



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Central Bank of Ireland Provisioning Guidelines for Credit Unions

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1. Introduction

1.1. Context of these Guidelines

This document sets out the Central Bank of Ireland's (the Central Bank) guidelines regarding the policies and procedures which credit unions should adopt to support the development and implementation of an appropriate provisioning framework.

An appropriate provisioning framework is essential for:

- the recognition of loan losses as early as possible within the context of accounting standards;
- the adoption of a sufficiently conservative and comparable approach to the measurement and recognition of provisions in the loan book; and
- appropriate disclosures to support members' understanding of the performance of the loan book and the credit union's credit risk management practices.

Appropriate procedures for assessing and measuring credit risk will provide relevant information for a credit union board to make judgements about the credit risk of its lending exposures and will facilitate the recognition of losses within the loan book as early as possible.

The Central Bank's expectation on provisioning in credit unions is outlined throughout these guidelines and credit unions should give due consideration to these guidelines when developing and implementing their provisioning frameworks and when assessing the adequacy of provisions held for loans. In particular, section 6 outlines the Central Bank's expectations on specific categories of loans in credit unions.

1.2. Accounting Standards

Financial Reporting Standard 102 (FRS 102) is the applicable accounting standard for credit unions. FRS 102 adopts an incurred loss approach to provisioning. Section 11 of this accounting standard outlines requirements in relation to the assessment of impairment and the calculation, measurement and recognition of provisions. FRS 102 requires that, at the end of each reporting period, an entity must assess whether there is objective evidence of impairment of any financial assets which are measured at cost or amortised cost. Where it is deemed that there is objective evidence of impairment, the entity shall recognise a provision in the income statement immediately.

Appendix A contains an extract from FRS 102 which outlines the main requirements in relation to provisioning.

1.3. Scope of these Guidelines

Section 84 of the Credit Union Act, 1997 (the Act) provides the Central Bank with the power to administer the system of regulation and supervision of credit unions with a view to the protection by each credit union of the funds of its members and the maintenance of the financial stability and well-being of credit unions generally.

This document applies to all credit unions and while it has the status of 'guidance', the Central Bank considers that the guidelines contained herein represent an appropriate basis for the development and application of a provisioning framework for credit unions.

The Central Bank deems these guidelines to be best practice and accordingly strongly encourages all credit unions to apply them.

These guidelines are designed to assist credit unions in developing and implementing an appropriate provisioning framework which reflects the nature, scale, complexity and risk profile of the credit union and ensuring that the level of provisions held for loans is adequate. Credit unions must ensure that they comply with all relevant accounting standards and should discuss the credit union's approach to provisioning with their auditors.

These guidelines are not intended to act as a sole source of guidance on provisioning for credit unions.

These guidelines are not intended to replace or over-ride the requirements of FRS 102. Credit unions remain subject to the requirements of FRS 102 when preparing year-end financial statements.

2. Responsibility in relation to Provisioning in Credit Unions

2.1. Overview

Section 108 of the Act requires that a credit union shall cause proper accounting records, whether in the form of documents or otherwise, to be kept on a continuous basis. A robust provisioning framework is important to ensure the adequacy and accuracy of the provisioning figure in the financial statements. The Board of Directors (the board) and management of a credit union have responsibility to ensure that an appropriate provisioning framework is in place and operating effectively in the credit union. They should ensure that the credit union has effective risk management practices in place to determine adequate provisions in accordance with stated policies and procedures, applicable accounting standards and regulatory guidance.

Overall responsibility in relation to ensuring the adequacy and accuracy of the provisioning figure in the financial statements rests with the board. The Central Bank expects directors of credit unions to apply a conservative and comparable approach in the measurement of provisions. In addition, directors should take into consideration the level of risk inherent in the loan book, being mindful of the current economic and financial environment.

The manager of a credit union is required to update the board on the financial position of the credit union, including submitting to them on a monthly basis unaudited financial statements that set out the financial position. This responsibility requires the manager to ensure that the provisioning figure in the credit union's accounts is calculated and recognised in the credit union's accounts in accordance with the credit union's approved provisioning policy.

The sections below set out the relevant requirements of both the board and the manager of a credit union in relation to provisioning.

