

Credit Enhancement in the Measurement of Expected Credit Losses (IFRS 9 *Financial Instruments*)—March 2019

The Committee received a request about the effect of a credit enhancement on the measurement of expected credit losses when applying the impairment requirements in IFRS 9. The request asked whether the cash flows expected from a financial guarantee contract or any other credit enhancement can be included in the measurement of expected credit losses if the credit enhancement is required to be recognised separately applying IFRS Standards.

For the purposes of measuring expected credit losses, paragraph B5.5.55 of IFRS 9 requires the estimate of expected cash shortfalls to ‘reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity.’

Accordingly, the Committee observed that the cash flows expected from a credit enhancement are included in the measurement of expected credit losses if the credit enhancement is both:

- a. part of the contractual terms; and
- b. not recognised separately by the entity.

The Committee concluded that, if a credit enhancement is required to be recognised separately by IFRS Standards, an entity cannot include the cash flows expected from it in the measurement of expected credit losses. An entity applies the applicable IFRS Standard to determine whether it is required to recognise a credit enhancement separately. Paragraph B5.5.55 of IFRS 9 does not provide an exemption from applying the separate recognition requirements in IFRS 9 or other IFRS Standards.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to determine whether to include the cash flows expected from a credit enhancement in the measurement of expected credit losses in the fact pattern described in the request. Consequently, the Committee decided not to add this matter to its standard-setting agenda.