Notice relating to the application of International Financial Reporting Standard (IFRS) 9 Financial Instruments

Scope

This Notice from the *Autorité des marchés financiers* (the "AMF" or the "Authority") is intended for Québec-chartered financial institutions ("institutions") governed by any of the following statutes:

- *An Act respecting insurance*, CQLR, c. A-32;
- *An Act respecting financial services cooperatives*, CQLR, c. C-67.3;
- *An Act respecting trust companies and savings companies*, CQLR, c. S-29.01.

Note that in the case of credit unions that are members of a federation, the guidance hereinbelow applies to the "entity" as defined in the scope of the *Ligne directrice sur les normes relatives à la suffisance du capital de base* (guideline on adequacy of capital base, available only in French). The generic term "institution" is used for purposes of applying the guidance in this Notice.

Introduction

In July 2014, the International Accounting Standards Board ("IASB") published the final version of IFRS 9 *Financial Instruments* ("IFRS 9"), which replaces IAS 39 *Financial Instruments: Recognition and Measurement* and all prior versions of this standard.

The standard sets out a new classification and measurement model, an impairment model based on expected losses, and a revised hedge accounting approach. It will apply to fiscal years beginning on or after January 1, 2018.

In addition to affecting the classification, recognition, measurement and presentation of financial instruments, the implementation of this standard entails changes to the functions pertaining to finances and risks. Institutions will have to assess the effectiveness of their credit risk practices, policies, processes and procedures that affect the calculation of provisions. Senior management of an institution must ensure that it has appropriate credit risk management practices. These practices include rigorous internal controls, tailored to the scope, nature and complexity of the institution's loan exposures, so that it can establish provisions in accordance with its policies and procedures, its accounting framework and prudential instructions in effect. The standard could also result in significant changes, including changes to business models and capital management.

IFRS 9 includes a number of practical expedients intended to facilitate its application by a broad range of non-financial sector enterprises. The AMF is of the opinion that in order to rigorously apply IFRS 9, institutions should limit their use of these practical expedients, because they are liable to generate significant biases.

For example, IFRS 9 states that there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. The AMF is of the view that financial institutions have the expertise allowing them to consider credit losses before the expiry of the 30-day period. Typically, credit risk increases significantly before a financial instrument becomes past due or other lagging borrower--specific factors are observed. Therefore, in carrying out their analyses, institutions must take into account the fact that a default is a backward-looking rather than a forward-looking indicator of decreased value.

Moreover, IFRS 9 states that an enterprise must measure expected credit losses of a financial instrument without "undue cost or effort." Given that financial institutions have highly specialized knowledge of the financial sector as well as practices, policies, processes and procedures for managing financial instruments and credit risk, the AMF expects them to apply all of these resources when measuring expected credit losses.

Lastly, on December 18, 2015, the Basel Committee on Banking Supervision (the "BCBS") issued a document entitled *Guidance on Credit Risk and Accounting for Expected Credit Losses*. This document pertains to banking institutions. The AMF adheres to the principles and guidance published by the BCBS that foster sound and prudent management practices and, as such, it expects financial services cooperatives to comply therewith. They could also be useful to any financial institution with respect to its credit risk management process.

Additional information

Additional information is available from:

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September 15, 2016