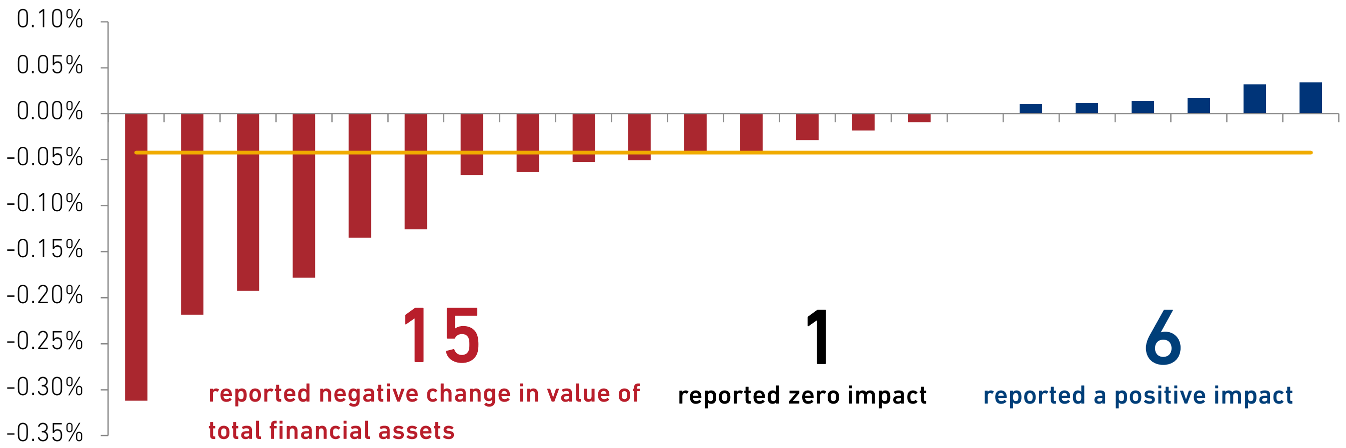
SAMPLE OF BANKS

Financial assets are classified according to their contractual cash flow characteristics (the so called "SPPI test") and the business models ("BM") under which they are held. These two tests allow a financial asset to be classified at amortised cost ("AC"), fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVTPL").

- The SPPI test concludes whether the variability the contractual cash flows of the asset are in line with a 'basic lending arrangement'. Should the SPPI fail, instruments will be measured at FVTPL whatever the BM.
- The BM reflects how an entity manages its financial assets in order to generate cash flows, either by held to collect contractual cash flows ("HTC"), held to collect contractual cash flows and to sell the financial assets ("HTCS"), or for other purposes such as trading.

OVERVIEW

Overall % change in net assets on balance sheet



With regards to remeasurement, we noted that **6 out of 22 banks reported a higher net asset value** after HKFRS 9 implementation. This may imply that the collective impairment recognised under HKAS 39 was higher than the new loss allowance requirement for non-impaired assets.

For the bank that reported no change in its net assets, we understand that no expected credit losses were recorded, either 12 months or lifetime.

