

What should we know about IFRS 9?

29 September 2016



The better the question. The better the answer.
The better the world works.

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Agenda

IFRS 9

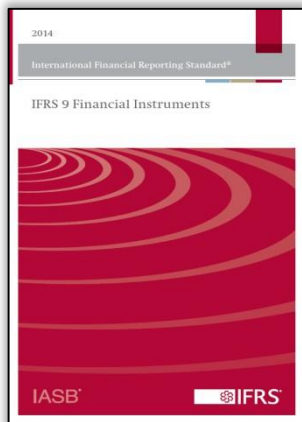
- ▶ Overview
- ▶ 3 phases of IFRS 9
 - ▶ Classification and Measurement
 - ▶ Impairment
 - ▶ Hedge Accounting
- ▶ Implementation
- ▶ Q&A

IFRS 9 Overview



IFRS 9 Overview

- ▶ On 24 July 2014, the International Accounting Standards Board (IASB) issued the final version of IFRS 9, bringing together all three phases of the financial instruments project:



1

Classification and Measurement

2

Impairment

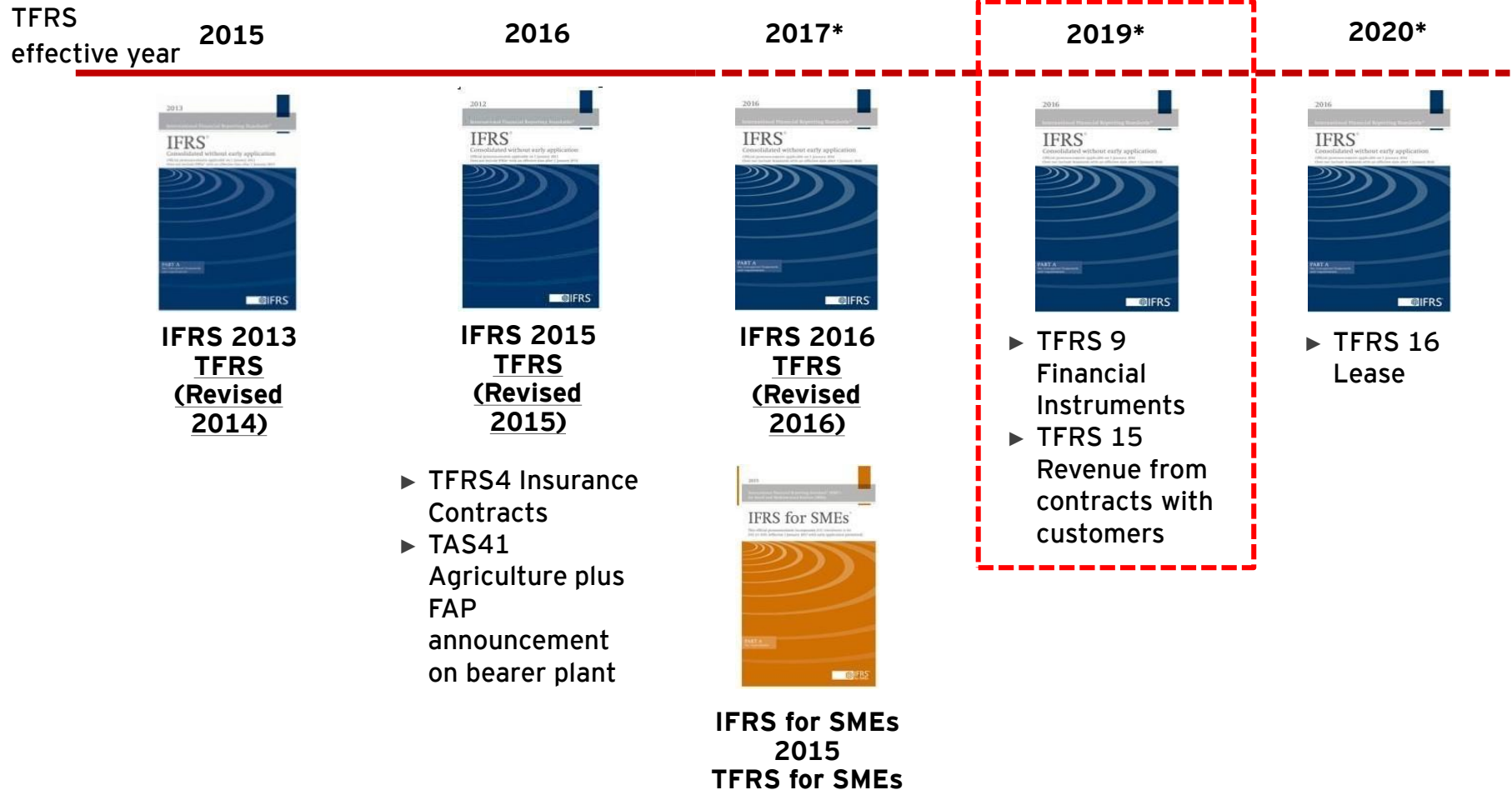
3

Hedge Accounting

- ▶ Affects all institutions reporting under IFRS (most notably excluding US institutions following the FASB US GAAP standards)
- ▶ IFRS 9 is effective for annual periods beginning on or after 1 January 2018
- ▶ Retrospective application with transition reliefs.

Thai Financial Reporting Standards Update

Key Accounting change in Thailand



*** Subject to formal announcement by FAP**

เอกสารเพื่อใช้ในการฝึกอบรมสำหรับสมาคมประกันวินาศภัยไทยเท่านั้น

Thai Financial Reporting Standards Update

Key differences between TFRS and IFRS

Even most of the TFRS are the same as IFRS BV2015, however, there are some areas of IFRS that are different from TFRS.

The following IFRSs have no equivalent TFRSs

- ▶ IFRS1 First-time adoption of IFRSs*
- ▶ IFRS15 Revenue from contracts with customers**
- ▶ IFRS14 Regulatory deferral accounts*
- ▶ IAS32 Financial Instruments : Presentation*
- ▶ IAS39 Financial instruments : Recognition and measurement*
- ▶ IFRS7 Financial instruments : Disclosures*
- ▶ IFRS9 Financial instruments**

* Already effective

** Effective in 2018 for international and 2019 for Thailand

Thai Financial Reporting Standards Update

Key differences between TFRS and IFRS

Even most of the TFRS are the same as IFRS BV2015, however, there are some areas of IFRS that are different from TFRS.

มาตรฐานการบัญชีไทย	2559	2562	
TAS 101 : หนี้สงสัยจะสูญและหนี้สูญ	✓		
TAS 103 : การเปิดเผยข้อมูลในงบการเงินของธนาคารและสถาบันการเงินที่คล้ายคลึงกัน	✓		
TAS 104 : การบัญชีสำหรับการปรับโครงสร้างหนี้ที่มีปัญหา	✓		
TAS 105 : การบัญชีสำหรับเงินลงทุนในตราสารหนี้และตราสารทุน	✓		
TAS 106 : การบัญชีสำหรับกิจการที่ดำเนินธุรกิจเฉพาะด้านการลงทุน	✓		
TAS 107 : การแสดงรายการและการเปิดเผยข้อมูลเครื่องมือทางการเงิน	✓		
TI 9 : แนวปฏิบัติสำหรับการโอนและรับโอนสินทรัพย์ทางการเงิน	✓		
TFRS 13 : การวัดมูลค่ายุติธรรม	✓	✓	
TFRS 9 : เครื่องมือทางการเงิน		✓	
TFRS 7 : การเปิดเผยข้อมูลสำหรับเครื่องมือทางการเงิน		✓	
TAS 32 : การแสดงรายการสำหรับเครื่องมือทางการเงิน		✓	

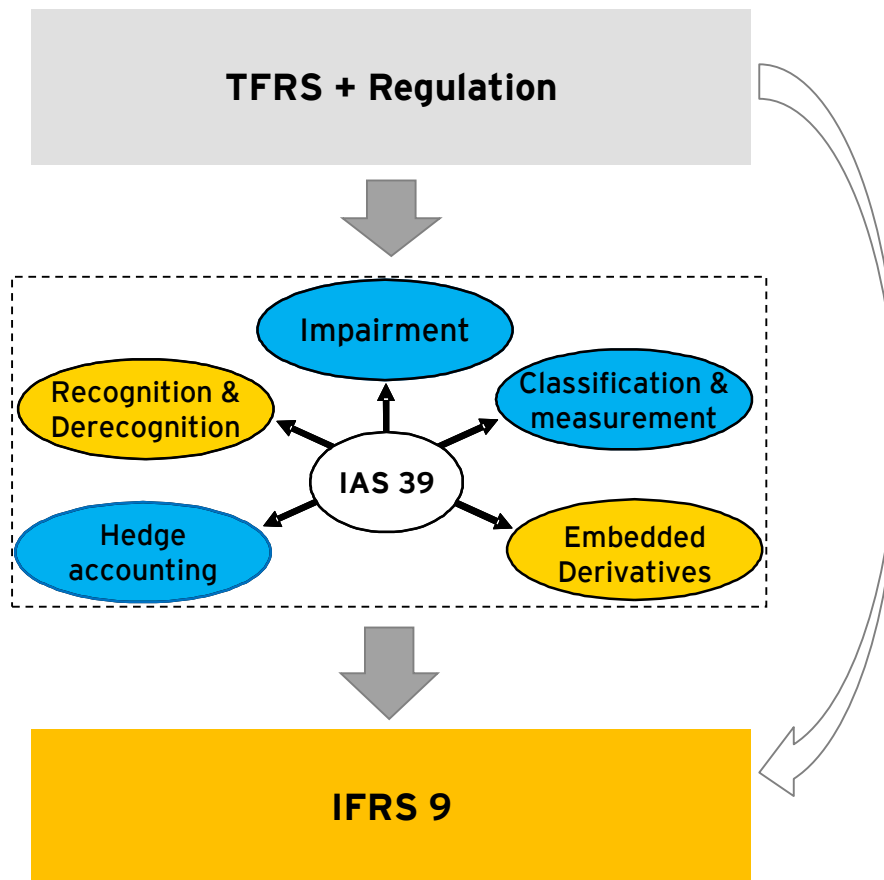
- ▶ IAS32 Financial Instruments : Presentation*
- ▶ IAS39 Financial instruments : Recognition and measurement*
- ▶ IFRS7 Financial instruments : Disclosures*
- ▶ IFRS9 Financial instruments**

* Already effective

** Effective in 2018 for international and 2019 for Thailand

IFRS 9 Overview

Current vs IFRS 9



Key gaps :

Classification & Measurements

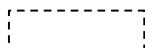
- ▶ New Classification & Measurement
- ▶ EIR - transaction cost, step rate and expected life

Impairment

- ▶ Expected loss concept

Hedge accounting (Optional)

- ▶ Relaxation
- ▶ Macro hedging

 Study phase + partial system implementation

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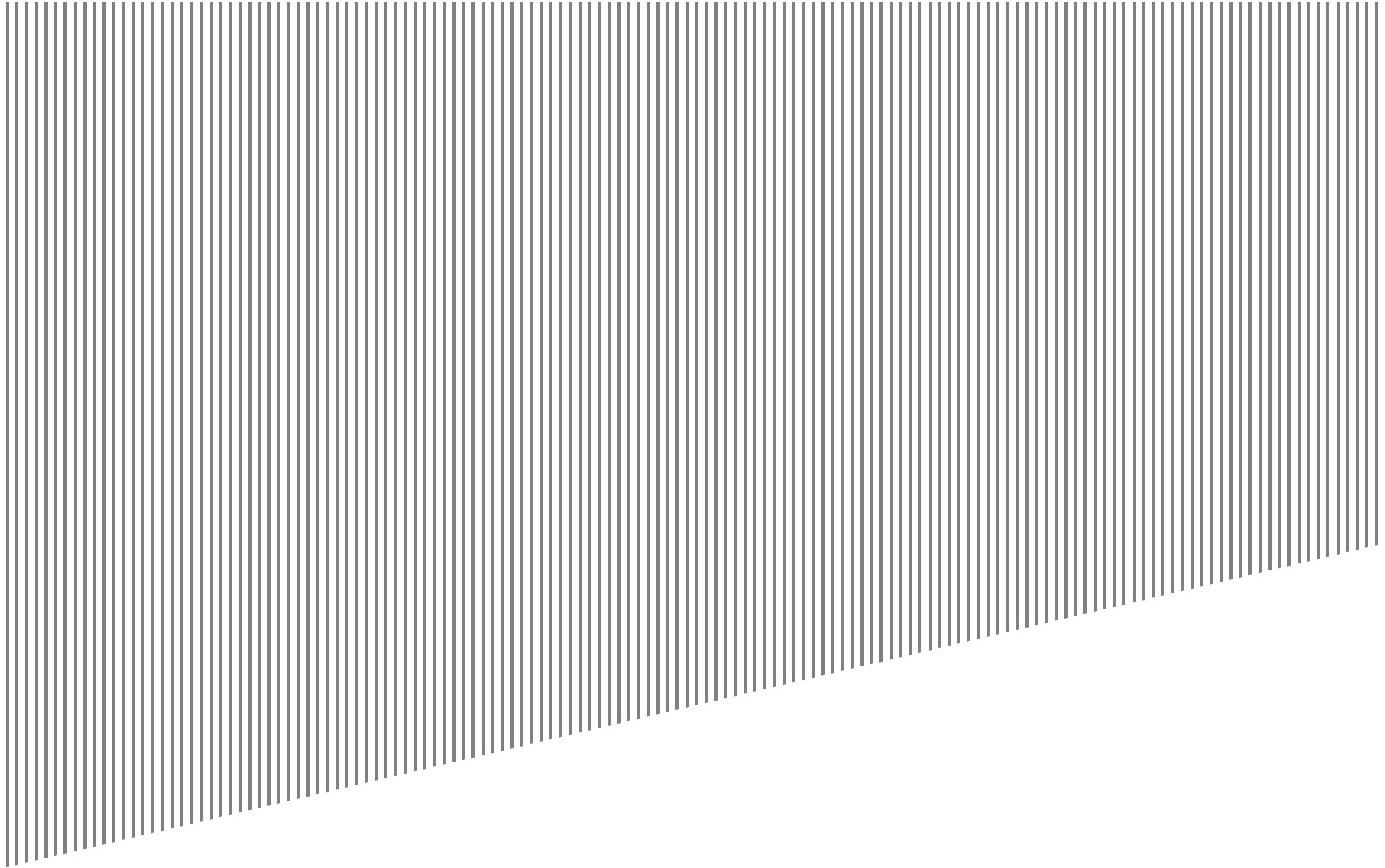
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Classification and Measurement



Classification and Measurement

Financial assets



Classification and Measurement

What are financial instruments?

สินทรัพย์

เงินสดและรายการเทียบเท่าเงินสด

รายได้จากการลงทุนค้างรับสุทธิ

เบี้ยประกันภัยค้างรับสุทธิ

สินทรัพย์จากการประกันภัยต่อ

สินทรัพย์ลงทุน

เงินลงทุนในหลักทรัพย์

เงินลงทุนเพื่อค้า

เงินลงทุนเพื่อขาย

เงินลงทุนที่จะถือจนครบกำหนด

เงินลงทุนทั่วไป

เงินให้กู้ยืม

ที่ดิน อาคารและอุปกรณ์สุทธิ

สินทรัพย์ที่ไม่มีตัวตนสุทธิ

สินทรัพย์ภาษีเงินได้รอตัดบัญชี

สินทรัพย์อื่น

ลูกหนี้-สุทธิ

สินไหมค้างรับคู่กรณี

อื่น ๆ

หนี้สิน

ภาษีเงินได้ค้างจ่าย

เจ้าหนี้บริษัทประกันภัยต่อ

หนี้สินจากสัญญาประกันภัย

สำรองค่าสินไหมทดแทน

และค่าสินไหมทดแทนค้างจ่าย

สำรองเบี้ยประกันภัย

ผลประโยชน์พนักงานค้างจ่าย

หนี้สินภาษีเงินได้รอตัดบัญชี

หนี้สินอื่น

เบี้ยประกันภัยรับล่วงหน้า

ค่านายหน้าค้างจ่าย

เจ้าหนี้อื่น

อื่น ๆ

ส่วนของผู้ถือหุ้น

ทุนเรือนหุ้น

ทุนที่ออกและชำระแล้ว

หุ้นบุริมสิทธิชนิดไม่สะสมเงินปันผล

หุ้นสามัญ

ส่วนเกินมูลค่าหุ้นสามัญ

องค์ประกอบอื่นของผู้ถือหุ้น

- ส่วนเกินกว่าทุนจากการเปลี่ยนแปลง

มูลค่าเงินลงทุน

กำไรสะสม

จัดสรรแล้ว

สำรองตามกฎหมาย

อื่น ๆ

ยังไม่จัดสรร

Classification and Measurement

Financial Asset (TAS 105 vs TFRS 9)

2016

TAS 105 Classification & Measurement

1. Trading → *FVTPL*

2. Available for sale (AFS)
→ *FVOCI*

3. Held to maturity (HTM)
→ *Amortised cost (AC)*

4. Other investment →
Cost - impair (if any)
e.g. *General investment*



1 January 2019* onward

IFRS 9 Classification & Measurement

1a. Fair Value through
Profit and Loss (FVTPL)

