IFRS 9 FINANCIAL INSTRUMENTS FRAMEWORKS

Financial Instruments Workshop

08 March 2018

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Building a better working world

Agenda

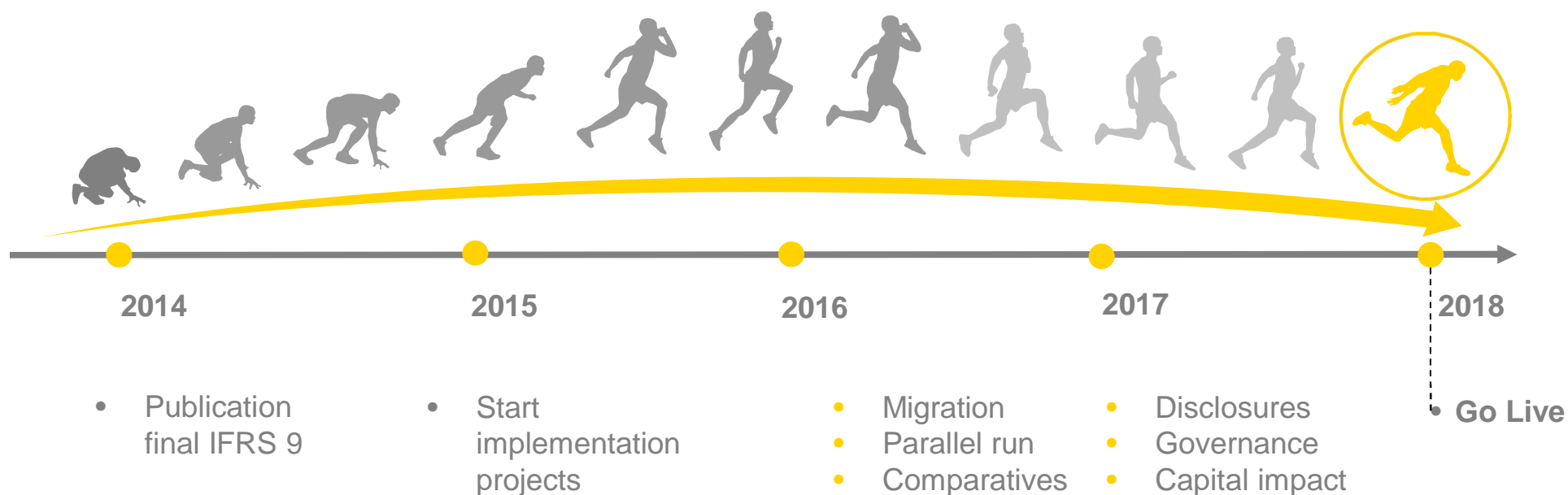|	
1	Overview of IFRS 9
2	Classification and measurement
3	Impairment approaches
4	Q&A

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Overview of IFRS 9

► IFRS 9 is one of the largest accounting changes since the introduction of IFRS

► Aimed at addressing the "too little, too late"

► Much more than an accounting change

  o Data and IT systems

  o Tax

  o Regulatory impact (banks and financial institutions)

► Significant judgements and estimates in the accounts

► Industry effort towards consistency expected to continue beyond 2018

► Transparent and informative disclosures will be key

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IFRS 9 implementation timeline

