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IFRS 9 *Financial Instruments* and research opportunities

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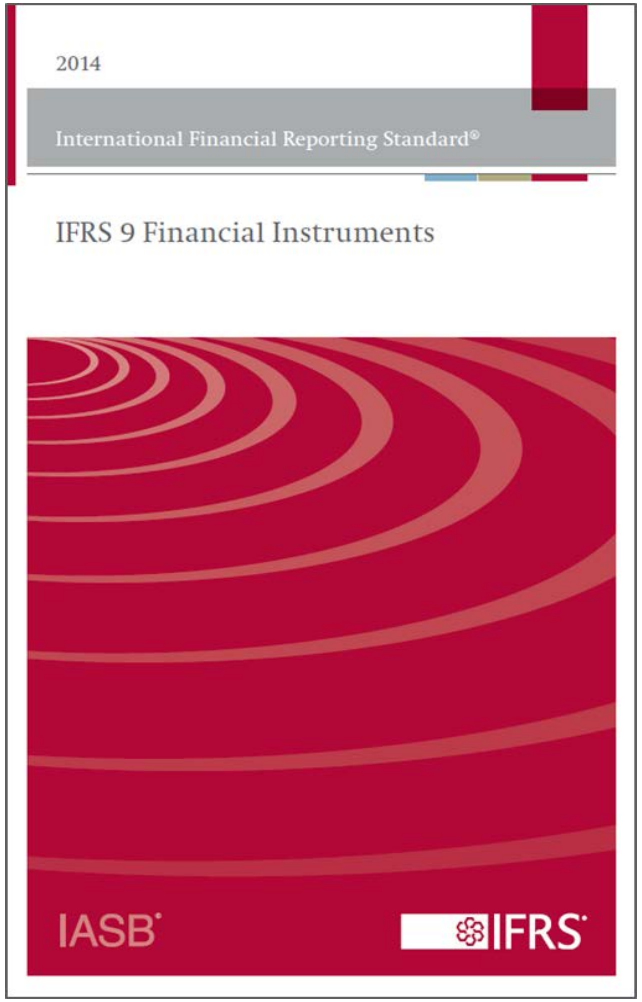
Overview

IFRS 9 at a glance



- Effective 1 January 2018
- Replaced IAS 39
- First stage of post-implementation review starting now

Classification and measurement

- A logical, single classification approach driven by cash flow characteristics and how it is managed

Impairment

- A much needed and strongly supported forward-looking ‘expected loss’ model

Hedge accounting

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

Research opportunities

IFRS 9 brings many changes to accounting for financial instruments

We are looking for evidence from studies:

about the impact of these changes

that use a range of methods

Pre and post application

- what changes in accounting practice are observed?
- what are the financial impacts of the changes?

Market effects

- what are the effects for market participants of the changes?
- what market outcomes are observed?

Classification and measurement

Classification of debt financial assets

Objective	Useful information about future cash flows		
Approach	Business model	+	Contractual cash flows

A large portion of financial assets in a traditional banking business continue to be measured at amortised cost

Classification of debt financial assets

		Business model		
		Hold to collect	Hold to collect and sell	Other
Cash flows	Solely payments of principal and interest (SPPI)	Amortised cost	FVOCI	FVPL
	Other	FVPL	FVPL	FVPL

Can also be measured at FVPL if elect fair value option at initial recognition due to an accounting mismatch

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Business model assessment

How are cash flows generated?	Typically observed through activities undertaken, eg business plans, manager compensation
Not about intent for individual asset	Determined on a level that reflects how financial assets are managed
Sales information in isolation does not determine the business model	However, it does provide evidence about the business model
Reclassify only if business model changes	It is a significant event and thus is expected to be uncommon

Solely payments of principal and interest

Solely payments of

PRINCIPAL	INTEREST		
Fair value at initial recognition	Time value of money	Credit risk	Other costs & profit

Features consistent with a basic lending arrangement

Solely payments of principal and interest

Financial asset	SPPI?
Bond with stated maturity date. Pays a variable market interest rate. That rate is capped	✓
Full-recourse loan secured by collateral	✓
Bond convertible into fixed number of equity instruments of the issuer	✗
Loan that pays floating interest rate that is inverse to market rate	✗

Investment in equity instruments

All equity instruments must be measured at fair value,
but there is a presentation alternative to present fair value changes in other comprehensive income (OCI)

