

Transition Resource Group for Impairment of Financial Instruments

Meeting Summary–22 April 2015

Introduction

1. The Transition Resource Group for Impairment of Financial Instruments (ITG) met on 22 April 2015 at the IASB offices in London.
2. This note is prepared by the staff of the IASB and is a high level summary of the discussion that took place with ITG members. A full recording of the meeting is available on the IASB website.
3. After introductory remarks from the Chair, ITG members considered issues in respect of the following aspects of the impairment requirements of IFRS 9 *Financial Instruments* (2014):
 - (a) forecasts of future economic conditions;
 - (b) loan commitments–scope;
 - (c) expected credit losses–measurement date;
 - (d) assessment of significant increase in credit risk for guaranteed debt instruments;
 - (e) the maximum period to consider when measuring expected credit losses;
 - (f) revolving credit facilities;
 - (g) measurement of expected credit losses for an issued financial guarantee contract; and
 - (h) measurement of expected credit losses in respect of a modified financial asset.

Introductory remarks

4. The Chair welcomed members of the ITG to the first full meeting of the ITG and thanked them for their support and time commitment in participating in the group.
5. The ITG was established to provide support for the IASB's stakeholders who are implementing the new expected credit loss requirements in IFRS 9. The objective of the ITG is to:
 - (a) provide a forum for questions about the implementation of the impairment requirements in IFRS 9.
 - (b) make the IASB aware of implementation issues and, if needed, help the IASB to understand what action may be required using its usual due process. The ITG itself will not issue any authoritative guidance.
 - (c) provide a public forum to assist stakeholders learn about the new impairment requirements from others involved in implementation.
6. The Chair emphasised the educational role of the ITG. This would be achieved through the ITG's discussion of questions, and confirmation of the relevant principles and requirements in IFRS 9, that need to be considered and applied to particular fact patterns. The Chair

anticipated that this would be particularly helpful for those who are implementing the new impairment requirements.

7. The Chair noted that the ITG has a finite life because at a certain point in time stability in the requirements will be necessary to avoid uncertainty, which might hinder or delay implementation. The Chair suggested that, while continuing to monitor the need for later meetings, the ITG should have a provisional end date of 2015 and encouraged stakeholders to submit their questions in time for the ITG to discuss them this year.
8. The IASB Technical Director drew attention to the Submissions Log, which had been compiled by IASB staff. Fourteen submissions had been received before the cut-off date for the meeting. Some of those submissions and questions were not discussed at the meeting because they:
 - (a) were requests for more examples, which the ITG is not constituted to provide; or
 - (b) did not meet the ITG's submissions criteria, because they were not potential implementation issues related to the impairment requirements.
9. The IASB Technical Director also mentioned that after the meeting, the IASB staff would prepare a summary of the meeting. This meeting summary would be non-authoritative.
10. The IASB Technical Director confirmed that the purpose, operating procedures and organisational structure of the ITG, which were discussed during the conference call of the ITG in December 2014, are available on the IASB's website.

Forecasts of future economic conditions (Agenda Paper 2)

11. When applying the impairment requirements, IFRS 9 requires entities to consider all reasonable and supportable information, including information that is forward-looking. The ITG considered a potential implementation issue about incorporating information about forecasts of future economic conditions when assessing significant increases in credit risk and measuring expected credit losses. The submitter of the issue highlighted that, for practical reasons, forecasts of future economic conditions developed in, say, November might be used as the basis for determining the expected credit losses at a reporting date of 31 December, for example.
12. The issue is about whether and how to incorporate events and forecasts, when applying the impairment requirements at the reporting date, that occur:
 - (a) after economic forecasts have been made but before the reporting date (Issue 1); and
 - (b) between the reporting period end and the date of signing the financial statements (Issue 2).
13. Paragraph 5.5.17(c) of IFRS 9 requires that an entity shall measure expected credit losses in a way that reflects reasonable and supportable information that is available without undue cost or effort *at the reporting date* about past events, current conditions and forecasts of future economic conditions. Paragraph B5.5.15 of IFRS 9 further emphasises that when determining whether the recognition of lifetime expected credit losses is required, an entity shall consider reasonable and supportable information that is available without undue cost or effort and that may affect credit risk on a financial instrument in accordance with paragraph 5.5.17(c).
14. Accordingly, with respect to Issue 1, ITG members noted that reasonable and supportable new information that becomes available before the reporting date is required to be taken into consideration when applying the impairment requirements.
15. With respect to Issue 2, the ITG members noted that IFRS 9 does not specifically require new information that becomes available after the reporting date to be reflected in the measurement of expected credit losses at the reporting date. Some ITG members observed that whether