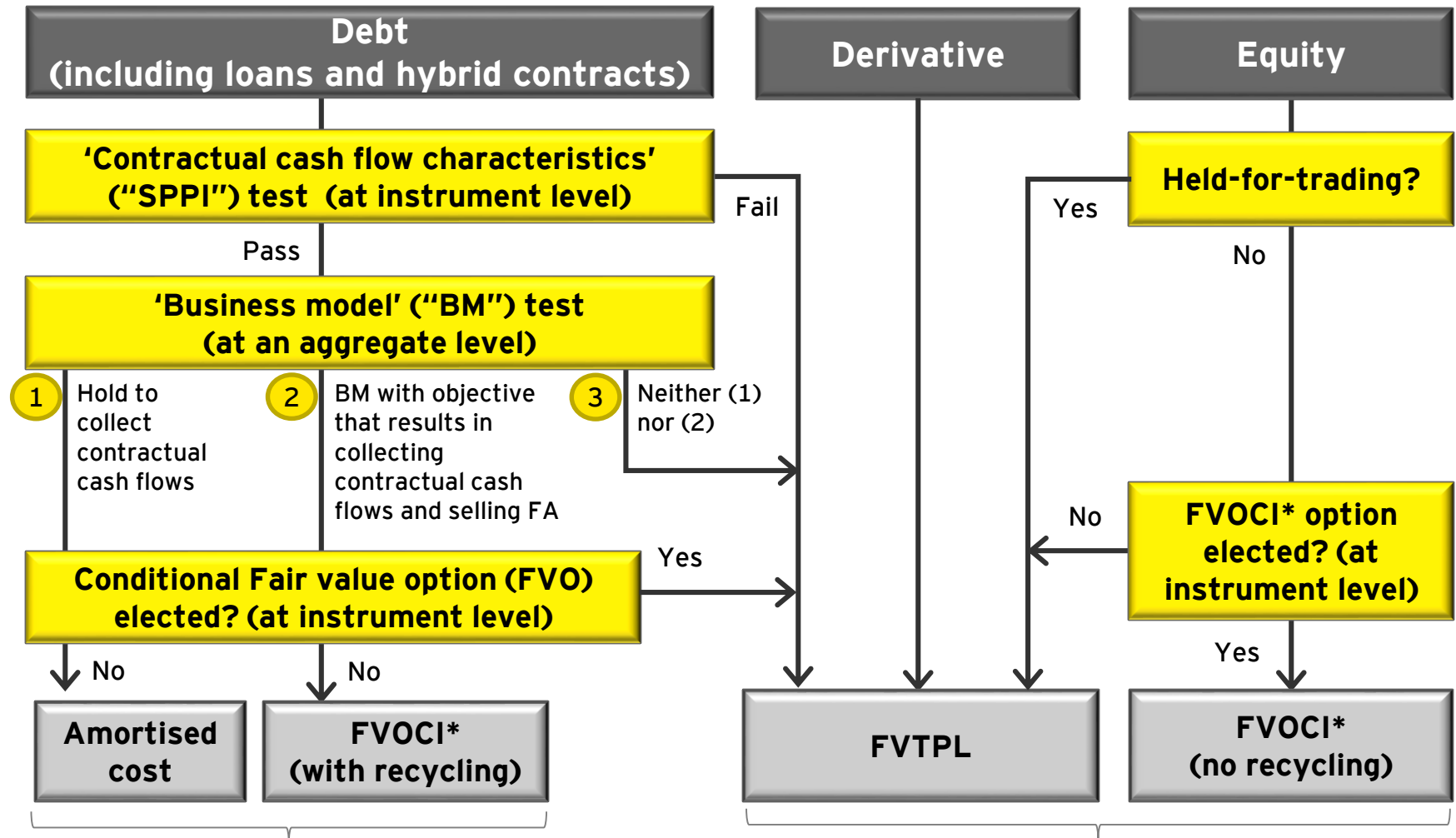
1b. Fair Value through
Other Comprehensive
Income (FVOCI)

2. Amortised cost (AC)

* : Tentative TFRS effective date

Classification and Measurement

New Model of Classification for Financial Assets



Subject to impairment assessment

*OCI = Equity reserve

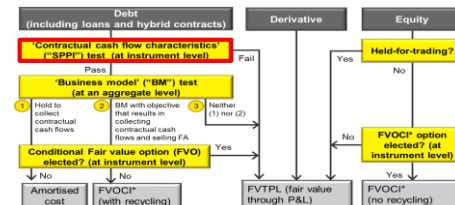
Impairment assessment not required

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Classification and Measurement

Solely Payments of Principal and Interest Cash Flow

The SPPI test (at instrument level)



Contractual cash flows that are 'solely payments of principal and interest on the principal amount outstanding' (SPPI)

☒ DO

Consistent with a basic lending arrangement which includes consideration for:

- ▶ Time value of money
- ▶ Credit risk
- ▶ Other basic lending risks and costs:
 - ▶ Liquidity risk
 - ▶ Admin costs
 - ▶ Profit margin

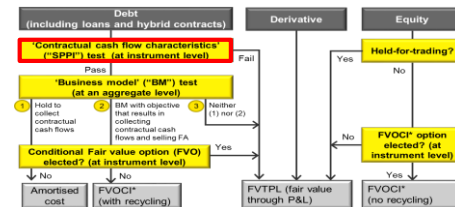
☒ DON'T

Do not introduce exposure to risks or volatility unrelated to a basic lending arrangement

- ▶ Elements inconsistent with a basic lending arrangement include:
 - ▶ Exposure to changes in equity or commodity prices
 - ▶ Leverage

Classification and Measurement

Solely Payments of Principal and Interest Cash Flow The SPPI test (at instrument level)

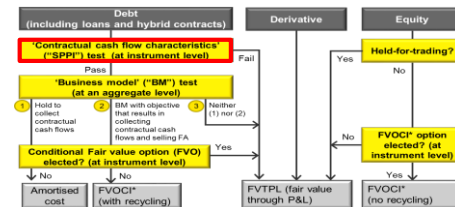


- ▶ Examples of features that will **qualify** for amortized cost (subject to certain conditions)
 - ▶ Prepayment options, extension options
 - ▶ Fixed / variable interest rate
 - ▶ Caps, floors, collars
 - ▶ Unleveraged inflation index linked instruments

Classification and Measurement

Solely Payments of Principal and Interest Cash Flow

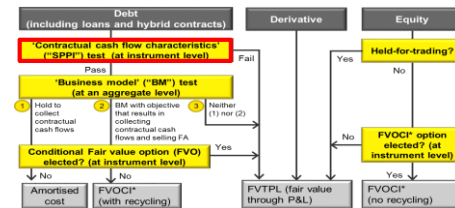
The SPPI test (at instrument level)



- ▶ Examples of features/assets that will **NOT qualify** for amortized cost
 - ▶ Leverage (e.g., options, forwards and swap) or link to a commodity price
 - ▶ Conversion options (e.g., convertible bonds)
 - ▶ Coupons paying a fixed rate minus LIBOR (e.g., inverse floaters)
 - ▶ Triggers that result in a significant reduction of principal, interest or both (e.g., catastrophe bonds)
 - ▶ Perpetual instrument
 - ▶ A perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due.
 - ▶ The instrument pays market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards. Deferred interest does not accrue additional interest.
 - ▶ Loan restructuring with equity components

Classification and Measurement

SPPI test - principal



► 'the fair value of the asset at initial recognition'

i.e., not the legal principal - allows assets acquired at a discount or premium to pass the SPPI test

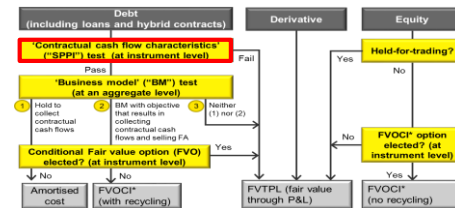
- May change over the life of the financial asset (e.g., if there are repayments of principal)
- Reflects the economics of the financial asset from the perspective of the current holder

► Example:

- Bond with a contractually stated principal of CU1,000
- Bond was originally issued at CU990
- Current holder acquired the bond for CU975
- From the perspective of current holder, the principal is THB 975
- The principal is, therefore, not necessarily the contractual par amount.

Classification and Measurement

SPPI test - Example 1



Scenario:

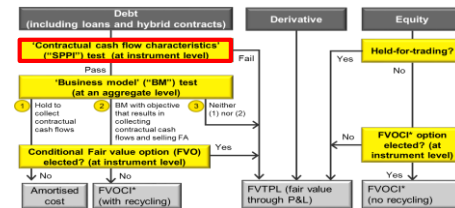
Entity L invests in 15-year floating rate government bonds and the coupons are reset every six months by referencing to the 10-year rate. Would the instrument qualify for amortised cost measurement?

Analysis:

- ▶ No. As worded, the Example B in paragraph B4.1.13 of the standard makes it clear that if the interest payable in each period is disconnected from the term of the instrument, the contractual cash flows do not reflect only the time value of money and compensation for credit risk.
- ▶ There are a number of instruments (across various jurisdictions), where the coupon rate is periodically reset to a reference rate that is not connected to the period to which it is applied. Hence, based on the example in the standard, such instruments may not qualify for an amortized cost classification.

Classification and Measurement

SPPI test - Example 2



Scenario:

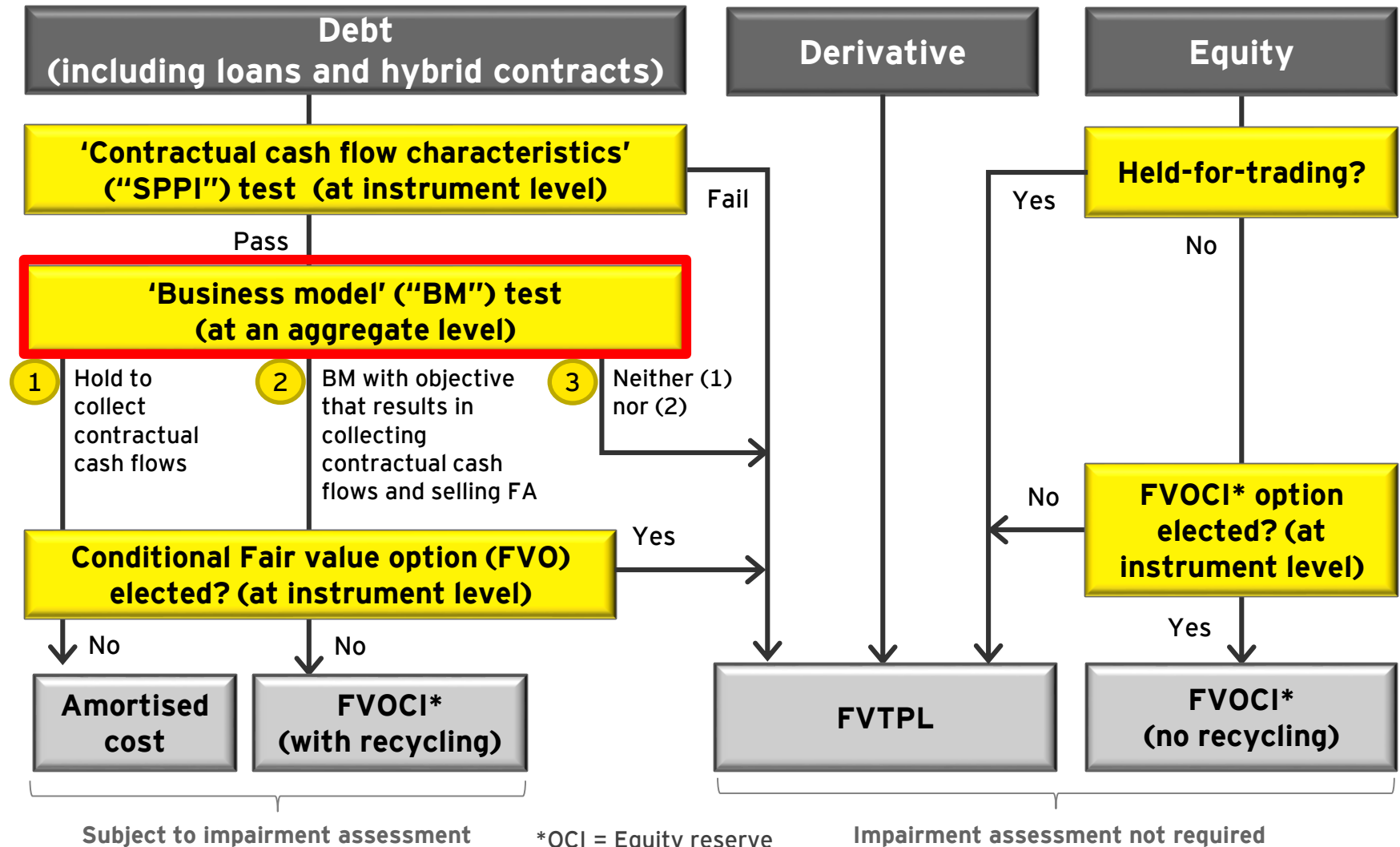
Entity M's investment bears interest at a stepped-up rate. Would instruments be considered to have cash flows that are solely payments of principal and interest?

Analysis:

- ▶ Yes, if the step-up rates throughout the life of the asset are contractually set at inception, and the net present value at inception is the same as if the instrument had been issued at a fixed market rate.
- ▶ However, if the step-up rates compensate the lender for more than just the time value of money and credit risk, amortized cost measurement may not be appropriate.

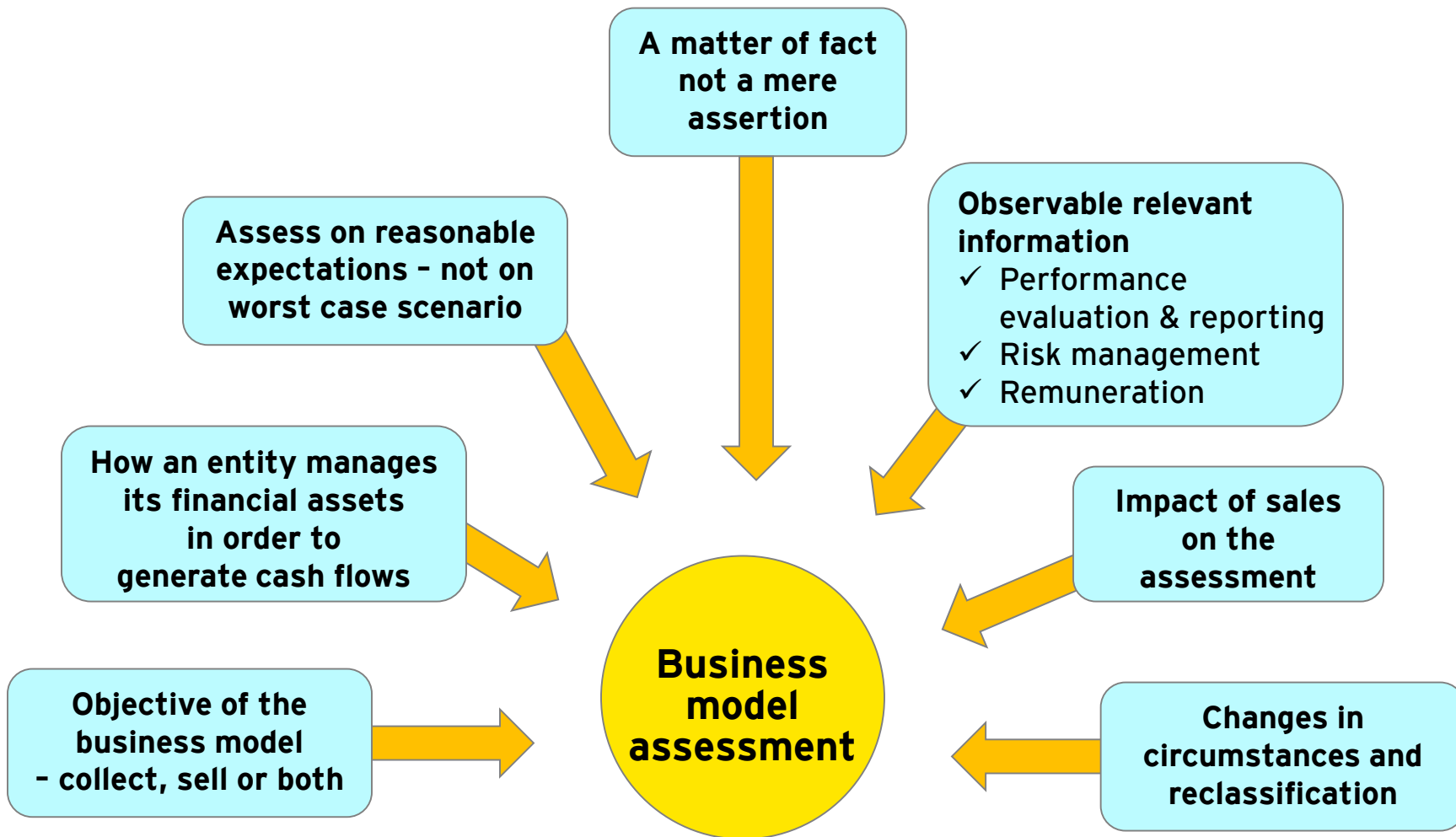
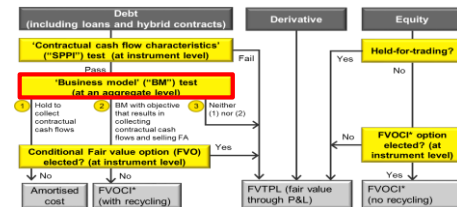
Classification and Measurement

New Model of Classification for Financial Assets



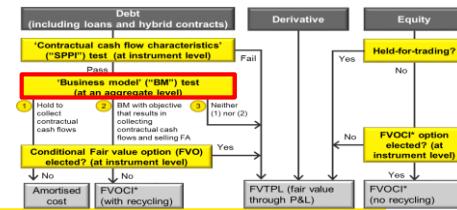
Classification and Measurement

Business Model (BM): Factors to consider



Classification and Measurement

Amortised cost business model (hold to collect)



Objective of the business model

- ▶ Hold assets to collect contractual cash flows

Considerations for sales

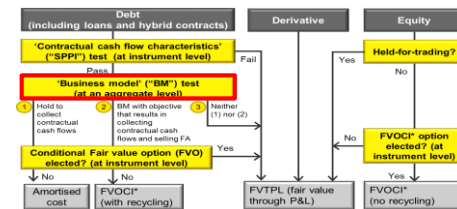
- ▶ Frequency, value and timing of past sales
- ▶ Expectations for future sales
- ▶ Sales should be considered even if imposed by a regulator

Examples of sales consistent with a hold to collect BM

- ▶ Due to deterioration in credit quality (asset no longer meets documented investment strategy)
- ▶ Infrequent sales even if significant (e.g., stress case scenario)
- ▶ Sales made close to maturity

Classification and Measurement

Amortised cost concept (1/2)



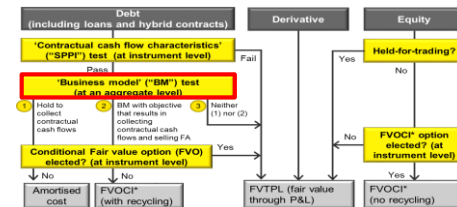
- ▶ All financial assets and liabilities are initially recognised at fair value (which is normally the transaction price) plus/minus
 - ▶ Transaction costs or
 - ▶ Fees which be a part of 'effective interest rate - "EIR"')

$$\text{Initial value} = \text{Fair value} + \text{Transaction cost}$$

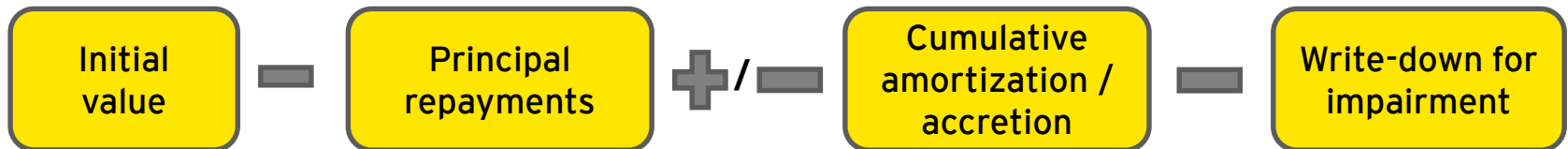
- ▶ The cost differ from the amortized cost in the following cases (i.e. EIR to be computed instead of using contractual rates):
 - ▶ When the financial instrument is initially recorded at premium / discount (including cases of zero-coupon / different than market interest rate financial instruments)
 - ▶ When there are transactions costs involved
 - ▶ When there is a "stepped margin" feature attached to the financial instrument
- ▶ Transaction cost:
 - ▶ Included in the calculation of amortised cost using the effective interest method
 - ▶ Amortised through profit or loss over the life of the instrument.