2014

2015

2016

2017

2018

- Publication final IFRS 9

- Start implementation projects

- Migration
- Parallel run
- Comparatives

- Disclosures
- Governance
- Capital impact

Go Live

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Overview of IFRS 9

▶ In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments to replace IAS 39 Financial Instruments: Recognition and Measurement, which brings together the three aspects:
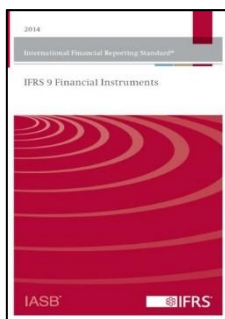
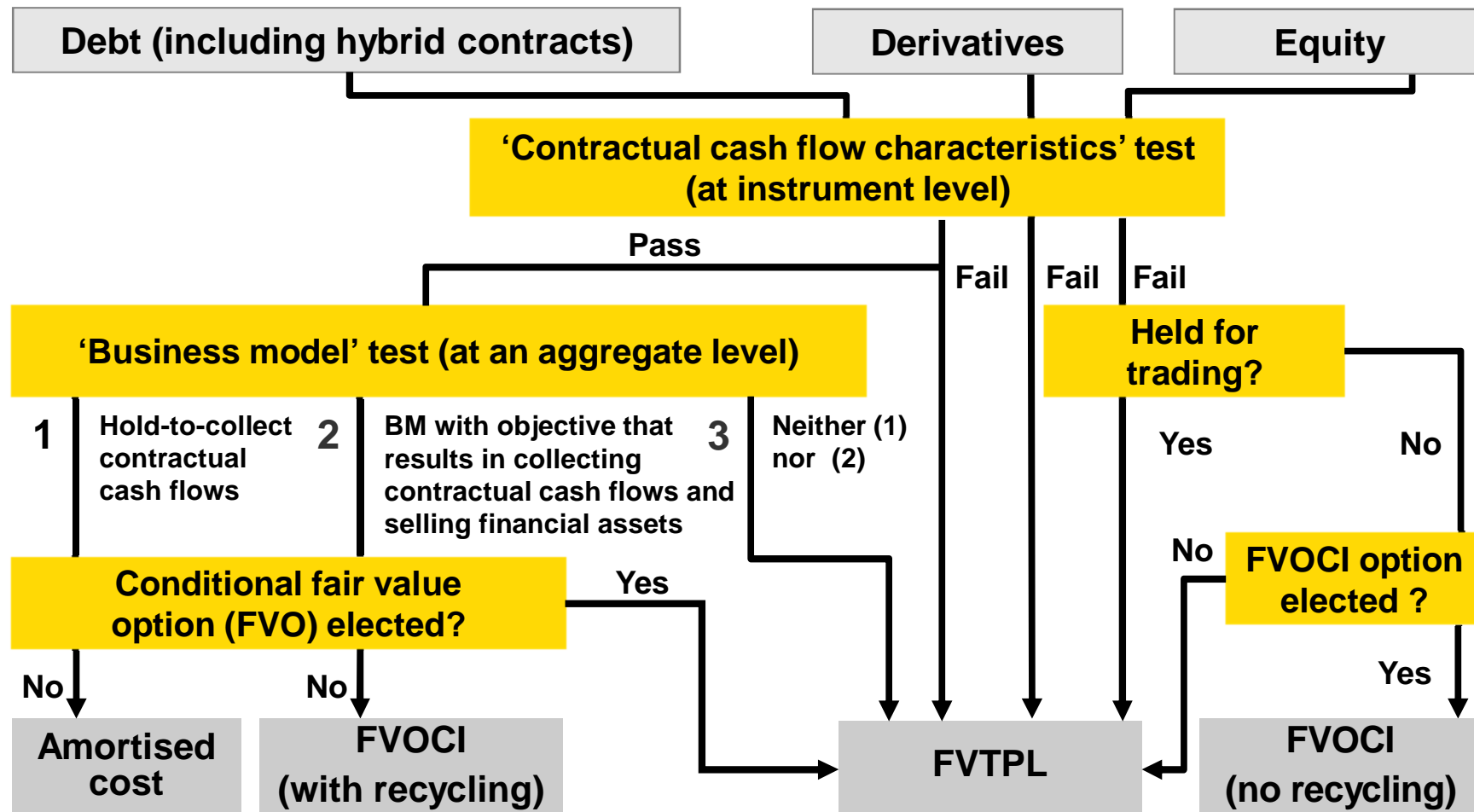| 1	Classification and Measurement
2	Impairment (expected credit losses)
3	Hedge Accounting (micro)

