

PUBLIC STATEMENT

Issues for consideration in implementing IFRS 9: *Financial Instruments*

1. The European Securities and Markets Authority (ESMA) is issuing its Public Statement on the implementation of IFRS 9 in order to promote consistent application of European securities and markets legislation and, more specifically, that of the International Financial Reporting Standards ('IFRS Standards'). In light of the expected impact and importance of the implementation of IFRS 9, ESMA highlights the need for consistent and high-quality implementation of IFRS 9 and the need for transparency on its impact to users of financial statements.
2. Issuers of securities admitted to trading on regulated markets and their auditors should take this Public Statement into consideration in their respective work during the implementation of IFRS 9, notably when disclosing and auditing its [expected] effects in the IFRS financial statements. In this respect, ESMA expects that, where relevant, quality of the implementation of IFRS 9 will be closely monitored by audit committees. Furthermore, ESMA highlights that some matters discussed below might not be relevant for some issuers and that the level of detail provided should be adapted depending on the significance of the matter to the financial statements.
3. ESMA expects that this Public Statement will be taken into account and reflected in the 2016 and 2017 annual and 2017 interim financial statements, thereby enhancing the comparability of IFRS financial statements in the EU. ESMA together with national competent authorities will monitor the level of transparency that issuers provide in their financial statements about the implementation of IFRS 9, changes in accounting policies resulting from the implementation and information relevant to assessing its possible impact on the issuer's financial statements in the period of initial application.

Background

4. IFRS 9 replaces major parts of IAS 39 *Financial Instruments: Recognition and Measurement* and contains a new impairment model based on expected credit losses (ECL).¹ It also includes new requirements and guidance on the classification and measurement of financial assets and introduces new requirements to address the so-called 'own credit' risk issue. These requirements stipulate that the effect of changes in the credit risk of financial liabilities designated at fair value through profit or loss under the fair value

¹ IFRS 9 defines expected credit losses as the weighted average of credit losses with the respective risks of a default occurring as its weights

option should be presented in other comprehensive income.² It also comprises new requirements and guidance, e.g. related to hedge accounting of individual exposures.³ ESMA notes that IFRS 9 effective date of application in the EU should be 1 January 2018.

5. While the new standard is expected to have significant impacts on financial institutions due to the introduction of the new impairment model, ESMA highlights that non-financial entities can also benefit from the changes made to the hedge accounting requirements that align hedge accounting and risk management and apply these new principles to a broader set of risk components. ESMA is thus of the view that all type of issuers need to carefully assess the impact of IFRS 9 in their particular circumstances when implementing the Standard.
6. ESMA notes that the IASB has finalised the amendments to IFRS 4 *Insurance Contracts* to address issues arising from the difference in the mandatory effective date between IFRS 9 and the new insurance contracts standard. In this context, ESMA expects insurance companies to provide, as soon as practicable, transparent information about their approach to the implementation of IFRS 9 and/or the application of the options addressing the effects of difference between the effective dates.

Transparency on implementation and effects of IFRS 9

7. ESMA notes that paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires disclosure of an impending change in accounting policies when an issuer has yet to implement a new IFRS Standard that has been issued but not yet come into effect (irrespective of whether it has already been endorsed in the EU).⁴ In addition, it requires disclosure 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*'. ESMA highlights that these requirements encompass both qualitative and quantitative information. Furthermore, ESMA stresses that the objective of these requirements is to enable users of the financial statements to understand beforehand the impacts that the future application of the new Standard will have on the financial position and performance of the entity.
8. ESMA expects that, as the implementation of IFRS 9 progresses, information about its impact should become more reasonably estimable and issuers are able to provide progressively more entity-specific qualitative and quantitative information about the application of IFRS 9 in their financial statements.
9. ESMA believes that the timing for providing disclosures is likely to vary between issuers depending on the complexity of the implementation process, the estimated impact and, where relevant, differences in the timetables for developing and implementing new information systems.

² Entities are permitted to early apply the requirements dealing with the 'own credit' issue for financial liabilities without applying the other requirements of IFRS 9 at the same time.

³ However, the existing hedge accounting requirements in IAS 39 can still be applied.

