CENTRAL BANK OF JORDAN

Instructions for Implementing the International Financial Reporting standard (IFRS 9)

No. (13/2018)

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Scope of Implementation

The instructions of IFRS 9 shall apply to all banks and at all levels as follows:

- **Jordan branches.**
- **Cross- border branches (abroad) [standalone].**
- **Jordan and abroad branches.**
- **Subsidiaries [standalone].**
- **Consolidated Bank [banking group].**

Sharia' Compliant Banks are subject to the expected credit loss part. While for the remaining aspects, they are subject to the Islamic Accounting Standard No. 25 until the instructions related to Sharia' Compliant banks are issued according to the requirements of Islamic Accounting Standard No. 30.

First Clause: Governance Requirements

The IFRS 9, in its content, is one of the risk management system areas/ aspects in banks (in addition to its accounting framework); it exists in the three components covered by IFRS 9 (Classification and Measurement), (Expected Credit Loss "ECL"/ Impairment) and (Hedge Accounting).

The IFRS 9 aims, through the ECL/ Impairment Component, at measuring the expected credit loss depending on future forward looking based on historical and current information/ data expected about the credit exposures, so it differs from previous methodologies which have relied on incurred losses (IAS 39). Furthermore, implementing the new standard will have implications and interconnections with other supervisory/ regulatory requirements (for example; Basel III, Capital Adequacy, Liquidity, and ICAAP) and with the mechanism of credit exposure management in the bank in terms of product types, pricing, collaterals, or the relationship with the clients, the matter that requires an effective supervision from the board of directors of the bank and its related committees and from the executive management to ensure the sound/ proper implementation of the new standard and to ensure providing and protecting the systems and programs used in the implementation.

So, the board of directors has the responsibility to set an appropriate structure and procedures of governance ensuring the sound/ proper implementation for the standard through defining certain roles for the committees, the departments/ divisions, and other functions in the bank and in a way to ensure the integration of the work among them, and make a suitable infrastructure available.

In this context, the bank has to take into consideration the following:

1. The implementation of the general framework for the calculation of the ECL requires a large amount of qualitative and quantitative information, whether historical, current, of future expectations, or of macroeconomic indicators. Therefore, the bank has to improve the systems necessary to make sufficient information/ data available in an accurate and secure way, thus enabling the bank to calculate the

ECL through cooperation among all related work functions in the bank and under the oversight of the board of directors and its committees in concern.

2. As depicted throughout these instructions, the calculation of the ECL, according to the requirements of IFRS 9, requires automated systems. Therefore, such systems should be of good and reliable quality which can be depended on in terms of the inputs, processes, or the outputs and results.

   Thus, the management of the bank shall adhere not to amend any outputs resulted from the systems regarding the process of calculating and measuring ECL and their related variables unless such amendment is done within the policy approved by the board of directors, where such policy shall specify the exceptions and the justifications for the set exceptions to override the outputs resulted from the systems. Such policy shall also specify the independent party in the bank who has the authorization to make the decisions for such exceptions or amendments provided that such cases shall be displayed on the board or its related committees in the upcoming meeting to obtain their approval.

3. In addition to these instructions and the requirements of IFRS 9, the guidelines issued by Basel Committee for banking supervision in the paper issued under the name (Guidance on Credit Risk and Accounting for Expected Credit Losses) shall be taken into consideration.

   http://www.bis.org/bcbs/pub/d350pdf

4. The board of directors shall approve a business model/ s which defines the objectives, acquisition basis, and the classification of the financial instruments in a way ensuring the integration with other requirements for work, and as depicted in the related item in these instructions.

5. The board of directors shall ensure that the controlling functions in the bank, specifically risk management and internal audit management, carry out the necessary work to verify the validity and integrity of methodologies and systems used in implementing IFRS 9 and shall provide such functions with the necessary support and authority.

Second Clause: Classification and Measurement

First: Financial Assets

A. Equity Instruments:

- Equity instruments are always measured at fair value in one of two portfolios:

1. Financial assets at fair value through statement of income: the Equity Instruments within this portfolio are measured at fair value and the subsequent changes in fair value are recorded in the statement of income.
2. Financial assets at fair value through the statement of other comprehensive income: the Equity instruments within this portfolio are measured at fair value and subsequent changes in fair value are recorded in the statement of other comprehensive income.