▶ Effective for annual periods beginning on/after 1 January 2018, early application permitted
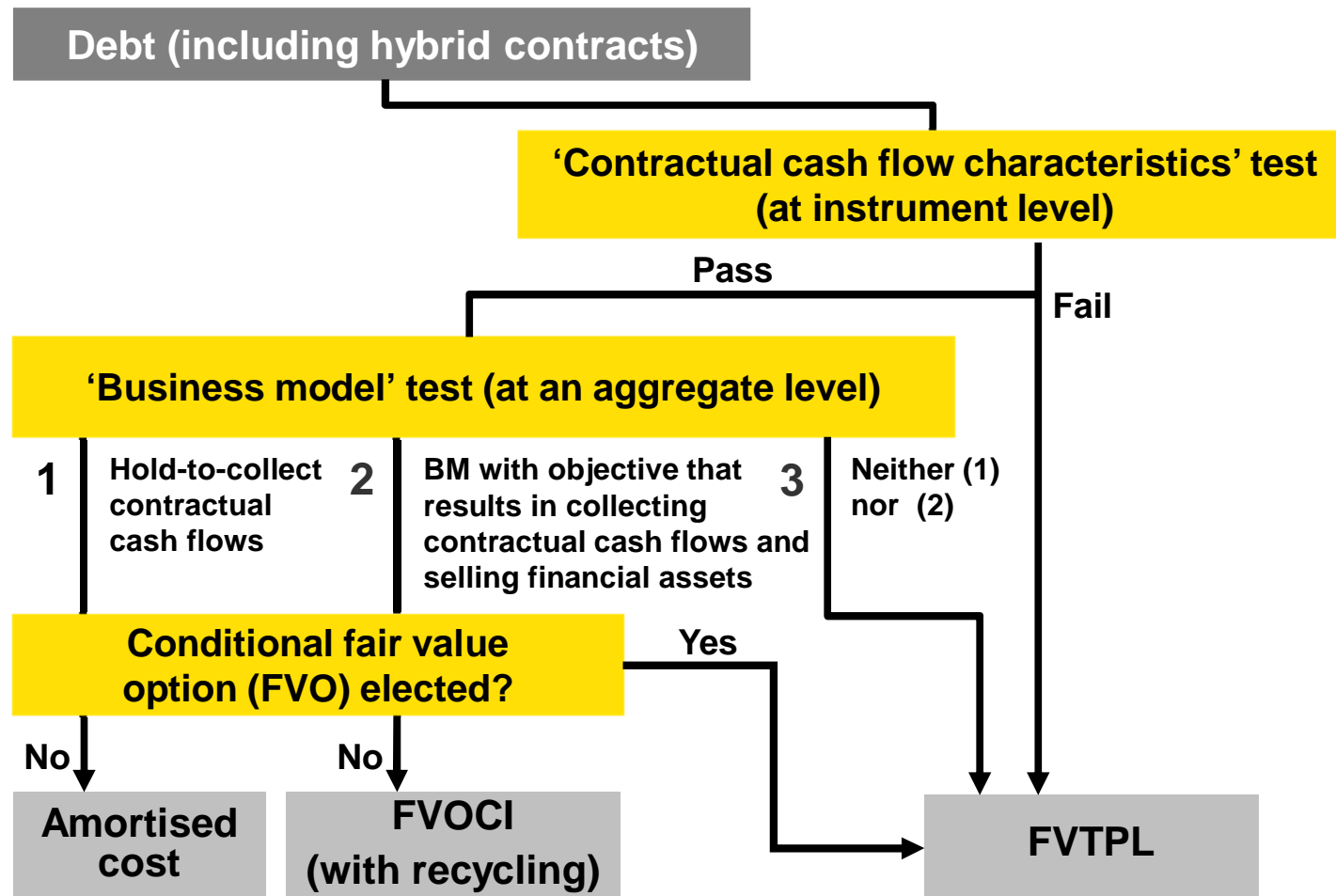
▶ Retrospective application with transition reliefs.
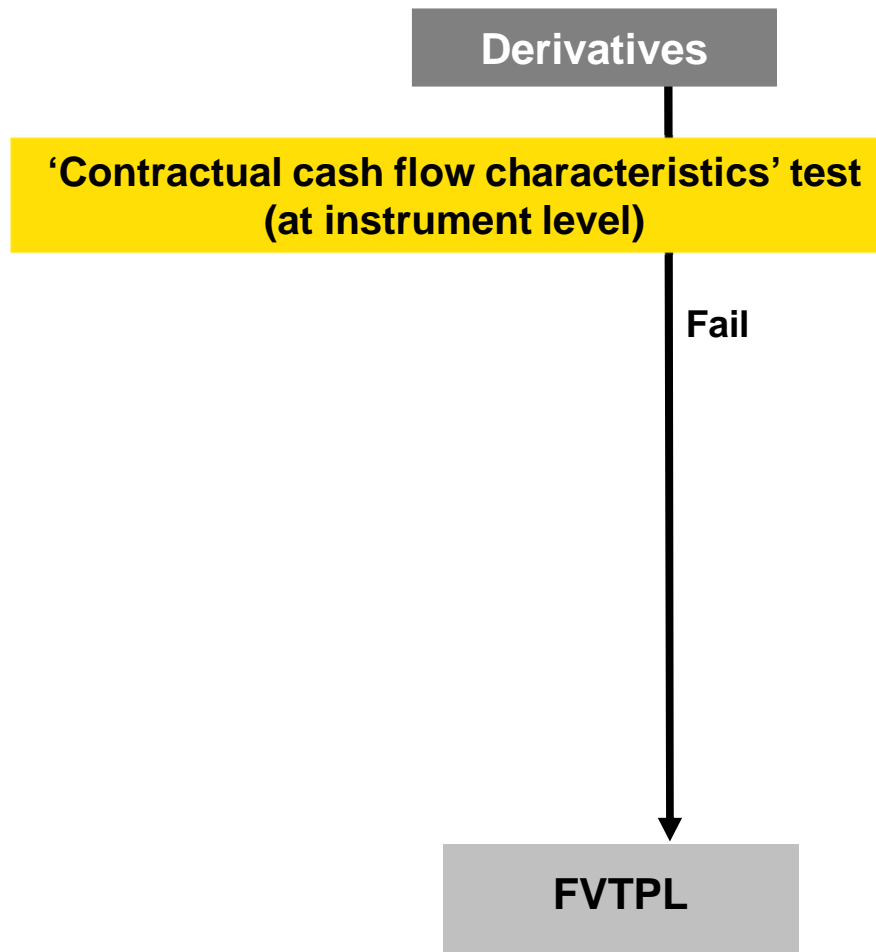
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Classification and measurement

