# COMMUNIQUE

17-COM-003 Nov. 27, 2017

**Release of IFRS 9 Guidance**

The Credit Union Prudential Supervisors Association (CUPSA) has released regulatory guidance for the adoption of IFRS 9 at Canadian credit unions and caisses populaires.

CUPSA has reviewed extensive interpretation and guidance on IFRS 9. The attached guidance is consistent with international standards and is intended to be scalable to the relative size, nature, scope, complexity and risk profile of a credit union.

Each CUPSA member jurisdiction may choose to apply this guidance in its current or amended form at their own discretion when developing regulatory frameworks and guidance for their credit unions and caisses populaires.

CUPSA will continue to monitor national and international research and guidance related to IFRS 9 and other international financial reporting standards in order to continuously enhance and clarify sound practices for financial reporting.

Supervisors of credit union jurisdictions outside Canada are welcome to review and adopt the guidance as may be appropriate.

**About CUPSA**

The Credit Union Prudential Supervisors Association (CUPSA) is an interprovincial association composed of credit union prudential supervisors across Canada. CUPSA works toward maintaining a sound and sustainable credit union sector through joint actions. For more information, visit CUPSA's website at www.cupsa-aspc.ca.

# IFRS 9 Financial Instruments and Disclosures Guidance

## Introduction

In July 2014, the International Accounting Standards Board (IASB) issued the final version of IFRS 9 *Financial Instruments*, which replaces IAS 39 *Financial Instruments: Recognition and Measurement.* Credit unions are required to implement IFRS 9 for their fiscal year commencing on or after January 1, 2018, and will experience some level of impact on finance, risk and operations.

There are three main components to the implementation of IFRS 9:

1. *Classification and Measurement* – move to a principle-based, unified model based on both the use of assets within the business model and the nature of cash flows;
2. *Impairment* – fundamental redesign of the provisioning model for financial assets, shifting from an "incurred loss" model to an "expected loss" model. The standard requires a more complex process of data gathering, analysis and projections for impairment, resulting in earlier recognition of impairment; and
3. *Hedging* – simplification of existing hedge accounting rules, accommodating more risks that can be hedged, and better reflecting how entities manage their risk.

## Purpose and Scope

This document outlines key regulatory guidance with respect to the adoption of IFRS 9. It is intended to assist CUPSA member organizations in their individual communications and guidance on IFRS 9. Each CUPSA member organization may choose to apply this guidance in its current or amended form at its own discretion.

CUPSA has reviewed extensive interpretation and guidance on IFRS 9. Key sources and documents that aided in the development of this guidance include:

- Canadian Credit Union Association (CCUA) – *IFRS 9 Readiness for Credit Unions*;
- Office of Superintendent of Financial Institutions (OSFI) – *Guideline: IFRS 9 Financial Instruments and Disclosures;* and
- Basel Committee on Banking Supervision (BCBS) – *Guidance on Credit Risk and Accounting for Expected Credit Losses.*

CUPSA acknowledges that IFRS 9 regulatory guidance may differ amongst the different CUPSA member jurisdictions, as each province has unique circumstances.

This guidance is intended to be scalable to the relative size, nature, scope, complexity and risk profile of Canadian credit unions and caisses populaires.

## Principles

CUPSA considers the following key principles when determining regulatory guidance relating to International Financial Reporting Standards (IFRS):

1. *Consistent Guidance* – responses amongst Canadian regulatory bodies should be consistent and support a “level playing field” for credit unions and caisses populaires in the financial industry and facilitate leveraging the work and experience of regulators across the country;
2. *Minimize Regulatory Requirements* – requirements should be minimized and issued only to support identified potential risks to prudential monitoring or regulatory capital; and
3. *Comparable Statements* – financial statements of different credit unions and caisses populaires should be materially comparable, to support prudential monitoring.

### Early Adoption

***Early adoption is not permitted.***

Section 7.1.2 of IFRS 9 permits early adoption of IFRS 9; however, CUPSA members advised their credit unions and caisses populaires in 2015 not to early adopt. This provided Canadian credit unions and caisses populaires maximum time to prepare for adopting the new standard, allowing for consistent interpretation to evolve within industry, and supporting the presentation of comparable financial statements.

