IFRS 9

Ahmed Ragab Desouky

CA, CPA, MBA, ESAA

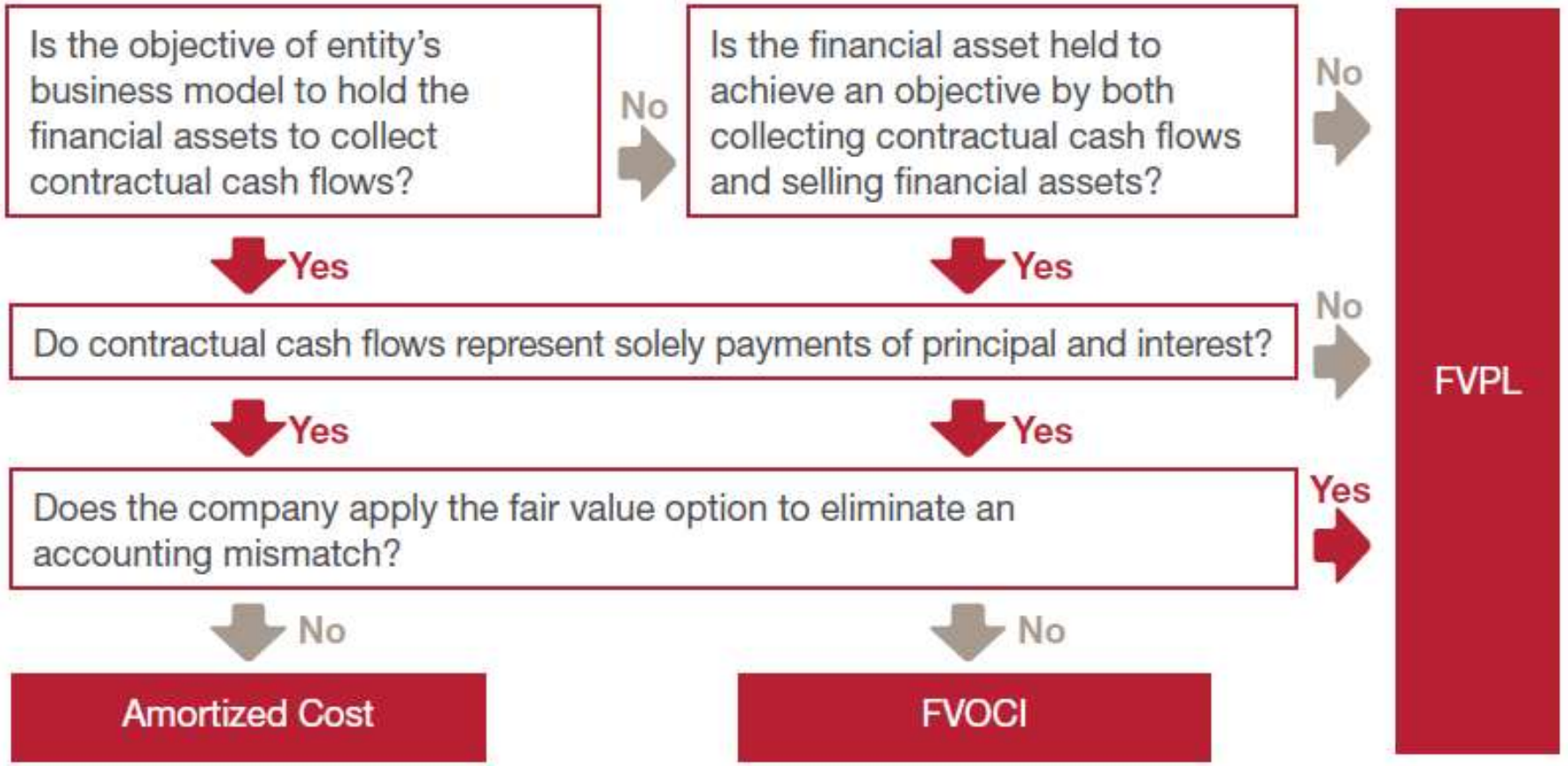
Main changes from IAS 39

- Reduces complexity
  - only two classification categories
  - single impairment model (only FI's at amortised cost)
  - embedded derivatives no longer separated from financial asset host contracts
- Aligns measurement of financial assets with entity's **'business model'** and **contractual cash flow characteristics** of instruments
- **'Own credit'** risk issue addressed
- Elimination of **'tainting rules'**
  - that caused bonds to be measured at fair value even if the business model was to hold

IFRS 9 vs IAS 39

IFRS 9	IAS 39	
Classifications and measurement models	**Classifications**	**Measurement model**
Amortized Cost	Loans and receivables	Amortized Cost
FVPL	FVPL	FVPL
FVOCI	Available for sale	FVOCI
	Held to maturity	Amortized Cost

Decision tree



IFRS 9 vs IAS 39

Fair value designation options under IFRS 9

		Option available?	
Option	**Condition for applying**	**IFRS 9**	**IAS 39**
FVPL	Eliminates or significantly reduces a measurement or recognition inconsistency, sometimes known as an 'accounting mismatch', that otherwise would arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases.	Yes	Yes
FVPL	A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management strategy, and information about the group is provided internally on that basis to key management personnel.	No	Yes
FVPL	Contract contains one or more embedded derivatives not closely related to the economic risks and characteristics of the host contract.	No	Yes
FVOCI	Any asset that otherwise would qualify for measurement at Amortized Cost.	No	Yes

Main categories

Loans and receivables "Basic" loans and receivables where the objective of the entity's business model for realizing these assets is either: • Collecting contractual cash flows; or • Both collecting contractual cash flows and selling these assets All other loans and receivables.	Amortized Cost FVOCI FVPL
Mandatorily redeemable preferred shares and "puttable" instruments (e.g., investments in mutual fund units)	FVPL
Freestanding derivative financial assets (e.g., purchased options, forwards and swaps with a positive fair value at the balance sheet date)	FVPL
Investments in equity instruments Entity irrevocably elects at initial recognition to recognize only dividend income on a qualifying investment in profit and loss, with no recycling of changes in fair value accumulated in equity through OCI. Other	FVOCI FVPL

