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AMF Recommendation
Implementation and information to be disclosed under IFRS 9 – Financial instruments – DOC-2016-12

Reference text: AMF General Regulation, article 223-1

IFRS 9 – *Financial instruments*, applicable as of 1 January 2018, includes, in particular, new principles for the classification and measurement of financial assets, a new impairment model based on expected credit losses and a new model for hedging individual exposures that more closely aligns financial and non-financial risk management with hedge accounting. The European Union is in the process of finalising its adoption of the standard.

For insurance companies, the IASB has published a specific amendment due to the different effective dates for IFRS 9 and the future insurance contracts standard (IFRS 4). The European Union is currently reviewing this amendment. Accordingly, companies concerned by these amendments will have to adapt the timeline for disclosing the expected impacts while endeavouring to provide information to the market as soon as possible.

IFRS 9 could have significant impacts on all companies (through the hedge accounting model) but in particular on financial institutions (due to the review of the classification and measurement of all of their financial assets, and the new impairment model).

On top of the 2015 recommendations, which encouraged companies to report on their progress in implementing IFRS 9, ESMA, along with all European market regulators, decided to publish recommendations for companies and their statutory auditors on implementation of IFRS 9 and the information to be disclosed to the market by 2018. As such, the AMF expects audit committees to monitor implementation of the standard and the accounting and financial information provided to the market.

The aim is to enable the market to understand the main changes resulting from the standard, to prepare it for the expected impacts and to provide it with relevant information on the key defining elements related to implementation of the standard.

To that end, ESMA published a Statement[1] on 10 November 2016. The AMF has modelled its recommendations on this Statement.

The task of setting and interpreting international accounting standards is assigned exclusively to the IASB and the IFRS Interpretations Committee. These recommendations seek to clarify the information expected by the market under IAS 8 in the context of implementation of IFRS 9.

Many of the recommendations made in this document require that companies provide descriptions or explanations in the notes to the financial statements. For some of the specific aspects related to implementation of a new standard, the level of detail of the information should be adapted to the relative significance of the matter so as to provide the reader with relevant and useful information.

Recommendation:
In line with its guide to the relevance, consistency and readability of financial statements, the AMF encourages companies to consider how they present information in the notes on the expected impacts on the financial statements of the future implementation of IFRS 9 in order to meet these financial reporting improvement objectives.

For example, where the information is included in the financial statements, in connection with other financial disclosures or the specific information provided.

[1] ESMA Statement – 2016/ESMA/1563
https://www.esma.europa.eu/sites/default/files/library/2016-1563_public_statement-issues_on_implementation_of_ifrs_9.pdf

1. Elements to be considered when implementing the standard

To date, two issues relating to the application of IFRS 9 have been submitted to the IFRS Interpretations Committee. The first deals with determining effectiveness for net investment hedges (see January 2016 *IFRIC Update*). The second, still under review, concerns the possibility of classifying certain financial instruments at amortised cost, particularly when there are prepayment options. More specifically, to be classified at amortised cost, the contractual cash flows of the financial asset must correspond solely to “payments of principal and interest on the principal amount outstanding” (see IFRS 9.4.1.2). The IFRS Interpretations Committee has been asked about the possibility of considering that certain prepayment options meet this criterion.

Recommendation:
The AMF encourages all companies to pay particularly close attention to IFRS 9-related matters that have been or could be submitted to and discussed in the IFRS Interpretations Committee[2] and, where applicable, to take the committee’s conclusions into account when implementing the standard.

See ESMA, page 5, par. 18

The AMF notes that, under IFRS 10.B87, the accounting policies used by all members of a group must conform to the group’s accounting policies[3].

See ESMA, page 5, par. 15

As such, companies shall verify that, despite the different economic conditions and environments that may exist within their group, the accounting principles adopted are applied uniformly and consistently by all group members, notably for the impairment model.

2. Importance of transparency on the implementation and impacts of IFRS 9

IAS 8 requires the disclosure, for standards that have been issued but are not yet effective, of “known or reasonably estimable information relevant to assessing the possible impact that application of the new IFRS will have on the entity’s financial statements in the period of initial application”. This paragraph applies, even if the standard has not yet been adopted by the European Union[4]. The objective is to enable users of the financial statements to understand the qualitative and quantitative impacts of the new standard on the company’s financial statements and performance.

The market expects more detailed disclosures on the expected impacts as the effective date of IFRS 9 draws nearer. Companies therefore need to take a gradual approach and provide more specific disclosures at each reporting date. Companies should focus on verifying the quality and reliability of the qualitative and quantitative information provided in this context while ensuring that the publication timeline for this information is consistent with market expectations.

Recommendation:
The AMF encourages companies that are significantly affected by IFRS 9 to implement a gradual approach with more specific disclosures at each reporting date to provide users of the financial statements with the relevant qualitative and quantitative information.