information that becomes available after the reporting date is an adjusting event in accordance with IAS 10 *Events after the Reporting Period* depends upon the nature of the event. Accordingly, they emphasised that judgement is needed, based on the specific facts and circumstances.

16. Some ITG members thought that, with respect to Issue 2, expected credit losses were similar in nature to the measurement of fair value at the reporting date, in that movements in fair value after the reporting date are generally not reflected in the measurement of fair value at the reporting date, as stated in paragraph 11 of IAS 10. For example, a change in interest rates or the outcome of a public vote after the reporting date would not be adjusting events. Therefore, expected credit losses should not be adjusted to reflect the change in interest rates or outcome of the public vote that occurs after the reporting date. None of the members objected to this approach.
17. However, in accordance with IFRS 9, expected credit losses are a probability-weighted estimate of credit losses at the reporting date. Accordingly, the determination of expected credit losses should take into consideration relevant possible future scenarios based on a range of expectations at the reporting date, using the information available at that date. Hence, with reference to the example above, the probabilities attached to future expected movements in interest rates and expected outcomes of a future public vote based on information available at the reporting date would be reflected in the determination of expected credit losses at that date.
18. Other observations made by ITG members were that:
 - (a) from a practical perspective, materiality considerations apply when addressing Issues 1 and 2, just as it does in the application of all Standards, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
 - (b) entities need proper processes and appropriate governance procedures for incorporating information, including forecasts of future economic conditions, to ensure transparent and consistent application of the impairment requirements in IFRS 9. This includes processes for updating expected credit losses for new information that becomes available after the initial modelling has taken place up until the reporting date.

Loan commitments–Scope (Agenda Paper 3)

19. An issuer of a loan commitment is required to apply the impairment requirements of IFRS 9 to that loan commitment. The issue discussed by the ITG is whether the impairment requirements in IFRS 9 must also be applied to other commitments to extend credit. Examples put forward by submitters are:
 - (a) a commitment (on inception of a finance lease) to commence a finance lease at a date in the future (ie a commitment to transfer the right to use an asset at the lease commencement date in return for a payment or series of payments in the future); and
 - (b) a commitment by a retailer through the issue of a store account to provide a customer with credit when the customer buys goods or services from the retailer in the future.
20. ITG members expressed their agreement with the analysis in Agenda Paper 3 that the impairment requirements in IFRS 9 apply to an agreement that contains a commitment to extend credit by virtue of paragraph 2.1(g) if:
 - (a) the agreement that contains the commitment meets the definition of a financial instrument as defined in IAS 32 *Financial Instruments: Presentation*, including considering all the relevant Application Guidance in IAS 32; and

- (b) the agreement meets the description of a loan commitment in paragraph BCZ2.2 of IFRS 9; that is, it is a 'firm commitment to provide credit under pre-specified terms and conditions'.
21. An ITG member observed that, in addition, it was necessary to determine whether some other more specific exemption from the requirements of IFRS 9 applies to the agreement instead.
22. No ITG members objected to the above comments.

Expected Credit Losses—Measurement Date (Agenda Paper 7)

23. Agenda Paper 7 addressed two questions raised by a submitter regarding whether there is a requirement to measure Expected Credit Losses at dates other than the reporting date, namely the date of derecognition and the date of initial recognition.

