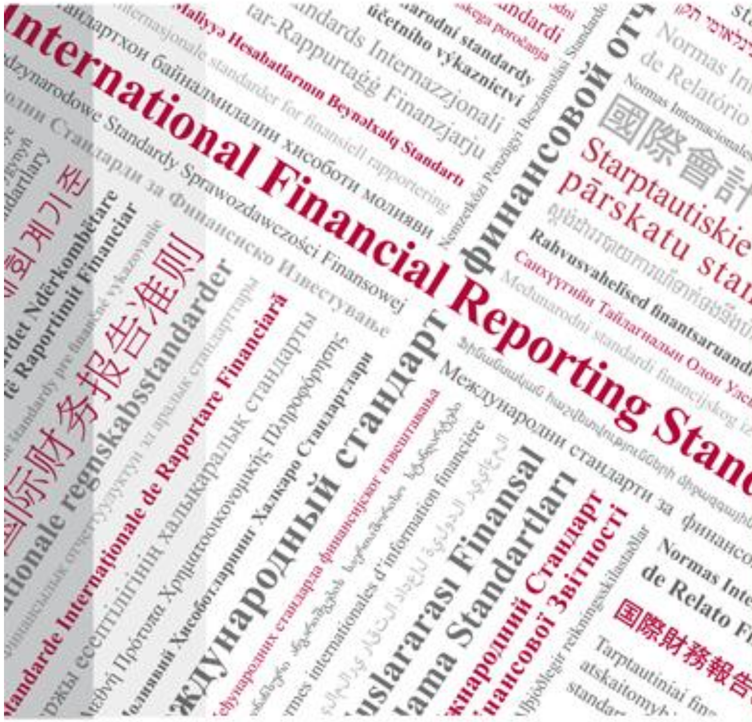
International Financial Reporting Standards



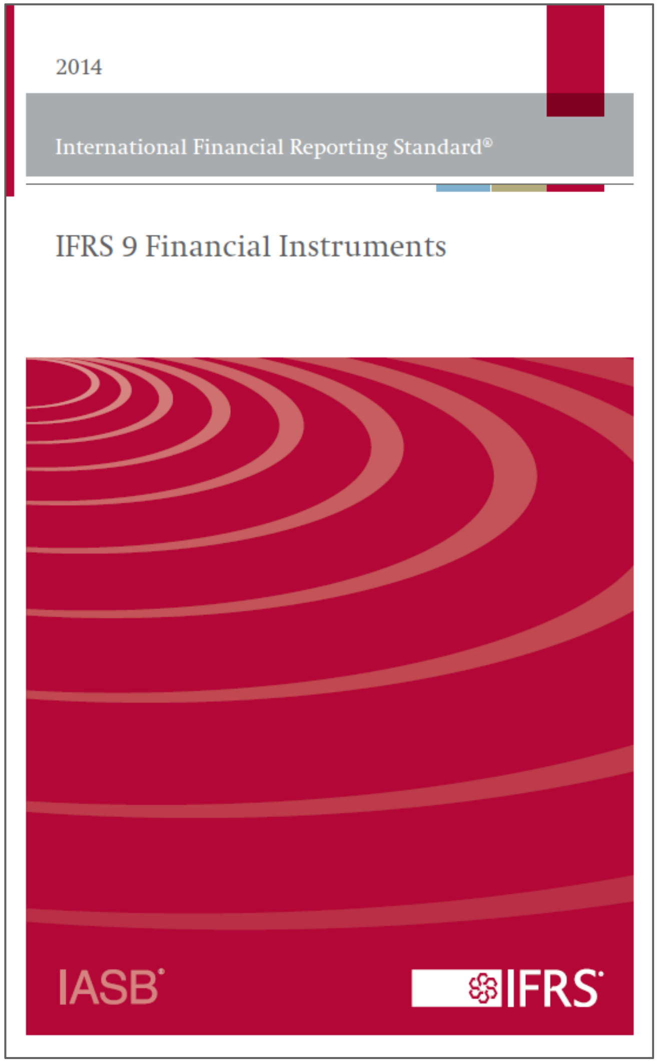
IFRS 9 *Financial Instruments* *Technical Update* *London July 2014*

Agenda paper 2A

Kumar Dasgupta, Technical Director

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

Finalisation of the IASB's response to the global financial crisis



Classification and measurement

A logical, single classification approach driven by cash flow characteristics and how it's managed

Impairment

An urgently needed and strongly supported forward-looking 'expected loss' model

Hedge accounting

An improved and widely welcomed model that better aligns accounting with risk management

A unified Standard to improve reliability in accounting for financial instruments

- IFRS 9 is the IASB's response to the financial crisis to improve the accounting for financial instruments

- We expect the benefits of IFRS 9 to outweigh the costs.
- IFRS 9 (2014) is a single package of requirements

Classification and measurement

Impairment

Hedge accounting

IFRS 9 Financial Instruments

IFRS

When will IFRS 9 be effective?