See ESMA, page 2, par. 8

If information on the impacts at the time of initial application is to be published, it must be reasonably estimable. Accordingly, the timing and degree of disclosure provided will likely vary by company due mainly to the diversity and complexity of the business models and to differences in the progress made on the necessary IT developments.

[2] http://www.ifrs.org/Updates/IFRIC-Updates/Pages/IFRIC-Updates.aspx
[3] Companies not covered by the exemption provided for in the draft amendment to IFRS 4 but that have associates in their financial statements that do qualify for this exemption are not affected with regard to these entities and this matter alone.
[4] See ESMA report ESMA/2013/1545, Ref EECS/0213-12 (14th Extract)

Recommendation:
The AMF recommends that companies provide quantitative information (order of magnitude, for example) on the estimated potential impacts of IFRS 9 in the period of initial application as soon as it is available or can be reasonably estimable. If the impact is significant, the AMF expects them to do so, in most cases, as of the publication of the 2017 interim financial statements.

See ESMA, page 3, par. 10

The real quantitative impacts of initial application will depend on the financial instruments and the circumstances in place at the time of the transition, while estimates of potential impacts before that date will be made based on portfolios and data that are potentially different and/or subject to change.

Recommendation:
The AMF recommends that companies provide the greatest possible clarity and make an effort to educate readers when communicating the possible impacts of the new standard and the bases on which these estimates have been made so as to enable users of financial statements to understand that these estimates will not necessarily correspond exactly to the impacts reported at the time of the actual transition to the new standard.

See ESMA, page 3, par. 11

Recommendation:
In the context of implementation of IFRS 9 and the information disclosed thereunder in the financial statements pursuant to IAS 8.30, the AMF recommends that significantly affected companies:

- **Provide information about the accounting policy choices that have been made (such as the choice to continue to apply the hedge accounting principles in IAS 39, the option to early apply only the presentation in other comprehensive income of the profit or loss on financial liabilities measured at fair value through profit or loss under IAS 39, or the irrevocable choice to present in other comprehensive income future changes in the fair value of a particular investment in equity instruments that would otherwise be measured at fair value through profit or loss);**
- **When they are presented, differentiate the possible impacts of IFRS 9[5] using a relevant, company-specific approach and explain the nature of the impacts so that readers can understand the changes and their drivers when compared notably with IAS 39.**

Moreover, the AMF recommends that the companies in question present the expected impacts on governance (financial risk management, in particular) and the anticipated changes in the aggregates used in their financial reporting (for example alternative performance measures, the company's forecasts or outlook).

See ESMA, pages 3 and 4, par. 13 and 14

3. Specific considerations for financial institutions

Although IFRS 9 will apply to all companies, it is particularly important for financial institutions as it concerns the accounting treatment for much of their balance sheets.

Recommendation:
The AMF recommends that companies now proceed with an in-depth analysis of the principles of the standard in light of potential changes to IT and/or risk management systems.

See ESMA, page 5 par. 16

The elements to be considered in the new financial asset classification principles concern, first, the characteristics of the instruments and, second, the business model.

[5] Where implementation takes place in several stages (for example, for liabilities classified at fair value), it would be useful to provide these various elements at every stage.

Moreover, because the impairment model is complex to implement and based on expected losses, it requires the use of assumptions, estimates and judgements which should be presented with explanations to ensure they are clearly understood by the market.

Recommendation:
The AMF underscores the importance of explaining how the financial asset classification criteria (characteristics of the instruments and business model) have been analysed and adapted in light of the company's activities and products. Similarly, for implementation of the expected loss model, detailed information in the notes on the elements considered (assumptions, estimates, judgements) will allow readers to understand the key factors in determining credit risk and how the model has been adapted within the company.

See ESMA, page 5, par. 17

In December 2015, in advance of adoption of IFRS 9, the EDTF[6] published a recommendation titled "*Impact of credit loss approaches on bank risk disclosures*". This recommendation provides a useful guide to developing credit risk disclosures with the aim of improving the comparability of this information in the context of implementation of IFRS 9.

Recommendation:
The AMF supports the EDTF's initiative and encourages international banks to follow this recommendation in compliance with the requirements defined (or being defined) in Pillar 3.

See ESMA, page 6, par. 23

The IASB has also established a group to assess application issues identified before 2018 (the ITG, or Transition Resource Group for Impairment of Financial Instruments). It is made up, among others, of preparers and auditors and serves as a discussion forum for issues arising from implementation of the new impairment model. This group cannot publish interpretations of IFRSs but has endeavoured, through its discussions and published reports, to highlight the specific aspects of the standard that provide some analysis of the issues identified. A number of questions have been referred to the ITG, and the IASB has posted a summary of the questions asked and analyses provided on its website[7].

