
JLGC

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

IFRS9 Implementation

Jordan Loan Guarantee Corporation (JLGC)

By : Adnan Naji (CEO)

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

Introduction

2014

Financial crises 2007 -2008

IFRS 9

VS.

IAS 39

1999

- Simpler framework
- Limitation on reclassification
- Forward looking

- Complex framework
- Too much optionality
- Too little too late

IN the wake of the financial crises in 2007/08 came under criticism for:

Initially issued in 1999 IAS 39 has been revised several times since its issuance and remains one of the most complex standards in the IFRS literature to apply in practice.

IAS 39 Background

- A very complex framework of accounting leading to inconsistent application ***(Complex framework)***
- Various options under IAS 39 mean that comparability between companies is not easy (***Too much optionality)***
- In the case of loan loss provisioning does not provide the right solution.***(Too little too late)***
- Accounting outcomes can seem to be disconnected with the business activities. (***Not reflective of business activities.)***

Effective date and transition – early application choices

Under IFRS 9 (2009, 2010, 2013)

IFRS 9 (2009)

Or

IFRS 9 (2009) and IFRS 9 (2010)

Or

IFRS 9 (2009), IFRS 9 (2010) and IFRS 9 (2013)

Or

Own credit requirements

Under IFRS 9 (2014)

Final version of IFRS 9 (2014)

Includes accounting policy choice to apply IAS 39 for hedge accounting

Or

Own credit requirements

- **IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted**
- **Early application of previous versions of IFRS 9 (2009, 2010, 2013) is permitted if date of initial application is before 1 February 2015**
- **Retrospective but restatement of comparatives not required**