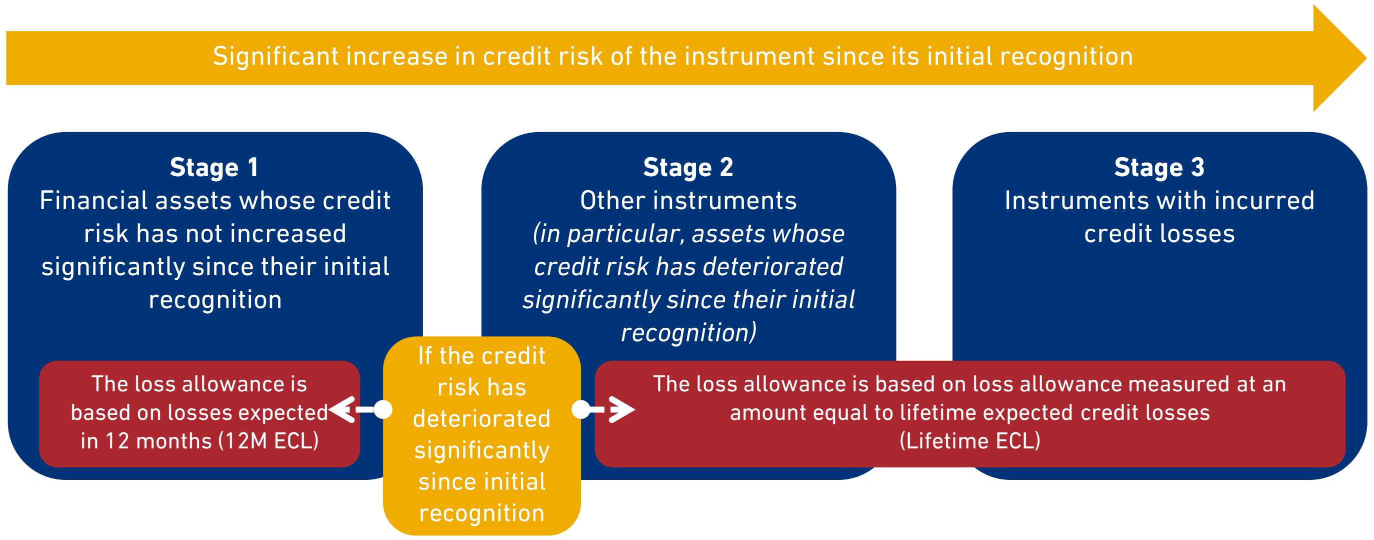
With regards to the FTA classification, we noted a general decrease in the value of financial assets accounted for under AC and FVTOCI while financial assets accounted for at FVTPL increased. This was due to the SPPI test failure or the election for BM not compliant with the criterion to be accounted for at AC. For instance:

- One bank reported a drop in the loans and receivables by HKD 20,061 million previously measured at AC was reclassified to FVTOCI because of the elected BM "held to collect and sell".
- Another bank presented a rise in assets at FVTPL for HKD 17,430 million as a result of the reclassification of inter-bank investments that did not satisfy the SPPI criterion.
- Several banks reclassified debt securities from AC to FVOCI in order to be in line with liquidity management which requires the bank to demonstrate that an adequate stock of unencumbered high-quality liquid assets (HQLA) is maintained to meet the liquidity needs for a 30 calendar day liquidity stress scenario.

IMPAIRMENT

OVERVIEW

The impairment model under HKFRS 9 is moving from "incurred loss" to "expected loss".

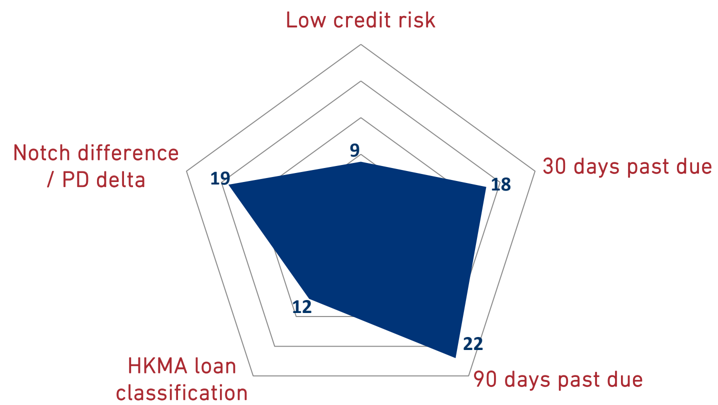


HKFRS 9 requires the bank to account for the impairment of financial instruments base on three situations, depending on the significant increase in credit risk ("SICR") since initial recognition. However, the standard leaves a number of operational simplifications and rebuttable presumptions regarding the SICR assessment. The measurement of ECLs reflects a probability-weighted outcome, considering all reasonable and supportable information, including that which is forward-looking. Forward looking means the inclusion of forecasts of future economic conditions.

As the SICR involves significant judgement by management, an entity has to explain its credit risk management practices and how these relate to the recognition and measurement of expected credit losses. Qualitative and quantitative disclosures under HKFRS 7 need to explain the inputs, assumptions and estimation used.