Recommendation:
Companies are encouraged to consider the analyses resulting from the ITG's work when implementing IFRS 9.

See ESMA, page 5, par. 19

The new accounting impairment model based on expected losses differs from the prudential model although some concepts might appear similar to what is currently used in the prudential standards (for example, EAD, PD, LGD), and which are published in the regulatory information (Pillar 3).

Recommendation:
The AMF urges companies to pay particularly close attention to the differences between the accounting and prudential models in their implementation of IFRS 9*.
The AMF encourages companies, where appropriate, to play an educational role by explaining to the market the major differences between the concepts used to date in the prudential framework and how they have been adapted from an accounting standpoint in the expected loss model.

**See ESMA, page 6, par. 21*

If the impacts on key prudential ratios are likely to have a material impact on the price of the company's financial instruments, this information must be disclosed as soon as possible under Article 17 of Regulation 596/2014 on market abuse.

[6] Enhanced Disclosure Task Force: international task force set up under the aegis of the FSB, composed of representatives of the private sector (preparers and users of financial information).
[7] http://www.ifrs.org/About-us/IASB/Advisory-bodies/ITG-Impairment-Financial-Instrument/Pages/home.aspx

See ESMA, page 3, par. 10

In addition, bank supervisors urge institutions to comply with the principles of the Basel Committee's guidance on the accounting expected loss model (*Guidance on credit risk and accounting for expected credit losses* — the EBA is finalising its adaptation at the European level) with a view to implementing the impairment principles provided for in IFRS 9 in a rigorous manner and as uniformly as possible.

Lastly, users of financial statements are also interested in the potential impacts of initial application of IFRS 9 on prudential ratios.

Recommendation:
If the prudential impacts are available at the time of publication of the accounting impacts, companies are encouraged to communicate on those impacts as well.

See ESMA, page 3, par. 12

4. Illustrative disclosure timeline (assuming application as of 1 January 2018)

Although the pace of implementation will be specific to each company, the following timeline could serve as an example of the information expected by the time IFRS 9 is first applied. This timeline can be adapted to the company's specific circumstances and the materiality of the changes arising from IFRS 9.

2016 annual accounting period

<u>In the financial statements</u>

1. Explanation of the company's timeline for implementing IFRS 9, including:
   - Projected timeline for disclosing impacts;
   - If a choice has been made, accounting principles adopted such as whether or not to early apply the presentation in other comprehensive income of profits and losses on financial liabilities measured at fair value through profit or loss, continued application of IAS 39 hedging principles, etc.
   - Option regarding comparative information at the time of initial application.
2. Customised description of IFRS 9 and of its key concepts to specify how the company will implement them, for example:
   - Classifications of the main types of instruments under IAS 39 and IFRS 9;
   - Description of the approach taken and modelling techniques used to determine expected credit risk and incorporation of forward-looking information, as well as an analysis of the concept of a significant deterioration in an asset's credit quality;
   - Description of the hedge accounting approach used in view of financial and non-financial risk management.
3. If they are known or can be reasonably estimated, indication of the possible quantitative impacts (order of magnitude, for example) of initial application of IFRS 9 (depending on the circumstances, positions and extent of the expected impacts). The information may be provided at different paces and with varying degrees of detail:
   - Presentation and explanation of this information according to a relevant, company-specific approach (for example, where appropriate, by phase (classification and measurement, credit risk, hedging) or by type of portfolio and/or business);
   - Scope of financial instruments in question;
   - Reference date for impact calculations.
4. If the quantitative impacts cannot be disclosed, a qualitative indication of the expected magnitude of these impacts.

2017 interim financial statements

Although IAS 34 does not require any specific information, develop and update the information provided for the previous accounting period by providing more detailed information. This is the case in particular when quantitative impacts could not be provided for the previous accounting period because they could not be reasonably estimated.

In other financial disclosure documents (management report or Pillar 3 report, for example), where applicable and provided the quantitative information below can be reasonably estimated, presentation of:
1. Explanations of the key impacts on governance, control and credit risk management and the work of the audit committee;
2. Changes and expected impacts on the key financial indicators used by the company (alternative performance measures);
3. Expected impacts on prudential ratios (capital; leverage and liquidity ratios) when the procedures for including IFRS 9 impacts in the prudential aggregates have been set.
4. If applicable, explanations of the expected changes in the company's forecasts and/or outlook.

2017 annual financial statements

When the financial statements at 31 December 2017 are published, the company will already be applying IFRS 9; also, under IAS 8, the company must disclose the known or reasonably estimated impacts of application of IFRS 9 on the financial statements in the period of initial application.
As such, the disclosures made in previous accounting periods will be developed and updated to provide more specific information.

The AMF notes that, beginning with the 2018 annual financial statements, IFRS 7.42I to 42S list a number of disclosures to be provided in the notes at the time of initial application of IFRS 9.