### Retrospective Application

***Retrospective application is permitted, but not required.***

The basic principle in IFRS 9 is retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* unless IFRS 9 contains more specific provisions for a particular aspect of the transition. However, IFRS 9 contains significant exemptions from retrospective application (see IFRS 9 - Section 7.2.1, IAS 8 - Sections 19, 22). In addition, a credit union may restate prior periods if and only if, it is possible without the use of hindsight[1] and the additional resources/information required for restatement is readily available.

CUPSA recognizes that there is diversity across provincial jurisdictions in terms of preparations for IFRS 9. Retrospective application is not practical for some credit unions, as the additional resources/information required for restatement may not be available. Other credit unions may be

[1] IFRS Readiness for Credit Unions: Transition Toolkit (June 2017), 9 p.

pro-active in gathering resources/information for restatement, in part, to simplify additional disclosure requirements under IFRS 9.

CUPSA has not identified any risks associated with permitting retrospective application under IFRS 9, which would materially impact the comparability of current year credit union financial statements. Prohibiting retrospective application of IFRS 9 could potentially create additional regulatory requirements or contradict IFRS 9 for some credit unions; as such CUPSA acknowledges that retrospective application is permitted but not required.

## Transitional Matters

***Credit union requests for a transitional period for reporting and capital adequacy should be considered on a case-by-case basis.***

CUPSA acknowledges that the CCUA's *IFRS Readiness for Credit Unions* project has provided comprehensive resources, training materials and ongoing support for credit unions to adopt IFRS 9 in a timely manner. National auditing firms have also been proactive in ensuring credit unions are prepared for the transition. As such, credit unions should be prepared for adoption of IFRS 9 and subsequent reporting requirements.

The adoption of IFRS 9 may have an impact on the capital position of individual credit unions; however, CUPSA member organizations have modelled the impact for their respective jurisdictions, and are not anticipating any requirement for a transition (or phase-in) period to accommodate the impact of IFRS 9.

CUPSA members may consider appropriate transitional measures on a case-by-case basis if a credit union advises of a material estimated impact of IFRS 9 on their capital position.

## Disclosure Requirements

***No guidance on disclosure requirements will be issued.***

CCUA's *IFRS 9 Readiness for Credit Unions* project has provided comprehensive illustrative disclosures for IFRS 9. CUPSA has not identified any risks associated with disclosure requirements under IFRS 9, which would materially impact the comparability of credit union financial statements; as such, CUPSA does not anticipate the issuance of guidance on disclosure requirements. This position is also consistent with OSFI's guidance.

**Classification & Measurement – Fair Value Option**

***A credit union should advise its provincial regulator if it plans to use the Fair Value Option*.**

IFRS 9 provides a Fair Value Option, where a financial instrument can be designated as "held for trading" at initial recognition. Under IFRS 9, the use of the Fair Value Option is a choice.

Credit unions that plan to use the Fair Value Option should advise their provincial regulator of their decision. Credit unions are cautioned to carefully consider the degree of reliability of the estimate of fair values before adopting this option. The decision to use the Fair Value Option should consider all relevant factors, including:

- Degree of reliability of fair value estimates for the instruments where the Fair Value Option will be applied;
- Appropriateness of risk management policies, procedures and controls in place where the Fair Value Option will be applied. For example, is the choice of the Fair Value Option supported by a documented risk management strategy that contributes to reliable fair values and eliminates or significantly reduces an accounting mismatch (arising from measuring assets and liabilities on a different basis) or eliminates or significantly reduces financial risks (arising from managing a group of financial instruments together on a fair value basis)?; and
- Appropriateness of the choice to use the Fair Value Option for loans and mortgages to individuals or to companies.

To determine if adoption of the Fair Value Option is appropriate and in accordance with IFRS, credit unions considering the option should review and discuss it with their external auditor. In addition, the credit union should provide the following to the provincial regulator for review:

- Confirmation from their external auditors that it is appropriate for the credit union to adopt the Fair Value Option; and
- Additional information and rationale to support adopting the Fair Value Option.

This information will assist the provincial regulator in assessing the impact of the credit union's use of the Fair Value Option on risk, earnings and capital adequacy, as well as with interpreting the financial performance being reported.

Consensus must be reached between the credit union, external auditor and provincial regulator as to the appropriateness of employing the Fair Value Option. After consensus, the credit union should provide final supporting documentation to the provincial regulator on the financial instruments that will be classified using the Fair Value Option. Reliable fair values can be determined using one of the following three techniques:

1. Published price quotations for identical financial instruments in which the credit union could actually transact at the measurement date;
2. Published price quotations (as described above) for issues by the same issuer of a similar size, risk and duration to the credit union's exposure; and

3. If the first two techniques are not available, valuation techniques (discounted cash flow analysis and option pricing models) may be used to derive fair values. However, to the maximum extent possible, inputs should be based on observable, active, two-way market values. Adjustments to reflect the unique characteristics of the instrument should be prudent and applied consistently from period to period.

