Introduction

1. This paper addresses an issue raised by two submitters regarding the application of the impairment requirements of IFRS 9 Financial Instruments (2014) to a portfolio of revolving credit card exposures. Both submissions relate to the determination of the appropriate period to consider when measuring expected credit losses for a portfolio of revolving credit card exposures.

2. This paper:
   (a) sets out the relevant accounting requirements in IFRS 9 and IFRS 7 Financial Instruments - Disclosures;
   (b) summarises the potential implementation issues raised by the submitters; and
   (c) asks the members of the Transition Resource Group for Impairment of Financial Instruments (‘the ITG’) for their views on the issues identified.
Accounting requirements

3. In accordance with paragraphs 5.5.3 and 5.5.5 of IFRS 9, an entity is required to measure either lifetime or 12-month expected credit losses at each reporting date [emphasis added]:

**5.5.3** Subject to paragraphs 5.5.13–5.5.16, at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the lifetime expected credit losses if the credit risk on that financial instrument has increased significantly since initial recognition.

[…..]

**5.5.5** Subject to paragraphs 5.5.13–5.5.16, if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to 12-month expected credit losses.

4. Paragraph 5.5.19 of IFRS 9 stipulates that the maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if that period is consistent with business practice:

**5.5.19** The maximum period to consider when measuring expected credit losses is the maximum contractual period (including extension options) over which the entity is exposed to credit risk and not a longer period, even if that longer period is consistent with business practice.

5. However, as discussed in paragraphs BC5.254–BC5.261 of IFRS 9, respondents raised some concerns on the 2013 Impairment Exposure Draft (‘2013 ED’) in

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1 Paragraphs BC5.254–BC5.261 of IFRS 9 are reproduced in Appendix A.
relation to the period to be considered for measuring expected credit losses for specific financial instruments:

BC5.255 Respondents noted that the use of the contractual period was of particular concern for some types of loan commitments that are managed on a collective basis, and for which an entity usually has no practical ability to withdraw the commitment before a loss event occurs and to limit the exposure to credit losses to the contractual period over which it is committed to extend the credit. Respondents noted that this applies particularly to revolving credit facilities such as credit cards and overdraft facilities. For these types of facilities, estimating the expected credit losses over the behavioural life of the instruments was viewed as more faithfully representing their exposure to credit risk.

6. In considering these concerns, the IASB noted that these types of financial instruments are managed on a facility level and consequently the period over which the expected credit losses are estimated should reflect the period over which the entity is expected to be exposed to the credit risk on the instrument as a whole:

BC5.259 The IASB further noted that from a credit risk management perspective, the concept of expected credit losses is as relevant to off balance sheet exposures as it is to on balance sheet exposures. These types of financial instruments include both a loan (ie financial asset) and an undrawn commitment (ie loan commitment) component and are managed, and expected credit losses are estimated, on a facility level. In other words there is only one set of cash flows from the borrower that relates to both components. Expected credit losses on the on balance sheet exposure (the financial asset) are not estimated separately from the expected credit losses on the off balance sheet exposure (the loan commitment).
Consequently, the period over which the expected credit losses are estimated should reflect the period over which the entity is expected to be exposed to the credit risk on the instrument as a whole.

7. As noted in paragraph BC5.261 of IFRS 9, the IASB reaffirmed its decision to use the maximum contractual period as the maximum period to consider when measuring expected credit losses. However, in acknowledgement of the concerns raised by respondents in paragraphs BC5.254-BC5.257 of IFRS 9 and as discussed in paragraph BC5.261 of IFRS 9, the IASB decided to include an exception to the requirement in paragraph 5.5.19 of IFRS 9 in very specific cases:

**BC5.261** However, to address the concerns raised about the financial instruments noted in paragraphs BC5.254–BC5.257, the IASB decided that for financial instruments that include both a loan and an undrawn commitment component and the entity’s contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity’s exposure to credit losses to the contractual notice period, an entity shall estimate expected credit losses over the period that the entity is expected to be exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. When determining the period over which the entity is exposed to credit risk on the financial instrument, the entity should consider factors such as relevant historical information and experience on similar financial instruments. The measurement of expected credit losses should take into account credit risk management actions that are taken once an exposure has increased in credit risk, such as the reduction or withdrawal of undrawn limits.

8. Consequently, the following exception is included in paragraph 5.5.20 of IFRS 9 [emphasis added]:

**ITG** Maximum period to consider when measuring expected credit losses for revolving credit facilities
5.5.20 However, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period. For such financial instruments, and only those financial instruments, the entity shall measure expected credit losses over the period that the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period.

