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IFRS 9 for banks

Illustrative disclosures

February 2017

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IFRS 9 for banks – Illustrative disclosures

This publication presents the disclosures introduced or modified by IFRS 9 '*Financial Instruments*' for a fictional medium-sized bank. It does not address all the disclosure requirements of IFRS, but instead focuses on the new disclosures introduced or modified by IFRS 9 through consequential amendments to IFRS 7 '*Financial instruments: Disclosures*'. Supporting commentary is also provided.

This publication is for illustrative purposes only and should be used in conjunction with the relevant financial reporting standards and any other reporting pronouncements and legislation applicable in specific jurisdictions.

Global Accounting Consulting Services

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Contents

Introduction

This publication presents illustrative disclosures introduced or modified by IFRS 9 'Financial instruments' for a fictional medium-sized bank.

We have illustrated a realistic set of disclosures for a medium-sized bank. However, as this publication is a reference tool, we have not removed any disclosures based on materiality. Consequently, some of the disclosures in this publication would likely be immaterial if the bank were a 'real life' company.

IFRS 9 allows a variety of approaches in measuring expected credit losses (ECL) and industry thinking continues to evolve at the date of this publication. Banks will need to take account of their individual circumstances in determining the approach taken to measuring ECL and the appropriate disclosures. The approaches illustrated in this publication are one possible way the requirements of IFRS 9 ECL may be met but are not intended to provide any view on the type of approach that should be applied.

Using this publication

The source for each disclosure requirement is given in the reference column. There is also commentary that (i) explains some of the most challenging areas, or (ii) lists disclosures that have not been included because they are not relevant to the fictional bank's circumstances.

The example disclosures may not be the only acceptable form of presenting financial statement disclosures. Alternative presentations may be acceptable if they comply with the specific disclosure requirements prescribed by IFRS. Readers may find our IFRS disclosure checklist useful to identify other disclosures that may be relevant under the circumstances but are not illustrated in this publication (such as those highlighted in observations boxes throughout this publication). Conversely, disclosures presented in this publication should not be included where they are not relevant or not material in specific circumstances.

Preparers of financial reporting should also consider local legal and regulatory requirements which may stipulate additional disclosures that are not illustrated in this publication. Specifically, this publication does not cover the disclosure recommendations proposed by the Enhanced Disclosure Task Force (EDTF) in its '*Impact of Expected Credit Loss Approaches on Bank Risk Disclosures*' report.

Finally, we note that, when banks provide some of the disclosures required by IFRS in sections of their Annual Reports other than the financial statements, these too need to be updated for changes introduced by IFRS 9.

Consolidated statement of profit or loss

Reference		Year ended 31 December	
IAS1(10)(b),(10A) IAS1(51)(c),(e) IAS1(113)		2018 CU'000	2017 CU'000
IFRS7(20)(b), IAS1(82)(a)	Interest income	10,010	8,059
IFRS7(20)(b)	Interest expense	(7,852)	(6,269)
	Net interest income	**2,158**	**1,790**
IFRS7(20)(c)	Fee and commission income	1,391	1,326
IFRS7(20)(c)	Fee and commission expense	(378)	(392)
	Net fee and commission income	**1,013**	**934**
	Net trading income	421	323
	Net investment income	188	90
IAS1(82)(ba)	Credit impairment losses	(530)	(300)
IAS1(82)(aa)	Net gains/(losses) on derecognition of financial assets measured at amortised cost	(12)	N/A
	Other operating income	12	30
	Net other operating income	**79**	**143**
	Personnel expenses	(983)	(1,057)
	General and administrative expenses	(315)	(351)
	Depreciation and amortisation expense	(451)	(447)
	Other operating expenses	(278)	(192)
	Operating profit	**1,223**	**820**
IAS1(82)(c)	Share of profit of associates and joint ventures accounted for using the equity method	12	15
	Profit before income tax	**1,235**	**835**
IAS1(82)(d), IAS12(77)	Income tax expense	(122)	(20)
IAS1(81A)(a)	**Profit for the year**	**1,113**	**815**
IAS1(81B)(a)	**Profit attributable to:**		
	Equity holders of the parent entity	1,106	831
	Non-controlling interests	7	(16)
IAS33(66)	**Earnings per share for the profit attributable to the equity holders of the parent entity during the year** (expressed in CU per share):		
	– Basic	0.90	0.82
	– Diluted	0.78	0.70

The above consolidated statement of profit or loss should be read in conjunction with the accompanying notes.

New presentation requirements in applying IFRS 9.

PwC observation – Disclosure of items of income, expense, gains or losses and reclassification

Paragraph 20 of IFRS 7 requires disclosure, either in the statement of comprehensive income or in the notes, of the following items of income, expense, gains or losses:

- Net gain or net losses on:
  - Financial assets or financial liabilities measured at FVPL, showing separately those designated upon initial recognition and those that are mandatorily measured at FVPL. For financial liabilities, gains or losses recognised in profit or loss and those recognised in OCI should be shown separately.
  - Financial liabilities measured at amortised cost.
  - Financial assets measured at amortised cost.
  - Investments in equity instruments designated at FVOCI.
  - Financial assets measured at FVOCI, showing separately amounts recognised in OCI and amounts reclassified upon derecognition to P&L in the period.
- Total interest revenue and total interest expense, for financial assets measured at amortised cost or FVOCI, and for financial liabilities not measured at FVPL.
- Fee income and fee expense, arising from financial assets and liabilities not measured at FVPL and from trust and other fiduciary activities.

In these illustrative financial statements, it has been assumed these are disclosed in the notes.

We also note that Banks choosing not to restate the comparative period, that previously used IAS 39 terms such as ‘Available for sale’ in line item descriptions, will need to show the retired IAS 39 categories for comparatives.

Gains and losses on derecognition of financial assets measured at amortised cost are now required to be presented separately on the face of the statement of profit or loss. While such amounts may also have arisen in the prior period, consistent with all other prior period amounts, the comparatives have not been restated.

Disclosures not illustrated as not applicable to the Group

Paragraphs 82(ca) and 82(cb) were introduced in IAS 1 ‘Presentation of Financial Statements’ as part of the consequential amendments from IFRS 9. These paragraphs require entities to present gains or losses arising from the reclassification of financial assets from amortised cost to FVPL, and from FVOCI to FVPL, on the face of the statement of profit or loss. Such reclassifications under IFRS 9 are expected to be rare in practice and therefore have not been illustrated.

Consolidated statement of comprehensive income

		Year ended 31 December	
		2018 CU'000	2017 CU'000
IAS1(81A)(a)	**Profit for the year**	**1,113**	**815**
	Items that may be reclassified to profit or loss		
	Net gains on investments in available for sale assets	N/A	20
	Net gains on investments in available for sale assets reclassified to profit or loss on disposal	N/A	12
IAS1p7(da)	Net gains on investments in debt instruments measured at FVOCI	12	N/A
	Net loss on financial assets measured at FVOCI reclassified to profit or loss on disposal	(3)	N/A
	Currency translation of foreign operations	10	(10)
	Net Investment hedges		
	– Net gains arising on hedges recognised in OCI	(9)	8
IAS1(82A)	Share of other comprehensive income of associates and joint ventures accounted for by the equity method	2	-
	Cash flow hedges		
	– Net losses arising on hedges recognised in OCI	(62)	(53)
	– Net amount reclassified to the profit or loss	21	–
IAS1(91)	Income tax relating to these items	6	4
	Items that will not be reclassified to profit or loss		
IAS1(7)(d), IFRS7(20)(a)(vii)	Net gains on investments in equity instruments designated at fair value through other comprehensive income	5	N/A
IAS1p7(f)	Change in fair value attributable to change in the credit risk of financial liability designated at FVPL	(37)	N/A
IAS1(82A)	Share of other comprehensive income of associates and joint ventures accounted for by the equity method	(1)	-
IAS1(82A),IAS 19(120)(c)	Remeasurements of post-employment benefit obligations, before tax	29	39
IAS1(91)	Income tax relating to these items	1	(8)
	Other comprehensive income for the year, net of tax	**(26)**	**12**
IAS1(81A)(c)	**Total comprehensive income for the year**	**1,087**	**827**
IAS1(81B)(b)	**Total comprehensive income attributable to:**		
	Equity holders of the parent entity (total)	1,080	843
	Non-controlling interests (total)	7	(16)
		1,087	**827**

The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

New presentation requirements in applying IFRS 9.

Consolidated balance sheet

		As at 31 December	
IAS1(10)(a),(54) IAS 1(51)(c),(e) IAS 1(113)		2018 CU'000	2017 CU'000
IAS1(60),(66)	**Assets**		
IAS1(54)(i)	Cash and balances with central banks	6,655	4,343
IFRS7(8)(f)	Loans and advances to banks	12,009	8,050
IFRS7(8)(f)	Loans and advances to customers	86,514	76,520
IFRS7(8)(a)(ii)	Trading assets	8,487	10,880
IAS1(59)	Hedging derivatives	2,153	1,654
IAS1(55)	Investment securities	8,765	4,987
IAS1(54)(e)	Investments in associates and joint ventures	147	141
IAS1(54)(a)	Property, plant and equipment	1,927	2,037
IAS1(54)(c)	Intangible assets	279	360
IAS1(54)(o)	Deferred income tax assets	358	334
IAS1(55)	Other assets	2,511	2,641
	Total assets	**129,805**	**111,947**
	Liabilities		
IFRS7(8)(g)	Deposits from banks	40,395	33,469
IFRS7(8)(g)	Deposits from customers	64,987	57,953
IFRS7(8)(e)(ii)	Trading liabilities	4,324	3,706
IFRS7(8)(e)(i)	Financial liabilities designated at fair value	1,791	1,717
IAS1(59)	Hedging derivatives	2,658	3,674
IAS1(54)(m), IFRS7(8)(g)	Debt securities in issue	2,313	1,614
IAS1(54)(l)	Retirement benefit obligations	310	290
IAS1(54)(l)	Provisions	507	300
IAS1(54)(n)	Current income tax liabilities	132	164
IAS1(54)(o)	Deferred income tax liabilities	1,453	908
IAS1(55)	Other liabilities	1,146	685
IFRS7(8)(g)	Convertible bonds	212	211
IAS32(18)(b), IAS1(55)	Subordinated debt	4,765	2,644
	Total liabilities	**124,993**	**107,335**

	Equity		
IAS1(54)(r)	**Capital and reserves attributable to equity holders of the parent entity**		
IAS1(78)(e)	Share capital	1,519	1,507
IAS1(78)(e)	Share premium	1,171	1,072
	Treasury shares	(63)	(68)
IAS1(78)(e)	Retained earnings	1,904	1,729
	Cashflow hedge	(37)	(4)
IAS1(78)(e)	Other reserves	224	279
		4,718	**4,515**
IAS1(54)(q)	**Non-controlling interests in equity**	**94**	**97**
	Total equity	**4,812**	**4,612**
	Total equity and liabilities	**129,805**	**111,947**

The above consolidated balance sheet should be read in conjunction with the accompanying notes.

PwC observation – Disclosure of financial assets and liabilities by category

Paragraph 8 of IFRS 7 requires disclosure, either in the balance sheet or in the notes, of the carrying amounts of financial assets and liabilities by the following categories:

- Financial assets measured at FVPL, showing separately those mandatorily classified and those designated upon initial recognition.
- Financial liabilities measured at FVPL, showing those that meet the definition of held for trading and those designated upon initial recognition.
- Financial assets measured at amortised cost.
- Financial liabilities measured at amortised cost.
- Financial assets measured at FVOCI, showing separately debt and equity instruments.

In these illustrative financial statements, it has been assumed these are disclosed in the notes. However, depending on the materiality of these items, separate presentation on the face of the balance sheet may be more appropriate.

