STAFF PAPER

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Project	**Transition Resource Group for Impairment of Financial Instruments**
Paper topic	Revolving Credit Facilities

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Introduction

1. This paper addresses two issues raised by a submitter regarding the application of the impairment requirements of IFRS 9 *Financial Instruments* (2014) to a portfolio of revolving credit card exposures. The first issue relates to the determination of the appropriate period to consider when measuring Expected Credit Losses ('ECL') and the second relates to the assessment of significant increases in credit risk.

2. In this paper, the staff deal with each issue in turn by:

    (a) setting out the relevant accounting requirements in IFRS 9;

    (b) summarising the example provided by the submitter along with the questions raised; and

    (c) asking the members of the Transition Resource Group for Impairment of Financial Instruments ('ITG') for their views on the issues identified.

Issue 1—Determining the appropriate period to consider when measuring ECL

Background

3. The submitter presents an example of a bank that holds a large portfolio of revolving credit facilities meeting the conditions of paragraph 5.5.20 of IFRS 9. At the reporting period, the bank has identified that 75 per cent of the portfolio has not suffered a significant increase in credit risk, 20 per cent of the portfolio has suffered a significant increase in credit risk and the remaining 5 per cent of the portfolio are credit impaired. The submitter asks how to determine the appropriate period to consider when measuring ECL for each of the subportfolios identified.

Accounting requirements

4. Paragraph 5.5.4 of IFRS 9 explains a fundamental objective of the impairment requirements as follows:

> The objective of the impairment requirements is to recognise lifetime expected credit losses for all financial instruments for which there have been significant increases in credit risk since initial recognition — whether assessed on an individual or collective basis — considering all reasonable and supportable information, including that which is forward-looking.

5. Paragraphs 5.5.3 and 5.5.5 distinguish between the approach in respect of financial instruments for which credit risk has significantly increased since initial recognition and those for which credit risk has not significantly increased since initial recognition.

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

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

6. The concept of 12 month ECL is further explained in paragraph B5.5.43 of IFRS 9 which clarifies that they are a portion of lifetime ECL:

> For lifetime expected credit losses, an entity shall estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses are a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring. Thus, 12-month expected credit losses are neither the lifetime expected credit losses that an entity will incur on financial instruments that it predicts will default in the next 12 months nor the cash shortfalls that are predicted over the next 12 months.

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

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

8. However, as discussed in paragraphs BC254–BC261 of IFRS 9, the IASB also considered concerns raised by respondents on the 2013 Impairment Exposure Draft in relation to the period to be considered for measuring expected credit

losses for specific financial instruments. These respondents noted that there were certain financial instruments that included both a loan and an undrawn commitment component and for which the entity's contractual ability to demand repayment, and cancel the undrawn commitment, did not limit the entity's exposure to credit losses to the contractual notice period. In these cases, both the drawn and undrawn balance are managed together from a credit risk perspective and lenders generally tended to extend credit for a duration longer than the contractual minimum and only withdraw the facility if observable credit risk on the facility had increased significantly. Consequently, restricting the recognition of ECL to the contractual notice period would not reflect the underlying economics or the way in which these facilities were managed.

9. Having considered these concerns, the IASB reaffirmed its decision to use the maximum contractual period as the maximum period to consider when measuring ECL. Nevertheless, in acknowledgement of the situation outlined in paragraph 8 above and as discussed in paragraphs BC260 and BC261 of IFRS 9, the IASB decided to include an exception to this principle in very specific cases:

> The IASB remains of the view that the contractual period over which an entity is committed to provide credit (or a shorter period considering prepayments) is the correct conceptual outcome. The IASB noted that most loan commitments will expire at a specified date, and if an entity decides to renew or extend its commitment to extend credit, it will be a new instrument for which the entity has the opportunity to revise the terms and conditions. Consequently, the IASB decided to confirm that the maximum period over which expected credit losses for loan commitments and financial guarantee contracts are estimated is the contractual period over which the entity is committed to provide credit.
>
> However, to address the concerns raised about the financial instruments noted in paragraphs BC5.254–BC5.257, the IASB decided that for financial instruments that include both a loan and an undrawn commitment

> component and the entity's contractual ability to demand repayment and cancel the undrawn commitment does not limit the entity's exposure to credit losses to the contractual notice period, an entity shall estimate expected credit losses over the period that the entity is expected to be exposed to credit risk and expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. When determining the period over which the entity is exposed to credit risk on the financial instrument, the entity should consider factors such as relevant historical information and experience on similar financial instruments. The measurement of expected credit losses should take into account credit risk management actions that are taken once an exposure has increased in credit risk, such as the reduction or withdrawal of undrawn limits.