IAS 32 – Presentation of liabilities and equity

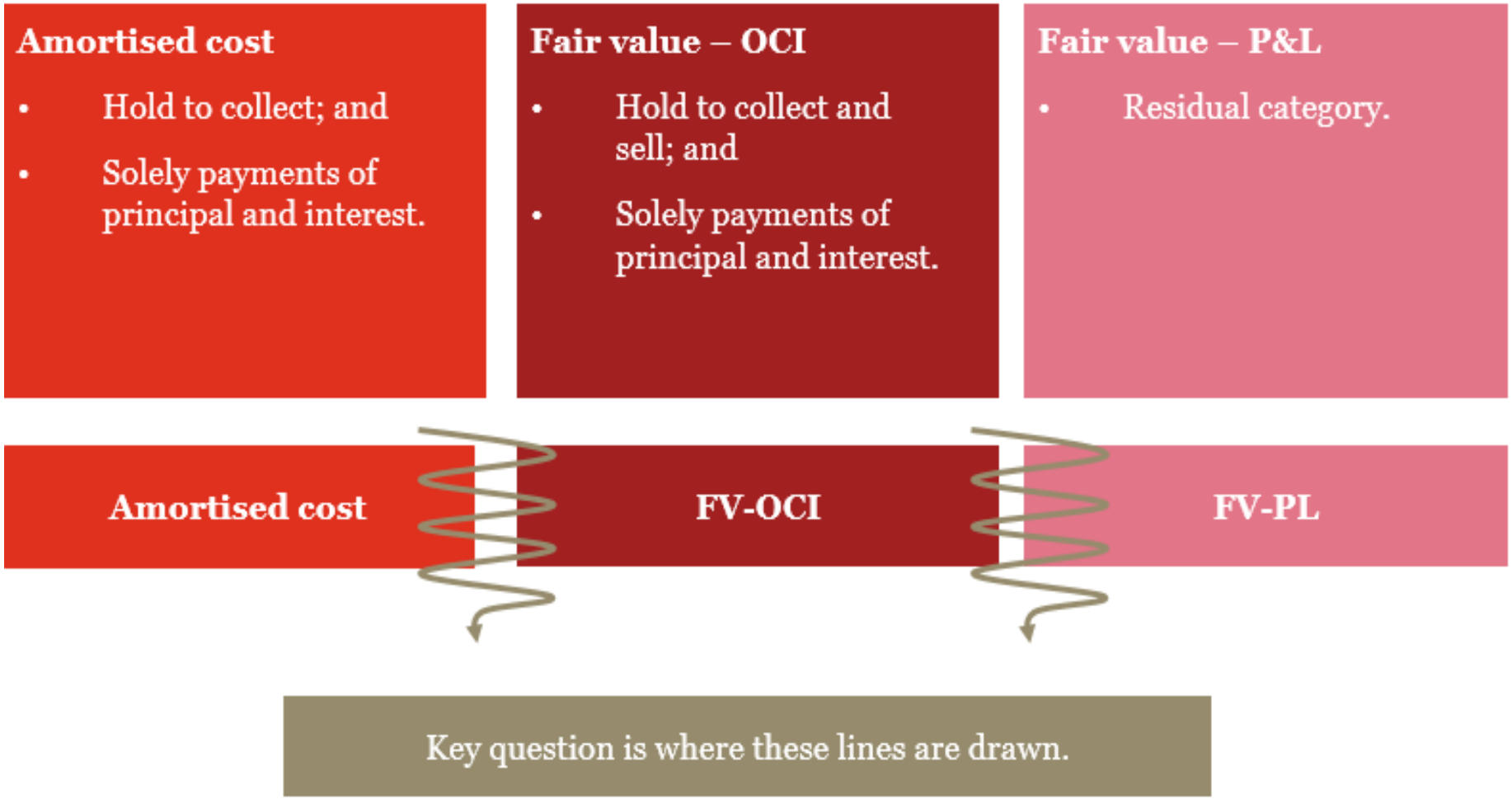
- Financial instruments (or their component parts) must be classified as liabilities or equity in accordance with their substance
  - preference shares could be classified as liabilities
- Payments to the providers of capital must be classified as interest or dividends accordingly
  - dividends on preference shares that are classified as liability will be recognised as expense

Liability or equity?

- A financial liability is:
  - any liability that is a contractual obligation:
    - to deliver cash or another financial asset to another entity; or
    - to exchange financial instruments with another entity under conditions that are potentially unfavourable
- Definition is applied based on substance
  - If the issuer has an option to redeem and in practice will be economically compelled to do so - liability

Classification and measurement of financial assets- Debt instruments

Three main Debt instrument categories:



Example

- Rosenberg records in the following financial assets as at December 2016:
  1) A loan of $200,000 to Financialinx. As per agreement, Financialinx pays interest of 6% annually, starting from 31 December 2017.
  2) 400,000 shares in HDC. Rosenberg acquired these shares on 1 December with the intention to sell them before Q1 2017.
  3) $300,000 7% bonds. Bonds mature on 31 December 20X8 and the company intends to hold these bonds till maturity.
- An option derivative contract entered on 31 January 2015.

10 **How the above investments should be classified and**

Answer

1) For the loan there are fixed repayments with only SPPI Accordingly it is measured at amortised cost
2) Shares are equity instrument that are held for a short term and in absence of contrary it should be classified as FVPL.
3) The bonds pay interest at a fixed rate with a fixed maturity. The company intends to hold them till maturity; accordingly these bonds can be measured at amortised cost.
4) Option contract is a derivative and therefore it must be classified as 'fair value through profit or loss'.

Please refer to the FS example for more details

Question

- Diamond invested in a company with an initial cost of $50 million with related associated transaction costs of $2 million. The asset was designated upon initial recognition as FVOCI. At the reporting date the fair value of the financial asset increased up to $65 million. Right after year end the financial asset was sold for $75 million.

How should this be classified and accounted for and how would the answer if the investment had been classified as FVPL?

Answer

- Upon initial acquisition the investment is recorded at the consideration paid including, as the asset is classified as FVOCI, the associated transaction costs:

Dr.	Investment	52	
Cr.	Cash		52

- At the reporting date the asset is re-assessed and the gain is recognized in OCI.