- **General Provisions**:

The bank shall comply with the requirements of IFRS 9 and the items hereunder at the minimum:

1. If the equity instruments classified as financial assets at fair value portfolio through the statement of other comprehensive income were disposed of or were derecognized, the balance of the change in fair value is not transferred to the statement of income and shall be transferred directly to the retained earnings item under equity.
2. Dividends received on equity instruments included in either of the above two portfolios are recognized in the income statement.
3. The reclassification from or to the two portfolios above shall not be permitted after the first classification of these financial assets (equity).
4. Equity instruments shall not be classified in a financial asset portfolio at fair value through statement of income unless the instruments are listed on an active market and can be actually traded. Furthermore, at this stage, they should be traded within a maximum period of (6) months from the date of the acquisition; otherwise, these instruments shall be included in the financial assets portfolio at fair value through the statement of other comprehensive income when acquired for the first time.
5. It shall be complied with IFRS 13 (fair value) for fair value measurement purposes as IFRS 9 requires the measurement of financial instruments at fair value, including those instruments that do not have a market price.

6. It should be noted that the cost does not reflect fair value except in very limited cases (such as contributions to newly established companies). Accordingly, models for measuring fair value must be developed and the Central Bank of Jordan shall be provided with methods of measuring the fair value of the financial assets that do not have a market price as they shall be attached with the final and interim financial statements of the bank.
7. Recording the exchange differences according to the requirements of IFRS (Exchange Rate Policy).

B. Debt Instruments:

Recording the debt instruments within one of the following three portfolios and according to the requirements of IFRS 9:

<u>**First Portfolio: Debt Instruments at Amortized Cost**</u>

1. Financial assets (debt instruments) within this portfolio are measured at cost and are not subject to fair value measurement.
2. The instruments included in this portfolio shall meet the conditions set forth in IFRS 9, which are summarized in the following:

<u>1.2 Contractual cash flows</u>: The objective of acquiring the instruments included in this portfolio should be limited to collecting the contractual cash flows of both the principal of the debt and its interest.

<u>2.2 Business Model Testing</u>: These instruments must be consistent with the business model(s) available at the bank [business model(s) must be approved by the board of directors].

3. The bank shall comply with the requirements of IFRS 9 and the following items hereunder at the minimum:

1.3 The bank shall not have the intention to dispose of these instruments before the agreed contractual maturity date. [Except within the limits permitted by IFRS 9, such as non- material, non- recurrent or close-to-maturity date transactions].

2.3 If the prospectus (issue of stock) contains the issuer right to call debt instruments, fully or partially, before the maturity date or their ability to convert debt in-

struments into shares, the existence of such conditions precludes the possibility of including debt instruments in this portfolio.

3.3 It should be noted in this regard that the concept of risk management and avoiding the risk is an integral part of the requirements of applying IFRS 9, and; therefore, in the cases where the bank faces high levels of credit risk according to the bank's risk management methodology, it is possible to dispose of them before their maturity date without considering this as a violation to the concept of applying the business model.

4.3 The instruments included in this portfolio are subject to impairment calculation (expected credit loss) according to the requirements of applying IFRS 9 and according to these instructions. Furthermore, the expected credit loss shall be recorded in the statement of income.

5.3 Debt instruments issued or guaranteed by the government of Jordan shall be excluded and as provided for in the item of measuring the probability of default.

6.3 The interest (yield) earned on these instruments shall be recorded in the statement of income.

7.3 Changes in the exchange rate for these instruments shall be subject to the accounting policies related to the exchange rate according to the IFRS.

8.3 Upon disposal, by the bank, of any debt instruments within this portfolio prior to their contractual maturity date, the bank shall attach a statement with the financial statements detailing those cases, including clarifying the reasons for their disposal.

Second Portfolio: Debt Instruments through the Statement of Other Comprehensive Income

The bank shall comply with the requirements of IFRS 9 and the items hereunder at the minimum:

1. Debt instruments that the bank intends to either hold until their maturity date to collect contractual cash flows or to sell (liquidity management portfolio) according to the business model(s) applicable in the bank for this regard.
2. These instruments are measured at fair value and subsequent changes in fair value are recorded in the statement of other comprehensive income.
3. The interest (yield) earned on these instruments is recorded in the income statement, as well as for changes in the exchange rate associated with these instruments (exchange rate policy).
4. The instruments included in this portfolio are subject to impairment calculation (expected credit loss) according to the requirements of applying IFRS 9 and according to these instructions. Furthermore, the expected credit loss shall be recorded in the statement of income.
5. Since these instruments are measured at fair value and are subject to the expected credit loss at the same time, there shall be a netting/ offsetting between the change in the fair value and the expected credit loss whereas the impairment (expected credit loss) has the priority in recognition/ recording.
6. It is noted that subsequent changes in the fair value of these instruments shall be recorded in the statement of other comprehensive income, but when the instruments are disposed of or derecognized, the fair value balance recognized in the other comprehensive income statement shall be recycled to the income statement.