Annual periods beginning on or after 1 January 2018

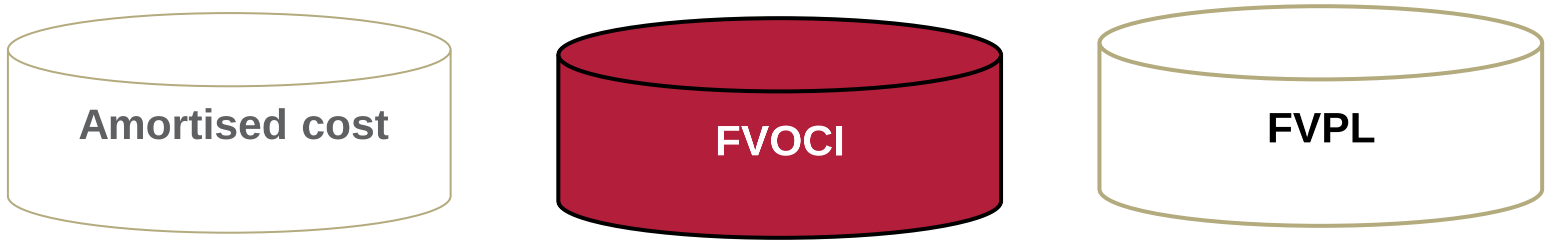
- A mandatory effective date consistent with stakeholder requests (a 3-year lead time)
- Entities permitted to early apply the completed (whole) version of IFRS 9
- Previous versions of IFRS 9 phased out:
  - Not permitted to early apply a previous version if date of initial application is more than 6 months after completed IFRS 9 is issued
- 'Own credit' requirements have been available for early application, in isolation, since the publication of IFRS 9 (2013)

International Financial Reporting Standards

Classification and measurement

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

Limited amendments



- Introduces new business model
- We received feedback requesting accommodation of a known business model that involves both:
  - Collecting contractual cash flows; and
  - Selling financial assets
- Better reflects how financial assets are actually managed
- Furthermore addresses potential accounting mismatches due to interaction with accounting for insurance contract liabilities

A superior approach to classification and measurement

- Principle-based, unified model with a logical structure and rationale for classification and measurement of financial assets
  - measurement categories and use of business model reflects nature of cash flows and how managed
- Improved reclassification rules consistent with changes in management
- Addresses ‘own credit’ concerns
  - P&L volatility will no longer result from changes in own credit, while information on own credit will still be available for users
- Single approach eliminates complex bifurcation requirements and multiple impairment approaches
- Elimination of IAS 39 tainting rules

International Financial Reporting Standards

Impairment

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

A thoroughly considered response on accounting for impairment

ED: Amortised Cost and Impairment (2009)

- Integrated measurement
- Conceptually most appropriate
- Significant operational challenges

Supplementary Document: Impairment (2011)

- ‘Decoupled’ expected credit losses from effective interest rate to address operational concerns
- Based on ‘good book’ or ‘bad book’
- Model still lacked support
- Not a basis to converge

ED: Expected Credit Losses (2013)

- Balances costs and benefits
  - Approximates outcome of 2009 ED in more operational manner
- Ensures more timely recognition of expected credit losses
- Identifies assets that have significantly deteriorated

Overview of the finalised model

Change in credit quality since initial recognition

	Stage 1 *Performing*	Stage 2 *Under-performing*	Stage 3 *Non-performing*
Expected credit losses ('ECL') recognised	12-month ECL	Lifetime ECL	Lifetime ECL
Interest revenue	Gross basis	Gross basis	Net basis

