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1. Application of Guidelines

1.1 Introduction

This paper sets out the Central Bank of Ireland’s (“the Central Bank”) best practice guidelines regarding the policies, procedures and disclosures which the State supported Covered Institutions (hereinafter referred to as the “Covered Institutions”)¹ should adopt for loans and receivables financial assets (and held to maturity financial assets where applicable) that are subject to impairment review in accordance with the requirements of International Accounting Standard 39 Financial Instruments: Recognition and Measurement (“IAS 39”). These guidelines should be read in conjunction with the existing Central Bank’s regulatory document entitled “Impairment Provisions for Credit Exposures”.

The paper has three principal objectives.

Covered Institutions should:

1. Recognise their incurred loan losses as early as possible within the context of International Financial Reporting Standards (“IFRS”);

2. Adopt a more conservative² approach to the measurement of impairment provisions across all loan portfolios; and

3. Significantly improve the number and granularity of their asset quality and credit risk management disclosures which will enhance users understanding of their asset quality profiles and credit risk management practices.

The Central Bank considers that the combination of a more conservative approach to impairment provisioning together with significantly enhanced asset quality and credit risk disclosures will assist in the restoration of investor confidence in the Irish banking sector.

1.2 Who needs to apply these guidelines?

This paper applies to all Covered Institutions. While this paper has the status of guidance, the Central Bank considers that the guidelines contained herein represent an appropriate basis, especially taking into account current economic conditions, for the development and application of impairment provisioning frameworks. As such, the Central Bank would be minded to interpret material deviations from this guidance as running counter to the detail and spirit of these guidelines. The Central Bank will, as a matter of course, scrutinise the Covered Institutions’ applications of these guidelines as part of our on-going supervision.

We expect Covered Institutions to implement these guidelines as early as possible. We expect the number and quality of disclosures in the 2011 annual reports will be significantly enhanced.

¹ The term “Covered Institutions” refers to the Covered Institutions that have received financial support under the Covered Institutions (Financial Support) Act 2008.

² Refer to IFRS Framework paragraph 37 which states that the inclusion of a degree of caution in the exercise of judgements is needed in making estimates required under conditions of uncertainty.
1.3 Impairment Provisioning – a more conservative approach

IAS 39 and in particular the incurred loss approach to impairment provisioning for financial assets, has been the subject of much discussion and some criticism. This has resulted in the International Accounting Standards Board (“IASB”) accelerating its work programme to replace IAS 39 in its entirety.

The impairment provisions in the Covered Institutions continued to increase during the years 2008-2011 as both the domestic and international economic conditions deteriorated more rapidly and for a longer period than the Covered Institutions had assumed in their impairment provisioning frameworks.

The Central Bank recognises that the level of impairment provisions are lower under the incurred loss approach to impairment provisioning than those which would have been recognised under an expected loss approach. However, we believe that the provision gap between the two approaches could have been narrowed, and that provisions could have been recognised earlier and measured more conservatively by some Covered Institutions had they:

► Adopted more conservative impairment triggers to their loan portfolios;
► Used more conservative estimates and assumptions relating to the condition and the evolution in property prices; and
► Used more conservative assumptions relating to the future domestic and international macroeconomic conditions.

This issue was brought into sharper focus when the Central Bank published “The Financial Measures Programme” dated, 31 March 20113 (“FMP”) which identified that expected losses in the Irish banking system greatly exceeded the stock of impairment provisions the Covered Institutions held at that time (Chart 1).

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The Central Bank has identified the need to publish new best practice guidelines which will support Covered Institutions in the development and application of their impairment provisioning frameworks. The frameworks should be appropriate to the current economic circumstances with more conservative impairment triggers being adopted which will result in earlier completion of impairment reviews and a more conservative approach to the measurement of provisions across all loan portfolios.

1.4 Why are we focusing on disclosures?

One objective underpinning the FMP was to improve investor confidence in the Irish banking sector through enhanced disclosures. The Central Bank has developed a comprehensive best practice template of asset quality and credit risk management disclosures which we are confident will further enhance users’ understanding of Covered Institutions’ loan portfolios asset quality profile and credit risk management practices.

1.5 IFRS 9 Financial Instruments (Replacement of IAS 39)

IFRS 9 Financial Instruments (“IFRS 9”) will eventually replace IAS 39 and is currently a “work in progress”. IFRS 9 is being developed in three phases:

- Phase 1 Classification and measurement;
- Phase 2 Amortised cost and impairment of financial assets; and
- Phase 3 Hedge accounting.

Whilst Phase 1 has been completed, the new requirements relating to Phases 2 and 3 remain under development. It is expected that, the new approach to impairment provisioning will be based on an expected loss approach.
The European Union has indicated that it will only consider endorsing IFRS 9 when the final two phases are complete.

The current exposure draft proposes to postpone the mandatory effective date of IFRS 9 to annual periods beginning on or after 1 January 2015.
2. The Central Bank review

To achieve the principal objectives of earlier recognition of incurred losses and improved transparency around asset quality and credit risk profiles, the Central Bank has:

► Reviewed and analysed the Covered Institutions\(^4\) impairment provisioning frameworks as at December 31 2010;
► Reviewed the Covered Institutions’ impairment disclosures and benchmarked them against international best practice.
► Designed an enhanced disclosures template in respect of the credit impairment disclosures, taking specific account of circumstances in the Irish market.
► Analysed the key management judgements, estimates and assumptions used by Covered Institutions in their impairment provisioning frameworks.
► Considered current issues such as forbearance measures, deteriorating loan-to-value ratios, weaker outlook for global growth, developments in the Basel Accord and IFRS.
► Undertaken a quantitative impact assessment study ("QIS") in respect of certain impairment provisioning inputs and parameters.
► Reviewed the impairment provision guidelines and publications issued by other regulators and standard setters.
► Reviewed the impairment provisioning for assets held for sale (specifically assets identified for deleveraging and assets remaining to be transferred to the National Asset Management Agency ("NAMA")).
► Engaged with various stakeholders including the Covered Institutions, their auditors, professional bodies and other regulatory authorities both in Ireland and across Europe.

The Central Bank requires that the following areas of the Impairment Provisioning Frameworks be carefully considered by the boards of the Covered Institutions.

Core loan portfolios

- Impairment triggers
- Forbearance measures
- Key management judgements, assumptions and estimates

Non-core loan portfolios

- Recognition and disclosure of impairments and losses associated with non-core portfolios which are required to be sold

Enhanced Asset Quality and Risk Disclosures

An objective underpinning the FMP was to improve investor confidence in the Irish banking sector through enhanced asset quality and credit risk management disclosures.

The Central Bank has developed a comprehensive template of asset quality and credit risk management disclosures (Appendix 1) which has been tailored to reflect the circumstances of the Irish market and is consistent with the disclosure requirements of IFRS 7, other relevant IFRS standards and the Capital Requirements Directive (“CRD”) Pillar 3.

We have included in the template selected risk management disclosures from the Pillar 3 requirements which we consider will further enhance users understanding of the Covered Institutions’ risk profiles. The new template is an important step towards the goal of improving investor confidence in the Irish banking sector.

The Central Bank recognises that some Covered Institutions may face challenges in 2011 in obtaining the detailed information required by these guidelines from their current management information systems and processes. In this context, the Central Bank has indicated to the Covered Institutions that where it is not possible to provide comparative information, or where there is not sufficient underlying documentation for certain new disclosures to be audited in 2011, that this is not a sufficient reason for excluding the disclosures.

The Central Bank does accept that for certain disclosures it may be necessary to use proxies in the 2011 annual reports. If this is the case, the use of proxies and the basis of their determination should be clearly stated in the published annual reports.

In 2012, the Central Bank expects that all the new disclosures will be audited.
2.1 Core loan portfolios

2.1.1 Impairment Triggers (all portfolios)

Covered Institutions apply IAS 39 which requires the use of an incurred loss approach for the calculation of impairment provisions. The standard’s core principle with respect to impairment is that impairment provisions are recognised only when losses are incurred and not before then. The approach, however, allows for subjective interpretation in a number of important areas, such as:

► Impairment triggers for each loan asset portfolio; and
► The inputs used in the specific, collective, and incurred but not reported (“IBNR”) impairment provisioning calculations.

In order to recognise an impairment provision on a loan asset IAS 39 requires that:

► There must be one or more objective events (‘impairment triggers’) that have occurred; and
► The event is likely to have a negative impact on the estimated future cash flows of the loan asset.

In reviewing the Covered Institutions impairment provisioning frameworks, the Central Bank observed varied triggers. Some Covered Institutions used reasonably conservative triggers whilst others could have changed to more conservative triggers much earlier to reflect the deterioration in the domestic and international economies.

Covered Institutions should review and revise their existing impairment triggers across each loan asset portfolio to ensure that a trigger identifies a loss event as early as possible. This should result in the earliest possible recognition of losses within the IFRS framework.

Covered Institutions should disclose their impairment triggers for each loan asset portfolio and not simply disclose generic triggers extracted from accounting standards. For all loan asset portfolios, the Central Bank believes that, where applicable, when a loan asset is 90 days in arrears an impairment trigger has occurred and the exposure should be assessed for impairment.

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5 Such judgements should be directionally consistent with deliverable data and indicative of incurred losses.
Guidelines

Impairment triggers should be conservative and appropriate for each loan asset class.

Macroeconomic triggers
► National or local economic conditions that indicate a measurable 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.

Mortgage portfolio triggers (examples only)
► A loan asset that is 90 days in arrears.
► A request for a forbearance measure from the borrower.
► A deterioration in the debt service capacity.
► A material decrease in rents received on a buy-to-let property.

Commercial Real Estate (“CRE”) portfolio triggers (examples only)
► A loan asset that is 90 days in arrears (where applicable).
► A request for a forbearance measure from the borrower.
► A material decrease in the property value.
► A material decrease in estimated future cash flows.
► The lack of an active market for the assets concerned.
► The absence of a market for refinancing options.
► A significant decline in the Institution’s credit rating of the borrower.