Scope

- Must be equity as defined in IAS 32
- Not eligible if held for trading

Features

- Irrevocable election at initial recognition
- Instrument by instrument election
- Dividends recognised in P&L
- No recycling of gains and losses in P&L
- No impairment

Not ‘AFS’ accounting and not the same as the FVOCI classification for debt instruments

Classification of financial liabilities

Financial liability accounting essentially unchanged from IAS 39, except for own credit on financial liabilities designated under the fair value option

Financial statements – IFRS 9			
Balance sheet		**P&L**	
Financial liabilities – FVO	Full FV	Gain or loss	all FV Δ except own credit
		OCI	
		Gain or loss	FV Δ due to own credit*

* Not recycled

Required by IFRS 9 for financial liabilities under FVO

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Research opportunities—classification and measurement

There is no available for sale ('AFS') category for equity instruments
(ie no impairment and recycling)

- what is the significance and characteristics of investments affected by this change?
- how has this affected entities investment decisions (ie nature and type of investment)?
- how prevalent is the use of the OCI presentation election?
- how do investors respond to choices made?

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Reclassification of financial assets due to **changes in business model** are expected to be rare

- under what circumstances have entities reclassified financial assets due to a change in business model?
- is the information disclosed about a reclassification useful to investors?

Research opportunities—classification and measurement

Only financial assets with cash flows that are **SPPI** are eligible for amortised cost or FVOCI (depending on the business model)

- do any financial assets that would generally have been considered as basic lending arrangements not meet SPPI? Why?
- do these two criteria (SPPI and business model) result in the most useful information being provided for particular financial assets?

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For financial liabilities designated under the fair value option, changes in the fair value of an entity's **own credit risk** are recognised in OCI rather than profit or loss

- is the information provided about an entity's own credit useful to investors?

Questions?

Impairment

Impairment—an expected loss model

Responds to calls from the G20 and others

- ✓ Forward-looking model
- ✓ Responsive to changes in credit risk

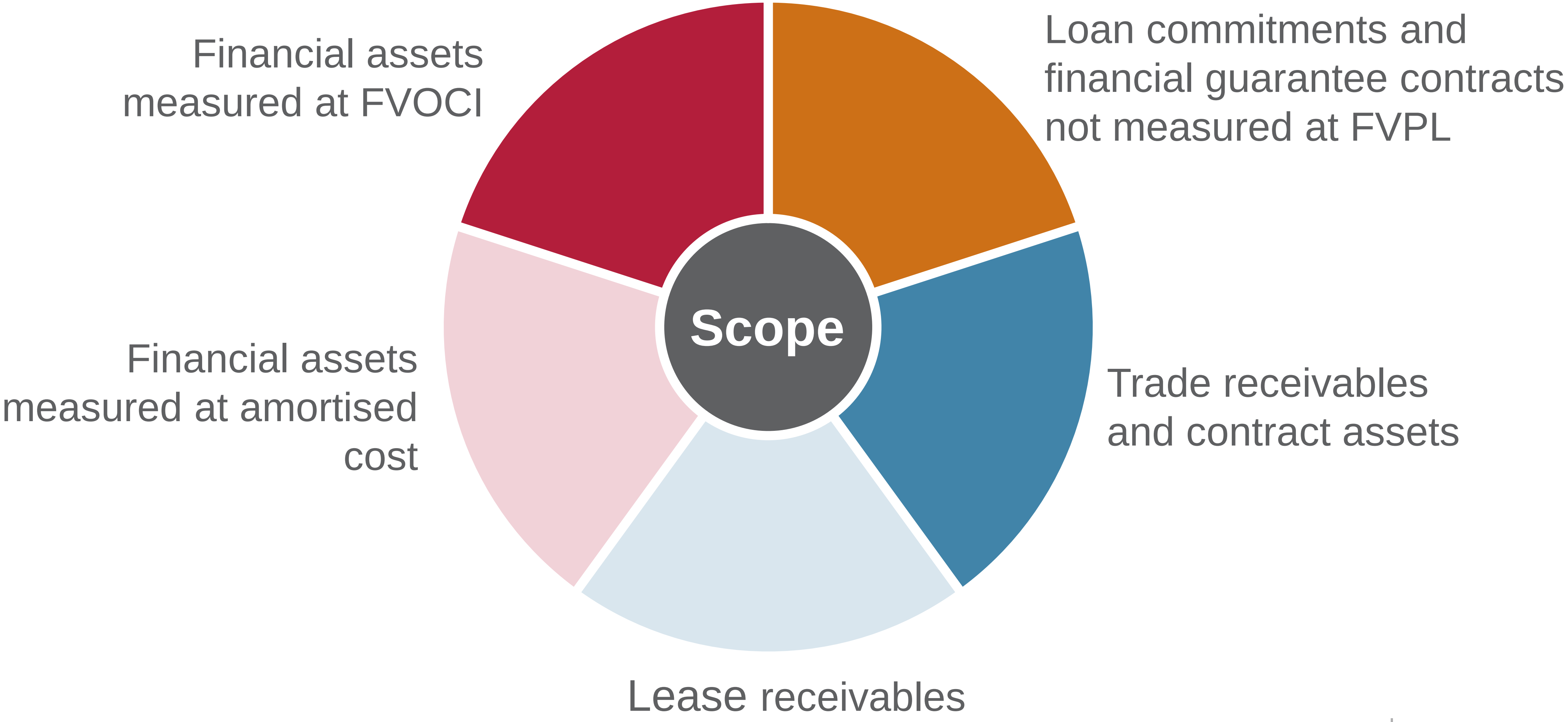
Single model reduces complexity of multiple approaches

