

STAFF PAPER

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Project	Financial Instruments: Classification and Measurement		
Paper topic	'Own credit' and IFRS 9 effective date		
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Introduction

1. IFRS 9 requires an entity to present in other comprehensive income (OCI) fair value gains or losses attributable to changes in the credit risk of financial liabilities designated under the fair value option (FVO)—‘the own credit requirements’. At the September 2012¹ meeting, the IASB tentatively decided to propose an amendment to IFRS 9 that would allow an entity to early apply only those own credit requirements once IFRS 9 was completed without otherwise changing the classification and measurement of financial instruments. In other words, the IASB was effectively proposing to permit an entity to apply the own credit requirements in conjunction with the classification and measurement requirements in IAS 39 *Financial Instruments: Recognition and Measurement*. This proposed amendment was included in the Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)—‘the Limited Amendments ED’—with a specific question that invited comments from respondents. A summary of the feedback received from respondents to the Limited Amendments ED on this proposal was provided at the May 2013 joint board meeting.

¹ Agenda Paper 6B <http://www.ifrs.org/Meetings/MeetingDocs/IASB/2012/September/FI-CM-0912-06A.pdf>

2. The IASB did not propose any changes to the mandatory effective date of IFRS 9 (1 January 2015) as part of the Limited Amendments ED and respondents were not specifically invited to comment on this. However subsequently, as part of the Exposure Draft *Financial Instruments: Expected Credit Losses* ('the Expected Credit Losses ED'), the IASB noted that all phases of IFRS 9 have the same effective date and asked for feedback on what lead time was required to implement the proposals on expected credit losses and what the resulting mandatory effective date for IFRS 9 should be.

3. Even though we did not ask a specific question in the Limited Amendments ED, many respondents urged the IASB to confirm as soon as possible that the mandatory effective date of IFRS 9 would be deferred, in particular because of the lead time needed to implement the proposals on expected credit losses.

4. The purpose of this paper is to analyse the responses received on these two matters and to ask the IASB:
 - (a) whether the own credit requirements in IFRS 9 should be made available for early application before the completed version of IFRS 9 is issued; and
 - (b) whether the effective date of IFRS 9 should be deferred as soon as this could possibly be done (ie before the responses to the Expected Credit Losses ED are analysed in detail) .

5. For each of these matters, this paper is structured as follows:
 - (a) Background;
 - (b) Feedback and responses received; and
 - (c) Staff analysis and question to the IASB.

Section A: Own credit

Background

6. The own credit requirements were added to IFRS 9 in October 2010. That guidance requires that when a financial liability is designated as at fair value through profit or loss under the FVO, the change in the fair value of the liability that is attributable to changes in own credit must be recognised in OCI². Amounts presented in OCI cannot be subsequently transferred to profit and loss (recycled). Currently an entity is permitted to early apply the own credit requirements only if it also early applies all of the other classification and measurement requirements in IFRS 9.
7. When the IASB was developing the own credit requirements in 2010, some respondents suggested incorporating them into IAS 39 to allow for immediate application. The IASB however decided that it would be inappropriate to amend IAS 39 while the IASB was in the process of replacing it.
8. Since the publication of IFRS 9 (2010), requests for the IASB to accelerate the application of the own credit requirements have intensified. This is because markets continue to be volatile and own credit gains or losses remain significant, which accentuates the concerns about the usefulness of reporting gains when an entity is experiencing deterioration in its own credit quality.
9. Currently entities can choose to apply different versions of IFRS 9. In developing the Limited Amendments ED, the IASB initially decided to propose that in order to improve comparability, once the completed version of IFRS 9 is issued (ie including the Classification and Measurement, Impairment and General Hedge Accounting chapters), entities will be permitted to early apply only that version; in other words, entities will no longer be permitted to early apply previous versions of IFRS 9. That would effectively have made early application of the own credit requirements dependent on the implementation of an expected loss impairment model. Consequently, the IASB considered whether the own credit

² Unless that treatment would create or enlarge an accounting mismatch in profit or loss. Refer to paragraphs 5.7.7-5.7.8, B5.7.5-B5.7.20 and BC5.35-BC5.43).

requirements should be made available more quickly. As discussed in paragraphs BC96-BC106 in the Limited Amendments ED, the IASB discussed the following possible approaches:

- **Approach A:** do not permit the own credit requirements to be applied in isolation (ie no acceleration);
- **Approach B:** amend IAS 39 to incorporate the own credit requirements;
- **Approach C:** modify the early application guidance in IFRS 9 (2010) and later versions of IFRS 9 to permit the early application of the own credit requirements in isolation; and
- **Approach D:** once the completed version of IFRS 9 is issued, permit the early application of the own credit requirements in isolation.