Date of Derecognition

24. As regards the requirement to re-measure expected credit losses at the date of derecognition of a financial asset, it was highlighted that:
- (a) paragraph 3.2.12 of IFRS 9 requires that expected credit losses must be re-measured at the date of derecognition in order to calculate the derecognition gain or loss; and
 - (b) paragraphs 82(aa) and 82(ba) of IAS 1 *Presentation of Financial Statements* require that separate line items must be presented for gains and losses arising from derecognition and impairment losses and reversals.
25. Consequently, ITG members noted that there was a requirement to re-measure expected credit losses at the date of derecognition of a financial asset (including on a derecognition arising as a result of a modification). However, it was highlighted that, as with the requirements of any IFRS, considerations of materiality in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* would need to be taken into account.

Date of Initial Recognition

26. Differing views were expressed regarding whether there was a requirement to measure expected credit losses at the date of initial recognition.
27. While IFRS 9 does not expressly require expected credit losses to be measured at the date of initial recognition, the requirements of other IFRSs (which in some cases IFRS 9 directly cross-refers to, for example paragraph B5.7.2 and Illustrative Example 14 of IFRS 9 which both refer to IAS 21 *The Effects of Changes in Foreign Exchange Rates*) may result in an entity measuring expected credit losses at the date of initial recognition. A few ITG members supported this view, stating that the only question that arose was the frequency with which an entity needed to perform that calculation. Those members also pointed out that considerations of materiality would again be the key factor in making this decision.
28. Some other ITG members took a different view. They pointed out that in accordance with paragraph 5.1.1 of IFRS 9, an entity is required to measure a financial asset at its fair value upon initial recognition and consequently measuring expected credit losses at initial recognition would be inconsistent with that requirement. In their view, Chapter 5.5 of IFRS 9 only requires an entity to begin measuring expected credit losses at the first reporting date after initial recognition (or on derecognition if that occurs earlier). While the requirements of other IFRSs should be applied to the loss allowance at that point, the application of those requirements should not result in an entity having to measure expected credit losses at a date earlier than that specifically required by IFRS 9.
29. It was noted that the workings of Illustrative Example 14 in IFRS 9 imply that there is a requirement to measure expected credit losses upon initial recognition in the context of a foreign-currency-denominated bond. However, it was pointed out that the illustrative

examples are non-authoritative and illustrate only one way of applying the requirements of IFRS 9.

Assessment of significant increase in credit risk for guaranteed debt instruments (Agenda Paper 5)

30. The issue relates to the application of the impairment requirements in IFRS 9 to guaranteed debt instruments in circumstances in which the financial guarantee contract held is integral to the contractual terms of the financial asset. IFRS 9 requires that measurement of the expected credit losses of the guaranteed debt instrument includes cash flows from the integral financial guarantee contract. However, the submitter asks whether an entity should consider the ability to recover cash flows through the integral financial guarantee contract when assessing whether there has been a significant increase in the credit risk of the guaranteed debt instrument since initial recognition.
31. Some ITG members commented that IFRS 9 is clear that recoveries from integral financial guarantee contracts should be excluded from the assessment of significant increases in credit risk of the guaranteed debt instrument. This is because the focus of the Standard is about the risk of the borrower defaulting when making such an assessment, as highlighted in the examples in paragraph B5.5.17 of IFRS 9. These examples clarify that information about the guarantee (or other credit enhancements) may be relevant to assessing changes in credit risk, but only to the extent that it affects the likelihood of the borrower defaulting on the instrument. Furthermore, this approach is consistent with the treatment of collateral. A few ITG members observed that the approach in the Standard is designed to give information about the extent to which an entity is reliant on the guarantee (and other credit enhancements) for the collection of cash flows, as opposed to relying on the ability and willingness of the obligor to make contractual payments.
32. A few members of the ITG commented that in certain circumstances, for example if the lender is as reliant, or more reliant, on the guarantor for the collection of cash flows, this approach did not seem intuitive. However these members agreed that the approach in the Standard was clear, as discussed above.