Answer

Dr.	Investment	13	
	Cr. OCI		13

- Upon selling the gain or loss on disposal is calculated by comparing disposal proceeds and carrying value, with the result taken to profit or loss.

Dr.	Cash	75	
	Cr. Investment		65
	Cr. Gain on sale		10

Answer

- Note that the any gains or losses previously taken to equity are not to be recycled but can be washed out (re-itemized) within Equity.

2) If Diamond had designated the investment as FVPL, the transaction costs would be charged to P&L and the JE should be as follow:

Dr.	Investment	50	
	Cr. Cash		50
Dr.	Transaction costs (P&L)	2	
	Cr. Cash		2

Answer

- Reassessing FV- at FVPL:

Dr.	Investment	15	
	Cr. Gain		15

- Upon selling the asset is the gain is taken to P&L

Dr.	Cash	75	
	Cr. Investment		65
	Cr. Realized gain		10

Answer

- The gain of $10 million will be recorded in P&L despite the fact the asset has been classified as FVOCI or FVPL.

- It should be noted that FVOCI treatment differs between Equity and Debt being recycled or not to be recycled.

Example of categories disclosure

24. Investment securities[a]

See accounting policy on Note 45(O).

	In millions of euro	2015	2014
IFRS 7R.8(a)(ii)	Investment securities mandatorily measured at FVTPL	**1,457**	
IFRS 7R.8(a)(i), 7.8(a)(i)	Investment securities designated as at FVTPL	**3,045**	3,239
IFRS 7R.8(f)	Investment securities measured at amortised cost	**410**	
IFRS 7R.8(h)(i)	Investment securities measured at FVOCI – debt instruments	**1,363**	
IFRS 7R.8(h)(ii)	Investment securities designated as at FVOCI – equity investments	**27**	
IFRS 7.8(b)	Held-to-maturity investment securities		101
IFRS 7.8(d)	Available-for-sale investment securities		1,929
		6,302	5,269

Presentation of FI categories

Investment securities measured at amortised cost

In millions of euro	2015
Government bonds	310
Corporate bonds	100
Debt securities	410

Debt investment securities measured at FVOCI

In millions of euro	*Note*	2015
Government bonds		514
Corporate bonds		551
Asset-backed securities		200
Retained interests in securitisations	*37*	98
Debt securities		1,363

Equity investment securities designated as at FVOCI

At 1 January 2015, the Group designated certain investments shown in the following table as equity securities as at FVOCI. In 2014, these investments were classified as available-for-sale and measured at cost. The FVOCI designation was made because the investments are expected to be held for the long-term for strategic purposes.

In thousands of euro	Fair value at 31 March 2015	Dividend income recognised 2015
Investment in XY Trust Company	15	1
Investment in AB Securities	12	1
	27	2

None of these strategic investments was disposed of during 2015, and there were no transfers of any cumulative gain or loss within equity relating to these investments.

Classification and measurement of financial assets- Equity-FVOCI

- Presentation of FV changes in OCI (like AFS under IAS 39 with some changes)
- Available for all equity instruments that are **not** held for trading
- Free choice for each holding of an instrument at initial recognition **Irrevocable** for that holding (no reclassification)
- Dividends will be recognized in profit or loss.
- **No recycling** of fair value changes to profit or loss on impairment, disposal or in any other circumstances.
- No impairment testing required
- Additional disclosures

Classification and measurement of financial assets- Debt-FVOCI

- Interest income should be recognized in profit or loss using the effective interest method that is applied to financial assets measured at amortised cost
- **Credit impairment losses/reversals** will be recognized in profit or loss using the same credit impairment methodology as for assets measured at amortised cost
- Net cumulative fair value gain or loss recognized in OCI should be recycled from OCI to profit or loss when these financial assets are derecognised
- Changes in fair value for reasons **other than credit** (e.g., a liquidity discount) will **not be recorded in profit or loss until derecognition**

Recycled vs Non recycled concept

Other comprehensive income			
Items that will not be reclassified to profit or loss			
Remeasurements of defined benefit liability (asset)		**7**	9
Movement in fair value reserve (equity instruments):			
Net change in fair value		**2**	
Movement in liability credit reserve	*30*	**3**	
Related tax		**(4)**	(3)
		8	6
Items that are or may be reclassified subsequently to profit or loss			
Movement in translation reserve:			
Foreign currency translation differences for foreign operations		**(45)**	17
Net gain (loss) on hedges of net investments in foreign operations		**30**	(15)
Movement in hedging reserve:			
Effective portion of changes in fair value		**(25)**	(21)
Net amount transferred to profit or loss		**15**	12
Movement in fair value reserve (debt instruments):			
Net change in fair value		**(166)**	
Net amount transferred to profit or loss		**129**	
Movement in fair value reserve (available-for-sale financial assets):			
Net change in fair value			(160)
Net amount transferred to profit or loss			125
Related tax		**16**	15
		(46)	(27)
Other comprehensive income, net of tax		**(38)**	(21)
Total comprehensive income		**599**	533

Initial Measurement

- At initial recognition, all financial assets are measured **at fair value.**

- **Fair value** should include transaction costs included in all assets other than those categorised at fair value through proift or loss.

Financial Asset at amortized cost

Category	Impact on financial statements
Amortized Cost	The asset is measured at the amount recognized at initial recognition minus principal repayments, plus or minus the cumulative amortization of any difference between that initial amount and the maturity amount, and any loss allowance. Interest income is calculated using the effective interest method and is recognized in profit and loss. Changes in fair value are recognized in profit and loss when the asset is derecognized or reclassified.

Financial Asset at Fair Value

FVOCI	The asset is measured at fair value. **Loans and receivables.** Interest revenue, impairment gains and losses, and a portion of foreign exchange gains and losses, are recognized in profit and loss on the same basis as for Amortized Cost assets. Changes in fair value are recognized initially in Other Comprehensive Income (OCI). When the asset is derecognized or reclassified, changes in fair value previously recognized in OCI and accumulated in equity are reclassified to profit and loss on a basis that always results in an asset measured at FVOCI having the same effect on profit and loss as if it were measured at Amortized Cost. **Investments in equity instruments.** Dividends are recognized when the entity's right to receive payment is established, it is probable the economic benefits will flow to the entity and the amount can be measured reliably. Dividends are recognized in profit and loss unless they clearly represent recovery of a part of the cost of the investment, in which case they are included in OCI. Changes in fair value are recognized in OCI and are never recycled to profit and loss, even if the asset is sold or impaired.
FVPL	The asset is measured at fair value. Changes in fair value are recognized in profit and loss as they arise.