Classification and Measurement

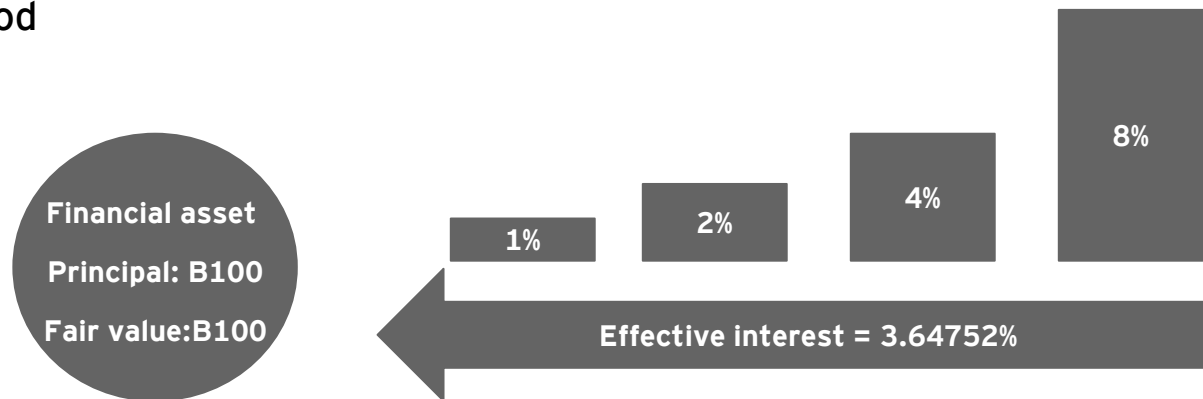
Amortised cost concept (2/2)



- The amortised cost of a financial instrument is defined as the amount at which it was measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the 'effective interest method' of any difference between that initial amount and the maturity amount, and minus any write-down (directly or through the use of an allowance account) for impairment or uncollectability.

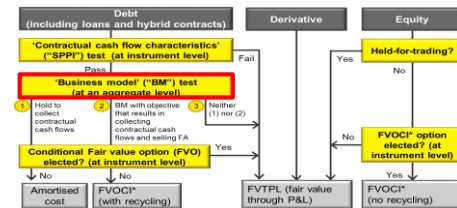


- Effective interest method is a method of calculating the amortised cost of a financial instrument (or group of instruments) and of allocating the interest income or expense over the relevant period



Classification and Measurement

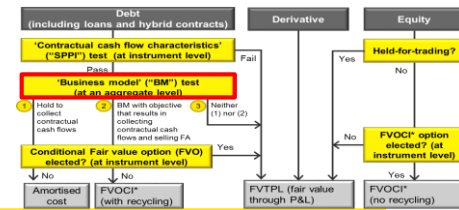
FVOCI business model (hold to collect and sell)



- ▶ Positively defined measurement category and neither a free choice nor a residual (unlike AFS)
- ▶ Managing financial assets, both to collect contractual cash flows and for sale, is the outcome of the way in which financial assets are managed to achieve a particular objective, rather than the objective itself
- ▶ Examples of such objectives include:
 - ▶ Manage every day liquidity needs
 - ▶ Replication portfolios
 - ▶ Liquidity portfolio where regulator requires 'churning'
- ▶ **Sales are integral** to the FVOCI business model and there is no threshold for the frequency or amount of sales

Classification and Measurement

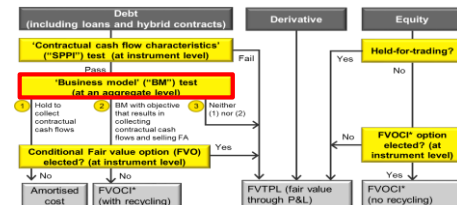
FVPL business model (other business model objectives)



- ▶ FVPL is the measurement category for all financial assets neither measured at amortised cost nor measured at FVOCI
- ▶ Characteristics of FVPL business model:
 - ▶ Management of financial assets with the objective to realise cash flows through sales
 - ▶ Decisions based on fair value information
 - ▶ Objectives result in active buying and selling
 - ▶ Collecting contractual cashflows is only incidental and not integral to that business model
- ▶ Portfolios of assets held for trading fall under a FVPL business model

Classification and Measurement

Business model - Example 1



Scenario:

Entity A holds investments to collect contractual cash flows but would sell the investment in particular circumstances, e.g., if

- ▶ An instrument no longer meets Entity A's investment policy (e.g., the credit rating declines below that required);
- ▶ The entity is an insurer and adjusts its portfolio to reflect a change in expected duration (expected timing of payouts); or
- ▶ Entity A needs to fund unexpected or unanticipated capital expenditures

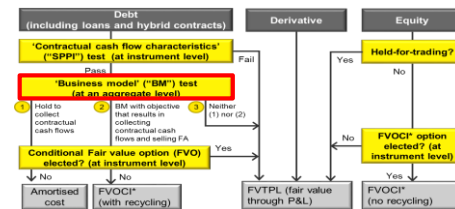
Analysis:

- ▶ While Entity A may consider the assets' fair value from a liquidity perspective, Entity A's objective is to hold the instruments and collect contractual cash flows.
- ▶ Some sales would not contradict that objective.
- ▶ **However**, if more than an infrequent number of sales are made out of a portfolio, the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows.

Note: Gains or losses on sale of such instruments will need to be disclosed as a separate line item in the statement of comprehensive income.

Classification and Measurement

Business model - Example 2



Scenario:

Entity D actively manages a portfolio of financial assets in order to realize fair value changes arising from changes in credit spreads and yield curves.

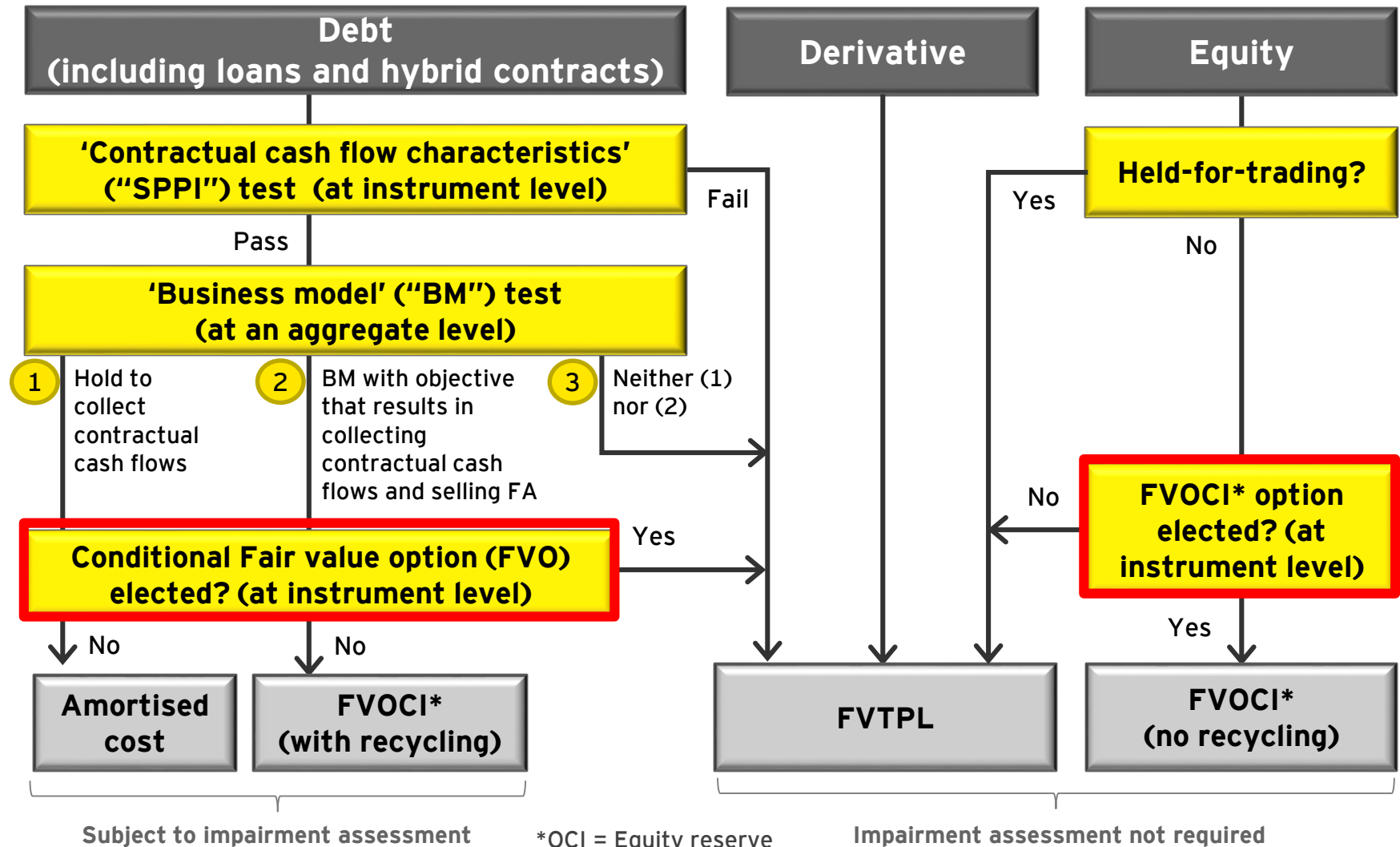
Entity D's objective results in active buying and selling.

Analysis:

Entity D is actively managing its portfolio to maximize fair value gains and is **not** holding the instruments to collect contractual cash flows.

Classification and Measurement

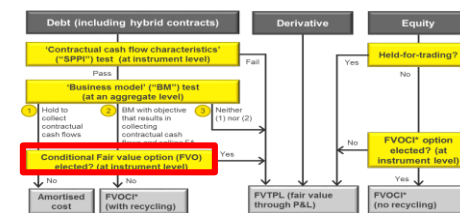
New Model of Classification for Financial Assets



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Classification and Measurement

Fair Value Option (FVO) (at instrument level)



► FVPL option

- **Irrevocable** option to designate **debt financial instrument** as measured at FVTPL at initial recognition if:
 - it eliminates or significantly reduces an **accounting mismatch** – applicable to financial asset and liability

Scenario:

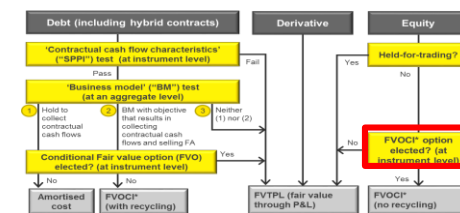
Company A holds a fixed-rate notes receivables. Company A entered into a fixed-for-floating interest rate swap with Company B.

Analysis:

- Measuring the notes receivables at amortized cost would create a measurement mismatch, as the interest rate swap will be accounted for at fair value through profit or loss.
- Company A should designate the notes receivables at fair value through profit or loss using the fair value option of IFRS 9 to eliminate or reduce the accounting mismatch.

Classification and Measurement

Fair Value Option (FVO) (at instrument level)

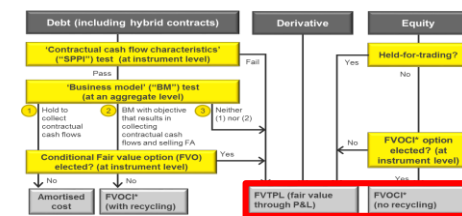


► FVOCI option

- **Irrevocable election** at initial recognition to present gains and losses of an **equity instrument** in OCI
- Available for all equity instruments that are not held for trading
- **Free choice** for each investment at initial recognition
- Irrevocable for that holding (**no reclassification**)
- **No recycling** of fair value changes to profit or loss on impairment, disposal or in any other circumstances
- **No impairment** testing required
- Dividends will be recognised in profit or loss, if return on investment (not return of investment)
- Additional disclosures.

Classification and Measurement

Unquoted equity instruments



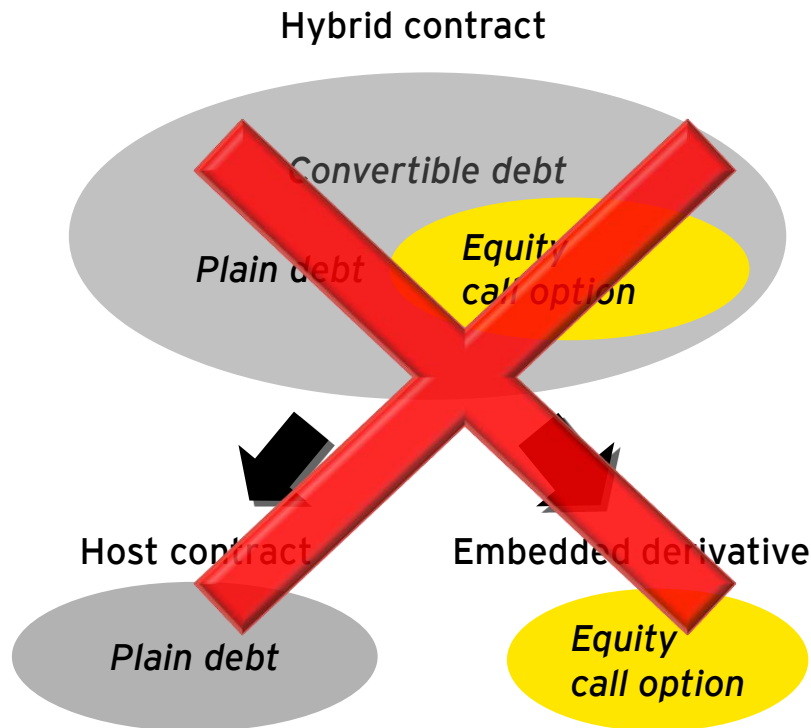
- ▶ No cost exemption for unquoted equity instruments
- ▶ All equities must be measured at fair value, an additional effort will be needed to value such unquoted equity instruments.
- ▶ Such valuation could, for example, be based on an EBITDA multiple or some other projected cash flow technique.

The flowchart illustrates the process for determining the fair value of an asset or liability, categorized into three main types: Debt (including hybrid contracts), Derivative, and Equity.

- Debt (including hybrid contracts):**
 - Starts with "Contractual cash flow characteristics" ("SPPI" test) at the instrument level.
 - If **Yes**, it proceeds to the "Business model" ("BM") test at the aggregate level.
 - If **Yes**, it results in "Amortised cost".
 - If **No**, it results in "FVOCI (with recycling)".
 - If **No**, it proceeds to the "Conditional Fair value option (FVO) elected?" test at the instrument level.
 - If **Yes**, it results in "FVOCI (with recycling)".
 - If **No**, it results in "FVTPL (fair value through P&L)".
- Derivative:**
 - Starts with "Contractual cash flow characteristics" ("SPPI" test) at the instrument level.
 - If **Yes**, it results in "FVOCI option elected?" (at instrument level).
 - If **Yes**, it results in "FVOCI (no recycling)".
 - If **No**, it results in "FVTPL (fair value through P&L)".
 - If **No**, it results in "FVTPL (fair value through P&L)".
- Equity:**
 - Starts with "Contractual cash flow characteristics" ("SPPI" test) at the instrument level.
 - If **Yes**, it results in "Held-for-trading".
 - If **No**, it results in "FVTPL (fair value through P&L)".

The flowchart uses color coding: Green for "Amortised cost", Blue for "FVOCI (with recycling)", Red for "FVTPL (fair value through P&L)", and Grey for "FVOCI (no recycling)".

- ▶ **Host contract - non financial assets**



- ▶ No change from IAS 39.
- ▶ an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:
 - a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host;
 - b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
 - c) the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss (i.e. a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).