9. Further application guidance pertaining to the requirements of paragraph 5.5.20 of IFRS 9 are contained within paragraphs B5.5.39 and B5.5.40 of IFRS 9 [emphasis added]:

B5.5.39 However, in accordance with paragraph 5.5.20, some financial instruments include both a loan and an undrawn commitment component and the entity’s contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity’s exposure to credit losses to the contractual notice period. For example, revolving credit facilities, such as credit cards and overdraft facilities, can be contractually withdrawn by the lender with as little as one day’s notice. However, in practice lenders continue to extend credit for a longer period and may only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. These financial instruments generally have the following characteristics as a result of the nature of the financial instrument, the way in which the financial instruments are managed, and the nature of the available information about significant increases in credit risk:
(a) the financial instruments do not have a fixed term or repayment structure and usually have a short contractual cancellation period (for example, one day);

(b) the contractual ability to cancel the contract is not enforced in the normal day-to-day management of the financial instrument and the contract may only be cancelled when the entity becomes aware of an increase in credit risk at the facility level; and

(c) the financial instruments are managed on a collective basis.

**B5.5.40** When determining the period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity's normal credit risk management actions, an entity should consider factors such as historical information and experience about:

(a) the period over which the entity was exposed to credit risk on similar financial instruments;

(b) the length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and

(c) the credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

10. In accordance with paragraph B5.5.31 of IFRS 9, an entity is required to estimate future drawdowns on loan commitments for the purposes of measuring expected credit losses and in the case of lifetime expected credit losses, the period over which an entity makes that estimation will be the expected life of the loan commitment:
B5.5.31 An entity’s estimate of expected credit losses on loan commitments shall be consistent with its expectations of drawdowns on that loan commitment, i.e., it shall consider the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses, and the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment when estimating lifetime expected credit losses.

11. Illustrative Example 10 of IFRS 9 illustrates the application of the requirements above to a revolving pool of credit card exposures. This example is reproduced in Appendix B.

12. In accordance with paragraph 35B of IFRS 7, an entity’s credit risk disclosures shall enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. More specifically, paragraph 35G of IFRS 7 requires disclosure regarding the inputs, assumptions and estimation techniques used to apply the impairment requirements of IFRS 9:

35G An entity shall explain the inputs, assumptions and estimation techniques used to apply the requirements in Section 5.5 of IFRS 9. […..]

13. Paragraph 35E of IFRS 7 also notes that in order to meet the objective of credit risk disclosures, an entity may be required to disclose additional information:

35E If the disclosures provided in accordance with paragraphs 35F–35N are insufficient to meet the objectives in paragraph 35B, an entity shall disclose additional information that is necessary to meet those objectives.

14. During the April 2015 ITG meeting, ITG members discussed the period over which to measure expected credit losses for revolving credit facilities. ITG
members noted the following in respect of the application of the requirements in paragraph B5.5.40 of IFRS 9:

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.

15. As noted in paragraph 42 of the April ITG meeting notes, ITG members also discussed that there could be different maximum period of measurement in accordance with paragraph B5.5.40 of IFRS 9 in respect of financial instruments in different stages.

Potential implementation issues identified

16. As noted in paragraph 1, we have received two submissions pertaining to the period over which to measure expected credit losses for revolving credit facilities falling within the scope of paragraph 5.5.20 of IFRS 9. We will first describe the

\(^2\) Paragraphs 40-44 of the April 2015 ITG meeting notes, which summarise the discussions pertaining to this issue are reproduced in Appendix C.
issues presented in both submissions in paragraphs 17-30 and then set out a review of the relevant accounting requirements in paragraphs 31-47.

**Issue 1**

17. In the first submission, the submitter asks how to determine the maximum period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity’s normal credit risk management actions in accordance with paragraph B5.5.40 of IFRS 9, for the purposes of estimating future drawdowns. The submitter presents the following example:

Bank A issues credit cards to its retail customers with the following terms:

- Customers in good standing can charge up to a predefined contractual credit limit.
- The bank has the contractual ability to cancel the card account at its discretion even if the customer pays on time and the card account is not in default.
- The card agreement has no stated maturity date but drawn balances are subject to minimum repayment schedules.

In addition, Bank A has the following policies:

- accounts of customers that have not been and are not delinquent are rarely cancelled;
- when contractual payments are 30 days past due a significant increase in credit risk is assumed to have occurred (for the purposes of this example, the requirement to incorporate the impact of forward-looking information has not been considered);
- when contractual payments are 60 days past due, the ability of the borrower to make further drawings on the card is put on hold;
- when contractual payments reach 90 days past due, the account is considered to be in default, ie credit-impaired and at that time, the commitment is cancelled;
- when contractual payments are 180 days past due, the account is considered to be uncollectable and the outstanding balance is written off.
18. Within the context of the example presented above, the submitter asks what type of credit risk management actions Bank A should take into account when determining the maximum period to consider in accordance with paragraph 5.5.40 of IFRS 9 for the purpose of estimating future drawdowns. The submitter presents three alternative views:

(a) **View 1**—Bank A should consider all credit risk management actions that management is *operationally and legally able* to carry out and that management *expects* to carry out (evidenced to a large extent by what management has done in the past and its current policies and plans).