The line items presented in the year of adoption of IFRS 9 may also vary depending on the line items previously used. For example, Banks that previously used IAS 39 terms in line item descriptions and choose not to restate comparative periods, may choose either to:

(i) Use consistent line item descriptions across both current and prior periods, such as ‘Financial assets at amortised cost’ and ‘Financial assets at fair value through other comprehensive income’ and reclassify prior year items (such as ‘Loans and receivables’ and ‘Available for sale’) under these headings; or

(ii) Leave the prior year classifications unchanged and show the retired IAS 39 categories within the comparatives.

Consolidated statement of changes in equity

IAS1(10)(c), IAS1(106) IAS1(108) IAS1(106)(d)

Reference		Attributable to owners of the parent entity							
		Share capital	Share premium	Treasury shares	Retained earnings	Cash flow hedges	Other reserves	Non-controlling interests	Total equity
		CU'000	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000
	Balance at 1 January 2017	**1,489**	**986**	**(62)**	**859**	**40**	**262**	**113**	**3,687**
IAS1(106)(d)(i)	Profit for the period	–	–	–	831	–	–	(16)	815
	Other comprehensive income	–	–	–	39	(44)	17	–	12
IAS1(106)(a)	**Total comprehensive income for the period**	**–**	**–**	**–**	**870**	**(44)**	**17**	**(16)**	**827**
IAS1(106)(d)(iii)	Issue of share capital	10	50	–	–	–	–	–	60
IAS1(106)(d)(iii), IAS1(109), IAS32(33)	Purchase of treasury shares	–	(15)	(6)	–	–	–	–	(21)
IFRS2(7)	Employee share option scheme:								
IFRS2(51)(a)	Value of employee services	–	51	–	–	–	–	–	51
IAS1(106)(d)(iii)	Proceeds from shares issued	8	–	–	–	–	–	–	8
	Balance at 31 December 2017	**1,507**	**1,072**	**(68)**	**1,729**	**(4)**	**279**	**97**	**4,612**
	Balance at 1 January 2018	**1,507**	**1,072**	**(68)**	**1,729**	**(4)**	**279**	**97**	**4,612**
IAS1(106)(b)	Changes on initial application of IFRS 9 (see note 1)	–	–	–	(938)	–	(35)	(10)	(983)
	Restated balance at 1 January 2018	**1,507**	**1,072**	**(68)**	**791**	**(4)**	**244**	**87**	**3,629**
IAS1(106)(d)(i)	Profit for the period	–	–	–	1,106	–	–	7	1,113
	Other comprehensive income	–	–	–	27	(33)	(20)	–	(26)
IAS1(106)(a)	**Total comprehensive income for the period**	**–**	**–**	**–**	**1,133**	**(33)**	**(20)**	**7**	**1,087**
IAS1(106)(d)(iii)	Dividends	–	–	–	(20)	–	–	–	(20)
IAS1(106)(d)(iii)	Issue of share capital	3	30	–	–	–	–	–	33
IAS1(106)(d)(iii), IAS1(109), IAS32(33)	Sales of treasury shares	–	9	5	–	–	–	–	14

		Attributable to owners of the parent entity							
IAS1(10)(c), IAS1(106) IAS1(108) IAS1(106)(d)		**Share capital**	**Share premium**	**Treasury shares**	**Retained earnings**	**Cash flow hedges**	**Other reserves**	**Non-controlling interests**	**Total equity**
		CU'000	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000
IFRS2(7)	Employee share option scheme:								–
IFRS2(51)(a)	Value of employee services	–	60	–	–	–	–	–	60
IAS1(106)(d)(iii)	Proceeds from shares issued	9	–	–	–	–	–	–	9
	Balance at 31 December 2018	**1,519**	**1,171**	**(63)**	**1,904**	**(37)**	**224**	**94**	**4,812**

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.

New presentation requirements in applying IFRS 9.

Consolidated statement of cash flows

Statement of cash flows not illustrated

A statement of cash flows has not been included in these illustrative financial statements as the required disclosures are not changed by IFRS 9.

Notes to the financial statements

1. Significant accounting policies

1.1 Changes in accounting policies

IFRS9 (7.2.15) The Group has adopted IFRS 9 as issued by the IASB in July 2014 with a date of transition of 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements. The Group did not early adopt any of IFRS 9 in previous periods.

As permitted by the transitional provisions of IFRS 9, the Group elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current period. The Group has also elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9.

Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also only been applied to the current period. The comparative period notes disclosures repeat those disclosures made in the prior year.

The adoption of IFRS 9 has resulted in changes in our accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7 'Financial Instruments: Disclosures'.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the Group. Further details of the specific IFRS 9 accounting policies applied in the current period (as well as the previous IAS 39 accounting policies applied in the comparative period) are described in more detail in section 1.2 below.

(a) Classification and measurement of financial instruments

IFRS7 (42I)(a),(b) The measurement category and the carrying amount of financial assets and liabilities in accordance with IAS 39 and IFRS 9 at 1 January 2018 are compared as follows:

	IAS 39		**IFRS 9**	
	Measurement category	**Carrying amount**	**Measurement category**	**Carrying amount**
Financial assets		CU'000		CU'000
Cash and balances with central banks	Amortised cost (Loans and receivables)	4,343	Amortised cost	4,343
Loans and advances to banks	Amortised cost (Loans and receivables)	8,050	Amortised cost	7,992
Loans and advances to customers	Amortised cost (Loans and receivables)	76,520	Amortised cost	68,992
			FVPL (Mandatory)	6,617
Trading assets	FVPL (Held for trading)	10,880	FVPL (Mandatory)	10,880
Hedging derivatives	FVPL (Hedging instrument) [a]	1,654	FVPL (Mandatory) [a]	1,654
Investment securities	FVOCI (Available for sale)	2,678	FVOCI	1,228
	Amortised cost (Loans and Receivables)	546	Amortised cost	2,209
	Amortised cost (Held to Maturity)	1,205		
	FVPL (Designated)	546	FVPL (Designated)	–
	FVPL (Embedded derivative)	12	FVPL (Mandatory)	1,536

IFRS9 (6.5.11) (b),(c)

Note:

(a) Except for derivatives designated in cash flow hedging relationships where, to the extent that the hedge is effective, changes in fair value are taken to the hedging reserve through other comprehensive income. Any ineffectiveness is recognised in profit or loss.

There were no changes to the classification and measurement of financial liabilities, other than to changes in the fair value of financial liabilities designated at fair value through profit or loss that are attributable to changes in the instrument's credit risk, which are now presented in other comprehensive income (refer to note 1.2.1.2(i)).

PwC observation – Classification of cash and deposits with banks

The classification of cash deposits is determined based on the same requirements as other financial assets. Therefore, an assessment of business model and SPPI criterion should be performed based on the specific facts and circumstances. However, in most situations, the business model would be expected to be Hold to Collect (e.g. the business model would not involve selling cash balances to other parties) and the SPPI test would be met (e.g. as only a benchmark rate, or nil, interest is earned).

(b) Reconciliation of statement of financial position balances from IAS 39 to IFRS 9

IFRS7(42J)

The Group performed a detailed analysis of its business models for managing financial assets and analysis of their cash flow characteristics.

Please refer to note 1.2.1.1(i) for more detailed information regarding the new classification requirements of IFRS 9.

IFRS7(42K)-(42O)

IFRS7(IG40E)

The following table reconciles the carrying amounts of financial assets, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

	Ref	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
		CU'000	**CU'000**	**CU'000**	**CU'000**
Amortised Cost					
Cash and balances with central banks					
Opening balance under IAS 39 and closing balance under IFRS 9		4,343			4,343
Loans and advances to banks					
Opening balance under IAS 39		8,050			
Remeasurement: ECL allowance				(58)	
Closing balance under IFRS 9					7,992
Loans and advances to Customers					
Opening balance under IAS 39		76,520			
Subtraction: To FVPL (IFRS 9)	**(C)**		(6,541)		
Remeasurement: ECL allowance				(987)	
Closing balance under IFRS 9					68,992

	Ref	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
		CU'000	**CU'000**	**CU'000**	**CU'000**
Investment securities – amortised cost					
Opening balance under IAS 39		546			
Subtraction: To FVPL (IFRS 9)	**(D)**		(102)		
Remeasurement: ECL allowance				(4)	
Addition: From financial assets held to maturity (IAS 39)	**(I)**		1,205		
Remeasurement: ECL allowance				(10)	
Addition: From available for sale (IAS 39)	**(B)**		341		
Remeasurement: from FV to amortised cost				(1)	
Addition: From designated at FVPL (IAS 39)	**(G)**		236		
Remeasurement: from FV to amortised cost				(2)	
Closing balance under IFRS 9					2,209
Investment securities – Held to maturity					
Opening balance under IAS 39		1,205			
Subtraction: To amortised cost (IFRS 9)	**(I)**		(1,205)		
Closing balance under IFRS 9					-
Total financial assets measured at amortised cost		**90,664**	**(6,066)**	**(1,062)**	**83,536**
Fair value through profit or loss (FVTPL)					
Trading assets					
Opening balance under IAS 39 and closing balance under IFRS 9		10,880			10,880
Loans and advances to Customers					
Opening balance under IAS 39		-			
Addition: From amortised cost (IAS 39)	**(C)**		6,541		
Remeasurement: from amortised cost to FV				76	
Closing balance under IFRS 9					6,617

	Ref	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
		CU'000	**CU'000**	**CU'000**	**CU'000**
Investment Securities – FVPL (mandatory)					
Opening balance under IAS 39		12			
Addition: From available for sale (IAS 39)	**(A)**		455		
Addition: From available for sale (IAS 39)	**(E)**		654		
Addition: From amortised cost (IAS 39)	**(D)**		102		
Remeasurement: from amortised cost to FV				3	
Addition: From designated at FVPL (IAS 39)	**(F)**		310		
Closing balance under IFRS 9					1,536
Investment Securities – FVPL (designated)					
Opening balance under IAS 39		546			
Subtraction: To mandatory FVPL (IFRS 9)	**(F)**		(310)		
Subtraction: To amortised cost (IFRS 9) – Voluntary reclassification	**(G)**		(236)		
Closing balance under IFRS 9					-
Hedging derivatives[(a)]					
Opening balance under IAS 39 and closing balance under IFRS 9		1,654			1,654
Total financial assets measured at FVPL		**13,092**	**7,516**	**79**	**20,687**
Fair value through other comprehensive income (FVOCI)					
Investment securities – FVOCI (debt instruments)					
Opening balance under IAS 39		-			
Addition: From available for sale (IAS 39)	**(I)**		778		
Closing balance under IFRS 9					778
Investment securities – FVOCI (equity instruments)					
Opening balance under IAS 39		-			
Addition: From available for sale (IAS 39) – Designated	**(H)**		450		
Closing balance under IFRS 9					450

	Ref	IAS 39 carrying amount 31 December 2017	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2018
		CU'000	**CU'000**	**CU'000**	**CU'000**
Investment securities – Available for sale financial assets					
Opening balance under IAS 39		2,678			
Subtraction: To mandatory FVPL (IFRS 9)	**(A)**		(455)		
Subtraction: To mandatory FVPL (IFRS 9)	**(E)**		(654)		
Subtraction: To amortised cost (IFRS 9)	**(B)**		(341)		
Subtraction: To FVOCI – equity instruments	**(H)**		(450)		
Subtraction: To FVOCI – debt instruments	**(I)**		(778)		
Closing balance under IFRS 9					-
Total financial assets measured at FVOCI		**2,678**	**(1,450)**	**-**	**1,228**

IFRS9 (6.5.11)(b),(c)

Note

(a) Derivatives designated in cash flow hedging relationships with effective changes in fair value taken to the hedging reserve through other comprehensive income. Any ineffectiveness is recognised in profit or loss.

The total remeasurement loss of CU 983,000 was recognised in opening reserves at 1 January 2018. In addition, an amount of CU 120,000 was reclassified from retained earnings to other reserves at 1 January 2018 in respect of cumulative own credit adjustments on financial liabilities designated at fair value through profit and loss.

