IFRS 9 Financial Instruments: Project Update

Global Preparers Forum: Agenda Paper 5A

8 November 2010

The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB or IFRS Foundation

Agenda

- Mandatory effective date and transition
- Hedge accounting
  - General model
  - Macro model
- Impairment
- Offsetting

Mandatory effective date and transition

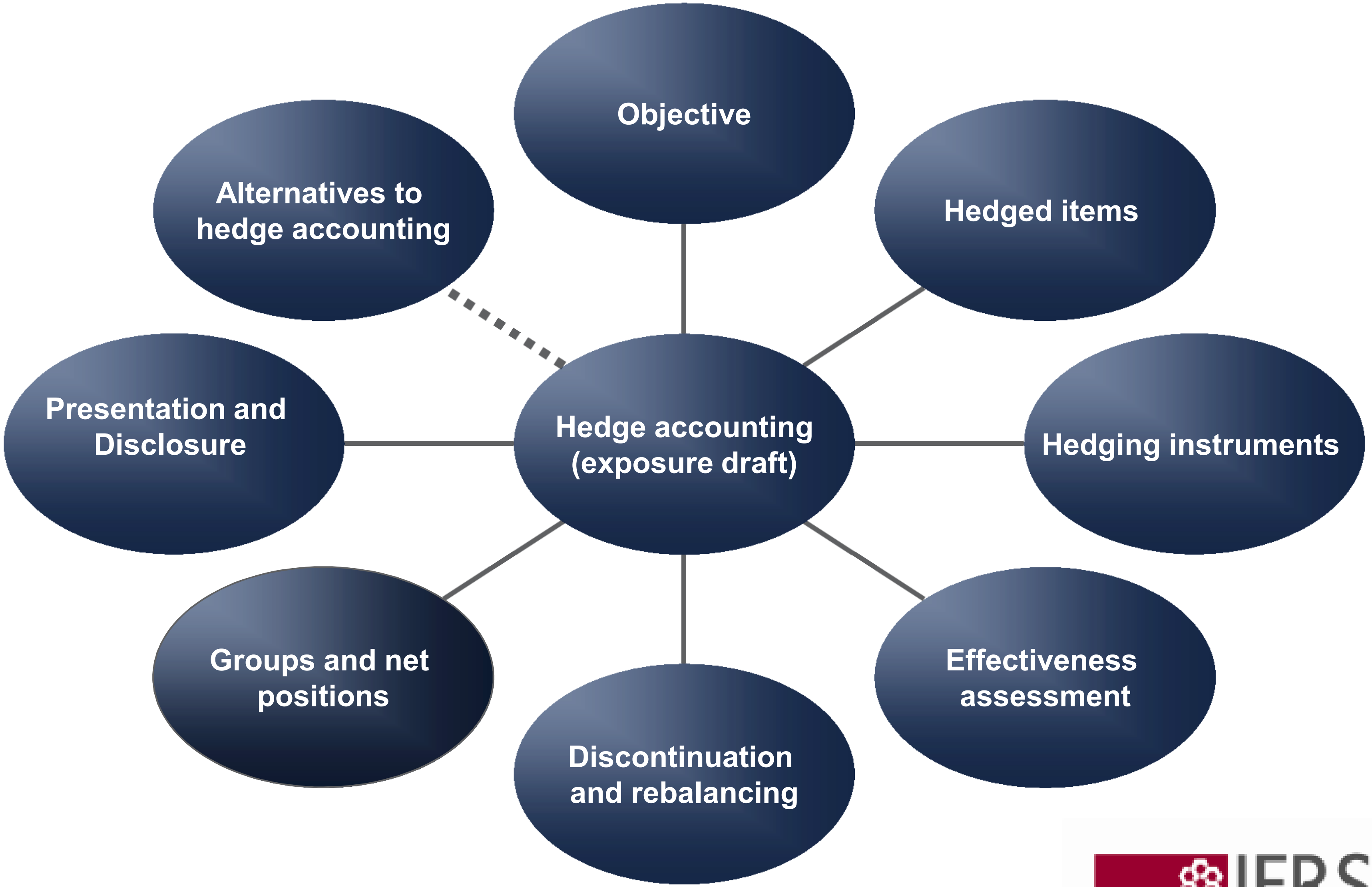
IFRS 9: Mandatory effective date

- ED proposing to extend the mandatory effective date to 1 January 2015
- Comment period closed on 21 October 2011
- In November 2011, the Board will consider comments received on the ED
- The amendment, if any, would be issued by late November