2.2. Board of Directors Responsibilities

In accordance with section 27A of the Act, a credit union shall maintain appropriate oversight, policies, procedures, processes, practices, systems, controls, skills, expertise and reporting arrangements to ensure the protection of members' savings. In order to ensure an appropriate provisioning framework is in place in the credit union, the board are expected at a minimum to:

- set the credit union's appetite for credit risks;
- understand and determine the nature and level of credit risk in the credit union;
- adequately resource the credit and credit control functions with suitably qualified personnel;
- appoint a credit committee;
- ensure that the sophistication of the risk management process is appropriate in light of the credit union's risk profile and business plan;

- ensure that an impairment review of the loan book is carried out at least quarterly and that any resulting adjustments to provisions are incorporated into the management accounts submitted to the board;
- review the adequacy of provisions and loan amounts written off on a quarterly basis;
- review and approve the methodology on an annual basis contained in the provisioning policy for the calculation of provisions;
- review the provisioning policy on an annual basis to ensure that it remains appropriate to the nature, scale and complexity of the credit union; and
- ensure that adequate supporting documentation is maintained in relation to the provisioning reviews conducted and signed off on.

2.3. Credit Union Manager Responsibilities

In accordance with section 63A of the Act, the manager of the credit union has responsibility for updating the board of directors on the financial position of the credit union, including submitting to the board of directors on a monthly basis unaudited financial statements that set out the financial position of the credit union. In the context of provisioning this includes, but is not limited to:

- establishing a provisioning policy document for credit risk management processes, to be approved by the board;
- establishing the methodology for determining provisions on loans to be approved by the board;
- reviewing on a regular basis, at least annually, the processes and systems in place (as outlined in the provisioning policy document) to monitor and manage the quality of the credit portfolio in a timely manner, and the methodology for determining provisions to ensure that it remains appropriate for the circumstances of the credit union;
- ensuring that the credit exposures are appropriately valued, with a suitable level of provisions for impairment made or uncollectable amounts written off;
- establishing a programme to periodically monitor and analyse security that is held on loans, which should be valued on a prudent basis and ensuring that such security is legally enforceable by the credit union. This is particularly important for house loans that are relying on the value of collateral in assessing whether an impairment provision is required;
- providing the board with regular reports on the adequacy of loan provisions and amounts written off; and
- providing appropriate disclosures to the Central Bank through the submission of the quarterly Prudential Return and other regulatory returns.

2.4. Internal Audit Function Testing

In accordance with section 76K of the Act, the board of a credit union shall appoint an internal audit function to provide for independent internal oversight and to evaluate and improve the effectiveness of the credit union's risk management, internal controls and governance processes. While it is not the responsibility of the internal audit function to assess the adequacy of the provisions in the credit union or to ensure compliance with the

requirements of accounting standards, it is expected that the internal audit function would perform regular testing to ensure that the provisioning framework in the credit union is operating as required. This testing should ensure that:

- the provisioning policy is comprehensive and includes all necessary elements to ensure its effectiveness;
- the provisioning policy as approved by the board is appropriately implemented by all those with responsibility in relation to provisioning;
- the provisioning policy is regularly reviewed and updated as required with material updates being approved by the board (at minimum this should be done annually);
- there is regular reporting to the board of the results of impairment reviews including evidence of challenge and consideration of the same by the board; and provisions are appropriately signed off by the board.

3. Provisioning Policy

Regulation 23 of the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 requires that a credit union establish and maintain a provisioning policy. This section provides detail and guidance on what should be included, at a minimum, in the provisioning policy and sets out the Central Bank's expectations in certain areas.

3.1. Objectives of the Provisioning Policy

The objectives which are to be achieved from implementation of the provisioning policy should be clearly documented.

3.2. Frequency

The provisioning policy should outline the frequency with which loan impairment reviews will be conducted.

FRS 102 requires that loan impairment reviews are conducted at the end of each reporting period. The Central Bank expects that credit unions undertake a loan impairment review on at least a quarterly basis (as part of preparation of the management accounts and quarterly prudential return) to help to ensure the recognition by credit unions of loan losses as early as possible within the context of accounting standards. This should ensure that a gradual approach to provisioning is taken throughout the year reflective of changing circumstances and should ensure that any additional provision required is recognised and accrued in a timely manner.

3.3. Organisational Arrangements

The provisioning policy should clearly state the roles, responsible persons and their related responsibilities in relation to provisioning within the credit union for those who are tasked with development, implementation and execution of the provisioning policy.

It is expected that there be a clear segregation of duties between the person responsible for undertaking loan impairment reviews and the person responsible for reviewing the results of loan impairment reviews and the related provision amounts (before presentation for sign off to the board). It is also expected that there is a clear segregation of duties between those persons involved in the credit function and those persons involved in loan impairment reviews.

3.4. Resourcing

Credit unions should ensure that the persons tasked with responsibility for performing loan impairment reviews and for analysing and signing off on the results of same, are suitably qualified and experienced individuals.

