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International Accounting Standards Board

Financial Accounting Standards Board

Financial Instruments Classification and Measurement: Business Model

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Agenda

- Introduction
- IFRS 9: Business Model Criterion (Financial Assets)
- FASB Tentative Model: Business Model Criterion (Financial Assets)
- IFRS 9 and FASB Business Model Comparison

Financial Instruments Classification and Measurement: Business Model

- This presentation describes *only* the **business model** assessment for classification and measurement of **financial assets** under IFRS 9 and the FASB's tentative model
- IFRS 9 and the FASB's tentative model also require assessment of the financial asset's cash flow characteristics
- Business model assessment only impacts classification of debt instruments

IFRS 9: Business Model (Financial Assets)

IFRS 9

Business Model Assessment

- Principle
 - Amortised cost category is defined
 - Business model whose objective is to **hold assets to collect contractual cash flows**
 - Business model is *not* hold to collect if the portfolio is managed and evaluated to realise cash flows through sale or on a fair value basis
 - Provides information about likely actual cash flows
 - FVPL category is a residual category
 - Includes financial assets held for trading and managed on a fair value basis
 - No FVOCI business model for debt instruments*

*There is a FVOCI option for equity instruments but it is not determined by business model

IFRS 9

Business Model Assessment

- Application guidance
 - Objective of the business model is determined by key management personnel and observed by how business is managed
 - The model is based on objective evidence and not management intent
 - The assessment is performed at a higher level of aggregation; not an instrument-by-instrument assessment
 - An entity may have more than one business model for managing financial assets

IFRS 9

Business Model Assessment

- Sales
 - Sales are not inconsistent with the objective of holding financial assets to collect contractual cash flows
 - For example, an entity may sell if
 - The asset no longer meets investment policy
 - The entity is an insurer and it adjusts its investment portfolio to match the duration of its liabilities
 - The entity needs to fund capital expenditures
 - If more than infrequent number of sales occur, assess whether and how such sales are consistent with the objective to hold to collect contractual cash flows
 - No tainting, but gains or losses from sales separately presented on the face of P&L with additional disclosures

IFRS 9

Business Model Assessment

- Reclassification
 - Required when business model changes
 - Change in business model must be
 - Determined by senior management
 - A result of external or internal changes
 - Significant to the entity's operations
 - Demonstrable to external parties
 - Expected to be “very infrequent”

FASB Tentative Model: Business Model Criterion (Financial Assets)

FASB Tentative Model

Business Model Criterion

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Categories	Business Model Criterion*
Amortised cost (Lending / customer financing activity)	<p>Must meet <i>all</i> of the following:</p> <ul style="list-style-type: none">• Manage through customer financing or lending activities with a primary focus on collection of substantially all contractual cash flows• Holder has ability to manage credit risk by negotiating any potential adjustment of contractual cash flows with the counterparty in the event of a potential credit loss. Sales or settlements limited to circumstances that would minimise losses due to deteriorating credit, or to exit a particular market• Not held for sale
FVOCI (Investing activity)	<p>Must meet <i>all</i> of the following:</p> <ul style="list-style-type: none">• Investing <i>either</i> to:<ul style="list-style-type: none">a. Maximise total return by collecting contractual cash flows or sellingb. Manage the interest rate or liquidity risk of the entity by holding or selling• Not held for sale
FVPL (Held for sale / trading activity)	<p>Must meet <i>either</i> of the following:</p> <ul style="list-style-type: none">• Held for sale• Actively managed and monitored internally on a fair value basis

* Applies to originated and purchased financial assets

FASB Tentative Model Business Model Criterion

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- Business model assessment
 - Based on **business activities** for *managing* financial assets rather than intent
 - Based on objective evidence and not management intent
 - The assessment is performed at a higher level of aggregation; not an instrument-by-instrument assessment
 - An entity may have more than one business activity for managing financial assets
- Financial assets at amortised cost subsequently identified for sale
 - Separately recognised as an impairment in net income as the difference between the carrying amount and fair value
- Realised gains and losses recognised in net income for FVOCI financial assets
- Reclassifications not permitted

IFRS 9 and FASB Business Model Comparison

Business Model Comparison

Area	IFRS 9	FASB
Amortised cost category	<ul style="list-style-type: none"> • Key driver – Collect contractual cash flows • Infrequent sales permitted (disciplined via transparency) • Loans and debt securities 	<ul style="list-style-type: none"> • Key driver – Lending and customer financing relationship (collect contractual cash flows and ability to manage credit by negotiating cash flows) • Sales limited to minimise credit losses or exit particular market • Generally loans; however certain debt securities may qualify
FVOCI category	<ul style="list-style-type: none"> • Not applicable for debt instruments 	<ul style="list-style-type: none"> • Investing activities; manage interest rate or liquidity needs • Loans and debt securities
FVPL category	<ul style="list-style-type: none"> • Residual category • Held for trading instruments • Managed on a fair value basis 	<ul style="list-style-type: none"> • Held for sale instruments • Managed on a fair value basis

Business Model Comparison

Area	IFRS 9	FASB
Reclassifications	<ul style="list-style-type: none">• Required if the entity's business model changes, which is expected to be rare	<ul style="list-style-type: none">• Not permitted
Recycling	<ul style="list-style-type: none">• Not applicable	<ul style="list-style-type: none">• Gains and losses recognised in OCI recycled into net income upon realisation
Tainting	<ul style="list-style-type: none">• No tainting	<ul style="list-style-type: none">• No tainting