The following pages analyse in detail the loss allowance by impairment stage, the approach retained by banks with regards to the scenario definition, the low credit risk simplification, the rebuttable 30 and 90 days past due presumptions, the definition of default as well as the alignment between the loan classification as prescribed by the HKMA and the impairment stage as prescribed by HKFRS 9.

We present an overview of this analysis of the inputs used in assessing the SICR among the 22 locally incorporated banks in Hong Kong in the graph below.



How to read this graph?

9 out of 22 locally incorporated banks in Hong Kong mention the use of low credit risk simplification to assess the SICR.

IMPAIRMENT

KEY HIGHLIGHTS OF THE SURVEY

Among the 22 banks covered by this study, 20 of them presented the gross exposure by impairment stage as of 31 December 2018.

96.4% Stage 1

3.3% Stage 2

0.3% Stage 3

- Most of the exposures are classified under stage 1. This **suggests a high asset quality of financial assets held by the banks incorporated in Hong Kong as of 31 December 2018.**

- The table below summarizes the % of gross exposure by bank*.

GROSS EXPOSURES BY STAGE	STAGE 1	STAGE 2	STAGE 3
BANK A	99.83%	0.14%	0.03%
BANK B	94.95%	4.58%	0.46%
BANK C	99.18%	0.63%	0.19%
BANK D	97.18%	2.68%	0.14%
BANK E	98.78%	0.98%	0.24%
BANK F	99.98%	0.02%	0.00%
BANK G	N/A	N/A	N/A
BANK H	94.59%	4.71%	0.70%
BANK I	96.33%	3.19%	0.48%
BANK J	95.21%	4.17%	0.62%
BANK K	N/A	N/A	N/A
BANK L	95.58%	4.25%	0.17%
BANK M	95.70%	3.94%	0.37%
BANK N	97.21%	1.98%	0.81%
BANK O	99.31%	0.41%	0.28%
BANK P	93.94%	5.72%	0.34%
BANK Q	98.76%	0.58%	0.67%
BANK R	96.63%	2.87%	0.50%
BANK S	95.27%	4.05%	0.67%
BANK T	100.00%	0.00%	0.00%
BANK U	100.00%	0.00%	0.00%
BANK V	96.12%	3.26%	0.62%

- 2 banks only provided impairment allowances by stage without indicating the gross amount, which prevented the presentation of their allocations.

** Purchased or Originated Credit-Impaired financial assets have been excluded from the staging classification.*

IMPAIRMENT

KEY HIGHLIGHTS OF THE SURVEY

As a result of moving from 'incurred loss' to 'expected loss', the standard requires the incorporation of forward-looking information into the computation of Expected Credit Loss ("ECL").

The ECL is a probability-weighted estimate of credit losses over the expected life of the financial instrument. In order to measure ECL, an entity needs to evaluate a range of possible outcomes. This involves identifying possible scenarios. As HKFRS 9 is principle-based, it only mentioned that changes in macroeconomic indicators are to be considered in computing the ECL, without specifying any criteria or parameters.

WEIGHT	STRESSED / DOWNSIDE	BASE / CENTRAL	OPTMISTIC / UPSIDE
BANK A	15%	60%	25%
BANK H	28%	65%	7%
BANK I	20%	70%	10%
BANK L	10%	80%	10%
BANK M	10%	80%	10%
BANK S	20%	60%	20%

	CITIC	Standard Chartered
Methodology	Weighted-average (Not specified how they come up with the weight) and a management overlay where required	Monte Carlo (except for less material retail loan portfolios which adopted simplified approaches)
No. of scenarios	5	Use of a set of scenarios around the base forecast and generates 50 scenarios upon which to compute ECL
Weighting of scenarios	1 base: 65%; 1 upside: 7%; 3 downside (mild, medium and severe): 28%	N/A
Macroeconomic variables used	GDP growth rate, inflation, property price index, unemployment, real exchange rate, 6-month settlement rate, 12-month settlement rate	GDP growth rate, interest rates, house price indices, commodity prices etc.
Level of incorporation	Portfolio level	Portfolio level
Other relevant information	Performance of sensitivity analyses of ECL calculation depending on economic scenarios and rating downgrade on expected credit loss	Approach considers the degree of uncertainty (or volatility) around economic outcomes and how these outcomes have generally tended to move together (or correlation)

- 14 out of 22 banks mentioned the **application of a 3 scenarios model** which includes **downside**, **base** and **upside scenario**. Only **6 banks mentioned the weight by scenario**.