The maximum period to consider when measuring Expected Credit Losses (Agenda Paper 1)

33. Agenda Paper 1 addressed a question raised by a submitter regarding the application of paragraph 5.5.19 of IFRS 9 to a portfolio of mortgage loans. The loans had a stated maturity of 6 months, but contained a contractual feature whereby the term was automatically extended every 6 months subject to the lender's non-objection. However, because the portfolio was managed on a collective basis and individual credit reviews were not undertaken, the lender would only object if information about an adverse credit event in respect of a particular borrower had been received. The submitter asked what the maximum period to consider would be when measuring expected credit losses in this case.
34. A number of ITG members noted that the requirements of paragraph 5.5.19 of IFRS 9 were clear in this area. Consequently, the maximum period to consider when measuring expected credit losses in this example would be restricted to 6 months, because this was the maximum contractual period over which the lender was exposed to credit risk.
35. However, the following observations in relation to paragraph 5.5.19 of IFRS 9 were also made during the course of discussions:
 - (a) Paragraph 5.5.19 of IFRS 9 requires that extension options must be considered when determining the maximum contractual period, but does not specify whether these are lender or borrower extension options. However, paragraph 5.5.19 refers

to the maximum contractual period *over which the entity is exposed to credit risk*. Consequently, it is only if a borrower holds an extension option that could force the lender to continue extending credit that this would have the effect of lengthening that maximum contractual period of credit exposure. Conversely, if the extension option is within the control of the lender, the lender cannot be forced to continue extending credit and therefore such an option cannot be considered as lengthening the maximum period of exposure to credit risk.

- (b) Consistently with the general application of IFRS¹, it was noted that the maximum contractual period over which the entity is exposed to credit risk should be determined in accordance with the *substantive* contractual terms of the financial instrument. To further illustrate this point, it was noted that a situation in which a lender is legally prevented from exercising a contractual right should be seen as distinct from a situation in which a lender chooses not to exercise a contractual right for practical or operational reasons.
36. Some ITG members requested clarification of the exception outlined in paragraph 5.5.20 of IFRS 9. Specifically, they asked whether it could be applied to the example presented by analogising the 6-month mortgage loan to a revolving credit facility that has been fully drawn at the reporting date.
37. In this regard, it was noted that paragraph 5.5.20 of IFRS 9 applies to financial instruments with a drawn and undrawn component where the borrower has flexibility in how frequently they make drawdowns on the facility and consequently it is possible that the facility could be fully drawn or fully undrawn at the reporting date. It was also highlighted that the Basis of Conclusions of IFRS 9 provides further context around the types of financial instruments that were envisaged would fall under the scope of paragraph 5.5.20 ie revolving credit facilities such as credit cards and overdraft facilities.² However, in the example presented, the facility is not of a revolving nature and the borrower does not have any such flexibility regarding drawdowns. Consequently, it would not be appropriate to analogise to the financial instruments described in paragraph 5.5.20 of IFRS 9.
38. One ITG member noted that from a credit risk perspective, a lender may choose to continue extending credit without having the contractual obligation to do so. For example, an entity may choose to continue extending credit to a long-standing customer despite being in a position to reduce or remove the exposure. Consequently, it was acknowledged that there may be a disconnect between the accounting and credit risk management view in some situations.

Revolving Credit Facilities (Agenda Paper 4)

39. Agenda Paper 4 addressed two issues raised by a submitter regarding the application of the impairment requirements to a portfolio of revolving credit card exposures. The first issue related to the maximum period to consider when measuring expected credit losses and the second issue related to the determination of the date of initial recognition of the revolving facilities for the purposes of assessing them for significant increases in credit risk.

Issue 1—The maximum period to consider when measuring Expected Credit Losses

40. For specific financial instruments, such as some types of portfolios of revolving credit facilities, paragraph 5.5.20 of IFRS 9 requires a period in excess of the contractual period over which the entity is exposed to credit risk to be used as the maximum period to consider when measuring expected credit losses. Paragraph B5.5.40 of IFRS 9 also provides guidance

¹ As discussed in paragraph BC3.26 of the *Conceptual Framework for Financial Reporting*.