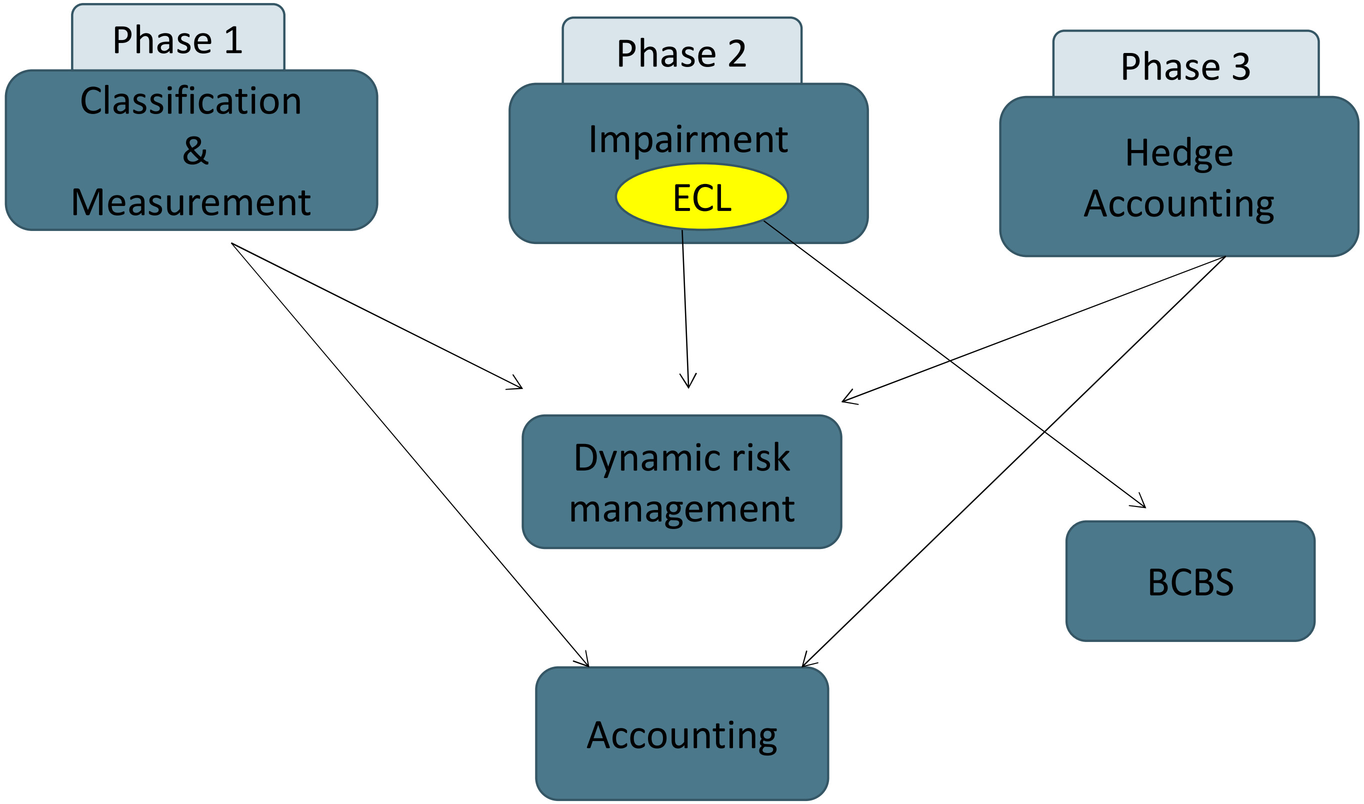
Introduction – IASB issues IFRS 9

- On 24 July 2014, the International Accounting Standards Board (IASB) issued the final version of IFRS 9, bringing together all three phases of the financial instruments project
  - Classification and measurement
  - Impairment (expected credit losses)
  - Hedge accounting

Accounting for dynamic risk management (macro hedging) is not included and forms a separate project

- IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted

IFRS 9 (3 Phases):



Moving Forward

- regulations to govern implementation of IFRS 9.
- Proper Implementation.
- Models Validation

*Income and deferred taxes treatments .

*Internal credit rate exercise for all institutions to be in place.

JORDAN
LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

Moving Forward (Cont'd)

* Institutions in different locations.

*One client may be treated differently in two different institutions depend on its credit risk.