10. On balance the IASB decided to propose Approach D in the Limited Amendments ED. In making that decision the IASB noted that it was desirable to make the own credit requirements available before other parts of the IFRS 9 model.
11. However, the IASB did not expect that there would be a significant time difference between allowing early application in the final version of IFRS 9 (Approach D) and modifying the early application guidance in IFRS 9 (2010) and the later version (ie Approach C). At the time that decision was made several IASB members noted that the decision not to amend IFRS 9 more quickly to enable own credit to be applied in isolation (ie using Approach C) should potentially be reconsidered depending on the project time line.

Feedback and responses received

12. Nearly all respondents to the Limited Amendments ED supported the proposal that entities would be permitted to early apply only the own credit requirements in IFRS 9. However, most of these respondents also asked the IASB to make these requirements available for early application before the IFRS 9 project is completed and the final Standard is issued.

13. Most suggested that this could be accomplished by incorporating the own credit requirements into IAS 39, which they believed would be the quickest way to make the own credit requirements available for jurisdictions that follow an endorsement process. These respondents expressed the view that IAS 39 will remain effective for quite a while, in particular because the effective date of IFRS 9 is likely to be deferred. Others suggested that incorporating the own credit requirements into IFRS 9 (2010) was a viable alternative.
14. Some respondents also commented on the fact that IFRS 9 prohibits entities from recycling own credit gains or losses into profit or loss when the liability is derecognised³. Although this requirement was not within the scope of the Limited Amendments ED, these respondents stated that recycling should be required for the following reasons:
- It would be consistent with the accounting for financial liabilities measured at amortised cost, because when those liabilities are derecognised, the own credit gain or loss is part of the gain or loss recognised in profit or loss.
 - It would be consistent with the requirements in the FASB's proposed Accounting Standards Update, which proposes that accumulated own credit gains or losses are recycled when the financial liability is derecognised⁴.
 - The Limited Amendments ED proposes to require recycling for investments in debt instruments mandatorily measured at fair value through other comprehensive income.
15. A limited number of respondents did not support making the own credit requirements available for early application. These respondents stated that permitting early application of particular requirements in IFRS 9 reduces comparability among entities and could lead to requests to make other requirements in IFRS 9 available for early application.

³ As noted in paragraph BC24(b) of the Limited Amendments ED, the cumulative effect of changes in own credit will naturally unwind to zero if the contractual amount is repaid at maturity.

⁴ *Financial Instruments—Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities*

Staff analysis and question to the IASB

16. As discussed in paragraph 9 of this paper, the Limited Amendments ED proposed that the own credit requirements could be early applied in isolation once the completed version of IFRS 9 is issued. However, at the time, the IASB noted that its preference for that alternative (as compared to modifying the early application guidance in IFRS 9 (2010) and later versions of IFRS 9 to permit the early application of the own credit requirements in isolation (Approach C)) was based on the expectation that there would not be a significant time difference between the completion of those approaches. In other words, the IASB believed that the own credit requirements would be available for early application at roughly the same time under both approaches. However, the IASB noted that by exposing the proposal as part of the Limited Amendments ED, it would be possible to change this approach if necessary.
17. The feedback received on the Limited Amendments ED reiterated the urgency to make the own credit requirements available as soon as possible—and there was also feedback that the mandatory effective date of IFRS 9 should be deferred. Because the IASB has a practice of allowing a minimum of 18 months between the finalisation of a Standard and the mandatory effective date, we think the mandatory effective date of IFRS 9 will need to be deferred. Consequently, in order to respond to the feedback received that the own credit requirements should be available for early application as soon as possible, we think the early application guidance in IFRS 9 should be amended—ie to permit entities to early apply only the own credit requirements—when the IASB adds the Hedge Accounting chapter to IFRS 9, which is expected to be in the next few months.
18. Similarly to the discussion of Approach C, the staff think that the change could be simply achieved by modifying the effective date paragraphs of IFRS 9 (2013⁵) to permit an entity that has not already applied IFRS 9 (2009) or IFRS 9 (2010) to early apply the own credit paragraphs⁶ without the need to early apply any of the other requirements of IFRS 9 (2013). The same modification to the effective date

⁵ The version of IFRS 9 that includes the Hedge Accounting Chapter, which is expected to be published in the next few months.

