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IFRS Advisory Council Meeting

Agenda reference **2**

Date **February 2012**

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Topic **Financial Instruments**

International Financial Reporting Standards

Financial Instruments

IASB Update for the IFRS Advisory Council

February 2012

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Agenda

- Financial instrument project timelines
- Completed Financial Instrument Agenda Projects
  - Mandatory Effective Date of IFRS 9 and Transition Disclosures
  - Offsetting Financial Assets and Financial Liabilities
- Active Financial Instrument Agenda Projects
  - Impairment of Financial Assets
  - Classification and Measurement of Financial Instruments
  - General Hedge Accounting
  - Macro Hedge Accounting

Financial instrument project timelines

Offsetting Financial Assets and Financial Liabilities

- *IFRS 7 Amendments effective date* — 1 January 2013
- *IAS 32 Amendments effective date* — 1 January 2014

General Hedge Accounting

- *Exposure draft* — Q4 2010, Comment period ended 9 March 2011
- *Review draft* — H1 2012
- *Target IFRS* — 2012

Impairment

- *Re-exposure or review draft* — H2 2012

Classification and measurement

- *Exposure draft* — H2 2012

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Completed Financial Instrument Agenda Projects

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Mandatory Effective Date of IFRS 9 and Transition Disclosures

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IFRS 9 Effective date

- IFRS 9 effective 1 January 2015
  - – Early application permitted
- Restatement of comparative financial statements not required
  - – Modified disclosures on transition

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Offsetting Financial Assets and Financial Liabilities

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Project timeline

Date	Milestone
January 2011	Joint exposure draft published
May 2011	Comment period ended
June 2011	Boards voted to keep their respective models
July 2011	Boards agreed on converged disclosures IASB decided to clarify IAS 32
September & November 2011	IASB agreed on clarifications to IAS 32
December 2011	Common offsetting disclosures published - effective 1 January 2013, retrospective application IAS 32 clarifications separately published- effective 1 January 2014, retrospective application

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Joint final disclosure requirements

- Responded to comments:
  - Preparers: Cost-benefit – scope, class vs. counterparty, existing disclosure requirements
  - Investors: Need for information about gross and net exposures
- Provide information about exposures in normal course *and* in times of stress
- Don't *reconcile* IFRSs and US GAAP but allow entities to be compared on a like basis

Gross amounts before offsetting (A)	Gross amounts set off (B)	Net amounts presented in balance sheet (C)	Other amounts in scope but not set off in balance sheet (D)	Net amounts (E)
[same for all preparers]	*[depends on offsetting model]*	*[depends on offsetting model]*	*[depends on offsetting model]*	*[same for all preparers]*

Final application guidance to IAS 32

- Comments received in comment letters and outreach highlighted inconsistencies in the application of the offsetting requirements in IAS 32
- In December 2011, the IASB separately clarified the application of the offsetting criteria in IAS 32, namely that:
  - To currently have a legally enforceable right of set-off, the entity must have a right of set-off legally enforceable in all of:
    - normal course of business;
    - event of default; and
    - event of insolvency or bankruptcy

    of the entity and all of the counterparties.
  - Some gross settlement systems considered equivalent to net settlement if they eliminate or result in insignificant credit and liquidity risk and process receivables and payables in a single settlement process or cycle.

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Active Financial Instrument Agenda Projects

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Financial Instruments: Impairment

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Joint project
Impairment: General overview

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

- Expected credit loss (EL) model
- Three-bucket approach
- Deterioration leads to recognition of lifetime losses
- Acknowledges inappropriateness of recognising full lifetime losses on financial assets priced at market
- Robust disclosures to support principle and ensure comparability

'Three-bucket' approach:

Bucket 1: 12 months expected loss allowance

All financial assets are initially classified in this bucket*

Bucket 2: Lifetime expected loss allowance

Evaluation performed on *groups* of financial assets

Bucket 3: Lifetime expected loss allowance

Evaluation performed on *individual* financial assets

Financial assets move out of Bucket 1 when:

1. there has been a *more than insignificant* deterioration in credit quality since initial recognition; **AND**
2. the likelihood of default is such that it is at least *reasonably possible* that all or some of the contractual cash flows may not be collected.

* Except for purchased financial assets with an explicit expectation of credit losses at acquisition, which are initially classified into Bucket 2 or 3, have an adjusted EIR and no initial allowance.