- 2 banks mentioned the **application of more than 3 scenarios** while **6 banks do not mention any details** of either the application or the number of scenarios applied.

- The most commonly used forward-looking information considered by the locally incorporated banks in Hong Kong to build scenarios were **GDP growth rate, inflation, unemployment rate, interest rates and the house price index**.

- While the methodologies applied and the information incorporated differ from bank to bank, we present some key disclosures extracted from 2 locally incorporated banks.

IMPAIRMENT

NOTCH DIFFERENCE & PD

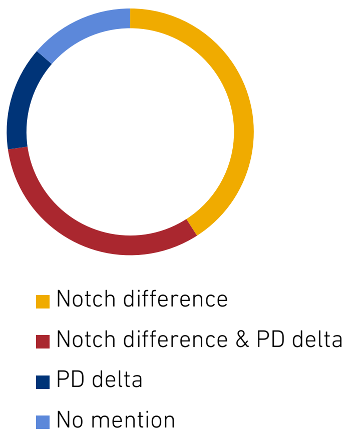
At each reporting date, an entity is required to assess the Significant Increase in Credit Risk ("SICR") by considering the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of

In some cases, the qualitative and non-statistical quantitative information available may be sufficient to determine the SICR. In other cases, the assessment may be based on quantitative information or a mixture of quantitative and qualitative information.

Several practical approaches are used to determine the "significant" threshold, including the notch difference and the Probability of Default ("PD") delta comparison between origination date and reporting date.

The notch difference on internal/external credit rating between initial recognition and the reporting date is one of the key indicators used to assess the SICR by banks. The required notch difference to trigger a SICR varies across banks.

Approach for staging



As the PD increases at a more than linear rate as the credit rating deteriorates, the number of grade notches required to materialise the SICR depends on the origination customer risk rating. This means the absolute increase in the PD between two low risk credit ratings is significantly less than between two higher risk ratings. In other words, a one-notch downgrade in the investment grade population results in a much smaller PD increase than in the sub-investment grade population.

The example below illustrates this assumption.

Hang Seng Bank Limited annual report 2018

Origination CRR	Additional significance criteria – Number of CRR grade notches deterioration required to identify as significant credit deterioration (stage 2) (> or equal to)
0.1	5 notches
1.1–4.2	4 notches
4.3–5.1	3 notches
5.2–7.1	2 notches
7.2–8.2	1 notches
8.3	0 notches

**CRR refers to customer risk rating*

- **19 out 22 banks mentioned the use of notch difference and/or PD delta approaches** without describing in detail the quantitative thresholds.
- **3 banks described in details their internal rating model** and the number of grade notches deterioration required to identify a SICR.
- We noticed that **2 banks are using a fixed number of grade notches deterioration to identify a SICR** which is an approach that neglects the non-linearity of the probability of defaults that may result in overstatement or understatement of ECLs.

IMPAIRMENT

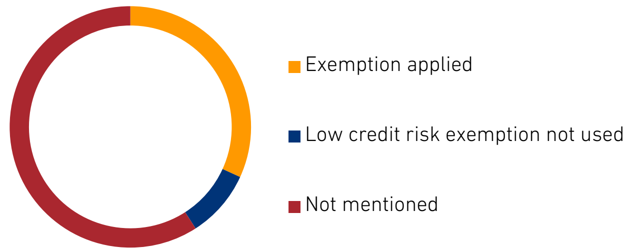
LOW CREDIT RISK SIMPLIFIED

As an **optional** simplification to the general impairment model, if a financial instrument has a low credit risk, then an entity is allowed to assume at the reporting date that no significant increase in credit risk has occurred. For low risk instruments, the entity would recognise an allowance based on 12-month ECLs.

An **entity shall disclose information** that enables the user of financial statements to understand how financial instruments are considered to have a low credit risk and indicate the classes of financial instruments it applies as per HKFRS 7.35F(a)(i).