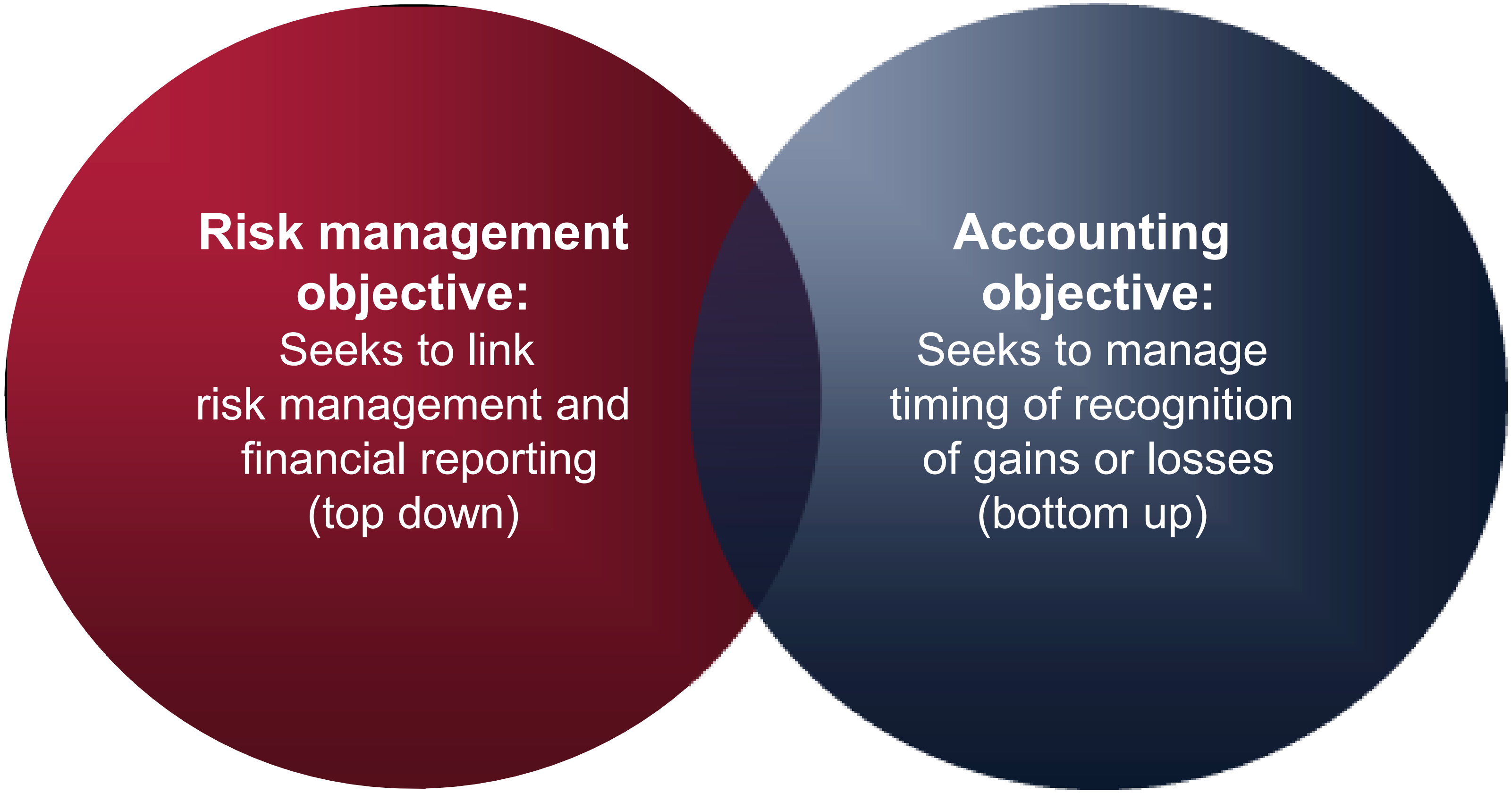
International Financial Reporting Standards