Third Portfolio: Debt Instruments at Fair Value through the Statement of Income

The bank shall comply with the requirements of IFRS 9 and the items below at the minimum:

1. Debt instruments in this portfolio are recorded according to the bank's business model(s), as these instruments are not included in the previous two portfolios.
2. Subsequent changes in the fair value of these instruments are recorded in the statement of income.
3. The interest (yield) earned on these instruments is recorded in the statement of income, as well as for changes in the exchange rate associated with these instruments (exchange rate policy).
4. Instruments within this portfolio are usually not subject to measurement of the expected credit loss.

5. According to the business model(s) for this portfolio, instruments recorded in this portfolio shall be traded in an active market and shall be traded within a maximum period of (6) months from the date of the acquisition.

❖ **Provisions of business model(s):**

The bank shall comply with the requirements of IFRS 9 and the items below at the minimum:

1. As mentioned earlier, it is possible that the bank has more than one business model provided that each of them meets the conditions stated in the requirements of IFRS 9 and should be approved by the board of directors of the bank.
2. According to the requirements of IFRS 9, there are factors (inside and outside the bank) that affect the effectiveness of the bank's business model(s). These factors may require a modification/ amendment on the bank's business model(s). In this case, which shall be limited and non- recurrent, it is possible to do a modification/ amendment for the business model (s).
3. Therefore, it is possible to carry out reclassifications for the financial instruments listed in the various portfolios according to the business model(s) of the bank, provided that the reclassification takes place in the fiscal year following the fiscal year during which the business model(s) was (were) modified.
4. While preparing the business model(s), the bank shall ensure that the risk management activities and objectives are included in these models in advance, taking into account the stress or unusual circumstances, liquidity management conditions, capital adequacy, and other regulatory requirements.
5. It is possible to include instruments issued by the same entity or have the same features in more than one portfolio according to the business model(s) applied by the bank.
6. When reclassification is made as stated above, a summary of the reclassification cases and their accounting impact shall be attached to the interim or final financial statements submitted to the Central Bank of Jordan explaining the reasons for the reclassifications and amendments to the business model(s) of the bank.

While preparing the business model(s) and carrying out the classification of financial instruments within the various portfolios; a study shall be done on the implications of each choice from different aspects of the bank's work and other

regulatory requirements such as liquidity management requirements, Basel III, ICAAP requirements, and capital adequacy requirements.

<u>Second: Financial Liabilities</u>

- Financial liabilities are generally measured and recorded at amortized cost.
- If the bank chooses to apply the concept of financial liabilities measurement at fair value through the statement of income, the financial liabilities are measured at fair value and subsequent changes in fair value are recorded in the statement of income. Changes in credit risk related to such liabilities are recognized in the statement of other comprehensive income and shall not be recycled to the statement of income even if such amounts are realized or the liabilities were disposed of.

<u>Third: Financial Derivatives for Trading</u>

- Financial Derivatives – which are not subject to the hedge accounting - intended to be traded are measured at fair value, and any subsequent changes in fair value are measured in the statement of income according to the requirements of IFRS 9.

<u>Fourth: Hedge accounting</u>

- It shall be committed to the requirements of IFRS 9 which are relating to hedge accounting; as the accounting framework for recording hedge accounting activities according to IFRS 9 aims at further linking these activities with the risk management activities of the bank.

Third Clause: Expected Credit Loss (ECL)

This Clause will present the requirements of IFRS 9 and the Central Bank of Jordan requirements for measuring the expected credit loss (credit impaired loss/ provisions (allocations)) for credit exposures within the scope of IFRS 9 in terms of know-how and the mechanism of including the debt instruments/ credit exposures, as well as the methodology for calculating the expected credit loss as follows:

First: Scope of Implementation/ Expected Credit Loss (ECL)

A. As per the requirements of the IFRS 9, the expected credit loss measurement model shall be applied within the following framework (except those measured at fair value in the income statement):
   - Loans and credit facilities (direct and indirect).
   - Debt instruments measured at amortized cost.
   - Debt instruments measured at fair value through other comprehensive income statement (FVOCI).
   - Financial guarantee contracts according to the requirements of the IFRS 9.
   - Lease receivables within the scope of International Accounting standard (IAS) 17 and IFRS 16.
   - Trade receivables.
   - Islamic finance products that have the characteristics of credit (principal and revenue/ interest).
   - Credit exposures for banks and financial institutions [excluding current balances used to cover bank transactions such as remittances, guarantees, and credits within a very short period of time (days)].
   - Debit balances resulting from Repurchase Agreements (Repo).
   - Any other receivables (balances) that are not measured at fair value.