Detail on the minimum expected competency of persons involved in loan impairment reviews should be included in the provisioning policy. The Central Bank accepts that this minimum expected competency may vary depending on the nature, scale and complexity of the credit union and the methodology used to undertake loan impairment reviews.

3.5. Loan Classification

The provisioning policy should outline the classification of loans used by the credit union in the loan portfolio as determined by the underlying performance of the loans. The characteristics of loans which are performing, performing in arrears, in arrears and in default should be clearly outlined. The criteria, rationale and parameters for the determination of these specific loan classifications should be clearly documented in the provisioning policy. Further detail on common loan classifications is set out in section 6.

3.6. Reporting Arrangements

The provisioning policy should outline the frequency and form of reporting the results of loan impairment reviews and the related provisioning amounts to the board.

It is expected that a report on the results of loan impairment reviews and the movement in the overall provisions figure is presented to the board on at least a quarterly basis for review and sign off. The report provided at a minimum should include a breakdown of the provision amount attributable to each of the different loan classes, split by (i) loans which are performing, (ii) loans which are performing but in arrears and (iii) loans which are in arrears or have defaulted.

3.7. Accounting Policy

A credit union's accounting policy for provisioning should ensure consistency with the requirements of applicable accounting standards. Credit unions are required to report their annual accounts under FRS 102.

The accounting policy should outline the following at a minimum:

- (a) the method of measurement applied to loans e.g. amortised cost;
- (b) detail on what is considered by the credit union to be an event which would necessitate a review of loans to assess for potential impairment;
- (c) detail on what is considered by the credit union to be a loss event i.e. an event which has occurred which may have an adverse impact on future cashflows;
- (d) the estimation techniques used by the credit union to assess and measure loan loss impairment; and
- (e) the principal assumptions used in the estimation techniques used to assess and measure loan loss impairment.

The stated accounting policy contained within the credit union's provisioning policy should be consistent with the accounting policy for provisions disclosed in the annual audited financial statements.

3.8. Provisioning Methodology and Estimation Tools

All credit unions should have in place an appropriate methodology for provisioning which incorporates an impairment assessment tool to accurately estimate loan losses. Where necessary, this should be compatible with the credit union's IT software and loan system.

The provisioning policy should outline what categories of loans are to be assessed on an individual basis. This may be loans which are individually significant or which the credit union deem represent a specific risk due to the characteristics of those loans. Detail should also be included in the provisioning policy on how loans are assessed for impairment on a collective basis (where such assessment is undertaken) and what methodology is employed to achieve this. Further detail on assessing loans on an individual and collective basis is outlined in Section 5.

3.9. Accounting for Provisioning Movements

The provisioning policy should set out how changes in provision amounts are to be accounted for. This should ensure consistency with the requirements of FRS 102 which specifies that:

- where there is objective evidence of an impairment loss, credit unions are required to recognise an impairment loss in the income statement immediately;
- where, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, credit unions are required to reverse the previously recognised impairment loss directly or by adjusting an allowance account.

3.10. Loan Default

The provisioning policy should outline when the credit union considers that an event is deemed to have occurred which indicates that there may be no reasonable expectation that any amounts owing will be received on the loan and that the full amount of the outstanding loan may require write off i.e. the loan is in default.

It is considered that where a loan is in arrears for >180 days that this is strongly indicative that there may be no reasonable expectation that any amounts owing will be received on the loan. Where this is identified, it is expected that a 100% provision of the net value of the loan should be recognised by the credit union.

3.11. Loan Write Offs and Write Backs

The provisioning policy should outline the credit union's approach to loan write offs. Consideration should be given by the credit union on what is a reasonable time period for a loan to remain on the balance sheet after it has defaulted and before it is written off. This time period should allow the credit union sufficient time to engage with the borrower with a view to securing full or part recovery of the defaulted loan.

It is acknowledged that what is considered 'reasonable time' will depend on the loan category, to an extent the individual circumstances of each loan and other factors including whether or not there is collateral attached to the loan. The Central Bank expects, where a loan is in arrears of 53 weeks or more, that serious consideration should be given to writing off that loan from the credit union's balance sheet (i.e. thereby removing it from the balance sheet). Notwithstanding that a loan is written off, a credit union may of course continue to pursue recovery of that loan from a borrower in line with its credit control policy.

3.12. Income Recognition

The provisioning policy should outline clearly how income is to be recognised on loans which are in default or have been written off.