Most of the banks apply this presumption as a back stop to assess the significant increase in credit risk since initial recognition, in addition to other credit risk assessment tools and indicators. 18 banks stated the 30 days past due is one of the considerations in identifying SICR from Stage 1 to Stage 2.

Low credit risk simplified approach



4 banks did not mention whether they apply or rebut the 30 days past due presumption. We would expect to indicate this fact as per HKFRS 7.

Application of the low credit risk exemption

- Among the banks that mentioned explicitly the application of the low credit risk option, **3 of them stated how they define low credit risk and to what financial instruments they apply the simplification**. 1 bank mentioned solely how they define low credit risk.
- 1 of the banks did not mention the adoption of the simplified approach but stated in the decision rules on staging that financial instruments within certain range of internal credit rating would always be treated as stage 1, which is applying the simplified approach.
- 2 other banks applying this simplified approach **did not explain further the definition of low credit risk or to which financial instruments it applies**.

Rejection of the low credit risk exemption

- 2 banks mentioned explicitly that they **do not apply the low credit risk exemption for any financial instruments**.

No mention of the low credit risk simplification

- 1**3 banks did not disclose if they had applied this option** in their financial statements. As best practice, we would expect to indicate whether the low credit risk simplification is applied.

Example of good practice:

"For cash and short-term funds, balances with banks and other financial institutions and debt securities measured at amortized cost, the Group is utilizing the low credit risk simplified approach. All obligors with investment grade ratings based on external rating agencies are allocated to Stage 1."

(extracted from Fubon Bank (Hong Kong) Limited Annual Report 2018)

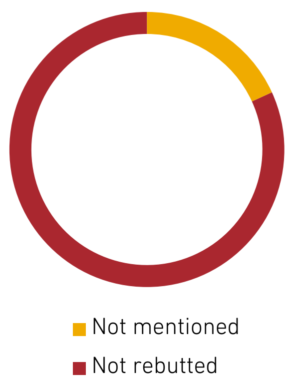
IMPAIRMENT

REBUTTABLE 30 DAYS PAST DUE PRESUMPTION

Regardless of the way in which an entity assesses a significant increase in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due.

An **entity shall disclose information** that enables the user of financial statements to understand whether the presumption that there has been a significant increase in credit risk since initial recognition when financial assets are more than 30 days past due has been rebutted, as per HKFRS 7.35F(a)(ii).

30 days past due presumption



- Most of the banks **apply this presumption as a back stop** to assess the significant risk since initial recognition, in addition to other credit risk assessment tools and indicators. **18 banks stated the 30 days past due** is one of the considerations in identifying SICR from Stage 1 to Stage 2.

- **4 banks did not mention whether they apply or rebut the 30 days past due presumption**. We would expect to indicate this as per HKFRS 7.

Example of good practice:

"However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due."

(extracted from The Hongkong and Shanghai Banking Corporation Limited Annual Report 2018)

IMPAIRMENT

HKMA LOAN CLASSIFICATION

We analysed how banks link the HKMA loan classification system with the impairment phasing under HKFRS 9. The HKMA loan classification system is used by banks for local regulatory reporting purposes.

HKMA's loan classification system classifies loans under 5 categories:

- Pass: Loans for which borrowers are current in meeting commitments and for which the full repayment of interest and principal is not in doubt.
- Special Mention: Loans with which borrowers are experiencing difficulties and which may threaten the authorized institution's position.
- Substandard: Loans in which borrowers are displaying a definable weakness that is likely to jeopardise repayment.
- Doubtful: Loans for which collection in full is improbable and the authorized institution expects to sustain loss of principal and/or interest, taking into account the net realisable value of collateral.
- Loss: Loans that are considered uncollectable after all collection options (such as the realisation of collateral or the institution of legal proceedings) have been exhausted

Loans that are classified as substandard, doubtful or loss are collectively known as "classified loans".

Source: HKMA loan classification: https://www.hkma.gov.hk/gdbook/eng/l/loan_classificat_sys.shtml

- Only 12 out of 22 banks present the **linkage between the loan classification system and the impairment phasing**.

