Accounting Standards Board
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Conseil des normes comptables

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May 6, 2016

The Office of the Superintendent of Financial Institutions Canada
255 Albert Street
Ottawa, ON K1A 0H2

Dear Sirs:

Re: Draft Guideline – IFRS 9 Financial Instruments and Disclosures

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the Office of the Superintendent of Financial Institutions' Canada (OSFI) Draft Guideline on 'IFRS 9 Financial Instruments and Disclosure'.

The AcSB is Canada's national accounting standard-setting body, holding the legal authority to set accounting standards in Canada. Since 2011, the AcSB has operated under the strategy of endorsing and then importing IFRS into Canada for application by publicly accountable enterprises, other than pension plans. To date, our policy has been to adopt IFRS as issued by the IASB, without modification (with the exception of deferring for a period of time the initial adoption of IFRS by investment and rate-regulated entities). As of January 1, 2015, all such deferrals by the AcSB have ended. The AcSB consists of members from a variety of backgrounds, including financial statement users, preparers, auditors and academics. Additional information about the AcSB can be found at www.frascanada.ca

The AcSB appreciates the opportunity to comment on the Draft Guideline. We commend the OSFI for:

- revisiting its existing Guidelines, including D-10, as the result of the issuance of IFRS 9; and
- its commitment to comprehensively review its disclosure Guidelines for Insurers once the IASB finalizes their Insurance Contracts standard.

We emphasize that the primary purpose of GAAP financial statements is to provide investors and creditors with decision-useful information for investment and lending activities, rather than as a suitable basis for regulatory capital purposes. Therefore, whether adjustments to financial statements are necessary to assess regulatory capital is solely in the purview of the prudential regulator, in this case the OSFI, and remains outside of the GAAP framework.

From this perspective, we have the following concerns with the OSFI's Draft Guideline on the application of IFRS 9 *Financial Instruments* and its disclosures for Federally Regulated Entities (FREs).

Overall recommendation

We recommend that the OSFI reconsider selective removal of the guidance in D-10 *Accounting for Financial Instruments Designated at Fair Value option* for certain entities. Instead, we strongly urge the OSFI to eliminate the fair value guidance in Chapter 1 of the Draft Guideline in its entirety for all FREs because we think the guidance, as currently proposed:

- reduces global comparability in financial reporting by Canadian FREs with their peers in other jurisdictions and will reduce comparability between Canadian banks and life insurers within Canada if finalized as proposed;
- places Canadian financial institutions at a competitive disadvantage by limiting the options they have available to manage interest-rate risks and the use of practical expedients when compared to their peers; and
- is not necessary given:
    - IFRS 13, *Fair Value Measurement* provides guidance to measure assets and liabilities including loans and receivables at fair value; and
    - the availability of market-based fair value information on certain loans and receivables, including mortgages.

Global comparability in financial reporting

The value of financial information is dependent on its usefulness to users. The AcSB strongly supports global comparability in financial reporting and the development of standards that improve the quality of information reported by Canadian entities. We have fully articulated both of these views in our responses to the IFRS Trustees Request for Views - Review of Structure and Effectiveness and the IASB's Agenda Consultation, and in discussions with the FASB.

We are concerned that domestically significant Canadian banks will not report in a globally comparable manner with their peers as the result of the OSFI requiring them to adopt IFRS 9 early. These banks are required to adopt IFRS 9 for years beginning on November 1, 2017. They are also subject to quarterly reporting requirements and will file their first set of financial statements adopting IFRS 9 in February or March 2018. In comparison, we understand that IFRS 9 is effective for other global banks for annual periods beginning on or after January 1, 2018. Therefore, at a minimum, Canadian banks will issue their first financial statements adopting IFRS 9 two months in advance of other global banks (assuming quarterly reporting requirements) and potentially 8-months in advance (assuming semi-annual reporting requirements). We understand that other global banks typically have December 31 year-ends. Therefore, Canadian banks will make final judgments regarding the application of IFRS 9 in their Q1 2018 financial statements, while their global peers are immersed in year-end activities. As a result, Canadian banks will have less opportunity to compare their accounting policy choices and application of those policies to their international peers through industry or audit firm discussions.

Limitations to accounting options and to practical expedients

The IASB considered whether the requirements of IFRS 9 will meet the information needs of financial statement users when developing the new standard. Practical expedients in IFRS 9 were included in the standard because the IASB determined that they would not, if applied, diminish the usefulness of the financial information. We think that limiting accounting options available to FREs and the use of practical expedients will cause Canadian institutions to be a competitive disadvantage when compared to their peers.

Limitations to accounting options available

Canadian FREs consider the accounting consequences of risk management strategies when evaluating alternatives. These institutions expend considerable time and resources managing business risks, including interest-rate risk. We think that restricting the use of accounting options available under IFRS (including restricting the use of FVTPL):

- reduces the range of risk management alternatives available to Canadian FREs; and
- places Canadian FREs at a competitive disadvantage

when compared to their peers.