Builds on existing systems to balance costs and benefits

Broader range of information required to be considered
- more timely recognition of expected credit losses
- IAS 39 threshold eliminated

Enhanced disclosures
- illustrate how entity has applied requirements
- show assets which have significantly increased in credit risk

Scope of impairment requirements



Overview of general impairment model

Change in credit risk since initial recognition

ECL recognised	12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses
Interest revenue	Gross basis	Gross basis	Net basis
	Stage 1 'Performing'	Stage 2 ‘Underperforming’	Stage 3 ‘Non-performing’/ Credit-impaired

Main judgements and estimates

- Determining whether there is a significant increase in credit risk since initial recognition
- Determining whether a collective or individual assessment is needed for portfolios of shared risk characteristics
- Measuring expected credit losses (ECL)
  - determining whether loans will be paid as due – and, if not, how much might be recovered and when
  - probability-weighting different scenarios
- Appropriately incorporating forward-looking information into assessment of changes in credit risk and measurement of ECL
- Determining the appropriate period over which to measure ECL for revolving credit facilities

Determining significant increases in credit risk

- Change in credit risk <u>over the life</u> of the instrument – ie risk of default occurring (not changes in expected credit losses)
  - no definition of default, but rebuttable presumption that no later than 90 days past due
  - maturity matters
- Compare to credit risk <u>at initial recognition</u>
  - consider reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk
- Financial instruments that have low credit risk at the reporting date
  - may assume credit risk has not increased significantly
- More than 30 days past due
  - rebuttable presumption that credit risk has increased significantly since initial consideration

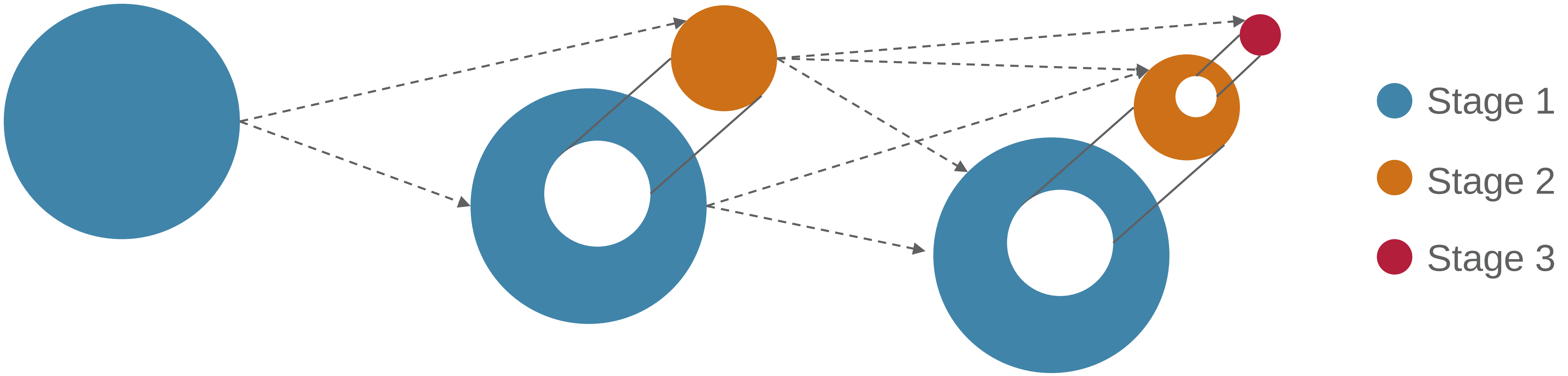
Assessment of increase in credit risk

As information emerges over time an entity is able to better distinguish credit risk of loans