Hedge Accounting: General Model

Components of the hedge accounting model



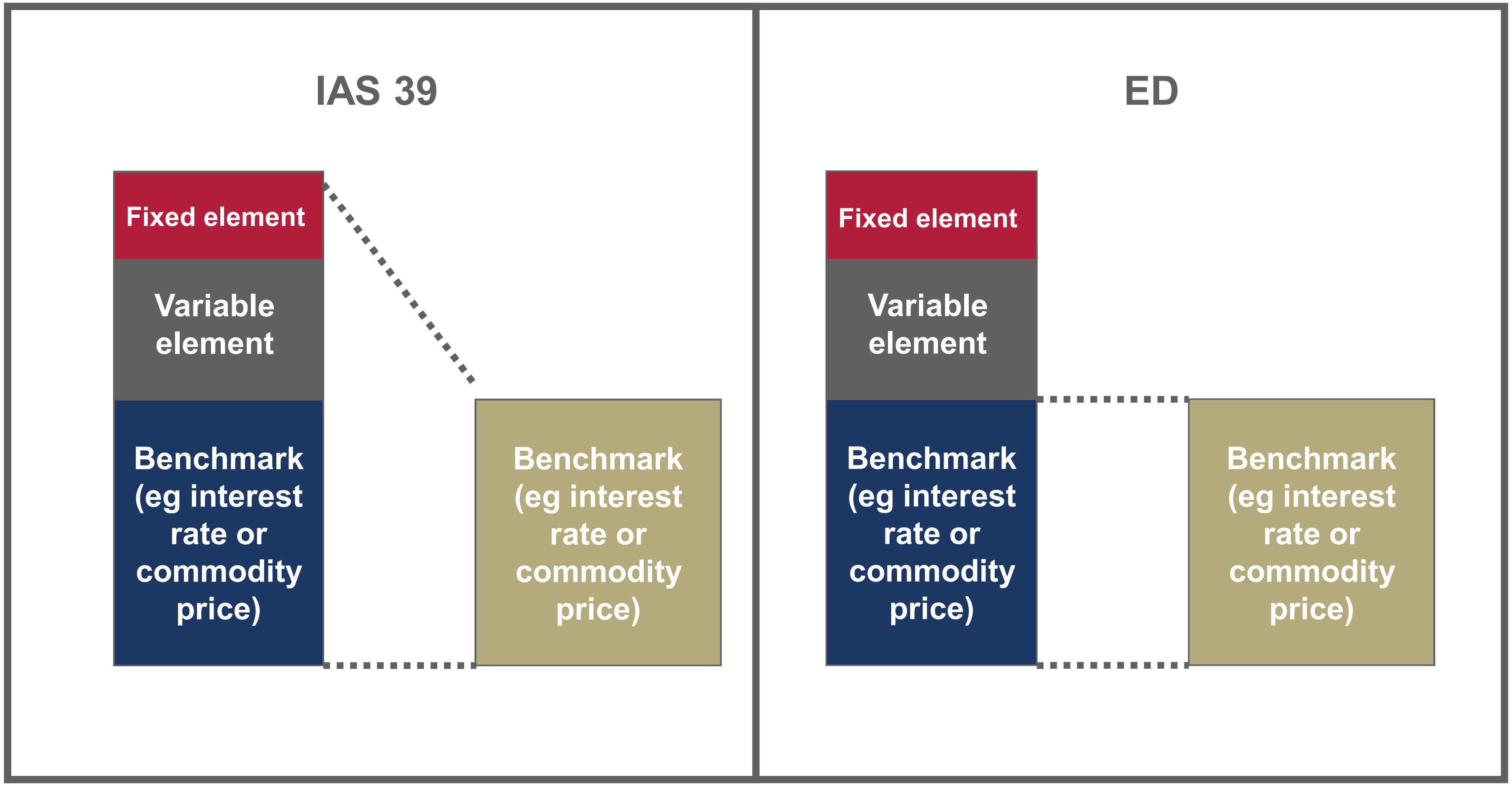
Objective


Risk management objective:
Seeks to link
risk management and
financial reporting
(top down)
Accounting objective:
Seeks to manage
timing of recognition
of gains or losses
(bottom up)

Hedged items

- Qualifying hedged item
  - Entire item
  - Component
    - Risk component (separately identifiable and reliably measurable)
    - Nominal component or selected contractual CFs