HKMA LOAN CLASSIFICATION	BANK A	BANK B	BANK C	BANK D	BANK E	BANK F	BANK I	BANK K	BANK O	BANK P	BANK S	BANK V
Pass	Not specified	S1 / S2	S1 / S2	S1 / S2*	S1 / S2	S1 / S2*	S1 / S2	S1 / S2	Not specified	S1 / S2	S1 / S2 / S3*	S1 / S2
Special-mention	Not specified	S2	S1 / S2	S1* / S2 / S3*	S2	S2 / S3*	S1 / S2	S2	Not specified	S2	S1 / S2 / S3*	S1* / S2 / S3*
Substandard	S3	S3	S3	S3	S3	S2* / S3	S3	S3	S3	S3	S1* / S2* / S3	S3
Doubtful	S3	S3	S3	S3	S3	S3	S3	S3	S3	S3	S3	S3
Loss	S3	S3	S3	S3	S3	S3	S3	S3	S3	S3	S3	S3

** Insignificant amount*

- Generally, we noticed that loans with the **HKMA loan classification of "Substandard" and below are treated as "Stage 3"** under HKFRS 9, which supposed an incurred loss.

- We noticed that several banks aligned the HKMA loan classification for the "special-mention" category with the stage 2 of HKFRS 9. We believe this approach may neglect the "relative" model of HKFRS 9 which allows **the initial recognition of non-investment grade** (e.g. with a higher probability of default) financial assets in stage 1.

IMPAIRMENT

DEFINITION OF DEFAULT

As there is no common definition of "default", the standard does not define what constitutes default. Instead the standard required an entity to apply a default definition that is consistent with the definition used for internal credit risk management purposes. To restrict diversity in the "default" definition, the standard introduces a rebuttable presumption that "default" does not occur later than when a financial asset is 90 days past due.

An **entity must disclose information** that enables user of financial statements to understand what constitutes a default. as per HKFRS 7.35F(b).

A default is considered to have occurred under Basel rules* when either or both of the two following events have taken place:

- The obligor is unlikely to pay its credit obligations to the banking group in full, without recourse by the bank to actions such as realising security
- The obligor is past due more than 90 days on any material credit obligation to the banking group.

The loan classification system used to assess asset quality reported by banks in Hong Kong **does not explicitly refer to the notion of default,** but to pass, special mention, substandard, doubtful and loss. Consequently, the disclosures of the banks incorporated in Hong Kong show diversity in their definition of default and its relationship with credit-impaired criteria that underpinned the stage 3 classification.

As a back-stop, the standard establishes a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due. **All the 22 banks refer to the 90 days past due as a back-stop** to transfer an exposure to stage 3, with one bank having also a shorten period of 60 days past due for credit card exposures.

Three situations arise from our analysis

- The **default criteria is fully aligned with the credit-impaired financial asset** as defined by HKFRS 9. This is the approach retained by 11 banks.
- **Default is one of the credit-impaired financial asset** definition. This is the approach retained by 9 banks, although 6 of them do not define what constitutes in a default which contravenes HKFRS 7 requirements.
- For 2 banks, **both default and credit-impaired financial assets are defined separately**, with an unclear relationship between the 2 criteria.

Among banks that define default:

- 12 banks include at least the **2 criteria retained in the International definition**: "90 days past due" and "unlikely to pay".
- 4 banks indicate that the default is incurred for the loan classified as "substandard", "doubtful" and "loss" as defined by the HKMA's loan classification system.

It is worth noting that one bank mentioned a slightly different default definition between corporate and retail exposures.

** Definition of default, BCBS, Basel III: Finalising post-crisis reforms, article 220, December 2017*

CHANGE IN CLASSIFICATION OF FINANCIAL LIABILITIES

OVERALL FINDINGS

The classification of financial liabilities under HKFRS 9 remains broadly the same as under HKAS 39. Financial liabilities are measured at AC, or FVTPL when they meet the definition of held for trading or when they are designated on initial recognition using the fair value option which is subject to conditions (accounting mismatch, performance evaluated on a fair value basis, or a hybrid contract that contains one or more embedded derivatives). For liabilities designated at FVTPL, the portion of fair value changes of such financial liabilities which is attributable to changes in the credit risk of the liability ("own credit risk" component) will have to be accounted for in OCI, with no possibility of subsequent recycling to P&L.