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The new classification and measurement model for financial assets

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The new classification and measurement model for financial assets

Debt (including hybrid contracts)

'Contractual cash flow characteristics' test (at instrument level)

Pass

Fail

'Business model' test (at an aggregate level)

1 Hold-to-collect contractual cash flows

2 BM with objective that results in collecting contractual cash flows and selling financial assets

3 Neither (1) nor (2)

Conditional fair value option (FVO) elected?

Yes

No

No

Amortised cost

FVOCI (with recycling)

FVTPL

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The new classification and measurement model for financial assets

Derivatives

'Contractual cash flow characteristics' test (at instrument level)

Fail

FVTPL

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The new classification and measurement model for financial assets

Equity

'Contractual cash flow characteristics' test (at instrument level)

Fail

Held for trading?

Yes

No

No

FVOCI option elected ?

Yes

**FVTPL**

FVOCI (no recycling)

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Impairment

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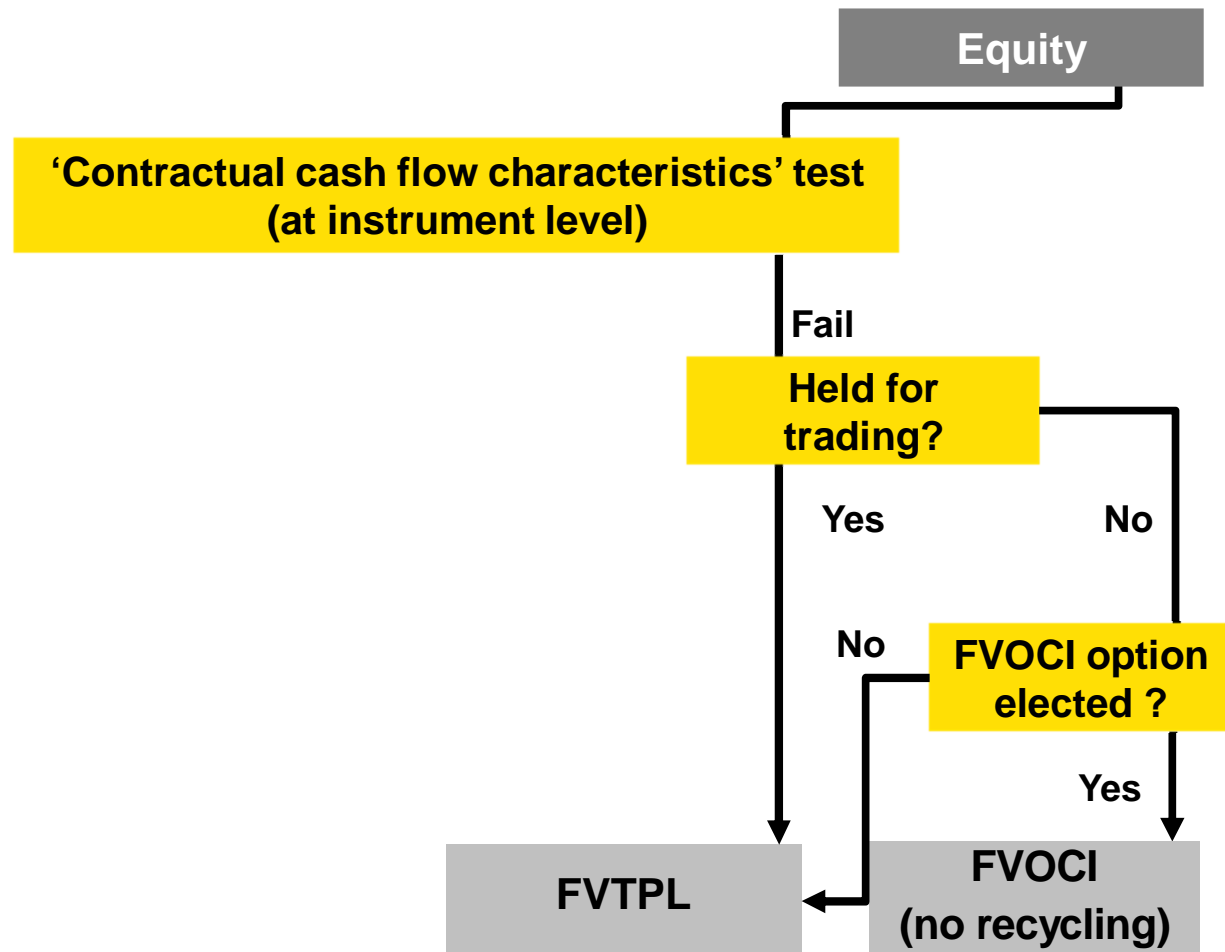
Impairment - Approaches

► In applying the IFRS 9 impairment requirements, an entity needs to follow one of the approaches below:-

  ► **The simplified approach** – The simplified approach does not require an entity to track the changes in credit risk , but, instead, requires the entity to recognise a loss allowance based on the lifetime ECLs at each reporting date, right from origination

  ► **The general approach** – Under this approach, at each reporting date, an entity recognises a loss allowance based on either 12 months ECLs or lifetime ECLs depending on whether there has been significant increase in credit risk.