Income recognition where a loan is in default:

It should be clearly outlined in the provisioning policy how any income received on loans, which are deemed to be in default but which remain on the balance sheet, should be recognised. It is expected that any income received on such loans would be accounted for as a bad debt recovery through the income statement.

Income recognition where a loan has been written off:

It should be clearly outlined in the provisioning policy how any income received on a loan which has been written off should be recognised. It is expected that any income received on such loans would be accounted for as a bad debt recovery through the income statement.

3.13. Collateral

The provisioning policy should outline the credit union's approach to realising collateral which is held against loans which have defaulted. This should articulate the circumstances in which collateral will be realised. The credit union's approach to collateral contained in the provisioning policy should be consistent with the approach to collateral documented in the credit union's credit policy. This will be of particular significance in relation to house loans.

Credit unions should take the collateral held on a loan into consideration only where the collateral is held via a first legal charge and where the credit union has demonstrable evidence that it can affect the security. The provisioning policy should outline clearly the approach to be taken to the valuation of collateral which is held

against an impaired loan. Generally, the collateral should be valued on the basis of market value being the estimated amount for which the collateral could be exchanged on a valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where such parties had each acted knowledgeably, prudently and without compulsion. The valuation should take account of all costs associated with realising the collateral including legal and selling costs. In addition, the Central Bank expects that credit unions would give consideration to applying a discount to collateral held in order to ensure a sufficiently conservative approach when valuing collateral attached to loans which are in default. Valuations of collateral held against loans should be updated on a frequent basis. It is expected that where a loan is in default that any collateral held against that loan would be valued immediately at the time the loan goes into default and that updated valuations would be undertaken on at least an annual basis thereafter.

3.14. Review of Provisioning Policy

The provisioning policy should outline the frequency with which a review should be undertaken to ensure that the provisioning policy remains appropriate to the circumstances of the credit union. In line with the requirements of section 55(o) of the Act, it is required that the provisioning policy be reviewed annually at a minimum. Responsibilities in relation to undertaking a review of the policy should be outlined. The provisioning policy should also document who has authority to approve amendments to the provisioning policy and the level of authority required for both significant and minor amendments.

It should be clearly documented within the policy when the last review was undertaken and who undertook and signed off on such review. The Central Bank would also expect that the provisioning policy is updated more frequently than annually if events in the credit union indicate that an early review may be required.

4. Guidelines for Assessing Impairment

The current accounting standard applicable to credit unions (FRS 102) requires the use of an incurred loss approach to the calculation of impairment provisions on loans. The core principle with respect to impairment is that there must be objective evidence of impairment before a provision is recognised.

Section 11.21 of FRS 102 requires that at the end of each reporting period a credit union is required to assess for objective evidence of impairment. Where it is deemed that there is objective evidence of impairment, the credit union shall recognise a provision in profit or loss immediately. In accordance with section 11.25 of FRS 102, the provision should be the difference between the carrying amount of the loan and the present value of the estimated future cash flows discounted at the loan's original effective interest rate.

Section 11.22 (e) permits that a provision may be required on a group of loans where there is observable data which indicates that there has been a measurable decrease in the estimated future cash flows on the group of loans since their initial recognition, even though the decrease cannot yet be identified with the individual loans in the group. This element of a credit union's overall provision is commonly known as incurred but not reported (IBNR).

Outlined below are guidelines in relation to assessing loans for impairment which may be of assistance to credit unions in informing their approach.

4.1. Assessment of Impairment

4.1.1. Frequency of Assessment for Impairment

The Central Bank expects that a credit union should assess, on at least a quarterly basis, whether there is objective evidence of impairment on all loans in their loan book. In accordance with FRS 102, assessment may be performed on either an individual or collective basis as appropriate and determined by the credit union.

4.1.2. Indication of Impairment

Impairment on a loan is generally deemed to have occurred where:

- (i) one or more objective events (impairment triggers) have occurred; and
- (ii) these triggers are likely to have a negative impact on the estimated future cash flows on the loan and indicate that a loss event has occurred.

(i) Impairment Triggers

Credit unions should assess all loans for objective evidence of impairment based on all available information including current information and events at the date of assessment. Certain information and events can be seen as impairment triggers that may affect the likelihood of loss events occurring, and therefore the appropriate levels of provisions for loans.