Small Medium Enterprises (“SME”) portfolio triggers (examples only)
► A loan asset that is 90 days in arrears (where applicable).
► A request for a forbearance measure from the borrower.
► Trading losses.
► Diversion of cash flows from earning assets to support non-earning assets.
► A material decrease in turnover or the loss of a major customer.
► A default or breach of contract.
► A significant decline in the Institution’s credit rating of the borrower.
2.1.2 Forbearance Measures

In the context of the challenging domestic and international economic climate, increasing numbers of mortgage, personal and business borrowers are experiencing financial stress. In order to assist borrowers who are experiencing financial stress, Covered Institutions are applying forbearance measures, which if designed appropriately, can benefit both the Covered Institutions and borrowers, as they may improve the ability of the borrower to repay their loans and therefore increase the probability of the Covered Institutions recovering the value of the loan asset.

Experience to date highlights that the most common forbearance measures employed are:

1. A move to interest only schedules;
2. Reduced payments schedules (less than interest only);
3. Reduced payments schedules (greater than interest only);
4. Payment holidays; and
5. Extension of loan term.

A policy of extending forbearance measures to borrowers experiencing financial stress has implications for the Covered Institutions’ credit management practices and their associated impairment provision frameworks.

The Central Bank considers that forbearance measures are reflective of the increasing underlying credit risk profiles of loan portfolios which therefore have a higher risk of default. Accordingly, these measures will have a negative impact on a Covered Institution’s future level of impairments.

Whilst many borrowers will perform in accordance with the forbearance measures, others may find that the concessions provided are insufficient to withstand the financial stress with which they are faced and default may ultimately still occur on the exposure. Hence, we believe that this higher inherent risk attaching to forborne exposures exists in both the performing and non-performing loan portfolios.

We believe that in respect of the forborne loan pools the probability of default ("PD") (as forborne borrowers are more likely to re-default/default) and the loss given default ("LGD") will increase in both performing loan and non-performing loan portfolios. As a result the Central Banks believes that it is appropriate to gather separate data in respect of these loan pools.
The Central Bank recognises that Covered Institutions will need to implement changes to their Management Information Systems (“MIS”) in order to facilitate the gathering of separate loan pools relating to forborne loans. The MIS will also need to have the capability to track which forbearance measure was applied to each borrower.

The Central Bank considers that the request for a forbearance measure from a borrower is an impairment trigger (refer to Chart 2). Accordingly, such exposures should be reviewed for impairment on a specific or collective basis as appropriate.

*Chart 2: Impact of forbearance measure on MIS and loan pools*

<table>
<thead>
<tr>
<th>Loan Portfolios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Request for forbearance measures is an impairment trigger</td>
</tr>
<tr>
<td>Management information systems must be able to identify</td>
</tr>
<tr>
<td>Forborne loans pools</td>
</tr>
</tbody>
</table>

**Specific provisioning**

When conducting an impairment review, IAS 39 requires that:

- The estimated recoverable amount is equal to the present value of the estimated future cash flows, discounted at the exposure’s original effective interest rate;
- The estimated recoverable amount may be measured on the basis of an exposures fair value using an observable market price (e.g. on secondary markets); and
- The estimation of the recoverable amount of a collateralised exposure reflects the cash flows that may result from foreclosure whether or not foreclosure is considered the likely course of action.

When conducting a specific assessment for impairment, the Central Bank expects a more conservative approach to the estimation of both the future cash flows and the collateral valuations. The estimates and assumptions should reflect the current economic challenges and the current view of the expected economic outlook. When determining the collateral valuations in the cash flow calculation, a more conservative approach should be applied to both the expected timing and the amount of the proceeds. Where foreclosure proceedings have been initiated and the expected time to security realisation is prolonged and or

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6 The Central Bank will shortly publish a Guidance Paper “Credit Risk Management in the Banking Crisis – Lessons Learned”.
delayed, the Central Bank expects that valuation of the underlying security should be reviewed on a regular basis.

In relation to CRE exposures, by extending forbearance measures to borrowers, Covered Institutions provide additional time to borrowers to adjust their Balance Sheets without immediately crystallising losses. The Central Bank believes that the tight credit markets could impact future refinancing risk. Accordingly, when undertaking a CRE impairment assessment, the impact of future higher refinancing risk should be particularly considered. This is to reflect the fact that if an exposure cannot be repaid at the contractual date, the refinancing of the exposure may not be achievable and this may have a corresponding impact on the recoverability of the exposure.

The Central Bank believes that existing CRE provision levels may be optimistic and that there exists a risk for future increases in impairment provisions arising in relation to CRE exposures which is particularly acute in forborne CRE exposures with high LTV's.

**Collective Provisioning**

**Chart 3: Non-performing loan portfolios**

If the exposure is below the threshold for specific assessment for impairment, forborne exposures should be collectively assessed for impairment provisioning.

IAS 39 requires that, when collective assessment is used; financial assets should be grouped on the basis of similar credit characteristics which indicate the borrower’s ability to pay in accordance with the contractually agreed terms.
Cognisant of this requirement and the impact which forbearance measures may have on impairment provisioning, the Central Bank believes that:

► Loan pools which are subject to forbearance measures should be separated from the remaining non-forborne loan pools (refer to chart 3);
► Non-forborne loan pools may need to be further stratified. Such stratification should further sub-divide the pools where the loans exhibit similar risk characteristics (refer to chart 3).

When calculating the collective impairment provisions, particularly for mortgage portfolios, certain model inputs which are based on historic data may require management judgement to be applied to adjust historic data to reflect current economic circumstances and the granting of forbearance measures. For example, where a borrower is up to date with their revised terms, having previously received forbearance measures, the historic roll rates to default may appear lower than the underlying risk profile of the loan pool.

In addition to ensuring that historic data is updated to reflect current economic circumstances, the Central Bank believes it is also necessary to ensure that other estimates and inputs included in collective impairment provisioning reflect an appropriate level of conservatism. For example:

► Conservative peak to trough house price assumptions should be used in relation to mortgage portfolios; and
► PDs should also be reflective of the credit characteristics of each appropriately stratified loan pool.

A non-performing forborne loan should only be considered for reclassification into the performing loan portfolio when payments have been made in accordance with the revised terms of the loan for a minimum of six months.

The Central Bank considers that aging of arrears and the number of repayments in arrears are key indicators of asset quality and are fundamental inputs into impairment provisioning frameworks. Accordingly, it is important that systems are capable of accurately capturing such data.

**Chart 4: Performing loan portfolios - IBNR**
Performing loan portfolios – IBNR

Covered Institutions should segregate their performing loan books into loan pools, differentiated between forborne and non-forborne pools. Forborne loan pools should be further segregated by the type of forbearance measures applied as Covered Institutions should include in their annual reports a commentary of the success of each type of forbearance measure.

The Central Bank believes that as a result of the concessions provided to borrowers, it may take a longer period of time for defaults to emerge on forborne loans pools. Therefore, the IBNR calculations in relation to the forborne loan pools should include a longer emergence period than those expected for the loan pools which have not been subjected to forbearance measures.

We also expect that the LGD could be higher on forborne loan pools than those applied to the non-forborne loan pools. Additionally, the Central Bank believes that the PD applied to forborne loan pools will be higher than the non-forborne pools. The Central Bank also requires the history of PDs relating to such forborne loan pools to be recorded and disclosed in the annual report over time.

Guidelines

Mortgage, CRE and SME portfolios

► A request by a borrower for a forbearance measure is an impairment trigger.
► MIS should be able to identify forborne and non-forborne loan pools.
► Forborne loans should be segregated into separate loan pools to reflect their higher inherent credit risk whether the forborne loan is performing or non-performing.
► Impairment provision model inputs should be representative of that pool. For example, forborne loans may have longer emergence periods, higher LGDs and higher PDs.
► In assessing impairment on a mortgage borrower, Covered Institutions should take into consideration any other exposures held by the borrower that may be subject to forbearance measures.
► Historic roll rates and cure rates should be updated to reflect the current economic circumstances.
► PDs should be more conservatively assessed in light of the current low interest rate environment.
2.1.3 Key management judgements, assumptions and estimates

The Central Bank recognises that impairment provisions are estimates which are determined based on informed management judgements as to what is an incurred loss based on the facts and circumstances pertaining at a point in time.

We recognise that there will always be a range of possible outcomes for impairment provision estimates and that management can only make their judgements based on the facts and circumstances pertaining at a point in time and their assumptions relating to the future which maybe by either a pessimistic, neutral or an optimistic view.

It is acknowledged that it is inevitable in some cases, future events and developments may result in a different outcome in relation to estimates which is either positive or negative.

The Central Bank requires Covered Institutions to regularly review and revise their key judgements, assumptions and estimates relating to their impairment provisioning and these should be:

► Reflective of the current domestic and international macroeconomic environment and currently predicted future macroeconomic outlook;
► More conservative than those included in the historical impairment provisioning; and
► Disclosed in the annual report to allow users see in a more transparent way, the impact that such key judgements, estimates and assumptions have on the impairment provisions.

The disclosure should include the key inputs and parameters used in the Covered Institutions mortgage impairment provisioning models and an explanation of significant changes in the inputs used from the prior year.

The Covered Institutions should disclose a sensitivity analysis of the impact of changes to the key assumptions and estimates on the impairment provisions.

Key facts and circumstances which impact impairment provisions include:
► Arrears data;
► Current economic data;
► Collateral asset values and LTV ratios;
► Historic cure rates;
► Interest rates;
► Historic emergence periods; and
► Historic asset workout policies.

Key assumptions relating to future events which impact impairment provisions include:
► Future economic activity and employment rates;
► Projected asset values over the work out period;
► Discounts on the disposal of repossessed assets;
► Gross Domestic Product (“GDP”);
► Unemployment rates;
► Institution specific asset foreclosure and disposal policies; and
► Future emergence periods.
Guidelines

► Covered Institutions should regularly review and revise their key management judgements, assumptions and estimates in their impairment provisioning frameworks.

► There should be appropriate disclosure of the key management judgements, estimates and assumptions.

► The disclosure should include the key inputs and parameters used in the Covered Institutions mortgage impairment provisioning models and an explanation of significant changes in the inputs used from the prior year.

► A sensitivity analysis disclosure should include factors such as changes to their house price assumptions, GDP and unemployment rates.