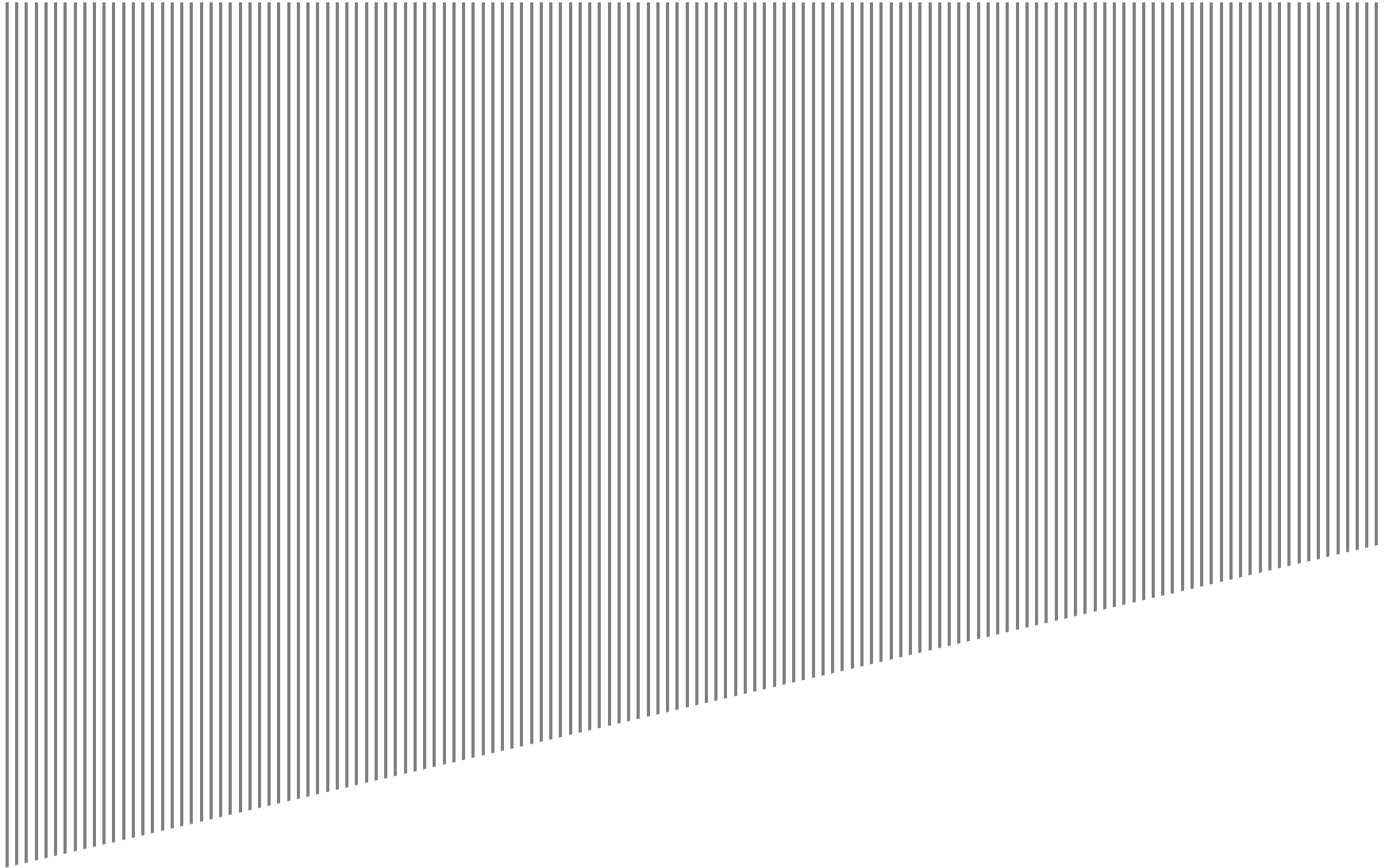
Classification and Measurement

Operational challenges

- ▶ New criteria make it more challenging in determining appropriate classifications. Amortised cost and FVOCI classifications for debt securities are in-scope for impairment.
- ▶ For debt securities classified as FVOCI and in scope for impairment, changes in credit will go to P&L. A valuation framework will be needed to quantify changes in credit risk.
- ▶ Loan and debt securities will need to be reviewed/assessed for terms that are not consistent with principal and interest ("**SPPI**"), process expected to be time consuming.
- ▶ Analysis on classification of investment in equity securities to be classified as FVOCI or FVPL.
- ▶ Cost is no longer an option for unlisted equity securities. A valuation framework will be needed for Other Investments.
- ▶ All derivatives need to be carried at FVTPL
- ▶ New disclosure requirements require more extensive data

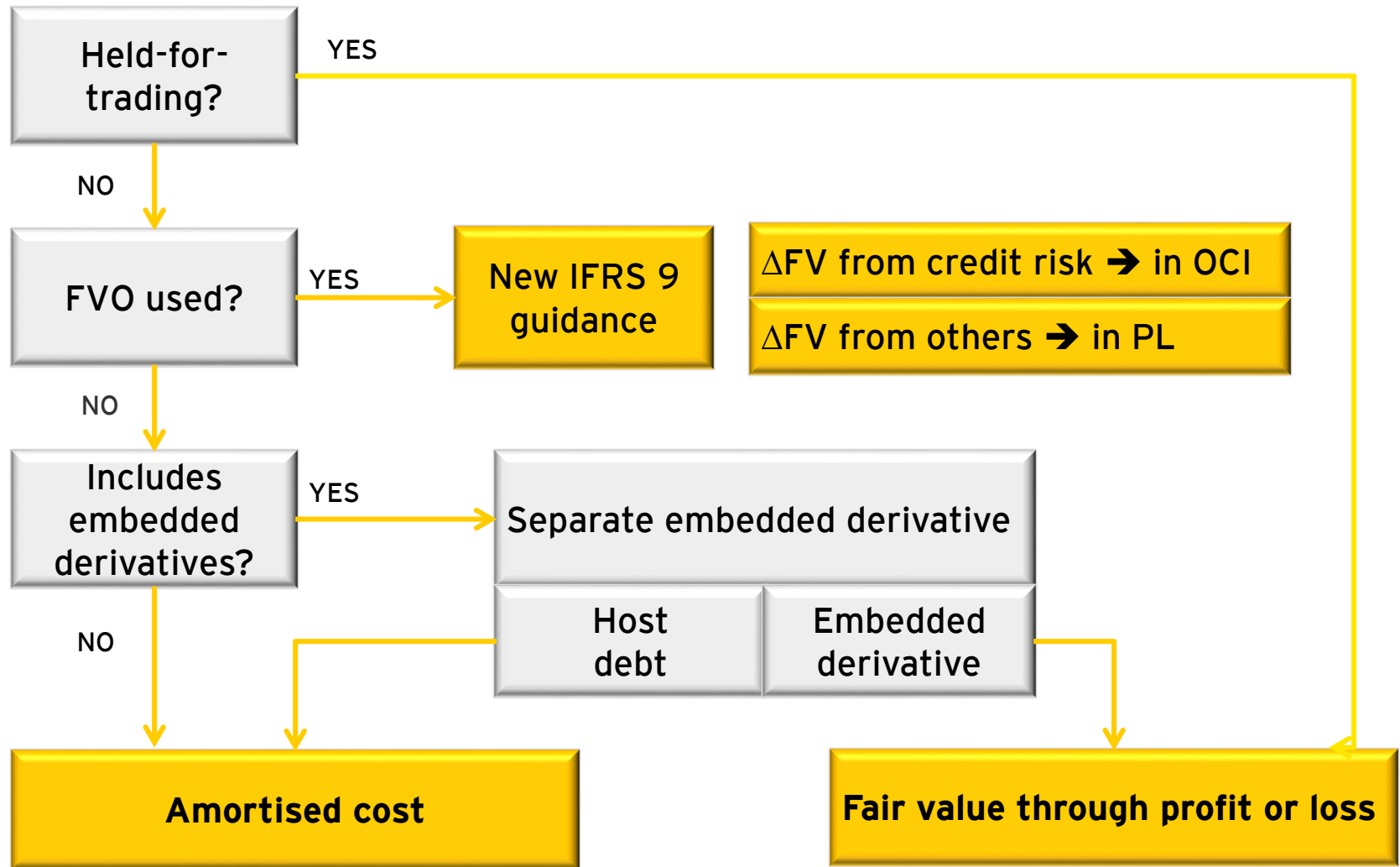
Classification and Measurement

Financial liabilities



Classification and Measurement

Financial liabilities



Classification and Measurement

Financial liabilities (cont'd)

- ▶ Gains and losses on liabilities designated at FVPL arising from changes in own credit risk are recorded in OCI and never recycled
 - ▶ Unless recognising such fair value changes in OCI would create or enlarge an accounting mismatch in P&L
- ▶ No other changes from IAS 39, this means that embedded derivatives separation rules are retained for financial liabilities

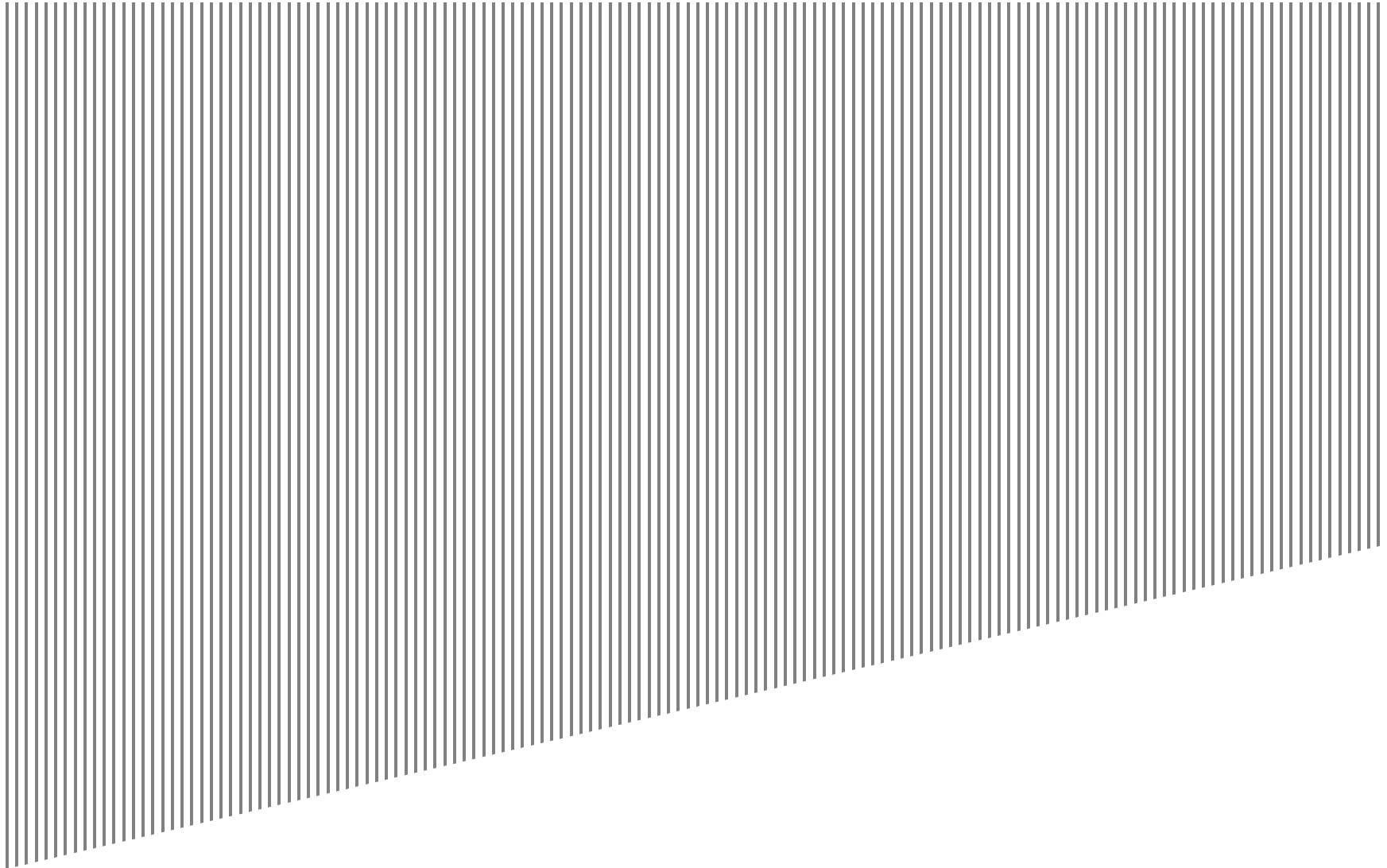
Classification and Measurement

Financial liabilities - Fair Value Option

- ▶ **Irrevocable option to designate financial instrument as measured at FVTPL at initial recognition if:**
 - ▶ It eliminates or significantly reduces an accounting mismatch
 - ▶ It is a financial liability and it is managed as part of a group of financial instruments the performance or which is evaluated on a fair value basis; or
 - ▶ It is a host that contains one or more embedded derivatives, unless:
 - ▶ the embedded derivatives do not significantly modify the outcome; or
 - ▶ separation of the embedded derivatives is prohibited (e.g. when they are closely related to the host)

Classification and Measurement

Other topics



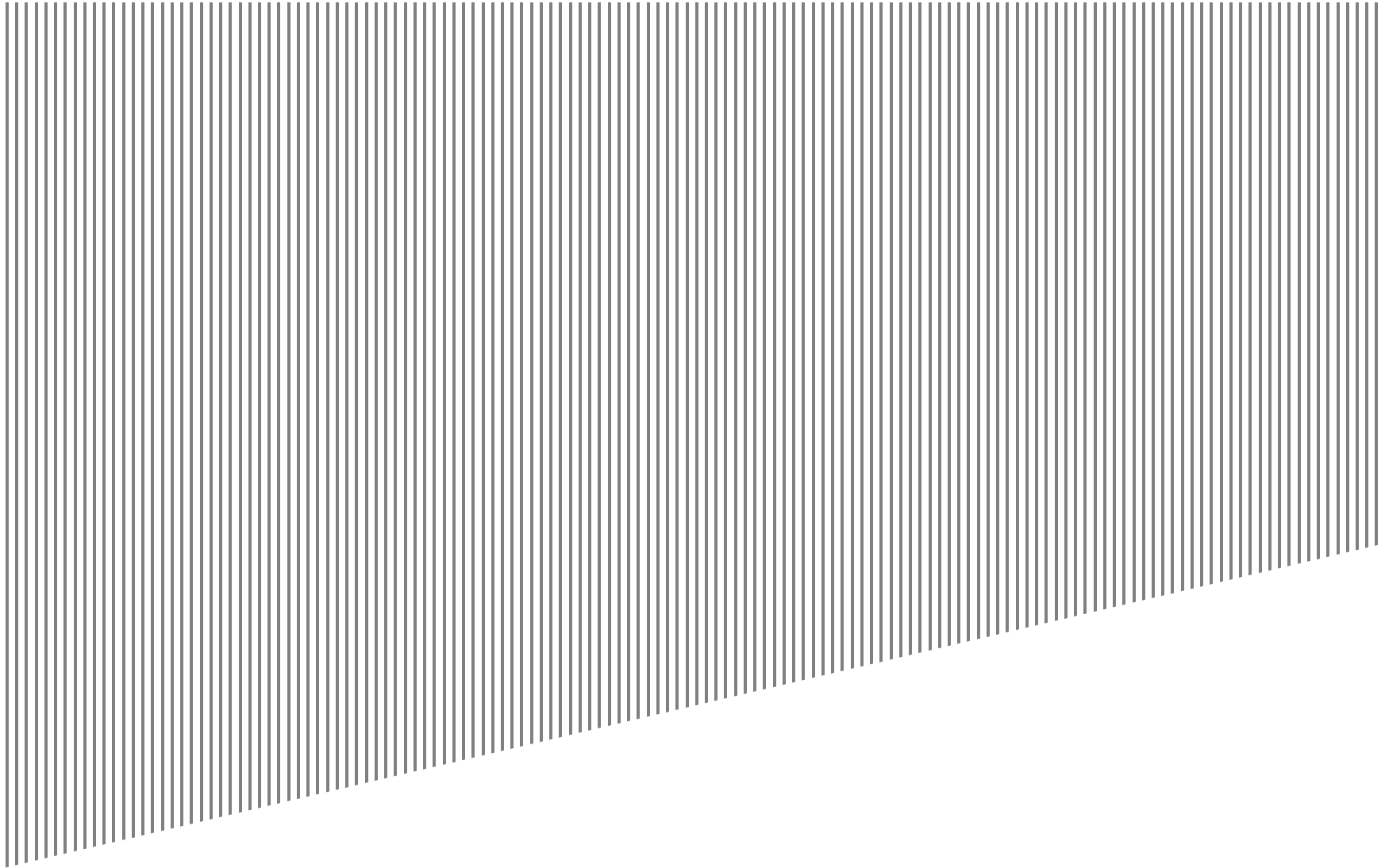
Classification and Measurement

Other topics

- ▶ Effective interest rate
 - ▶ Day 1 fair value
 - ▶ Loan to parent company / Loan to staff or management
 - ▶ Transaction cost (Fees) on loans or borrowings

- ▶ Derecognition

Classification and Measurement Reclassification



Classification and Measurement

Reclassification: Financial assets

- ▶ Reclassification of the affected financial assets should be in accordance to the new business model.
- ▶ Reclassification should be applied prospectively from the reclassification date, i.e the first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets. Any previously recognised gains, losses or interest should not be restated.
- ▶ Changes in business model for managing financial assets are expected to be very infrequent.
- ▶ Some examples of change in business model include:
 - ▶ An entity has a portfolio of commercial loans that it holds to sell in the short term. The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows.
 - ▶ A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale.