The following explains how applying the new classification requirements of IFRS 9 led to changes in classification of certain financial assets held by the Group as shown in the table above:

(A) Debt instruments previously classified as available for sale but which fail the SPPI test

The Group holds a portfolio of debt instruments that failed to meet the 'solely payments of principal and interest' (SPPI) requirement for amortised cost classification under IFRS 9. These instruments contain provisions that, in certain circumstances, can allow the issuer to defer interest payments, but which do not accrue additional interest. This clause breaches the criterion that interest payments should only be consideration for credit risk and the time value of money on the principal. As a result, these instruments, which amounted to CU 455,000, were classified as FVPL from the date of initial application.

(B) Securities within the liquidity portfolio

After assessing its business model for securities within the Group's liquidity portfolio, which are mostly held to collect the contractual cash flows and sell, the Group has identified certain securities which are managed separately and for which the past practice has been (and the Group's intention remains) to hold to collect the contractual cash flows. Consequently, the Group assessed that the appropriate business model for this group of securities is held to collect. These securities, which amounted to CU 341,000 and which were previously classified as available for sale, were classified as amortised cost from the date of initial application. The remainder of the Group's liquidity portfolio is held to collect contractual cash flows and sell.

(C) Syndicated loans

The Group acted as the lead arranger of a syndicated loan facility to one of its major customers. The facility amount requested by the customer exceeded the Group's limit for single client exposure under the Group credit risk policy, so the facility was approved with the condition that the excess amount of CU 6,541,000 be sold in the medium term. Under IFRS 9, this amount exceeding the Group's limit is classified as part of a hold to sell business model and measured at FVPL. The loan was previously measured at amortised cost in its entirety.

(D) Investments in convertible loan notes

The Group holds investments in convertible loan notes of CU 102,000 which are not traded in an active market. These were accounted for previously as hybrid instruments with (i) the equity conversion feature representing an embedded derivative separately accounted for at fair value through profit or loss (presented together with Investment Securities) and (ii) the debt host classified as a loan and receivable and measured at amortised cost. Under IFRS 9, the instruments are assessed as a whole and, due to the equity conversion feature, failed the SPPI test. Consequently, the instruments are now measured at FVPL in their entirety.

(E) Investments in asset-backed securities

The Group holds investments in a portfolio of fixed rate securities backed by real estate property loans which were issued by a special purpose entity. After performing detailed analysis, the Group concluded that these investments do not pass the SPPI test given the notes form part of one of the more subordinated tranches issued by the special purpose entity, so that the exposure to credit risk of the investment is greater than the exposure to credit risk of the underlying asset pool as a whole. As a result, this portfolio of securities, which were previously classified as available-for-sale and amounted to CU 654,000, have been reclassified to FVPL.

(F) Investment in debt securities previously designated at fair value through profit or loss

IFRS7(42I)(c)
IFRS7(42J)(b)

The Group holds an investment of CU 310,000 in a portfolio of debt securities which had previously been designated at fair value through profit or loss as the debt securities were managed on a fair value basis. As part of the transition to IFRS 9, these securities are part of an 'other' business model and so required to be classified as FVPL, instead of designated FVPL.

(G) De-designation of investment in debt instrument previously designated at fair value through profit or loss

IFRS7(42I)(c)
IFRS7(42J)(b)

The Group holds debt instruments amounting to CU 236,000 equivalent which had previously been designated at FVPL to reduce an accounting mismatch with derivatives used in an economic hedge of interest rate risk. The Group has chosen to de-designate these financial assets upon transition to IFRS 9 and measure them at amortised cost as, subsequent to initial recognition, the Group has economically offset the original exposure with debt securities and, consequently, terminated the derivatives previously used in the economic hedge.

IFRS7(42N)

The effective interest rate of these debt instruments is 8.5% per annum and CU 20,000 of interest income has been recognised during the year.

IFRS7(42N)

PwC observation – Disclosures of EIR and interest income for financial assets and liabilities reclassified out of FVPL category on transition to IFRS 9

If an entity treats the fair value of a financial asset or a financial liability as the new gross carrying amount at the date of initial application (when allowed by paragraph 7.2.11 of IFRS 9), the disclosure above shall be made for each reporting period until derecognition. If an entity does not, these disclosures need not be made after the annual reporting period in which the entity initially applies the classification and measurement requirements for financial assets in IFRS 9.

(H) Designation of equity instruments at FVOCI

The Group has elected to irrevocably designate strategic investments of CU 450,000 in a small portfolio of non-trading equity securities in clearing houses and exchanges at FVOCI as permitted under IFRS 9. These securities were previously classified as available for sale. The changes in fair value of such securities will no longer be reclassified to profit or loss when they are disposed of.

(I) Reclassification from retired categories with no change in measurement

In addition to the above, the following debt instruments have been reclassified to new categories under IFRS 9, as their previous categories under IAS 39 were 'retired', with no changes to their measurement basis:

(i) Those previously classified as available for sale and now classified as measured at FVOCI; and

(ii) Those previously classified as held to maturity and now classified as measured at amortised cost.

IFRS7(42M) For financial assets and liabilities that have been reclassified to the amortised cost category, the following table shows their fair value as at 31 December 2018 and the fair value gain or loss that would have been recognised if these financial assets and liabilities had not been reclassified as part of the transition to IFRS 9:

Reclassifications to amortised cost	**2018**
	CU'000
From available-for-sale (IAS 39 classification) – Item (B) above	
Fair value as at 31 December 2018	378
Fair value gain/(loss) that would have been recognised during the year if the financial asset had not been reclassified	37
From designated at fair value through profit or loss (IAS 39 classification) – Item (G) above	
Fair value as at 31 December 2018	210
Fair value gain/(loss) that would have been recognised during the year if the financial asset had not been reclassified	(26)

Disclosures not illustrated as not applicable to the Group

The same information included in the table above should be provided, when applicable, for financial assets that have been reclassified out of FVPL category to FVOCI.

IFRS7(42P)

(c) Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 January 2018:

Measurement category	**Loan loss allowance under IAS 39/Provision under IAS 37**	**Reclassification**	**Remeasurement**	**Loan loss allowance under IFRS 9**
	CU'000	CU'000	CU'000	CU'000
Loans and receivables (IAS 39)/Financial assets at amortised cost (IFRS 9)				
Cash and balances with central banks	–	–	–	–
Loans and advances to Banks	–	–	58	58
Loans and advances to Customers	3,001	(65)	987	3,923
Investment securities	–	–	7	7
Total	**3,001**	**(65)**	**1,052**	**3,988**
Held to maturity (IAS 39)/Financial assets at amortised cost (IFRS 9)				
Investment securities	–	–	10	10
Available for sale financial instruments (IAS 39)/Financial assets at FVOCI (IFRS 9)				
Investment securities	–	–	1	1
Loan commitments and financial guarantee contracts				
Loans and advances to Customers (Loan commitments)	–	–	7	7
Provisions (Loan commitments)	–	–	3	3
Provisions (Financial guarantees)	–	–	65	65
Total	**3,001**	**(65)**	**1,138**	**4,074**

Further information on the measurement of the impairment allowance under IFRS 9 can be found in note 3.1.2.

IFRS7(42R), (42S)

Disclosures not illustrated as not applicable to the Group

Additional disclosures need to be made if the entity takes advantage of the specific exemptions set out in paragraphs 7.2.4 and 7.2.5 of IFRS 9. These exemptions relate to situations where it is impractical, at the date of initial application, to assess the modified time value of money element within the SPPI test or impracticable to assess whether the fair value of a prepayment feature was insignificant. Banks should disclose the carrying amount of the financial assets for which these exemptions have been taken.

1.2 Summary of significant accounting policies

PwC observation – Completeness of accounting policies

The following are selected accounting policies which have been significantly impacted by IFRS 9 and so are not a complete listing of all required accounting policies. In particular, the IAS 39 accounting policies applied in the prior period and IFRS 13 policies relating to the measurement of fair value in both periods are not repeated here, but will need to be presented.

This note sets out the significant accounting policies adopted in the preparation of these consolidated financial statements.

1.2.1 Financial assets and liabilities

Measurement methods

Amortised cost and effective interest rate

IFRS9(App A) The amortised cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability. The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired ('POCI') financial assets – assets that are credit-impaired (see definition on note 3.1.2.2) at initial recognition – the Group calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial assetinstead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

When the Group revises the estimates of future cash flows, the carrying amount of the respective financial assets or financial liability is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in profit or loss.

Interest income

IFRS9(5.4.1) Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

(a) POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortised cost of the financial asset.

(b) Financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the expected credit loss provision).

Initial recognition and measurement

IFRS9(3.1.1) IFRS9(3.1.2) Financial assets and financial liabilities are recognised when the entity becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on trade-date, the date on which the Group commits to purchase or sell the asset.

IFRS9(5.1.1) At initial recognition, the Group measures a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss. Immediately after initial recognition, an expected credit loss allowance (ECL) is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, as described in note 3.1.2, which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

IFRS 9 (B5.1.2A) When the fair value of financial assets and liabilities differs from the transaction price on initial recognition, the entity recognises the difference as follows:

(a) When the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognised as a gain or loss.

(b) In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement.

1.2.1.1 Financial assets

(i) Classification and subsequent measurement

IFRS9(4.1.1) From 1 January 2018, the Group has applied IFRS 9 and classifies its financial assets in the following measurement categories:

- Fair value through profit or loss (FVPL);
- Fair value through other comprehensive income (FVOCI); or
- Amortised cost.

The classification requirements for debt and equity instruments are described below:

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse.

IFRS9(5.1.1) Classification and subsequent measurement of debt instruments depend on:

(i) the Group's business model for managing the asset; and

(ii) the cash flow characteristics of the asset.

Based on these factors, the Group classifies its debt instruments into one of the following three measurement categories:

IFRS9(4.1.2)
- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in note 3.1.2. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

IFRS9(4.1.2A)
- Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net Investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

IFRS9(4.1.4)

- Fair value through profit or loss: Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented in the profit or loss statement within 'Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

IFRS9 (B4.1.2.A), (B4.1.2.B)

Business model: the business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Factors considered by the Group in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated. For example, the Group's business model for the mortgage loan book is to hold to collect contractual cash flows, with sales of loans only being made internally to a consolidated SPV for the purposes of collateralising notes issued, with no resulting derecognition by the Group. Another example is the liquidity portfolio of assets, which is held by the Group as part of liquidity management and is generally classified within the hold to collect and sell business model. Securities held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. These securities are classified in the 'other' business model and measured at FVPL.

IFRS9 (B4.1.7A)

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

PwC observation – Significant accounting judgements in determining business model and applying SPPI test

Determining the appropriate business model and assessing whether cash flows generated by an asset constitute solely payments of principal and interest is sometimes complex and may require significant judgement. Depending on the level of judgement and the amount of financial assets affected by the conclusion, the SPPI and/or business model assessment may require disclosure as a significant judgement in accordance with paragraph 122 of IAS 1. For example, a judgement on whether or not a contractual clause in all loans of a certain type (e.g. all residential mortgages) breaches SPPI and results in a material portfolio being recorded at FVPL.

IFRS9(4.3.2), (4.3.3)

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

IFRS9(4.4.1)

The Group reclassifies debt investments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

IFRS9(4.1.5) **Disclosures not illustrated as not applicable to the Group**

The following is a possible accounting policy for fair value option for financial assets, which was not included as not used by the Group:

Fair value option for financial assets

The Group may also irrevocably designate financial assets at fair value through profit or loss if doing so significantly reduces or eliminates a mismatch created by assets and liabilities being measured on different bases.

Equity instruments

IAS32R(11) Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include basic ordinary shares.

IFRS9(5.7.2) The Group subsequently measures all equity investments at fair value through profit or loss, except where the Group's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Group's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal. Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the Group's right to receive payments is established.

Gains and losses on equity investments at FVPL are included in the 'Net trading income' line in the statement of profit or loss.