Jordan Loan Guarantee Corp.
The Small Business Company Of Jordan

IFRS 9 – Phase 1 Classification and Measurement

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

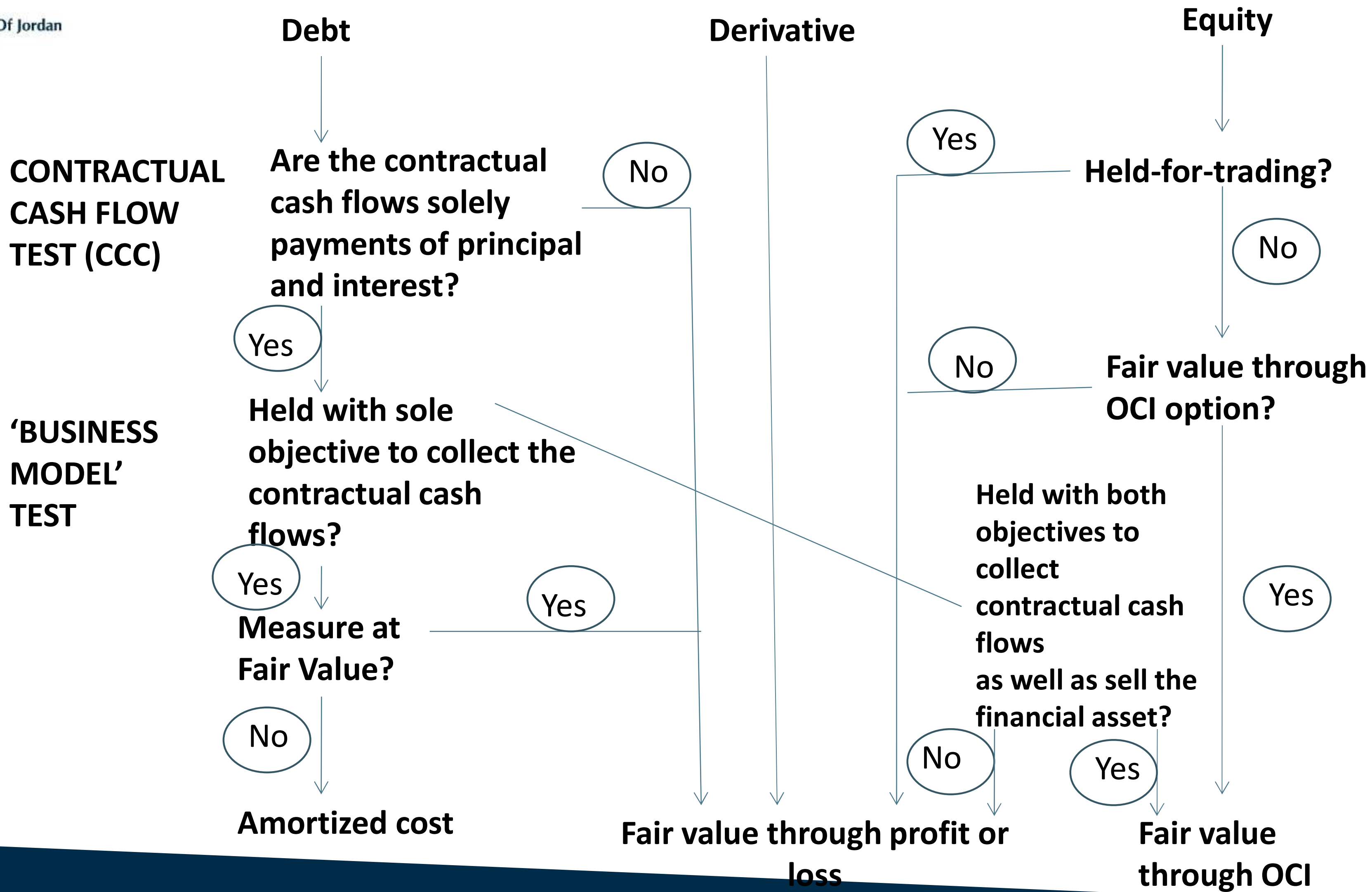
Objectives of IFRS9 Phase 1

With the role of accounting under the spotlight after the global financial crises, the IASB commenced work to develop a new financial instrument accounting standard to replace IAS39.

- Intention was to design a simpler model that reflected the objectives of the Business(***Simpler framework)***
- Reclassification between categories allowed only under restricted Circumstances (***Limitation on reclassification)***
- Fewer and simpler options based on the business purpose of holding the assets as opposed to the intention of holding the individual asset (***Reduced optionality)***