(b) **View 2**—Bank A should consider all credit risk management actions that management is *operationally and legally able* to carry out and that management *expects* to carry out (evidenced to a large extent by what management has done in the past and its current policies and plans) and that serve to *mitigate* expected credit losses.

(c) **View 3**—Bank A should consider all credit risk management actions that management is *operationally and legally able* to carry out (even if those responses are not expected to be carried out in practice) and that serve to *mitigate* expected credit losses.

19. In support of View 1, the submitter points out that paragraph B5.5.40 of IFRS 9 refers to the entity’s *normal credit risk management actions* and paragraph B5.5.40(c) of IFRS 9 states that an entity should consider credit risk management actions that it *expects* to take once the credit risk on the financial instrument has increased. Under this view, all credit risk management actions (ie actions that mitigate expected credit losses for example suspension of credit limits and other actions such as the future reinstatement of credit limits) that the entity expects to take should be considered. However, actions that are theoretically possible but that are not expected to occur should not be considered. In the example presented, this would result in Bank A considering both its expected practice of mitigating credit risk by putting accounts on hold after 60 days past due and any subsequent expected reinstatement of those accounts.
20. In support of View 2, the submitter points to the same areas of guidance as View 1 as to why only expected credit risk management actions should be taken into account. However, under this view only actions that serve to mitigate expected credit losses in response to an increase in credit risk should be considered. Subsequent decisions that might be taken to reverse the previous credit risk mitigation action, such as the reinstatement of credit limits, should not be considered. In the submitter’s view, this is consistent with paragraph 5.5.20 of IFRS 9, which refers to the period during which the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions and also with paragraph B5.5.40(c) of IFRS 9, which states that an entity should consider the credit risk management actions that the entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of the undrawn credit limits. In the example presented, this would result in Bank A considering its expected practice ofmitigating credit risk by putting accounts on hold after 60 days past due, but would not consider any subsequent expected reinstatement of those accounts.

21. In support of View 3, the submitter observes that as explained in paragraphs B5.5.39 and BC5.255 of IFRS 9, the rationale behind the exception in paragraph 5.5.20 of IFRS 9 related to specific financial instruments for which lenders did not have the practical ability to enforce their contractual right to cancel the contract; in other words, they continued to extend credit for a period in excess of the contractual commitment period and would only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. The submitter notes that at the point in time when management has access to information about an increase in credit risk, it has an opportunity to review all available information and to take action to mitigate that credit risk. Consequently, the actions that are relevant at that time are all actions that serve to mitigate expected credit losses and that are legally and practically available to entity, irrespective of whether those actions have been used in the past. In the example presented, this would result in Bank A considering its ability to put accounts on hold once it became aware of an increase
in credit risk—ie after 30 days past due. Any subsequent expected reinstatement of those accounts would not be considered.

**Issue 2**

22. In the second submission, the submitter asks how to determine the maximum period over which the entity is expected to be exposed to credit risk, but for which expected credit losses would not be mitigated by the entity’s normal credit risk management actions in accordance with paragraph B5.5.40 of IFRS 9. The submitter asks how both the starting and ending-points of that maximum period should be determined.

23. In order to illustrate the issue, the submitter identifies various phases (Period A through Period E) that could arise in the life of a particular hypothetical credit card account. Table 1 in Appendix D summarises these different phases.

24. As regards the starting point, the submitter identifies five alternative views together with their supporting rationales:

(a) **View 1**—the starting-point is the date of origination of the revolving credit facility (eg the issue date of a credit card). In the submitter’s view, this would be consistent with paragraphs 5.5.20 and B5.5.40(a) of IFRS 9, which refer to the period over which the entity is exposed to credit risk. In Table 1, this would coincide with the start of Period A.

(b) **View 2**—the starting-point is the date when credit risk has increased. In the submitter’s view, this would be consistent with paragraph B5.5.40(c) of IFRS 9, which refers to credit risk management actions that an entity expects to take once credit risk has increased. In Table 1, this could coincide with either the start of Period B or the start of Period C.

(c) **View 3**—the starting-point is the date when credit risk has increased significantly. In the submitter’s view, this would be consistent with paragraph B5.5.40(b) of IFRS 9, which refers to the length of time for
related defaults to occur following a significant increase in credit risk. The submitter notes that this point does not necessarily align to any particular period in Table 1, because it would be dependent upon the entity’s own assessment of when a significant increase in credit risk had occurred.