► There should be increased conservatism in the future cash flow estimates and collateral values estimates used in impairment provision calculations and this should be supported by objective evidence, given currently expected future economic conditions at the reporting date.
2.2 Non-Core Portfolios

2.2.1 Recognition and disclosure of impairments and losses associated with non-core asset portfolios.

As part of the EU-IMF programme of financial support for Ireland, certain Irish Covered Institutions are required to “deleverage” their balance sheets to achieve a target loan to deposit ratio of 122.5% by the end of 2013. The agreement requires these Covered Institutions to submit business plans demonstrating their explicit commitment to deleverage and restructure operations through clear periodical targets, which are defined on the basis of criteria developed by the Central Bank in consultation with the European Commission (“EC”), the European Central Bank (“ECB”) and the International Monetary Fund (“IMF”).

This has resulted in the sub-division of the balance sheet assets on a core and non-core basis, with the latter cohort representing the assets to be deleveraged by December 2013.

Impairment triggers

IAS 39 indicates that national or local economic conditions that correlate with default on particular groups of assets are considered to provide objective evidence that impairment may exist.

In relation to impairment provisioning, the Central Bank believes that the asset quality of some non-core asset portfolios could be negatively impacted by the tighter credit conditions interacting with the weakening economic activity across Europe.

The Central Bank believes that regardless of the classification of non-core assets which are identified for deleveraging, if impairment exists, it should be recognised as early as permitted under IFRS.

Disclosures

Covered Institutions should include a comprehensive commentary of the progress which they have made in relation to their non-core asset disposals achieved at the reporting date in comparison to what was required in their EU restructuring plan.

Guidelines

- The current economic circumstances and austerity measures across Europe could be considered a ‘loss event’ in relation to the non-core loan portfolios.
- Covered Institutions should include a comprehensive commentary of the progress which they have made in relation to their non-core asset disposals at the reporting date in comparison to what is required in their E.U. restructuring plan.
3. Disclosures

IFRS 7 requires Covered Institutions to provide disclosures in their annual reports that help users evaluate the nature and extent of the risks arising from the financial instruments to which a Covered Institution is exposed and how they manage these risks.

Additionally, Covered Institutions are required to adhere to the CRD Pillar 3 disclosure requirements which requires disclosures to assist users assess key information about a Covered Institutions risk profile, capital structure and the level of capital. The Pillar 3 requirements have placed an emphasis on European Covered Institutions to improve their disclosures in order to highlight their risk profiles.

The European Banking Authority noted in its September 2011 update in relation to the Pillar 3 disclosures that “further efforts are necessary regarding the interrelationship between IFRS and Pillar 3 disclosures with a view to enable users to gain a better understanding of the overall profile of the bank as provided by both accounting and prudential information”.

The Central Bank expects that over time, the template will be further enhanced to reflect the changing nature of the risks and future IFRS developments.

Whilst it is not intended that the Covered Institutions disclosures should follow the template’s format, the Covered Institutions are expected to provide the granularity of these disclosures within their annual reports.

In developing our disclosure guidelines, the Central Bank has reviewed the Financial Stability Board’s (“FSB”) peer review report of March 2011 entitled “Thematic Review on Risk Disclosure Practices”. The Central Bank expects Covered Institutions to review this report and consider it as guidance to further enhance their risk disclosures.
Guidelines

Numerical disclosures

► Loan origination profiles of the residential mortgage loan portfolios.
► Loan-to-value ratios segregated between private dwelling house (PDH) and buy-to-let in the mortgage loan portfolios.
► Quantitative disclosures of forbearance measures for residential mortgage loan portfolios.
► Impairment charges by individual and collective, by industry or geography.
► The impairment allowance segregated by the same groupings.
► The valuation of underlying collateral for residential mortgages loan portfolios.
► Loans and advances by asset quality.
► Internal grading profile.
► Ageing profile of the past due loans.
► Repossessed collateral.

Narrative disclosures

► Triggers for impairment testing across all portfolios.
► The nature of key management judgements, estimates and assumptions used in determination of impairment.
► The detailed methodologies for calculating impairment charges, including how the loan portfolios are stratified to reflect the differing credit characteristics.
► Disclosure of how the credit risks are managed should be included in the risk management section.
► Policy for write off of loans.
► Policy for reversal of loan portfolio impairments.
► Policy for impairment on reclassification into loans and receivables.
► Forbearance measures employed.
► Policy for debt to equity exchange (if applicable).
► The impairment charge sensitivities of changes to key assumptions.
► A detailed description of the cost of credit risk including disclosures of PDs, EADs and LGDs.
► Description of the calculation of the present value of future cash flows when impairment is measured.
► Detailed non-core portfolio disclosures should be provided as outlined in section 2.2.
3.1.1 Disclosure of forbearance measures

IFRS 7 requires Covered Institutions to disclose information pertaining to the credit quality of their financial assets including assets that are neither past due nor impaired. Should the quantitative disclosures be unrepresentative of a Covered Institution’s risk exposures, the Institution is required to provide additional information which is representative.

The Central Bank considers that the extent and nature of forbearance measures within the Irish banking sector is reflective of the increasing credit risk profiles of the loan portfolios and consistent with the objective of improving the transparency of a Covered Institution’s underlying risks, the Central Bank therefore requires that there should be appropriate disclosures of forbearance measures which will assist users to better understand the Covered Institution’s risks and the associated negative impact on the Institution’s impairment provisioning.

In the FSB’s 2011 paper, “Thematic Review on Risk Disclosure Practices”, it was noted that the emergence of forbearance measures employed by the Institutions “needs to be effectively disclosed”. The Central Bank requires increased disclosures around forbearance measures and their related impact on impairment provisioning.

The table below is an example of one of the new residential forbearance disclosures which will enhance transparency by disclosing the residential volume of loans to which forbearance measures have been applied.

<table>
<thead>
<tr>
<th>31 December 2011</th>
<th>All Loans</th>
<th>Loans &gt; 90 days in arrears and / or impaired</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Balance € million</td>
</tr>
<tr>
<td>Interest only</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduced payment (less than interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduced payment (greater than interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment moratorium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Arrears capitalisation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term extension</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hybrid (term extension and interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Guidelines

► The specific forms of forbearance measures employed should be disclosed.
► A forbearance request is an impairment trigger and should be disclosed as such in the Covered Institution's accounting policies.
► Covered Institutions should disclose the type of forbearance measures applied to both the residential and buy-to-let mortgages loan portfolios.
► Covered Institutions should disclose an assessment of the sustainability of individual forbearance measures.
4. Future developments

The Central Bank will review the outputs of the FMP 2012 and will review any issues raised which may need to be addressed in the context of impairment provisioning frameworks and their related disclosures.

The Central Bank will review the implementation of these guidelines in 2012. Based upon observations from our review and taking into account stakeholder views, the Central Bank may consider publishing an updated paper in 2012.

However, the Central Bank expects the Covered Institutions to apply the guidelines in this paper to all portfolios for the purposes of 2011 annual reports.
5. Detailed impairment provisioning guidelines for credit exposures and disclosures

Part 1 – Qualitative Requirements for the Covered Institutions

This section sets out detailed guidance in relation to the credit risk management policies and procedures that should be adopted by Covered Institutions when considering impairment provisioning.

5.1 Board of Directors and Senior Management

As part of managing the business, the board of directors’ ("the board") responsibilities include:

► Understanding and determining the nature and level of risk in the Covered Institution;
► Setting the Covered Institution’s tolerance for risks;
► Ensuring that there are appropriate processes, systems and reporting lines in place to monitor and manage these risks, this includes ensuring that there are processes and systems to capture credit risk for all aspects of the business conducted by an individual Covered Institution or group;
► Appointing a credit committee;
► Adequately resourcing the credit function with suitably qualified personnel;
► Ensuring that the sophistication of the risk management processes is appropriate in light of the Covered Institution’s risk profile and business plan; and
► Reviewing the adequacy of provisions for impairment losses and amounts written off.

It is the responsibility of the board to ensure that the requirements of the Central Bank with regard to impairment provisions are reflected in either the Covered Institution’s credit policy or a separate impairment provisioning policy. The policy should be reviewed and approved by the board on at least an annual basis to ensure its continued appropriateness.

Senior Management’s responsibility for managing credit risk in the context of impairment provisioning includes, but is not limited to:

► Establishing a policy document for credit risk management processes, to be approved by the board;
► Establishing the methodology for determining impairment provisions;
► Reviewing and approving on a regular basis the processes and systems in place to monitor and manage the quality of the credit portfolio in a timely manner, and the methodology for determining the provisions;
► Ensuring that the credit exposures are appropriately valued, with an appropriate level of provisions for impairment made or uncollectable amounts written off;
► Establishing procedures to ensure that all collateral held by the Covered Institution in addition to available for sale financial assets, are appropriately valued by personnel independent of the credit origination function;
Establishing a programme to periodically monitor and analyse collateral, which should be valued on a conservative basis. This is particularly important for exposures that are relying on the value of collateral in assessing whether an impairment provision is required. For example, for significant commercial real estate loans, Covered Institutions should obtain sound appraisals of the current fair value of the collateral from qualified professionals external to the Covered Institution. Management have the responsibility for reviewing each appraisal’s assumptions and conclusions to ensure timeliness and reasonableness, exercising appropriate judgement to recognise the inherent subjectivity of valuation estimates. Appraisals should take into account, on a discounted basis, the ability of the real estate to generate income over time based on reasonable and supportable assumptions.

Applying increased conservatism in the future cash flows and collateral values estimates used in impairment provision calculations. This should be supported by objective evidence, given current and expected future economic conditions at the reporting date;

Regularly reviewing and revising the key management judgements, assumptions and estimates used in the Institution’s impairment provisioning;

Appropriately disclosing key management judgements, estimates and assumptions;

Disclosing a sensitivity analysis which considers factors such as changes to house price assumptions, GDP and unemployment rates;

Evaluating the sensitivity and reasonableness of the key assumptions used in the impairment provision assessment and measurement system, this may include the performance of stress tests to incorporate economic conditions that may affect credit exposures; and

Providing the Central Bank with regular reports on the adequacy of impairment provisions and amounts written off.