Restrictions to practical expedients

Restricting the use of the fair value option (Chapter 1 of the Guideline) and practical expedients, including the "without undue cost and effort" provisions of IFRS 9 (Chapter 2 of the Guideline), may hold Canadian FREs to a different standard when compared to those jurisdictions or entities (both domestically and internationally) not required to apply the Basel Committee (or Section 2.1) guidance.

We are aware that the OSFI participates in many discussions with its international peers. We encourage the OSFI to share with its constituents the dialogue that it has had with prudential regulators in other jurisdictions to ensure any restrictions placed on Canadian banks, related to the use of the fair value option and the practical expedients, are comparable to the restrictions placed on similarly-sized global banks in other jurisdictions. We also urge the OSFI to be transparent in communicating why, if applicable, Canadian FREs are subject to different regulatory requirements when compared to other jurisdictions. Overall, we think that this level of transparency will greatly support the acceptance of the Draft Guideline.

Reliability of fair value

The IASB permits the use of fair value:

- given its belief that fair value is the most relevant measure in many circumstances; and
- as the result of outreach with users that indicates their preference for use of fair value measurement.

In 2011, the IASB issued IFRS 13 *Fair Value Measurement* which provides a framework for measuring the fair value of assets and liabilities, including those that are not traded in an active market. In our view, IFRS 13 has enhanced the consistency and quality of the measurement of fair value. Increases and decreases in fair values reflect changes in economic circumstances and can result in volatility in profit or loss. Such volatility does not necessarily mean that the fair value of investments in loans cannot be estimated reliably. IFRS 13 uses the fair value hierarchy to increase consistency in fair value measurements and related disclosures. The fair value hierarchy gives highest priority to using observable inputs or prices quoted in an active market.

Many FREs use observable inputs to reliably measure the fair value of loans, including mortgages. Mortgages in Canada trade through established and liquid markets and channels, including through ongoing programs sponsored by entities such as the Canada Mortgage and Housing Corporation.

Furthermore, we think that it is contradictory that Canadian FREs are restricted from electing to measure low risk mortgages with observable information at fair value yet are required to measure other, more risky instruments (including derivatives), at fair value. Therefore, we recommend that the OSFI:

- consult with its auditor advisory group to review the various programs used to trade mortgages; and
- reconsider the thresholds established in Section IV and simply require that an entity's accounting policy choice, with regard to the use of fair value, result in information that is reliable and relevant for financial statement users.

We have included specific comments on the Draft Guideline in the Appendix to this letter. We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Rebecca Villmann, Director, Accounting Standards (+1 416 204-3464 or email rvillmann@cpacanada.ca) or Andrew White, Principal, Accounting Standards (+1 416 204-3487 or email awhite@cpacanada.ca).

We appreciate the opportunity to provide the OSFI input on the Draft Guidance as by working together we can better support the enhanced functioning of the Canadian financial system.

Yours truly,

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APPENDIX

Overall Views

The views expressed under this heading are pervasive in nature and impact more than one Section of the Draft Guideline.

Use of the fair value option by life insurers

1. We encourage the OSFI to amend the Draft Guideline to permit all FREs to apply the fair value option to measure all loans and receivables, including mortgages for entities with sales revenue of $62.5 million or less, in accordance with IFRS 9. We think that having different requirements for banks and life insurers will reduce comparability in financial reporting between these groups (both domestically and internationally) and cause Canadian banks to be at a competitive disadvantage compared to life insurers as well as to their global peers. Furthermore, we think that the draft guidance as proposed will not accomplish the OSFI's objectives with regard to life insurers.

2. We have conducted substantial outreach with Canadian insurers in connection with the IASB's *Insurance Contracts* project. Our understanding is that given the nature of Canadian insurance contracts that insurers expect to classify investments in loans at Fair Value through Profit or Loss (FVTPL) when they adopt the forthcoming new insurance contracts standard. We understand that the OSFI is proposing to exempt life insurers from the scope of Chapter 1 "for their investments in loans if these investments are classified as Fair Value through Comprehensive Income under IFRS 9." Based on this narrow scope, investments in loans accounted for at amortized cost would not be exempted. Investment in loans will generally support insurance contract liabilities. There will be situations when the business model for assets supporting insurance contract liabilities are held to collect the underlying cash flows, leading to loans being classified as amortized cost. Therefore, the only way to avoid an accounting mismatch for these assets carried at amortized cost would be to elect the fair value option. As such, we are concerned that the scope exemption for life insurers in Section I (and later in Section IV) will limit their ability to classify loans at FVTPL so that these entities can appropriately eliminate the accounting mismatch that is created as the result of using current information to measure insurance contracts consistent with paragraph B4.1.30(a) of IFRS 9. Therefore, we encourage OSFI to amend the scope exemptions in Section I and IV for life insurers to include all investments in loans.