(d) **View 4**—the starting-point is the reporting date. In support of this view, the submitter observes that an entity is required to measure expected credit losses that are forward-looking in nature at each reporting date.

(e) **View 5**—the starting-point is the later of the reporting date or the point identified under View 2 or View 3. In support of this view, the submitter observes that the measurement period cannot start any earlier than the reporting date, because the assessment of expected credit losses is forward-looking in nature, but in accordance with the arguments set out under Views 2 and 3, it could start at a later point.

25. As regards the ending-point, the submitter observes that in their the view, the ending-point should be the point at which credit risk management actions are taken plus the period up to the date of default for drawn amounts. The submitter observes that it is therefore necessary to establish what is meant by ‘credit risk management actions’. In this regard, the submitter identifies a number of alternative views:

(a) **View 1**—a complete withdrawal of the limit—in the submitter’s view, this would be consistent with paragraphs 5.5.20 and B5.5.39 of IFRS 9, which refer to the lender demanding repayment, and cancelling the undrawn commitment and the withdrawal of a facility, respectively.

(b) **View 2**—a withdrawal or a reduction of the limit—in the submitter’s view, this appears to be consistent with paragraph B5.5.40(c), which refers to a reduction or removal of undrawn limits.

(c) **View 3**—the initiation of reminder calls to the client—in the submitter’s view, this would be consistent with paragraph BC5.255 of IFRS 9,
which refers to the entity’s practical ability to take credit risk management action.

26. In addition to the above, the submitter observes that it would also be necessary to establish whether credit risk management actions should take into account actions such as the subsequent reinstatement of limits. For example, a facility may suffer a significant increase in credit risk that results in credit limits being withdrawn or reduced, but that facility may subsequently cure and consequently credit limits may be reinstated.

27. The submitter also asks whether, having determined the ending-point using one of the approaches set out above, it may be considered appropriate to limit that point to the next date that the entity expects to carry out a review process. By this, the submitter is referring to a review process that is at least as thorough as that which took place on origination, and therefore may lead to credit risk management actions.

28. Finally, the submitter makes the following observations:

(a) the determination of measurement periods will require appropriate levels of portfolio segmentation and in some cases an entity may be able to determine different measurement periods in respect of financial instruments in different stages (ie Stage 1, Stage 2 and Stage 3 assets) \(^3\), and

(b) entities might need to disclose the basis upon which they have segmented their portfolios and how they have determined the appropriate measurement periods for revolving credit portfolios.

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\(^3\) The submitter observes that in Illustrative Example 10 of IFRS 9, only one measurement period is determined. However, in the submitter’s view, this is a simplified example and it may be possible to determine measurement periods for financial instruments in different stages. The submitter observes that this is consistent with the discussions at the April 2015 ITG meeting (see paragraph 42 of the April 2015 ITG meeting notes).
Summary of questions raised by submitters

29. We observe that both submitters raise questions regarding the maximum period to consider when measuring expected credit losses in accordance with paragraphs 5.5.20 and B5.5.40 of IFRS 9. The key questions can be summarised as follows:

(a) How should an entity determine the starting-point of the maximum period to consider when measuring expected credit losses in accordance with paragraphs 5.5.20 and B5.5.40 of IFRS 9?

(b) How should an entity determine the ending-point of the maximum period to consider when measuring expected credit losses in accordance with paragraphs 5.5.20 and B5.5.40 of IFRS 9? In this regard, we observe that the submitters ask for clarification of the meaning of ‘credit risk management actions’, specifically:

(i) whether an entity needs to consider all credit risk management actions that the entity is legally and operationally able to take, or only those that the entity expects to take;

(ii) whether an entity needs to consider only those credit risk management actions which serve to mitigate credit risk or all credit risk management actions – ie including actions that do not mitigate credit risk such as the reinstatement of previously curtailed credit limits; and

(iii) within the context of credit risk management actions which serve to mitigate credit risk, whether an entity needs to consider only credit risk management actions that serve to terminate the exposure or whether they should include other actions that limit the exposure in some way.

30. We will address each of these questions in turn in paragraphs 31-43.
Review of accounting requirements

How should an entity determine the starting-point of the maximum period to consider when measuring expected credit losses in accordance with paragraphs 5.5.20 and B5.5.40 of IFRS 9?

31. We note that in accordance with paragraph 5.5.20 IFRS 9, entities are required to measure expected credit losses over a period that may extend beyond the maximum contractual notice period. Consequently, we observe that this requirement serves to extend the maximum period to consider when measuring expected credit losses and does not alter the starting-point.

32. We note that in accordance with paragraphs 5.5.3 and 5.5.5 of IFRS 9, an entity is required to measure either lifetime or 12-month expected credit losses at each reporting date.

