

IFRS 9 Financial Instruments Advisory Services

IFRS 9 changes

IFRS 9 is one of the most significant accounting changes of recent years. It not only impacts on general ledger entries and the financial statements, but also risk management; business models; and, financial performance of the business.

Preparing for IFRS 9 requires a thorough review and modification of existing workflows; policies and procedures; processes; and data and systems. Regulatory returns to the SFC and HKMA have to be prepared in accordance with IFRS 9 **from 1 January 2018** leaving little time for implementation.

Classification and measurement

Financial assets

IFRS 9 introduces a new classification model for financial assets. Financial assets are classified according to their contractual cash flow characteristics and the business models under which they are held.

Financial liabilities

The only change in respect of financial liabilities is related to liabilities designated as at FVPL using the fair value option, where the fair value changes that is attributable to the change in the entity's own credit risk is presented in other comprehensive income (OCI) instead of profit or loss, unless doing so would introduce an accounting mismatch.

Impairment

IFRS 9 replaces the existing incurred loss model by forward looking expected credit loss (ECL) model. The model applies to debt instruments measured at amortized cost or at FVOCI, lease receivables, trade receivables, contract assets, loan commitments and financial guarantee contracts that are not at FVPL, with the following approaches:

General approach

Applies to most loans and debt securities. Entities must recognize ECLs in two stages (12-month ECL "Stage 1" and lifetime ECL "Stage 2) and is determined by whether there has been a significant increase in credit risk since initial recognition.

Simplified approach

For trade receivables or contract assets that result from transactions within the scope of IFRS 15 and do not contain a significant financing component, entities are required to apply the simplified approach. For trade receivables or contract assets that do contain a significant financing component, and lease receivables, entities have a policy choice to apply the simplified approach or the general approach. It does not require tracking of changes in credit risk, but requires recognition of lifetime ECLs at all times.

Purchased or originated credit-impaired approach

For financial assets that are considered to be credit-impaired on acquisition or origination, the EIR is calculated taking into account the initial lifetime ECLs in the estimated cash flows, resulting in a credit adjusted EIR. The resulting fair value at initial recognition already takes into account lifetime expected losses and there is no additional 12-month ECL allowance.

Hedge accounting

The objective of IFRS 9 is to reflect the effect of an entity's risk management activities in the financial statements. The key changes are as follow:

- Ability to hedge risk components
- Potential reduction in volatility in P/L (exclusion of time value of options, forward points and currency basis)
- Aggregation exposures as hedged item
- Elimination of the 80-125% quantitative threshold
- No requirement for retrospective effectiveness test
- Emphasis on qualitative factors for prospective effectiveness assessment
- Expanded ability to hedge net positions or hedge layers of hedged items in fair value hedges
- Rebalancing instead of discontinuation and re-designation

General impact

C&M	Impairment	Hedge accounting
<ul style="list-style-type: none"> ▶ Contractual Cash Flow Characteristics (SPPI) test ▶ Business Model (BM) test ▶ FVOCI Irrevocable election ▶ Data availability and quality ▶ Policies and workflow ▶ Reclassification of available for sale assets ▶ Increased use of FV measurement 	<ul style="list-style-type: none"> ▶ Incorporation of forward looking elements ▶ Identification of significant increase in credit risk ▶ Increased data and modeling requirements ▶ Definition of lifetime ▶ Day-one impact on financial statements 	<ul style="list-style-type: none"> ▶ Revise and re-document risk management policies and procedures ▶ Redesign workflow, hedge documentation and approvals ▶ Hedge effectiveness assessment ▶ Design rebalancing mechanism

Sector specific impact

Banks	Broker-dealers	Wealth and asset management
<ul style="list-style-type: none"> ▶ Increase in impairment provisions, largely driven by retail portfolios, generally less significant for wholesale products ▶ Credit card exposures driving increase in retail provisions ▶ Impairment provision and pro-cyclicality ▶ Impact on CET1 ratio 	<ul style="list-style-type: none"> ▶ New complex models with forward looking elements are required for impairment measurement ▶ Challenges to integrate market data with financial reporting ▶ Developing ECL for margin loans and other exposures with limited default data 	<ul style="list-style-type: none"> ▶ Requirement to perform SPPI and BM testing on large/diverse fund portfolios ▶ Valuation of private equity investments ▶ Development of new complex models for impairment models including probability weighted scenarios