10. Consequently, the following exception is included in paragraph 5.5.20 of IFRS 9:

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

11. Further application guidance pertaining to this exception is included in paragraphs B5.5.39 and B5.5.40 of IFRS 9:

> However, in accordance with paragraph 5.5.20, some financial instruments include both a loan and an undrawn commitment component and the entity's contractual ability to demand repayment and cancel the undrawn

commitment does not limit the entity's exposure to credit losses to the contractual notice period. For example, revolving credit facilities, such as credit cards and overdraft facilities, can be contractually withdrawn by the lender with as little as one day's notice. However, in practice lenders continue to extend credit for a longer period and may only withdraw the facility after the credit risk of the borrower increases, which could be too late to prevent some or all of the expected credit losses. These financial instruments generally have the following characteristics as a result of the nature of the financial instrument, the way in which the financial instruments are managed, and the nature of the available information about significant increases in credit risk:

(a) the financial instruments do not have a fixed term or repayment structure and usually have a short contractual cancellation period (for example, one day);

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

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

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

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

> (b) the length of time for related defaults to occur on similar financial instruments following a significant increase in credit risk; and
>
> (c) the credit risk management actions that an entity expects to take once the credit risk on the financial instrument has increased, such as the reduction or removal of undrawn limits.

12. Paragraphs B5.5.30 and B5.5.31 of IFRS 9 also contain application guidance regarding the measurement of expected credit losses on loan commitments:

> For undrawn loan commitments, a credit loss is the present value of the difference between:
>
> (a) the contractual cash flows that are due to the entity if the holder of the loan commitment draws down the loan; and
>
> (b) the cash flows that the entity expects to receive if the loan is drawn down.
>
> An entity's estimate of expected credit losses on loan commitments shall be consistent with its expectations of drawdowns on that loan commitment, ie it shall consider the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses, and the expected portion of the loan commitment that will be drawn down over the expected life of the loan commitment when estimating lifetime expected credit losses.

13. In measuring ECL, paragraph 5.5.17 of IFRS 9 provides the following general guidance:

> An entity shall measure expected credit losses of a financial instrument in a way that reflects:
>
> (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
>
> (b) the time value of money; and

> (c) 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.

14. Determining what is considered to be reasonable and supportable information will require judgement. Paragraph B5.5.50 of IFRS 9 provides requirements in this area, including the following:

> An entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument. The degree of judgement that is required to estimate expected credit losses depends on the availability of detailed information. As the forecast horizon increases, the availability of detailed information decreases and the degree of judgement required to estimate expected credit losses increases. The estimate of expected credit losses does not require a detailed estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information.

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

Potential implementation issue identified

16. The submitter provides the following example:

Bank A holds a portfolio of revolving credit facilities (eg credit cards). The following apply:

- The average life of a card that does not default is 5 years. Because Bank A has had a steady book for a number of years the average remaining life is 2.5 years at the reporting date.
- On average cards that default do so 18 months after the card was originated and 9 months after a significant increase in credit risk. Because Bank A has had a steady book for a number of years, the average remaining lives at the reporting date would be 9 months and 4.5 months respectively.
- Every card has the same credit limit of CU1,000[1] and the average month end balance is CU500.
- The credit risk management policy of Bank A is to monitor the monthly balance in relation to previous activity and the credit limit set on the card. Bank A also receives some information from an external credit bureau on the credit standing of individual customers—eg if a customer fails to make a payment on a card or other loan with another lender in the same jurisdiction or the customer's overall credit score increases for other reasons.
- Bank A judges that a significant increase in credit risk occurs for an individual customer when any of the following occur (in addition Bank A makes a collective forward-looking overlay that considers macroeconomic factors, eg unemployment rates):
    - the customer made only the minimum monthly repayment for either 2 consecutive months or for more than 3 months in the last 12;
    - the customer has failed to make a payment on a loan with a different lender or external data indicates its credit risk has increased for other reasons; and
    - the customer has failed to make one (or more) minimum monthly repayments.

If any of the above occurs, Bank A:

- lowers any unused credit limit (though is unlikely to withdraw it completely, because doing so would not meet local regulatory requirements to 'treat

[1] In this paper, currency amounts are denominated in 'currency units' (CU).

customers fairly')—to an average of CU700;

- contacts the customer to discuss his/her finances; and
- withdraws any bonus rates (eg on balance transfers etc.) that the customer had been entitled to, so the interest rate reverts to the standard APR—with the aim of discouraging the customer from using the card further, because it has become more expensive to do so.

