

Financial Instruments

A decorative horizontal bar at the bottom of the slide, composed of various colored rectangular segments in shades of blue, yellow, orange, red, and purple.

IFRS 9 – Financial instruments



- IASB project plan
- Classification and measurement:
Cross-cutting issues
- Impairment methodology
- Hedge Accounting

IASB project plan

- Project plan and Progress report on the IASB-FASB convergence released on 21 April.
- Extended the completion target beyond June 2011 to permit further work and consultation with stakeholders. Goal is to complete the work in the second half of 2011.
- Before the standard is issued the boards will consider whether re-exposure or outreach are necessary.

Issues:

- The IASB should consider the entire package before finalising the standard
- Consequentially review of IFRS 7 needed

Classification and measurement:

□ Cross-cutting issues

Financial assets

- *Business model test*: Is asset held to collect contractual cash flows?
- *Instrument characteristics test*: Amortised cost limited to contractual cash-flows that are solely payments of principal & interest.
- Hybrids not bifurcated.
- Option for fair valuing equity not held for trading in OCI, but no recycling to profit or loss allowed.

Financial liabilities: requirements of IAS 39 are retained, including bifurcation. Presentation in OCI the own credit amount under the fair value option.

Cross-cutting issues:

- Interactions between the characteristics of the instrument and the business model tests
- Risk management approach in the Hedge Accounting ED: eligibility of a separate risk component as hedged item

Classification and measurement:

□ Cross-cutting issues (continued)

Financial assets

- *Business model test*: Is asset held to collect contractual cash flows?
- *Instrument characteristics test*: Amortised cost limited to contractual cash-flows that are solely payments of principal & interest.
- Hybrids not bifurcated.
- Option for fair valuing equity not held for trading in OCI, but no recycling to profit or loss allowed.

Financial liabilities: requirements of IAS 39 are retained, including bifurcation. Presentation in OCI the own credit amount under the fair value option.

Cross-cutting issues:

- Principles-based model for the bifurcation
 - Avoid different treatment for the same economic transaction (i.e. embedded or separate derivatives), including eligibility as hedging instruments
- Eligibility of equity investments at FV-OCI as hedged items

Classification and measurement:

□ IASB project plan

Phase	Current status	Next steps
Classification and measurement	<ul style="list-style-type: none">•IFRS 9 requirements finalised in November 2009 (IFRS 9 - assets) and November 2010 (IFRS 9 - liabilities).•<u>The FASB</u> has tentatively decided: (1) Instruments with variable cash flows at FV (2) Customer financing at amortised cost (3) FV-OCI category: Investments with a focus on managing risk exposures or total return.	<ul style="list-style-type: none">•FASB to complete decisions in Q3-2011.•IASB to expose the FASB's final conclusions.

-FASB re-deliberations make the convergence a more achievable goal

Classification and measurement:

□ Questions

- What are your views in relation to the cross-cutting issues?
- Do you see other major issues in relation to the IASB project plan for this phase?

□ Impairment methodology



- The Exposure Draft and the Supplementary Document
- Different approaches for good book and bad book
- The floor and ‘foreseeable future’
- The time-proportionate allocation
- IASB Project plan

The Exposure Draft and the □ Supplementary Document ('SD')

- Original model based on expected cash flows and effective interest rate.
- Operational challenges (decoupling, open portfolios).
- Converged approach.
- Scoped out :
Measurement guidance,
Short-term trade
receivables.

EFRAG Position

- Support a converged operational approach. Objectives of the revised model to be clarified.
- Proper quantitative assessment and field testing before finalising.
- Decoupling should be applied consistently to all assets carried at amortised cost. No free choice between the revised and the original model.

Different approaches for the good book

□ and the bad book

- For the good book, expected losses would be recognised over a time period. For the 'bad book' the entire amount would be recognised.
- Bad book: if the collectibility becomes so uncertain that the credit risk management objective changes from receiving regular payments to recovery.

EFRAG Position

- Appropriate to provide in full for 'incurred' losses. The good book/bad book distinction does not adequately cater for losses 'incurred but not yet reported'.
- In the revenue recognition aspect, the time-proportionate approach is appropriate.
- Further developments needed for non-lending businesses, closed portfolios and individual items.

□ The floor and ‘foreseeable future’

- Open/closed portfolios.
- Good book: expected losses recognised at the higher of the time-proportional amount and losses expected to occur in the foreseeable future (minimum 12 months).
- Period for which specific projections of loss events/ conditions can be reasonably estimated.

EFRAG Position

- EFRAG disagrees with the floor, as it would result in immediate recognition of credit allowances for performing portfolios with short term life, as if they were bad.
- The concept of ‘foreseeable future’ is not clearly articulated.
- Should IASB retain a floor in the model, EFRAG recommends a fixed 12-month period.

□ The time-proportionate allocation

- The time-proportionate amount is determined by multiplying the expected losses for the entire remaining life by the ratio of the portfolio's age to its expected life.
- Straight-line or annuity allocation allowed.
- Discounted or undiscounted losses allowed.
- Flexibility in the discount rate.

EFRAG Position

- The impairment model should reflect the link between pricing of the asset and expected losses.
- EFRAG understands that the TPA has a partial catch-up effect.
- The floor is not the only way to deal with front loaded patterns. If an entity expects losses to occur in the near future, it should be required to provide immediately for expected losses in excess of the time-proportionate amount.