Key changes from current accounting

A responsive, forward-looking expected credit loss model

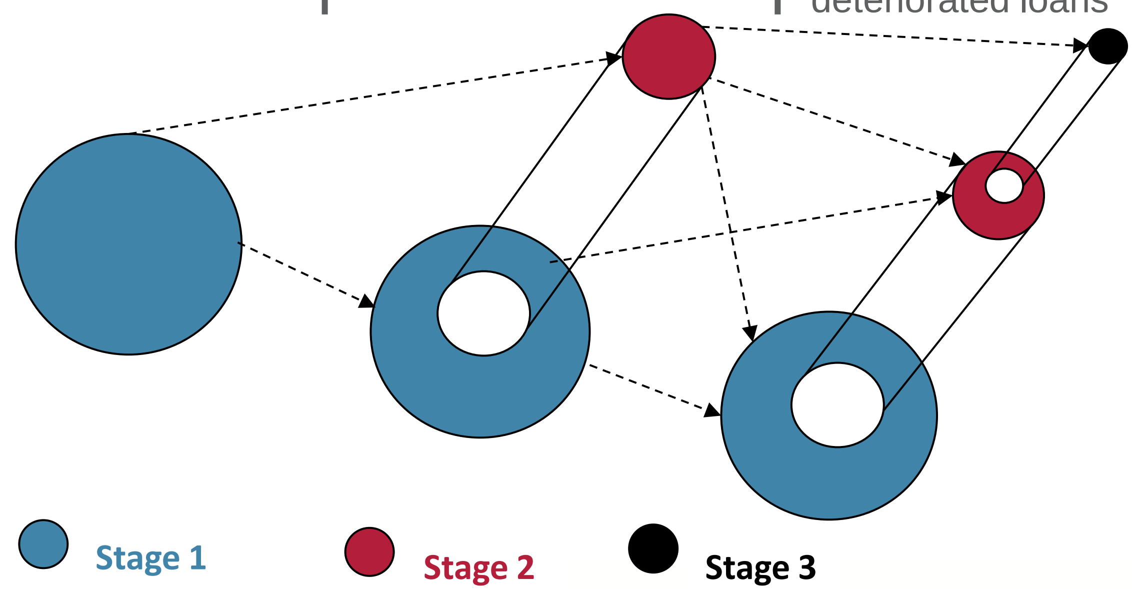
- Meets the calls of the G20 and others
- Responds to delayed recognition concerns and provides timely information about ECL
- Single model reduces the complexity of multiple approaches in IAS 39
- Robust disclosures to understand changes in ECL and credit risk

As information emerges over time – entity is able to better distinguish credit quality of loans

Origination of a portfolio of loans

Entity observes deteriorating economic conditions

More information enables entity to identify specific deteriorated loans



Feedback on 2013 ED

- Substantial support
  - For recognising lifetime ECL after significant deterioration
  - Avoids excessive front loading of ECL
  - Pragmatic reflection of economics of lending (12-month ECL)
- Consider the model operational
  - Can build on credit risk management systems

An appropriate balance of costs and benefits

International Financial Reporting Standards

Hedge accounting

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

IFRS™

A better link between accounting and risk management

Feedback on IAS 39: *Recognition and Measurement*

- Lack of an overarching principle; complex and rule-based
- Inability for **preparers** to reflect hedges in financial statements
- Hard for **users** to understand risk management practices

Solutions in IFRS 9: *Financial Instruments*

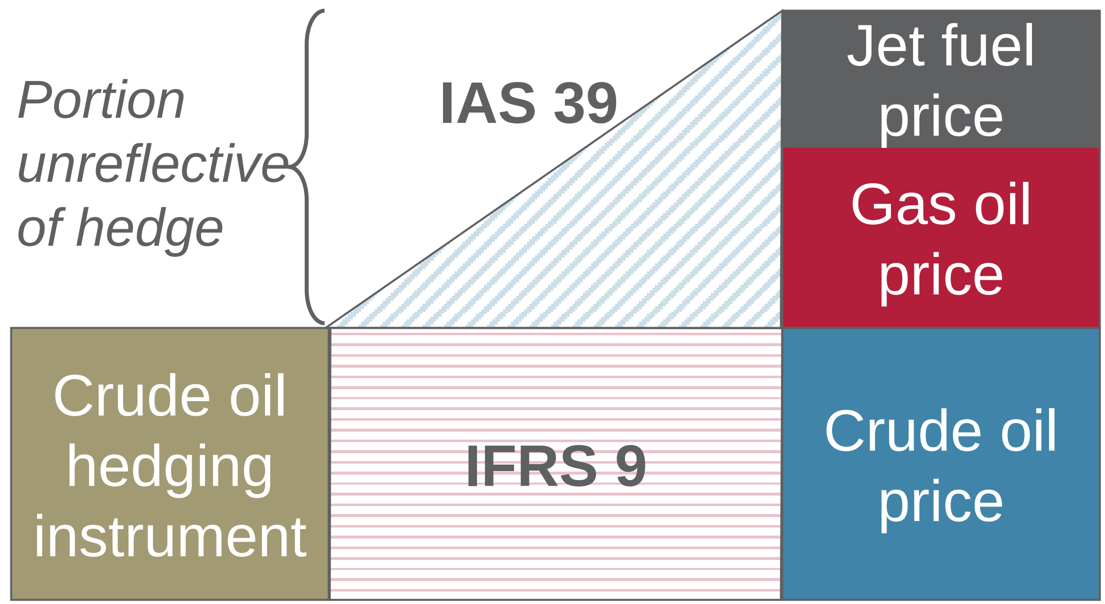
- Align accounting treatment with risk management activity
- Enable **preparers** to better reflect hedging in financial statements
- Provide disclosures to help **users** understand risk management and its impact on the financial statements