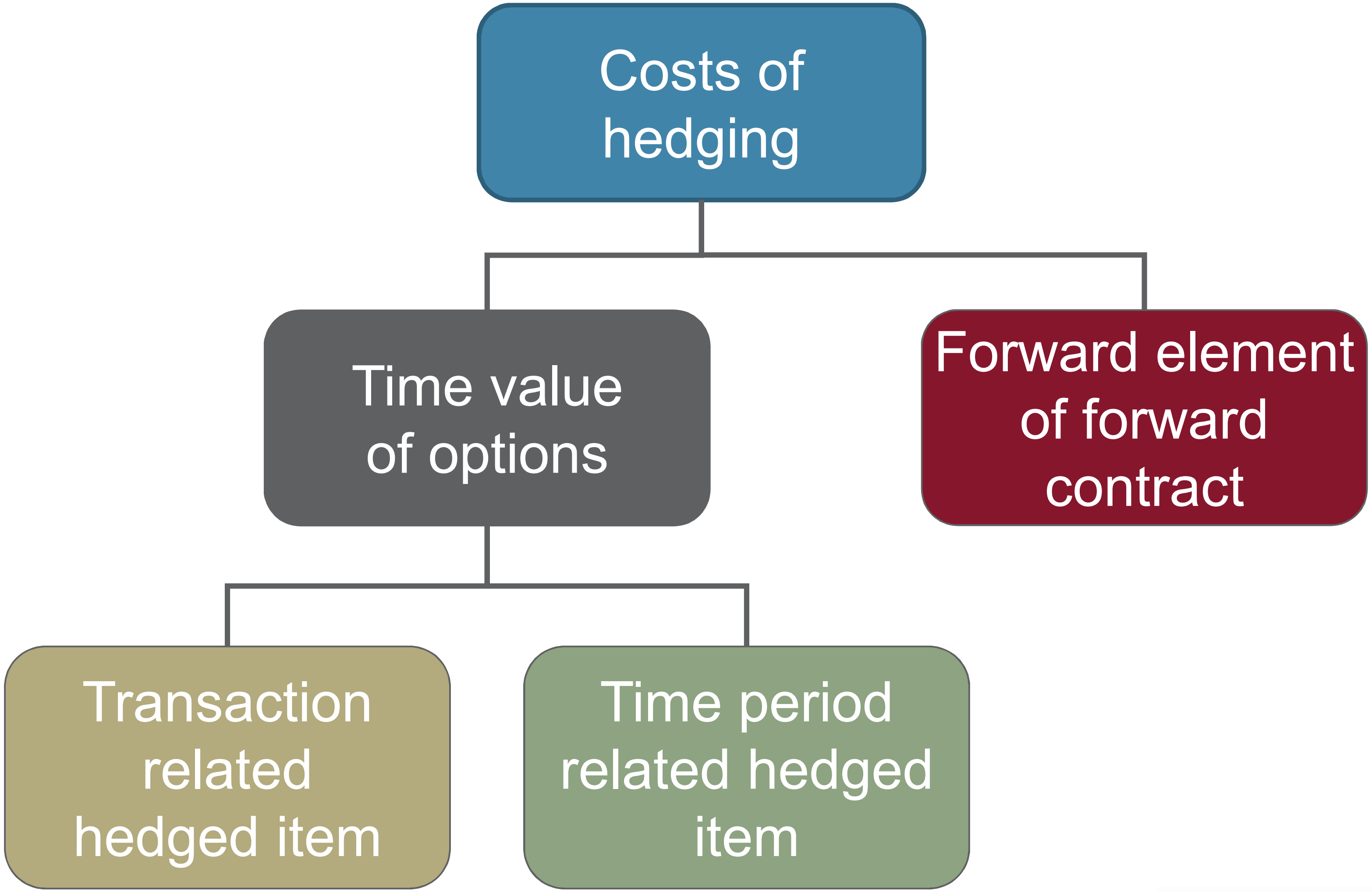
Hedged items: risk components



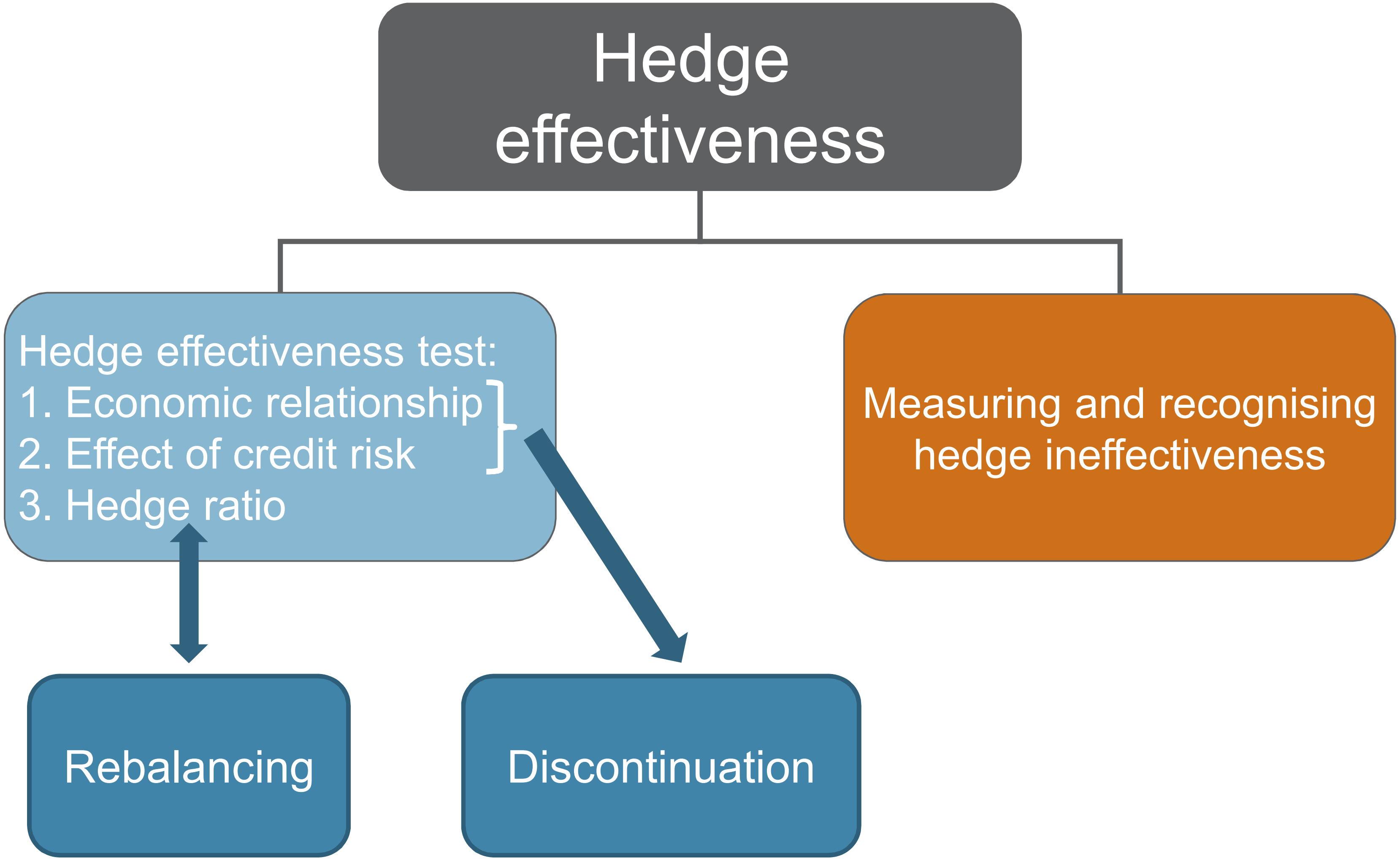
Hedging instruments

- **Qualifying hedging instruments**
  - Entire item
  - Partial designation
    - FX risk component
    - • Intrinsic value
      • Spot element
    - Percentage of nominal amount