Classification and measurement

Financial assets

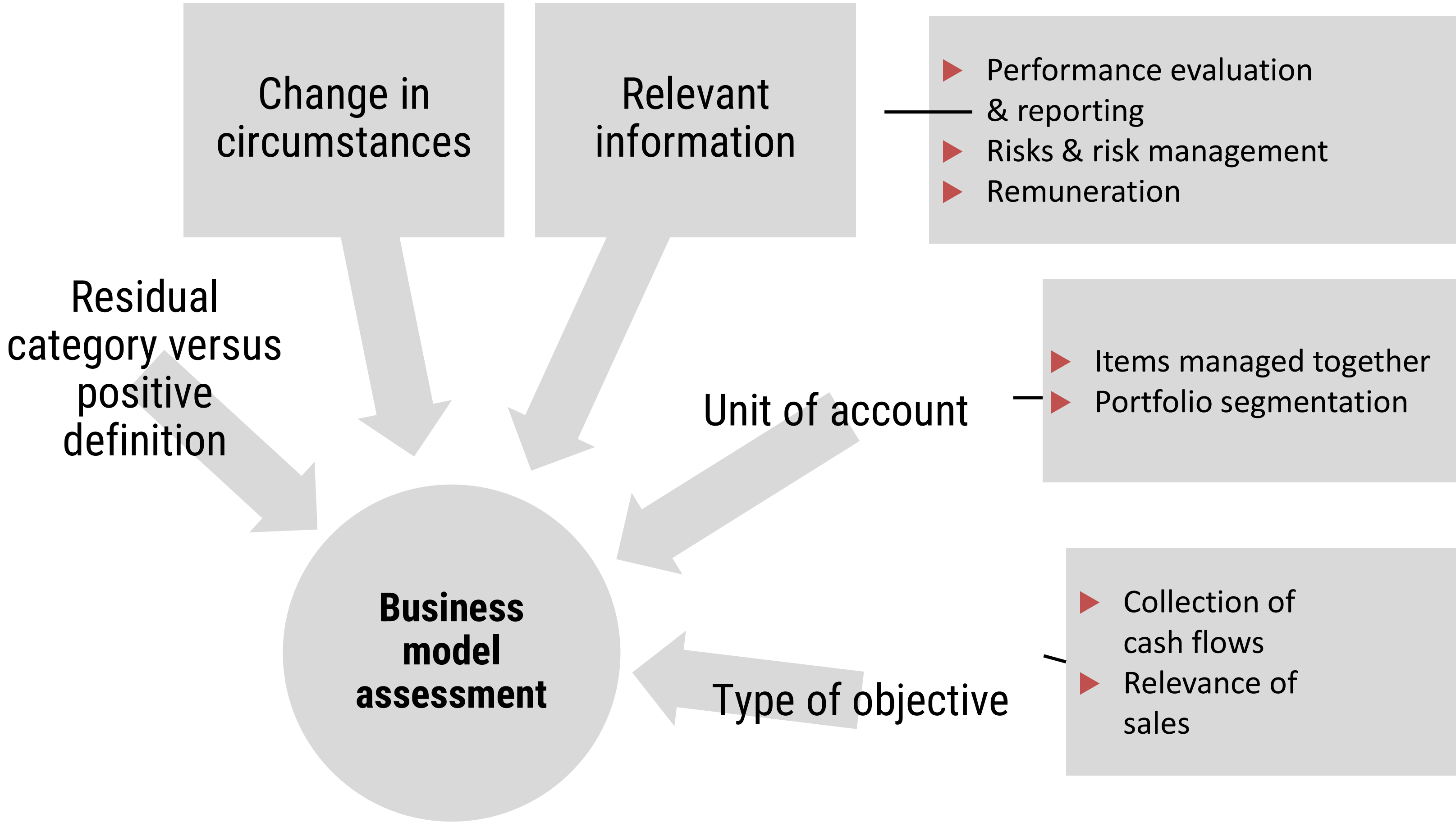


JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

Business model

Business model is determined by the entity's *key management personnel (as defined in IAS 24)*

How to assess the business model



Jordan Loan Guarantee Corp.
The Small Business Company Of Jordan

Reclassification of financial assets

External or internal changes which are significant to the entity's operations

→

Entity's senior management changes business model

The first day of the first reporting period following the change in business model

↓

Reclassification of financial assets prospectively from the reclassification date

FVOCI measurement category – Debt

- FVOCI mechanics
  - Fair value gains and losses of the asset are recorded in OCI
  - Cumulative gains and losses recycled to P&L upon derecognition
  - ECLs are derived using the same model as amortised cost instruments and are recorded in P&L with offseting entry in OCI
  - Interest income is calculated using effective interest method and recorded in P&L

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

Business model: AC or FVOCI

- **Infrequent or insignificant sales** during a particular period would still qualify as amortised cost
- **Sale close to maturity** would continue to qualify as amortised cost
- **Frequent sales**: need to assess if it it is still consistent with amortised cost model

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

Business model: AC or FVOCI

- Increase in credit risk which trigers sales of amortised cost instruments, would qualify as amortised cost (irrespective of frequqncy and value)
- **Credit risk management activities** aimed at minimizing potential credit losses **are integral part of amortised cost model**

Measurement of equity instruments

- Must be measured at fair value
- Cost is never the best estimate of fair value for quoted equity instruments

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

IFRS 9: Impairment for Financial Institutions and Similar Entities

JORDAN
LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

The new approach

IAS 39	►Incurred credit loss model
IFRS 9	►Expected credit loss model

Impairment

Switch from Incurred to Expected Loss Model

SCOPE:

The new model should be applied to:

* Debt instruments measured at amortized cost;

* Debt instruments measured at fair value through other comprehensive income (FVOCI);

* Loan book and loan commitments not measured at fair value through profit or loss;

* Financial guarantee contracts, including standby letters of credit to which IFRS 9 is applied and that are not accounted for at fair value through profit or loss; and

*Lease receivables that are within the scope of IAS 17, Leases, and trade receivables or contract assets within the scope of IFRS 15 that give rise to an unconditional right to consideration.