A card is deemed to be in default when the borrower has failed to make the minimum monthly repayment required for 2 consecutive months. At this point, Bank A contacts the customer again to initiate recovery proceedings.

At the reporting date, 75 per cent of cards have not suffered a significant increase in credit risk and so are in Stage 1; 20 per cent of cards have suffered a significant increase in credit risk and so are in Stage 2; and the other 5 per cent have defaulted (ie are credit impaired and are in Stage 3). Of those in Stage 2, half (ie 10 per cent of the total number of cards) are expected to default and the other half are expected to 'cure' and not default.

It is assumed that the portfolio meets the conditions of paragraph 5.5.20 of IFRS 9.

Questions:

1. What life should be used under IFRS 9 to calculate expected credit losses for:

(a) assets in Stage 1

(b) assets in Stage 2

(c) assets in Stage 3?

Issue 1—Question 1(a)—What life should be used under IFRS 9 to calculate expected credit losses on assets that are within Stage 1?

17. The submitter suggests that the life of assets in Stage 1 should be a maximum of 12 months. However, the staff note that the expected life used to measure ECL of assets in Stage 1 should be determined in accordance with the requirements in B5.5.40 and more generally, it should not be assumed that the maximum life for assets in Stage 1 is 12 months. This conclusion would be inconsistent with the concept of 12 month ECL being a portion of the lifetime ECL as described in paragraph B5.5.43 of IFRS 9.

18. The staff point out that in accordance with paragraph B5.5.31 of IFRS 9, Bank A must consider the expected portion of the loan commitment that will be drawn

down within 12 months of the reporting date when estimating 12 month ECL. However, it should be noted that this requirement relates to the period over which drawdowns should be estimated for the purposes of estimating exposure at default and does not relate to the determination of the expected life for the purposes of measuring ECL.

19. The application of these requirements is illustrated in paragraphs IE63 and IE64 of Illustrative Example 10 of IFRS 9. In this example, the entity determines an expected life used to measure ECL of 30 months in accordance with paragraph B5.5.40 of IFRS 9 but in order to estimate the exposure at default for the purposes of the 12-month ECL calculation, additional drawdowns are determined over a 12-month period (as prescribed by paragraph B5.5.31 of IFRS 9). Having derived the respective exposures at default, both the lifetime ECL and 12-month ECL are measured using the expected life.

20. The staff point out that as explained in paragraphs B9.5.40 and BC5.260 - BC5.261 of IFRS 9, the IASB decided that in respect of portfolios meeting the requirements of paragraph 5.5.20 of IFRS 9, an entity should estimate expected credit losses over the period that the entity is expected to be exposed to credit risk <u>and</u> expected credit losses would not be mitigated by credit risk management actions, even if that period extends beyond the maximum contractual period. Consequently, in order to determine the appropriate expected life for measuring ECL in respect of this portfolio (including assets in Stage 1), Bank A should apply the requirements set out in paragraph B9.5.40 of IFRS 9 as illustrated in paragraphs IE60 and IE61 of Illustrative Example 10 of IFRS 9.

21. The submitter also suggests that for some of the assets in Stage 1, a period shorter than 12 months may be appropriate.

22. The staff observe that when an entity has the ability to subdivide the portfolio in a way that identifies groups of assets with different expected lives (including periods shorter than 12 months), then it may be appropriate to do so. In order to determine those different expected lives, the entity would apply the requirements in paragraph B5.5.40 of IFRS 9.

Issue 1—Question 1(b)—What life should be used under IFRS 9 to calculate lifetime expected credit losses on assets that are within Stage 2?

23. The submitter points out that in the example presented, Bank A has identified two subportfolios of assets for which a significant increase in credit risk has been identified: those that are expected to cure and not default and those that will default. Consequently, the submitter concludes that it may be appropriate for these subportfolios to have different lives.

    (a) For the cards that are expected to cure, the life should be based on the average remaining life of cards that do not default, ie 2.5 years.

    (b) For the cards that are expected to default, the life should be based on the average remaining life of cards that are expected to default after a significant increase in credit risk has been identified, ie 4.5 months.

24. In determining the periods above and the resulting amount of loss, the submitter points out that consideration would be given to the requirements in paragraph B5.5.40 of IFRS 9 regarding credit risk management actions taken once credit risk had increased.