Costs of hedging

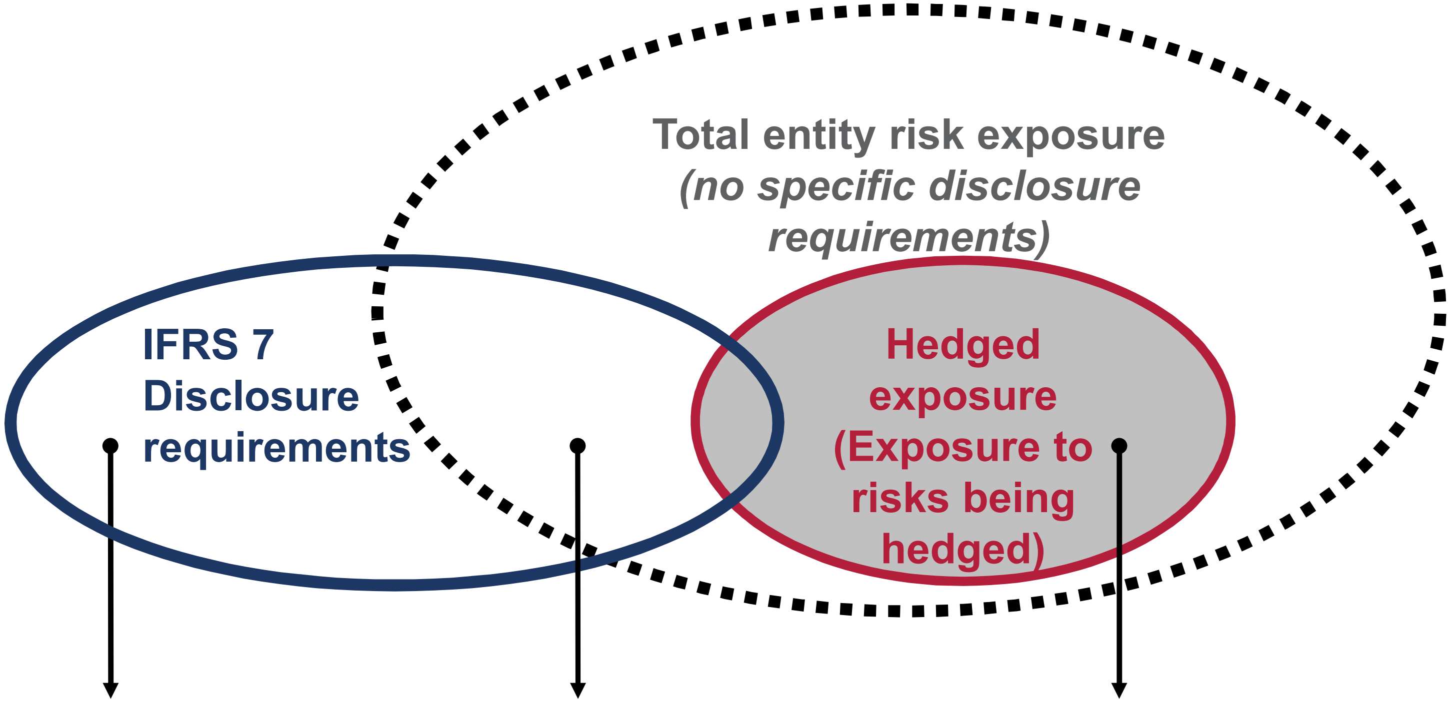


Hedge effectiveness



Disclosures: scope

Proposed scope for hedge accounting disclosures



Significance of financial instruments for financial position and performance

Nature and extent of risks arising from financial instruments

Entity's exposure attributable to the hedged risk

Disclosures

- Hedge accounting disclosures
  - Risk management strategy
  - Amount, timing and uncertainty of future cash flows
  - Effects of hedge accounting on the primary financial statements
  - Specific disclosures for dynamic strategies and credit risk hedging

Alternatives to hedge accounting

Alternatives

‘Own use’ scope exception in IAS 39

Eligible for FVO in IFRS 9

Credit derivatives

Elective FVTPL

- At initial recognition or subsequently
- At discontinuation: amortisation

Transition

- Prospective transition with limited exceptions
  - Retrospective application
    - Required for time value of options
    - Permitted for accounting for forward elements (if elected, applies to all such hedging relationships)
  - Practical expedients
    - Allowed to consider the moment IAS 39 ceases to apply and the moment from which the new model applies as one point in time
    - For rebalancing, the starting point will be the hedge ratio used under IAS 39 (any gains or losses will be recognised in profit or loss)
  - Hedging relationships that qualified under IAS 39 and qualify under the new model will be treated as *continuing* hedging relationships

General hedge accounting: timetable

- Exposure Draft on general hedge accounting published December 2010
- Redeliberations started in March 2011—completed in September 2011
- Staff draft of final general hedge accounting requirements available on website in Q4 2011 (for about 3 months)
- Effective date will be aligned with other phases of IFRS 9
  - Annual periods beginning on or after 1 January 2013/2015* with earlier application permitted
  - All existing IFRS 9 requirements must be adopted at the same time (or already have been adopted)

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Hedge Accounting: Macro Model