B. Regarding the granting of lease (Ijarah) at the Sharia' Compliant banks, the part that is subject to the calculation of the expected credit loss (ECL) represents the due (and unpaid) liability of the counterparty (the lessee), and the lease (Ijarah) assets continue to be treated as currently applied.

Second: The General Framework for Implementing the Standard

A. **According to the general framework, all credit exposures/ debt instruments that are subject to the measurement (classification) and calculation of expected credit loss should be included in one of the three stages described below:**

(Note that this process shall be fully updated in every preparation of the interim and final financial statements).

Stage One:

1. It includes credit exposures/ debt instruments that do not have a significant or influential increase in their credit risk since the initial recognition of the exposure/ instrument [taking into account that credit risks occur gradually over time and may not occur suddenly] or have a low credit risk at the date of preparing the financial statements. Credit risk is considered low if the following conditions are met:
   - 1.1 Low default risk.
   - 2.1 The debtor has a high short- term ability to meet their obligations.
   - 3.1 The creditor (the bank) does not anticipate adverse changes in the economy and in the long- term working environment that adversely affect the debtor's ability to meet their obligations (macroeconomic indicators and stress tests).
2. Expected credit loss represents the potential loss arising from default events that may occur within the next 12 months from the date of preparing the financial statements. (note: it does not represent the deficit of the expected cash flow in the next 12 months, i.e. the credit exposure and the amount of debt loss are for the entire lifetime of the credit exposure/ debt instrument).
3. For the purpose of proving the income for credit exposures listed at this stage, the interest/ yield is calculated on the basis of the total credit exposure/ debt instrument recorded in the books.

Stage Two:

1. It includes the credit exposures/ debt instruments that have received an important (significant) increase in their credit risk since their initial recognition; however,

they have not yet reached the default point as there is no objective evidence confirming default.

2. The expected credit loss is calculated for the entire lifetime of the credit exposure/ debt instrument and it represents the expected credit loss resulting from all probability of default over the remaining duration of the credit exposure/ debt instrument lifetime [weighted average for credit loss, taking into account the risk of default occurring, and calculating the three variables, which are: the probability of default, exposure at default, and the loss ratio assuming a complete default for the entire credit exposure/ debt instrument].
3. For the purpose of proving the revenue of the credit exposures listed at this stage, the interest/ yield is calculated on the basis of the total credit exposure/ debt instrument recorded in the books.
4. IFRS 9 includes certain indicators –for example but not limited to- that are appropriate for assessing an increase in the level of credit risk (indicators of significant adverse changes in credit risk):
   1.4 Declining the actual or expected internal credit rating of the debtor or credit exposure/ debt instrument according to the internal rating system in the bank.
   2.4 Actual or expected significant decline in the external credit rating of the credit exposure/ debt instrument.
   3.4 Substantial negative changes in the performance and behavior of the debtor such as late payment of installments or unwillingness to respond to the bank.
   4.4 The need to reorganize the obligations of the debtor (structuring the obligations) due to poor repayment capacity, reduced cash flows, or the need to amend the contractual terms with the debtor or to cancel (waiver) certain existing contractual terms as a result of actual/ expected violations for the current terms due to the debtor's lacking the ability to continue with the bank within the existing contractual framework, such as giving the debtor grace periods either to the interest or for the asset of the instrument/ exposure that was not originally agreed upon (contractually) or for raising the rates of the interest/ yield for the future periods.
   5.4 Information on the debtor having past dues either for the bank or for any other creditor.
   6.4 Increasing the interest rates on credit exposure/ debt instrument due to the increased credit risk of the debtor at the current stage (increasing risk prices)

compared to prices on acquisition (creation or purchase) of credit exposure/ debt instrument.

7.4 Actual or expected adverse changes in the debtor's operating activity, such as (decrease in revenues/ actual or expected margin of profit, higher operational risk, working capital deficiency, decline of asset quality, increased financial leverage, weakness and decline in liquidity, management problems, and the partial stop of the client's activity, etc.), that may materially affect the debtor's ability to repay.

8.4 Change in the bank's credit management methodology for the credit exposure/ debt instrument due to the emergence of negative indicators and changes in the credit risk of the exposure/ instrument so that the credit risk management of the exposure/ instrument is expected to become more focused, close, and under continued monitoring or being intervened by the bank with the counterparty (the debtor) to manage the exposure/ instrument.