Key changes from current accounting

This has been a comprehensive review of hedge accounting

- Links economics of risk management with accounting treatment
- Significantly reduces accounting considerations that affect risk management decisions
- Ability to account for more hedges of non-financial items

Example: Measuring the success of hedging jet fuel contracts with crude oil futures



Other core improvements

Hedge effectiveness testing

1. Economic relationship
2. Effect of credit risk
3. Hedge ratio

Costs of hedging

Improves the transparency around some hedging instruments:

- time value of options
- forward element of foreign currency
- basis risk for hedges of foreign exchange risk

Disclosures

To understand risks being hedged; how those risks are managed; and the effect of hedging those risks on the financial statements.

IFRS™

Conclusion

IFRS™

Convergence with the FASB

The lack of convergence has been disappointing for all of us.

Strong attempts have been made, but the starting points were already different.

We developed limited amendments to the existing IFRS 9, whereas for the FASB it was an entirely new model

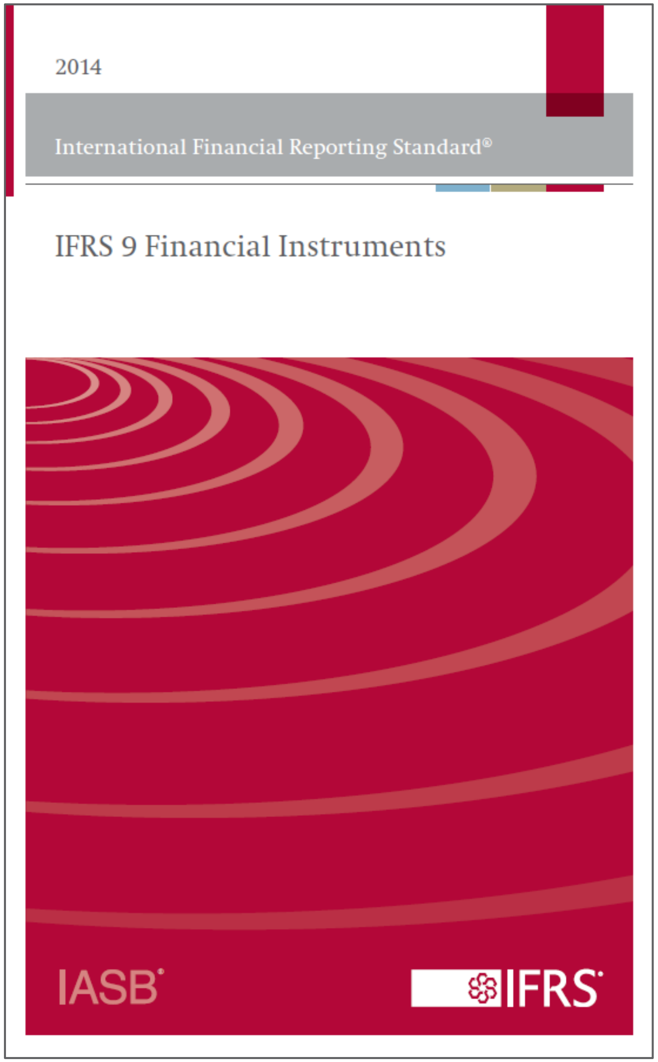
Multiple attempts to converge on various impairment models, however the FASB stepped away from most recent jointly developed proposals

Hedge accounting has been an IASB-only project

Where are we in terms of publication?

- On track for publication in **July**
- Next version published will be the complete IFRS 9
- Detailed Communication plan in place covering
  - Identification of key messages
  - Media interaction and Web Casts
  - Stakeholder meetings and
  - Out reach activities for key jurisdictions
- Impairment - Transition Resource Group announced

Questions and comments



- We are pleased to be finalising our response to the financial crisis, and expect that IFRS 9 will provide a new stage of reliability in financial reporting

More information available at www.ifrs.org