² See paragraphs BC5.254-BC5.261 of IFRS 9 which summarise the IASB's redeliberations on this matter and specifically paragraphs BC5.255-BC5.256 of IFRS 9 which discuss the case of revolving credit facilities.

about how an entity should determine that appropriate period. The question raised by the submitter was in relation to how this period should be determined.

41. Some ITG members commented that in determining the appropriate period over which to measure expected credit losses, an entity's ability to segment and stratify the portfolio into different sections of exposures in accordance with how those exposures are being managed will be relevant. For example, an entity may be able to identify exposures with specific attributes that are considered more likely to default and consequently would have shorter average lives than those that are expected to continue performing.
42. In addressing the specific questions raised by the submitter, ITG members noted the following points:
 - (a) As regards assets in Stage 1, it was not clear how the average life had been determined by the submitter. Furthermore, it was noted that the example presented was quite simplified and that in practice it is more likely that an entity would further segment the portfolio and identify subsections of assets within Stage 1 that have different average lives.
 - (b) As regards assets in Stage 2, it was acknowledged that the probability of assets defaulting and curing would have to be taken into account and that it would be necessary to build this into any models dealing with expected credit loss calculations. However, it was noted that materiality would need to be considered.
 - (c) As regards assets in Stage 3, it was noted that the position is far more straightforward, because at that point it is expected that the entity would have taken steps to terminate the facility and the focus is on the recovery period.
43. In respect of assets in Stage 1, it was further noted that while an entity applies a 12 month probability of default when measuring the expected credit losses, the resulting cash shortfalls must still be considered over the full life of those assets.
44. In determining the appropriate period over which to measure expected credit losses for assets in Stages 1, 2 and 3, it was highlighted that entities must consider all three factors set out in paragraph B5.5.40, including the impact of credit risk management actions as required by B5.5.40(c). It was noted that while the exception in paragraph 5.5.20 sets out the specific circumstances under which IFRS 9 requires a period in excess of the maximum contractual period to be used when measuring expected credit losses, the fundamental aim was still to determine the period over which the entity is exposed to credit risk. Consequently, because the entity's ability to take credit risk management actions could result in a shorter period of exposure than that indicated by the behavioural life, it would not be appropriate for an entity to assume that the behavioural life is always equal to the period over which it is exposed to credit risk.

Issue 2—Determining the date of initial recognition for the purposes of assessing significant increases in credit risk

45. The submitter asked how to determine the date of initial recognition of a revolving credit facility for the purposes of the assessment of significant increases in credit risk. The question was raised in the context of a large portfolio of revolving credit facilities with a diverse customer base, ranging from long-standing customers who have been with the bank for many years, to new customers who have only recently opened an account.
46. Some ITG members noted that this was one of the key operational challenges presented by the new impairment requirements.
47. A number of ITG members noted that IFRS 9 was clear in that the date of initial recognition was the date that the facility was issued and that this should only be changed if there had been a derecognition of the original facility.
48. The challenge presented was how to determine when changes are sufficiently significant to result in a derecognition of the original facility and recognition of a new facility. ITG members discussed some of the factors that might be taken into consideration in making that judgement, such as issuing a new card, revising credit limits or conducting credit reviews.

However, it was noted that judgement would be required in making this assessment and that it would depend on the specific facts and circumstances. In this regard, the following observations were made:

- (a) in some circumstances issuing a new card may be indicative that the original facility has been derecognised, but in other cases, this may be a purely operational process and thus would not indicate that a new facility has been issued; and
 - (b) credit reviews in themselves may not indicate that a new facility has been issued.
49. One ITG member questioned whether it would be appropriate to identify proxies such as the probability of default as at the last reporting date, if an entity does not have the information pertaining to the credit risk at initial recognition of the facility. It was noted that IFRS 9 requires the credit risk at initial recognition to be used subject to relief being available on transition to IFRS 9 to determine whether there has been a significant increase in credit risk since initial recognition.³

Measurement of expected credit losses for an issued financial guarantee contract (Agenda Paper 6)