5.2 Written Policy for Impairment Provisioning

The Board will approve a written policy for impairment provisioning, which will address, but not be limited to:

5.2.1 Procedures and Internal Controls

The roles and responsibilities of the Covered Institution’s departments and personnel (including the lending function, credit review, financial reporting, internal audit, senior management, audit committee, and the board) in relation to correctly implementing the policy, determining impairment and measuring provisions.

A description of the procedures and internal controls the Covered Institution employs in determining impairment provisions. This should include, but not be limited to:

- an effective grading system that is consistently applied, identifies differing risk characteristics and quantifies problems accurately and in a timely manner, and prompts appropriate administrative actions;

- sufficient internal controls to ensure that all relevant information is appropriately considered in determining whether impairment has occurred and in estimating the impairment provision;
► clear formal communication and coordination between a Covered Institution’s credit administration function, collection and recovery functions, financial reporting group, management, the board, and others involved in the determination or review of impairment provisions; and

► Covered Institutions will need to implement changes to their management information systems in order to facilitate the gathering of separate loan pools relating to forborne loans.

► A description of the independent credit review process indicating who is responsible for performing the review and how often it takes place.

### 5.2.2 Credit Risk Management

► A description of the methodology for assessing credit risk.

► A description of the credit risk management system. This should include disclosures of policies and procedures regarding:

I. credit risk classification systems (loan grading systems);

II. collateral and guarantees;

III. periodic review of exposures and collateral;

IV. internal credit quality reviews;

V. monitoring overdue credits;

VI. limiting and controlling exposures; and

VII. forbearance measures and the process for granting them;

VIII. where applicable;

   i. reducing exposures through legally enforceable netting arrangements; and

   ii. the use of credit derivatives and credit insurance (including how these instruments affect the Covered Institution’s recognition and measurement of losses).

### 5.2.3 Measuring Impairment

Covered Institutions applying IFRS will document the following information in their written policy:

► A description of the methodology for assessing exposures for objective evidence of impairment, and measuring impairment, on a specific basis. The methods used to identify exposures to be analysed individually should be disclosed.

► A description of the methodology for assessing exposures for objective evidence of impairment, and measuring impairment, on a collective basis. A description of how information on historical loss experience has been gathered by the Covered Institution for different categories of exposures, current conditions, changes in portfolio composition, and trends in delinquencies and recoveries should be disclosed. If using peer group experience, the Covered Institution should explain how this was sourced. The period used in accumulating the historical loss experience should be stated, along with the adjustments that were made to the results due to different conditions, and why these adjustments were necessary. The factors that were considered when establishing appropriate timeframes over which to evaluate loss experience should also be disclosed.
► Each policy should require that a description of the observable data that is used in the determination of impairment triggers and the measurement of the impairment of each portfolio is retained on file.
► The method of segmenting portfolios for collective evaluation should be disclosed, along with the types of exposures in each portfolio.

5.2.4 Actual Loss Review

► How often actual losses in the preceding period are compared to historical experience for each portfolio.
► How often actual losses are compared to the impairment provisions held against such losses.

5.2.5 Collateral Valuation

► When using the fair value of collateral in assessing the recoverable amount of the exposure, the following should be documented:
  I. how the fair value was determined, including the use of appraisals, valuation assumptions, and calculations;
  II. the supporting rationale for adjustments to appraised values, if any;
  III. the determination of costs to sell, if applicable;
  IV. the expertise and independence of the appraiser; and
  V. the assumed timeline to recover.
► When the observable market price is used to assess the recoverable amount of the exposure, the amount, source and date of the observable market price should be documented on file.
► The Covered Institution should ensure that this procedure is consistent across the divisions and its subsidiaries.

5.2.6 Other

► The policy for releasing provisions.
► How often the provisioning policy is reviewed by senior management and approved by the board, and the date of the last approval.
► The existence and effect of concentrations of credit and changes in the level of such concentrations, changes in the operating environment of borrowers and changes in lending policies and procedures including underwriting standards and collection and recovery practices.

5.3 Role of Internal Audit/Credit Review Function

The Covered Institution should ensure that an internal independent function reviews the credit risk processes and the methodology for determining the level of provisions in order to confirm their effectiveness. This function may be performed by either a department of the Covered Institution itself, or, in the case of subsidiaries, a department of the parent Covered Institution. This role may be performed by the Internal Audit or Risk Management Functions.
This review should be performed at least every two years and should include at a minimum, a review of the following:

▶ the appropriateness of the credit risk assessment processes given the nature, scope and complexity of the Covered Institution’s operations;
▶ the reasonableness, accuracy and completeness of data inputs and parameters into the assessment processes;
▶ the reasonableness of the collective assessment methodology/IBNR assessment methodology;
▶ the adequacy of
  I. Impairment provisions (with particular emphasis on the adequacy of impairment provisions for exposures which have received forbearance measures);
  II. Stress tests; and
  III. Supporting documentation.

The outputs of this review should be appropriately documented and reported to senior management and the board. Any areas of weakness identified should to be addressed on a timely basis.

5.4 Frequency of Review

The Board should review the impairment provisioning policy at least on an annual basis to ensure that it is still appropriate for the business the Covered Institution undertakes and the economic environment in which it operates. In doing so, it should review and sign off on the processes and systems for credit risk, and the methodology used in determining the level of impairment provisions. In certain circumstances the Central Bank would expect the board to review the impairment provisioning policy more frequently than once a year e.g. where a event occurs that is likely to materially affect a sector to which the Covered Institution engages in lending activity.

5.5 Disclosures

The Central Bank requires Covered Institutions to provide the following asset quality and credit risk management disclosures in their financial statements to enhance users’ understanding of Covered Institutions’ loan portfolios asset quality profile and credit risk management practices:

Numerical disclosures:

▶ Loan origination profiles of the residential mortgage loan portfolios.
▶ Loan-to-value ratios segregated between private dwelling house (PDH) and buy-to-let in the mortgage loan portfolios.
▶ Quantitative disclosures of forbearance measures for residential mortgage loan portfolios.
▶ Impairment charges by individual and collective, by industry or geography.
▶ The impairment allowance segregated by the same groupings.
▶ The valuation of underlying collateral for residential mortgages loan portfolios.
▶ Loans and advances by asset quality.
▶ Internal grading profile.
Ageing profile of the past due loans.
Repossessed collateral.
The estimated range of future expected losses on disposal in relation to assets being sold under the Covered Institutions deleveraging plan.

Narrative disclosures:
Triggers for impairment testing across all portfolios.
The nature of key management judgements, estimates and assumptions used in the determination of impairment.
The detailed methodologies for calculating impairment charges, including how the loan portfolios are stratified to reflect the differing credit characteristics.
Disclosure of how the credit risks are managed should be included in the risk management section.
Policy for write off of loans.
Policy for reversal of loan portfolio impairments.
Policy for impairment on reclassification into loans and receivables.
Forbearance measures employed.
Policy for debt to equity exchange (if applicable).
The impairment charge sensitivities of changes to key assumptions.
A detailed description of the cost of credit risk including disclosures of PDs, EADs and LGDs.
Description of the calculation of the present value of future cash flows when impairment is measured.

5.6 Recognition and disclosure of impairments and losses associated with the non-core portfolios which are required to be sold.

Certain Covered Institutions are required to “deleverage” their balance sheets. This has resulted in the sub-division of the balance sheet assets on a core and non-core basis, with the latter cohort representing the assets to be deleveraged. The Central Bank requires the following guidelines to be followed by Covered Institutions:

IAS 39 indicates that national or local economic conditions that correlate with default on particular groups of assets are considered to provide objective evidence that impairment may exist.

In relation to impairment provisioning, the Central Bank believes that the asset quality of some non core asset portfolios of Covered Institutions could be negatively impacted by the tighter credit conditions interacting with the weakening economic activity across Europe. The Covered Institutions should be cognisant of the deterioration in the forward looking indicators of credit risk across Europe coupled with the significant number of corporate ratings downgrades.

Covered Institutions should include a comprehensive commentary of the progress which they have made in relation to their non-core asset disposals at the reporting date in comparison to what is required in their E.U. restructuring plan.
Part 2 – Impairment provisioning methodology

5.7 Objective Evidence of Impairment

For the purpose of this paper and in accordance with IAS 39 an exposure is considered to be impaired when “there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a ‘loss’ event) and the loss event (or events) has an impact on the estimated future cash flows.” Impairment occurs if the estimated recoverable amount of an exposure is lower than its relevant carrying amount.

All exposures should be assessed for impairment by the Covered Institution either individually or collectively. If there is objective evidence of impairment either individually or collectively, the exposure or group of exposures should be measured for an impairment provision.

If a Covered Institution determines that no objective evidence of impairment exists for an individually assessed exposure, that exposure should be included in a group of exposures with similar credit risk characteristics that are collectively assessed for impairment.  

5.7.1 Loss Events

A Covered Institution should assess all credit exposures for objective evidence of impairment based on current information and events at the date of assessment. Such loss events should be considered on a portfolio by portfolio basis, and objective evidence of such might 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.

Mortgage portfolio triggers (examples only)
- A loan asset that is 90 days in arrears.
- A request for a forbearance measure from the borrower.
- A deterioration in the debt service capacity.
- A material decrease in rents received on a buy-to-let property.

Commercial Real Estate (“CRE”) portfolio triggers (examples only)
- A request for a forbearance measure from the borrower.
- A material decrease in the property value.
- A material decrease in estimated future cash flows.
- The lack of an active market for the assets concerned.
- The absence of a market for refinancing options.
- A significant decline in the Institution’s credit rating of the borrower.

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7 Per paragraph 59 of IAS 39.
8 Paragraph 64 of IAS 39.
Small Medium Enterprises (‘‘SME’’) portfolio triggers (examples only)

- A request for a forbearance measure from the borrower.
- Trading losses.
- Diversion of cash flows from earning assets to support non-earning assets.
- A material decrease in turnover or the loss of a major customer.
- A default or breach of contract.
- A significant decline in the Institution’s credit rating of the borrower.

The following factors should also be taken into consideration:

- Debt service capacity;
- Financial performance;
- Net worth and future prospects;
- The prospects for support from any financially responsible guarantors;
- The nature and degree of protection provided by the current and stabilised cash flow and value of any underlying collateral; and
- Country risk.