9.4 Important (significant) changes in the terms of credit exposure/ debt instrument (Rates or terms) that would have been placed differently if such exposure/ instrument had been issued recently or at the date of preparing the financial statements (such as tightening conditions, increasing collaterals and guarantees, increasing coverage of income) due to the increase in credit risk of exposure/ instrument since initial recognition.

10.4 Significant increase in credit risk for other credit exposures/ debt instruments attributable to the same debtor from other lenders.

11.4 Negative changes in the value of any collaterals or guarantees provided by a third party or credit enhancements provided against obligations and that may result in a lower economic motivation for the debtor to meet their obligations or have a negative impact on the probability of default (PD); for example, the decrease in the value of mortgaged property for home financing.

12.4 Negative changes in the quality of guarantees provided by the shareholders or the parent company if they have the motivation or the financial ability to prevent default through capital or cash flow.

13.4 Negative changes due to the reduction of financial support from the parent company or its associates, or the actual or expected adverse changes in the quality of the credit enhancements that are expected to adversely affect the economic motivation of the debtor to meet their contractual credit obliga-

tions. (regarding the credit enhancements, the financial conditions for the guarantor shall be considered).

14.4 Substantial negative changes in the external market indicators of credit risk for a particular debt instrument/ credit exposure or for a similar exposure/ instrument with the same term (e.g., greater credit spread, increasing the prices of CDs, the duration of the decline in the fair value of the financial instrument below its amortized cost, taking into consideration the extent of this decline, the decline in the prices of the financial instruments issued by the debtor such as bonds, shares and other negative information from the market regarding the debtor).

15.4 Negative changes in internal indicators of the credit risk prices due to the increase in credit risk since the beginning of the relationship (creation/ purchase), including but not limited to, increasing the credit spread that might happen due to the issuance of new credit exposures under the same terms and with the same debtor or might be issued on the date of preparing the financial statements.

16.4 Actual or expected adverse changes in the business environment and in the financial and economic conditions that are expected to adversely affect the debtor's ability to meet their obligations (for example, actual or expected increase in the interest rates, actual or expected substantial increase in unemployment rates).

17.4 Actual or expected adverse changes in the legislative, economic, or technological environment in which the debtor operates and that may result in a material adverse decline in the debtor's ability to repay, e.g. reduced demand on the debtor's products due to technological changes.

18.4 Overdrawn current and on demand accounts for a period of more than (30) days and less than (90) days shall be listed in this stage.

* In addition to the above, the Central Bank of Jordan instructions No. (47/2009) dated on 10/12/2009 included a set of indicators (second clause/C) indicating an effective increase in credit risk that must also be complied with **[Provided that the period having receivables for (60) days is used as a clear indication of listing in this stage, noting that this period will be decreased by (10) days per year to become (30) days during the upcoming (3) years from the date of application].**

If there is an evidence of a significant increase in credit risk from the above conditions, the debt instrument/ credit exposure will be included in Stage Two. In case there is an overlap between the available indicators (items 1-19) and the items contained in Central Bank of Jordan Instructions (No. 47/2009) dated on 10/12/2009 (second clause/C), the strictest of them shall be taken.

Stage Three:

1. It includes the debt instruments that have evidence(s) of becoming impaired (irregular), where the expected credit loss for the entire life of the credit exposure/ debt instrument is calculated.
2. Interest/ yield of the accounts in this stage are suspended and the bank shall continue this suspension as long as the accounts remain in this stage.
3. IFRS 9 refers to a group of factors that affect and provide evidences of credit default, including but not limited to, the following:
   - 3.1 The debtor is experiencing significant financial difficulties (severe weakness in the financial statements).
   - 3.2 Lack of commitments for the contractual conditions such as having past dues equal to or greater than (90) days.
   - 3.3 The bank amortizes part of the obligations incurred by the debtor for reasons of financial difficulties facing the debtor and of his inability to pay the full amount of the obligations on time.
   - 3.4 There are clear indications that the debtor is nearing bankruptcy.
   - 3.5 Lack of an active market for a financial instrument due to financial difficulties faced by the debtor (source of credit exposure/ debt instrument).
   - 3.6 Acquisition (purchase or creation) of debt instrument with a large discount that represents a credit loss.

* In addition to the above, the Central Bank of Jordan instructions No. (47/2009) dated on 10/12/2009 (second clause/D) included a number of indicators indicating that there is a default situation which must also be adhered to.

If one or more of the above conditions is met in an indication of a significant increase in credit risk (default), debt instrument/ credit exposure shall be included in Stage Three. In case there is an overlap between the available indicators (items 1-6) and items in the Central Bank of Jordan instructions No.

(47/2009) dated on 10/12/2009 (second clause/D), the strictest of them shall be taken.