⁴ Report, 14th Extract from the EECS' Database of Enforcement, 29 October 2013, ESMA/2013/1545, Ref EECS/0213-12

10. ESMA expects that, for most issuers, the impacts of the application of IFRS 9 in the period of initial application will be known or reasonably estimable at the time of preparation of their 2017 interim financial statements, so that issuers are able to implement IFRS 9 compliant accounting policies as of 1 January 2018. Consequently, ESMA is of the view that in most cases it would be appropriate to provide disclosures about the changes in the accounting policies and their impacts on the entity's financial statements (or magnitude of the impacts) in the period of initial application already prior to their 2017 annual financial reports. ESMA reiterates that any disclosures in accordance with IAS 8 do not replace the obligation of issuers under other EU legislation such as the Market Abuse Regulation, with regard to inside information.
11. The impact in the period of initial application of IFRS 9 will be affected by the issuer's specific business and economic conditions at that date and the composition of its portfolios, circumstances which cannot be fully anticipated prior to the transition date. However, if reasonably estimable quantitative information on the impact of the application of IFRS 9 exists based on all information available as of a reporting date prior to transition date (e.g. in the 2016 annual financial statements or in the 2017 interim financial statements), this should be disclosed notwithstanding that the actual figures in the 2018 financial statements might be different owing to changes in the composition of the portfolios or different economic conditions.
12. Moreover, the markets are interested in assessing the potential impacts of first application of IFRS 9 on prudential ratios. While as of the date of this statement, there is no sufficient clarity on any possible changes to the prudential treatment of provisions when calculating prudential ratios taking into account effects of IFRS 9, if reliable information on the IFRS 9 impact on applicable prudential ratios is available at the time of publication of the financial statements, issuers are encouraged to communicate on the impacts of IFRS 9 in the financial statements together with the impacts of IFRS 9 on capital planning.⁵
13. Where the impact is expected to be significant, ESMA expects issuers to:
 - a. provide information about the accounting policy choices that are to be taken upon first application of IFRS 9 (such as the accounting policy choice to continue to apply the hedge accounting requirements in IAS 39, the option to early apply the requirements for the presentation of the fair value changes arising from credit risk on financial liabilities designated at fair value through profit or loss under the fair value option, or the option to irrevocable designate equity instruments at fair value through other comprehensive income);
 - b. disaggregate the expected impact into elements that issuers use to measure the impact and are useful to users of financial statements; and
 - c. explain the nature of the impacts so that users of the financial statements understand the changes and their key drivers when compared to the accounting principles and measurement categories based on IAS 39.⁶

⁵ Information on regulatory requirements could also be included as part of the regulatory disclosures (Pillar III disclosures) in accordance with the Regulation (EU) No 575/2013 (CRR), however, issues should consider disclosing in the financial statements information on capital to be provided in accordance with paragraphs 134-135 of IAS 1 *Presentation of Financial Statements*.

⁶ ESMA notes that application of paragraph 7.1.2 of IFRS 9 could lead to implementation of the Standard that results in more than one date of initial application for different IFRS 9 requirements. In such situation, ESMA expects issuers to provide sufficient clarity on the impact of such accounting policy separately for each of the dates and disclosure of relevant transition requirements required by IFRS 9 in each period of initial application.

14. Moreover, ESMA encourages issuers to explain the impact, if any, to risk management and/or to alternative performance measures (APMs) that the issuer may use in any regulated information (financial communication of the issuer and/or in other parts of the annual financial report) to which the ESMA Guidelines on APMs⁷ apply.
15. Finally, ESMA highlights the need to verify that IFRS 9 is understood and implemented consistently within a group during the period over which IFRS 9 is being implemented. While acknowledging different economic conditions in different economic environments, ESMA points to the importance of consistent implementation of IFRS 9 (and notably the impairment model) within groups in order to apply uniform accounting policies as required by paragraph B87 of IFRS 10 *Consolidated Financial Statements*.