Why EY

- ▶ We are a market leader in supporting IFRS 9 implementation and can draw upon this experience and insight to inform the approach for your company and help accelerate services.
- ▶ We worked with the IASB on the Expert Advisory Panel in the development of IFRS 9 Impairment and we have an ongoing role as part of the IFRS Transition Resource Group for implementation.
- ▶ We have global presence and in most areas are already supporting other local clients with their IFRS 9 implementation programs.
- ▶ We can put forward an experienced and senior teams that has hands-on and in-depth knowledge of market approaches, and has worked with a number of clients to design and structure complex IFRS 9 programs.

Our value proposition

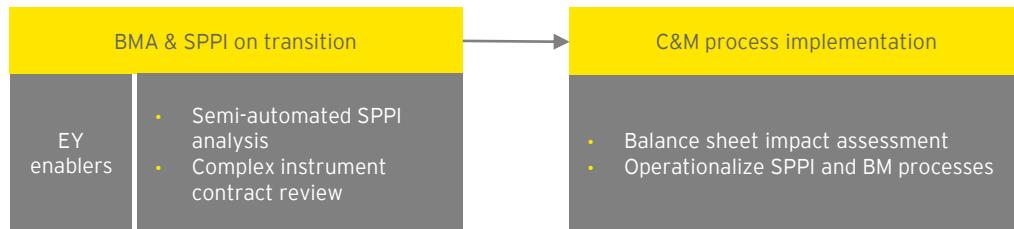
Our track record of IFRS 9 engagements will enable us to support you in mobilizing and engaging quickly; source data effectively and accelerate the delivery of results. Interaction between audit and advisory teams will reduce the audit burden, confirm that management assumptions are pre-cleared with the audit engagement professional and documentation is "audit-ready".

Independence

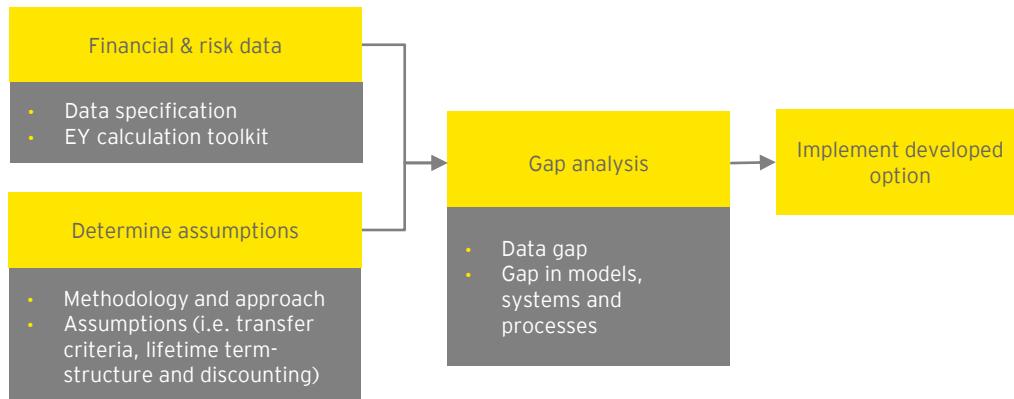
Audit client management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework. In executing the engagement, care will be taken to make sure that EY is not performing management responsibilities.