Examples of such impairment triggers include, but are not limited to:

- macroeconomic triggers
- national or local economic conditions that indicate a measureable decrease in estimated future cash flows of the loan asset class
- an increase in the unemployment rate
- a decrease in property prices for mortgages
- an adverse change in industry conditions
- general triggers
- significant financial difficulties of the borrower
- a breach of contract, such as default or delinquency in repayments (capital and/or interest amounts)
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation
- personal lending triggers
- any forbearance measure by the borrower including requests for payment holidays or restructuring/rescheduling of loans
- requests for multiple top-ups on loans
- share/loan transfers to cover repayments
- commercial or community lending triggers
- trading losses
- a material decrease in turnover or the loss of a major customer
- a default or breach of contract

Detail and examples of what is viewed to be an impairment trigger should be set out in the credit union's provisioning policy. Credit unions should review and revise their impairment triggers for each loan group to ensure that triggers identify potential loss events as early as possible.

Impairment triggers should also reflect localised factors which are specific to the individual credit union and which have the potential to impact on the repayment of loans in the credit union. An example of this may be where a large number of borrowers in the credit union rely on one local employer and should an adverse event occur with that employer, this may potentially impact on the loan servicing ability of the borrowers. Local specific impairment triggers should be documented, reviewed regularly and updated as necessary.

The following factors should also be taken into account when assessing an individual loan for impairment:

- the debt service capacity of the borrower;
- the financial performance of the borrower; and
- the prospects for support from any financially responsible guarantors and any collateral provided based on its current value.

(ii) Occurrence of Impairment

Where an impairment trigger indicates that a loss event may have occurred, the credit union should assess whether this is likely to have a negative effect on the estimated future repayments on a loan. Where it is established that this is the case then a loss event is deemed to have occurred and accordingly a provision should be made against the loan.

4.1.3. Calculating an impairment loss

As stated in FRS 102, an impairment loss should be calculated by reference to the difference between a loan's carrying amount and the present value of the estimated future cash flows discounted at the loan's original effective interest rate. The Central Bank expects that factors such as the time, costs and difficulties in recovering the loan and any security or collateral held on the loan would be taken into consideration when undertaking an estimate of the future cash flows on the loan. The value of collateral held against a loan should be arrived at after application of an appropriate discount to the market value of the loan. The cash outflows incurred during collateral execution and the sales process should include all legal costs, selling costs, taxes and other expenses and any additional maintenance costs to be incurred in relation to the repossession and disposal of collateral. A credit union should take a conservative and realistic approach in assessing these matters. The methodology for assessing loan impairment on an individual or collective basis and the calculation of the amount of the impairment provision is outlined in section 5.

5. Guidelines for Calculating Impairment Provisions

5.1. Methodology for Calculating Impairment

As set out in section 4, a credit union's provisioning policy should outline the methodology to be applied when assessing loans for objective evidence of impairment and should specify how impairment provisions are to be calculated and recognised. This is aimed at ensuring that a consistent approach is taken to the appropriate measurement and recognition of impairment provisions.

The following are two common and acceptable methodologies which may be employed when assessing loans for impairment.

(i) Individual assessment of loans:

This involves examining the loan files of specific loans on an individual basis to ascertain if loan losses have occurred on each individual loan.

(ii) Collective assessment of loans:

This involves examining specific groups within the loan portfolio which have common characteristics on a collective basis, using previous experience of losses in that specific group of loans, to estimate the expected future cash flows on that specific group of loans with a view to establishing the amount of losses in that specific group of the loan book.

5.2. Approach to using either Individual or Collective Assessment

The Central Bank expects that where collective assessment of the loan book is performed, analysis should also be performed on specific individual loans as identified by the credit union to assess for impairment. At a minimum, the loans selected for individual assessment by the credit union should be those which represent a significant exposure for the credit union. Where a loan is assessed in the first instance on an individual basis and it is deemed that no provision is necessary, this loan should be re-assessed for impairment as part of any collective assessment undertaken. The provisioning policy should specify those loans which are to be assessed on an individual basis. It is acceptable for a credit union to assess all loans for impairment on an individual basis if this is practicable.

5.2.1. Individual Assessment

Individual assessment may be performed on certain loans which are deemed to represent individually significant exposures for the credit union. A credit union may assess all loans on an individual basis if it is considered practical to do so. Credit unions should give consideration to the definition of an individually significant exposure, taking into account the nature, scale, complexity and risk profile of the credit union. The definition of what is deemed to be an individually significant exposure should be outlined in the credit union's provisioning policy.

Credit unions may also individually assess certain loans, that do not represent a significant exposure, due to specific risk characteristics of these loans. Examples of such categories may include, but are not limited to:

- top 100 loans;
- rescheduled loans;
- top up loans;
- loans to officers;
- interest-only loans;
- loans with atypical repayment schedules (including single or lump sum repayment loans); and
- loans where there have been share to loan transfers within a specified timeframe.