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

General approach

Start here

	Stage 1	Stage 2	Stage 3
		30 days	90 days / Default occurred
Loss allowance updated at each reporting date	12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses
Lifetime expected credit losses criterion		Credit risk has increased significantly since initial recognition (individual or collective basis)	+ Credit-impaired
Interest revenue calculated based on	Effective interest rate on gross carrying amount	Effective interest rate on gross carrying amount	Effective interest rate on amortised cost

Change in credit risk reflected in FS

Improvement ⟷ *Deterioration*

Expected Credit Losses

General approach

Has the credit risk increased significantly?

No → **Stage 1**

- Financial instruments whose credit risk has not increased significantly since initial recognition or
- that have low credit risk at the reporting date

12-month expected credit losses

Gross carrying amount

Yes → **Stage 2**

Is there objective evidence of impairment?

No → **Stage 2**

Lifetime expected credit Losses

Gross carrying amount

Yes → **Stage 3**

Lifetime expected credit Losses

Net carrying amount

JORDAN
LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

As an exception to the general model, if the credit risk of a financial instrument is low at the reporting date, management can measure impairment using 12-month ECL, and so it does not have to assess whether a significant increase in credit risk has occurred. In order for this operational simplification to apply, the financial instrument has to meet the following requirements:

1) Low risk of default,
2) 2) the borrower is considered, in the short term, to have a strong capacity to meet its obligations; and
3) the lender expects, in the longer term, that adverse changes in economic and business conditions might, but will not necessarily; reduce the ability of the borrower to fulfil its obligations.

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

General approach for impairment measurement

Financial assets may move between different stages of credit quality

Change in credit quality since initial recognition

	Stage 1	Significant increase in credit risk → Stage 2	Occurrence of credit event → Stage 3
Credit loss recognition	• At initial recognition, record12 months expected credit loss in P&L, unless credit impaired • This serves as a proxy for the initial expectation of credit losses that are priced in to the assets	• When credit risk significantly increases and credit quality is below investment grade (in absolute terms), record full lifetime expected credit loss • Compare credit quality at reporting date with that at initial recognition (relative approach)	• When credit quality further deteriorates and objective evidence of impairment exists, continue to recognize full lifetime expected credit loss • Compare credit event occurrence to prior reporting Date
Interest revenue	• For financial assets, interest revenue is calculated on the gross carrying amount of the asset, i.e. without adjustment for the loss allowance	• Calculation of interest revenue unchanged to stage1	• Interest revenue is calculated based on net amortised cost carrying amount less loss allowance
	performing	underperforming	non-performing

Jordan Loan Guarantee Corp.
The Small Business Company Of Jordan

Measurement of expected credit losses

Expected credit losses

- **Present value of all cash shortfalls** **over the remaining life**
- **Discounted at the original effective interest rate (EIR)**
- **The period over which to estimate ECL: maximum contractual period** (for revolving credit facilities, this extends beyond contractual period)
- **Probability-weighted outcomes**: possibility that a credit loss occurs, no matter how low the possibility
- **Reasonable and supportable information**

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

Interpretation and implementation issues

In practice

- **<u>Adjusting historical information</u>** to reflect current conditions and forecasts of future conditions
- Translating **<u>macroeconomic factors</u>** into expected credit losses
- Leveraging on calculation, **<u>stress testing</u>** and information used for Basel regulatory requirements
- **<u>Forward looking information</u>**

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

Increase of credit risk and default Rebuttable presumptions

- **Rebuttable presumption:**
  - **30 days past due payments – significant increase in credit risk, unless supportable information are provided**
  - **The standard does not provide definition for default, however, default does not occur later than 90 days**

Modified financial assets

- **Renegotiated terms:**
  - **Loans restructuring**
  - **Loans rescheduling**

Reasonable & supportable information

- **Compare credit at initial recognition and at reporting date**
- **Significant Increase in credit risk**
- **Allowance for expected credit losses is required**

Expected credit losses
Significant increase in credit risk – Stage 2

12-month expected losses ⟷ Significant increase in credit risk ⟷ Lifetime expected losses

Measuring the probability of default (PD) over remaining life VS Probability of default at initial recognition.
EXCEPTION: If financial asset has a low credit risk ("investment grade" in absolute terms) then no analysis of change in credit risk is required.
REBUTTABLE PRESUMPTION: credit risk has significantly increased if contractual payments are more than 30 days past due