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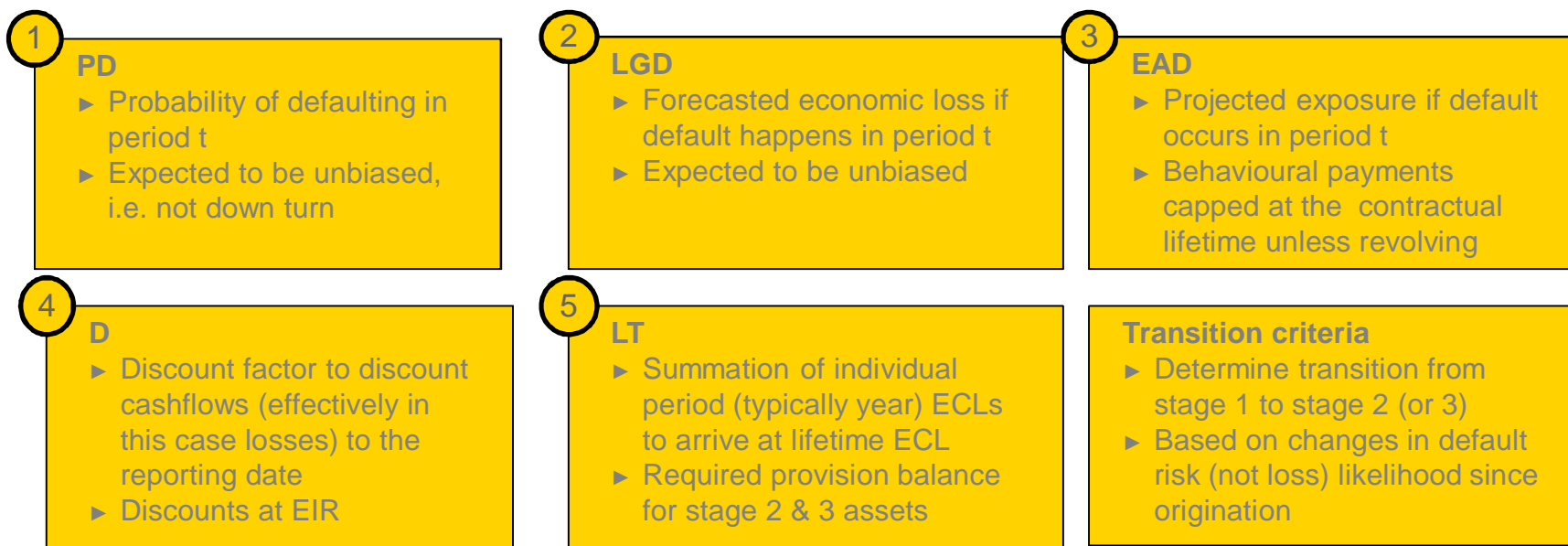# General Approach - Overview