Status of the Macro Hedge Accounting Project

Fact finding

Project status

Common themes

Common themes

Implications for accounting model

Implications for accounting model

Sept 2011

Design of accounting model

Design of accounting model

Interest rate risk

Other risks

Insights from the project so far

Transfer (Benchmark) Prices - Component

Consumer Loans

Mortgage Loans

Commercial Loans

- Margin:
  contractual market rate vs. internal transfer price
- Impairment Risk/Prepayment Risk/Market Rate Risk
- Volatility in profit or loss due to:
  Uncertainty regarding impairment and prepayment (model risk)
- Margin for new business dependent on market forces

Asset Liability Management (ALM)

- Margin (Bid-Offer Spread of Transfer Prices)
- Repricing Risk / Yield Curve Risk / Basis Risk
- Use of Risk Limits for Management
- Volatility in net profit and loss due to:
  - Differences in timing of cash flows
  - Basis differences
  - Amount differences (vintage)
  - Open positions

Demand Deposits

Time Deposits

Other Liabilities

- Margin:
  internal transfer price vs. contractual market rate
- Prepayment Risk / Market Risk
- Volatility in profit or loss due to:
  Uncertainty regarding prepayment (model risk)
- Margin for new transactions dependent on market forces

Internal Transactions (Derivatives)

