Financial Instruments
Classification and Measurement: Business Model

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FASB Memo No. 134
Agenda

• Introduction
• IFRS 9: Business Model Criterion (Financial Assets)
• FASB Tentative Model: Business Model Criterion (Financial Assets)
• IFRS 9 and FASB Business Model Comparison
Financial Instruments Classification and Measurement: Business Model

• This presentation describes only the business model assessment for classification and measurement of financial assets under IFRS 9 and the FASB’s tentative model.

• IFRS 9 and the FASB’s tentative model also require assessment of the financial asset’s cash flow characteristics.

• Business model assessment only impacts classification of debt instruments.
IFRS 9: Business Model (Financial Assets)
IFRS 9
Business Model Assessment

• Principle
  – Amortised cost category is defined
    ▪ Business model whose objective is to **hold assets to collect contractual cash flows**
    ▪ Business model is *not* hold to collect if the portfolio is managed and evaluated to realise cash flows through sale or on a fair value basis
    ▪ Provides information about likely actual cash flows
  – FVPL category is a residual category
    ▪ Includes financial assets held for trading and managed on a fair value basis
  – No FVOCI business model for debt instruments*

*There is a FVOCI option for equity instruments but it is not determined by business model
IFRS 9
Business Model Assessment

• Application guidance
  – Objective of the business model is determined by key management personnel and observed by how business is managed
  – The model is based on objective evidence and not management intent
  – The assessment is performed at a higher level of aggregation; not an instrument-by-instrument assessment
  – An entity may have more than one business model for managing financial assets
IFRS 9
Business Model Assessment

• Sales
  – Sales are not inconsistent with the objective of holding financial assets to collect contractual cash flows
  – For example, an entity may sell if
    ▪ The asset no longer meets investment policy
    ▪ The entity is an insurer and it adjusts its investment portfolio to match the duration of its liabilities
    ▪ The entity needs to fund capital expenditures
  – If more than infrequent number of sales occur, assess whether and how such sales are consistent with the objective to hold to collect contractual cash flows
  – No tainting, but gains or losses from sales separately presented on the face of P&L with additional disclosures
IFRS 9
Business Model Assessment

• Reclassification
  – Required when business model changes
  – Change in business model must be
    ▪ Determined by senior management
    ▪ A result of external or internal changes
    ▪ Significant to the entity’s operations
    ▪ Demonstrable to external parties
  – Expected to be “very infrequent”
FASB Tentative Model: Business Model Criterion (Financial Assets)
# FASB Tentative Model
## Business Model Criterion

<table>
<thead>
<tr>
<th>Categories</th>
<th>Business Model Criterion*</th>
</tr>
</thead>
</table>
| **Amortised cost (Lending / customer financing activity)** | Must meet all of the following:  
• Manage through customer financing or lending activities with a primary focus on collection of substantially all contractual cash flows  
• Holder has ability to manage credit risk by negotiating any potential adjustment of contractual cash flows with the counterparty in the event of a potential credit loss. Sales or settlements limited to circumstances that would minimise losses due to deteriorating credit, or to exit a particular market  
• Not held for sale |
| **FVOCI (Investing activity)** | Must meet all of the following:  
• Investing either to:  
  a. Maximise total return by collecting contractual cash flows or selling  
  b. Manage the interest rate or liquidity risk of the entity by holding or selling  
• Not held for sale |
| **FVPL (Held for sale / trading activity)** | Must meet either of the following:  
• Held for sale  
• Actively managed and monitored internally on a fair value basis |

* Applies to originated and purchased financial assets
FASB Tentative Model
Business Model Criterion

- Business model assessment
  - Based on **business activities** for *managing* financial assets rather than intent
  - Based on objective evidence and not management intent
  - The assessment is performed at a higher level of aggregation; not an instrument-by-instrument assessment
  - An entity may have more than one business activity for managing financial assets

- Financial assets at amortised cost subsequently identified for sale
  - Separately recognised as an impairment in net income as the difference between the carrying amount and fair value

- Realised gains and losses recognised in net income for FVOCI financial assets

- Reclassifications not permitted
IFRS 9 and FASB Business Model Comparison
## Business Model Comparison

<table>
<thead>
<tr>
<th>Area</th>
<th>IFRS 9</th>
<th>FASB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amortised cost category</td>
<td>- <strong>Key driver – Collect contractual cash flows</strong></td>
<td>- <strong>Key driver – Lending and customer financing relationship</strong></td>
</tr>
<tr>
<td></td>
<td>- Infrequent sales permitted (disciplined via transparency)</td>
<td>- (collect contractual cash flows <strong>and</strong> ability to manage credit by negotiating cash flows)</td>
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<td></td>
<td>- Loans and debt securities</td>
<td>- Sales limited to minimise credit losses or exit particular market</td>
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<td></td>
<td>- Generally loans; however certain debt securities may qualify</td>
</tr>
<tr>
<td>FVOCI category</td>
<td>- Not applicable for debt instruments</td>
<td>- Investing activities; manage interest rate or liquidity needs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Loans and debt securities</td>
</tr>
<tr>
<td>FVPL category</td>
<td>- Residual category</td>
<td>- Held for sale instruments</td>
</tr>
<tr>
<td></td>
<td>- Held for trading instruments</td>
<td>- Managed on a fair value basis</td>
</tr>
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## Business Model Comparison

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<tr>
<td>Reclassifications</td>
<td>• Required if the entity’s business model changes, which is expected to be rare</td>
<td>• Not permitted</td>
</tr>
<tr>
<td>Recycling</td>
<td>• Not applicable</td>
<td>• Gains and losses recognised in OCI recycled into net income upon realisation</td>
</tr>
<tr>
<td>Tainting</td>
<td>• No tainting</td>
<td>• No tainting</td>
</tr>
</tbody>
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Questions and Answers