KEY TAKE-AWAY

For most of the banks, the classification and measurement of financial liabilities **did not change** from HKAS 39 to HKFRS 9, either in classification or re-measurement.

16
reported no change in measurement categories or carrying amounts.

6
reported changes in measurement categories or carrying amounts.

For banks that reclassify financial liabilities, the reasons were as follows:

Opportunity regarding financial liabilities classification upon HKFRS 9 first time application

- After consideration of market practices, 2 banks reclassified 'Trading liabilities' which contain both a deposit and derivative component to financial liabilities designated at FVTPL, since they are managed and their performance is evaluated on a fair value basis. **This enables the banks to recognise the change in their own credit risk in OCI rather than in P&L**.
- One bank revoked the previous designation at FVTPL justified by the elimination or significant reduction of an accounting mismatch between debt securities issued and undocumented hedging derivatives; this condition is no longer met, derivatives having matured. **This FTA reclassification of the debt securities from FVTPL to AC avoid volatility in P&L**, following the cessation of the hedge relationship .
- One bank reported a reclassification of liabilities originally measured at AC to FVTPL, on which a fair value hedge of interest rate risk was applied. Upon transition, the subordinated liabilities were designated at FVTPL to eliminate or significantly reduce the accounting mismatch with the hedging instruments. **We assume the bank decided to cease the hedge accounting relationship for practical reasons**.
- One bank early adopted the requirement to designate financial liabilities at fair value under the fair value option **to recognise fair value changes that are attributable to the bank's own credit risk in OCI, rather than P&L**. As a result of this early adoption from 1 January 2017, the bank classified un-bifurcated structured notes and deposits as at FVTPL.

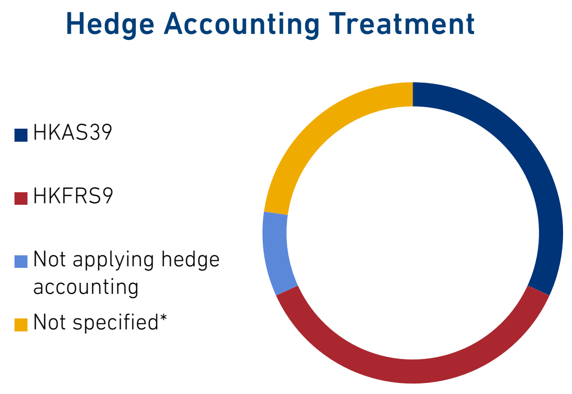
Impact of the HKFRS 9 first time application with regards to FV change due to own credit risk

- One bank reclassified the amount of changes in fair value due to the change in the liability's own credit rating on both certificate of deposits and debt securities issued, from retained earnings to FVOCI on 1 January 2018 to comply with HKFRS 9 requirements.

HEDGE ACCOUNTING

OVERALL FINDINGS

Macro-hedging has been excluded from HKFRS 9 and will be subject to a separate standard. Pending the finalization of the macro-hedging standard, the Hong Kong Institute of Certified Public Accountants ("HKICPA") offers different options to deal with the accounting for micro hedging, either by applying partially of fully HKFRS 9 or continuing to apply HKAS 39.



- 8 banks stated they apply the hedge accounting requirements as per HKFRS 9.
- 7 banks indicated that they continue to apply hedge accounting rules in accordance with HKAS 39.
- 6 banks did not specify their treatment of hedge accounting when transitioning to HKFRS 9.
- 1 bank indicated that it elected not to apply hedge accounting at all.