Specific considerations for financial institutions/credit institutions

16. IFRS 9 is expected to have a significant impact on financial institutions and in particular, on credit institutions due to the new classification model for financial assets as well as the implementation of the new impairment model based on expected credit losses. Furthermore, in light of the expected impacts related to changes in IT and/or risk management systems, ESMA urges issuers to proceed with their implementation efforts on a timely basis.
17. Taking into account the complexity and the significant judgement required under the impairment model, ESMA is of the view that relevant disclosures on management judgements, estimates and assumptions should be provided in order to enable users to evaluate the credit risks to which an issuer is exposed.
18. ESMA also draws issuers' attention to the fact that some matters related to the application of IFRS 9, namely on classification of financial assets, have been submitted to IFRS Interpretations Committee (IFRS IC). Issuers that are affected are encouraged to follow the discussions at the IFRS IC in order to apply the clarifications to be provided.⁸
19. ESMA notes that the IASB has set up the IFRS Transition Resource Group for Impairment of Financial Instruments (ITG) in order to provide a forum intended to identify and discuss implementation issues arising from the new impairment requirements under IFRS 9. While the discussions of the ITG do not provide authoritative guidance, they do highlight some specific elements of the standards that are helpful to address the issues raised. Consequently, ESMA encourages issuers to consider the meetings' summaries when implementing IFRS 9.⁹
20. ESMA notes that in order to promote high-quality implementation of the impairment model, the Basel Committee on Banking Supervision (BCBS) issued *Guidance on credit risk and*

⁷ ESMA Guidelines on Alternative Performance Measures, 30 June 2015, ESMA/2015/1057

⁸ <http://www.ifrs.org/Current-Projects/IFRIC-Projects/Pages/IFRS-Standards-list.aspx>

⁹ <http://www.ifrs.org/About-us/IASB/Advisory-bodies/ITG-Impairment-Financial-Instrument/Pages/Meetings.aspx>

accounting for ECL.¹⁰ This document sets out supervisory guidance on sound credit risk practices associated with the implementation and ongoing application of ECL accounting frameworks, including an Appendix related to supervisory guidance specific to banks applying IFRS Standards. In July 2016 EBA published a consultation paper proposing EBA Guidelines on credit risk management practices and accounting for ECL. These draft guidelines aim to incorporate in the EU the BCBS Guidance by requiring competent authorities and credit institutions to make every effort to comply with the EBA Guidelines and thus ensure high quality and consistent application of IFRS 9 by credit institutions. ESMA welcomes the initiatives of the BCBS and the EBA which contribute to consistent implementation of the ECL model by credit institutions applying IFRS 9.

21. Furthermore, as the requirements for determining ECL according to IFRS 9 differ from those related to expected credit losses determined for regulatory purposes, ESMA highlights the need for proper consideration of those differences.
22. ESMA notes that EBA has launched an assessment that examines the estimated impact of IFRS 9 on credit institutions' own funds and the way credit institutions are preparing for the application of IFRS 9. In this context ESMA will co-operate with the EBA and the relevant prudential supervisors assessing the implementation of IFRS 9 as well as its impact on credit institutions.
23. The Enhanced Disclosure Task Force (EDTF) published in 2015 its report¹¹ regarding ECL approaches in IFRS 9. The publication aims to achieve greater consistency and comparability in the banking sector by encouraging specific disclosures on IFRS 9. ESMA welcomes the EDTF's objective to improve comparability by providing clear and sufficiently granular explanations about the concepts and estimation techniques used.

Illustrative timeline and good disclosure practices for financial institutions

24. The following paragraphs illustrate good practices of disclosure to be provided when an issuer expects the application of IFRS 9¹² to have a significant impact on its financial statements. Accordingly, this illustrative list is not exhaustive and each individual financial institution should take into account materiality and its individual circumstances in order to provide relevant and transparent financial information to users of financial statements.

2016 IFRS annual financial statements:

- Detailed description and explanation on how key IFRS 9 concepts will be implemented (e.g. approaches for classification of financial assets, business model test, modelling techniques and judgements used to estimate ECL and to incorporate forward-looking

¹⁰ Guidance on credit risk and accounting for expected credit losses, Basel Committee for Banking Supervision, December 2015, <http://www.bis.org/bcbs/publ/d350.pdf>

¹¹ Report, Impact of ECL Approaches on Bank Risk Disclosures, EDTF, 7 December 2015, <http://www.fsb.org/wp-content/uploads/Impact-of-expected-credit-loss-approaches-on-bank-risk-disclosures.pdf>