Classification and Measurement

Reclassification: Financial assets / liabilities

- ▶ A change in the objective an entity's business model must be effected **before the reclassification date.**
 - ▶ Example, if a financial services firm decides on 15 February to shut down its retail mortgage business and hence must reclassify all affected financial assets on 1 April (i.e., the first day of the entity's next reporting period, assuming it reports quarterly), the entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former business model after 15 February.
- ▶ The examples below are not considered change in business model:
 - ▶ A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions)
 - ▶ A temporary disappearance of a particular market for financial assets
 - ▶ A transfer of financial assets between parts of the entity with different business models
- ▶ **Financial liabilities must never be reclassified.**

Classification and Measurement

Reclassification: Financial assets scenarios

		Reclassification from		
		Amortised cost	Fair value through OCI	Fair value through PL
Reclassification to	Amortised cost		- Reclassify the financial asset at its FV at the reclassification date - The cumulative gain or loss previously recognized in OCI is removed from equity and adjusted against the fair value - The effective interest rate and expected credit losses is not adjusted as a result of the reclassification	- The fair value of the financial asset at reclassification date becomes its new carrying amount - The effective interest rate is calculated on the basis of that amount. - For the purpose of applying impairment requirements, the reclassification date is treated as the date of initial application
	Fair value through OCI	- Fair value measured at reclassification date - Difference between the previous carrying amount and fair value is recognized in OCI - The effective interest rate and expected credit losses is not adjusted as a result of the reclassification		- The fair value of the financial asset at reclassification date becomes its new carrying amount - The effective interest rate is calculated on the basis of that amount. - For the purpose of applying impairment requirements, the reclassification date is treated as the date of initial application
	Fair value through profit or loss	- Fair value measured at reclassification date - Difference between the previous carrying amount and fair value is recognised in profit or loss	- Continue to measure at FV - The cumulative gain or loss previously recognized in OCI is reclassified from equity to profit or loss at reclassification date	

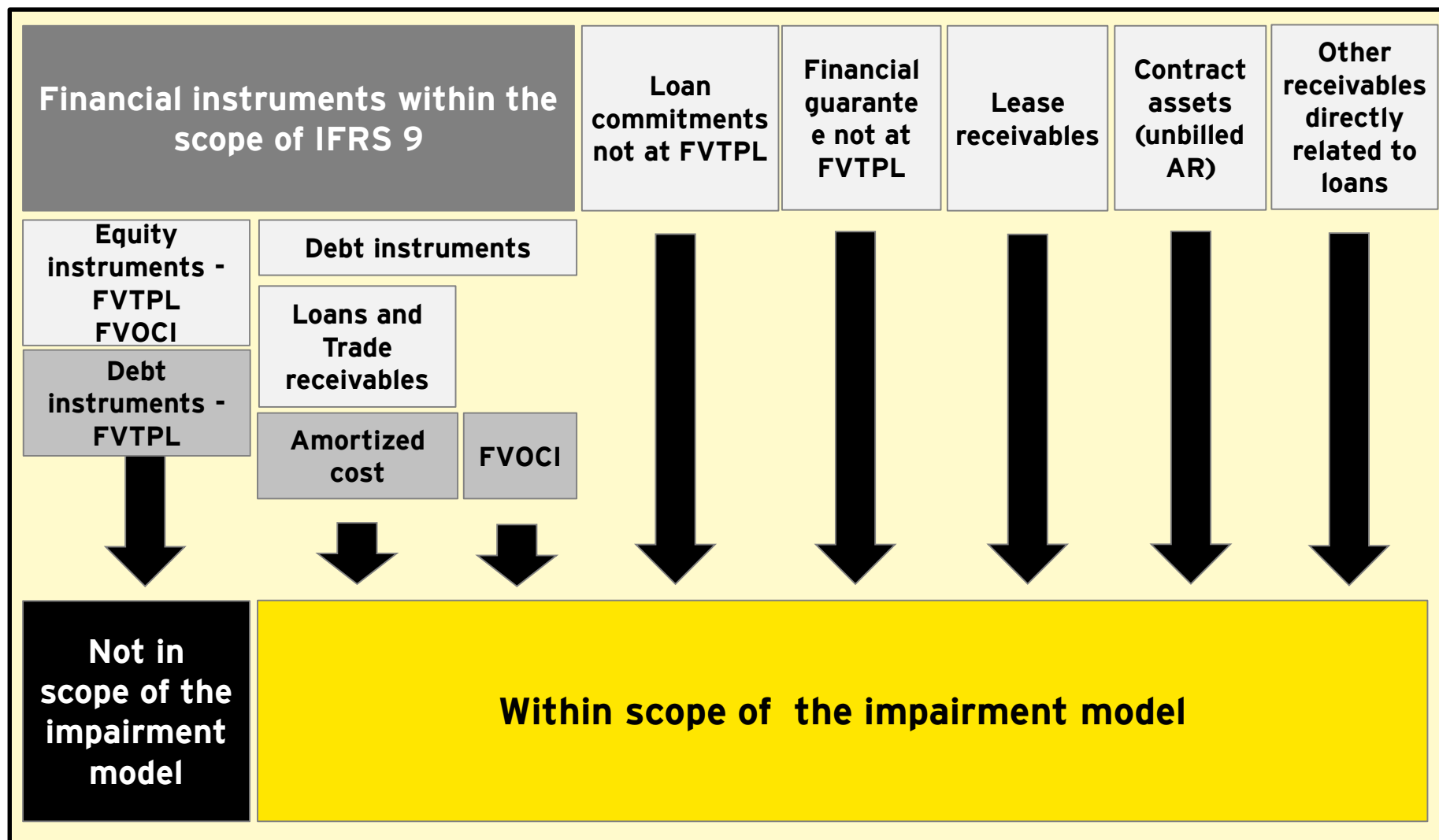
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Impairment



Impairment

Scope of The Expected Credit Loss (ECL) Model

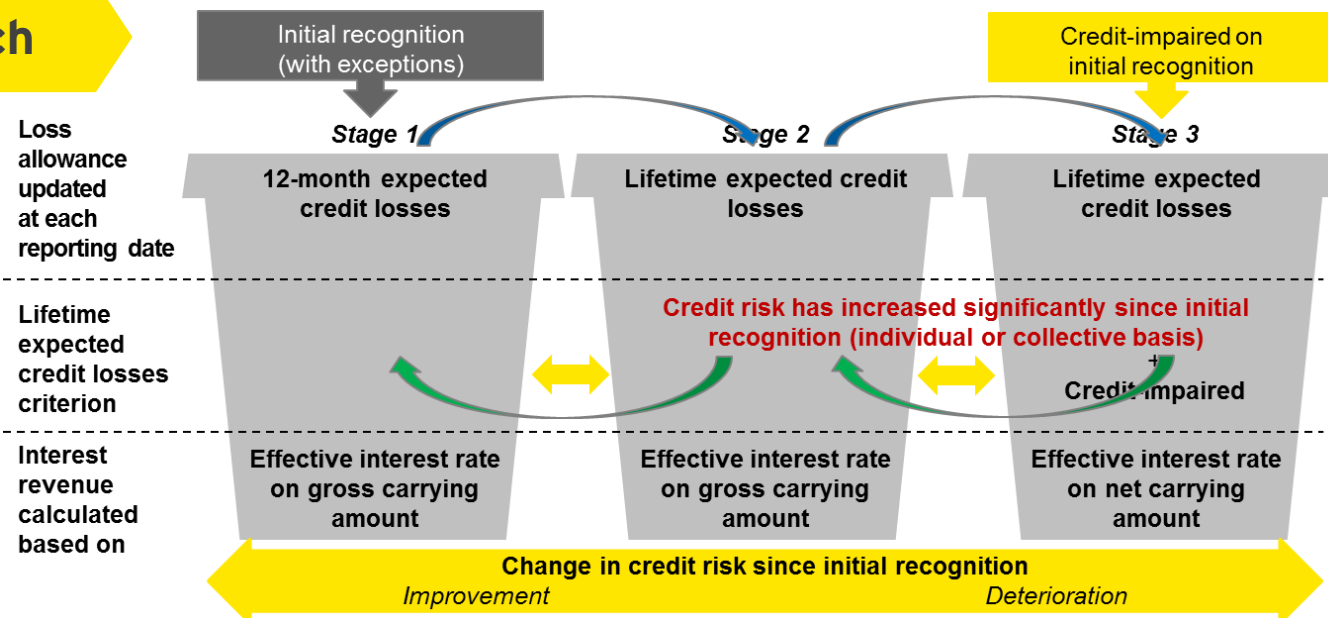


Impairment

Impairment approach

1. General approach
2. Simplified approach
3. Purchased or originated credit-impaired assets

1. General approach



Impairment

Simplified approach and Purchased or originated credit-impaired assets

2. Simplified approach

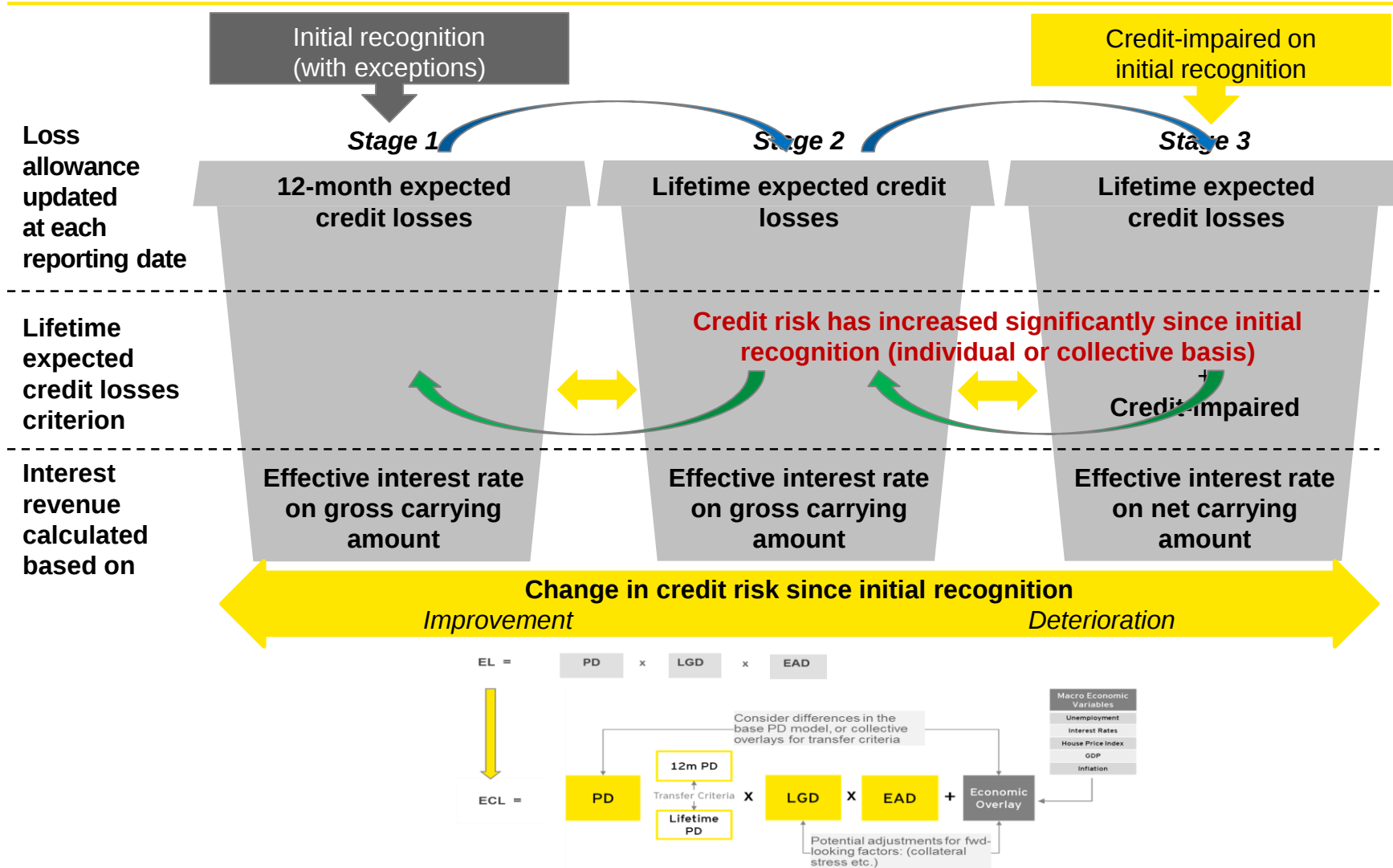
- ▶ Scope: contract assets, trade receivables and lease receivables
- ▶ Loss allowance based on lifetime ECL
- ▶ Allow using a provision matrix based on historical customer default rates, but would need to adjust for forward-looking information
- ▶ No tracking of changes in credit risk

3. Purchased or originated credit-impaired assets

- ▶ Scope: financial assets that are credit-impaired on purchase or origination
- ▶ ECL on initial recognition reflected in credit-adjusted EIR (*no "day one" 12-month ECL*)
- ▶ *Impairment gain or loss* based on subsequent changes in lifetime ECL

Impairment

1. General approach



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Impairment

1. General approach

► Stage 1

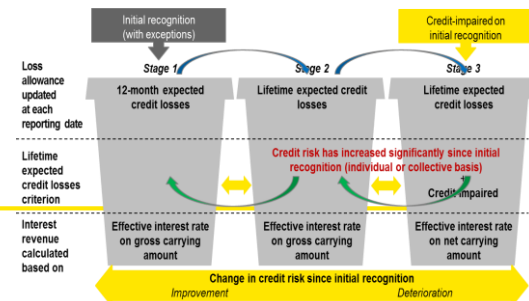
- No significant deterioration in credit quality; or
- 'Investment grade'

► Stage 2

- **Significant deterioration in credit quality;** and
- Not 'investment grade'
- Rebuttable presumption met if more than 30 days past due

► Stage 3

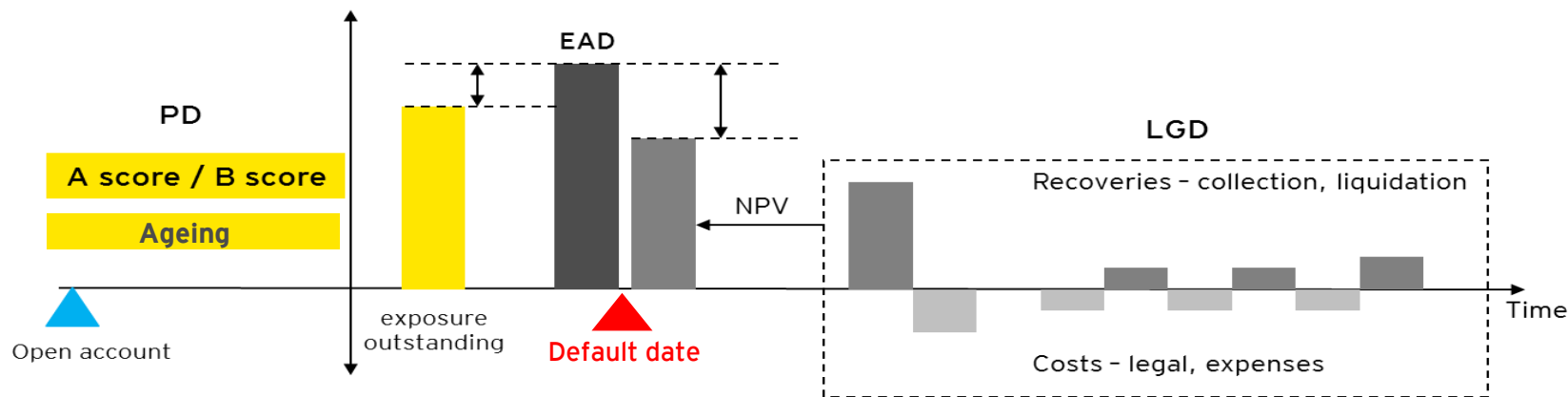
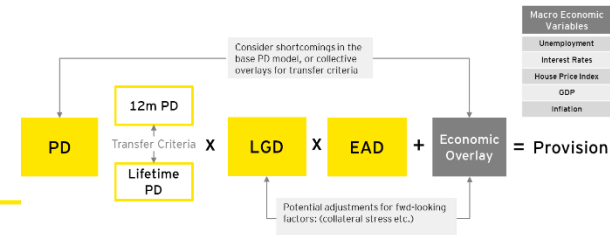
- Credit-impaired or incurred loss has occurred
- Rebuttable presumption met if more than 90 days past due



Expected credit losses are updated at each reporting date for new information irrespective of whether a financial instrument stays at the same 'stage'

Impairment

Measurement expected credit losses



PD (Probability of Default)

- ▶ Represents the probability that a customer will reach a defaulted or loss state within the next 12 months, or over the remaining lifetime of a loan
- ▶ Needs to consider both customer specific risk drivers, as well as systematic or economic risk drivers

EAD (Exposure at Default)

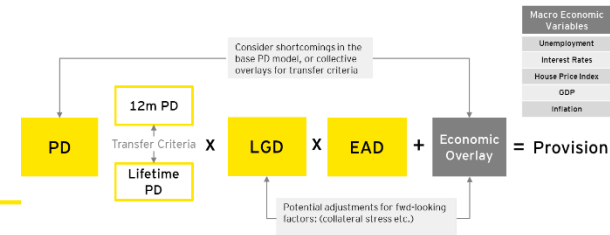
- ▶ The expected balance of a customer's loan at the point of default
- ▶ Needs to consider the possibility that the customer will redraw any difference between current balance and loan limit

LGD (Loss Given Default)

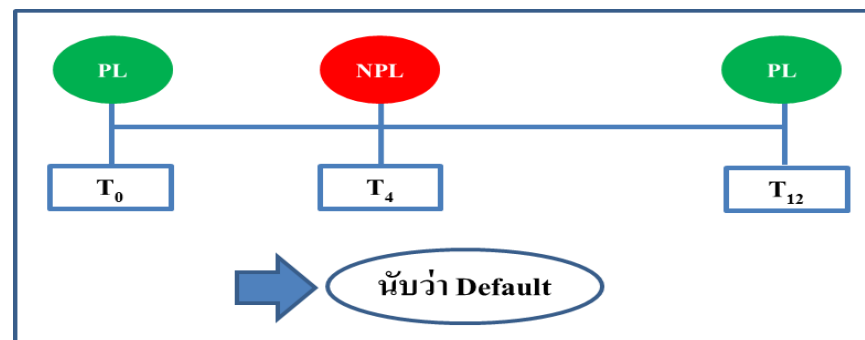
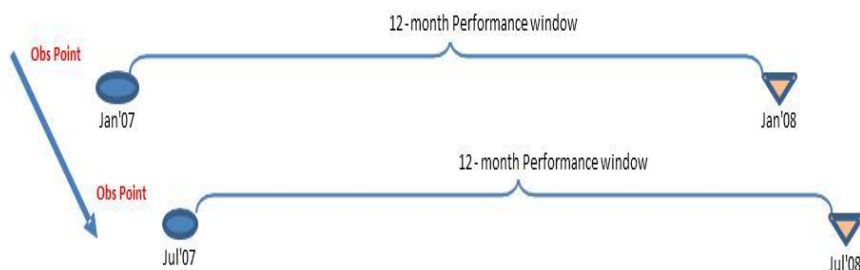
- ▶ Expected Loss on an account that reaches a default state
- ▶ Needs to consider all recovery channels - sale of security, recovery through legal proceedings, potentially 'curing' etc.