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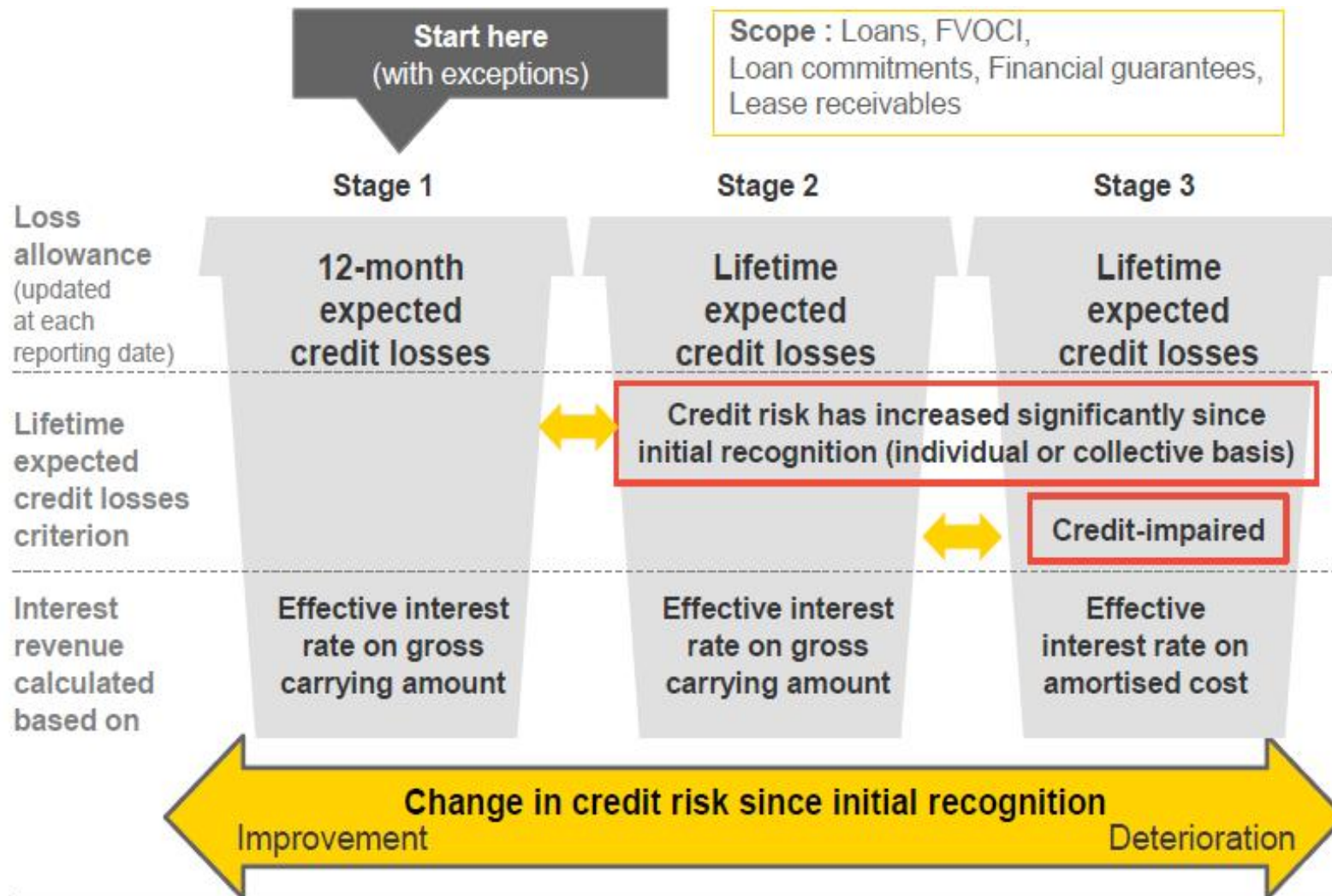
Overview of impairment model (cnt)