Portfolio of home loans originated in a country

Information emerges that one region is experiencing tough economic conditions

More information emerges and entity can identify particular loans in default or that will imminently default



Measuring expected credit losses

ECL needs to reflect:

Probability-weighted outcome

- Must consider at least possibility that default will/will not occur

Time value of money

- Discount at effective interest rate or an approximation thereof

Reasonable and supportable information

- Available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions

Particular measurement methods are not prescribed –
designed to accommodate different information availability

Information set

Historical

Current

Reasonable and supportable forecasts of future economic conditions

Need to ensure historical information is relevant (may need to be adjusted)

- Emphasis on forward looking information, but if nothing more forward-looking is available, delinquency information may be used
- Expect move to stage 2 <u>before</u> delinquent

Available without undue cost or effort

Reasonable and supportable information

Objective

Consider all reasonable and supportable information, including forward-looking information, that is relevant and available without undue cost or effort

- Information with these characteristics is used in both assessment of significant increases in credit risk and in measurement of expected credit losses
- Will require judgement
- Information should not be excluded simply because:
  - the event has a low or remote likelihood of occurring; or
  - the effect of that event on credit risk or the amount of expected credit losses is uncertain

Reasonable and supportable information (cont'd)

Borrower-specific factors

- Changes in operating results of borrower
- Technological advances that affect future operations
- Changes in collateral supporting obligation

Macroeconomic factors

- House price indexes
- GDP
- Household debt ratios

Data sources could be

Internal
Credit loss experience and ratings

External
Ratings, statistics or reports

Information does not need to flow through statistical model or credit-rating process to determine whether it is reasonable and supportable and relevant

Disclosures—objective

Enable users to
understand the **effect of credit risk**
on the **amount**, **timing** and **uncertainty**
of **future cash flows**

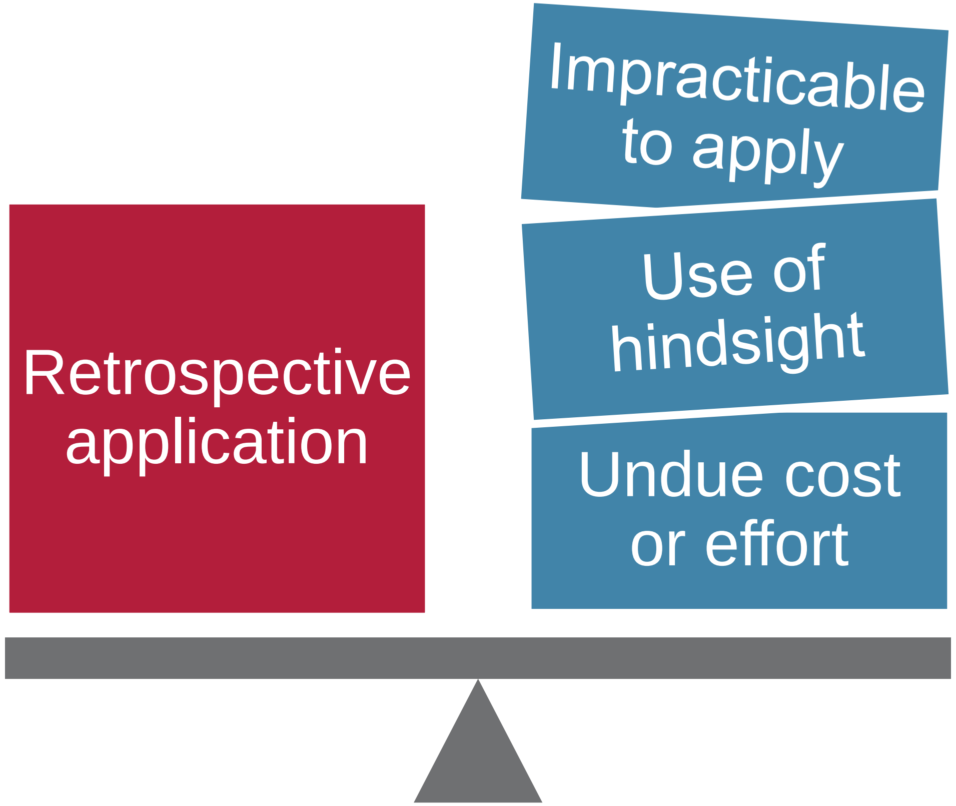
Entities' **credit risk management practices** and how they relate to recognition and measurement of ECL