Within the requirements of IFRS, if fair values cannot be reliably estimated for the financial instruments concerned, at inception and in subsequent periods, the Fair Value Option should not be used.

This position is consistent with OSFI's guidance, while maintaining stable and comparable financial statements amongst credit unions, and was previously communicated by provincial regulators.

## Impairment

***Credit unions should consider the concept of materiality in their application of IFRS 9.***

The application of materiality should not result in individual exposures or portfolios being considered immaterial if, cumulatively, these represent a material exposure. In addition, materiality should not be assessed only on the basis of the potential impact on the profit or loss statement at the reporting date.

***Credit unions should recognize allowances on a timely basis, and not delay the recognition of credit deterioration, given the range of judgment existing in IFRS 9.***

CUPSA members may choose to comment on the frequency of impairment assessment, based on the circumstances unique to their own jurisdiction.

***Credit unions should limit and clearly document the use of the IFRS 9 practical expedients in assessing impairment.***

IFRS 9 includes a number of practical expedients, intended to ease the implementation of the standard for a wide variety of companies. Credit unions should limit the use of practical expedients – given their business – as the cost of obtaining relevant information is not likely to involve "undue cost or effort."

Practical expedients possibly leveraged by credit unions may include:

1. The information set

IFRS 9 states that "an entity shall consider the best reasonable and supportable information that is available, without undue cost and effort" and that "an entity need not undertake an exhaustive search for information." Credit unions and caisses populaires should not read these statements restrictively.

The objective of the IFRS 9 model is to deliver fundamental improvements in the measurement of credit losses; as such, credit unions should develop systems and processes that use all reasonable and supportable information that is relevant to the group or individual exposure, as needed, to achieve a high-quality, robust and consistent implementation of the approach. This may require upfront investments in new systems and processes; however CUPSA members do not expect additional upfront investments in new systems and processes to be introduced where they do not contribute to a high-quality implementation of IFRS 9.

2. "Low credit risk" exemption

IFRS 9 introduces an exception to the general model in that, for "low credit risk" exposures, entities have the option not to assess whether credit risk has increased significantly since initial recognition.

Credit unions should recognize changes in 12-month expected credit losses (ECL) through the allowance where there is not a significant increase in credit risk, and a move to lifetime ECL measurement if there is a significant increase in credit risk. Any use of the low-credit-risk exemption must be accompanied by clear evidence that credit risk as of the reporting date is sufficiently low that a significant increase in credit risk since initial recognition could not have occurred.

3. More-than-30-days-past-due rebuttable presumption

The 30-days-past-due simplification permits the use of delinquency together with other more forward-looking information, to identify a significant increase in credit risk. IFRS 9 notes that delinquency is a lagging indicator of significant increases in credit risk.

A credit union cannot rely solely on past due information. If reasonable and supportable information that is more forward-looking than past due information is available, without undue cost or effort, it must be used to assess changes in credit risk.

Credit unions should have assessment and measurement processes in place to ensure that credit risk increases are detected well ahead of exposures becoming past due or delinquent. These processes will ensure a timely transfer of exposures to lifetime ECL measurement.

If a credit union has information indicating that there has not been a significant increase in credit risk even though contractual payments are more than 30 days past due, it will have to provide evidence rebutting the 30-days-past-due presumption.

This approach is consistent with Basel and OSFI guidance, and will improve the quality of credit union implementation of IFRS 9.

## Other Items

This regulatory guidance is intended to be consistent with IFRS 9 and should not conflict with it. Should a perceived conflict arise between IFRS 9 and this regulatory guidance, IFRS 9 shall take precedence.

This regulatory guidance should not unexpectedly impact the auditor's opinion on a credit union's financial statements. Credit unions should not use this regulatory guidance document as a technical resource for interpreting IFRS 9.

This guidance is intended to assist CUPSA member organizations in their individual communications and guidance on IFRS 9. Each CUPSA member organization may choose to apply this guidance in its current or amended form at its own discretion.

CUPSA encourages credit unions and caisses populaires to contact their individual regulatory authorities on application and adoption of IFRS 9.