Impairment

Measurement expected credit losses



Probability of Default (PD)

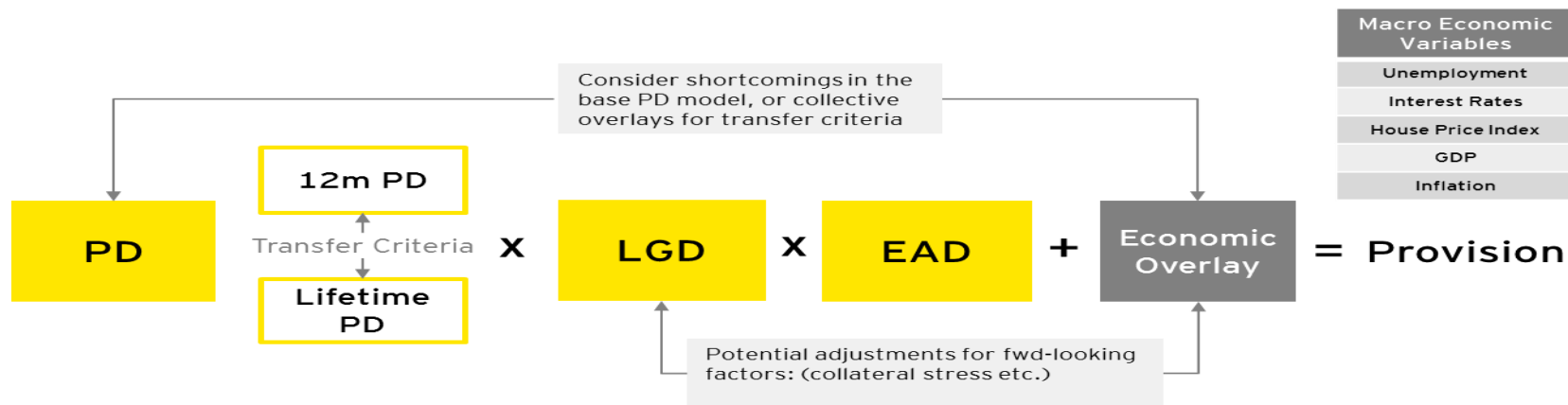


Ageing (Jan'07)	Total no. of accounts	Total no. of defaults	%PD
Not over due	377,000	4,620	1.23%
1 - 30DPD	65,900	2,950	4.48%
31 - 60DPD	85,300	13,960	16.37%
61 - 90DPD	21,000	8,900	42.38%
>90DPD	26,200	26,200	100.00%
Total	575,400		

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Impairment - General approach

Measuring expected credit losses - Summary



Unbiased and probability-weighted estimate

Best available information

Information about
past events

+

Information about
current
conditions

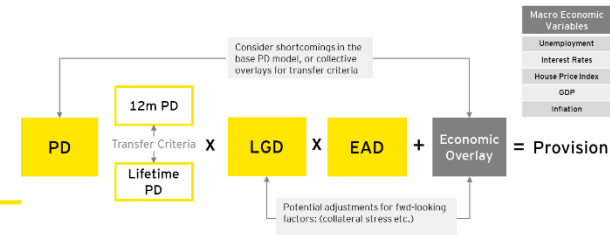
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Reasonable and
supportable
forecasts

The time value of money

Impairment - General approach

12-month vs lifetime expected losses



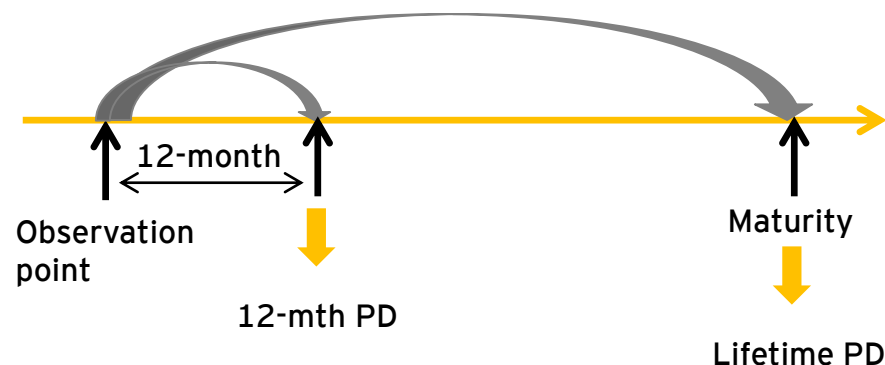
Loan balance = 1m

Contract life = 5 yrs.

12-month PD = 5%

Lifetime PD for 5 yrs. = 23% $(1 - (1 - PD_{12})^5)$

LGD = 60%



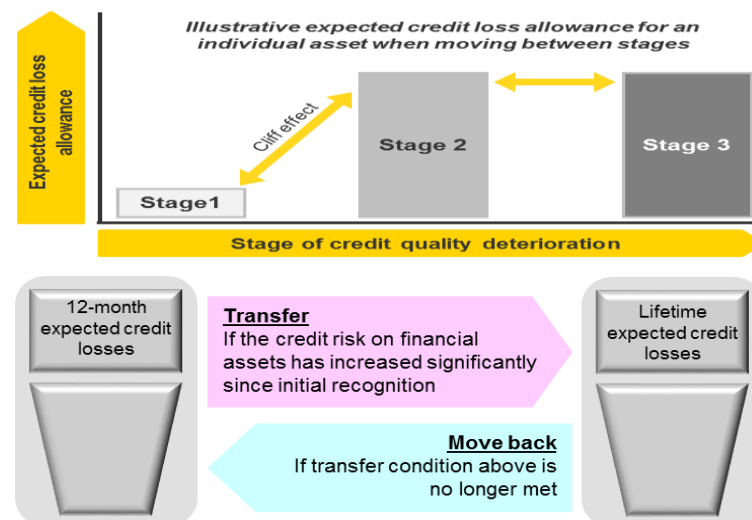
12-month expected loss = 30,000 $(5\% \times 60\% \times 1,000,000)$

Lifetime expected loss (when there is significant deterioration of credit quality) = 138,000 $(23\% \times 60\% \times 1,000,000)$

Impairment

Business Impact

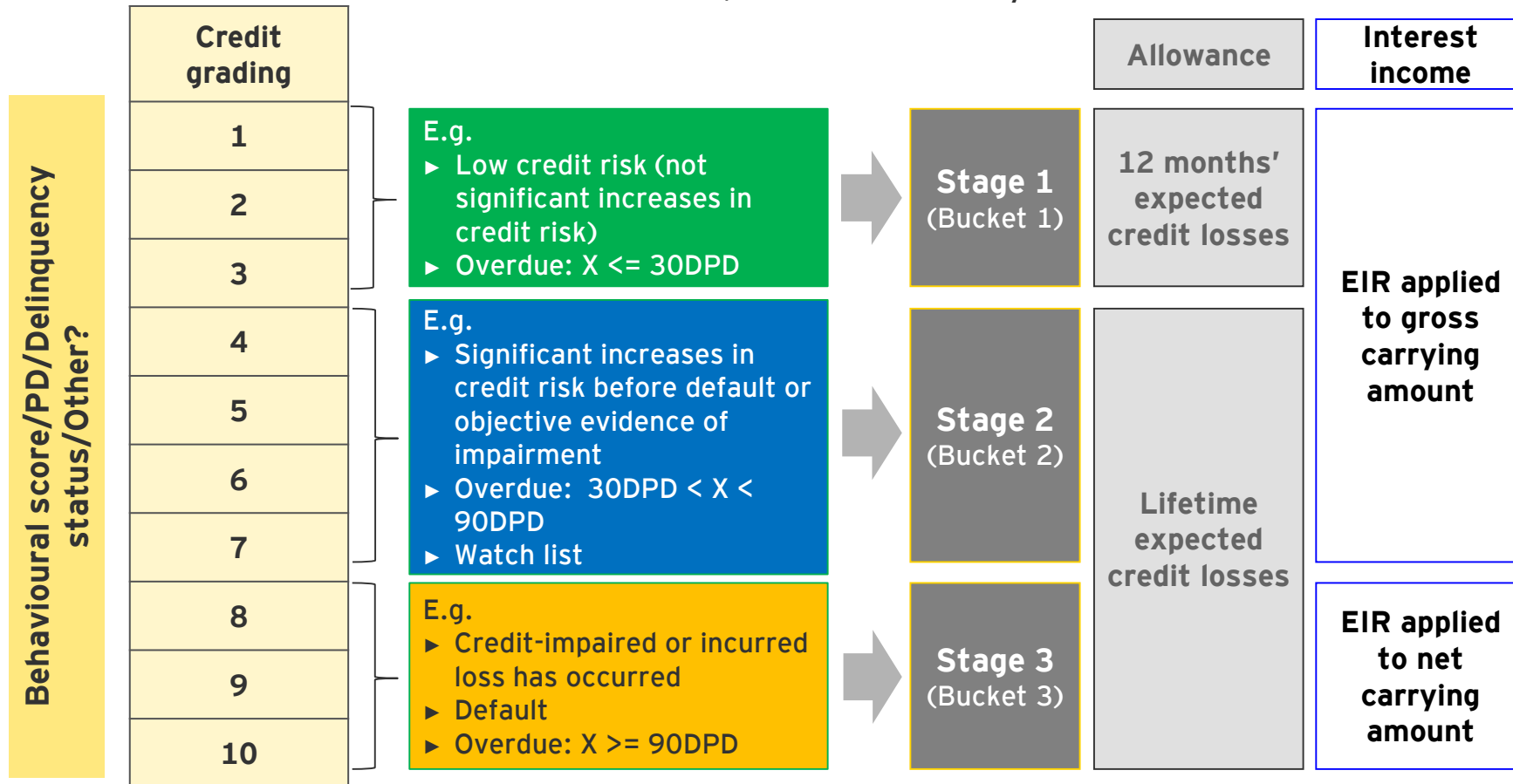
- ▶ Impact from Day 1 Adoption of IFRS 9 impairment provision
- ▶ Will mostly increase impairment provisions, especially from the 12 months' expected losses on initial recognition
- ▶ Potential **cliff-effect** in the income statement as financial assets are moved between Stage 1 and 2
- ▶ Potentially greater **volatility** as 12 months' expected loss estimates change from one reporting period to another
- ▶ Changes require early and ongoing quantitative impact assessment to:
 - ▶ Prepare communication of change to key stakeholders and
 - ▶ Inform key design choices including:
 - ▶ Model methodology
 - ▶ Stage 2 and 3 cut-offs
- ▶ Impact on Tax implication
- ▶ Disclosure requirement
- ▶ Consider pricing strategy and portfolio mix



Impairment

Example

Loans would be mapped to buckets based on grading or score measures. Concepts such as a 'watch list' may be useful, but not mandatory.



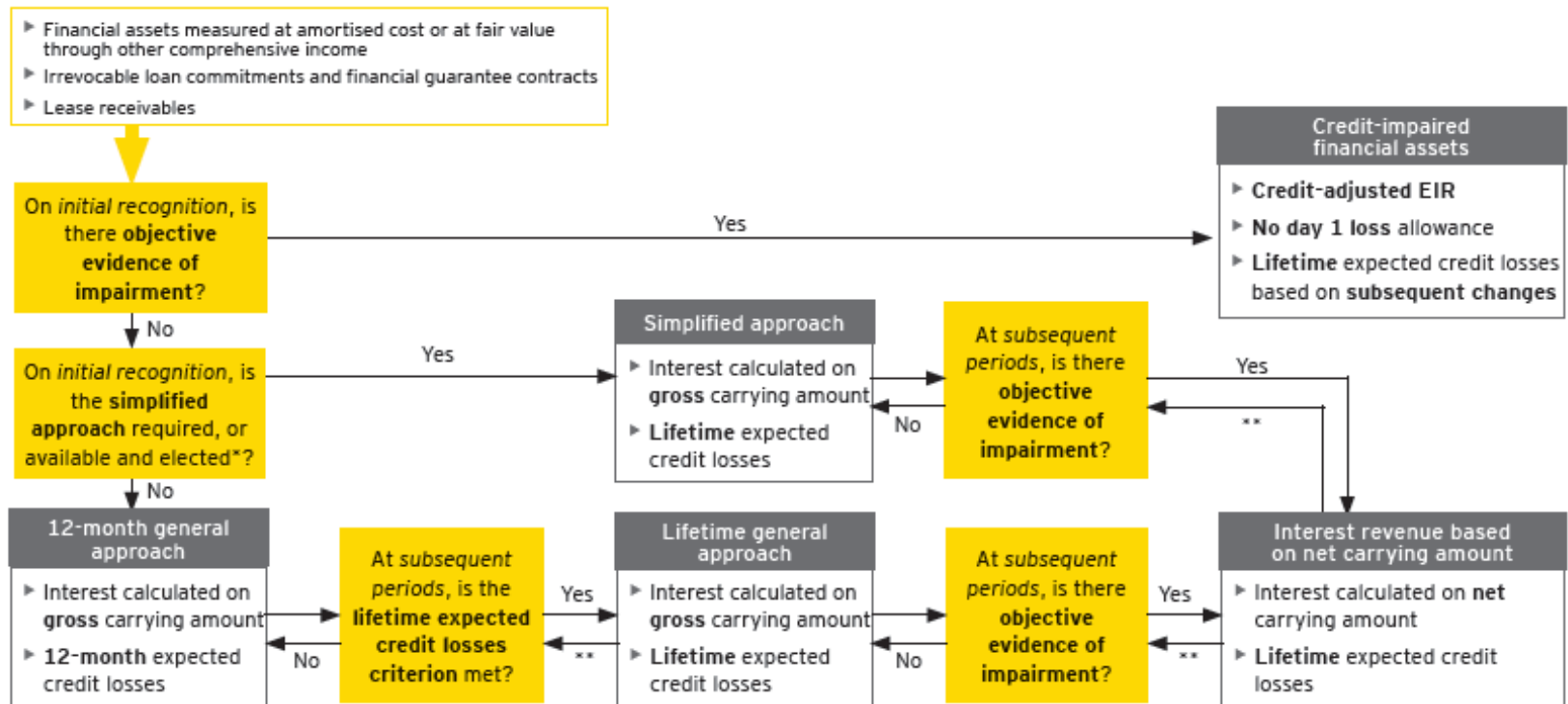
Impairment

Expected Credit Losses: Challenges

Challenges	Specifics
Classification	▶ Determine the threshold of asset transfer from Bucket 1 to Buckets 2 or 3 ▶ Determine significance threshold for collective impairment assessment (Bucket 2) / individual impairment assessment (Bucket 3) ▶ How to track credit deterioration by facility level vs counterparty
Measurement	▶ Measure lifetime expected loss ($ECL = PD \times LGD \times EAD$) ▶ Determine maturity (contractual, behavioral, estimated for revolving) ▶ Develop PD ▶ Develop LGDs (discounting requirements, consider repayment pattern, amortization) ▶ Measure EAD ▶ Incorporate forward-looking macroeconomic indicators of future expected loss into impairment models ▶ Discounting by the effective interest rate (EIR)
Management	▶ Assess the impact on profit and loss ▶ Assess the impact on core tier 1 regulatory capital under Basel III ▶ Assess impact on tax implication

Impairment

Overall summary of IFRS 9 Impairment requirements



* The simplified approach would be required for trade receivables that do not constitute a financing transaction and may be elected, when available, for trade receivables that constitute a financing transaction and for lease receivables.

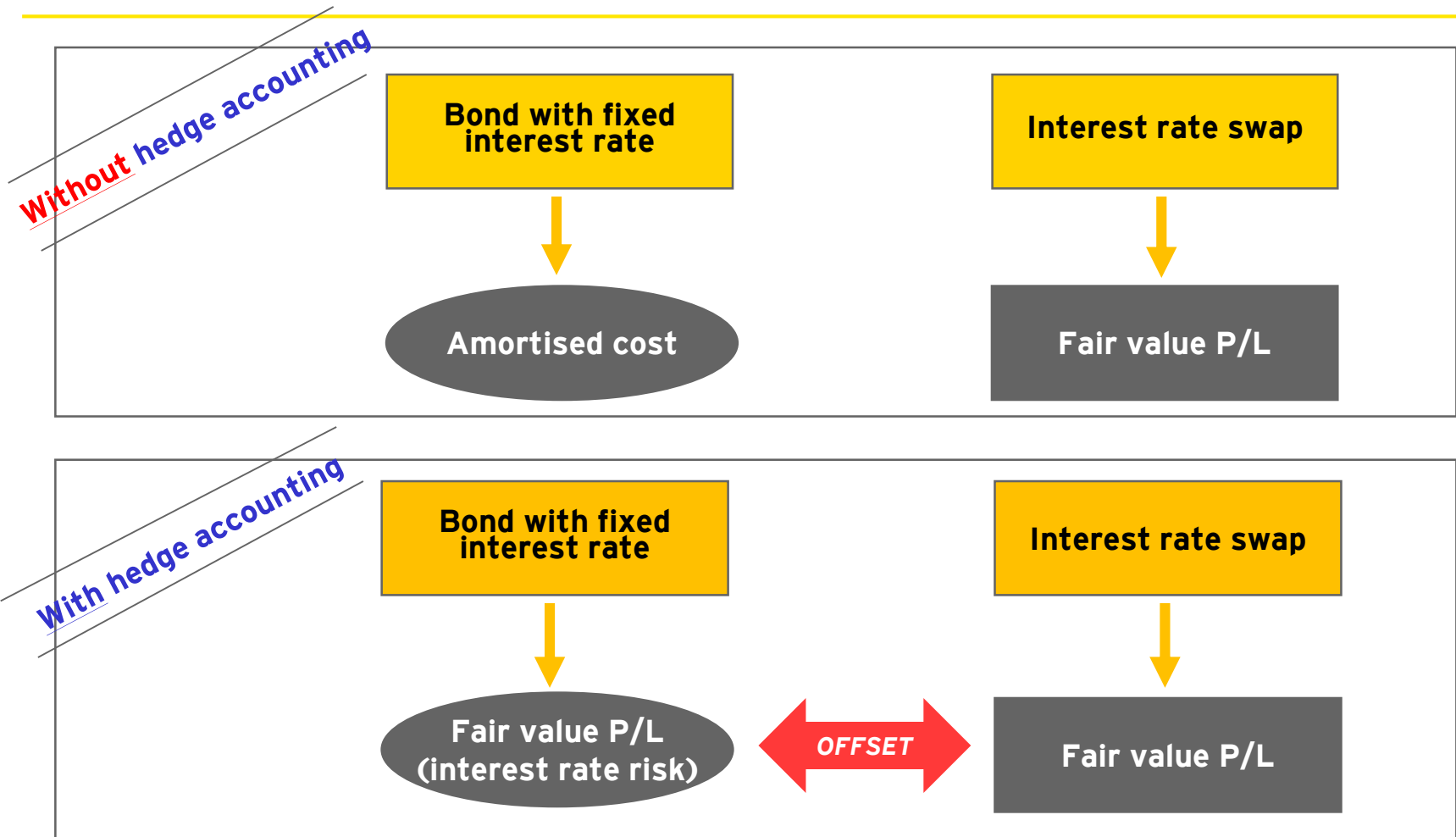
** In subsequent periods, if there is improvement in credit quality such that the lifetime expected credit losses criterion is no longer met, then an entity would recognise 12-month rather than lifetime expected credit losses. Similarly, if there is no longer objective evidence of impairment, an entity would calculate interest revenue on the gross rather than the net carrying amount.

Hedge Accounting



Why Hedge Accounting?