(ii) Impairment

IFRS9(5.5.17) The Group assesses on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- 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.

Note 3.1.2 provides more detail of how the expected credit loss allowance is measured.

(iii) Modification of loans

IFRS9(5.4.3) The Group sometimes renegotiates or otherwise modifies the contractual cash flows of loans to customers. When this happens, the Group assesses whether or not the new terms are substantially different to the original terms. The Group does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced, such as a profit share/equity-based return that substantially affects the risk profile of the loan.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change in the interest rate.
- Change in the currency the loan is denominated in.
- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

IFRS9(B5.5.25), (B5.5.26) If the terms are substantially different, the Group derecognises the original financial asset and recognises a 'new' asset at fair value and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Group also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

IFRS9(5.4.3) If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Group recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

The impact of modifications of financial assets on the expected credit loss calculation is discussed in note 3.1.5.

PwC observation – Derecognition of revolving products

The derecognition assessment for revolving products, such as credit cards and overdrafts, is a complex area which requires significant judgement in applying the IFRS 9 requirements. Therefore, additional disclosures would be expected about the accounting policies applied to such products where these are relevant to the entity.

(iv) Derecognition other than on a modification

IFRS9(3.2.3) Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Group transfers substantially all the risks and rewards of ownership, or (ii) the Group neither transfers nor retains substantially all the risks and rewards of ownership and the Group has not retained control.

IFRS9(3.2.5) The Group enters into transactions where it retains the contractual rights to receive cash flows from assets but assumes a contractual obligation to pay those cash flows to other entities and transfers substantially all of the risks and rewards. These transactions are accounted for as 'pass through' transfers that result in derecognition if the Group:

(i) Has no obligation to make payments unless it collects equivalent amounts from the assets;

(ii) Is prohibited from selling or pledging the assets; and

(iii) Has an obligation to remit any cash it collects from the assets without material delay.

Collateral (shares and bonds) furnished by the Group under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitisation transactions in which the Group retains a subordinated residual interest.

1.2.1.2 Financial liabilities

(i) Classification and subsequent measurement

IFRS9(4.2.1) IFRS9(B5.7.16) In both the current and prior period, financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;

- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Group recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments (see note 1.3).

(ii) Derecognition

IFRS9(3.3.1)

Financial liabilities are derecognised when they are extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

IFRS9(3.3.2), (3.3.3), (B3.3.6)

The exchange between the Group and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

1.2.2 Financial guarantee contracts and loan commitments

IFRS9 (Appendix A)

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and others on behalf of customers to secure loans, overdrafts and other banking facilities.

IFRS9(4.2.1)

Financial guarantee contracts are initially measured at fair value and subsequently measured at the higher of:

- The amount of the loss allowance (calculated as described in note 3.1.2); and
- The premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

IFRS9(2.3)

Loan commitments provided by the Group are measured as the amount of the loss allowance (calculated as described in note 3.1.2). The Group has not provided any commitment to provide loans at a below-market interest rate, or that can be settled net in cash or by delivering or issuing another financial instrument.

IFRS7(B8E)

For loan commitments and financial guarantee contracts, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Group cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognised together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognised as a provision.

1.2.3 Derivatives and hedging activities

IFRS9(7.2.21)

The Group has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9.

IFRS7(44Z)

The Group has not provided comparative information for periods before the date of initial application of IFRS 9 for the new disclosures introduced by IFRS 9 as a consequential amendment to IFRS 7, as permitted by IFRS 7 paragraph 44Z.

Disclosures not illustrated as not applicable to the Group

For the purposes of these Illustrative financial statements, the Group has not adopted the new hedge accounting requirements of IFRS 9. Nevertheless, the revised hedge accounting disclosures introduced by the consequential amendments to IFRS 7 are applicable whether or not an entity has adopted the hedge accounting requirements of IFRS 9 and are therefore illustrated in note 4.

Where banks choose to adopt the new hedge accounting requirements of IFRS 9, they will need to disclose different accounting policies along with an explanation of the resulting impacts.

IFRS9(4.1.4), (4.2.1a)

Derivatives are initially recognised at fair value on the date on which the derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

IFRS9(4.3.2)
IFRS9(4.3.3)

Certain derivatives are embedded in hybrid contracts, such as the conversion option in a convertible bond. If the hybrid contract contains a host that is a financial asset, then the Group assesses the entire contract as described in the financial assets section above for classification and measurement purposes. Otherwise, the embedded derivatives are treated as separate derivatives when:

(i) Their economic characteristics and risks are not closely related to those of the host contract;

(ii) A separate instrument with the same terms would meet the definition of a derivative; and

(iii) The hybrid contract is not measured at fair value through profit or loss.

These embedded derivatives are separately accounted for at fair value, with changes in fair value recognised in the statement of profit or loss unless the Group chooses to designate the hybrid contracts at fair value through profit or loss.

IAS39p86

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

(a) Hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges);

(b) Hedges of highly probable future cash flows attributable to a recognised asset or liability (cash flow hedges); or

(c) Hedges of a net investment in a foreign operation (net investment hedges).

IAS39p88

The Group documents, at the inception of the hedge, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

IAS39p89

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of profit or loss, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

IAS39p92

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity and recorded as net interest income.

IAS39p95 *(b) Cash flow hedge*

IAS39p95 IAS39p100, IAS39p101 The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the statement of profit or loss.

Amounts accumulated in equity are recycled to the statement of profit or loss in the periods when the hedged item affects profit or loss. They are recorded in the income or expense lines in which the revenue or expense associated with the related hedged item is reported.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the periods when the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur (for example, the recognised hedged asset is disposed of), the cumulative gain or loss previously recognised in other comprehensive income is immediately reclassified to the statement of profit or loss.

IAS39p102 *(c) Net investment hedge*

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised directly in other comprehensive income; the gain or loss relating to the ineffective portion is recognised immediately in the statement of profit or loss. Gains and losses accumulated in equity are included in the statement of profit or loss when the foreign operation is disposed of as part of the gain or loss on the disposal.

2. Critical accounting estimates and judgements

IAS1(122), (125) The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. Management also needs to exercise judgement in applying the Group's accounting policies.

This note provides an overview of the areas that involve a higher degree of judgement or complexity, and major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year. Detailed information about each of these estimates and judgements is included in the related notes together with information about the basis of calculation for each affected line item in the financial statements.

Measurement of the expected credit loss allowance

The measurement of the expected credit loss allowance for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour (e.g. the likelihood of customers defaulting and the resulting losses). Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 3.1.2.3, which also sets out key sensitivities of the ECL to changes in these elements.

A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgements and estimates made by the Group in the above areas is set out in note 3.1.2.

PwC observation

Significant judgements in measuring ECL

Not all the significant judgements listed above may be relevant to all Banks. Conversely, judgements not listed above may be significant for some Banks, for example determining the relevant period of exposure to credit risk when measuring ECL for credit cards and revolving credit facilities. The disclosure provided should, therefore, be tailored appropriately.

Business models and SPPI as significant judgments

As well as ECL, determining the appropriate business models and assessing the SPPI requirements for financial assets may require significant accounting judgement and have a significant impact on the financial statements, as discussed in note 1.2.1.1(i). When this is the case, these judgements should also be disclosed or cross-referenced in this section.

3. Financial risk management

PwC observation – Comparative disclosures

IFRS 9 introduced and modified several disclosure requirements in IFRS 7 in relation to credit risk and impairment of financial instruments. These new disclosures are not required to be provided for the comparative period if a bank chooses not to restate the prior period in accordance with the exemption provided in IFRS 9 paragraph 7.2.15. Consequently, all disclosures required by the previous version of IFRS 7 should be provided in respect of the comparative period. Such disclosures have not been illustrated in this document.

The following section discusses the Group's risk management policies. The measurement of ECL under IFRS 9 uses the information and approaches that the Group uses to manage credit risk, though certain adjustments are made in order to comply with the requirements of IFRS 9. The approach taken for IFRS 9 measurement purposes is discussed separately in note 3.1.2.

3.1 Credit risk

IFRS7(33)(a)

Credit risk is the risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk arises mainly from interbank, commercial and consumer loans and advances, and loan commitments arising from such lending activities, but can also arise from credit enhancement provided, such as credit derivatives (credit default swaps), financial guarantees, letters of credit, endorsements and acceptances.

The Group is also exposed to other credit risks arising from investments in debt securities and other exposures arising from its trading activities ('trading exposures') including non-equity trading portfolio assets and derivatives as well as settlement balances with market counterparties and reverse repurchase agreements.

Credit risk is the single largest risk for the Group's business; management therefore carefully manages its exposure to credit risk. The credit risk management and control are centralised in a credit risk management team which reports regularly to the Board of Directors and head of each business unit.

IFRS7 (33)(b)

3.1.1 Credit risk measurement

(a) Loans and advances (incl. loan commitments and guarantees)

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9. Refer to note 3.1.2 for more details.

Credit risk grading

The Group uses internal credit risk gradings that reflect its assessment of the probability of default of individual counterparties. The Group use internal rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application (such as disposable income, and level of collateral for retail exposures; and turnover and industry type for wholesale exposures) is fed into this rating model. This is supplemented with external data such as credit bureau scoring information on individual borrowers. In addition, the models enable expert judgement from the Credit Risk Officer to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

The credit grades are calibrated such that the risk of default increases exponentially at each higher risk grade. For example, this means that the difference in the PD between an A and A- rating grade is lower than the difference in the PD between a B and B- rating grade.

The following are additional considerations for each type of portfolio held by the Group:

Retail

After the date of initial recognition, for retail business, the payment behaviour of the borrower is monitored on a periodic basis to develop a behavioural score. Any other known information about the borrower which impacts their creditworthiness – Such as unemployment and previous delinquency history – is also incorporated into the behavioural score. This score is mapped to a PD.

Wholesale

For wholesale business, the rating is determined at the borrower level. A relationship manager will incorporate any updated or new information/credit assessments into the credit system on an ongoing basis. In addition, the relationship manager will also update information about the creditworthiness of the borrower every year from sources such as public financial statements. This will determine the updated internal credit rating and PD.

Treasury

For debt securities in the Treasury portfolio, external rating agency credit grades are used. These published grades are continuously monitored and updated. The PD's associated with each grade are determined based on realised default rates over the prior 12 months, as published by the rating agency.

The Group's rating method comprises 25 rating levels for instruments not in default (1 to 25) and five default classes (26 to 30). The master scale assigns each rating category a specified range of probabilities of default, which is stable over time. The rating methods are subject to an annual validation and recalibration so that they reflect the latest projections in the light of all actually observed defaults.

The Group's internal rating scale and mapping of external ratings are set out below:

[not mandatory]

Group Rating	PD range as percentage	S&P		Description of the grade
1	0	AAA	AAA	Investment Grade
2	0 – 0.02			
3	0.02 – 0.03	AA+	AA	
4	0.03 – 0.05	AA, AA-		
5	0.05 – 0.08	A+, A	A	
6	0.08 – 0.13	A-		
7	0.13 – 0.21	BBB+	BBB	Standard monitoring
8	0.21 – 0.31	BBB		
9	0.31 – 0.47			
10	0.47 – 0.68	BBB-		
11	0.68 – 0.96	BB+	BB	
12	0.96 – 1.34	BB		
13	1.34 – 1.81			
14	1.81 – 2.40	BB-		
15	2.40 – 3.10	B+	B	
16	3.10 – 3.90			
17	3.90 – 4.86	B		
18	4.86 – 6.04			
19	6.04 – 7.52			
20	7.52 – 9.35	B-		
21	9.35 – 11.64			
22	11.64 – 14.48	CCC+	CCC	Special monitoring
23	14.48 – 18.01			
24	18.01 – 22.41	CCC to CC-		
25	22.41 – 99.99			
26	Imminent insolvency	C, D-I, D-II		Default
27	Restructuring			
28	Restructuring with recapitalisation/ partial waiving of claims			
29	Cancellation without insolvency			
30	Insolvency			

PwC observation – Credit rating mapping table

The inclusion of the mapping table above is not explicitly required by IFRS 7. It has been included as it provides useful information to users of the financial statements in understanding the entity's risk management practices and evaluating the nature of risks arising from financial instruments in line with the disclosure objective in paragraph 31 of IFRS 7.