B. General Provisions:

1. Any credit exposures classified as Stage Three or any part thereof may not be paid by granting the client any new exposures or increase the existing exposures, or grant the same to the parties related to the client or has an influential interest with him/ her or his/ her relatives up to the third degree.
2. No new credit exposures or increased exposure shall be granted to any client whose account is included in Stage Three.
3. No credit exposure may be granted to a client whose credit exposure has been partially or totally canceled unless he pays the amount.
4. The bank shall study, evaluate, and estimate credit risk for all accounts of the client whose either credit exposures have been included under Stage Three, in a way that the bank gets sufficient knowledge of the size of such risks and considers that the classification of such accounts is consistent. If the bank ensures that all the client's accounts are interrelated (in terms of sources of payment/ cash flow, guarantees, financed for the same project (s) ...), it should classify them as Stage Three as long as the conditions apply to one of them.
5. The bank shall study, evaluate, and estimate credit risk for all accounts of the client whose either credit exposure have been included under Stage Three, in a way that the bank gets sufficient knowledge of the size of such risks and takes into consideration the consistency of the classification of other exposures of the client (in Stage Two (at least)) as well as sets adequate impairment loss against them. It is to be noted that this procedure is only permitted if the other exposures of the client are not directly related to Stage Three exposures [such as accounts for the execution of projects that have independent accounting and are secured by specific entitlement remittances or repayment sources and sufficient cash flows].
6. Any collections for any credit exposure included in Stage Three is used to settle the source of exposure first, and after collecting the full amount of exposure, subsequent collections are recorded as received interest.
7. New credit exposures may be increased/ granted for no more than 25% of the outstanding exposure balance of the client whose exposure has been classified as Stage Two, provided that this happens only after an in-depth study for the

risks of the exposure/ client. Furthermore, the increase/ grant shall not be used for paying the outstanding/ due exposures on the client or clients related to him/ her.

8. The Audit Committee (or who is with similar responsibilities for non-Jordanian banks) shall verify the adequacy of the expected credit loss (impairment loss) provided by the bank and ensure that it is adequate in all financial statements.
9. When an improvement in the quality of credit is made and sufficient and documented reasons are provided to make it possible to transfer credit exposures from Stage three to Stage Two or from Stage Two to Stage One, the transfer should only take place after the credit status of the exposure is proven to be improved and committed to repay (3) monthly installments or two quarterly installments or one semi-annual installment at least on time; that is, the early payment of the installments for the purpose of transferring the debt to a better stage is not considered. This applies to the provisions of the "rescheduling" in instructions No. (47/2009) and their amendments; after so, the transfer can take place.
10. According to the requirements of IFRS 9, the principal to settle the obligations of any debtor is the cash flow from the client's activity. Accordingly, the credit studies should clarify the expected cash flows in a professional and carefully considered manner and based on fundamental financial statements that reflect the debtor's ability to provide these cash flows and as stated in circular No. (10/1/1271) dated 25/1/2016 and circular No. (10/1/14233) dated 18/11/2015.

    In this regard, and where exposures grant a grace period, the bank shall prepare a detailed study of cash flows that demonstrate the debtor's ability to repay so that the bank can determine the credit risk for such exposures.
11. The assessment of credit risk and the ability to meet obligations of the debtor must be made regardless of the guarantees or the risk mitigations provided by the debtor.
12. The credit risk of certain debt instruments should not be considered low because they have lower credit risk than those found in other instruments of the bank, the business environment, or the countries in which the bank operates.
13. **If there is evidence of a significant increase in credit risk -regardless of the current stage of the credit exposure/ debt instrument- the bank must reclassify the exposure/ instrument within either Stage Two or Stage Three in a**

manner consistent with the degree of its risk and to monitor the impairment losses against it.

IFRS 9 requires the adoption of absolute standards (such as credit classification) and relative standards (decline in credit classification) for the purpose of determining a significant increase in credit risk and the banks shall determine the important increase according to whichever is worse (change in the classification degree or the decline in classification).

(A decline for 2 degrees in credit classification for credit exposure/ credit instrument, on the credit classification system consisting of 10 degrees, since the date of initial recognition is usually considered as a sign of significant credit risk decline).

Third: Measurement of Credit Risk and Expected Credit Loss (ECL)

A. Mathematical model for calculating expected credit loss:

According to IFRS 9, the mathematical model is:

$$\textbf{(ECL)} = \textbf{PD\%} \times \textbf{EAD (JOD)} \times \textbf{LGD\%}$$

- PD: Probability of Default
- EAD: Exposure At Default
- LGD: Loss Given Default

The IFRS 9 did not provide a certain accounting methodology for the calculation of (ECL) variables. However, the Standard presented directions and guidance for the possible methods of calculating ECL.