25. As noted in paragraph 22 above, when the entity has the ability to subdivide the portfolio in a way that identifies groups of assets with different expected lives, then it may be appropriate to do so. In order to determine those different expected lives, the entity would apply the requirements in paragraph B5.5.40 of IFRS 9.

26. In respect of assets within Stage 2, the submitter raised a related question regarding how far in the future predictions should be expected to cover as some assets in Stage 2 may initially cure and then subsequently default. The submitter asks whether an entity should include those subsequent defaults in measuring expected credit losses (because the Stage 2 calculation aims to calculate lifetime ECL) or whether the subsequent defaults should be excluded (because this is more consistent with paragraph B5.5.40 of IFRS 9 which requires credit risk management actions to be taken into account in determining the appropriate expected life).

27. The staff point out that Bank A would need to consider both the general requirements around incorporating forecasts of future conditions along with the specific requirements in respect of revolving portfolios of this nature.

28. As regards the general requirements, IFRS 9 requires that entities measure ECL over the relevant expected life. However, paragraph 5.5.17(c) of IFRS 9, requires Bank A to incorporate reasonable and supportable information that is available without undue cost or effort at the reporting date about forecasts of future economic conditions. In applying this requirement, consideration should also be given to the requirements in paragraph B5.5.50 of IFRS 9, which states that the level of detail required for future estimates will depend on the availability of information and that increasing amounts of judgement will be required for periods far in the future.

29. Furthermore, as the portfolio described in the example meets the conditions set out in paragraph 5.5.20 of IFRS 9, Bank A is also required to apply the more specific requirements in paragraph B5.5.40 of IFRS 9 in order to determine the appropriate expected life used to measure ECL. Consequently, it would be necessary to consider the impact of credit risk management actions on the period over which the entity is expected to be exposed to credit risk.

Issue 1—Question 1(c)—What life should be used under IFRS 9 to calculate lifetime expected credit losses on assets that are within Stage 3?

30. The submitter presents the following view.

    (a) In accordance with paragraphs 5.5.20 and 5.5.40 of IFRS 9, when determining the period over which the entity is exposed to credit risk, credit risk management actions must be taken into account. In this example, Bank A initiates recovery proceedings upon a default. Consequently, for assets in Stage 3, Bank A will have already taken actions to terminate the credit facility. In order to calculate ECL, Bank A should take into account the cash flows it expects to recover from the portfolio (both their amount and timing) and calculate the ECL based on this information.

Question for ITG members
What are your views on the issues presented above?

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

Background

31. The submitter presents an example of a bank that holds a large portfolio of revolving credit facilities meeting the conditions of paragraph 5.5.20 of IFRS 9. The portfolio has a diverse customer base, ranging from long-standing customers who have been with the bank for many years, to new customers who have only recently opened an account. The submitter asks how to determine the date of initial recognition of the credit facility for the purposes of the assessment of significant increases in credit risk.

Accounting requirements

32. Paragraph 5.5.9 of IFRS 9 requires that, at each reporting date, an entity should assess whether the credit risk on a financial instrument has increased significantly since initial recognition.

> At each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, an entity shall use the change in the risk of a default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses. To make that assessment, an entity shall compare the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and consider reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk since initial recognition.

33. IFRS 9 provides the following requirements regarding the date of initial recognition in respect of financial assets and loan commitments:

(a) in respect of financial assets, paragraph 3.1.1 of IFRS 9 states:

> An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs B3.1.1 and B3.1.2).

(b) in respect of loan commitments, paragraph 5.5.6 of IFRS 9 states:

> For loan commitments and financial guarantee contracts, the date that the entity becomes a party to the irrevocable commitment shall be considered to be the date of initial recognition for the purposes of applying the impairment requirements.

34. IFRS 9 did not change the derecognition requirements in IAS 39 (they were simply relocated from IAS 39). IFRS 9 acknowledges that the renegotiation or modification of a financial asset can sometimes lead to derecognition of the existing financial asset and sometimes not.[2]

35. Where the financial asset is derecognised, the modified financial asset is considered 'new' and IFRS 9 states that the date of the modification should be treated as the date of initial recognition for that new financial asset for the purposes of applying the impairment requirements. In contrast, if the financial asset is not derecognised, then it is not considered 'new' and the date of initial recognition remains unchanged. This is discussed in paragraphs B5.5.25 and B5.5.26 of IFRS 9:

> In some circumstances, the renegotiation or modification of the contractual cash flows of a financial asset can lead to the derecognition of the existing financial asset in