3.1.2 Expected credit loss measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group.
- If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 3.1.2.1 for a description of how the Group determines when a significant increase in credit risk has occurred.
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 3.1.2.2 for a description of how the Group defines credit-impaired and default.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 3.1.2.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information. Note 3.1.2.4 includes an explanation of how the Group has incorporated this in its ECL models.
- Purchased or originated credit-impaired financial assets are those financial assets that are credit-impaired on initial recognition. Their ECL is always measured on a lifetime basis (Stage 3).

Further explanation is also provided of how the Group determines appropriate groupings when ECL is measured on a collective basis (refer to note 3.1.2.5).

The following diagram summarises the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

Change in credit quality since initial recognition

Stage 1	**Stage 2**	**Stage 3**
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit-impaired assets)
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

The key judgements and assumptions adopted by the Group in addressing the requirements of the standard are discussed below:

IFRS7(35F)(a)

3.1.2.1 Significant increase in credit risk (SICR)

IFRS7(35G)(a)(ii)

The Group considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following quantitative, qualitative or backstop criteria have been met:

Quantitative criteria:

The remaining Lifetime PD at the reporting date has increased, compared to the residual Lifetime PD expected at the reporting date when the exposure was first recognised, so that it exceeds the relevant threshold per the table below:

Retail Mortgages

Lifetime PD band at initial recognition	Increase in Lifetime PD at reporting date which is considered significant
≤a%	[X]bps
>a% and ≤b%	[X]bps
>b% and ≤c%	[X]bps
[add additional bands as necessary]	

Other retail products:

Lifetime PD band at initial recognition	Increase in Lifetime PD at reporting date which is considered significant
≤a%	[X]bps
>a% and ≤b%	[X]bps
>b% and ≤c%	[X]bps
[add additional bands as necessary]	

Wholesale

Lifetime PD band at initial recognition	Increase in Lifetime PD at reporting date which is considered significant
≤a%	[X]bps
>a% and ≤b%	[X]bps
>b% and ≤c%	[X]bps
[add additional bands as necessary]	

To illustrate the application of these thresholds, take for example a 25-year Retail Mortgage exposure which at initial recognition five years ago had a Lifetime PD of [X]% and was expected to have a residual Lifetime PD of [Y]% five years later at the current reporting date. If at the current reporting date the lifetime PD is actually [Z]% and this exceeds the expected PD of [Y]% by more than the threshold shown above, then a significant increase in credit risk has occurred.

These thresholds have been determined separately for Retail Mortgages, Other retail products and Wholesale, by assessing how the Lifetime PD moves prior to an instrument becoming delinquent. The Lifetime PD movements on instruments which do not subsequently become delinquent have also been assessed, to identify the "natural" movement in Lifetime PD which is not considered indicative of a significant increase in credit risk.

IFRS7(35G)(a)(ii) **Qualitative criteria:**

For Retail portfolios, if the borrower meets one or more of the following criteria:

- In short-term forbearance
- Direct debit cancellation
- Extension to the terms granted
- Previous arrears within the last [12] months

For Wholesale and Treasury portfolios, if the borrower is on the Watchlist and/or the instrument meets one or more of the following criteria:

- Significant increase in credit spread
- Significant adverse changes in business, financial and/or economic conditions in which the borrower operates
- Actual or expected forbearance or restructuring
- Actual or expected significant adverse change in operating results of the borrower
- Significant change in collateral value (secured facilities only) which is expected to increase risk of default
- Early signs of cashflow/liquidity problems such as delay in servicing of trade creditors/loans

The assessment of SICR incorporates forward-looking information (refer to note 3.1.2.4 for further information) and is performed on a quarterly basis at a portfolio level for all Retail financial instruments held by the Group. In relation to Wholesale and Treasury financial instruments, where a Watchlist is used to monitor credit risk, this assessment is performed at the counterparty level and on a periodic basis. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the independent Credit Risk team.

PwC observation – Disclosure of SICR criteria

In the illustrative disclosure presented above, consistent criteria have been applied to each of Retail Mortgages, Other retail products and Wholesale. In practice, a significant increase in credit risk might be determined differently for different products or portfolios within such groupings, in which case the disclosures presented above should be adapted accordingly.

IFRS7(35F) (a)(ii) **Backstop**

A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

IFRS7(35F)(a)(i) The Group has not used the low credit risk exemption for any financial instruments in the year ended 31 December 2018.

PwC observation – Significant increase in credit risk (SICR) and IAS 1 critical estimates disclosure

Defining SICR is likely to be a critical element within the overall ECL estimate, given the potential effect on provisions of moving financial instruments from 12-month ECL to Lifetime ECL. Appropriate disclosure should, therefore, be provided in accordance with IAS 1. The nature of the disclosure will need to take account of the specific approach(es) taken by an entity to determine SICR. Different impacts on distinct portfolio types may also warrant varying depths of disclosure. One possible way in which a disclosure could be presented is illustrated below.

The following table shows the impact on the 31 December 2018 ECL allowance of changing the PD thresholds for SICR. Increases in ECL (positive amounts) represent higher impairment allowances that would be recognised.

			ECL impact of	
Lifetime PD band at initial recognition	**Actual threshold applied**	**Change in threshold**	**Lower threshold**	**Higher threshold**
Retail mortgages				
≤a%	[X]bps	[-/+ X]bps	X	[X]
>a% and ≤b%	[X]bps	[-/+ X]bps	X	[X]
>b% and ≤c%	[X]bps	[-/+ X]bps	X	[X]
Other retail products				
≤a%	[X]bps	[-/+ X]bps	X	[X]
>a% and ≤b%	[X]bps	[-/+ X]bps	X	[X]
>b% and ≤c%	[X]bps	[-/+ X]bps	X	[X]
Wholesale				
≤a%	[X]bps	[-/+ X]bps	X	[X]
>a% and ≤b%	[X]bps	[-/+ X]bps	X	[X]
>b% and ≤c%	[X]bps	[-/+ X]bps	X	[X]

IFRS7(35F)(b)
IFRS7(35F)(d)

3.1.2.2 Definition of default and credit-impaired assets

IFRS7(B8A)(a)
IFRS7(35G)(a)(iii)

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments (with the sole exception of prime retail mortgages where a borrower is required to be more than 180 days past due to be considered in default).

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance
- The borrower is deceased
- The borrower is insolvent
- The borrower is in breach of financial covenant(s)
- An active market for that financial asset has disappeared because of financial difficulties
- Concessions have been made by the lender relating to the borrower's financial difficulty
- It is becoming probable that the borrower will enter bankruptcy

- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss given Default (LGD) throughout the Group's expected loss calculations.

IFRS7(B8A)(b) The 180 days past due default definition used for prime retail mortgages has been aligned with the definition used for regulatory capital purposes. Furthermore, the Group performed an analysis which shows that the cure rate (the proportion of instruments which would have moved out of default back to Stage 2 or Stage 1) after 90 days past due is [X]% (compared to [Y]% after 180 days past due) and therefore 90 days past due is not considered an appropriate default definition. Therefore, the Group considers 180 days past due to be a more appropriate default definition and has rebutted the 90 days past due presumption under IFRS 9 for the prime retail mortgage portfolio. This rebuttal will be monitored and reviewed by the Credit Risk department on an annual basis to ensure it remains appropriate.

IFRS7(B8A)(c) An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of six months. This period of six months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

IFRS7(35G)(a)

3.1.2.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The Expected Credit Loss (ECL) is measured on either a 12-month (12M) or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default and credit-impaired" above), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.
- EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). For example, for a revolving commitment, the Group includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.
- Loss Given Default (LGD) represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD). LGD is calculated on a 12-month or lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and Lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each individual exposure or collective segment. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

IFRS7(35G)(a)(i) The Lifetime PD is developed by applying a maturity profile to the current 12M PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis.

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type.

- For amortising products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12month or lifetime basis. This will also be adjusted for any expected overpayments made by a borrower. Early repayment/refinance assumptions are also incorporated into the calculation.
- For revolving products, the exposure at default is predicted by taking current drawn balance and adding a “credit conversion factor” which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilisation band, based on analysis of the Group’s recent default data.

The 12-month and lifetime LGDs are determined based on the factors which impact the recoveries made post default. These vary by product type.

- For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed.
- For unsecured products, LGD’s are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGD’s are influenced by collection strategies, including contracted debt sales and price.

Forward-looking economic information is also included in determining the 12-month and lifetime PD, EAD and LGD. These assumptions vary by product type. Refer to note 3.1.2.4 for an explanation of forward-looking information and its inclusion in ECL calculations.

The assumptions underlying the ECL calculation – such as how the maturity profile of the PDs and how collateral values change etc. – are monitored and reviewed on a quarterly basis.

IFRS7(35G)(c) There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

IFRS7(35G)(b)

3.1.2.4 Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Group has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio.

These economic variables and their associated impact on the PD, EAD and LGD vary by financial instrument. Expert judgment has also been applied in this process. Forecasts of these economic variables (the “base economic scenario”) are provided by the Group’s Economics team on a quarterly basis and provide the best estimate view of the economy over the next five years. After five years, to project the economic variables out for the full remaining lifetime of each instrument, a mean reversion approach has been used, which means that economic variables tend to either a long run average rate (e.g. for unemployment) or a long run average growth rate (e.g. GDP) over a period of two to five years. The impact of these economic variables on the PD, EAD and LGD has been determined by performing statistical regression analysis to understand the impact changes in these variables have had historically on default rates and on the components of LGD and EAD.

In addition to the base economic scenario, the Group’s Economics team also provide other possible scenarios along with scenario weightings. The number of other scenarios used is set based on the analysis of each major product type to ensure non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. At 1 January 2018 and 31 December 2018, for all but two portfolios the Group concluded that three scenarios appropriately captured non-linearities. For portfolios [X] and [Y], the Group concluded that two additional downside scenarios were required. The scenario weightings are determined by a combination of statistical analysis and expert credit judgement, taking account of the range of possible outcomes each chosen scenario is representative of. The assessment of SICR is performed using the Lifetime PD under each of the base, and the other scenarios, multiplied by the associated scenario weighting, along with qualitative and backstop indicators (see note 3.1.2.1). This determines whether the whole financial instrument is in Stage 1, Stage 2, or Stage 3 and hence whether 12-month or lifetime ECL should be recorded. Following this assessment, the Group measures ECL as either a probability weighted 12 month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes and has analysed the non-linearities and asymmetries within the Group's different portfolios to establish that the chosen scenarios are appropriately representative of the range of possible scenarios.

IAS1(125)

Economic variable assumptions

The most significant period-end assumptions used for the ECL estimate as at 31 December 2018 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios. The scenarios "downside 2" and "downside 3" were applied only to portfolios [X] and [Y].

		2019	**2020**	**2021**	**2022**	**2023**
Interest rates	Base	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Upside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 2	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 3	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
Unemployment rate	Base	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Upside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 2	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 3	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
House price index	Base	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Upside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 2	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 3	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
Domestic GDP	Base	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Upside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 2	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 3	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%

[Other assumptions should be disclosed as appropriate to the circumstances]

The weightings assigned to each economic scenario at 31 December 2018 were as follows:

	Base	Upside	Downside	Downside 2	Downside 3
Portfolios X and Y	[X]%	[X]%	[X]%	[X]%	[X]%
All other portfolios	[X]%	[X]%	[X]%	N/A	N/A

The most significant period-end assumptions used for the ECL estimate as at 1 January 2018 are set out below. The scenarios “base”, “upside” and “downside” were used for all portfolios. The scenarios “downside 2” and “downside 3” were applied only to portfolios [X] and [Y].