33. Consequently, the starting point of the period to consider when measuring expected credit losses for all financial instruments, including those falling within the scope of paragraph 5.5.20, should be the reporting date.

How should an entity determine the ending-point of the maximum period to consider when measuring expected credit losses in accordance with paragraphs 5.5.20 and B5.5.40 of IFRS 9?

34. We observe that the submitters have raised a number of specific questions regarding the meaning of credit risk management actions. Before addressing these specific questions, we set out below our analysis of the requirements of paragraphs 5.5.20 and B5.5.40 of IFRS 9:

(a) paragraph 5.5.20 of IFRS 9 introduces a limited exception to the requirements of paragraph 5.5.19 of IFRS 9. This exception applies to the maximum period to consider when measuring expected credit losses for specific financial instruments that include both a loan and an undrawn commitment component and for which the entity’s contractual ability to demand repayment and cancel the undrawn commitment does
not limit the entity’s exposure to credit losses to the contractual notice period. In accordance with that exception, an entity is required to measure expected credit losses over the period that the entity is exposed to credit risk and during which expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period; and

(b) paragraph B5.5.40 of IFRS 9 sets out additional application guidance regarding how to determine the period over which the entity is exposed to credit risk and during which expected credit losses would not be mitigated by the entity’s normal credit risk management actions. The additional application guidance highlights three particular factors that an entity should consider (see paragraph 9). We note that one of these factors relates to the credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of credit limits. However, we also note that there are two additional factors that need to be considered, namely the period over which the entity was exposed to credit risk on similar financial instruments and the length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk.4

35. We observe that the exception set out in paragraph 5.5.20 of IFRS 9 was introduced in response to concerns raised by respondents to the 2013 Impairment Exposure Draft in relation to specific types of financial instruments that contained both a loan and undrawn commitment component such as revolving credit facilities. As highlighted in paragraphs BC5.254-BC5.257 of IFRS 9, respondents were concerned that applying the requirements in paragraph 5.5.19 of IFRS 9 to these financial instruments would result in inadequate allowances and would not reflect the way in which these financial instruments were managed.

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4 We note that application of paragraph B5.5.40 of IFRS 9 was discussed during the April 2015 ITG meeting, during which it was noted that an entity is required to consider all three factors set out in paragraph B5.5.40 of IFRS 9 when determining the maximum period of credit exposure.
36. In considering these concerns, we note that as set out in paragraph BC5.259 of IFRS 9, the IASB observed that because of the way in which these financial instruments were managed, there was only one set of cash flows from the borrower and that expected credit losses were estimated on a facility level. Consequently, the IASB noted that the period over which the expected credit losses are estimated should reflect the period over which the entity is expected to be exposed to the credit risk on the instrument as a whole.

37. We consider the guidance above within the context of the questions raised by the submitters in paragraphs 38-44 below.

**Does an entity need to take into account all credit risk management actions that the entity is legally and operationally able to take or only those that the entity expects to take?**

38. In respect of this question we note the following:

   (a) paragraph 5.5.20 of IFRS 9 refers to the period that the entity is exposed to credit risk and during which expected credit losses would not be mitigated by credit risk management actions;

   (b) paragraph B5.5.40 of IFRS 9 refers to the period over which the entity is exposed to credit risk and expected credit losses would not be mitigated by the entity’s normal credit risk management actions; and

   (c) paragraph B5.5.40(c) of IFRS 9 refers to credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased.

39. Consequently, in accordance with the guidance above, an entity should take into account its normal credit risk management actions that it expects to take, rather than all credit risk management actions that are legally and operationally available to the entity.

40. We observe that this is consistent with paragraph BC5.259 of IFRS 9, which refers to the period over which the entity is expected to be exposed to the credit risk on the instrument as a whole and with paragraph BC5.260 of IFRS 9, which
refers to credit risk management actions that are taken once an exposure has increased in credit risk.

**Does an entity need to consider only credit risk management actions that serve to mitigate credit risk or all credit risk management actions—ie including actions that do not mitigate credit risk such as the reinstatement of previously curtailed credit limits?**

41. In respect of this question, we firstly point out that, as discussed in paragraphs BC5.254-BC5.261 of IFRS 9, the exception described in paragraph 5.5.20 of IFRS 9 was aimed at establishing a maximum period of credit exposure in the very limited circumstances in which the contractual notice period did not appropriately reflect the maximum period of credit exposure. We observe that having determined the maximum period in accordance with paragraph B5.5.40 of IFRS 9, it would not be appropriate to further extend this period by considering future actions within the control of the lender that served to extend that period of credit exposure beyond that maximum period. We observe that this principle would be consistent with the treatment of other financial instruments falling within the scope of paragraph 5.5.19 of IFRS 9. Consequently, it would not be appropriate to consider credit risk management actions such as the reinstatement of previously curtailed limits on assets that cure. We observe that this is further supported by the specific guidance in paragraphs 5.5.20 and B5.5.40 and in the Basis for Conclusions of IFRS 9, which refers to the need to consider credit risk management actions that would mitigate expected credit losses. Specifically:

(a) paragraphs 5.5.20 and 5.5.40 of IFRS 9 both refer the period during which the entity is exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions; and

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5 During the April 2015 ITG meeting, the significance of lender and borrower extension options was discussed and it was noted that a lender’s option to extend credit for a period in excess of the contractual period of credit exposure would not be considered to lengthen the maximum contractual period of credit exposure. See paragraph 35(a) of the April 2015 ITG meeting notes.
(b) paragraph B5.5.40(c) of IFRS 9 refers to credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the *reduction or removal of limits*; and

(c) paragraph BC5.261 of IFRS 9, which refers to the period during which the entity is expected to be exposed to credit risk and expected credit losses would not be mitigated by credit risk management action.

*Within the context of credit risk management actions that serve to mitigate credit risk, does an entity need to consider only credit risk management actions that serve to terminate the exposure or whether they should include other actions that limit the exposure in some way?*

42. As noted in paragraph 41, in accordance with paragraphs 5.5.20 and B5.5.40 of IFRS 9, an entity is required to consider credit risk management actions that serve to mitigate expected credit losses. We note that paragraph B5.5.40(c) of IFRS 9 describes a reduction of limits as one such example of the type of credit risk management action that an entity should consider.

43. Consequently, in accordance with this guidance, an entity should consider credit risk management actions that serve to mitigate expected credit losses in some way. We also observe that this would not be limited to actions that terminated the entity’s exposure to credit risk.

44. In respect of the example presented by the submitter in Issue 2, we note that in paragraph 27, the submitter asks whether the ending-point should be limited to the next date that the entity expects to carry out a review process that is at least as thorough as that which took place on origination. In this regard, we observe that if the entity’s normal business practice was to take credit risk mitigation actions as part of this review process, then it may be appropriate to consider that the maximum period considered in accordance with paragraph B5.5.40 of IFRS 9 should not extend beyond this point.
Additional observations

45. We observe that in Issue 1, the submitter asks how to determine the maximum period in accordance with paragraph B5.5.40 of IFRS 9 for the purpose of estimating future drawdowns. However, as noted in paragraph 36, the undrawn and drawn components of the financial instruments that fall within the scope of paragraph 5.5.20 of IFRS 9 were understood to be managed as one set of cash flows from the borrower. Consequently, the period over which the expected credit losses are estimated should reflect the period over which the entity is expected to be exposed to the credit risk on the instrument as a whole. Consequently, we note that the maximum period determined in accordance with paragraph B5.5.40 of IFRS 9 applies to both the drawn and undrawn components of financial instruments that fall within the scope of paragraph 5.5.20.

46. We also observe that, as is the case with all financial assets, there may be a period of recovery that extends beyond the maximum period to consider in accordance with paragraphs 5.5.19 or 5.5.20 of IFRS 9.

47. Finally, within the context of the issues presented in this paper, we observe that an entity should be mindful of the disclosure requirements of IFRS 7. In this regard, we note that paragraph 35G of IFRS 7 requires an entity to provide a number of credit risk disclosures including disclosures regarding the inputs, assumptions and estimation techniques used to apply the impairment requirements of IFRS 9. In addition, we note that in accordance with paragraph 35E of IFRS 7 an entity may be required to provide additional disclosures in order to meet the overall objective of credit risk disclosures in accordance with paragraph 35B of IFRS 7.

Question for ITG members

What are your views on the issues presented above?
Appendix A

Extracts from the Basis for Conclusions of IFRS 9

**BC5.254** Respondents to the 2013 Impairment Exposure Draft widely supported the proposed requirements for loan commitments and financial guarantee contracts in general, and no new arguments were raised that the IASB considered would call into question its prior analysis. However, the majority of respondents that supported including loan commitments within the scope of the proposed model noted that expected credit losses on some loan commitments should be estimated over the behavioural life of the financial instrument, instead of over the contractual commitment period. Although they noted that the use of the contractual period would be conceptually appropriate, there was concern that using the contractual period:

(a) would be contrary to how the exposures are handled for credit risk management and regulatory purposes;

(b) could result in insufficient allowances for the exposures arising from these contracts; and

(c) would result in outcomes for which no actual loss experience exists on which to base the estimates.