B. Measurement on an individual or collective basis (portfolio):

1. IFRS 9 mentions that credit risk and expected credit loss can be measured on an individual basis (credit exposure/ debt instrument) or on a collective basis (portfolio of credit exposure/ debt instruments). Therefore, if the bank chooses to measure credit risk and the expected credit loss on a collective basis (portfolio), the credit exposures/ debt instruments included in the same portfolio should have similar credit risk. For instance, credit instruments have to share several elements, including but not limited to:
   i. Type of credit product (exposure/ instrument type).
   ii. Internal credit classification.
   iii. Quality of guarantees (risk mitigations).
   iv. Date of acquisition.
   v. The remaining life time.
   vi. Sector.
   vii. Geographical area.
   viii. Interest/ yield rate.

2. It is to be noted that it is practically possible to have more than one portfolio of certain exposures/ instruments or certain credit products. For example, car loans

could be distributed on more than one portfolio, each of which is convincingly expressed and similar in its risks and credit specifications.

3. The principle of measuring the credit risk and expected credit loss may be applied on a collective basis for one or more credit exposures**, provided that the size of the credit exposure for each component of the portfolio does not exceed JD 250,000 (or equivalent) in the bank.**

[In limited cases, where the bank has certain credit products/ exposures and their ECL's are calculated on a portfolio basis and the amount of any individual exposure/ component exceeds 250,000 JD; the bank shall apply to the Central Bank for its approval].

C. Measurement of Credit Quality and Decline of Credit Quality:

1. As mentioned above, and while preparing the financial statements, the level of credit risk at the reporting date (the date of financial statements) is compared to those since the initial recognition of each credit exposure/ debt instrument, and this is done within the scope of IFRS 9 in order to calculate the expected credit loss as the credit risk is usually presented gradually and built over time and not at once.
2. Credit exposure/ debt instrument, which is subject to expected credit loss measurement, should be of good quality at initial recognition and recorded in the First Stage, unless there is objective evidence of a significant decline in credit quality (at initial recognition) (For example, the purchase or acquisition of a debt instrument/ credit exposure at a significant discount).

D. Unclassified credit debts:

IFRS 9 requires the comparison of the risk degree of each debit/ credit exposure at the date of financial statements with the risk degree since the grant (first recognition). In practice, this requires a reliable internal credit classification system. Otherwise, and in case of having no information about the performance of the debt, it is supposed to be in Stage Two (taking into account the materiality of its impact), the matter that requires the documentation of historical information about the risks of each exposure if it is not available or it is not reliably reflected by the system and otherwise it should be included in Stage Two.

In this regard, it is worth noting that in the case of debts granted years ago, and the bank did not have an internal credit classification system covering previous periods; it shall be sufficient to document the information regarding the risks and performance of the exposure for the last 5 years, and in a manner that the quality of these debts on the date of the financial statements can be historically compared.

E. Probability of Default (PD):

1. According to IFRS 9 regarding the credit exposures/ debt instruments included in Stage One, and for measuring the expected credit loss; the Probability of Default of the exposure/ instrument is considered for the next 12 months from the date of the financial statements.
2. In order to measure the expected credit loss of credit exposures/ debt instruments included in Stage Two and Stage Three, the Probability of Default on the remaining lifetime of the credit exposure/ debt instrument is considered as from the date of the financial statements (taking into account what is required for renewable or revolving credit exposures/ debt instruments such as current debt account where the behavior of the renewable exposures is examined to determine its expected life duration that extends beyond its contractual date).
3. As mentioned above, the implementation of IFRS 9 regarding the measurement of expected credit loss is considered to be a future outlook [unlike IAS 39 requirements]. Therefore, when developing systems, banks should consider the following factors:
    a. Historical data: which reflect the historical default rates to which the relation with macroeconomic indicators is added.
    b. Modify the historical data on the current status of credit exposures/ debt instruments (quantitative and qualitative indicators, financial and non-financial).
    c. Modify the historical and current data with macro and micro future forecasts (macroeconomic indicators and credit exposure indicators) including the impact of stress testing and their results as mentioned in (G) below.
4. Address the credit exposures of the Jordanian government and those under its guarantee without credit loss.
5. Address the credit exposures of the governments in the host countries to the external presence of Jordanian banks according to the instructions of the regulatory authorities in those countries provided that they are in the local currency of those

countries. Otherwise, or in the absence of instructions issued by the host regulatory authority, the expected credit loss against such exposure is calculated according to these instructions and IFRS 9 requirements.