		2018	2019	2020	2021	2022
Interest rates	Base	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Upside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 2	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 3	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
Unemployment rate	Base	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Upside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 2	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 3	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
House price index	Base	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Upside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 2	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 3	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
Domestic GDP	Base	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Upside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 2	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%
	Downside 3	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%	[X-Y]%

[Other assumptions should be disclosed as appropriate to the circumstances]

The weightings assigned to each economic scenario as at 1 January 2018 were as follows:

	Base	Upside	Downside	Downside 2	Downside 3
Portfolios X and Y	[X]%	[X]%	[X]%	[X]%	[X]%
All other portfolios	[X]%	[X]%	[X]%	N/A	N/A

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis.

PwC observation – Different geographies, number of forward-looking macro-economic scenarios and use of management "overlays"

Banks should consider how the illustrative disclosures above should be adapted to take account of their own particular circumstances, for example to cover different geographies and/or different assumptions which may also be relevant.

For illustrative purposes only, the same three forward-looking macroeconomic scenarios have been considered appropriate for all but two of the portfolios held by the Group. In practice, Banks will have to determine for each material portfolio both the appropriate number of scenarios to be used and what those scenarios should be, taking account of the types of products, geographies etc. to which they are exposed and the resulting nonlinearities and potential losses.

In the above illustrative disclosure, management has concluded that no additional provision or "overlay" is required for regulatory, legislative or political changes. However, where major events occur close to the reporting date, so that the potential effects are not appropriately captured in models and inputs, this may well be a key area of judgement that also requires greater disclosure. More recent examples of such events include the UK "Brexit" vote to leave the EU.

Sensitivity analysis

IAS1(129) The most significant assumptions affecting the ECL allowance are as follows:

Retail portfolios

(i) *House price index,* given the significant impact it has on mortgage collateral valuations; and

(ii) *Unemployment rate,* given its impact on secured and unsecured borrowers' ability to meet their contractual repayments.

Wholesale portfolios

(i) *GDP,* given the significant impact on companies' performance and collateral valuations; and

(ii) *Interest rate,* given its impact on companies' likelihood of default.

Set out below are the changes to the ECL as at 31 December 2018 that would result from reasonably possible changes in these parameters from the actual assumptions used in the Group's economic variable assumptions (for example, the impact on ECL of increasing the estimated unemployment rate by [X]% in each of the base, upside, downside, downside 2 and downside 3 scenarios):

Retail portfolios

		Unemployment		
		[-X%] CU'000	**No change CU'000**	**[+X%] CU'000**
House price index	[+X%]	X	X	X
	No change	X	-	X
	[-X%]	X	X	X

Wholesale portfolios

		Interest rates		
		[-X%] CU'000	**No change CU'000**	**[+X%] CU'000**
GDP	[+X%]	X	X	X
	No change	X	-	X
	[-X%]	X	X	X

PwC observation – Sensitivity analysis on ECL measurement

The key drivers of sensitivity disclosed above are purely illustrative and Banks will need to analyse their own portfolios to determine which parameter's sensitivities are most relevant to users of the financial statements.

In particular, whilst not illustrated above, this may include the sensitivity of the ECL provision to changes in the weightings determined for each of the economic scenarios.

The disclosure above represents one way of meeting the disclosures required by IAS 1 paragraphs 125 and 129. Banks should also consider, as applicable, the expectations and guidance provided by different national regulators and other international bodies, such as the Financial Stability Board's Enhanced Disclosure Task Force (EDTF). Furthermore, Banks should also consider the appropriate level of granularity for these disclosures, which may vary depending on the characteristics of their different portfolios and which elements of the ECL calculation have the greatest impact.

IFRS7(35F)(c)

3.1.2.5 Grouping of instruments for losses measured on a collective basis

For expected credit loss provisions modelled on a collective basis, a grouping of exposures is performed on the basis of shared risk characteristics, such that risk exposures within a group are homogeneous.

In performing this grouping, there must be sufficient information for the group to be statistically credible. Where sufficient information is not available internally, the Group has considered benchmarking internal/external supplementary data to use for modelling purposes. The characteristics and any supplementary data used to determine groupings are outlined below:

Retail – Groupings for collective measurement

- Loan to value ratio band
- Credit Rating band
- Product type (e.g. Residential/Buy to Let mortgage, Overdraft, Credit Card)
- Repayment type (e.g. Repayment/Interest only)
- Utilisation band

Wholesale – Groupings for collective measurement

- Industry – External data sourced from study by [X] dated [X]
- Collateral type
- Credit Rating band
- Geographical region of risk exposures – external data sourced from study by [X] dated [X]

The following exposures are assessed individually:

Retail

- Stage 3 loans with current exposure above [X]
- Properties in repossession proceedings

Wholesale

- Stage 3 facilities
- Stage 2 facilities with exposure above [X]

The appropriateness of groupings is monitored and reviewed on a periodic basis by the Credit Risk team.

3.1.3 Credit risk exposure

3.1.3.1 Maximum exposure to credit risk – Financial instruments subject to impairment

IFRS7(34)(a)
IFRS7(35M)
IFRS7(35K)(a)
IFRS7(IG20C)

The following table contains an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets.

Retail Mortgages

	2018					2017
	ECL staging					
	Stage 1 12-month ECL	**Stage 2** Lifetime ECL	**Stage 3** Lifetime ECL	Purchased credit-impaired	**Total**	**Total**
	CU'000	CU'000	CU'000	CU'000	CU'000	CU'000
Credit grade						
Investment grade	56,248	-	–	–	56,248	51,823
Standard monitoring	1,894	598	–	–	2,492	2,583
Special monitoring	–	1,993	–	–	1,993	1,606
Default	–	–	1,479	78	1,557	1,381
Gross carrying amount	**58,142**	**2,591**	**1,479**	**78**	**62,290**	**57,393**
Loss allowance	(87)	(78)	(462)	(8)	(635)	(402)
Carrying amount	**58,055**	**2,513**	**1,017**	**70**	**61,655**	**56,991**

[The disclosures above should be repeated for each class of financial instrument, but are omitted here for illustrative purposes].

PwC observation – Determining classes of financial instruments appropriate for each disclosure

The table above is designed to meet the disclosure requirement of paragraph 35K(a) of IFRS 7, which requires disclosure of maximum exposure to credit risk, as well as of paragraph 35M of the same standard, which requires disclosure of gross carrying amount of financial assets by credit risk grading. Providing these disclosures in the same table avoids duplication of information, as often the gross carrying amount also represents the maximum exposure to credit risk on financial instruments subject to IFRS 9 impairment requirements.

However, the disclosure in paragraph 35K of IFRS 7 should be provided by each class of financial instrument, including loan commitments and financial guarantee contracts when material.

IFRS 7 paragraph 6 requires grouping of financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The level at which 'class' is defined can vary across different disclosure requirements.

Therefore, judgement should be applied in determining the classes of financial instrument to be disclosed, which will often be on a more granular level than the balance sheet line items.

IFRS7(35N)
IFRS7(B8J)

Disclosure not illustrated as not applicable to the Group

When the simplified approach permitted by IFRS 9 paragraph 5.5.15 is used to calculate the ECL of trade receivables, contract assets and lease receivable, the balances for such financial assets should be separately disclosed in an additional column in the table above. Alternatively, the information provided for these assets may be based on a provision matrix.

When an entity has measured expected credit losses on a collective basis, it may not be able to allocate the gross carrying amount of individual financial instruments to the credit risk rating grades for which lifetime expected credit losses are recognised. In this case, an entity should provide the disclosures above to those financial instruments that can be directly allocated to a credit risk rating grade, and disclose separately the gross carrying amount of financial instruments for which lifetime expected credit losses have been measured on a collective basis.

Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in note 3.1.2 'Expected credit loss measurement'.

3.1.3.2 Maximum exposure to credit risk – Financial instruments not subject to impairment

IFRS7(34)(a)
IFRS7(36)(a)

The following table contains an analysis of the maximum credit risk exposure from financial assets not subject to impairment (i.e. FVPL):

	Maximum exposure to credit risk CU'000
Trading assets	
– Debt Securities	6,126
– Derivatives	2,361
Hedging Derivatives	2,153
Financial assets designated at fair value	
– Debt securities	1,654
– Loans and advances to customers	6,890

3.1.3.3 Collateral and other credit enhancements

IFRS7(35K)(b) IFRS7(36)(b) IFRS7(B8F) IFRS7(B8G)

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation.

The Group prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Margin agreement for derivatives, for which the Group has also entered into master netting agreements;
- Charges over business assets such as premises, inventory and accounts receivable; and
- Charges over financial instruments such as debt securities and equities.

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured.

Collateral held as security for financial assets other than loans and advances depends on the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by portfolios of financial instruments. Derivatives are also collateralised.

IFRS7(35K)(b)(ii)

The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

IFRS7 (35K)(b)(iii)

A portion of the Group's financial assets originated by the mortgage business has sufficiently low 'loan to value' (LTV) ratios, which results in no loss allowance being recognised in accordance with the Group's expected credit loss model. The carrying amount of such financial assets is CU 5,732 as at 31 December 2018.

IFRS7(35K)(c)

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

	Gross exposure	Impairment allowance	Carrying amount	Fair value of collateral held
Credit-impaired assets	CU'000	CU'000	CU'000	CU'000
Loans to individuals:				
– Overdrafts	310	(264)	46	–
– Credit cards	302	(272)	30	–
– Term loans	326	(218)	108	–
– Mortgages	1,557	(470)	1,087	965
Loans to corporate entities:				
– Large corporate customers	120	(41)	79	100
– Small and medium-sized enterprises (SMEs)	122	(61)	61	86
– Other	5	(4)	1	2
Total credit-impaired assets	**2,742**	**(1,330)**	**1,412**	**1,153**

IFRS7(B8F)

PwC observation – Fair value of collateral held as security for credit-impaired financial assets

The table above includes a column disclosing the fair value of collateral held as security for credit-impaired financial assets, which has been included to meet the requirement to present quantitative information about collateral held as security and other credit enhancements for such financial assets. However, we note that paragraph B8F of IFRS 7 clarifies that entities are neither required to disclose information about the fair value of collateral and other credit enhancements nor to quantify the exact value of the collateral included in the calculation of ECL. Therefore, this disclosure requirement may be met in alternative ways.

The following table shows the distribution of LTV ratios for the Group's mortgage credit-impaired portfolio:

Mortgage portfolio – LTV distribution	Credit-impaired (Gross carrying amount)
	CU'000
Lower than 50%	31
50 to 60%	62
60 to 70%	93
70 to 80%	171
90 to 100%	529
Higher than 100%	671
Total	**1,557**

IFRS7(35H)
IFRS7(IG20B)

3.1.4 Loss allowance

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent "step up" (or "step down") between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments de-recognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period (see note 3.1.5).

The following tables explain the changes in the loss allowance between the beginning and the end of the annual period due to these factors:

Retail Mortgages	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased credit-impaired	Total
	CU'000	CU'000	CU'000	CU'000	CU'000
Loss allowance as at 1 January 2018	**69**	**40**	**513**	**7**	**629**
Movements with P&L impact					
Transfers:					
Transfer from Stage 1 to Stage 2	(3)	40	–	–	37
Transfer from Stage 1 to Stage 3	(1)	–	17	–	16
Transfer from Stage 2 to Stage 1	–	(1)	–	–	(1)
New financial assets originated or purchased	18	–	–	–	18
Changes in PDs/LGDs/EADs	3	1	2	1	7
Changes to model assumptions and methodologies	4	5	8	–	17
Modification of contractual cash flows of financial assets	–	–	(36)	–	(36)
Unwind of discount[(a)]	3	2	21	–	26
FX and other movements	(1)	–	–	–	(1)
Total net P&L charge during the period	**23**	**47**	**12**	**1**	**83**
Other movements with no P&L impact					
Transfers:					
Transfer from Stage 2 to Stage 3	–	(5)	5	–	–
Transfer from Stage 3 to Stage 2	–	1	(1)	–	–
Financial assets derecognised during the period	(5)	(5)	(10)	–	(20)
Write-offs	–	–	(57)	–	(57)
Loss allowance as at 31 December 2018	**87**	**78**	**462**	**8**	**635**

Note:
(a) The unwind of discount on Stage 3 financial assets is reported within 'Interest Income' so that interest income is recognised on the amortised cost (after deducting the ECL allowance).