Reduce accounting mismatch



- ▶ **Hedge accounting only allowed when the hedge meets specific criteria**

Hedge Accounting

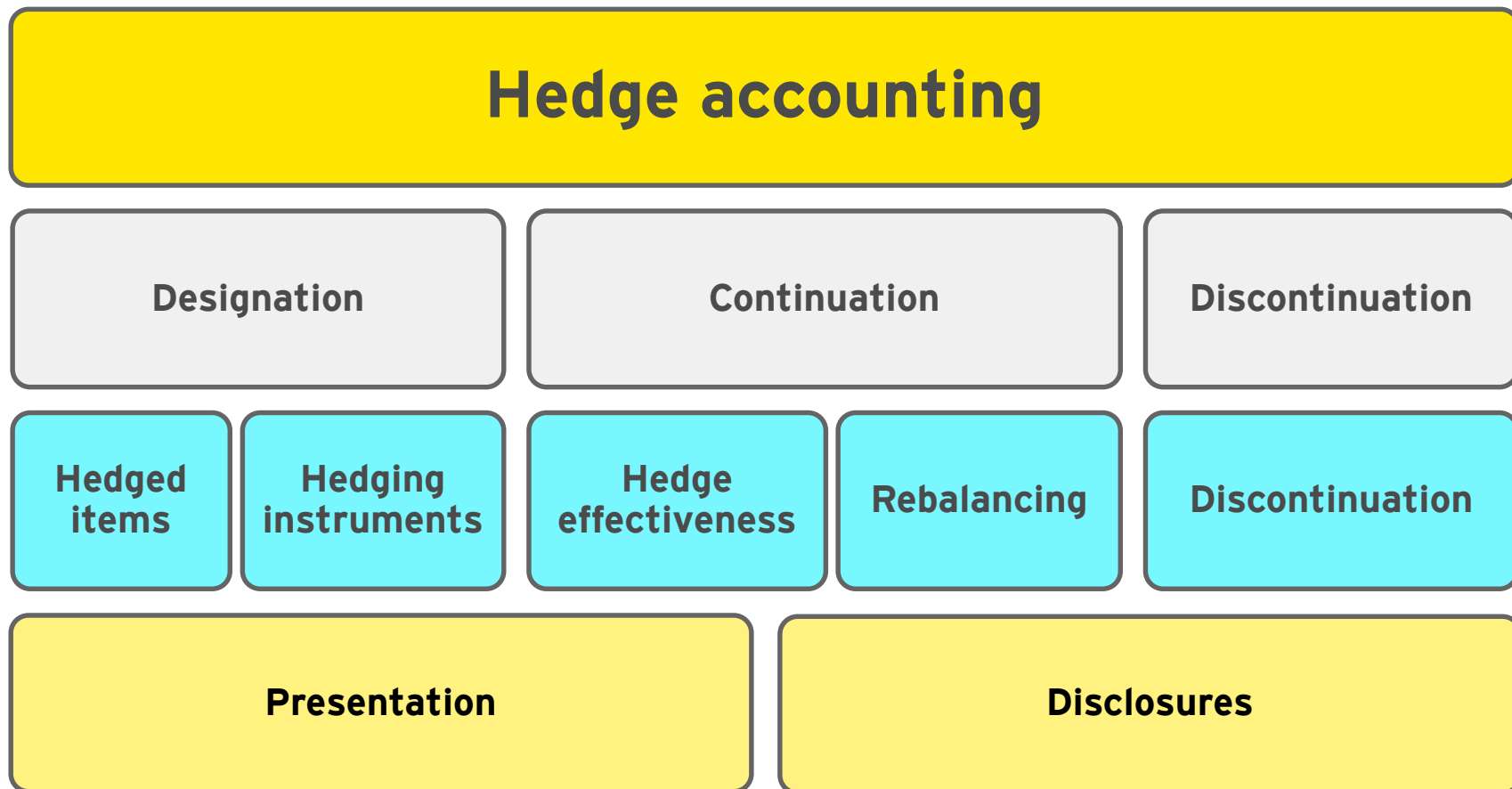
Objective under IFRS 9

► **Represent in the financial statements the effect of an entity's risk management activities**

- Compared to IAS 39, the focus shifts from hedging items to hedging risks
- This should result in more eligible hedged items
- More economic hedging strategies should qualify for hedge accounting
- It should be easier for users of financial statements to understand hedging activities and the accounting consequences

Hedge Accounting

Overview



Hedge Accounting

Types of hedges

1) Fair Value Hedge ("FVH")

A hedge of exposure to fair value change of:

- ▶ a recognised asset or liability; or
- ▶ An unrecognised firm commitment; or
- ▶ a component of any such item;

that is attributable to a particular risk and could affect profit or loss



Something is
already "locked in"
and you need to
protect it

2) Cash Flow Hedge ("CFH")



You are
"locking in"
something

A hedge of exposure to cash flow variability that is:

- ▶ is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable-rate debt); or
 - ▶ a highly probable forecast transaction;
- and could affect profit or loss

3) Hedge of a net investment in a foreign operation.

Hedges of a net investment in a foreign operation (i.e. the amount of the reporting entity's interest in the net assets of that operation), including a hedge of a monetary item that is accounted for as part of the net investment

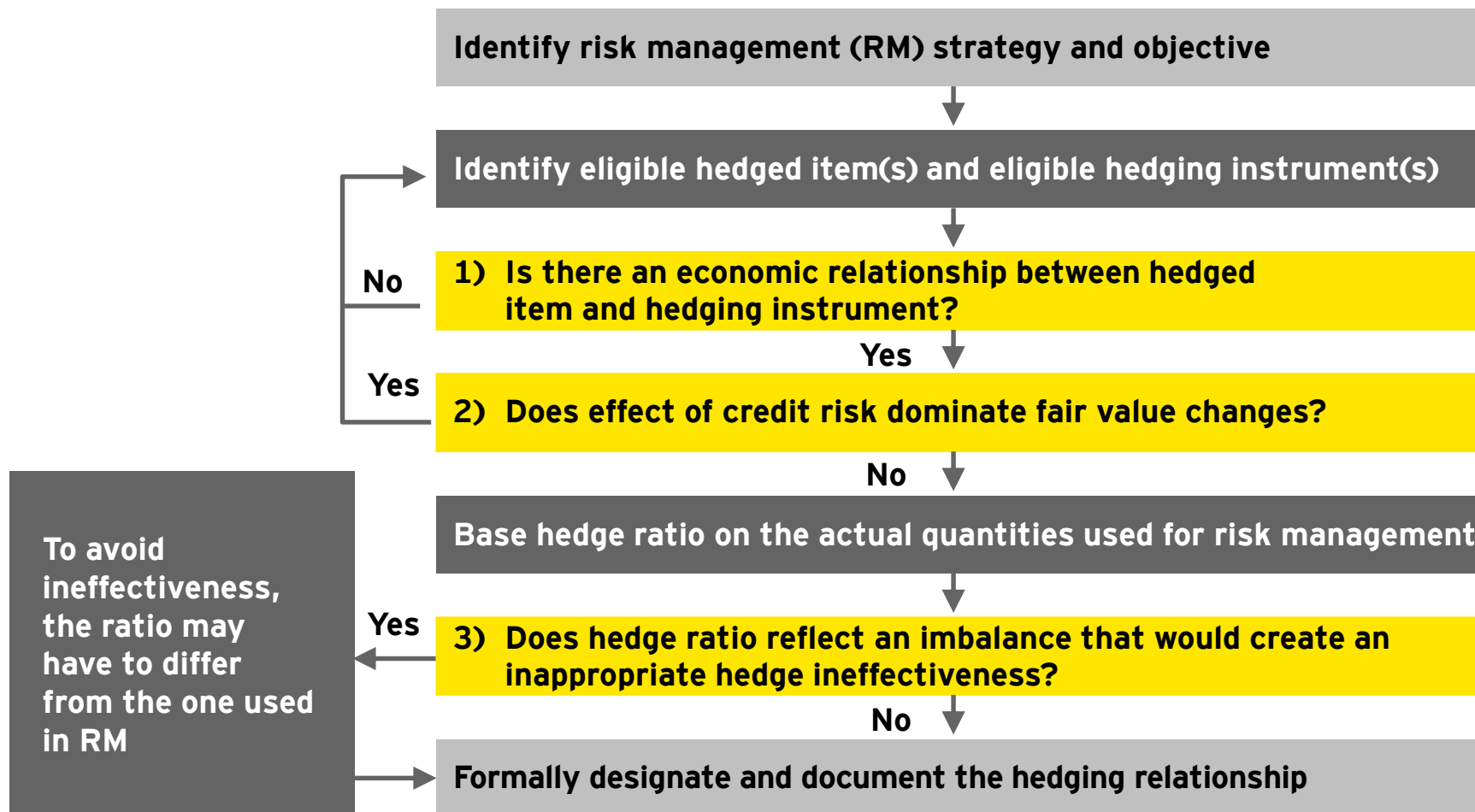
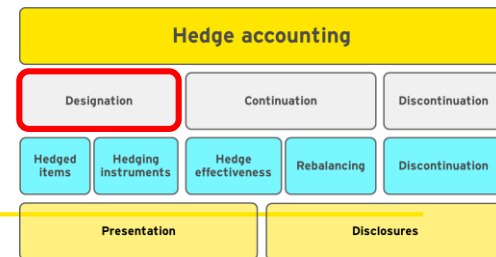
Hedge Accounting

Hedge accounting treatment: Summary

Type of Hedge	On balance sheet		Change in fair value through	
	Hedging instrument	Hedged item	Hedging instrument	Hedged item
Fair Value Hedge 	Fair value	Fair value <i>(only risk being hedged)</i>	Profit or loss	Profit or loss
Cash Flow Hedge 	Fair value	-	Equity (OCI) <i>(only effective portion)</i>	-
Hedge of net investment	Fair value	-	Equity (OCI) <i>under translation adjustments</i> <i>(only effective portion)</i>	-

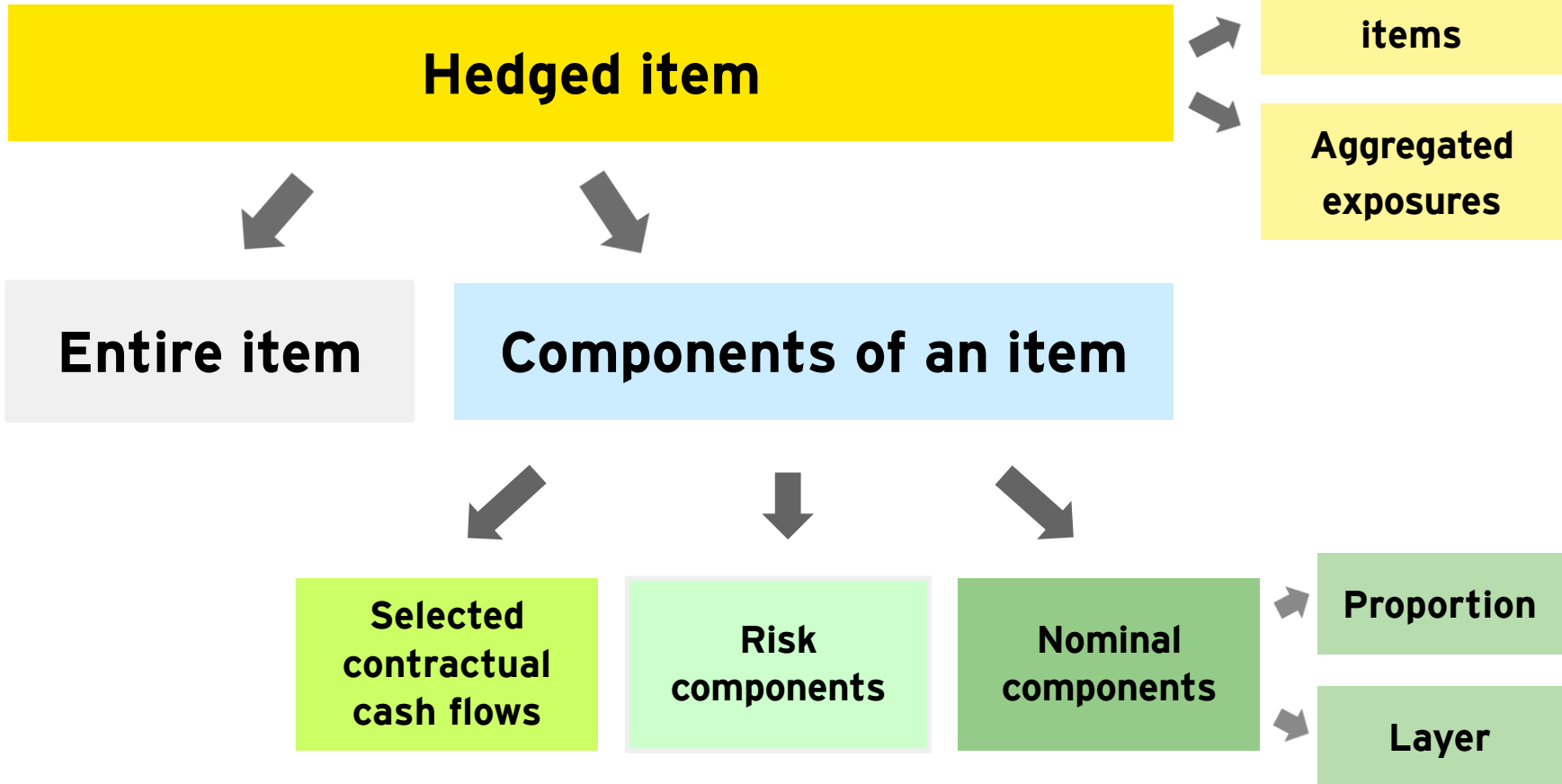
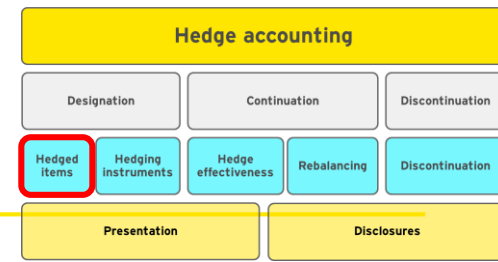
Hedge Accounting

Designating a hedging relationship



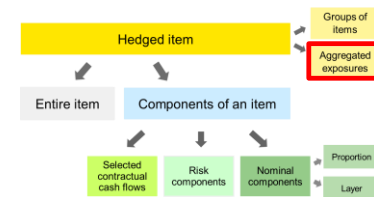
Hedge Accounting

Hedged item



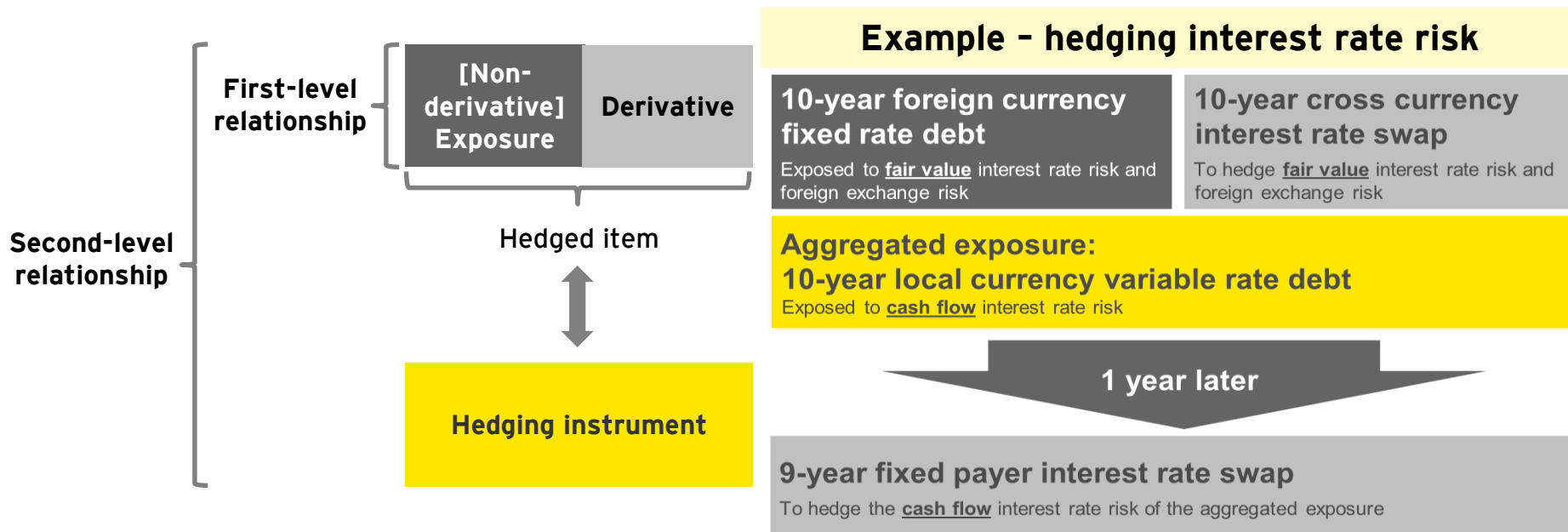
Hedge Accounting

Hedged items - aggregated exposures



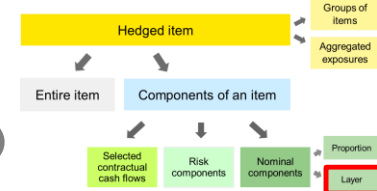
Aggregated exposure (comprising a derivative and non-derivative) is an eligible hedge item under IFRS 9

- ▶ Entities sometimes economically enter into transactions that can result in different aggregated risk exposures.
- ▶ An entity may manage these risk exposures together or separately
- ▶ Under IFRS 9, entities will be allowed to hedge these exposures as one



Hedge Accounting

Hedged items - Components of nominal amounts (layers)



- ▶ Entities can now designate components of nominal amounts (i.e., layers) for **fair value hedges**

Example of nominal components

- ▶ The bottom layer of CHF 60m of a CHF 100m loan

IAS 39 limitations

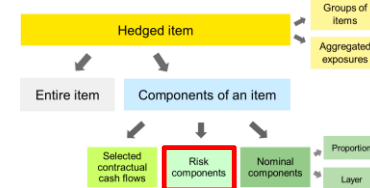
- ▶ IAS 39 does not allow designation of layers for fair value hedges
- ▶ **Impact?** = Entity's were required to identify specific items within the group or designate a percentage of the total as the hedged item

Example:

- ▶ \$50M notional interest rate swap was designated as hedging the benchmark rate of \$50M of a \$100M fixed rate bond = deemed to be a 50% hedge of the \$100M fixed rate bond
- ▶ Assume \$30M (or 30%) of the bond was sold
- ▶ Hedged item = $(\$100M - \$30M) 50\% = \$35M$
- ▶ Hedging instrument = unchanged = \$50M notional
- ▶ **IAS 39 Result:** Ineffectiveness when compared to the \$50M IRS
- ▶ **IFRS 9 Result:** A bottom layer of \$50M could be designated resulting in no such ineffectiveness