50. The issue relates to financial guarantee contracts that are issued by an entity, under which the entity receives premiums from the holder of the guarantee over the life of the guarantee. The question asked was whether the measurement of expected credit losses for financial guarantee contracts issued should consider future premium receipts due from the holder and, if so, how.
51. Agenda Paper 6 noted that cash outflows under the guarantee depend upon the risk of default of the guaranteed financial asset, whereas the premiums to be received are subject to the risk of default by the holder of the guarantee.
52. Some members of the ITG agreed with the analysis in Agenda Paper 6 that the expected credit losses for the cash outflows under the guarantee should be considered separately from the expected credit losses in respect of the future premiums receivable. Under this approach, the provision for expected credit losses in respect of the expected cash outflows payable under the guarantee (less any reimbursements for those outflows) excludes future premium receipts. None of the members objected to this approach.
53. An ITG member noted that the terms of a financial guarantee contract may affect the period of exposure to credit risk on the guarantee, for example if the guarantee was contingent or cancellable. This should be taken into consideration when measuring the expected credit losses of the guarantee. None of the other members expressed disagreement with this point or had any further comments.

Measurement of Expected Credit Losses in respect of a modified financial asset (Agenda Paper 8)

54. Agenda Paper 8 addressed the measurement of expected credit losses in respect of a modified financial asset if the modification had not resulted in a derecognition but the modified cash flows have been renegotiated in such a way as to represent the cash flows which the lender expects the borrower can repay.
55. As regards the calculation of the modification gain or loss and subsequent requirement to measure expected credit losses on the modified financial asset, it was noted that an entity is required to:

³ See paragraphs 7.2.18-7.2.20 of IFRS 9.

- (a) calculate a new gross carrying amount and take the modification gain or loss to profit or loss in accordance with paragraph 5.4.3 of IFRS 9; and
 - (b) continue applying the impairment requirements of IFRS 9 to the modified financial asset in the same way as it would for other unmodified financial instruments, taking into account the revised contractual terms
56. The following points were specifically highlighted:
- (a) The definition of a modification gain or loss, set out in Appendix A of IFRS 9, requires an entity to compare the gross carrying amount (which excludes any adjustment for expected credit losses) before and after the modification. Consequently, an entity must calculate the modification gain or loss as a first step before going on to consider the revised expected credit loss allowance required on the modified financial asset.
 - (b) A question was raised regarding the impact of a write-off of a financial asset prior to the modification, which would have served to directly reduce the gross carrying amount of the financial asset. It was noted that if a write-off had taken place in accordance with paragraph 5.4.4 of IFRS 9, this would affect the calculation of the modification gain or loss.
 - (c) The revised expected credit loss cannot be assumed to be nil, because in accordance with paragraph 5.5.18 of IFRS 9 an entity is required to consider the possibility that a credit loss occurs, even if the likelihood of that credit loss occurring is very low.
57. ITG members also discussed the appropriate presentation and disclosure requirements pertaining to modified financial assets and noted the following:
- (a) In accordance with paragraph 82(ba) of IAS 1, impairment losses and reversals must be presented as a separate line item in the statement of profit and loss. Modification gains and losses would be presented separately if the entity considered it appropriate to do so in accordance with paragraph 85 of IAS 1. However, if an entity considered that disclosing these items on a net basis would be relevant information for users of financial statements (for example, if the reason for the modification was credit-related), it was noted that this could be dealt with through additional disclosure in the notes.
 - (b) The requirements of paragraph 35J of IFRS 7 *Financial Instruments: Disclosures* apply to all modifications whether they are as a result of credit related or other commercial reasons. In this regard, it was specifically noted that the IASB had previously received feedback that suggested that identifying the modifications that have been performed only for credit risk management purposes would be operationally challenging. However, if an entity has the ability to separately identify different types of modifications and considers that the separate disclosure of these items was relevant to achieving the overall objective of the credit risk disclosures as set out in IFRS 7, it was noted that an entity could provide this additional detail as part of the disclosure.

Next steps

58. The next meeting of the ITG is to be held on 16 September 2015.