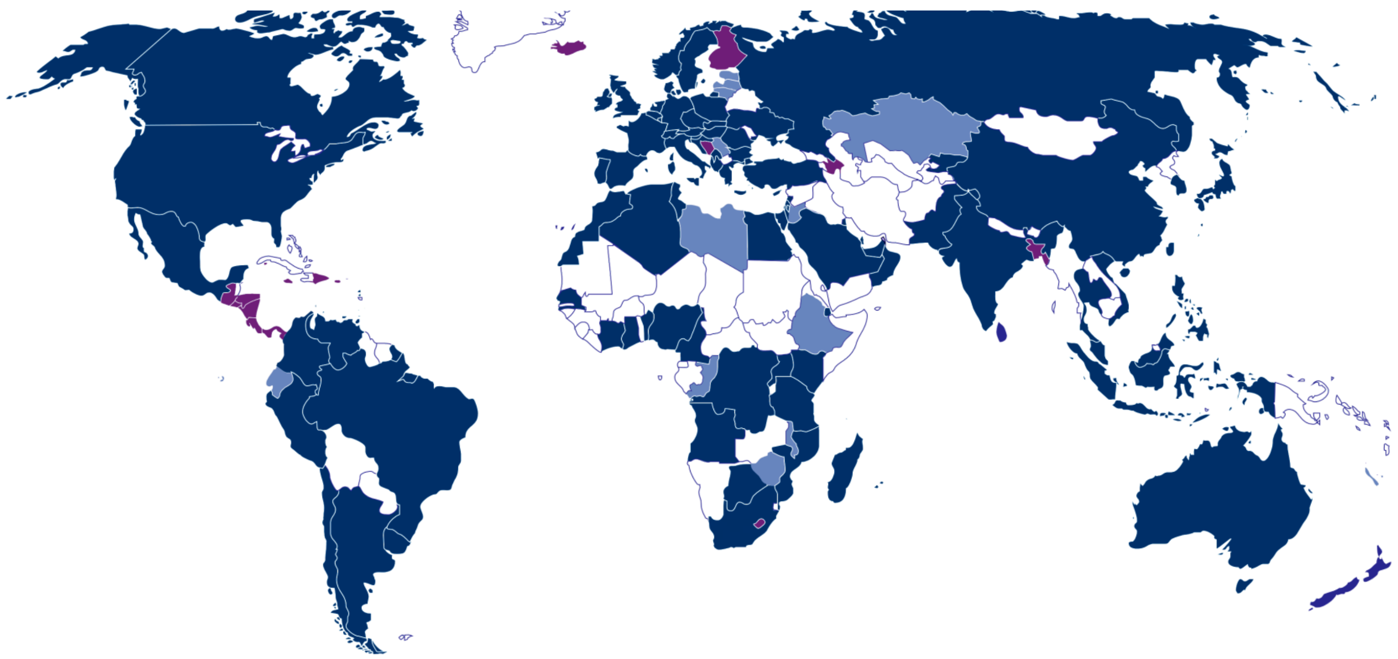
The below table extracted some key disclosures from one locally incorporated bank.

	DBS
Methodology	Hedge Accounting under HKFRS 9
Type of hedging	➢ Apply on a hedge-by-hedge basis ➢ Fair value hedge to mitigate the risk of changes in interest rates on the fair value from: - issued fixed rate debt - a portion of purchased fixed rate bonds ➢ Cash flow hedge to mitigate the risk of variability in future cash flows due to interest rate movements and foreign currency fluctuations against HKD from: - forecast interest earnings denominated in foreign currency - issued floating or fixed rate foreign currency debt - a portion of purchased floating or fixed rate foreign currency bonds
Source of ineffectiveness	➢ Use of different discounting curves when measuring the fair value of the hedged items and hedging instruments ➢ Difference in the timing of settlement of hedging instruments and hedged items ➢ Use of derivatives as a protection against interest rate risk or foreign currency risk creates an exposure to the derivative counterparty's credit risk which is not offset by the hedged item

** Not specified means that the bank describes hedge accounting in its accounting policies without indicating whether it applies hedge accounting, either under HKFRS 9 or HKAS 9. It also includes banks that do not held derivatives as at 31/12/2018.*

ABOUT MAZARS

Mazars is an internationally integrated partnership, specialising in audit, tax and advisory services. Operating in 89 countries and territories around the world, we draw on the expertise of 40,000 professionals – 24,000 in the Mazars integrated partnership and 16,000 via the Mazars North America Alliance - to assist clients at every stage in their development.



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