The specifics on what loans the credit union deems are necessary to be individually assessed for impairment should be outlined in the provisioning policy.

Where a credit union assesses a loan for impairment individually and deems that it is impaired and requires a provision, it should recognise a provision for this loan in the income statement immediately.

5.2.2. Collective Assessment

In general, due to their homogenous nature, a large proportion of credit union loans may be grouped together and assessed on a collective basis e.g. those loans which have similar credit risk characteristics that are indicative of a member's ability to repay according to the credit agreement. The following characteristics may be taken into consideration when grouping exposures:

- loan Category;
- geographical location;
- date of origination;
- security type;
- size of loans;
- other forbearance indicators including rescheduled loans; and
- past due status.

Where loans have been individually assessed and it is not deemed that they are impaired they should be included within the group of loans which are to be assessed on a collective basis.

An element of the overall impairment provision arrived at as a result of a collective assessment of the loan book will relate to the loans within the collective assessment pool which are currently performing based on the probability of these loans moving from the performing pool into the non-performing pool. This element of the overall provision is commonly referred to as IBNR.

Outlined below is an example of how a credit union could approach a collective assessment of its loan book.

The calculation of provisions for the collective assessment of loans may be done in a number of ways. One such way is for it to be based on analysis of 'days in arrears' payment performance. Similar loans are grouped (i.e. car loans, term loans, house loans) and split between arrears categories - each arrears category referring to the number of days in arrears (usually up until 90 days or an equivalent default event). Subsequently the behaviour of loans from a given arrears category is assessed (in terms of movement towards the 'default event'), over a defined length of time - normally designed to reflect an appropriate emergence period.

Careful attention must be given to the effect of any loan re-aging, forbearance or restructuring practices on both the categorisation of arrears and default identification, with appropriate adjustments made as necessary (for instance forbearance loans may need to be treated separately, considered as an indicator of default etc.). In addition, recoveries from the default event are accounted for - with a recovery rate estimated to reflect all cash flows post default (collateral related or otherwise); with cashflows discounted to reflect their inherent risk as well as the time value of money. The costs involved in making recoveries must also be taken into account.

Historical loss experience should be adjusted to reflect the effects of current economic conditions that did not impact the period that the historical loss experience covers, and historical conditions that do not currently exist.

The methodology and assumptions used for estimating cash flows should be reviewed regularly to minimise any differences between loss estimates and actual loss experience.

5.3. Miscellaneous Considerations

5.3.1. Concentration Risk

As part of the measurement of loan portfolio provisions, credit unions should be cognisant of large exposures and connected borrowers. This may help to reduce the risk of credit unions incurring large losses as a result of the failure of an individual borrower or group of connected borrowers, due to the occurrence of unforeseen events (see the Lending Chapter of the Credit Union Handbook for further guidance on large exposures and connected borrowers). Certain loans, while not individually significant, could represent in aggregate a concentration risk resulting from a shared characteristic across the loans. When assessing loans for impairment, loans which credit unions deem to represent a concentration risk should be assessed in conjunction with one another.

5.3.2. Post Balance Sheet Events

Where credit unions have prepared their year-end accounts and presented a balance sheet at the reporting date, they need to remain aware up to the date that the financial statements are authorised for issue, of circumstances which may have an impact on the amounts which are presented in the financial statements. Section 32 of FRS 102 outlines that the receipt of information after the end of the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted, is deemed to be an adjusting event after the end of the reporting period. Where

such circumstances arise this would require a credit union to adjust the provisioning amount in its financial statements including making amendments to any related disclosures.

6. Supervisory Expectations

The Central Bank expects:

- credit unions to have in place a comprehensive provisioning framework which results in the recognition of loan losses as early as possible;
- that there is a clear understanding of the respective responsibilities of the board, management and internal audit with regard to provisioning in the credit union;
- that there is a 'fit for purpose' approved provisioning policy implemented by the credit union which will result in an adequate level of provisions being recognised on impaired loans;
- that there is appropriate oversight and approval of provisioning practices and the results of the same at board level; and
- that credit unions maintain a comprehensive understanding of the underlying risk profile of the loan book and be capable of identifying specific loans or group of loans which represent an increased credit risk for the credit union.

It is considered that the ageing of arrears and the number of repayments in arrears are key indicators of asset quality and are fundamental inputs into the assessment of loan impairments. It is important that credit unions are capable of accurately segmenting and reporting on their loan book in such a manner.

Specific categories of loans which should be carefully considered by credit unions and the Central Bank's expectations of an acceptable approach to provisioning on these loans are outlined below.