Covered Institutions should regularly review their impairment triggers for each loan asset portfolio in order to test for impairment as early as possible within IFRS.

Exposures that are not in breach of contract should nonetheless be reviewed for impairment regularly. For example, a loan for which significant repayment occurs only at maturity may be impaired prior to maturity, when the counterparty’s financial condition has deteriorated significantly so that full repayment is not expected.

If a Covered Institution has advanced multiple loans to a borrower, some of which are performing according to the contract, and others which are in default, all exposures to this borrower should be assessed for objective evidence of impairment.

5.7.2 Occurrence of Impairment

If any such objective evidence of impairment exists the Covered Institution should estimate the recoverable amount of the exposure or group of exposures. Impairment occurs if the estimated recoverable amount of an exposure is lower than its relevant carrying amount. It must be possible to reliably measure the impact on the estimated future cash flows. An impairment provision should be created to decrease the carrying amount to the recoverable amount in the case of exposures.

5.7.3 Forbearance Measures

Forbearance measures occur where a Covered Institution, for reasons relating to the actual or apparent financial stress of a borrower, grants a concession whether temporarily or permanently to that borrower. A concession may involve restructuring the contractual terms of a debt or payment in some form other than cash, such as an equity interest in the borrower. If the decision to make a concession is not related to the actual or apparent financial distress of the borrower, forbearance has not occurred.

Covered Institutions should consider a request by a borrower for a forbearance measure to be an impairment trigger.
5.8 Methodology for Assessing Impairment

5.8.1 Individually Significant and Non-Significant Exposures

Exposures should be assessed for objective evidence, measurement, and recognition of impairment on an individual basis for individually significant exposures. Where a Covered Institution has a number of individually significant exposures to one counterparty each loan should be individually assessed while also considering the overall position of the counterparty. Exposures that are not individually significant may be assessed for impairment either on an individual or a group basis.

5.8.2 Individual Assessment

An impairment assessment should be performed for exposures for which there is objective evidence of impairment, as follows:

- Individually significant exposures; and
- Exposures that are not individually significant.\(^9\)

Exposures that are individually assessed for impairment and for which an impairment provision has been recognised are not included in a collective assessment of impairment.\(^10\) If a Covered Institution determines that no objective evidence of impairment exists for an individually assessed exposure, whether significant or not, it includes this in a group of exposures with similar credit risk characteristics that are collectively assessed for impairment.\(^11\) These groups should be determined based on the criteria outlined below.

Collective Assessment – Portfolio Provision

A collective assessment should be performed for exposures as follows:

- Exposures that have been individually assessed and were found not to be impaired on an individual basis; and
- Exposures that have not been individually assessed.

Portfolio impairment provisions are recognised for incurred losses not specifically identified but which experience in addition to observable data indicates are present in the portfolio of exposures at the date of collective assessment, i.e. incurred but not reported.

IBNR

Covered Institutions should segregate their performing loan books into different loan pools, differentiated between forborne and non-forborne pools. Forborne loan pools should be segregated further by the type of forbearance measures applied (such information being required for disclosures relating to the successfulness of the measures).

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\(^9\) Exposures that are not Individually Significant may be assessed on an individual or a group basis.

\(^10\) This requirement of IAS 39 is outlined in paragraph IN 21, IAS 39.

\(^11\) Paragraph IN 21, IAS 39 states “an asset that has been individually assessed for impairment and found not to be individually impaired should be included in a collective assessment of impairment”.
The Central Bank believes that as a result of the concessions provided to borrowers, it may take a longer period of time for defaults to emerge on forborne loan pools. Therefore, the IBNR calculations in relation to the forborne loan pools should include a longer emergence period and a higher probability of default than those expected for the loan pools which have not been subjected to forbearance measures.

The Central Bank believes that the probability of default applied to forborne loan pools will differ to the non-forborne pools and that a history of such forborne loan pools probability of default should be recorded and disclosed over time.

**Credit Risk Characteristics**

Exposures should be grouped on the basis of similar credit risk characteristics that are indicative of the counterparty’s ability to repay according to the contractual terms. If a Covered Institution does not have a group of assets with similar risk characteristics, this assessment is not performed.

The following characteristics should be taken into consideration when grouping exposures:

- Asset type;
- Industry;
- Geographical location;
- Collateral type;
- Past-due status;
- Forbearance measures applied;
- Other Relevant Factors; and
- Concentration of counterparties or otherwise exposure to a group of related entities.

**5.8.3 Forbearance Measures**

The following guidelines are required to be followed by Covered Institutions when considering the impact of forbearance measures on the methodology for assessing impairment:

- Loan pools which are subject to forbearance measures should be separated from the remaining non-forborne loan pools;
- Non-forborne loan pools may need to be further stratified based on similar risk characteristics;
- When calculating the collective impairment provisions, particularly for mortgage portfolios, certain model inputs which are based on historic data may require management judgement to be applied to adjust historic data to reflect current economic circumstances and the granting of forbearance measures;
- For example, where a borrower is up to date with their revised terms, having previously received forbearance measures, the historic roll rates to default may appear lower than the underlying risk profile of the loan pool;
- The LGD could be higher on forborne loan pools than those applied to the non-forborne loan pools; and
The PD applied to forborne loan pools will be higher than the non-forborne pools. The Central Bank also requires the history of PDs relating to such forborne loan pools to be recorded and disclosed in the annual report over time.
5.8.4 Other Factors

Exposures that have been assessed and are impaired on a group basis should be monitored for the occurrence of objective evidence of impairment on an individual basis. As soon as information is available that specifically identifies losses on individually impaired exposures in a group, those exposures are removed from the group\(^\text{12}\).

The probability of default in the performing loan portfolios will increase (as forborne borrowers are more likely to re-default/ default) and the loss given default will increase in both performing and non-performing loan portfolios.

5.8.5 Frequency

The Central Bank expects that Covered Institutions to monitor their portfolios on an ongoing basis, and the level of impairment should be formally assessed and measured on at least an annual basis.

However, if any new information comes to light in the period between impairment measurements, this should be used to update the impairment provision for that exposure or group of exposures, at least on a quarterly basis.

5.8.6 Supporting Documentation

Covered Institutions should maintain supporting documentation on each individual exposure or group of exposures, 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 become available; and

- If there is objective evidence of impairment, the Covered Institution should document the type of objective evidence existing. If no objective evidence of impairment exists, the Covered Institution should document the steps taken in arriving at this conclusion.

5.9 Impairment Provision Calculation

The amount of the impairment provision should be calculated by reducing the carrying amount of an exposure to the estimated recoverable amount. The estimated recoverable amount is determined as follows:

\(^{12}\) Per AG 88, IAS 39.
5.9.1 Specific Assessment

The estimated recoverable amount and thus the amount of the provision required should be calculated using three different methods:

- The estimated recoverable amount is equal to the present value of the estimated future cash flows\(^{13}\), discounted at the exposure’s original effective interest rate\(^{14}\);
- The estimated recoverable amount may be measured on the basis of an exposure’s fair value using an observable market price (e.g. on secondary markets); and
- The estimation of the recoverable amount of a collateralised exposure reflects the cash flows that may result from foreclosure whether or not foreclosure is considered the likely course of action. The time, costs and difficulties involved in obtaining repayment through collateral or guarantees should be taken into account when determining the recoverable amount.

The Central Bank considers the discounted cash flow method to be the principal method to be used in the calculation of impairment provisions for exposures carried at amortised cost.

5.9.2 Collective Assessment – Portfolio Provision

The future cash flows of a group of exposures that are collectively evaluated for impairment are calculated on the basis of the estimated contractual cash flows\(^ {15}\) of the exposures in the group and historical loss experience for exposures with credit risk characteristics similar to those in the group. Covered Institutions may develop an emergence period for each portfolio or group of exposures that is utilised in calculating a portfolio provision. An emergence period is the period of time between a loss event occurring and objective evidence of the event coming to the attention of a Covered Institution.

Factors to take into consideration when determining the historical loss experience are:

- Analysis of impairment;
- Ageing of balances;
- Past loss experience;
- Current economic conditions; and
- Other relevant circumstances.

Covered Institutions that do not have the necessary historical loss experience for evaluating impairment shall use peer group experience\(^ {16}\) (for example, sourced from peer group information published by rating agencies) for a portfolio that is representative of the Covered Institution’s own portfolio.

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\(^{13}\) Changes in the amount and timing of estimated cash flows may have a significant impact on the overall impairment provision, and consequently the assumptions used by a bank with respect to the timing of the cash flows must be prudent and supportable.

\(^{14}\) The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the exposure to the net carrying amount of the asset, per IAS 39. If an exposure has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate(s) determined under the contract, per AG 84, IAS 39.

\(^{15}\) In determining the effective interest rate for a group of exposures that are collectively evaluated for impairment, the estimated stream of cash receipts rather than the contractual stream of cash receipts should be tested.

\(^{16}\) Per AG 89, IAS 39.
Historical loss experience should be adjusted to reflect the effects of current economic conditions that did not affect the period that the historical loss experience covers, and historical conditions that do not currently exist. Current factors to be considered that are likely to cause losses associated with the Covered Institution’s portfolio to differ from historical experience, include, but are not limited to:

► Changes in lending policies and procedures, including underwriting standards and collection, the extension of forbearance measures, write-offs, and recovery practices;
► Changes in international, national and local economic and business conditions and developments, including the condition of various market segments;
► Changes in the trend, volume and severity of past due and adversely classified exposures, as well as trends in the volume of impaired exposures and restructurings;
► The existence and effect of any concentrations of credit, and changes in the level of such concentrations;
► The effect of external factors such as competition, legal and regulatory requirements on the level of estimated credit losses in the Covered Institution’s current portfolio; and
► Changes in the risk profile of the portfolio as a whole.

The Central Bank believes it is also necessary to ensure that other estimates and inputs included in collective impairment provisioning reflect an appropriate level of conservatism. For example:

► Conservative peak to trough house price assumptions should be used in relation to mortgage portfolios.
► PDs should also be reflective of the credit characteristics of each appropriately stratified loan pool.