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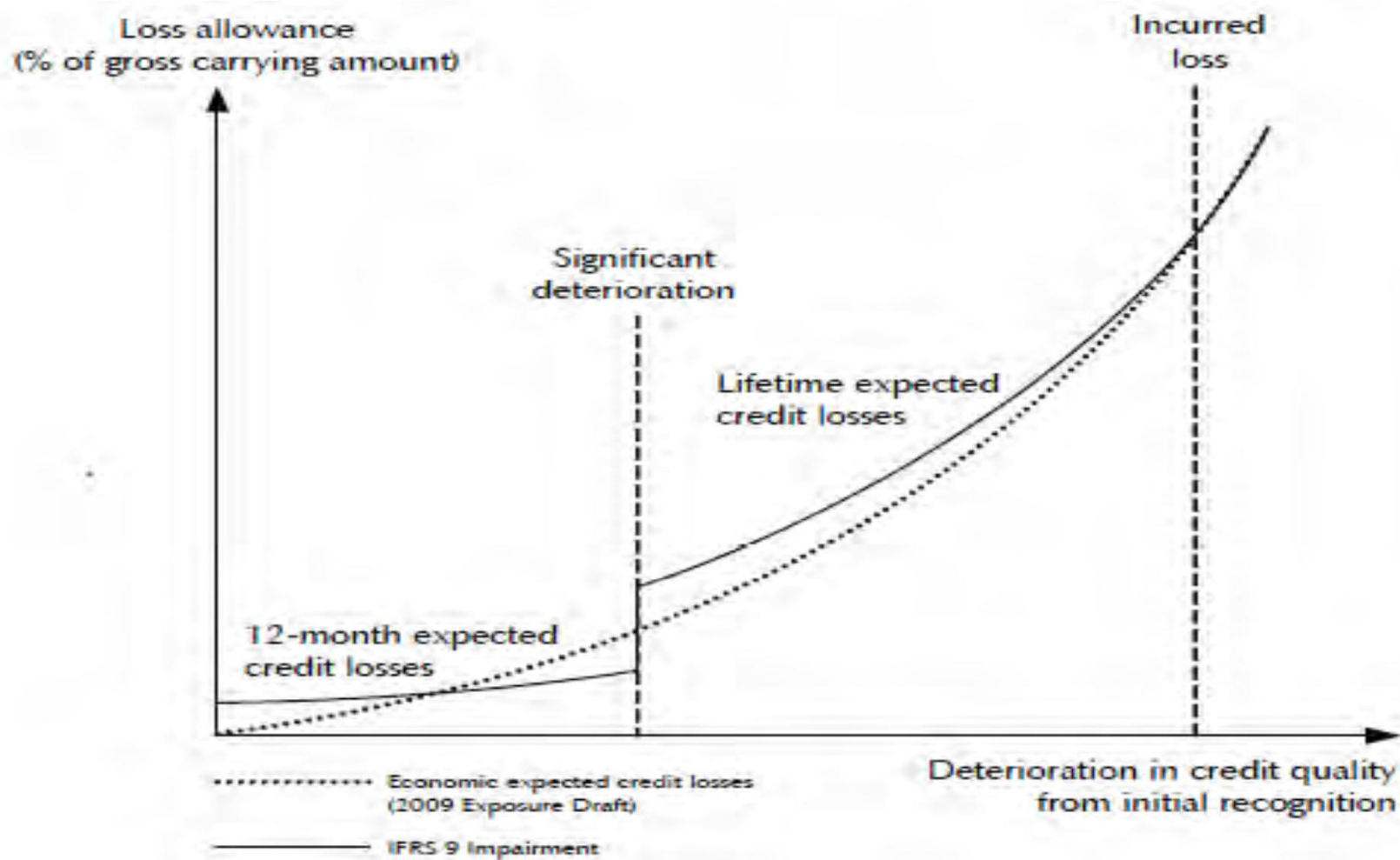
General approach - Measurement of ECL