Accounting for assets reclassification

From	To	Requirement
Amortized Cost	FVPL	Measure fair value at reclassification date and recognize difference between fair value and Amortized Cost in profit and loss
FVPL	Amortized Cost	Fair value at the reclassification date becomes the new gross carrying amount
Amortized Cost	FVOCI	Measure fair value at reclassification date and recognize any difference in OCI
FVOCI	Amortized Cost	Cumulative gain or loss previously recognized in OCI is removed from equity and applied against the fair value of the financial asset at the reclassification date
FVPL	FVOCI	Asset continues to be measured at fair value but subsequent gains and losses are recognized in OCI rather than profit and loss
FVOCI	FVPL	Asset continues to be recognized at fair value and the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit and loss

Business Model Assessment

- Based on the **overall business, not** instrument-by-instrument.
- Focus on whether financial assets are held to collect contractual cash flows:
  - How the entity is run
  - The objective of the business model as determined by key management.
- The business model is:
  - classification to be determined at the portfolio level
  - **It is a matter of fact and not management intent**
- Financial assets **do not** have to be held to **contractual maturity** in order to be deemed to be

Business Model Assessment (Cont.)

- Examples of sales **that will not violate** hold to collect business model:
  - Sales due to deterioration in credit quality in line with a documented investment policy
  - **Infrequent** sales (e.g., unanticipated stress scenarios), even if significant
  - Insignificant sales, both individually and in aggregate, **even if frequent**
  - Sales made close to the maturity and the proceeds approximate the collection of the remaining cash flows

Application of Business Model

Illustrating the application of the Business Model and SPPI tests

Amortized Cost or FVOCI possible	FVPL mandatory
Bank deposits repayable on demand, where interest, if payable, is at a fixed or floating market rate	Investments in common shares where the holder does not designate the asset as FVOCI
Trade receivables requiring payment only of fixed amounts on fixed dates	Investments in mandatorily redeemable preferred shares and puttable instruments (or instruments issued by entities having a limited life) such as mutual fund units where non-payment of dividends is not a breach of contract or the holder has no claim for a fixed amount in bankruptcy
Full recourse loans or investments in debt securities that require only fixed payments on fixed dates	Self-standing derivative financial assets such as purchased options, swaps and forward contracts

Application of Business Model (Cont.)

Full recourse floating rate loans requiring fixed payments on fixed dates of principal and bearing interest at a floating market rate (such as the BA rate) where the interest rate is for a period that is the same as the interest rate reset period (e.g., the interest rate is reset every three months based on the 3 month BA rate)	Floating rate loans where the interest rate is for a period that does not correspond to the interest reset period (e.g., interest is reset every 3 months based on the 6 month BA rate) and the impact on cash flows is significant
Non-recourse loans (i.e., those where recourse is limited to specific assets) where at initial recognition the lender has an economic exposure to the underlying asset's value and cash flows that is consistent with a basic lending arrangement	Non-recourse loans where at initial recognition the lender has an economic exposure to the underlying asset's value and cash flows greater than that of a basic lender
Trade receivables, loans and investments in debt securities, having the attributes described above but that can be prepaid, subject to meeting certain criteria	Fixed or floating rate loans including terms where payments are based on factors such as equity or commodity prices, unless the terms are not genuine or their effect is de minimis

Contractual Cash Flows (SPPI)

- **Interest** is consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of

IFRS 9 defines principal as the fair value of a financial asset at initial recognition, which may change over the life of a financial instrument (for example, if there are repayments of principal). Interest is the consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks (e.g., liquidity risks) and costs (e.g., administrative costs), as well as a profit margin.

Liabilities

- Liabilities are valued at amortised cost unless they are held for trading, in which case they are FVTPL.
- IFRS 9 permits entities to opt to designate liabilities which would normally fall to be measured at amortised cost, to be designated at fair value through profit or loss (Fair value Option (FVO)).
- This designation, if made, must be made upon initial recognition and is **irrevocable.**

Entity's own risk (OCI vs P&L)

- The fair value of an entity's own debt is affected by changes in the entity's own credit risk (own credit).
- As an example the credit rating went down from AAA to AA.
- As a result the value of the debt instrument from investors point of view declined, that when an entity's credit quality **declines** the value of its liabilities **fall**, and if those liabilities are measured at fair value **a gain is recognized !!!** in profit or loss (and vice versa).
- To address the **so-called own credit issue**, IFRS 9 requires changes in the fair value of an entity's own credit risk **to be recognized in other comprehensive**

Objective of the IFRS 9 impairment model

The objective of the IFRS 9 impairment model is to recognise expected credit losses for all financial instruments within the scope of the requirements. Expected credit losses are defined as the expected shortfall in contractual cash flows. An entity should estimate expected credit losses considering past events, current conditions and reasonable and supportable forecasts.

The IASB believes that this will provide users of financial statements with **more useful and timely information.**

Key Definitions

The following definitions are important in understanding this section, and you should refer back to them when studying this material.