When senior management adjusts impairment provisions for these factors, there should be documentation that clearly demonstrates the estimated impact of changes in the factors on the historical loss experience.

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

5.9.3 Off-Balance Sheet Transactions

Impairment of exposures should be made after the initial recognition of the asset. Additional disclosure of contingent liabilities under the terms of IAS 37 Provisions, Contingent Liabilities and Contingent Assets is not proposed in this paper and will continue to be reported for capital adequacy purposes in the Common Reporting Framework (“COREP”) templates.
5.9.4 Forborne Exposures

Restructured exposures after receiving forbearance measures should be reviewed by internal audit/the credit review function on a regular basis to evaluate the need for impairment provisions where none are created and to assess the adequacy of impairment provisions that have been created for restructured exposures.

5.9.5 Other Matters

Review of Impairment Provisions

The Covered Institution should regularly compare assumptions and parameters used to create the portfolio provision against experience. This should involve testing or verifying on an annual basis:

- Comparison of actual losses to provision held for major categories of exposures;
- Analysis of recent experience that considers recent economic conditions; and
- Consistent review over portfolios and time. When new methods are introduced, the rationale should be documented and results on both the new and old methodology compiled over one year.

Stress testing of the exposures (particularly loans) should be performed at regular intervals. These tests should incorporate both normal and extreme conditions, and immediate and long-term horizons. The results of the stress tests should be appropriately documented and reported to senior management, and appropriate action taken if results exceed agreed tolerances.

Credit Concentration Risk

As part of the measurement of portfolio provisions, Covered Institutions should be cognisant of credit concentration risk. Credit risk concentrations are based on similar or positively correlated risk factors, which, in times of stress, have an adverse effect on the creditworthiness of each of the individual counterparties making up the concentration. Such concentrations include, but are not limited to:

- Significant exposures to an individual counterparty or group of related counterparties;
- Credit exposures to counterparties in the same economic sector or geographic region;
- Credit exposures to counterparties whose financial performance is dependent on the same activity or commodity; and
- Indirect credit exposures arising from a Covered Institution’s credit risk mitigation techniques (e.g. exposure to a single collateral type or to credit protection provided by a single entity).

A Covered Institution should have in place effective internal policies, systems and controls to identify, measure, monitor, and control their credit risk concentrations. The internal policies, systems and controls should be clearly documented and should include a definition of the credit risk concentrations relevant to the Covered Institution and how they and their corresponding limits are calculated. A Covered Institution’s management should conduct periodic stress tests of its major credit risk concentrations and review against expectations.
The Central Bank will carry out a review of sectoral requirements and this work will also consider other regulatory developments in this area currently taking place.

Supporting Documentation

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;
- When using the observable market price method:
  - the amount, source, and date of the observable market price;
- When using the fair value of collateral method:
  - how fair value was determined;
  - the supporting rationale for adjustments to appraised values, and the amount of the adjustments;
  - the determination of expected costs to sell; and
  - appraisal quality, and the expertise and independence of the appraiser;
- for collectively evaluated 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 Institutions estimates have an economic relationship to, and are representative of, impairment of a group of exposures.
- Details of the type of forbearance measures applied to exposures
5.9.6 Restoration of Exposure to Unimpaired Status

An impaired exposure should only be restored to unimpaired status when the contractual amount of principal and interest is deemed to be fully collectible in accordance with the terms of the agreement. Objective evidence must exist subsequent to the initial recognition of the impairment to justify restoration to unimpaired status. Typically, this should take place when:

► The Covered Institution has received repayment of the loan's past due principal and interest, none of the principal and interest is due and unpaid, and the Covered Institution expects repayment of the remaining contractual principal and interest as scheduled in the agreement;
► The counterparty has resumed paying the full amount of the scheduled contractual principal and interest payments for a reasonable period and all remaining contractual payments (including full compensation for overdue payments) are deemed to be collectible in a timely manner; or
► The exposure becomes well secured and is in the process of collection.

A Covered Institution's determination of the ultimate collectability of an exposure should be supported by a current, well documented credit evaluation of the counterparty's financial condition and other factors affecting the prospects for repayment, including consideration of the counterparty's repayment performance and other relevant factors.

5.9.7 Quarterly Impairment Return

Covered Institutions should ensure that the Central Bank quarterly impairment return is completed accurately.

5.9.8 Capital Adequacy Treatment

IAS 39 requires an ‘incurred loss’ approach to impairment provisioning. However, the Capital Requirements Directive is based on expected and unexpected losses. The CRD has set out requirements to ensure that expected losses, which are not covered by capital under the Internal Ratings Based Approach or impairment provisions, are captured. Therefore any shortfall or surplus of expected losses over impairment provisions are dealt with for capital adequacy purposes in accordance with the Capital Requirements Directive.
Appendices
## Appendix 1 – Illustrative Disclosure Template

The Central Bank of Ireland

To be applied by the Irish Covered Institutions in their 2011 annual reports

The template attached here is a representative template. The Central Bank recognises that individual Covered Institutions may prefer to present the disclosures in their own format. We also recognise that the Covered institutions may tailor this template to relate to the specific portfolios held by them. The Covered Institutions, where possible, should provide comparative information. If this cannot be provided in 2011, it is expected that it will be provided in 2012. We accept that there may be some challenges around the auditability of these disclosures during the transition period. Any unaudited information should be disclosed as such by the Covered Institutions.

### New disclosures and enhanced existing disclosures

<table>
<thead>
<tr>
<th>Disclosures in 2011</th>
<th>New</th>
<th>Enhanced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting policy for forbearance measures</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Impairment charge sensitivity to critical accounting estimates</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Impairment allowance split by product</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Quantitative disclosures on forbearance measures (ROI only)</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>LTV ratios of mortgage lending</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Loan origination profiles of residential mortgage loan portfolio</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Accounting policy for debt for equity exchange</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Detailed disclosure on the Institutions’ non-core portfolios</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Impairment charge (split by individual and collective)</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Impairment charge (split by PDH and buy to let)</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Triggers for impairment testing across all portfolios</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Detailed methodologies for calculating impairment charges</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>The internal grading profile</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Disclosure of how credit risk is managed</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Policy for write off of loans</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Policy for reversal of loan portfolio impairments</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>The nature of key management judgements, estimates and assumptions used in the determination of impairment</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Disclosure of the cost of credit risk including disclosures of PDs, EADs and LGDs</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Disclosure of the cost of calculation of the present value of future cash flows when impairment is measured</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Repossessed collateral</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>
Impairment Disclosure Template:

Bank plc (‘Bank’)

Illustrative extract of financial statements for the year ended 31 December 2011

Based on International Financial Reporting Standards in issue at 31 December 2011
INCOME STATEMENT (extract)
For the year ended 31 December 2011

<table>
<thead>
<tr>
<th>Note</th>
<th>2011 € million</th>
<th>2010 € million</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impairment losses on financial investments</td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

BALANCE SHEET (extract)
For the year ended 31 December 2011

<table>
<thead>
<tr>
<th>Note</th>
<th>2011 € million</th>
<th>2010 € million</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans and receivables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans and advances to customers</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>
NOTES TO THE FINANCIAL STATEMENTS (extract)

1. Accounting policies (extract)
   a. Impairment of loans and advances

   A financial asset is considered to be impaired, and therefore its carrying amount is adjusted to reflect the effect of impairment, when there is objective evidence that events have occurred which give rise to an adverse impact on the cash flows that were estimated at the transaction date. Impairment provisions are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of impairment provision accounts. Losses expected from future events are not recognised.

   Individually assessed loans and advances

   For all loans that are considered individually significant, Bank assesses on a case-by-case basis at each balance sheet date if there is any objective evidence that a loan is impaired. All loans 90 days or more in arrears are classified as impaired, unless the value of the supporting collateral is sufficient to repay the outstanding balance. Further examples of trigger events, that may lead to the initial recognition of impairment provision include:

   Macroeconomic triggers
   - National or local economic conditions that indicate a measurable 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.

   Mortgage portfolio triggers (examples only)
   - A loan asset that is 90 days in arrears.
   - A request for a forbearance measure from the borrower.
   - A deterioration in the debt service capacity.
   - A material decrease in rents received on a buy-to-let property.

   Commercial Real Estate (“CRE”) portfolio triggers (examples only)
   - A request for a forbearance measure from the borrower.
   - A material decrease in the property value.
   - A material decrease in estimated future cash flows.
   - The lack of an active market for the assets concerned.
   - The absence of a market for refinancing options.
   - A significant decline in the Institution’s credit rating of the borrower.

   Small Medium Enterprises (“SME”) portfolio triggers (examples only)
   - A request for a forbearance measure from the borrower.
   - Trading losses.
   - Diversion of cash flows from earning assets to support non-earning assets.
   - A material decrease in turnover or the loss of a major customer.
   - A default or breach of contract.
   - A significant decline in the credit institution’s credit rating of the borrower.

   For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

   - Bank’s aggregate exposure to the customer;
   - Viability of the customer’s business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
   - The amount and timing of expected receipts and recoveries;
   - Likely dividend available on liquidation or bankruptcy;
   - The extent of other creditors’ commitments ranking ahead of, or pari passu with, Bank and the likelihood of other creditors continuing to support the company;
   - The complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
   - The realisable value of security (or other credit mitigants) and likelihood of successful repossession;
   - The likely deduction of any costs involved in recovery of amounts outstanding; and
   - The ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency.
Impairment provisions are calculated by discounting the expected future cash flows of a loan at its original effective interest rate and comparing the resultant present value with the loan's current carrying amount. The impairment provisions on individually significant accounts are reviewed at least quarterly and more regularly when circumstances require. Refer note 4 in the Risk management section for key principles applied in respect of property collateral held by the Bank.

Collectively assessed loans and advances

Impairment is assessed on a collective basis in the following circumstances:

- to estimate losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- to estimate losses for homogeneous groups of loans that are considered individually insignificant.

**Incurred but not yet identified impairment**

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics (exposure to an industry or geographical location) for the purpose of calculating an estimated collective loss. This reflects impairment losses that Bank has incurred as a result of events occurring before the balance sheet date, which Bank is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

The collective impairment provision is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector,
- loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate provision against the individual loan; and
- management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

The period between a loss event occurring and its identification is estimated by local management for each identified portfolio.