⁶ Currently paragraphs 5.7.7 – 5.7.9 of IFRS 9 (2010)

paragraphs of IFRS 9 (2010) would be required, but this can be achieved through a consequential amendment to IFRS 9 (2010). We note that if an entity elects to early apply these paragraphs, it will also be required to early apply paragraph 10A of IFRS 7, which will result in modifications to IFRS 7 as well.

19. This approach would enable entities to apply only the selected (own credit-related) paragraphs without affecting any decisions that would be made once the remaining phases in IFRS 9 are finalised. Taking this approach, a jurisdiction that only wants to adopt the own credit solution could adopt (or endorse, as applicable) IFRS 9 and activate only the effective date paragraph relevant to own credit. This enables a jurisdiction to make the own credit requirements available, even if it is not ready to adopt IFRS 9 in full. If a jurisdiction took this approach prior to the mandatory date of IFRS 9, it would not contradict IFRS 9 as published by the IASB because that would also allow entities only to adopt the changes related to own credit.

Amending IAS 39

20. Clearly many would prefer IAS 39 to be amended so that the own credit requirements are decoupled from the IFRS 9 timeline (and where relevant, the associated endorsement processes). However, the staff continue to think that own credit requirements should not be incorporated into IAS 39 because that Standard is being replaced by IFRS 9. The staff also note that amending IAS 39 for this change would not be straightforward, because the provisions have been drafted within the context of a different Standard, and such an amendment would require care to ensure there were no unintended consequences.
21. The staff question whether such an amendment can be made to IAS 39 without the need to publish a separate Exposure Draft (ED) in accordance with the IASB's due process. In order to publish an ED, staff resources would have to be diverted from the major IFRS 9 projects at a time when the focus is on the finalisation and delivery of the complete IFRS 9 Standard. The requirement to meet due process would also result in an amendment not being finalised for some time. This delay would be amplified for jurisdictions subject to endorsement, because the endorsement process can take considerable time. In contrast, following the

exposure of the proposals to amend IFRS 9 to allow own credit to be applied prior to the rest of IFRS 9, this change could be incorporated in the amendments that are about to be balloted to incorporate the Hedge Accounting chapter in IFRS 9.

22. Furthermore, the staff are concerned that from a document management perspective, amending IAS 39 and thereby creating new variants of IAS 39 in addition to all of the versions of IFRS 9 available for application could cause complexity and confusion among constituents. For those incorporating these amendments into their IFRS regimes, it is more streamlined to include it in IFRS 9 when the IASB adds the Hedge Accounting chapter to IFRS 9. This will also be more consistent with the IASB's recent efforts to amalgamate changes to existing IFRSs into fewer documents to streamline the production and documentation processes to assist our stakeholders.
23. Because of these considerations and those mentioned above, the staff still do not support amending IAS 39, and believe amending IFRS 9 when adding the Hedge Accounting chapter would in fact be more expedient.

Recycling of 'own credit'

24. The staff think that the IASB should not reconsider the recycling of own credit gains and losses. Although some respondents to the Limited Amendments ED asked the IASB to consider the recycling of 'own credit', the staff note that this was not exposed for comment as part of this ED. The staff further believe that the question of the use of OCI and recycling remains open, and will be covered in the forthcoming Conceptual Framework Discussion Paper. The only directly relevant development since the own credit requirements were issued in IFRS 9 (2010) is that the FASB's classification and measurement proposals would require recycling of such amounts. However the staff note that the boards sought only to reduce *key* differences, in particular areas of classification and measurement. Moreover, the staff note that the IASB has always been mindful of the need to minimise the extent of change to IFRS 9 and therefore the Limited Amendments ED proposed only limited amendments to IFRS 9.

Question to the IASB

Does the IASB agree to with the staff recommendation to incorporate the early application of only the own credit requirements into IFRS 9 in the forthcoming amendments that will add the *Hedge Accounting* chapter to IFRS 9?

Section B: Mandatory effective date**Background**

28. IFRS 9 (2009) and IFRS 9 (2010) originally had a mandatory effective date of 1 January 2013. On the basis of the progress with finalising the remaining phases of IFRS 9 (ie impairment and hedge accounting), in November 2011 the IASB amended IFRS 9 so that it applied for annual periods beginning on or after 1 January 2015. At that time, the IASB noted that it was appropriate to continue to require the same effective date for all phases of IFRS 9.
29. At the time that the mandatory effective date was amended, the IASB noted that because of the difficulty in assessing the amount of lead time necessary for implementation, the IASB's conclusion to retain the same effective date for all phases might be changed in the future. The IASB did however propose *reducing* the extent of phased application of IFRS 9 in the Limited Amendments ED.

