International Financial Reporting Standards

Replacement of IAS 39

IASC Foundation

Timetable for IAS 39 replacement
One project – three phases

	Phases	Due process documents	Finalisation
FASB ED to cover all phases	**1. Classification and measurement**	**ED published in July 2009** **IFRS 9 published on 12 Nov 2009**	**In time for year end financial statements 2009 for financial assets** **During 2010 for financial liabilities**
	2. Impairment methodology	ED published in November 2009 Comments due by 30 June 2010	During 2010
	3. Hedge accounting	Target: issue ED that allows finalisation in 2010	During 2010

Overview of classification model for financial assets only - recap

Business model

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Contractual cash flow characteristics

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Amortised cost (one impairment method)

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FVO for accounting mismatch (option)

Reclassification <u>required</u> when business model changes

All other instruments:
- Equities
- Derivatives
- Some hybrid contracts
- …

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Fair Value (No impairment)

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Equities: OCI presentation available (election)

Financial liabilities – way forward

- Feedback to ED ➔ financial liabilities less urgent
- Board wants to address the issue of ‘own credit risk’ based on feedback received
- Symmetry ➔ not necessary
- Ultimately **excluded financial liabilities from the scope of IFRS 9 for 2009 year ends**
- Allows more time to seek input on the best way to address own credit risk
- Objective ➔ revised classification and measurement for financial liabilities during 2010
- Discussing jointly with the FASB

Financial liabilities – alternatives considered

- Alternatives would apply to financial liabilities that:
  - **are** managed on a contractual cash flow basis; and
  - **do not** have ‘basic loan features’
- Alternatives for these financial liabilities:
  1. Measure at fair value but recognise effect of changes in ‘own credit risk’ in OCI
  2. Measure at adjusted fair value that excludes effect of changes in ‘own credit risk’
  3. Bifurcate
  4. Measure at amortised cost with fair values presented in brackets on face of balance sheet
  5. Measure at fair value with <u>all</u> changes in OCI
- In first two alternatives, the ‘own credit risk’ portion would be separated in a manner similar to that used in IFRS 7 for disclosure (IFRS 7 B4)

Financial liabilities – <u>tentative</u> decisions

To address the issue of ‘own credit risk’ the Board decided to:

- Retain the measurement requirements in IAS 39 for financial liabilities:
  - liabilities held for trading ➔ fair value through P&L
  - hybrid liabilities ➔ bifurcation requirements in IAS 39
  - ‘vanilla’ liabilities (not HFT) ➔ amortised cost
- Carry forward the FVO
  - 3 eligibility conditions in IAS 39
  - additional requirements for ‘own credit risk’ portion of the change in fair value

Financial liabilities – <u>tentative</u> decisions

- For all liabilities designated under the FVO, an entity must:
  - – recognise all changes in fair value in profit or loss; and
  - – recognise the change in own credit risk in OCI (with an offsetting entry to P&L)
    - ➢ amounts in OCI will <u>not</u> be recycled if the liability is derecognised prior to maturity
    - ➢ the ‘own credit risk’ portion would be separated in a manner similar to that used in IFRS 7 for disclosure (IFRS 7 B4)

Question

- The Board tentatively decided the effect of own credit would be split out whenever the FVO is used
- Some Board members queried whether that is appropriate when assets are managed on a fair value basis
- Are you aware of any situations when splitting out the effect of own credit (if calculated as the change in margin over the benchmark rate) may CAUSE a mismatch?
  - Eg if a AA rated issuer issues debt to fund AA rated structured bonds.
  - The AA asset is fair valued (in its entirety) through P&L. The liability is fair valued but the change in the AA margin is excluded from P&L

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Hedge Accounting – Broad direction

- Phasing:
  - general hedge accounting first
    - modification of fair value hedge accounting
    - simplification of cash flow hedge accounting mechanics and other requirements
  - in the context of the general approach consider specific aspects:
    - portfolio hedge accounting
    - hedge accounting for hedges of net investments in foreign operations

Hedge Accounting – tentative approach

IAS 39

Fair value hedge accounting	Cash flow hedge accounting

Simplifications to existing hedge accounting requirements

Fair value hedge	Cash flow hedge
Cash flow hedge accounting mechanics	

- Gains/losses on effective portion in OCI
- Any ineffectiveness recognised in P/L
- Hedged item is not remeasured
- Lower of test is not used for fair value hedges

Hedge Accounting – tentative decisions

- Eligible hedged items
  - Items measured at amortised cost under IFRS 9 are eligible
  - Derivatives (in some situations, in particular when the hedged exposure is a combination of a derivative and a non-derivative)
  - Components
    - Nominal amounts ie ‘proportions’, percentages
    - One-sided risks
    - Develop new criteria for risk components ie ‘portions’

Economic hedges – Questions

1. Are there any economic hedges that your organisation enters into where it is currently impossible or difficult to apply hedge accounting?
2. If so, what types of hedges and why is it difficult to achieve hedge accounting?
3. How would you suggest this impossibility/difficulty be dealt with?

Next steps…

- Continue outreach efforts (users and preparers)
- Board discussions on:
  - eligible hedged risks, items and hedging instruments
  - treatment of option premiums
  - simplifications of existing hedge accounting requirements (in particular effectiveness testing)
  - designation, hedge accounting as a choice
  - presentation and disclosures (including basis adjustments)
- Finalise exposure draft

Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.