Our approach

Classification and measurement

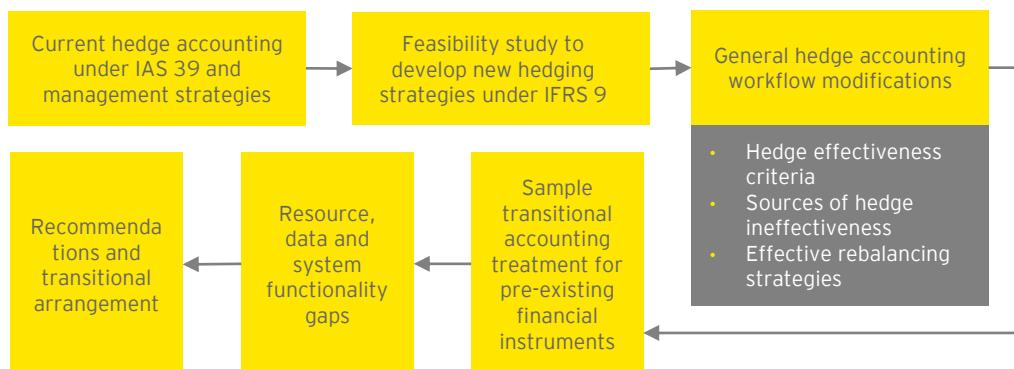


Impairment



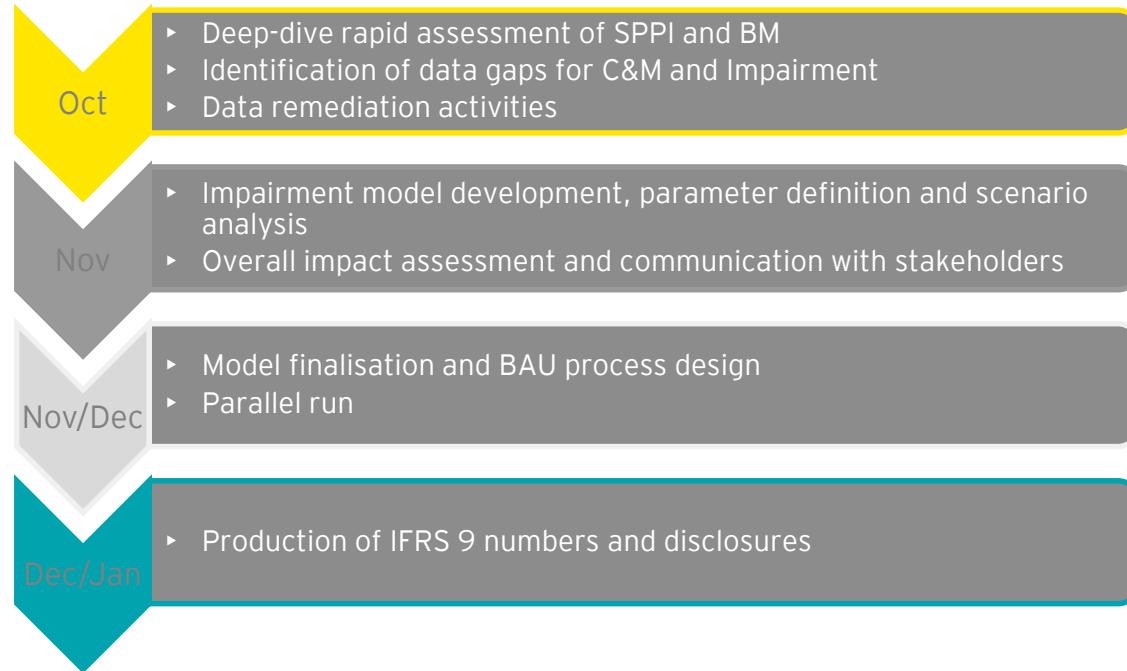
Project governance (program structure and services)

Hedge accounting



Accelerated IFRS 9 roadmap

For regulated entities typically IFRS 9 compliant figures will be required for the first regulatory submissions (Banking Returns or FRR)



Our tools and accelerators

We have developed a number of tools and accelerators which might be of use in recommending IFRS 9 implementation across your sites:

- Business model checklist** to assist in performing the business model assessment for classification purposes
- Automated classification tool** to classify any financial instrument with an identifier (e.g., ISIN, CUSIP etc.), where data is available
- IFRS 9 calculation toolkit**, which can easily be tailored to fit your company's portfolios in scope and be used to assess the impact of IFRS 9 and the sensitivity to different choices available
- Example **IFRS 9 plans and roadmaps**, which can be used as standards and inputs for the development of your own IFRS 9 program

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by

guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2017 Ernst & Young, China. All Rights Reserved.

APAC no. 03005481

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

Contact EY



Patricia Tay
Partner
Financial Services
Ernst & Young
+852 2846 9621
patricia.tay@hk.ey.com



Martin Grosvenor
Senior Manager
Financial Services
Ernst & Young Advisory
Services Limited
+852 2849 9159
martin.grosvenor@hk.ey.com



Aaron Li
Senior
Financial Services
Ernst & Young Advisory
Services Limited
+852 2629 1723
aaron-zl.li@hk.ey.com