Feedback received

30. As noted in paragraphs 2 and 3 above, the Limited Amendments ED did not specifically ask for feedback on the mandatory effective date of IFRS 9. Nevertheless, many respondents to the ED urged the IASB to confirm as soon as possible that the mandatory effective date of IFRS 9 would be deferred, in particular because of the lead time needed to implement the proposals on expected credit losses. These respondents noted that the IASB has a practice of allowing a minimum of 18 months between the finalisation of a Standard and the mandatory effective date. They noted that even if the remaining phases of IFRS 9 were to be

completed by the end of 2013 there would not be 18 months until the mandatory effective date of 1 January 2015.

31. Some respondents, notably insurers and standard-setters, also requested that the mandatory effective date should be aligned with the mandatory effective date of Phase II of the project on IFRS 4 *Insurance Contracts*. If the IASB decides not to align the mandatory effective dates of IFRS 9 and IFRS 4, they requested additional transition requirements for those entities that have to adopt IFRS 4 at a later date.⁷

Staff analysis and question to the IASB

32. The Limited Amendments ED did not solicit comments on the mandatory effective date of IFRS 9, but the Expected Credit Losses ED, which was published in March 2013, asked for feedback on what lead time was required to implement the proposals on expected credit losses and what the resulting mandatory effective for IFRS 9 should be.
33. Although the IASB has indicated that it intends to defer the mandatory effective date of IFRS 9, many interested parties have requested confirmation as soon as possible.
34. The *IASB and IFRS Interpretations Committee Due Process Handbook*, as issued February 2013, describes how the IASB determines effective dates:
- A Standard, or an amendment to a Standard, has an effective date and transition provisions. The mandatory effective date is set so that jurisdictions have sufficient time to incorporate the new requirements into their legal systems and those applying IFRS have sufficient time to prepare for the new requirements.*
35. Many entities have already started implementation processes in anticipation of applying at least the classification and measurement requirements by 1 January 2015. Such implementation processes usually incorporate a period of parallel reporting and the staff are aware that for some entities, the parallel period spans a

⁷ The Exposure Draft *Insurance Contracts* proposes that on initial application of the proposals for accounting for insurance contracts an entity could refresh designations under the fair value option.

full financial reporting cycle (12 months), which means that given the current mandatory date some will start this process by 1 January 2014.

Pre-implementation activities and processes such as approval of accounting policies and transition decisions therefore have to be finalised prior to this date.

36. The staff note that prior to finalising details of the expected credit loss approach, it is not possible to recommend an appropriate mandatory effective date for IFRS 9 at this stage. The feedback received in response to the impairment ED indicated preparers would need at least 3 years to implement the proposed expected credit loss model.
37. The staff believe that in light of past practice of allowing at least 18 months for the implementation of a new Standard, it would be appropriate to confirm the deferral of the mandatory effective date at least 18 months before the current mandatory effective date of 1 January 2015. The staff note that the IASB will only be able to determine an exact mandatory effective date after the redeliberations on the impairment and classification and measurement have been completed, and the issue date of the final version of IFRS 9 is known.
38. Consequently, the staff recommend that the IASB should confirm that the current mandatory effective date of 1 January 2015 will be deferred with the issuance of the forthcoming Hedge Accounting chapter of IFRS 9, without specifying the exact mandatory effective date. This can be achieved by amending paragraph 7.1.1 of IFRS 9 (2010) and paragraph 8.1.1 of IFRS 9 (2009) to read as follows:

This IFRS is available for early application. If an entity chooses to early apply this IFRS, it shall disclose that fact ...

The Basis for Conclusions to IFRS 9 (2013) should explain that the mandatory effective date will be determined when the outstanding phases of IFRS 9 are finalised. The staff also recommend that we should indicate the likely lead time that will be allowed following the issuance of the final version of IFRS 9 and suggest that the appropriate period is around 3 years after the issuance of the final version of IFRS 9.

Question 2

Does the IASB agree to confirm the deferral of the mandatory effective date and that the mandatory effective date of IFRS 9 should be left open pending the finalisation of the impairment and classification and measurement phases?