Credit loss. The expected shortfall in contractual cash flows. *(IFRS 9)*

Expected credit losses. The weighted average of credit losses with the respective risks of a default

occurring as the weights. *(IFRS 9)*

Lifetime expected credit losses. The expected credit losses that result from all possible default events over the expected life of a financial instrument. *(IFRS 9)*

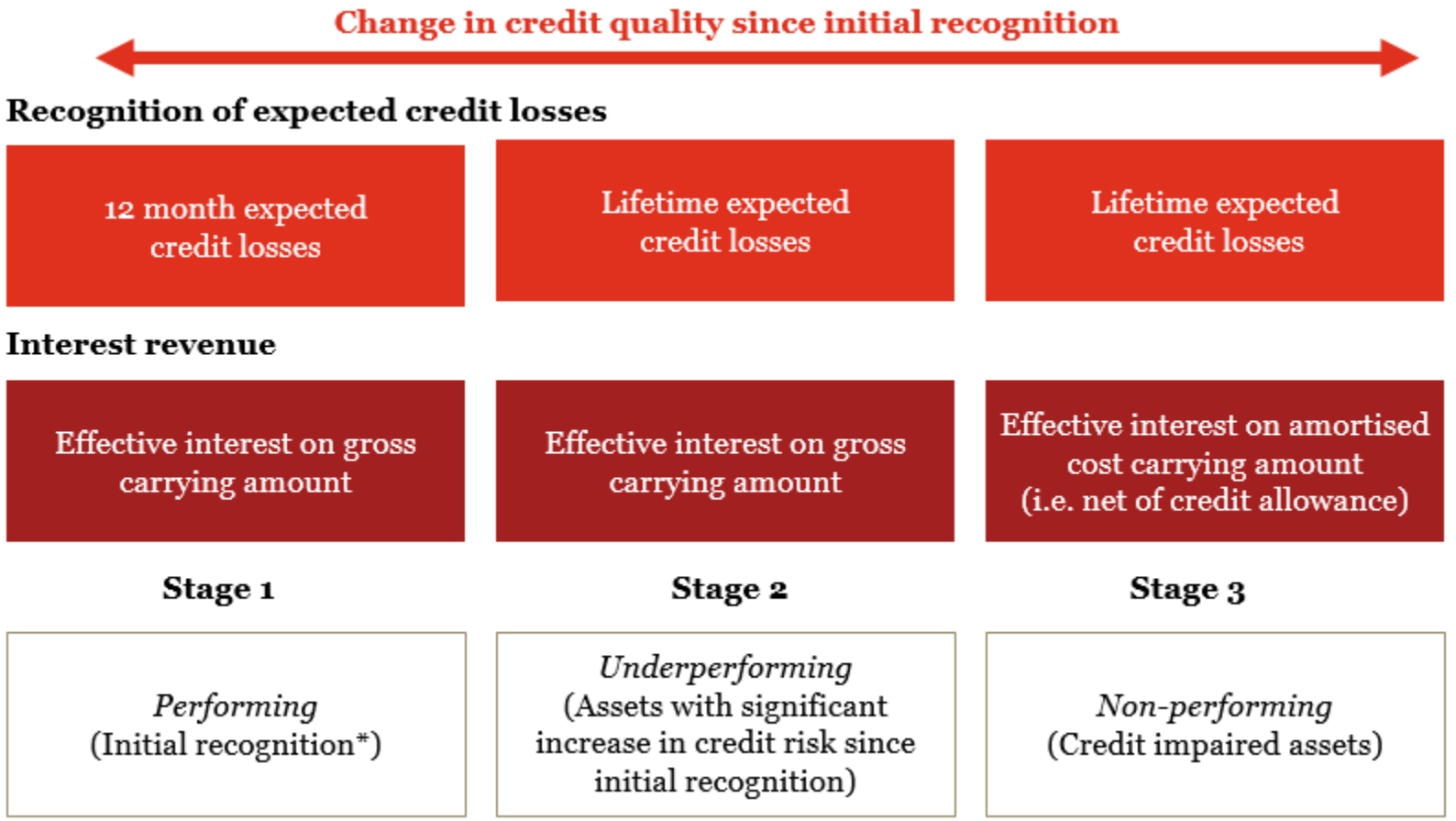
Past due. A financial asset is past due when a counterparty has failed to make a payment when that

payment was contractually due. *(IFRS 9)*

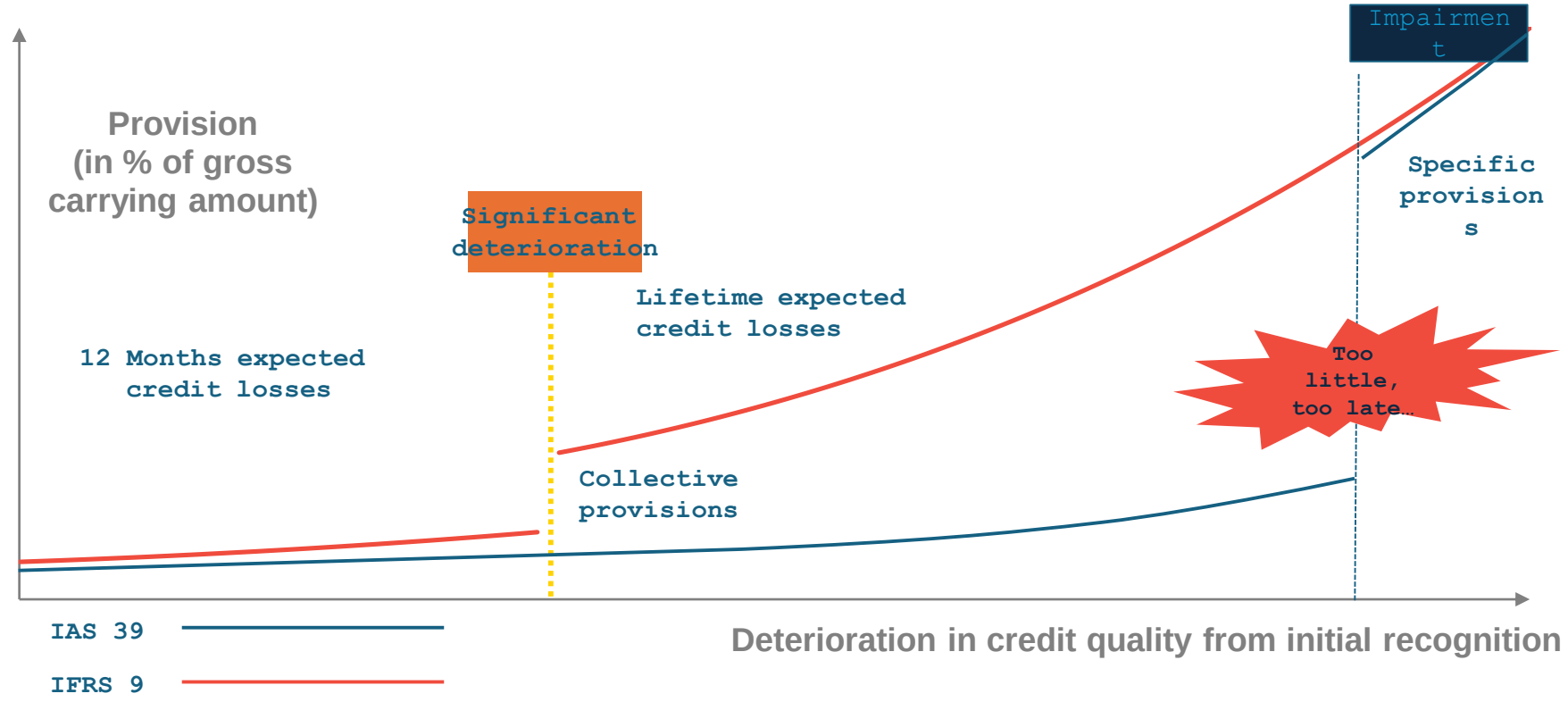
Purchased or originated credit-impaired financial asset. Purchased or originated financial asset(s) that are credit impaired on