$$ECL_{12m} = PD_{12m} \times LGD_{12m} \times EAD_{12m} \times D_{12m}$$

$$ECL_{LT} = \sum_{t=1}^{LT} PD_t \times LGD_t \times EAD_t \times D_t$$

1 PD
- ► Probability of defaulting in period t
- ► Expected to be unbiased, i.e. not down turn

2 LGD
- ► Forecasted economic loss if default happens in period t
- ► Expected to be unbiased

3 EAD
- ► Projected exposure if default occurs in period t
- ► Behavioural payments capped at the contractual lifetime unless revolving

4 D
- ► Discount factor to discount cashflows (effectively in this case losses) to the reporting date
- ► Discounts at EIR

5 LT
- ► Summation of individual period (typically year) ECLs to arrive at lifetime ECL
- ► Required provision balance for stage 2 & 3 assets

Transition criteria
- ► Determine transition from stage 1 to stage 2 (or 3)
- ► Based on changes in default risk (not loss) likelihood since origination

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Overview of IFRS 9, ctnt

What will change...

Financial assets	• New principles based classification criteria • Contractual cash flow characteristics and business models now drive classification • Impairment assessment only applies to debt instruments at amortised cost & FVOCI • Impairment assessment for loan commitments and financial guarantee contracts. • Tainting rule has been expunged • No need separate embedded derivatives from host contract • Equities must be measured at fair value
Financial liabilities & Hedge accounting	• Eligible hedge items have been expanded • No longer required to perform retrospective effectiveness test • 80 -125% test has been removed • Designation of hedge relationship continues (even when ineffective) as long as risk management objectives remains unchanged.

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Overview of IFRS 9, ctnt
Impairment – consequences

► **Increase** in the level of loss allowances

► Greater **volatility** in loss allowances

► Greater **subjectivity**

► Results probably be **less comparable**

► Lots of new impairment **disclosures**

► May affect behaviours

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Hedging overview
Why the change?

IAS 39 criticized

Too complex

Rules based

Not aligned with risk management activities

Disclosures lack sufficient transparency

IFRS 9 improves the current model

Rules broadened: more economic hedging strategies will qualify

Disclosures revamped to improve transparency

Types of hedges & the main mechanics of hedge accounting are unchanged

Still to come…

IFRS 9 hedge accounting is not finalised

Dynamic risk management project (macro-hedging)

Transition choices exist to avoid double implementation

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Questions