**Homogeneous groups of loans and advances**

The bank should describe how they stratify the overall portfolio included for collective assessment into pools that reflect similar risk characteristics. In particular, describe how the bank separates out from the overall portfolio, the pool in which forbearance measures have been applied. Other metrics that are representative of the pool should take into account significantly different LTVs, debt on other account, or external bureau scores.

Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant, because individual loan assessment is impracticable.

Losses in these groups of loans are recorded on an individual basis when individual loans are written off, at which point they are removed from the group. Two alternative methods are used to calculate provisions on a collective basis: (When describing models or methods used to calculate provisions, use separate comments about how models are calibrated to take account of forbearance activities.)

- When appropriate empirical information is available, Bank utilises roll rate methodology. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date which Bank is not able to identify on an individual loan basis, and that can be reliably estimated. Under this methodology, loans are grouped into ranges according to the number of days past due and statistical analysis is used to estimate the likelihood that loans in each range will progress through the various stages of delinquency, and ultimately prove irrecoverable. Current economic conditions are also evaluated when calculating the appropriate level of provision required covering inherent loss. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.
- When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, Bank adopts a formulaic approach.
- Additional risk factors may be identified as part of this process. These risk factors, where relevant, are taken into account when calculating the appropriate level of impairment provisions by adjusting the impairment provisions derived solely from historical loss experience. Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Write-off of loans and advances

Loans (and the related impairment provisions) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment provision account accordingly. The write-back is recognised in the income statement.

Reclassified loans and advances (if applicable)

Where financial assets have been reclassified out of the fair value through profit or loss category to the loans and receivables category, the effective interest rate determined at the date of reclassification is used to calculate any impairment losses. Following reclassification, where there is a subsequent increase in the estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the effective interest rate from the date of change in the estimate rather than as an adjustment to the carrying amount of the asset at the date of change in the estimate.

Forbearance measures

Forbearance based on sound conduct principles provides for sound prudential management. Forbearance provided should be based on an individual assessment of the customer.

In considering the forbearance measures employed, refer to note 6 in the risk management section of this document.

The forbearances measures disclosed by the Covered Institution should include measures employed for loans that are forborne due to financial stress.

Mortgages

The Covered Institution should provide details on what type of forbearance is being applied in both the PDH and Buy to Let categories. There should also be disclosed an assessment of the sustainability of individual forbearance measures.
CRE and SME

The Covered Institution should provide details on what type of forbearance is being applied in both the CRE and SME categories. There should also be disclosed an assessment of the sustainability of individual forbearance measures.

Debt for equity exchange (if material)

Securities acquired in exchange for loans in order to achieve an orderly realisation are accounted for as a disposal of the loan and an acquisition of equity securities. Where control is obtained over an entity as a result of the transaction, the entity is consolidated; where the Bank has significant influence over an entity as a result of the transaction, the investment is accounted for by the equity method of accounting. Any subsequent impairment of the assets or business acquired is treated as an impairment of the relevant asset or business and not as an impairment of the original instrument.

b. Significant accounting judgments, estimates and assumptions

Impairment losses on loans and advances

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment provisions on both individually and collectively assessed loans and advances.

The most significant judgemental area is the calculation of collective impairment provisions. They are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis because of the large number of individually insignificant loans in the portfolio.

The methods involve the use of statistically assessed historical information which is supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience. In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio, though sometimes it provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, when there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models. In these circumstances, the risk factors are taken into account by adjusting the impairment provisions derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

However, the exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas.

Given the relative size of the mortgage portfolio, the key variables include house price which determine the collateral value supporting loans in such portfolios and rates by which defaulted or delinquent accounts are assumed to return to performing status (‘cure rate’). A 2% favourable change in the cure rate will reduce the impairment charge by approximately €20 million. The value of collateral is estimated by applying changes in house price indices to the original assessed value of the property. If average house prices were 10 per cent lower than those estimated at 31 December 2010, the impairment charge would increase by approximately €195 million.

The foreclosure costs and period influence the value of the collateral. A 5% increase in foreclosure costs and an increase in one month in the foreclosure period will result in increasing the impairment charge by €189 million.

A collective unimpaired provision is made for impairments that have been incurred but have not been separately identified at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Wholesale division, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unimpaired provisions would result in an increase in the collective unimpaired provision of approximately £33 million.
c. Non-Core portfolios (*we would expect a significant qualitative disclosure*)

The Non-Core Division within the bank separately manages assets that the bank intends to exit from by 2013. The division contains a range of businesses and asset portfolios, higher risk profile asset portfolios (including excess risk concentrations) and other illiquid portfolios. It also includes a number of portfolios and businesses that the Bank has concluded are no longer part of its core strategy.

2. Loans and advances to customers

<table>
<thead>
<tr>
<th>Loans and advances to customers</th>
<th>2011€ million</th>
<th>2010€ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural, forestry and fishing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Energy and water supply</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgages</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Personal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property companies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial, business and other services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total loans and advances to customers before provision for impairment losses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impairment provision</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net loans and advances to customers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Core</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Core</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. Impairment losses on loans and advances

<table>
<thead>
<tr>
<th>Impairment losses on loans and advances</th>
<th>2011€ million</th>
<th>2010€ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non Core</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Impairment losses</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Split of impairment charge by nature of impairment provision is set out below:

<table>
<thead>
<tr>
<th>Impairment Charge by nature of impairment provision</th>
<th>2011€ million</th>
<th>2010€ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collective</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IBNR</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Impairment losses</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Impairment charge on loans and advances to customers by division | 2011 | 2010  
--- | --- | ---  
Retail | € million | € million  
Wholesale | |  
Wealth and International | |  
**Total impairment charge** | |  
Retail division | 2011 | 2010  
Owner Occupier | |  
Ireland | |  
United Kingdom | |  
Buy-to-let | |  
Ireland | |  
United Kingdom | |  
Other | |  
**Total impairment charge** | |  
Retail’s impairment charge decreased by €1,480 million to €2,747 million in 2010 compared with 2009 and was lower in both secured and unsecured portfolios. This improvement was driven primarily by the improved quality of new business and effective portfolio management, coupled with the continuing slow recovery of the economy. Across Retail in 2010, there were fewer cases going into arrears. The impairment provision on loans and advances to customers, as an annualised percentage of average loans and advances to customers, decreased to 0.74 per cent from 1.11 per cent in 2009.  

Wholesale division | 2011 | 2010  
Corporate Markets | |  
Asset finance | |  
**Total impairment charge** | |  
Wholesale’s impairment charge decreased by €6,237 million, or 62 per cent, compared to €10,683 million for 2009. Impairment charges as an annualised percentage of average loans and advances to customers reduced to 2.08 per cent from 5.92 per cent in 2009. Together with the stabilising UK environment in 2010, a low interest rate environment helping to maintain defaults at a lower level and a number of write backs due to asset disposals, impairment charges have decreased substantially compared with 2009.  

Wealth and International division | 2011 | 2010  
UK | |  
Ireland | |  
**Total impairment charge** | |  
Wealth and International’s impairment charge increased by €2,661 million to €3,534 million in 2010 compared with 2009. Impairment charges as a percentage of average loans and advances to customers increased to 8.90 per cent from 6.04 per cent in 2009.  

Total Impairment charge on loans and advances to customers by geographical location | 2011 | 2010  
Republic of Ireland | |  
United Kingdom | |  
United States | |  
**Total impairment charge** | |  

### Impairment Provision for Loans and Advances to Customers

A reconciliation of the provision for impairment losses for loans and advances is as follows (table for 2009 not reproduced):

<table>
<thead>
<tr>
<th></th>
<th>Residential Mortgages</th>
<th>Other Personal</th>
<th>Property &amp; Construction</th>
<th>SME &amp; Other Commercial</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>At 1 January 2011</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Charge for the year (Note 2)</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Unwinding of discount</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Recoveries</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Amounts written off</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Interest accrued on impaired loans and advances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>At 31 December 2011</strong></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Residential Mortgages</th>
<th>Other Personal</th>
<th>Property &amp; Construction</th>
<th>SME &amp; Other Commercial</th>
<th>Corporate</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Core</strong></td>
<td></td>
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<tr>
<td><strong>At 1 January 2011</strong></td>
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<tr>
<td>Charge for the year (Note 2)</td>
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<tr>
<td>Unwinding of discount</td>
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<tr>
<td>Recoveries</td>
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<tr>
<td>Amounts written off</td>
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<tr>
<td>Interest accrued on impaired loans and advances</td>
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<tr>
<td><strong>At 31 December 2011</strong></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Residential Mortgages</th>
<th>Other Personal</th>
<th>Property &amp; Construction</th>
<th>SME &amp; Other Commercial</th>
<th>Corporate</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non Core</strong></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td><strong>At 1 January 2011</strong></td>
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<tr>
<td>Charge for the year (Note 2)</td>
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<tr>
<td>Unwinding of discount</td>
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<tr>
<td>Recoveries</td>
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<td>Amounts written off</td>
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<tr>
<td>Interest accrued on impaired loans and advances</td>
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<tr>
<td><strong>At 31 December 2011</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Impaired loans for which provisions are held are further split in the table below:

<table>
<thead>
<tr>
<th>Total</th>
<th>Loans &amp; Advances</th>
<th>Impaired Loans</th>
<th>Impaired Loans as % Total Loans</th>
<th>Provision Individually Assessed</th>
<th>Provision Collectively Assessed</th>
<th>Total Impairment Provision</th>
<th>Provision as % Impaired Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wealth &amp; International</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total gross lending</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impairment Provision</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>At 31 December 2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

A further Divisional split of Secured and Unsecured Lending in Retail Division is as follows (by bank product line):