Indicators

Internal -External

Individual vs. Collective basis

- Principle: individual basis
- However, collective assessment is allowed if Financial instruments in the group have shared risk characteristics

Jordan Loan Guarantee Corp.
The Small Business Company Of Jordan

Assessment on a collective basis based on shared credit risk characteristics

- **Examples in the standard include:**

Shared credit risk characteristics

- Date of initial recognition
- Instrument type
- Credit risk ratings
- Remaining term to maturity
- Collateral type
- Geographical location of the borrower
- Industry
- Loan to value, if this impacts the risk of a default occurring

In practice

groupings are required to be amended over time, banks and similar entities need to put in place processes to reassess whether loans continue to share similar credit risk characteristics.

Loss rate approach

Loss rate approach: An entity develops **loss rate statistics** on the basis of the amount written off over the life of the financial assets **rather than** developing a **separate probability of default and loss given default statistics** and then adjusts these historical credit loss trends for current conditions and expectations about the future.

In practice

- Difficulty in assessing significant increases in credit risk based on the change in the risk of a default occurring
- Requires an overlay of measuring and forecasting the level of default

Simplified approach for trade receivables

- **For trade receivables, entities shall always measure the loss allowance at an amount equal to the lifetime expected credit losses: provision matrix.**

Expected credit losses – Cont'd

Use of a provision matrix for trade receivable & retail loans
A Provision matrix could be set up based on historical observed default rates which is adjusted for forward-looking estimates and establishes that ECL should be calculated as:

1. non-past due: 0.5% of carrying book value
2. 31 to 60 days past due: 2% of carrying book value
3. 61-90 days past due: 3% of carrying book value
4. 91-120 days past due: 10% of carrying book value
5. 120 - 180 days past due: 15% of carrying book value
6. Over 180 days past due: 50% of carrying book value

The standard allows for a provision matrix to be used for recognizing ECL on trade receivables & retail, by applying historical credit impairment loss pattern and more forward-looking information in order to establish the applicable loss rates.

12 – Month expected loss

At the reporting date (which is before payment on the loan is due), there has been no change in the **12-month PD,** and there was no significant increase in credit risk since initial recognition. Creditor assumes that **Loss Given Default [LGD] X% of the gross carrying amount will be lost if the loan defaults**

Creditor measures the loss allowance at an amount equal to 12-month ECL using the 12-month PD of y%, whereas probability of no default would be 100% - y%. At the reporting date, the loss allowance for the **12-month ECL is CE x LGD x PD**

JORDAN LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

IFRS 7 *Financial Instruments: Disclosures* New credit risk disclosures

Quantitative	Qualitative

▶ Reconciliation of loss allowance
▶ Explanation of gross carrying amounts showing key drivers for change
▶ Gross carrying amount by credit risk rating grade or delinquency
▶ Modifications, write-offs, recoveries and collateral
	▶ Inputs, assumptions and techniques used to:
	  ▶ Estimate expected credit losses
	  ▶ Determine significant increase in credit risk
	  ▶ Determine credit-impaired financial assets
	▶ Modification policies, write-off policies and collateral

36

- At JLGC we deploy a hybrid model using internal data and data from our partners (banks)

Having full engine in house (JLGC) is challenge due to:

- Limited data available (qualitative and quantitative)
- Macroeconomics indicators and stress scenarios
- Cost of the Engine

Based on that a completed mythology were developed by JLGC team to comply with IFRS9 requirements and approved by the Risk Committee and Board of Directors

Developing the mythology conducted in cooperation with external auditors (one of the big four audit firms)

Methodology covers the mechanism of calculating the following:

1. Historical data losses
2. Credit worthiness
3. Three Parameters (PD,EAD, LGD)
4. Credit deterioration
5. ECL Calculation

JORDAN
LOAN GUARANTEE CORP.
The Small Business Company Of Jordan

For quality assurance, we conduct back testing to compare methodology outcomes with real figures on annual basis, the results show ECL calculated is more conservative which consider as additional cushion is in place

Jordan Loan Guarantee Corp.
The Small Business Company Of Jordan

Thank You !