Quantitative and qualitative information to evaluate amounts in the financials arising from ECL

Entities' **credit risk exposure** including significant credit risk concentrations

Transition to IFRS 9—impairment

- Retrospective application required
- Reliefs available
  - low credit risks simplification
  - 30 days past due rebuttable presumption
  - undue cost or effort to determine credit risk at initial recognition



Research opportunities—impairment

New **expected credit loss model**

- what is the impact on reported numbers and financial ratios?
- how do entities’ calculations relate to economic conditions?
- how do entities, industries and countries compare in their application of the model?
- in the long term, how does better measurement of impairment contribute to goals such as financial stability?

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Transition choices

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- what transition approaches have entities adopted?
- what are the characteristics of entities making various choices?
- are any market impacts observable in relation to these choices?

Research opportunities—impairment

Objective-based **disclosure requirements** were included in IFRS 7 for ECL

- can researchers observe changes in entities' disclosures, and the quality thereof, because the drafting of disclosure requirements is different?
- what factors are associated with better ECL disclosures?
- are regulatory effects observed?
- are costs or benefits of better disclosure observable?

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Questions?

IASB Research opportunities

See News on our Academic page https://www.ifrs.org/academics/

- Webinars:
  - IFRS 9 *Financial Instruments*

    Thursday 21 January, 09:00-10:00 and Thursday 21 January, 15:00-16:00
  - IFRS 16 *Leases*

    Friday 22 January, 09:30-10:30 and Friday 22 January, 15:00-16:00
  - IFRS 15 *Revenue from Contracts with Customers*

    Monday 8 February, 09:00-10:00 and Monday 8 February, 15:00-16:00
- Journal special issues
- Upcoming conferences, including IASB Research Forum 2021

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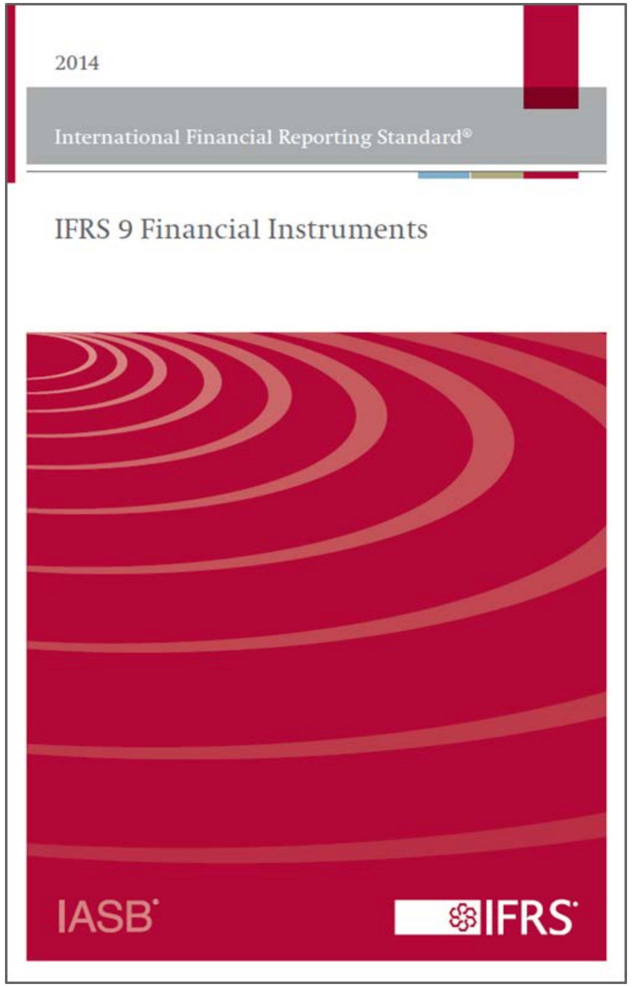
Relevant materials



IFRS 9 overview and access to Standard

Project Summary

Supporting materials

Articles

Big changes ahead: accounting for financial instruments

IFRS 9: a complete package for investors