[The disclosures above should be repeated for each class of financial instrument, but are omitted here for illustrative purposes].

IFRS7(35H)(b)(iii)
IFRS7(16A)

PwC observation – ECL reconciliation table

Please note the following in relation to the ECL reconciliation disclosure above:

1 In determining how to analyse ECL allowance movements over the period, Banks should consider the underlying modelling approach adopted, the drivers of ECL change within that approach and how best to explain the effect of those drivers on ECL in the disclosure. Banks should also consider whether there are other material causes of movement that should be shown separately. These might, for example, be shown in the analysis prepared internally for senior management. Additional rows may also be required to explain ECL movements for different types of products.

Where ECL allowance movements could potentially be reported in more than one row, explanation of which changes are reported in which row will assist users of the financial statements. Similarly, where changing the order in which key drivers are changed could result in a significantly different allocation between rows, explanation of the ordering used will be useful.

Banks should also consider disclosing whether ECL movements from transfers between stages are measured at the beginning or the end of the reporting periods.

2 When applicable, separate presentation (for example, in an additional column) is also required for trade receivables, contract assets or lease receivables for which loss allowances are measured in accordance with paragraph 5.5.15 of IFRS 9 using the ‘simplified’ approach.

3 The loss allowance for financial assets measured at fair value through OCI shall not be presented separately in the statement of financial position as a reduction of the carrying amount of the financial asset, but should be disclosed in the notes.

4 The reconciliation presented above splits items between those that impact P&L and those that do not. This is not an explicit requirement of IFRS 7 paragraph 35H, however this information is likely to be helpful to users in understanding the impact of the various movements in ECL allowance.

IFRS7(35I) Significant changes in the gross carrying amount of financial assets that contributed to changes in the loss allowance were as follows:

- The high volume of new mortgages loans originated during the period, aligned with the Group’s organic growth objective, increased the gross carrying amount of the mortgage book by 13%, with a corresponding CU 18 increase in loss allowance measured on a 12-month basis.
- The modification of mortgage contracts following renegotiation with customers facing financial difficulties resulted in a reduction of CU 61,000 in the gross carrying amount of Stage 3 mortgages. This also resulted in the reversal of CU 36,000 of Stage 3 loss allowance. Also refer to note 3.1.6.
- The write-off of mortgage loans with a total gross carrying amount of CU 57,000 resulted in the reduction of the Stage 3 loss allowance by the same amount.

IFRS7(35I) The following table further explains changes in the gross carrying amount of the mortgage portfolio to help explain their significance to the changes in the loss allowance for the same portfolio as discussed above:

	Stage 1	**Stage 2**	**Stage 3**		
Retail Mortgages	12-month ECL	Lifetime ECL	Lifetime ECL	Purchased credit-impaired	**Total**
	CU’000	CU’000	CU’000	CU’000	CU’000
Gross carrying amount as at 1 January 2018	**54,475**	**1,537**	**1,309**	**72**	**57,393**
Transfers:					
Transfer from Stage 1 to Stage 2	(1,345)	1,345	–	–	–
Transfer from Stage 1 to Stage 3	(120)	–	120	–	–
Transfer from Stage 2 to Stage 3	–	(166)	166	–	–
Transfer from Stage 3 to Stage 2	–	3	(3)	–	–
Transfer from Stage 2 to Stage 1	33	(33)	–	–	–
Financial assets derecognised during the period other than write-offs	(4,862)	(166)	(28)	–	(5,056)
New financial assets originated or purchased	7,619	–	–	6	7,625
Modification of contractual cash flows of financial assets	–	–	(61)	–	(61)
Changes in interest accrual	2,233	64	33	–	2,330
Write-offs	–	–	(57)	–	(57)
FX and other movements	109	7	–	–	116
Gross carrying amount as at 31 December 2018	**58,142**	**2,591**	**1,479**	**78**	**62,290**

[The disclosures above should be repeated for each class of financial instrument, but are omitted here for illustrative purposes].

PwC observation – Reconciliation of gross carrying amount

IFRS 7 paragraph 35I does not explicitly require the gross carrying amount of financial instruments to be reconciled. However, a reconciliation table, in addition to narrative disclosures, is included in IFRS 7 paragraph IG20B as an illustration of how the information required by that paragraph can be provided. In our view, including such a reconciliation table will typically be the most helpful way of meeting these disclosure requirements.

Movement descriptions in this table may need to be amended based on product types (e.g. a specific line for 'additional drawings' on existing drawn facilities).

If included, this table should also be provided for each class of financial instrument.

IFRS7(35H)(c) The total amount of undiscounted expected credit losses at initial recognition for purchased or originated credit-impaired financial assets recognised during the period was CU 10,000.

3.1.5 Write-off policy

IFRS7(35F)(e) The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovering in full.

IFRS7(35F)(e)
IFRS7(35L) The Group may write-off financial assets that are still subject to enforcement activity. The outstanding contractual amounts of such assets written off during the year ended 31 December 2018 was CU 41,000. The Group still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

3.1.6 Modification of financial assets

The Group sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximising recovery.

Such restructuring activities include extended payment term arrangements, payment holidays and payment forgiveness. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

IFRS7(35F)(f)(i)
IFRS7(35J)(b) The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset (refer to notes 1.2.1.1(iv) and (v) above). The Group monitors the subsequent performance of modified assets. The Group may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more. The gross carrying amount of such assets held as at 31 December 2018 was CU 41,000.

IFRS7(35F)(f)(ii) The Group continues to monitor if there is a subsequent significant increase in credit risk in relation to such assets through the use of specific models for modified assets.

IFRS7(35J)(a) The following table includes summary information for financial assets with lifetime ECL whose cash flows were modified during the period as part of the Group's restructuring activities and their respective effect on the Group's financial performance:

	Loans and advance to customers
	CU'000
Amortised cost before modification	234
Net modification (loss)	(61)

PwC observation – Voluntary disclosure of net impact in P&L from modifications

The overall profit or loss impact of modifications will often be less than the net gain/(loss) disclosed above, which excludes the impact of any offsetting release of ECL allowances. While not required by IFRS 7, Banks may, therefore, wish to explain this, with disclosure such as:

'The net modification loss above represents the changes in the gross carrying amounts (i.e. before impairment allowance) of the financial assets from immediately before, to immediately after, modification. In the significant majority of cases, this gross loss had been anticipated and already materially reflected within the ECL allowance. The impact of modification on the ECL allowances associated with these assets was a release of ECL allowances of CU[X]. The net impact on the statement of profit or loss for the period was, therefore, CU[X].'

4. Hedge accounting disclosures

The Group applies hedge accounting in three separate hedging strategies, as follows:

Interest rate risk on fixed rate mortgages (fair value hedge)

IFRS7(22A)(a), (22B)(a)

The Group holds a portfolio of long-term fixed rate mortgages and therefore is exposed to changes in fair value due to movements in market interest rates. The Group manages this risk exposure by entering into pay fixed/receive floating interest rate swaps.

IFRS7(22A)(b), (22B)(b), (22C)

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged by the Group. The interest rate risk component is determined as the change in fair value of the long-term fixed rate mortgages arising solely from changes in 3-month LIBOR (the benchmark rate of interest). Such changes are usually the largest component of the overall change in fair value. This strategy is designated as a fair value hedge and its effectiveness is assessed by comparing changes in the fair value of the loans attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps.

IFRS7(22B)(c), (23D)

The Group establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Possible sources of ineffectiveness are as follows:

(i) differences between the expected and actual volume of prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience;

(ii) difference in the discounting between the hedged item and the hedging instrument, as cash collateralised interest rate swaps are discounted using Overnight Indexed Swaps (OIS) discount curves, which are not applied to the fixed rate mortgages;

(iii) hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument; and

(iv) counterparty credit risk which impacts the fair value of uncollateralised interest rate swaps but not the hedged items.

IFRS7(23C)

The Group manages the interest rate risk arising from fixed rate mortgages by entering into interest rate swaps on a monthly basis. The exposure from this portfolio frequently changes due to new loans originated, contractual repayments and early prepayments made by customers in each period. As a result, the Group adopts a dynamic hedging strategy (sometimes referred to as a 'macro' or 'portfolio' hedge) to hedge the exposure profile by closing and entering into new swap agreements at each month-end. The Group uses the portfolio fair value hedge of interest rate risk to recognise fair value changes related to changes in interest rate risk in the mortgage portfolio, and therefore reduce the profit or loss volatility that would otherwise arise from changes in fair value of the interest rate swaps alone.

IFRS7(24D)

Disclosures not illustrated as not applicable to the Group

Paragraph 23C of IFRS 7 exempts entities from disclosing the profile of the timing of the nominal amounts and the average price or rate of the hedging instruments for ‘macro’ hedges – as in such hedges entities frequently reset the hedging relationship – and instead requires the disclosure of information included in the illustrative disclosure above. When the volume of such hedging relationships is unrepresentative of normal volumes during the period (i.e. the volume at the reporting date does not reflect the volumes during the period), an entity shall disclose that fact and the reason it believes the volumes are unrepresentative.

Foreign exchange risk on foreign currency debt (cash flow hedge)

IFRS7(22A)(a), (22A)(b), (22A)(c), (22B)(a), (22C)

The Group accesses international markets in order to obtain effective sources of funding. As part of this process, the Group assumes significant foreign currency exposure, principally USD. The foreign currency risk component is then managed and mitigated by the use of cross currency swaps, which exchange fixed interest payments in the foreign currency for fixed interest payments in CU. These instruments are entered into to match the maturity profile of estimated repayments of the Group’s debt instruments. This hedging strategy is applied to the portion of the exposure that is not naturally offset against matching asset positions held by the Group in financial investments also denominated in foreign currencies. The foreign currency risk component is determined as the change in cash flows of the foreign currency debt arising solely from changes in the relevant foreign currency forward exchange rate. Such changes constitute a significant component of the overall changes in cash flows of the instrument.

IFRS7 22B(b)

The effectiveness of this strategy is assessed by comparing the changes in fair value of the cross currency swap with changes in fair value of the hedged debt attributable to the hedged risk (changes in foreign currency forward exchange rates), using the hypothetical derivative method.

IFRS7(22B)(c), (23D)

The Group establishes the hedging ratio by matching the notional of the derivative with the principal of the specific debt instrument being hedged (sometimes referred to as a ‘micro’ hedge). Possible sources of ineffectiveness are as follows:

(i) Differences in timing of cash flows between debt instruments and cross currency swaps;

(ii) Differences in the discounting between the hedged item and the hedging instrument, as cash collateralised cross currency swaps are discounted using Overnight Indexed Swaps (OIS) discount curves, which are not applied to the foreign debt;

(iii) Hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument; and

(iv) Counterparty credit risk which impacts the fair value of uncollateralised cross currency swaps but not the hedged items.

IFRS7(23F)

Disclosures not illustrated as not applicable to the Group

For cash flow hedges, an entity shall also disclose a description of any forecast transaction for which hedge accounting had been used in the previous period, but which is no longer expected to occur.

Net investment in foreign operation (net investment hedge)

IFRS7(22A)(a), (22A)(b), (22A)(c), (22B)(a), (22B)(b)

The Group has an investment in a foreign operation which is consolidated in its financial statements and whose functional currency is US Dollars. The foreign exchange rate exposure arising from this investment is hedged through the use of two year FX forward contracts. These contracts are entered into to hedge 90% of the exposure arising from the net assets held in the foreign operation and are rolled forward on a periodic basis.