Influence on risk limit and target cash flow profile

Treasury

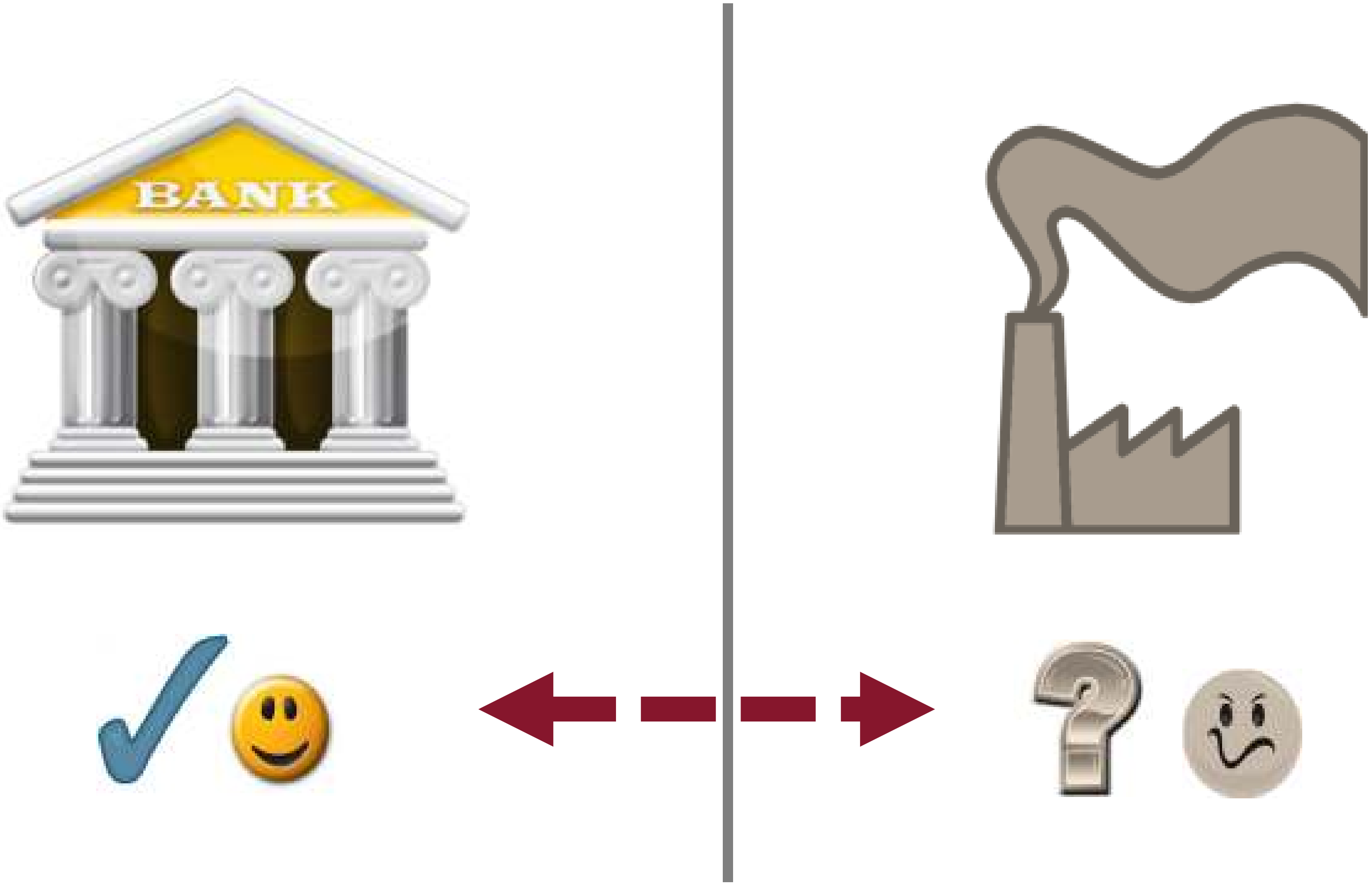
Trading Unit

- Management within predefined risk limits.
- Trading Unit takes and manages the counterparty risk of the entire derivative position.

Equity

- Capital Protection
- Dividend targets

Applicability to other industries



Impairment

‘Three-bucket’ approach

Guiding principle: Reflect the general pattern of deterioration of credit quality of financial assets.

- Pattern of deterioration of credit quality is captured through a three-bucket approach
- Deterioration at some point leads to recognition of lifetime losses
- Based on expected credit losses (EL)
- Responsive to changes in information impacting credit expectations
- Builds on credit quality differentiation in joint Supplementary Document (SD)
- Robust disclosures to support principle of the model and to ensure comparability
- Model to be applicable for various types of financial assets and various types of entities.

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‘Three-bucket’ approach

Deterioration in credit risk	Bucket 1	Bucket 2	Bucket 3
Transfer between Buckets 1 - 3	All financial assets are initially classified in this bucket	Financial assets that deteriorated in credit quality since initial recognition	Financial assets that deteriorated in credit quality since initial recognition

Acknowledges link between pricing and credit risk <u>and</u> inappropriateness of recognising full lifetime losses on loans priced at market.

‘Three-bucket’ approach

Allowance balance

Bucket 1	Bucket 2	Bucket 3

Allowance balance equal to:

Bucket 1	Buckets 2 and 3
Less than lifetime expected losses	Full remaining lifetime expected losses

– The boards have not yet decided on the measurement of Bucket 1 allowance.
– Measurement of Bucket 1 allowance shall be based on a principle.

‘Three-bucket’ approach

Next steps

Boards to further discuss:

- Principle that underpins the measurement attribute of the credit allowance for financial assets in Bucket 1
- Principle and indicators for when recognition of lifetime expected losses becomes appropriate
- Application of the model for various types of financial assets and various types of entities
- Implication for purchased financial assets
- Scope of Bucket 2 and Bucket 3 (ie what is to be captured in Bucket 3)
- Disclosures

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Offsetting

Amendments to IAS 32 and disclosures

Criteria

IASB

- Retain basic IAS 32 offsetting requirements
- Add application guidance to improve consistency of application regarding:
  - the meaning of '<u>currently</u> has a legally enforceable right of set-off'; and
  - that some (non-simultaneous) gross settlement systems would be considered equivalent to net settlement
- Next steps
  - Final document planned for Q4 2011
  - Retrospective application
  - Effective for all periods beginning on or after 1 January 2013

FASB

- Continue to allow netting for particular derivatives / collateral with conditional rights of set-off

Amendments to IAS 32 and disclosures

Disclose information about rights of set-off and related arrangements associated with financial assets and financial liabilities to enable users to understand the effect of those rights and arrangements on the entity's financial position.

- Applies only to instruments under an enforceable master netting agreement or similar arrangement (eg derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, securities lending arrangements)

	a.	b.	c.	d.		e.
	Gross carrying amounts (before offsetting)	Gross amounts offset	Net amount presented in statement of financial position (a-b)	Amounts available to be offset in bankruptcy or default (not offset in statement of financial position)		Net exposure (c-d)
Category				Financial instruments	Collateral	
• Derivatives	X	(X)	X	(X)	X	X
• Repos and similar arrangements	X	(X)	X	(X)	X	X
• Other	X	(X)	X	(X)	X	X

Columns d and e could be shown by category of instrument or by counterparty

- Final document planned for Q4 2011
- Retrospective application
- Effective for interim and annual periods beginning on or after 1 January 2013

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.