Impairment methodology:

□ IASB project plan

Phase	Current status	Next steps
Impairment	<ul style="list-style-type: none">•IASB Exposure Draft issued in November 2009. FASB Exposure draft issued in May 2010. Joint FASB-IASB Supplementary Document issued in January 2011; comment period ended on 1 April.•The boards are re-deliberating on the basis of the outreach and comment letters. There was not clear consensus among respondents.	<ul style="list-style-type: none">•Consensus IASB-FASB on a basic approach expected by the end of June 2011.•Subsequent steps, including potential re-exposure to be discussed.•Ballot between June and Q3, target IFRS Q3.

Impairment methodology

□ GASB position

- Principal support for an expected loss model
- Disagrees with the ‘floor’; prefers alternative approach: if expected loss pattern deviates from a linear distribution (based on indicators and reliably determinable) recognise impairment allowance in accordance with this pattern, otherwise use TPA as proposed in the SD
- Strong concerns with the scope exception for short term receivables
 - Objective is to have one impairment model for financial assets at amortised cost
 - Trade receivables may not be adequately considered
- Possible effects of transition (retrospective application) on retained earnings (and resulting regulatory capital)

□ Questions

- What are your main concerns in relation to this project phase?
- Do you see major issues in relation to the IASB project plan for this phase?

□ Hedge Accounting



- Overview of the Exposure Draft
- Eligibility criteria (hedged items and hedging instruments)
- Effectiveness assessment
- Rebalancing and discontinuation
- Macro-hedge
- Project plan

Hedge Accounting:

□ Overview of the Exposure Draft

- Objective of hedge accounting to link accounting and risk management.
- Only risks affecting profit and loss eligible.
- Hedging open portfolios (macro-hedge) out of the scope of the Exposure Draft.

EFRAG Position

- Objective to be strengthened: the resulting reporting better reflects the effects of risk management than would otherwise be the case.
- Macro hedging model needed prior finalisation of the general model standard.
- Clarifications needed pursuant to new key concepts introduced. Revised text should be made available for comments and tested for operationality.

Hedge Accounting: main proposals

Eligibility criteria

- Non-derivatives financial assets and liabilities measured at fair value through profit and loss eligible as hedging instruments.
- A combination of an exposure and a derivative may be designated as hedged item.
- A separately identifiable and reliably measurable risk component is eligible as hedged item.

EFRAG Position

- This model will make hedge accounting more accessible.
- Certain remaining restrictions to be lifted (non-contractually specified inflation risk, credit risk, risks not affecting P&L, sub-LIBOR, non-derivative instruments not at FV through P&L).
- Further explore how to represent valid risk management activities not fitting the proposed model.

Hedge Accounting: main proposals

Effectiveness assessment

- The 80-125 percent range has been replaced by an objective-based assessment.
- A hedging relationship meets the effectiveness requirements when :
 1. producing an unbiased result and minimising expected hedge ineffectiveness; and
 2. expected to achieve other than accidental offsetting.

EFRAG Position

- Important improvements in hedge effectiveness assessment.
- The removal of the 80-125 percent bright line simplifies implementation and align hedge accounting more closely to risk management.
- Need for clarification: ‘unbiased result’ and ‘minimizing expected hedge ineffectiveness’.

Hedge Accounting: main proposals

□ Rebalancing and discontinuation

- When the effectiveness assessment is no longer met, but the risk management objective remains the same, an entity should rebalance.
- Hedge discontinuation only when the relationship ceases to meet the qualifying criteria (ie. not permitted when the hedging relationship still meet the risk management objective).

EFRAG Position

- The rebalancing enables to reflect changes in the risk management .
- Mandatory rebalancing and impossibility to voluntary discontinue are necessary.
- The model may not be flexible enough to allow for discontinuation, when internal derivatives are used in the risk management strategy.

Hedge Accounting:

□ IASB project plan

Phase	Current status	Next steps
General hedge accounting	<ul style="list-style-type: none">•The comment period for the IASB ED ended on 9 March 2011. In February the FASB issued a Discussion Paper, asking feedback of US constituents on the IASB ED, the comment period ended the 25 April.•The IASB is currently re-deliberating on the ED. The FASB will participate.	<ul style="list-style-type: none">•Ballot between June and Q3, target IFRS Q3.
Portfolio hedge accounting	<ul style="list-style-type: none">•IASB deliberations will start in May.	<ul style="list-style-type: none">•Target date for the IASB ED is between Q3 and Q4.

Hedge accounting:

Questions

- What are your main concerns in relation to this project phase?
- Do you see major issues in relation to the IASB project plan for this phase?

Hedge accounting model:

□ GASB position

- principal support for the hedge accounting phase, i.e. finalisation soon and resolving dynamic macro hedging later
- no full support for the hedge accounting objective
 - Objective and proposed hedge accounting requirements are not in conformity with each other
 - as long as certain risk management activities cannot be reflected in financial statements (internal hedges, core deposits, other instruments used but not eligible)
 - Link between risk management and hedge accounting important, but a rather subordinated principle
 - Designation should be as much in line with underlying risk management as possible, but under the condition an accounting mismatch occurs prior to applying hedge accounting