Expansion of IFRS requirements

3. In our experience, Canadians apply accounting guidance literally. Therefore, we caution the OSFI to consider the effect of certain descriptions used in the Draft Guideline. Descriptions such as "thorough analysis, clearly evidencing and all information" may expand the required application of IFRS 9 beyond that set by the IASB and the AcSB. Therefore, we encourage the OSFI to consider whether they intended to expand the required application of IFRS 9, and if yes, to explain their reasoning to their stakeholders.

Use of permissive and restrictive language

4. In addition we encourage the OSFI to review the language used in the document to ensure its appropriateness. For example, paragraph 22 of Section 2.1 states the following:

   "The fundamental concepts described below provide guidance on how banks should utilize common elements of the credit risk management process to allow for high-quality and robust assessments and measurement of ECL."

5. The term "allow" is permissive in nature. We recommend using "ensure" in this context of this discussion.

Use of extracts from IFRS

6. In our experience, the use of extracts from IFRS can make guidance more confusing, particularly for smaller entities, as readers lose the context of the underlying discussion of that extract. There are several additional risks in using extracted IFRS in the Guideline, including:

   (a) IFRS is subject to regular updates and editorial changes. The OSFI will need to allocate resources to monitor the activities of the IASB to ensure that any changes to IFRS are appropriately reflected in the Guideline.
   (b) There is a risk that IFRS information will not be duplicated consistently into the Guideline. We identified the following extract in Chapter 1, Section III of the Guideline that does not agree with IFRS 9.4.2.2(b):

   > "For IFRS 9.4.2.2(b), institutions may apply the Fair Value Option under this criterion if: (a) the institution has a documented risk management strategy".

   IFRS 9.4.2.2(b) refers to "a documented risk management or **investment strategy**". It is not clear to us whether the above difference between the Guideline and IFRS 9 is intentional.

7. We suggest the OSFI reconsider its approach to including IFRS 9 extracts in the Guideline. Alternatively, we encourage the OSFI to ensure that the information is extracted from IFRS is reviewed for completeness and accuracy and appropriately cross-referenced when necessary.

Section Specific Views:

Accounting standards in Canada

8. Broadly speaking, it is our understanding that most Canadian legal requirements refer to Canadian GAAP, and accordingly the AcSB has the responsibility to consider incorporating all IFRS into Part I of the CPA Canada Handbook – Accounting. The Handbook includes only those IFRS that have been approved by the AcSB after carrying out our endorsement process. Thus, entities preparing their financial statements in accordance with Canadian GAAP are not permitted to apply new or amended IFRS before they are

incorporated into the Handbook. Therefore, we strongly encourage the OSFI to amend the following sentence in the Introduction to the Draft Guideline to also refer to Canadian GAAP as set out in CPA Canada Handbook – Accounting:

"… financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IASB")."

Chapter 2

Section 2.1

Paragraph 8

9. Paragraph 8 of the Draft Guideline is unclear as to how Basel's capital framework expected loss calculation differs from the accounting expected credit loss model. It is our understanding that models differ in the timing and amount of the recognition of the provision. We suggest that the OSFI amend the Draft Guideline to:

   (a) more clearly illustrate how the models differ; and

   (b) clarify that through the application of Basel framework it expects or intends FREs to be able to fully comply with IFRS.

Paragraph 145

10. We disagree with the statement that the use of past trends would introduce bias into the implementation of the expected credit loss model. We think that FREs use past trends in conjunction with their judgments about the future. Overall, reliance on backward-looking information will affect the implementation of an expected credit loss model but not necessarily bias the result. Therefore, we suggest that paragraph 145 be amended to reflect that FREs should use an appropriate balance, based on the facts and circumstances, between backward-looking information in conjunction with their judgments about the future.

Section 2.2

Paragraph 4

11. The requirements in Section 2.2 appear, given the nature of the entities included in its scope, to be less restrictive than Section 2.1. In particular, we note that paragraph 4 of Section 2.2 does not appear to preclude the consideration of undue cost and effort (referring to material lending exposures). If an entity is in the scope of this section and is a branch of a foreign bank, it would be interesting to understand whether the practical expedients are available to the larger foreign bank in their jurisdiction. If yes, we think that this would create a competitive disadvantage for Canadian FREs in the scope of Section 2.1.

Chapter 3

12. The IASB is currently working on its disclosure initiative which includes several projects. To date, they have issued a Practice Statement on Materiality and we expect them to issue a Discussion Paper on the Principles of Disclosure later this year. Globally, there is a focus on improving the usefulness and relevance of information disclosed in financial statement. Therefore, we encourage the OSFI to:

    (a) monitor the developments in these projects and consider their prudential disclosure requirements beyond IFRS 9 in light of these activities; and

    (b) exercise caution in requiring additional prudential disclosure requirements.