¹² Assuming the effective date of 1 January 2018, without early adoption. For issuers adopting IFRS 9 later (e.g. insurance companies benefiting from the temporary exemption from IFRS 9), the timeline for providing disclosure should reflect their specific circumstances but at the same time meet the aim to provide sufficient information for users of financial statements as soon as they become specific enough to be reasonably estimable. The timeline for insurance companies that will be concerned by any temporary exception from applying IFRS 9 will need to be adapted to take into account their specific circumstances as well as any additional disclosures required by the expected amendment to IFRS 4.

information, assessment of significant increase in credit risk, approach to hedge accounting). Where relevant, highlight the differences to current approaches.

- Where available, explanation of the timeline for implementing IFRS 9, including expected use of the transition relief (e.g. approach to comparative information at the date of initial application).
- If known or reasonably estimable, reliable quantification of the possible impact¹³ or its magnitude of application of IFRS 9 on the financial position, financial performance and equity (and where relevant and to the extent reliably estimable on capital planning), including disaggregation of disclosures that is useful to identify the drivers of the expected impact (e.g. by operating segments or phase¹⁴ of IFRS 9).¹⁵
- When the quantitative information is not disclosed because it is unknown or not reasonably estimable, additional qualitative information enabling users to understand the magnitude of the expected impact on the financial position in the financial statements and, where relevant, on capital planning.

2017 IFRS Interim financial statements:

While IAS 34 *Interim Financial Reporting* does not require specific disclosures related to updates of information provided in the latest annual financial statements in relation to a new IFRS Standard that has been issued but has not yet come into effect, ESMA is of the view that where significant, issuers should consider whether it is useful to provide an update of information provided in the 2016 IFRS annual financial statements (as referred above) in the interim financial statements.¹⁵

In particular, an issuer could provide quantitative information on the impact of the transition to IFRS 9 on its financial position and performance, in the following cases:

- The issuer expects a significant impact from the application of IFRS 9 but is unable to provide reliable information on it in the 2016 annual financial statements and reliable quantitative information on the impact becomes available before publication of the 2017 interim financial statements; or
- The issuer is able to provide significantly more specific information in the 2017 interim financial statements compared to the one provided previously.

Where relevant (e.g. when a significant impact is expected on the management of capital or on regulatory requirements) and to the extent available, further explanation on the impact that the implementation of IFRS 9 has on key regulatory ratios is encouraged.

2017 IFRS annual financial statements:

ESMA notes that as the annual financial statements for 2017 will be published after IFRS 9 becomes effective, issuers should provide a quantitative assessment of the impact of IFRS 9 on their financial statements as of 1 January 2018. Where relevant, ESMA also

¹³ Such information might need to be disclosed in advance of publication of the respective financial statements based on the provisions of the Market Abuse Regulation if considered to be inside information.

¹⁴ ESMA notes that in some cases the management monitors the impact in a different way (e.g. combined effects of classification of financial assets and impairment and separate effects on classification of financial liabilities and hedge accounting). Users of financial statements should be provided the most relevant information fit to the individual circumstances of the issuer.

¹⁵ Depending on the particular circumstances, the complexity of implementation and expected impact, disclosure about different drivers of the impact of IFRS 9 could be provided with a different level of granularity and at a different time.

encourages disclosure of the impact on regulatory requirements¹⁵ (such as, e.g. own funds and leverage ratio).

Consequently, ESMA expects that the 2017 annual financial statements provide the quantitative impact of the application of IFRS 9 and explain the changes to the amounts reported under IAS 39, disaggregated as appropriate. Moreover, ESMA expects that the information already provided in previous financial statements will be further developed and elaborated taking into account the actual implementation of IFRS 9.

Next steps

25. ESMA notes that once IFRS 9 is applied, i.e. at the latest in the 2018 annual financial statements,¹⁶ disclosures required by paragraphs 42I to 42S of IFRS 7 *Financial Instruments: Disclosures* related to the initial application of IFRS 9 need to be provided. These disclosures aim at providing an overview of the impact of the transition from IAS 39 to IFRS 9.

¹⁶ Except for entities applying the temporary exemption from IFRS 9 requirements set out by the expected modification of IFRS 4 *Insurance Contracts*