Lifetime credit loss recognition

- Assessment of lifetime credit loss recognition should be based on the likelihood of not collecting cash flows
- The model will include indicators for when the recognition of lifetime expected credit losses may be appropriate (ie when items move out of bucket 1)

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Unit of evaluation

- When evaluating for movement out of Bucket 1:
  - Required to evaluate a financial asset individually if it:
    - cannot be included in a group because the entity does not have a group of similar financial assets, or
    - is individually significant.
  - Permitted to evaluate financial assets individually or within a group of financial assets with ‘shared risk characteristics’.
  - May not group at a more aggregated level if shared risk characteristics of a sub-group indicate that transfer is appropriate.

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Purchased credit-impaired assets

- Assets purchased with an ‘explicit expectation of credit losses’
- IASB: Same population as IAS 39 today
- FASB: Consider whether scope should be broadened
- All purchased credit-impaired assets initially recognised in Bucket 2 or 3, but use a credit-adjusted effective interest rate
- No initial impairment loss recognised
- Effect of changes in credit loss expectations symmetrical (favourable changes in expectations immediately recognised in profit or loss as a reduction of impairment loss)
- Presented in statement of financial position at the transaction price without presentation of an allowance for implicit expected losses
- Disclosure of implicit expected losses required

Main open points and project timeline

- Practical expedients and application guidance
- Non-financial institutions, including trade receivables
- Loan commitments and financial guarantee contracts
- Restructurings
- Disclosures

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Classification and Measurement of Financial Instruments

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Limited modifications to IFRS 9

- Address specific application issues
- Consider interaction of IFRS 9 and insurance contracts project
- Consider ways to reduce differences with FASB's classification and measurement model

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Scope

- Clarify how characteristics test is to be applied
  - Consider providing additional guidance
- Reconsider need for bifurcation of financial assets
- To address interaction with the insurance contracts project and align with the FASB model, consider:
  - Introducing a third business model for debt instruments remeasured through OCI

Convergence efforts

- IASB and FASB have different models
  - IASB: IFRS 9
  - FASB: near-final model not yet exposed
- Both mixed measurement models
- Agreed in January 2012 to seek to reduce key differences
- Jointly redeliberate selected aspects of models
- Separate exposure drafts

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General and Macro Hedge Accounting

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Main themes

- Improves decision usefulness of information about hedge accounting for users of financial statements
- Better aligns economic hedging activities and hedge accounting
- Enhanced disclosures about risk management activities

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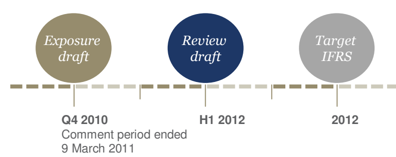
Key decisions

- Effectiveness testing
  - Remove the 80-125% bright line
  - Objective based assessment:
    - Economic relationship
    - Effect of credit risk
    - Hedge ratio (based on actual quantities of the hedged item and hedging instrument)
- Hedging of risk components
  - Eliminate the prohibition on hedging risk components of non-financial items—use a single set of criteria for all items
  - A hedged risk component must be separately identifiable and reliably measurable

Project timeline



- A review draft of the final requirements, including application guidance and a Basis for Conclusions, will be posted on the IASB website for approximately 90 days
- This will:
  - provide the Board with the opportunity to undertake an extended fatal flaw process and to undertake additional outreach, and
  - give the FASB the opportunity to consider the planned requirements
- The Board decided that re-exposure of the proposed IFRS would not be necessary and is therefore not formally requesting comments on the draft
- The Board plans to finalise the requirements once this review has been completed

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Macro Hedge Accounting

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Status update

- Decisions and Plans
  - Interest rate risk management in the banking industry has been starting point
  - Significant time spent on outreach and education about risk management of banks
  - Other industries also need macro hedge accounting
  - September 2011 first discussion asking Board for direction
  - Valuation approach discussed at the November meeting
  - December and January focussed on aspects of model in more detail

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Status update (cont'd) and project timeline

- Decisions and Plans
  - Further topics to be considered include:
    - Presentation of the valuation impact
    - Dealing with valuation assumptions (modelling)
    - Multi-dimensional risk management objectives
    - Floating leg of derivatives
    - Counterparty risk
    - Internal Derivatives and Risk Limits

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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.

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