**BC5.255** Respondents noted that the use of the contractual period was of particular concern for some types of loan commitments that are managed on a collective basis, and for which an entity usually has no practical ability to withdraw the commitment before a loss event occurs and to limit the exposure to credit losses to the contractual period over which it is committed to extend the credit. Respondents noted that this applies particularly to
revolving credit facilities such as credit cards and overdraft facilities. For these types of facilities, estimating the expected credit losses over the behavioural life of the instruments was viewed as more faithfully representing their exposure to credit risk.

**BC5.256** Respondents also noted that those revolving credit facilities lack a fixed term or repayment structure and allow borrowers flexibility in how frequently they make drawdowns on the facility. Such facilities can be viewed as a combination of an undrawn loan commitment and a drawn-down loan asset. Typically, these facilities can be contractually cancelled by a lender with little or no notice, requiring repayment of any drawn balance and cancellation of any undrawn commitment under the facility. There would be no need on a conceptual basis to recognise expected credit losses on the undrawn portion of these facilities, because the exposure period could be as little as one day under the proposals in the 2013 Impairment Exposure Draft.

**BC5.257** Outreach performed during the comment period on the 2013 Impairment Exposure Draft indicated that, in practice, lenders generally continue to extend credit under these types of financial instruments for a duration longer than the contractual minimum and only withdraw the facility if observable credit risk on the facility has increased significantly. The IASB noted that, for such facilities, the contractual maturities are often set for protective reasons and are not actively enforced as part of the normal credit risk management processes. Participants also noted that it may be difficult to withdraw undrawn commitments on these facilities for commercial reasons unless there has been an increase in credit risk. Consequently, economically, the contractual ability to demand repayment...
and cancel the undrawn commitment does not necessarily prevent an entity from being exposed to credit losses beyond the contractual notice period.

**BC5.258** The IASB noted that the expected credit losses on these type of facilities can be significant and that restricting the recognition of a loss allowance to expected credit losses in the contractual notice period would arguably be inconsistent with the notion of expected credit losses (ie it would not reflect actual expectations of loss) and would not reflect the underlying economics or the way in which those facilities are managed for credit risk purposes. The IASB also noted that the amount of expected credit losses for these facilities could be significantly lower if the exposure is restricted to the contractual period, which may be inconsistent with an economic assessment of that exposure.

**BC5.259** The IASB further noted that from a credit risk management perspective, the concept of expected credit losses is as relevant to off balance sheet exposures as it is to on balance sheet exposures. These types of financial instruments include both a loan (ie financial asset) and an undrawn commitment (ie loan commitment) component and are managed, and expected credit losses are estimated, on a facility level. In other words there is only one set of cash flows from the borrower that relates to both components. Expected credit losses on the on balance sheet exposure (the financial asset) are not estimated separately from the expected credit losses on the off balance sheet exposure (the loan commitment). Consequently, the period over which the expected credit losses are estimated should reflect the period over which the entity is expected to be exposed to the credit risk on the instrument as a whole.
BC5.260 The IASB remains of the view that the contractual period over which an entity is committed to provide credit (or a shorter period considering prepayments) is the correct conceptual outcome. The IASB noted that most loan commitments will expire at a specified date, and if an entity decides to renew or extend its commitment to extend credit, it will be a new instrument for which the entity has the opportunity to revise the terms and conditions. Consequently, the IASB decided to confirm that the maximum period over which expected credit losses for loan commitments and financial guarantee contracts are estimated is the contractual period over which the entity is committed to provide credit.

BC5.261 However, to address the concerns raised about the financial instruments noted in paragraphs BC5.254–BC5.257, the IASB decided that for financial instruments that include both a loan and an undrawn commitment component and the entity’s contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity’s exposure to credit losses to the contractual notice period, an entity shall estimate expected credit losses over the period that the entity is expected to be exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. When determining the period over which the entity is exposed to credit risk on the financial instrument, the entity should consider factors such as relevant historical information and experience on similar financial instruments. The measurement of expected credit losses should take into account credit risk management actions that are taken once an exposure has increased in credit risk, such as the reduction or withdrawal of undrawn limits.
Appendix B

Example 10—revolving credit facilities

IE58 Bank A provides co-branded credit cards to customers in conjunction with a local department store. The credit cards have a one-day notice period after which Bank A has the contractual right to cancel the credit card (both the drawn and undrawn components). However, Bank A does not enforce its contractual right to cancel the credit cards in the normal day-to-day management of the instruments and only cancels facilities when it becomes aware of an increase in credit risk and starts to monitor customers on an individual basis. Bank A therefore does not consider the contractual right to cancel the credit cards to limit its exposure to credit losses to the contractual notice period.

IE59 For credit risk management purposes Bank A considers that there is only one set of contractual cash flows from customers to assess and does not distinguish between the drawn and undrawn balances at the reporting date. The portfolio is therefore managed and expected credit losses are measured on a facility level.

