June 2009

International Financial Reporting Standards

Financial Instruments Recognition and Measurement: Replacement of IAS 39

June 23 2009 Project Update

IASC Foundation

2008 IASC Foundation | 30 Cannon Street | London EC4M 6XH | UK | www.iasb.org

Timetable
One project – three stages

Project stage	Exposure Draft	Finalisation
1. Classification and Measurement (Board deliberations ongoing)	**July 2009**	**In time for year end financial statements 2009**
2. Impairment (Board deliberations ongoing)	October 2009	Full replacement of IAS 39 during 2010
3. Hedge Accounting (Board deliberations not started yet)	December 2009	Full replacement of IAS 39 during 2010

Classification and measurement Overview of approach considered

Amortised cost

- Basic loan features <u>&</u>
- Managed on contractual yield basis
- (No tainting and no need to assert intent and ability to HTM)

Fair Value

- All other instruments
- elective OCI presentation available for equity investments not held for trading
- Fair value option for mismatches

Classification and Measurement

Approach considered for embedded derivatives

- Embedded derivatives with financial hosts
  - Bifurcation of embedded derivatives will be eliminated
  - **One classification approach (excluding hybrids with non-financial hosts)**
  - Also applied to concentration of credit risk
- Embedded derivatives with non-financial hosts
  - not addressed at this stage

Classification and Measurement

Approach considered for presentation in other comprehensive income (OCI)

- Scope – available for all equity instruments that are not held for trading
- Characteristics:
  - Optional instrument by instrument
  - No recycling, impairment or change in presentation
  - Dividends recognised in OCI

Classification and Measurement

Approach considered for fair value option (FVO)

- **FVO for accounting mismatches only**
- The classification approach being considered makes two of the existing FVO criteria irrelevant
  - instruments that have basic loan features and are managed on a contractual yield basis measured at amortised cost
  - embedded derivative accounting is eliminated for hybrid contracts with financial hosts

Classification and measurement
What would this approach change?

IAS 39	Approach being considered
Many classification categories eg held to maturity investments, available for sale financial assets, loans and receivables, fair value through profit and loss…all with different measurement methods	Two measurement methods: Fair value or Amortised cost Elective presentation of fair value changes of equity instruments in OCI (unless held for trading) with no recycling or impairment requirements
Tainting rules for held to maturity category	No tainting rules or need to assert HTM
Cost exemption for unquoted equity instruments and related derivatives	No cost exemption
Reclassification under certain circumstances	No reclassification
Hybrid instruments are assessed for embedded derivatives which may result in bifurcation of the hybrid instrument into a derivative financial instrument and a non-financial host	No bifurcation of embeddeds for financial hosts – use classification categories above Retain existing requirements for non-financial hosts

Example 1 – effect of classification and measurement being discussed

AFS equity instrument – changed to:

If held for trading → **Fair value - with changes recognised in profit or loss**

Not held for trading → **Fair value – irrevocable choice of recognising changes in P&L or OCI**

Example 2 – effect of classification and measurement being discussed

AFS debt instrument (basic loan features):

Managed on a contractual yield basis → **Amortised cost**

Fair value option available if there is an accounting mismatch

Not managed on a contractual yield basis → **Fair value through P&L**

Example 3 – effect of classification and measurement being discussed

Debt instrument with embedded derivative features:

Hybrid contract (as a whole) has basic loan features and is managed on a contractual yield basis → **Whole instrument at amortised cost**

All other hybrid contracts with financial hosts → **Whole instrument at fair value through P&L**

Approach considered for transition and effective date

- Retrospective, but with some transition reliefs
  - On adoption assets and liabilities will be classified under the new criteria – so reclassification required
- Likely mandatory date for adoption – not before1 January 2012
- Available for 2009 year end financial statements

Classification and measurement
Possible alternative features discussed

Same as approach considered, <u>except</u>:

- Two measurement models applied:
  - Fair value in balance sheet, except loans & receivables
  - Amortised cost in P&L for basic loan instruments managed on contractual yield basis, with OCI the balancing item

Impairment
Where have the IASB got to?

- IASB has already had extensive discussions about a possible expected loss impairment approach
  - included discussions with some interested stakeholders
- Education sessions conducted – presentations on operational aspects of expected loss impairment and dynamic provisioning
- Wider consultation needed given the significant impact any proposed change could have
  - Request for initial input via website posting
- IASB will issue ED in October 2009

Replacement of IAS 39
Outlook and associated areas

- Classification and measurement ED in July 2009
- Invitation to comment on own credit risk in liability measurement
  - Comment period until 1 September 2009
- Request for information on feasibility of an expected cash flow approach to impairment
  - To be posted on the IASB website by end of June 2009