AGENDA PAPER

IFRS Foundation Trustees meeting – Due Process Oversight Committee

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Financial Instruments: Overview of the publication of IFRS 9

Overview

1. This report outlines some of the major considerations for the forthcoming publication of the final version of IFRS 9 *Financial Instruments*. This version of IFRS 9 incorporates the newly developed requirements for impairment of financial assets and the limited amendments to classification and measurement. It replaces prior versions of IFRS 9 (issued in 2009, 2010 and 2013). This final version thus incorporates all three phases of IFRS 9: classification and measurement, impairment and hedge accounting.

2. This report accompanies the due process 'life cycle' reviews for the following phases of the financial instruments project:

   (a) impairment (see Agenda Papers 3C(i) and (ii)); and

   (b) limited amendments to classification and measurement (see Agenda Papers 3C(iii) and (iv)).

3. The topics addressed in this report are as follows:

   (a) Stakeholder engagement strategy.

   (b) Mandatory effective date.

   (c) Publication plan.

Background

4. The accompanying papers outline the extensive due process that has been undertaken on both of these phases of the project and the IASB's view that all necessary due process steps have been completed. DPOC members are reminded that the Committee considered a due process lifecycle review of the hedge accounting phase of the project at its meeting in April 2013 (Agenda Paper 3B for that meeting refers[1]) and concluded that all the necessary due process steps had been satisfactorily completed.

5. The accompanying papers also show that, despite the best efforts of the two boards, it has not proved possible for the IASB and the US Financial Accounting Standards Board (FASB) to reach converged decisions on either of these phases.

Stakeholder engagement strategy

6. The final version of IFRS 9 is being issued as a single package of requirements for classification and measurement, impairment and hedge accounting. The three components have been developed as part of the three-phase programme to replace IAS 39 and interlink closely with one another. All three components have the same mandatory effective date[2] (the mandatory effective date is discussed in more detail below).

7. IFRS 9 is central to the reform of IFRS following the global financial crisis. The IASB expects the benefits of IFRS 9 to outweigh the costs of application.

8. The IASB plans to focus on ensuring stakeholders understand IFRS 9 and its associated benefits and costs. To accomplish this, the IASB plans to prepare a variety of supporting materials to inform stakeholders. These will include press releases, Q&A documents, a 'snapshot' (high level summary), and other messaging documents.

Key messages—Classification and Measurement

9. IFRS 9 provides a logical structure and rationale for the classification and measurement of financial instruments. The measurement categories and use of a business model approach for financial assets reflect the nature of their cash flows and the way they are actually managed. This is in contrast to the existing requirements which in many cases result in

[1] Available at http://www.ifrs.org/Meetings/MeetingDocs/Trustees/2013/April/AP3B_DPOC_HedgeAccounting.pdf
[2] IFRS 9 is available for early application and the 'own credit' requirements are available for early application (refer to paragraph 24 of this document).

financial assets being measured on the basis of free choice. The introduction of a single classification approach for all financial assets also eliminates the existing complex requirements for bifurcating hybrid financial assets.

10. A further improvement is that, compared to the complex rules for reclassification in IAS 39, financial assets are reclassified between measurement categories when, and only when, the entity's business model for managing them changes, which is a significant event and thus uncommon. This ensures that users of financial statements are always provided with information reflecting how the cash flows on financial assets are expected to be realised.

11. IFRS 9 originally included only two categories for debt instruments—amortised cost and fair value through profit or loss (FVPL). The limited amendments to the classification and measurement requirements introduced in the final version of IFRS 9, introduced a Fair Value through Other Comprehensive Income (FVOCI) category. The existing classification structure in IFRS 9 was retained. This responded to feedback requesting accommodation of a known business model with an objective of both collecting contractual cash flows and selling financial assets. It also addresses potential accounting mismatches that would arise because of the interaction between the accounting for financial assets and the accounting for insurance contracts liabilities, and specific application questions.

12. The IASB noted that despite the addition of the FVOCI category, it did not expect the amendments to the classification and measurement requirements to increase the amount of instruments measured at fair value. The IASB expects that banking books that could be measured at amortised cost under IFRS 9 will generally continue to be measured as such. Some financial assets that would have been measured at FVPL would now be measured at FVOCI. The IASB also notes the introduction of the FVOCI category was done at the specific request of many constituents.

13. IFRS 9 also responds to longstanding concerns about the volatility that occurs in profit or loss due to changes in an issuer's own credit risk, when non-derivative financial liabilities are measured at fair value. The Standard does this by requiring the amount of change in

the fair value attributable to changes in credit risk to be presented in other comprehensive income for financial liabilities an entity chooses to measure at fair value. As this change is urgently required, IFRS 9 allows this change to be applied in isolation before any other parts of IFRS 9 are applied.