The Group only designates the undiscounted spot element of the FX forwards as hedging instruments. Changes in the fair value of the hedging instruments attributable to changes in forward points and the effect of discounting are recognised directly in profit or loss within the “Net trading income” line – These amounts are, therefore, not included in the hedge effectiveness assessment.

IFRS7(22B)(c), (23D), (22C)

The Group establishes the hedging ratio by matching the notional of the forward contracts with 90% of the net assets of the foreign operation. Given that only the undiscounted spot element of the FX forwards is designated in the hedging relationship, no ineffectiveness is expected unless the foreign operation’s losses exceed 10% of net assets during the reporting period. The foreign currency risk component is determined as the change in the carrying amount of net assets of the foreign operation arising solely from changes in spot foreign currency exchange rates.

IFRS7(23E)

Disclosures not illustrated as not applicable to the Group

If other sources of hedge ineffectiveness emerge in a hedging relationship, an entity shall disclose those sources by risk category and explain the resulting hedge ineffectiveness.

IFRS7(23B)

The following table sets out the maturity profile and average price/rate of the hedging instruments used in the Group's non-dynamic hedging strategies:

	Maturity				
	Up to one month	**One to three months**	**Three months to one year**	**One year to five years**	**More than five years**
	CU'000	CU'000	CU'000	CU'000	CU'000
Cash flow hedges					
Foreign exchange					
Cross currency interest rate swap					
Notional	120	234	443	2,312	652
Average fixed interest rate	5.30%	5.31%	6.34%	9.25%	9.56%
Average CU/USD exchange rate	1.23	1.27	1.43	1.51	2.01
Net investment hedge					
Foreign exchange					
FX forward					
Notional	–	–	–	587	–
Average CU/USD exchange rate	–	–	–	1.47	–

PwC observation – Hedges of multiple risk categories

Hedging disclosures are generally required to be provided by risk category. When hedging debt instruments issued in a foreign currency, Banks may elect to hedge interest rate risk as well as foreign exchange risk, through the use of cross currency swaps. In the example above, the hedge designated for accounting purposes related only to foreign exchange risk. If both foreign exchange and interest rate risks had been hedged, a new category of "Foreign exchange and interest rate" would have been required across the hedging disclosures.

IFRS7(*24A*)

The following table contains details of the hedging instruments used in the Group's hedging strategies:

	Notional	Carrying amount Assets	Carrying amount Liabilities	Balance sheet line item(s)	Changes in fair value used for calculating hedge ineffectiveness
	CU'000	CU'000	CU'000		CU'000
Fair value hedges					
Interest rate					
– Interest rate swaps	23,412	301	612	Hedging Derivatives	(192)
Cash flow hedges					
Foreign exchange					
– Cross currency interest rate swaps	3,761	–	262	Hedging Derivatives	28
Net investment hedge					
Foreign exchange					
– FX forwards	587	124	–	Hedging Derivatives	23

IFRS7 (*24B*)

The following table contains details of the hedged exposures covered by the Group's hedging strategies:

	Carrying amount of hedged item		Accumulated amount of fair value adjustments on the hedged item		Balance Sheet line item	Change in fair value of hedged item for ineffectiveness assessment	Cash flow hedge/currency translation reserve	
	Assets	Liabilities	Assets	Liabilities			Continuing hedges	Discontinued hedges
	CU'000	**CU'000**	**CU'000**	**CU'000**		**CU'000**	**CU'000**	**CU'000**
Fair value hedges								
Interest rate								
– Fixed rate mortgages	23,412	–	648	326	Loans and advances to customers	202	N/A	N/A
Cash flow hedges								
Foreign exchange								
– Foreign currency debt	–	3,345	N/A	N/A	Debt securities in issue	(31)	62	-
Net investment hedge								
Foreign exchange								
– Investment in a foreign operation	721	-	N/A	N/A	N/A	23	124	–

IFRS7 (24B) (a) (v)

The accumulated amount of fair value hedge adjustments remaining in the statement of financial position for hedged items that have ceased to be adjusted for hedging gains and losses is CU 212,000.

IFRS7*(24C)*

The following table contains information regarding the effectiveness of the hedging relationships designated by the Group, as well as the impacts on profit or loss and other comprehensive income:

				Amounts reclassified from reserves to P&L as:		
	Gains/ (loss) recognised in OCI	**Hedge Ineffectiveness recognised in P&L**	**P&L line item that includes hedge ineffectiveness**	**Hedged cash flows will no longer occur**	**Hedged item affected P&L**	**P&L line item that includes reclassified amount**
	CU'000	CU'000		CU'000	CU'000	
Fair value hedges						
Interest rate						
– Fixed rate Mortgages	N/A	10	Net trading income	N/A	N/A	N/A
Cash flow hedges						
Foreign exchange						
– Foreign currency debt	(41)	(3)	Net trading income	–	2	Interest expense[(a)]
				–	19	Other operating expenses[(a)]
Net investment hedge						
Foreign exchange						
– Investment in a foreign operation	10	–	Other operating expenses	–	–	–

Note

(a) The portion of the accumulated reserve that relates to the hedge of the foreign exchange risk arising from the accrued interest of the debt is allocated to interest expense, while the portion relating to the principal is allocated to other operating expenses together with other foreign translation gains and losses.

IFRS7 (24C)(b)(iv) IFRS9(6.6.4)

Disclosures not illustrated as not applicable to the Group

For hedges of net positions, the hedging gains or losses recognised in a separate line item in the statement of comprehensive income should also be disclosed.

IFRS7(24E) The following table shows a reconciliation of each component of equity and an analysis of other comprehensive income in relation to hedge accounting:

	Cash flow hedge reserve	Currency translation reserve
	CU'000	CU'000
Balance as at 1 January 2018	**(4)**	**120**
Amounts recognised in other comprehensive income:		
Cash flow hedge – foreign exchange risk		
Effective portion of changes in fair value of cross currency swaps	(62)	–
Amounts reclassified from reserves to statement of profit or loss	21	–
Taxation	8	–
Net investment hedge – foreign exchange risk		
Foreign operation translation – USD	–	10
Changes in fair value of USD FX forwards attributed to changes in the undiscounted spot rate of USD	–	(9)
Balance as at 31 December 2018	**(37)**	**121**

IFRS7(24G)

Disclosures not illustrated as not applicable to the Group

The following disclosure requirement has not been illustrated as it is only applicable to Banks adopting IFRS 9 hedge accounting:

'If an entity designated a financial instrument, or a proportion of it, as measured at fair value through profit or loss because it uses a credit derivative to manage the credit risk of that financial instrument, it shall disclose:

(a) for credit derivatives that have been used to manage the credit risk of financial instruments designated as measured at fair value through profit or loss in accordance with paragraph 6.7.1 of IFRS 9, a reconciliation of each of the nominal amount and the fair value at the beginning and at the end of the period;

(b) the gain or loss recognised in profit or loss on designation of a financial instrument, or a proportion of it, as measured at fair value through profit or loss in accordance with paragraph 6.7.1 of IFRS 9; and

(c) on discontinuation of measuring a financial instrument, or a proportion of it, at fair value through profit or loss, that financial instrument's fair value that has become the new carrying amount in accordance with paragraph 6.7.4(b) of IFRS 9 and the related nominal or principal amount (except for providing comparative information in accordance with IAS 1, an entity does not need to continue this disclosure in subsequent periods).'

5. Other disclosures

PwC observation – Additional new disclosures introduced by IFRS 9

This note highlights additional new disclosures required by IFRS 9 that Banks should consider when preparing their financial statements under IFRS 9.

5.1 Financial liabilities designated at FVPL

The Group issued a 15-year note in 2015 with an annual fixed coupon of 4% and which contained a call option that is not closely related to the host contract. The Group designated the entire hybrid contract as a financial liability at fair value through profit or loss.

IFRS7 *(10)(b)* The contractual undiscounted amount that will be required to be paid at maturity of the above structured note is CU 951,000 greater than its carrying amount of CU 1,791,000.

At 31 December 2018, the cumulative own credit adjustment gain amounted to CU 83,000. The cumulative gain is recognised within 'Other Reserves' in Equity.

Disclosures not illustrated as not applicable to the Group

The disclosures requirements in relation to financial liabilities designated at fair value through profit or loss have not changed significantly under IFRS 9. However, the following additional disclosures, which were not applicable to the Group, need to be presented when applicable:

IFRS7*(10)(c), (10)(d)* (i) For financial liabilities designated at fair value for which changes in the liability's credit risk are recognised OCI, in addition to disclosure of the cumulative changes in fair value attributable to changes in credit risk of that financial liability and the difference between its carrying amount and the amount contractually required to be paid at maturity (which are also required for financial liabilities with all changes presented in profit or loss), disclosure should also be given of transfers of the cumulative gain or loss within equity during the period and the reason for these transfer, and the amount (if any) presented in OCI that was realised on derecognition of financial liabilities during the period.

IFRS7*(11)(c)* (ii) A detailed description of the methodology used to determine whether presenting effects of changes in a liability's credit risk in OCI would create or enlarge an accounting mismatch. If an entity is required by paragraph 5.7.8 of IFRS 9 to present the effects of changes in a liability's credit risk in profit or loss for this reason, the disclosure must include a detailed description of the economic relationship between the characteristics of the liability and the characteristics of the other financial instruments whose change in fair value is expected to be offset within profit or loss.

5.2 Investments in equity instruments designated at FVOCI

IFRS7*(11A)(a), (b)* The Group has designated at FVOCI investments in a small portfolio of equity securities issued by the following clearing houses and exchanges:

- Clearing House A;
- Clearing House B;
- Exchange C; and
- Exchange D.

The Group chose this presentation alternative because the investments were made for strategic purposes rather than with a view to profit on a subsequent sale, and there are no plans to dispose of these investments in the short or medium term.

IFRS7*(11A)(c), (d),(e)* The fair value of these investments is CU 753,000 as at 31 December 2018. There was no dividend recognised during the period nor transfers of the cumulative gain within equity.

IFRS7(*11B*)

Disclosures not illustrated as not applicable to the Group

When an entity derecognises investments in equity instruments measured at FVOCI, it shall disclose:

(a) The reason for disposing of the investments;

(b) The fair value of investments at the date of derecognition; and

(c) The cumulative gain or loss on disposal.

5.3 Reclassification

Disclosures not illustrated as not applicable to the Group

The disclosure requirements in relation to the reclassification of financial assets under IFRS 9 are similar, but not the same as those under IAS 39. Such reclassifications under IFRS 9 are expected to be rare in practice and therefore have not been illustrated in this document. The following are the disclosures that should be presented when applicable:

IFRS7(*12B*)

For each such reclassification, in the current or previous reporting periods, the following should be disclosed:

(a) The date of reclassification;

(b) A detailed explanation of the change in business model and a qualitative description of its effect on the Bank's financial statements; and

(c) The amount reclassified into and out of each category.

IFRS7(*12C*)

For each reporting period following a reclassification from FVPL to amortised cost or FVOCI, until derecognition, the Bank should disclose:

(a) The effective interest rate determined on the date of reclassification; and

(b) The interest revenue recognised.

IFRS7(*12D*)

If, since its last annual reporting date, a Bank has reclassified a financial asset (i) from FVOCI to amortised cost, or (ii) from FVPL to amortised cost or FVOCI, it shall disclose:

(a) The fair value of the financial asset at the end of the period; and

(b) The fair value gain or loss that would have been recognised in profit or loss or OCI during the reporting period if the financial assets had not been reclassified.

5.4 Net gains/(losses) on derecognition of financial assets measured at amortised cost

IFRS7 (*20A*)

During the period, the Group sold a portfolio of loans to customers due to a credit risk management decision to eliminate the exposure following a deterioration in credit risk. The Group incurred a loss of CU 12,000 on the sale.

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