IFRS 9 Expected credit loss model

- General model:



ECL VS incurred



ECL

Expected credit losses

Financial assets

ECL represent a probability-weighted estimate of the difference over the remaining life of the financial instrument, between:

Present value of cash flows according to contract	≠	Present value of cash flows the entity expects to receive

Undrawn loan commitments

ECL represent a probability-weighted estimate of the difference over the remaining life of the financial instrument, between:

Present value of cash flows if holder draws down	≠	Present value of cash flows the entity expects to receive if drawn down

ECL different approaches

	General approach	Simplified approach	Credit adjusted approach
Applies to	All other loans and receivables not covered by another approach	Qualifying trade receivables, IFRS 15 contract assets and lease receivables	Assets that are credit impaired at initial recognition – see page 34
Timing of initial recognition	Same period as asset is acquired	Same as general approach	Cumulative change in Lifetime ECLs since initial recognition
Measurement basis of the loss allowance	12 month ECLs (or Lifetime ECLs if the term of the asset is shorter) unless a significant increase in credit risk occurs, then Lifetime ECLs unless the increase reverses	Lifetime ECLs	

ECL General Model

12-month expected credit losses	Are a *portion* of the lifetime *expected credit losses* and represent the amount of *expected credit losses* that result from default events that are possible within 12 months after the reporting date.
Lifetime expected credit losses	The *expected credit losses* that result from all possible default events over the life of the financial instrument.
Credit loss	The difference between all principal and interest cash flows that are due to an entity in accordance with the contract and all the cash flows the entity expects to receive discounted at the original EIR.
Expected credit losses	The weighted average of credit losses.

Inputs into ECL

Inputs, assumptions and techniques used for estimating impairment (continued)

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- probability of default (PD);
- loss given default (LGD);
- exposure at default (EAD).

Illustrative example: PD approach

12-month ECL allowance	**PD x LGD x EAD** 0.15% x 25% x $1 m = $375 ▸ Loan originated at $1 million, i.e., exposure at default (EAD) ▸ 25% gross carrying amount irrecoverable if loan defaults, i.e., loss given default (LGD) ▸ 0.15% probability of a default (PD) in next 12 months
Challenges	▸ Correlating PD and LGD ▸ Relying on rating agencies' data ▸ Individual vs collective assessment

Illustrative example: provision matrix

Lifetime ECL allowance

Days past due (DPD)	0–30	31–90	Over 90
Carrying amount	$800,000	$200,000	$50,000
Lifetime ECL rate	1%	5%	10%
Lifetime ECL	$8,000	$10,000	5,000

- Portfolio of trade receivables categorised by common risk

Challenges

- Adjusting historical loss rates with forward-looking estimates

Measurement of ECLs

IFRS 9 also defines expected credit losses as "the weighted average of credit losses with the respective risks of a default occurring as the weights".

IFRS 9 does not prescribe a particular method of measuring expected credit losses.

The Standard instead acknowledges that measurement might vary based on the type of instrument in concern and the information that is available.

It does however require that any method that an entity uses to measure credit losses should take into account the following:

- The period over which to estimate ECLs
- Probability-weighted outcomes
- Time value of money
- Reasonable and supportable information

Example

Orange Co advanced a three-year interest bearing loan of $2m to Lemon Co on 1 July 20X4. At that date management estimates the risk of default in the next 12 months as 2% and the risk of default over the remaining term of the loan as 5.5%. The loss that would result from the default was estimated at $800,000.

What is the amount of the credit loss provision that Orange Co should record on initial recognition?

Solution

The credit loss provision on initial recognition is based on the 12-month expected losses. A provision of $16,000 (2% × $800,000) should be recognised.

Example continued

Orange Co has a reporting date of 31 December. By 31 December 20X4 management estimates that the risk of default in the next 12 months is 3.5% and in the remaining term of the loan is 10.5%. The loss that would result from the default was estimated at $750,000.

What is the amount of the credit loss provision that should be included in the statements of financial position as at 31 December 20X4?

Solution

Since the total risk of default has increased from 7.5% on initial recognition to 14% by 31/12/X4, this would seem to be a significant increase in credit risk. The credit loss provision must therefore be

Example continued

By 31 December 20X5 management estimates that the risk of default in the next 12 months is 1.5% and in the remaining term of the loan is 1%. The loss that would result from the default was estimated at $450,000.

What is the amount of the credit loss provision that should be included in the statements of financial position as at 31 December 20X5?

Solution

Since the total risk of default has decreased from 14% on initial recognition to 2.5% by 31/12/X5, this would seem to be a significant improvement in credit quality. The 12-month expected credit loss basis is now reinstated, and a credit loss provision of $6,750 (1.5% * $450,000) should be included

Measuring expected credit losses

Credit losses are the present value of all cash shortfalls. Expected credit losses are an estimate of credit losses over the life of the financial instrument. An entity should consider the following when measuring expected credit losses.

(a) The **probability-weighted outcome**. Expected credit losses should not be a best or worst-case scenario, but should reflect the possibility that a credit loss will occur, and the possibility that it will not.