[2] The IFRS Interpretations Committee ('Interpretations Committee') considered the topic of derecognition when addressing the accounting for different aspects of restructuring Greek Government Bonds in September 2012. See IFRIC Update September 2012: Interpretations Committee Agenda Decision - IAS 39 *Financial Instruments: Recognition and Measurement*—Derecognition of financial instruments upon modification

> accordance with this Standard. When the modification of a financial asset results in the derecognition of the existing financial asset and the subsequent recognition of the modified financial asset, the modified asset is considered a 'new' financial asset for the purposes of this Standard.
>
> Accordingly the date of the modification shall be treated as the date of initial recognition of that financial asset when applying the impairment requirements to the modified financial asset. This typically means measuring the loss allowance at an amount equal to 12-month expected credit losses until the requirements for the recognition of lifetime expected credit losses in paragraph 5.5.3 are met. However, in some unusual circumstances following a modification that results in derecognition of the original financial asset, there may be evidence that the modified financial asset is credit-impaired at initial recognition, and thus, the financial asset should be recognised as an originated credit-impaired financial asset. This might occur, for example, in a situation in which there was a substantial modification of a distressed asset that resulted in the derecognition of the original financial asset. In such a case, it may be possible for the modification to result in a new financial asset which is credit- impaired at initial recognition.

36. Paragraph B5.5.47 of IFRS 9 also provides the following requirements in respect of the date of initial recognition for a loan commitment which is subsequently drawn down:

> The expected credit losses on a loan commitment shall be discounted using the effective interest rate, or an approximation thereof, that will be applied when recognising the financial asset resulting from the loan commitment. This is because for the purpose of applying the impairment requirements, a financial asset that is recognised following a draw down on a loan commitment shall be treated as a continuation of that commitment

instead of as a new financial instrument. The expected credit losses on the financial asset shall therefore be measured considering the initial credit risk of the loan commitment from the date that the entity became a party to the irrevocable commitment.

Potential implementation issue identified

37. The submitter provides the following example:

> Bank A holds a portfolio of revolving credit facilities (eg credit cards).
>
> The portfolio includes some customers that have had a credit card with the bank for many years (20 years +), while others only opened a credit card account within the last month. The weighted average time that customers have had a credit card with the bank is 5 years.
>
> For customers that have had a credit card with the bank for many years, several events may have taken place:
>
> - the customer may have changed to a different type of card. For example, a customer may have initially taken out a card while a student and at that time had a 'student card'; then later may have changed to a 'standard card'; and sometime later still may have changed again to a 'premium card' (eg once their income met a specified minimum level and/or paying an annual fee in return for enhanced benefits).
> - the bank may have increased the customer's credit limit, in some cases multiple times. This may have been in response to a request from the customer (subject to the customer meeting the bank's credit criteria), or initiated by the bank.
> - the bank conducts an annual review of each credit card facility once a year. This is a largely automated process that in many cases results in no change to the terms of the card account. But in some cases it may result in the customer's credit limit being increased or decreased or to other changes to terms and conditions.
>
> It is assumed that the portfolio meets the conditions of paragraph 5.5.20 of IFRS 9.
>
> **Question:**
>
> 1. How should Bank A determine the date of initial recognition of the revolving credit facilities (for the purpose of determining if there has been a significant increase in credit risk since initial recognition)?

Issue 2—Question 1—How should Bank A determine the date of initial recognition of the revolving credit facilities (for the purpose of determining if there has been a significant increase in credit risk since initial recognition)?

38. The submitter suggests a number of different approaches in determining the date of initial recognition for revolving credit facilities.

39. One approach focuses on determining the date of initial recognition of the original undrawn facility, whereas the other approaches focus on the determination of whether subsequent events, such as the issue of new credit card products, changes to credit limits or revised credit reviews would result in a change in the point used to consider whether there has been a significant increase in credit risk.

40. The staff note that in accordance with paragraph 5.5.9 of IFRS 9, the assessment of increases in credit risk focuses on the date of initial recognition of the financial instrument which is being accounted for and being assessed for significant increases in credit risk.

Question for ITG members
What are your views on the issue presented issue?

Appendix I

A1. Example 10—revolving credit facilities

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

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

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

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

(b) the length of time for related defaults to occur on similar financial instruments; and

(c) past events that led to credit risk management actions because of an increase in credit risk on similar financial instruments, such as the reduction or removal of undrawn credit limits.

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

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

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

IE64 The exposure at default and expected life determined by Bank A are used to measure the lifetime expected credit losses and 12-month expected credit losses on its credit card portfolio.

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