6.1. Performing Loans

A loan may be categorised as performing where the loan is not past due and does not present a risk of not being paid back to the credit union in full. The assessment of impairment on these loans should be based on the probability of such loans moving from the performing pool into the non-performing pool over a defined period. This provision is referred to as IBNR provision.

Performing Loans in Arrears

A loan which is up to 9 weeks past due may be categorised by a credit union as performing but in arrears. The likelihood of full recovery on a loan which is up to 9 weeks past due is less than that of a fully performing loan and as a result it is expected that the level of provisions for this category of loans should be higher than that for loans which are classified as fully performing.

6.2. Non-Performing Loans

The Central Bank considers that a loan which is greater than 9 weeks in arrears should be classified by the credit union as non-performing. The likelihood of these loans become fully recovered is less than that for a performing

loan or a loan which is performing but in arrears and accordingly it is expected that the level of provisions on such loans would be higher.

6.3. Defaulted Loans

Where a loan is in arrears for ≥ 180 days it is viewed that this is strongly indicative that all amounts owing on the loan may not be received. The Central Bank would expect that such loans would have a 100% provision based on the net exposure (i.e. after security/collateral)¹ of the loan.

Where there is a deviation from this 100% provisioning expectation by a credit union, it is expected that the credit union can demonstrate with acceptable objective evidence, that a 100% provisioning amount is not warranted. Where such an explanation provided by a credit union is not deemed sufficient, the Central Bank may require the credit union to:

- (i) increase the level of provision held on the loan, provided that such an increase is permissible within the context of FRS 102; and/or
- (ii) hold the amount of the additional provision required to reach 100% provision as a non distributable reserve.

6.4. Rescheduled Loans

Rescheduled loans are those loans where the repayment conditions have been altered by the credit union so that:

- (i) the duration of the loan is extended; or
- (ii) the repayment amounts have been reduced for 4 or more consecutive months within the period of the loan; and
- (iii) the loan was in arrears at the time of the repayment conditions being altered, or the loan would have fallen into arrears if the repayment conditions were not altered because the terms of the original loan agreement would no longer be met.

Where a loan is rescheduled this may be indicative of objective evidence of impairment having occurred and accordingly all rescheduled loans should be reviewed for impairment on an individual basis at the time that the loan is being rescheduled. Where it is assessed that the loan is not impaired at the time of this review, the loan should be collectively assessed within a pool of loans with similar credit characteristics. Where a loan is deemed to be impaired, a provision should be made.

It is expected that rescheduled loans are closely monitored for impairment by credit unions given that such loans are likely to represent an increased credit risk for the credit union.

¹ The value of security/collateral should be arrived at based on the open market value of the property after application of an appropriate discount and taking account of all costs likely to be incurred during collateral execution including legal costs, selling costs/taxes/expenses and any additional maintenance costs to be incurred in relation to the repossession and disposal of the collateral.

Rescheduling should not interrupt the ageing of arrears of a rescheduled loan unless the borrower repays all amounts which were in arrears without new financing provided by the credit union for such purposes.

6.5. Top Up Loans

A top up loan can be defined as further credit granted to an existing borrower. Credit unions should remain cognisant of the potential increased credit risk which is posed by such loans.

Where a borrower requests a top up loan, the credit union should undertake an individual impairment assessment of the borrower's existing loans, to assess whether or not they are impaired and if a provision is required. Where impairment is not evident on the borrowers existing loans, the credit union should assess whether they could potentially become impaired should the top up loan not be granted and make any provision which is considered necessary following this assessment. The Central Bank would expect that top up loans are only granted to borrowers where it is assessed that there no specific concerns with regards the borrowers repayment capacity in relation to the initial and any subsequent loans granted.

6.6. Cured Loans

A cured loan can be defined as a loan which was once non-performing but simultaneously the financial situation of the borrower has improved to the extent that full repayment of the loan is likely to be made and the borrower no longer has any amount in arrears on the loan.

Credit unions should retain a cautious approach on such loans when assessing loan books for impairment as they are likely to represent an increased credit risk as a borrower who has a cured loan is more likely to re-default than a borrower who has loans which have never been classified as non-performing.

The Central Bank would not expect to see any reversal of a provision on a loan, which was previously classified as non-performing but is now classified as cured, until such time that there is demonstrable evidence that the loan is performing in line with the terms and conditions of the credit agreement and should continue to perform in such a way. An appropriate time period for assessing such performance should be contained in the provisioning policy of the credit union.

7. Loan Write Offs

As detailed in section 3, a credit union's provisioning policy should state when loans, which are considered to be in default, should be written off.