IE60 At the reporting date the outstanding balance on the credit card portfolio is CU60,000 and the available undrawn facility is CU40,000. Bank A determines the expected life of the portfolio by estimating the period over which it expects to be exposed to credit risk on the facilities at the reporting date, taking into account:

(a) the period over which it was exposed to credit risk on a similar portfolio of credit cards;

(b) the length of time for related defaults to occur on similar financial instruments; and
(c) past events that led to credit risk management actions because of an increase in credit risk on similar financial instruments, such as the reduction or removal of undrawn credit limits.

IE61 On the basis of the information listed in paragraph IE60, Bank A determines that the expected life of the credit card portfolio is 30 months.

IE62 At the reporting date Bank A assesses the change in the credit risk on the portfolio since initial recognition and determines in accordance with paragraph 5.5.3 of IFRS 9 that the credit risk on a portion of the credit card facilities representing 25 per cent of the portfolio, has increased significantly since initial recognition. The outstanding balance on these credit facilities for which lifetime expected credit losses should be recognised is CU20,000 and the available undrawn facility is CU10,000.

IE63 When measuring the expected credit losses in accordance with paragraph 5.5.20 of IFRS 9, Bank A considers its expectations about future draw-downs over the expected life of the portfolio (ie 30 months) in accordance with paragraph B5.5.31 and estimates what it expects the outstanding balance (ie exposure at default) on the portfolio would be if customers were to default. By using its credit risk models Bank A determines that the exposure at default on the credit card facilities for which lifetime expected credit losses should be recognised, is CU25,000 (ie the drawn balance of CU20,000 plus further draw-downs of CU5,000 from the available undrawn commitment). The exposure at default of the credit card facilities for which 12-month expected credit losses are recognised, is CU45,000 (ie the outstanding balance of CU40,000 and an additional draw-down of CU5,000 from the undrawn commitment over the next 12 months).
IE64  The exposure at default and expected life determined by Bank A are used to measure the lifetime expected credit losses and 12-month expected credit losses on its credit card portfolio.

IE65  Bank A measures expected credit losses on a facility level and therefore cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component. It recognises expected credit losses for the undrawn commitment together with the loss allowance for the loan component in the statement of financial position. To the extent that the combined expected credit losses exceed the gross carrying amount of the financial asset, the expected credit losses should be presented as a provision (in accordance with IFRS 7 Financial Instruments: Disclosure).
Appendix C

Extract from April 2015 ITG meeting notes

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 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.
Appendix D—Table 1

<table>
<thead>
<tr>
<th>Defined Period⁶</th>
<th>Start Date</th>
<th>End Date</th>
<th>Time period⁷</th>
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<tbody>
<tr>
<td><strong>Period A:</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>‘all good’</td>
<td>Date of origination</td>
<td>Customer is facing financial difficulties but these problems are not yet identified by the lender</td>
<td>25 months</td>
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<tr>
<td></td>
<td>[January 20x2]</td>
<td>[February 20x4]</td>
<td></td>
</tr>
<tr>
<td><strong>Period B:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘trouble identification/confirmation/emergence’</td>
<td>Customer is facing financial difficulties but these problems are not yet identified by the lender</td>
<td>Increase in credit risk has been identified by the bank (eg paying minimum balance for a number of payment cycles)</td>
<td>9 months</td>
</tr>
<tr>
<td></td>
<td>[February 20x4]</td>
<td>[November 20x4]</td>
<td></td>
</tr>
<tr>
<td><strong>Period C:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>‘credit monitoring and mitigation’</td>
<td>Increase in credit risk has been identified by the bank (eg paying minimum balance)</td>
<td>Taking mitigating action (eg cut-off/reduce undrawn limit/send to collections division and establish a repayment schedule)</td>
<td>30 months</td>
</tr>
<tr>
<td></td>
<td>[November 20x4]</td>
<td>[April 20x7]</td>
<td></td>
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<tr>
<td><strong>Period D:</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>‘post mitigation’</td>
<td>eg cut-off/reduce undrawn limit and establish a repayment schedule)</td>
<td>Default</td>
<td>4 months</td>
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<tr>
<td></td>
<td>[April 20x7]</td>
<td>[August 20x7]</td>
<td></td>
</tr>
<tr>
<td><strong>Period E:</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>‘recovery’</td>
<td>Default</td>
<td>Write-off/transfer to an external collection agency</td>
<td>2 months</td>
</tr>
<tr>
<td></td>
<td>[August 20x7]</td>
<td>[October 20x7]</td>
<td></td>
</tr>
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⁶ The periods illustrated in this table should not be taken to reflect IFRS 9 expected credit loss stages.

⁷ The length of each period and associated start and end dates for each period are assumed for illustrative purposes.