Key messages—Impairment

14. IFRS 9 provides a single, forward looking impairment model which is consistent with requests from the G20 and others.

15. IFRS 9 responds to the concerns about the delayed recognition of credit losses identified during the financial crisis as a key weakness in accounting standards. It replaces the ‘incurred loss’ impairment model that disallows considering the effects of future losses and requires meeting a recognition threshold to recognise credit losses. The new approach introduces a model where expected credit losses are always accounted for and where changes in expectations of credit losses are reflected. It also requires considering a broader range of reasonable and supportable information, including forward-looking information, and seeks to capture all significant increases in credit risk in a timely manner.

16. The requirements will provide more timely and accurate signals about an entity’s current estimates of expected credit losses and the changes in those estimates over time. Moreover, they include a comprehensive package of disclosures that will help investors understand the judgements, assumptions and information used by an entity in developing its estimates of expected credit losses.

17. IFRS 9 also provides a single impairment model that applies to all financial instruments subject to impairment accounting. This reduces the complexity of current IAS 39 accounting which features different impairment models and can result in different impairment amounts being recognised on identical financial instruments simply due to the classification of the instrument. This was a major source of criticism in the financial crisis.

Key messages—Hedge accounting

18. IFRS 9 substantially overhauls the hedge accounting requirements of IAS 39, which have been criticised as being complex, rule-based and inconsistent with risk management. IFRS 9 works from the objective of linking the economics of risk management with the accounting treatment and helps management to better communicate their risk management activities. The new requirements will significantly reduce the accounting considerations that currently affect risk management decisions and provide users of financial statements with more useful information about hedging activities, including the cost of such activities, resulting in better economic decision making. These changes are expected to be particularly beneficial to corporate entities, who have previously found it difficult to apply hedge accounting in a meaningful way.

19. Until the separate project on macro hedging is completed, entities will have an accounting policy choice to apply the hedge accounting requirements in IAS 39 or IFRS 9. Even if they choose the IFRS 9 requirements, they will furthermore be able to choose whether they want to continue to use the IAS 39 requirements specific to macro fair value hedges. This means that banks can essentially continue to apply their current hedge accounting using a combination of IFRS 9 and IAS 39 or alternatively can choose to make no changes at all until further work is undertaken on the project for accounting for macro hedging.

Mandatory effective date

20. The majority of respondents to the impairment project indicated that they would need three years to implement the proposed impairment requirements. Many noted that even sophisticated entities would need to make significant system changes in order to implement the proposed model, and that specialised resources would be required. Respondents indicated that such a lead time would enable them to apply the model in parallel with the current incurred loss impairment model for a period of time to ensure operability and information quality.

21. The IASB also discussed the interaction between the respective mandatory effective dates of IFRS 9 and the forthcoming new Insurance contracts Standard. The IASB noted that

most respondents to the 2013 Insurance ED[3] commented that it would be ideal if the effective dates of the new Insurance contracts Standard and IFRS 9 were aligned. This was for operational reasons and for concerns about accounting mismatches. However, most constituents recognised that IFRS 9 should not be delayed only because of the new Insurance contracts Standard.

22. The IASB decided on a mandatory effective date of 1 January 2018 balancing the desire to have the new model effective, the timeline for systems changes and the desire to allow time to progress the insurance contracts project.

23. IFRS 9 will be available for early application. In addition, 'own credit' changes can be applied in isolation without the need to change any other accounting for financial instruments. This is particularly important given the expected lead time to implement the changes to impairment accounting.

Publication plan

24. The IASB staff plan to submit two pre-ballot drafts to the IASB in order to provide the IASB ample opportunity to consider the final drafting and ensure a quality outcome. The IASB does not intend to publish a publicly available review draft. However, the IASB will engage in a detailed fatal flaw review to ensure accuracy and clarify of drafting.

25. The IASB plans to finalise and publish IFRS 9 by late June or early July.

Finalising IFRS 9

26. At the February 2014 IASB meeting when the IASB was asked if it gave permission to ballot the final classification and measurement and impairment requirements for inclusion in IFRS 9, the IASB was provided with an update on the status of the FASB's deliberations. Although the IASB's preference was to achieve a converged outcome, given the efforts undertaken to achieve this, the difference in opinions of US and non-US stakeholders and the desire to complete IFRS 9, the IASB granted the staff permission to proceed to ballot the final requirements. As noted by Hans Hoogervorst during the

[3] Exposure Draft 2013/7 *Insurance Contracts*

Chairman's speech at the Asia-Oceania Regional Policy Forum, New Delhi in March 2014[4], this also brings to a conclusion our work in response to the global financial crisis.

[4] Hans Hoogervorst's speech can be accessed at: http://www.ifrs.org/Alerts/Conference/Documents/2014/Speech-Hans-Hoogervorst-March-2014.pdf.