When assessing the recoverability of a loan credit unions should pay particular attention to those loans which have prolonged arrears. In general, where a loan is in arrears for 53 weeks or more this is strongly indicative that the loan should be written off and removed from the credit union's balance sheet. In certain instances, a partial write off may be warranted where there is reasonable financial evidence to demonstrate an inability on the borrower's behalf to fully repay all amounts outstanding on the loan.

Loans deemed irrecoverable should be presented to the board for review and approval. These should be written off as they arise during the year and not left to the financial year end for write off.

Where a loan has prolonged arrears for a period of greater than 53 weeks and following an assessment for write off, a decision is made that the loan should remain on the credit union's balance sheet, this should be supported by appropriate evidence. A list of all such loans and the supporting evidence should also be presented to the board for approval. All such loans should be re-reviewed at regular intervals to ensure that it remains appropriate for them to be kept on the balance sheet.

The provisioning policy should clearly document how any monies subsequently received on loans previously written off should be accounted for in the credit union's accounts. It is expected that these should be accounted for as bad debt recoveries through the income statement.

8. Supporting Documentation

Credit unions should maintain supporting documentation on each individual loan or group of loans, including:

- documentation of the rationale for determining whether an exposure should be assessed individually or collectively for impairment;
- documentation of the rationale for determining appropriate groupings of exposures, including observable data supporting the conclusion that the exposures in each grouping have similar attributes or characteristics. This data must be assessed periodically as circumstances change or as new data that is more relevant and more directly representative of loss becomes available; and
- if there is objective evidence of impairment, the credit union should document the type of objective evidence existing. If no objective evidence of impairment exists, the credit union should document the steps taken in arriving at this conclusion.

In addition to the supporting documentation required above, the following supporting documentation should be maintained on files (particularly loan files) in relation to the calculation of the impairment provision:

- the method and result of the impairment provision calculation for each individually measured exposure, including where relevant how the most appropriate technique for measurement was determined;
- when using the discounted future cash flows method:
 - the amount and timing of cash flows;
 - the effective interest rate used to discount the cash flows; and
 - the basis for the determination of cash flows, including consideration of current environmental factors and other information reflecting past events and current conditions;
- for collectively assessed exposures, the supporting rationale for adjustments made to the historical loss experience of each group, and the quantity of the adjustment; and
- documentation supporting the opinion that the credit union's estimates have an economic relationship to, and are representative of, impairment of a group of exposures.

Appendix A: Extract from Section 11 of FRS 102 outlining the main requirements in relation to Provisioning

The below represents an extract from FRS 102 only. Please revert to FRS 102 in its entirety for the full accounting requirements in relation to provisioning.

Impairment of financial instruments measured at cost or amortised cost

Recognition

11.21 At the end of each reporting period, an entity shall assess whether there is objective evidence of impairment of any financial assets that are measured at cost or amortised cost. If there is objective evidence of impairment, the entity shall recognise an impairment loss in profit or loss immediately.

11.22 Objective evidence that a financial asset or group of assets is impaired includes observable data that come to the attention of the holder of the asset about the following loss events:

- (a) significant financial difficulty of the issuer or obligor;
- (b) a breach of contract, such as a default or delinquency in interest or principal payments;
- (c) the creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider;
- (d) it has become probable that the debtor will enter bankruptcy or other financial reorganisation; and
- (e) observable data indicating that there has been a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, even though the decrease cannot yet be identified with the individual financial assets in the group, such as adverse national or local economic conditions or adverse changes in industry conditions.

11.23 Other factors may also be evidence of impairment, including significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates.

11.24 An entity shall assess the following financial assets individually for impairment:

- (a) all equity instruments regardless of significance; and
- (b) other financial assets that are individually significant.

An entity shall assess other financial assets for impairment either individually or grouped on the basis of similar credit risk characteristics.

Measurement

11.25 An entity shall measure an impairment loss on the following instruments measured at cost or amortised cost as follows:

- (a) For an instrument measured at amortised cost in accordance with paragraph 11.14(a), the impairment loss is the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the asset's original effective interest rate. If such a financial instrument has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.
- (b) For an instrument measured at cost less impairment in accordance with paragraph 11.14(c) and (d)(ii) the impairment loss is the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation) of the amount (which might be zero) that the entity would receive for the asset if it were to be sold at the reporting date.

Reversal

11.26 If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the entity shall reverse the previously recognised impairment loss either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset (net of any allowance account) that exceeds what the carrying amount would have been had the impairment not previously been recognised. The entity shall recognise the amount of the reversal in profit or loss immediately.



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