(b) The **time value of money**: they should be discounted at the reporting date.

(c) **Reasonable and supportable information** that is available without undue cost or effort, including information about past events, current conditions and forecasts of future conditions. A 'crystal ball' is not required.

Example: portfolio of mortgages and personal loans

Credito Bank operates in South Zone, a region in which clothing manufacture is a significant industry. The bank provides personal loans and mortgages in the region. The average loan to value ratio for all its mortgage loans is 75%.

All loan applicants are required to provide information regarding the industry in which they are employed.

If the application is for a mortgage, the customer must provide the postcode of the property which is to serve as collateral for the mortgage loan.

Credito Bank applies the expected credit loss impairment model in IFRS 9 *Financial instruments*. The bank tracks the probability of customer default by reference to overdue status records. In addition, it is required to consider forward-looking information as far as that information is available.

Credito Bank has become aware that a number of clothing manufacturers are losing revenue and profits as a result of competition from abroad, and that several are expected to close.

Required

How should Credito Bank apply IFRS 9 to its portfolio of mortgages in the light of the changing situation in the clothing industry?

Solution

Credito Bank should segment the mortgage portfolio to identify borrowers who are employed by suppliers and service providers to the clothing manufacturers. This segment of the portfolio may be regarded as being 'in Stage 2', that is having a significant increase in credit risk. Lifetime credit losses must be recognised.

In estimating lifetime credit losses for the mortgage loans portfolio, Credito Bank will take into account amounts that will be recovered from the sale of the property used as collateral. This may mean that the

lifetime credit losses on the mortgages are very small even though the loans are in Stage 2.

Defining and measuring 12-month and lifetime ECL

- **Lifetime ECL** = present value of all cash shortfalls over remaining life of financial instrument
- **12-month ECL** = a portion of lifetime ECL associated with probability of a default occurring in next 12 months after reporting date

- **Any definition of *default* *must be consistent* with *credit risk management* practices**
- ***Qualitative* indicators of default should be considered**
- **Rebuttable presumption that default does *not occur later than 90 days past due* unless reasonable and supportable information indicate otherwise**

a) **12-month ECL are a *portion* of the lifetime ECL**
b) **12-month ECL are *neither* the lifetime ECL that an entity will incur on financial instruments that it predicts will default in the next 12 months, nor the cash shortfalls that are predicted over the next 12 months**

Measuring ECL

Unbiased and probability-weighted estimate

Best available information

Information about past events	+	Information about current conditions	+	Reasonable and supportable forecasts

The time value of money

ECL must be discounted at the *effective interest rate (EIR)* *or an approximation* thereof.

ECL should reflect *management's expectations* of credit losses and management should consider *observable market information* about credit risk.

- **The measurement of ECL should incorporate the *best available information***
- ***Regulatory* ECL models may form a basis for ECL calculations, but the measurement may need to be adjusted**

Movement in loss allowance

Loss allowance (continued)

In millions of euro	2015 12-month ECL	Lifetime ECL not credit-impaired	Lifetime ECL credit-impaired	Purchased credit-impaired	Total
Loans and advances to customers at amortised cost – retail customers*					
Balance at 1 January	**249**	**380**	**410**	**-**	**1,039**
Transfer to 12-month ECL	**35**	**(32)**	**(3)**	**-**	**-**
Transfer to lifetime ECL not credit-impaired	**(70)**	**85**	**(15)**	**-**	**-**
Transfer to lifetime ECL credit-impaired	**(15)**	**(75)**	**90**	**-**	**-**

Movement in loss allowance Cont'd

Loss allowance (continued)

In millions of euro	2015 12-month ECL	Lifetime ECL not credit-impaired	Lifetime ECL credit-impaired	Purchased credit-impaired	Total
Loans and advances to customers at amortised cost – corporate customers					
Balance at 1 January	**256**	**420**	**475**	**15**	**1,166**
Transfer to 12-month ECL	**30**	**(28)**	**(2)**	**-**	**-**
Transfer to lifetime ECL not credit-impaired	**(15)**	**67**	**(52)**	**-**	**-**
Transfer to lifetime ECL credit-impaired	**(10)**	**(90)**	**100**	**-**	**-**

Impairment requirements

Comparison to IAS 39 impairment requirements

	IFRS 9—Amortized Cost and FVOCI assets	IAS 39	
		Amortized Cost assets	FVOCI assets
Method of recognition	Loss allowance	Either by direct reduction of the asset or an allowance	Decline in fair value recognized in OCI transferred to profit and loss
Basis for recognition	Expected credit losses	Objective evidence of impairment	Objective evidence of impairment
Basis for measurement	12 month or Lifetime ECLs, as applicable	Difference between asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate	Difference between acquisition cost (net of any principal repayment and amortization) and current fair value, less any previously recognized impairments
Restrictions on recognition of reversal of impairment losses in profit and loss	None	Reversal can be related objectively to an event occurring after the impairment, subject to a limit	Reversal can be objectively related to an event occurring after the impairment (applies only to debt instruments)