Hedge Accounting

Hedged items: risk components



Risk components

Criteria for designation

Separately
identifiable



Reliably measurable

Contractually specified

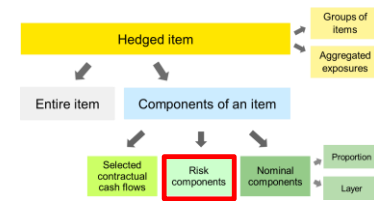
Other components

Rebuttable presumption
against designation of
*inflation risk in financial
instruments*

Market
structure

Hedge Accounting

Hedged items: risk components of non-financial items - Examples



Examples of contractually specified components

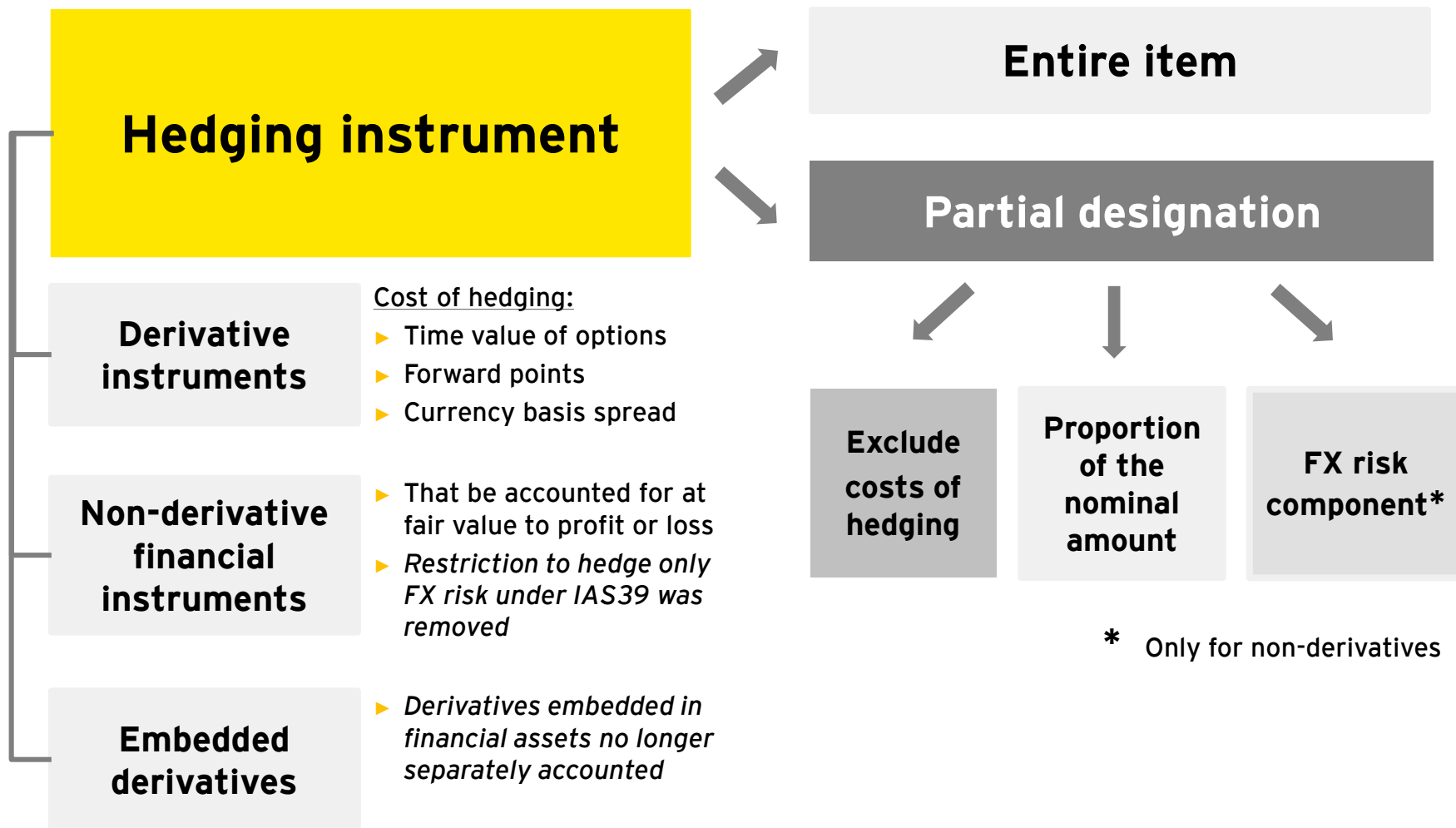
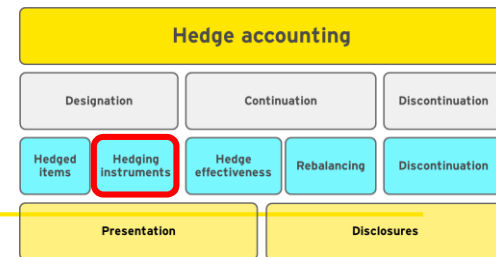
- Price of gas contractually linked to gas oil or fuel oil benchmark price
- Price of electricity contractually linked to coal benchmark price
- Price of cans contractually linked to aluminium benchmark price
- Price of coffee purchased on a specific market contractually linked to benchmark price for Arabica coffee

Examples of non-contractually specified components

- Crude oil component in jet fuel
- (Theoretically) all components listed above, just not contractually specified

Hedge Accounting

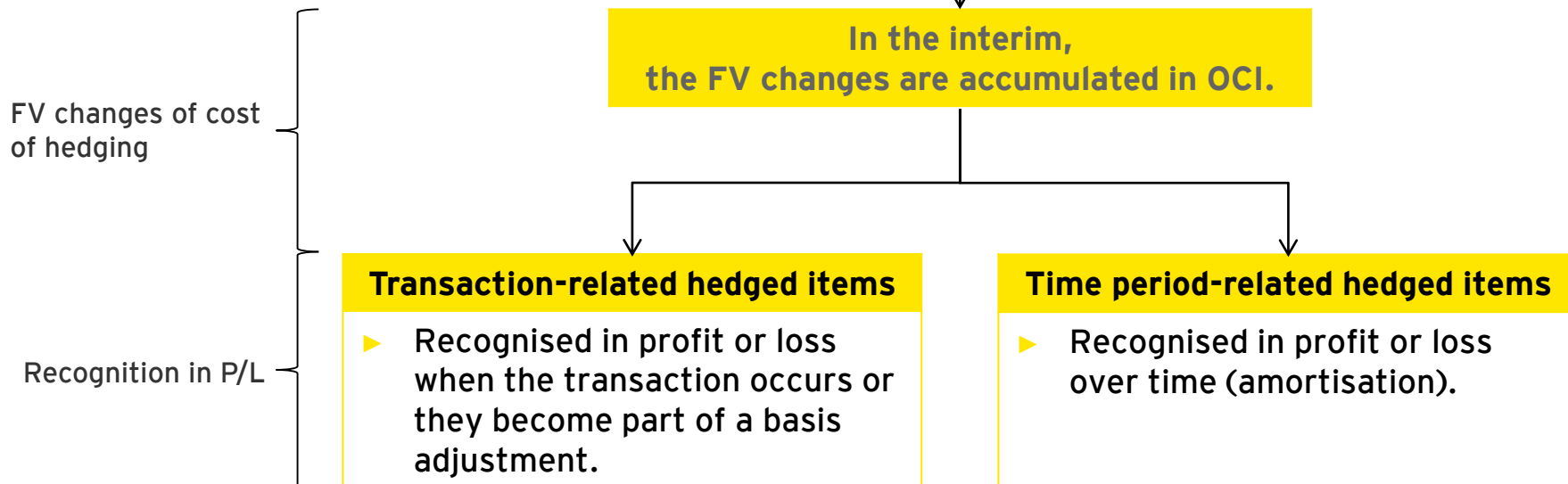
Hedging instruments



Hedge Accounting

Hedging instruments: Cost of hedging

Accounting for costs of hedging



Hedge Accounting

Effectiveness assessment and rebalancing

Hedge accounting

Designation

Continuation

Discontinuation

Hedged items

Hedging instruments

Hedge effectiveness

Rebalancing

Discontinuation

Presentation

Disclosures

Effectiveness assessment

Effective hedge

Retrospectively measure ineffectiveness and recognize in P&L

1. Has the risk management objective for designated hedging relationship changed?

Yes

No

2. Is there still an economic relationship between hedged item and hedging instrument?

No

Yes

3. Does the effect of credit risk dominate value changes that result from an economic relationship?

Yes

No

No

4. Is there an imbalance in the hedge ratio that would create an inappropriate ineffectiveness?

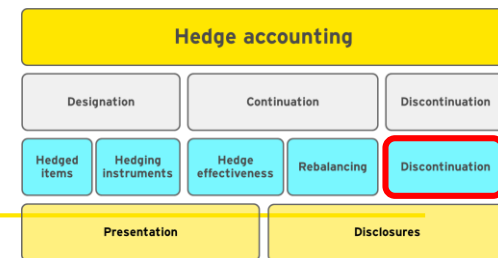
Yes

Rebalancing

Discontinuation

Hedge Accounting

Discontinuation



- Under IFRS 9, voluntary discontinuation when the **qualifying criteria are met is prohibited**
- Examples in which a hedging relationship has to be (partly) discontinued prospectively:
 - There is no longer an economic relationship between the hedged item and the hedging instrument
 - The effect of credit risk dominates the value changes of the hedging relationship
 - The hedging instrument expires or is sold, terminated or exercised
 - The risk management objective has changed
 - As part of rebalancing, the volume of the hedged item or the hedging instrument is reduced

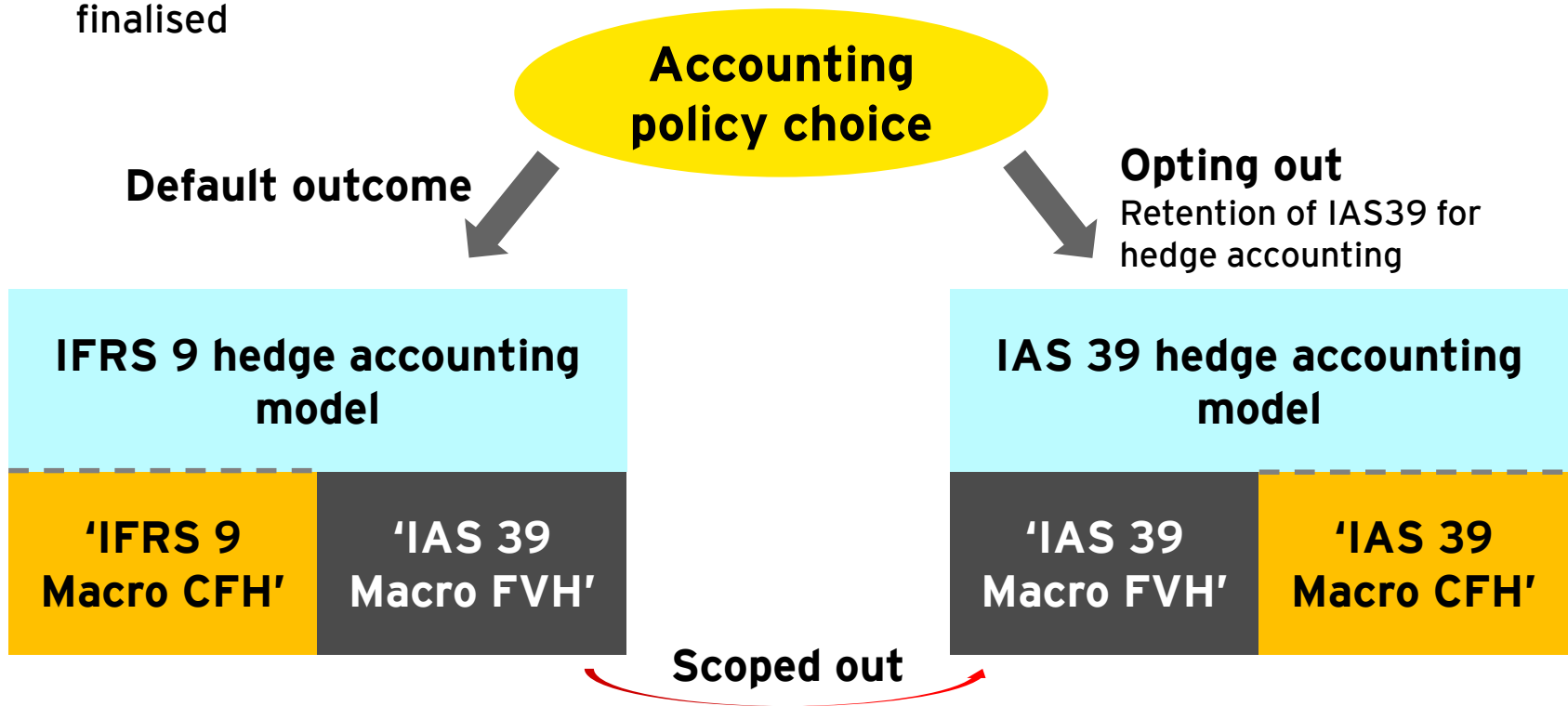
Hedge Accounting

IFRS 9 accounting policy choice

For Thailand, there is no choice but to adopt hedge accounting under IFRS 9 (without macro hedging).

Entities have an accounting policy choice to apply:

- a) Hedge accounting requirements of IFRS 9 (with the scope exception only for fair value macro hedges of interest rate risk (IAS 39)); or
- b) hedge accounting requirements of IAS 39 until the macro hedging project is finalised



Hedge Accounting

Key differences: snapshot (1/2)

Requirement	IAS 39	IFRS 9
Hedged items		
Risk components	Financial Items	All Items
Components of nominal amounts	Layers limited to CFH	Layers allowed for FVH & CFH
Aggregated exposures	Not permitted	Permitted
Group of items	Permitted	Requirements changed
Hedging instruments		
Non-derivative financial instruments measured at FVTPL	FX risk only	All eligible risk
Special accounting for 'costs of hedging'	N/A	Permitted

Hedge Accounting

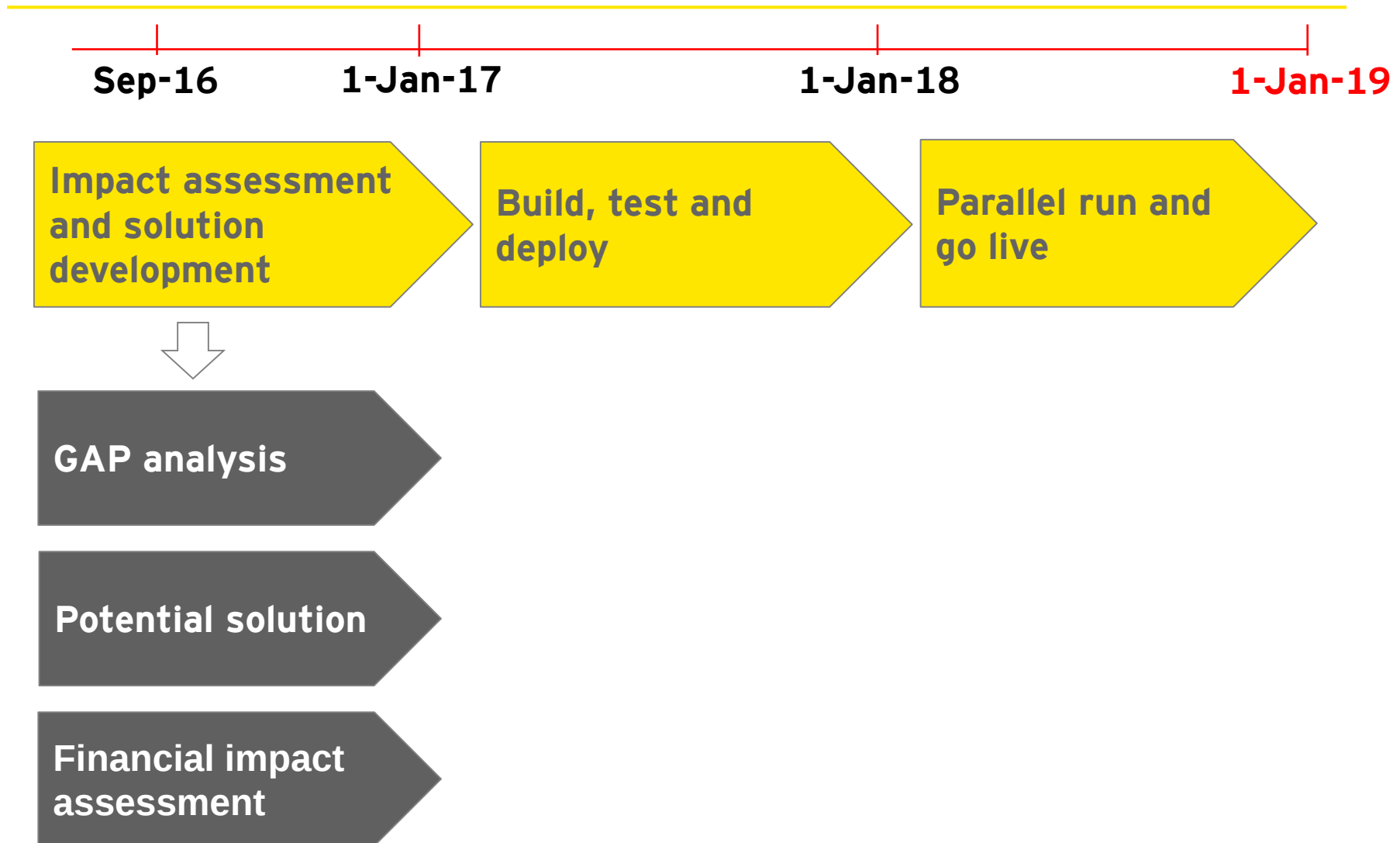
Key differences: snapshot (2/2)

Requirement	IAS 39	IFRS 9
Hedge effectiveness requirements		
80% - 125% test	Required	Removed
Prospective effectiveness testing	Required	Required
Retrospective effectiveness testing	Required	Not required
Measure ineffectiveness	Required	Required
Quantitative effectiveness test	Required	Depends
Qualitative effectiveness test	Not permitted	Depends
Rebalancing of hedge ratio		
Rebalancing of hedge ratio	Silent	Allowed
Discontinuation		
Voluntary de-designation if ineffective while risk management objective unchanged	Permitted	Not permitted

Implementation



Sample of key activities on IFRS 9 implementation





Question ?



The better the question. The better the answer.
The better the world works.

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