F. Exposure within the banking group:

Upon preparing the financial statements at the bank/ branch level in Jordan, credit exposures within the banking group shall be addressed as follows:

- Exception of exposures of external branches.
- Addressing exposures of subsidiaries according to the requirements of IFRS 9 and these instructions.

G. Stress Tests:

According to the requirements of IFRS 9, Stress tests are considered as a requirement and should be treated as part of the calculation process to measure the expected credit loss. Therefore, banks are required to conduct at least three scenarios to study future forecasts and their impact on the variables of the expected credit loss measurement model; where these scenarios represent a normal (basic) scenario, a worse scenario, and a better scenario.

Furthermore, and according to the requirements of IFRS 9; the calculated expected credit loss must reflect an Unbiased and Probability-Weighted Amount, which is determined based on an assessment of a set of expected results rather than on the best or worst- case scenarios.

H. Deficiency in cash flows:

The cash flow deficit represents the difference between the cash flow to be received by the bank under contractual terms with the debtor and the cash flows expected to be received from the debtor. Therefore, expecting that the debtor will not be obliged to make any payment or repay it at a later date to its original payment date by contract should be reflected/ captured by the expected credit loss.

I. Exposure At Default (EAD):

For the purpose of calculating expected credit loss and according to the requirements of IFRS 9, EAD may not necessarily represent the current balance, but consideration should be given to amounts that may be used in the future by the debtor, for example:

1. The granted unused limits: the amounts that may be withdrawn by the debtor in the future (the bank's right to cancel the contracts without referring to the client is not considered) shall be taken into consideration. **This is based on a study carried out by the bank to determine the size of utilizing the limits such as current receivable account. Otherwise, the entire limit is considered to represent the balance at default as well as for other credit limits available to clients such as financing credit limits and bill of exchange discount limits.**

2. Similarly, the expected duration of the debt to remain outstanding shall be considered even if its contract duration is a year, for example the current receivable accounts that are renewed annually; where the expected life of the debt extends beyond the contractual date according to an internal study of the bank that determines the duration where the debt continues to remain outstanding.

3. Indirect facilities and obligations:
According to the requirements of IFRS 9, indirect (unfunded) credit exposures are considered to be credit exposures. Thus, the ECL of such exposures shall be calculated by taking into account the probability of funding, the timing of such funding, and their amounts, in addition to the probability of default. This shall be done using the same methodology applied to direct liabilities and exposures.

J. Time value for money:

According to the requirements of IFRS 9, the expected credit loss represents the present value of the entire expected deficit in cash flows over the life of the credit exposure/ debt instrument.
Therefore, the discount factor used to calculate the current value (until the date of the financial statements) represents the effective interest rate (EIR) granted to the credit exposure/ debt instrument at the date of calculation.

K. Loss Given Default (LGD) (Guarantees / Risk Mitigations):

1. Upon calculating the expected credit loss, the bank shall consider the loss assuming that the default occurred after calculating the recoverable value from the credit

exposure/ debt instrument and the timing of the recovery, and the most important part represents the guarantees provided against granting the credit exposure/ debt instrument which are legally documented in the credit contracts and there is no legal impediment for the bank to access the guarantee.

2. To reach the expected credit loss calculation, the stages of accessing the guarantee (timing) and converting it to cash (to calculate the present value) shall be considered (expected cash flow and its timing, minus any expenses related to the transaction).

It is to be noted that according to the requirements of IFRS 9, any guarantee that is enforced due to default is recorded as an asset only if the conditions for recognizing the asset were met according to the requirements of International Financial Reporting Standards.

3. The deduction rates specified in the Debt Classification Instructions No. (47/2009) on 10/12/2009 shall be applied as a minimum. The time period and the time value of the money shall be taken into account for the purposes of calculating the expected credit loss by adding additional deduction rates representing the duration of transferring the guarantee to cash, provided that the bank has sufficient information to document and support the accounting process.

Fourth Clause: Required Disclosures

IFRS 9 contains a set of quantitative and qualitative disclosures to be complied with, and IFRS 7 has been amended following the issuance of IFRS 9 which requires banks, in cooperation with the external auditors, to comply with these disclosures while preparing their financial statements, and as specified in Attachment (1) regarding quantitative and qualitative disclosures.

Fifth Clause: Statements for the Central Bank Purposes

The bank shall provide the Central Bank with the statements set forth in Attachment (2) attached to each financial statement, provided that they are audited (reviewed) by the auditor and comply with circular No. (10/1/16153) dated on 28/12/2015.