Calculating interest under IFRS 9 ECL

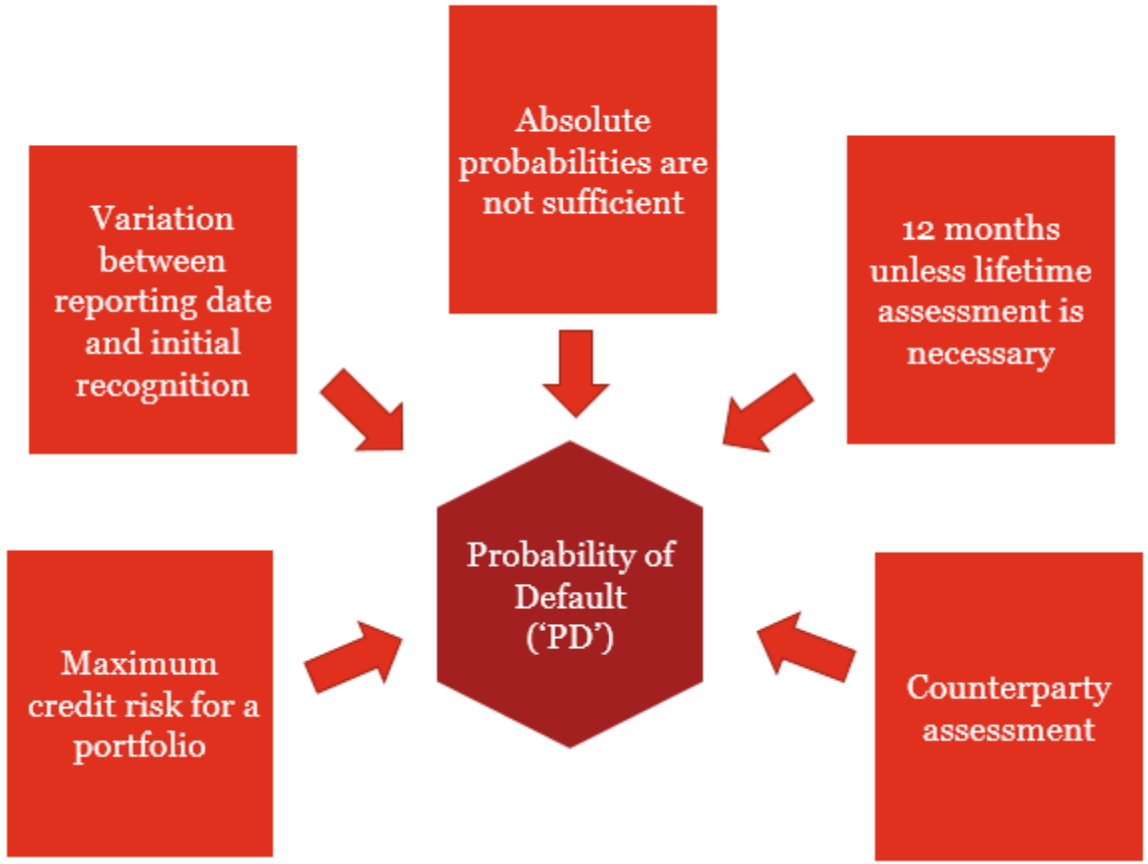
	General or simplified approach		
	No objective evidence of impairment exists	**Objective evidence of impairment**	**Credit adjusted approach**
Base on which interest income is calculated	Carrying amount of the asset at the beginning of the period **before** allowance for ECLs	Carrying value of the asset at the beginning of the period, **after** allowance for ECLs	Carrying value of the asset at the beginning of the period after allowance for ECLs
Interest rate to apply to base	Effective interest rate	Effective interest rate	Credit adjusted effective interest rate

General approach vs credit adjusted approach

	General approach	Simplified approach	Credit adjusted approach
Timing of initial recognition	Same period as asset is recognized	Same as general approach	Cumulative change in Lifetime ECLs since initial recognition of the asset
Measurement basis of loss allowance	12 Month ECLs unless a significant increase in credit risk occurs, then Lifetime ECLs unless the increase reverses	Lifetime ECLs	

Significant increase in credit risk

Assessment of a significant increase in credit risk



Assessing significant increases in credit risk – Lifetime ECL

- The assessment of significant deterioration is key in establishing the point of switching between the requirement to measure an allowance based on 12-month ECLs and one that is based on lifetime ECLs.
- The standard is prescriptive that an entity cannot align the timing of significant increases in credit risk and the recognition of lifetime ECLs with the time when a financial asset is regarded as credit-impaired or to an entity's internal definition of default.
- Financial assets should normally be assessed as having increased significantly in credit risk earlier than when they become credit-impaired or default occurs.

Assessing significant increases in credit risk – Lifetime ECL

- In order to make the assessment, an entity should consider reasonable and supportable information that is available without undue cost or effort and compare
  - Credit risk at the reporting date, with
  - Credit risk at initial recognition.
- At each reporting date, an entity is required to assess significant increases in credit risk based on the change in the risk of a default occurring over the expected life of the financial instrument rather than the change in the amount of ECLs.

Example of significant increase in credit risk

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

ECL disclosure example

Inputs, assumptions and techniques used for estimating impairment (continued)

Significant increase in credit risk (continued)

Credit risk grades (continued)

Each exposure is allocated to a credit risk grade at initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade. The monitoring typically involves use of the following data.

Corporate exposures	Retail exposures	All exposures
• Information obtained during periodic review of customer files – e.g. audited financial statements, management accounts, budgets and projections. Examples of areas of particular focus are: gross profit margins, financial leverage ratios, debt service coverage, compliance with covenants, quality of management, senior management changes • Data from credit reference agencies, press articles, changes in external credit ratings • Quoted bond and credit default swap (CDS) prices for the borrower where available • Actual and expected significant changes in the political, regulatory and technological environment of the borrower or in its business activities	• Internally collected data on customer behaviour – e.g. utilisation of credit card facilities • Affordability metrics • External data from credit reference agencies including industry-standard credit scores	• Payment record – this includes overdue status as well as a range of variables about payment ratios • Utilisation of the granted limit • Requests for and granting of forbearance • Existing and forecast changes in business, financial and economic conditions

ECL and rebuttable presumption

90 days past due rebuttable presumption

- **Expected credit losses**
  - An entity's estimate of expected credit losses must reflect:
    - ✓ the best available information.
    - ✓ an unbiased and probability-weighted estimate of cash flows associated with a range of possible outcomes (including at least the possibility that a credit loss occurs and the possibility that no credit loss occurs).
    - ✓ the time value of money.
  - Various approaches can be used.
  - An entity should apply a default definition that is consistent with internal credit risk management purposes and take into account qualitative indicators of default when appropriate.

Comparative Financial Statements

IFRS 9 does not require an entity to restate prior periods. Restatement is permitted, if and only if, it is possible without the use of hindsight and the restated financial statements reflect all of the requirements of IFRS 9.

If the entity does not restate prior periods, any difference between previous carrying amounts and those determined under IFRS 9 at the date of initial application should be included in opening retained earnings (or other equivalent component of equity).

IFRS 9 also provides that an entity need not apply IFRS 9 to interim periods prior to the date of initial application if this is impracticable. "Impracticable" for this purpose has the meaning attributed to it in IAS 8; i.e., the entity cannot apply the requirement after making every reasonable effort to do so.