<table>
<thead>
<tr>
<th>Retail Division</th>
<th>Loans &amp; Advances</th>
<th>Impaired Loans</th>
<th>Impaired Loans as % Total Loans</th>
<th>Provision Individually Assessed</th>
<th>Provision Collectively Assessed</th>
<th>Total Impairment Provision</th>
<th>Provision as % Impaired Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Occupier</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buy to let</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Cards</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal Loans</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Including joint ventures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unsecured</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total gross lending</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impairment Provision</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>At 31 December 2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wealth &amp; International Division</td>
<td>Loans &amp; Advances</td>
<td>Impaired Loans</td>
<td>Impaired Loans as % Total Loans</td>
<td>Provision Individually Assessed</td>
<td>Provision Collectively Assessed</td>
<td>Total Impairment Provision</td>
<td>Provision as % Impaired Loans</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-----------------</td>
<td>---------------</td>
<td>---------------------------------</td>
<td>---------------------------------</td>
<td>---------------------------------</td>
<td>-----------------------------</td>
<td>------------------------------</td>
</tr>
<tr>
<td>UK Ireland</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total gross lending Impairment Provision At 31 December 2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale Division</td>
<td>Loans &amp; Advances</td>
<td>Impaired Loans</td>
<td>Impaired Loans as % Total Loans</td>
<td>Provision Individually Assessed</td>
<td>Provision Collectively Assessed</td>
<td>Total Impairment Provision</td>
<td>Provision as % Impaired Loans</td>
</tr>
<tr>
<td>Corporate Markets: Corporate Commercial Wholesale equity Wholesale markets Total Corporate Markets Treasury and Trading Asset finance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total gross lending Impairment Provision At 31 December 2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
RISK MANAGEMENT (extract)

Commentary: The risk management disclosures in this section are focused only on impairment provisioning and related disclosures with respect to loans and receivables and available-for-sale investments. Accordingly, other credit risk disclosures not included in this extract are set out below:

- Overview of credit risk exposures.
- Credit risk organisation and structure.
- Techniques to mitigate credit risk.
- Concentrations of credit risk and maximum exposure to credit risk by class of financial instruments including financial guarantees and commitments. Disclosure by industry and geography, where material.
- Details of collateral and other credit enhancements.

As stated in the introduction, this extract provides relatively condensed information and extracts where applicable of best practice disclosures (as quoted via footnotes). In practice, more detailed information might be necessary to reflect the circumstances of each bank. In addition, further narrative may be required to explain changes in risks and risk management processes compared to the previous year. Additionally, the general requirement of IFRS 7.34(a) is that the quantitative data on risk exposures should be based on information provided internally to key management personnel.

Please note that tables for 2009 i.e. comparatives are not re-produced in some instances due to the repetitive nature of this disclosures.

1. Measurement and internal ratings

The principal objective of credit risk measurement is to produce the most accurate possible quantitative assessment of the credit risk to which the Bank is exposed, from the level of individual facilities up to the total portfolio. Integral to this is the use of an internal ratings system. This system is comprised of three elements – probability of default, exposure at default and loss given default – which are listed and explained below. These parameters are fundamental in assessing the credit quality of loan exposures, with variants of these used for the calculation of regulatory and economic capital. The key building blocks of this process are:

- Probability of default (PD) – the likelihood of a borrower being unable to repay his obligations on his obligations;
- Exposure at default (EAD) – the exposure to a borrower who is unable to repay his obligations, at the point of default
- Loss given default (LGD) – the loss associated with a defaulted loan or borrower.

Use of PD, LGD and EAD within Credit Risk management processes

The bank should disclose how often the methodology they use for calculating PD is reviewed.

Forbearance

The bank should separately disclose the PDs for non-performing and performing forborne loans

As part of its credit risk management processes, Bank uses a rating scale that is built upon these concepts. More specifically, borrowers are graded on an internal grading scale in accordance with their likelihood of default. This grading is fundamental to credit sanctioning and approval, and to the on-going credit risk management of loan portfolios.

For example, Bank can assign an expected loss over the next 12 months to each customer by multiplying these three factors. We calculate probability of default (PD) by assessing the credit quality of borrowers and other counterparties. For the sake of illustration, suppose a customer has a 2% probability of defaulting over a 12-month period.

The exposure at default (EAD) is our estimate of what the outstanding balance will be if the customer does default. Supposing the current balance is €150,000, our models might predict a rise to €200,000 by then. Should customers default, some part of the exposure is usually recovered. The part that is not recovered, together with the economic costs associated with the recovery process, comprise the loss given default (LGD), which is expressed as a percentage of EAD. Supposing the LGD in this case is estimated to be 50%, the expected loss for this customer is: 2% x €200,000 x 50% or €2,000. To calculate probability of default (PD), Bank assesses the credit quality of borrowers and other counterparties and assigns them an internal risk rating. Multiple rating methodologies may be used to inform the overall rating decision on individual large credits, such as internal and external models, rating agency ratings and other market information. For smaller credits, a single source may suffice such as the result from an internal rating model. Bank recognises the need for two different expressions of PD depending on the purpose for which it is used. However, for the purposes of pricing and existing customer...
management. PDs should represent the best estimate of probability of default given the current position in the credit cycle. Hence, point-in-time (PIT) PDs are also required.

Each PD model outputs an estimate of default probability that is PIT, TTC or a hybrid (e.g. a 50:50 blend). Bespoke conversion techniques, appropriate to the portfolio in question, are then applied to convert the model output to pure PIT and TTC PD estimates. In deriving the appropriate conversion, industry and location of the counterparty and an understanding of the current and long-term credit conditions are considered. Both PIT and TTC PD estimates are recorded for each client.

The calculation of internal ratings differs between wholesale and retail customers. For wholesale portfolios, the rating system is constructed to ensure that a client receives the same rating regardless of the part of the business with which it is dealing. To achieve this, a model hierarchy is adopted which requires users to adopt a specific approach to rating each counterparty depending upon the nature of the business and its location. A range of methods are utilised for estimating wholesale counterparty PDs. These include bespoke grading models developed internally in the bank (internal models), vendor models such as MKMV Credit Edge and RiskCalc, and a conversion of external alphabet ratings from either S&P, Moody’s or Fitch. Retail models, especially those used for capital purposes, are almost exclusively built internally using the bank’s data. In many cases bureau data is used to complement internal data. In addition, in some low data/low default environments, external developments may also be utilised.

A key element of the wholesale framework is the PD Master scale. This scale has been developed to distinguish meaningful differences in the probability of default risk throughout the risk range. In contrast to wholesale businesses, retail areas rarely bucket exposures into generic grades for account management purposes (although they may be used for reporting purposes). Instead, accounts are managed at a more granular and bespoke level.

Exposure at default (EAD) represents the expected level of usage of the credit facility should default occur. At the point of default, the customer exposure can vary from the current position due to the combined effects of additional drawings, repayment of principal and interest and fees. EAD parameters are all derived from internal estimates and are determined from internal historical behaviour. The lower bound of EAD for regulatory capital purposes is the current balance at calculation of EAD. For derivative instruments, exposure in the event of default is the estimated cost of replacing contracts where counterparties have incurred obligations which they have failed to satisfy.

Should a customer default, some part of the exposure is usually recovered. The part that is not recovered, the actual loss, together with the economic costs associated with the recovery process, comprise the loss given default (LGD), which is expressed as a percentage of EAD. The Bank estimates average LGD using historical information. The level of LGD depends principally on: the type of collateral (if any); the seniority or subordination of the exposure; the industry in which the customer operates (if a business); the length of time taken for the recovery process and the timing of all associated cash flows; and the work-out expense. The outcome is also dependent on economic conditions that may determine, for example, the prices that can be realised for assets, whether a business can readily be refinanced or the availability of a repayment source for personal customers. For the purposes of regulatory capital an adjustment is made to the modelled LGD to account for the increased losses experienced under downturn conditions, giving a ‘downturn LGD’.

Use of PD, LGD and EAD within Regulatory Capital and in Impairment Provisioning

The three parameters PD, LGD and EAD are key components in deriving the regulatory capital. As outlined above, the parameters are modelled in varying ways for different portfolios, in order to capture the differential credit risks within these portfolios. Parameters drawn from bank’s internal models are used to determine the aggregate level of risk weighted assets, in accordance with the requirements of the Central Bank and Financial Services Authority of Ireland and the Capital Requirements Directive, with PD’s reflecting the likelihood of borrower default within a 1-year time horizon, and LGD’s reflecting the ‘down-turn’ LGD outlined above.

These parameters also impact the provisioning process, but to a lesser degree, with collective provisioning models based upon movements between arrears and / or grading classifications. Where PD or LGD elements have been used for provisioning purposes, the time-horizon has necessarily been altered to reflect a period of greater than 1 year in accordance with existing accounting standards.

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17 Dependent on individual methodologies in each institution and as such may not be applicable in all instances.
2. **Distribution of EAD and expected loss**

The table below sets out the distribution by industry of the outstanding credit exposure to customers in terms of EAD, PD, LgD and EL. The expected loss from customer exposure as can be seen from the table below can be considered as a medium-to-low risk profile.

<table>
<thead>
<tr>
<th>31 December 2011</th>
<th>EAD € million</th>
<th>%</th>
<th>Average PD (%)</th>
<th>Average LgD (%)</th>
<th>EL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential Mortgages: Owner Occupiers</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residential Mortgages: Buy to Let Properties</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale lending: Commercial property</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale lending: Corporate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale lending: SME</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other consumer</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. **Monitoring weakness in portfolios**

The bank should describe how they incorporate forbearance measures into their methods for monitoring weaknesses in portfolios.

Whilst the basic principles for monitoring weaknesses in wholesale and retail exposures are broadly similar, they will reflect the differing nature of the assets. As a matter of policy all facilities granted to corporate or wholesale customers are subject to a review on, at least, an annual basis, even when they are performing satisfactorily. Corporate accounts that are deemed to contain heightened levels of risk are recorded on graded early warning lists or watch lists comprising three categories graded in line with the perceived severity of the risk attached to the lending, and its probability of default.

These are updated monthly and circulated to the relevant risk control points. Once an account has been placed on watch list (WL) or early warning list (EWL), the exposure is carefully monitored and, where appropriate, exposure reductions are affected. Should an account become impaired, it will normally have passed through each of the three categories, which reflect the need for increasing caution and control. Where an obligor's financial health gives grounds for concern, it is immediately placed into the appropriate category. While all obligors, regardless of financial health, are subject to a full review of all facilities on, at least, an annual basis, more frequent interim reviews may be undertaken should circumstances dictate. Specialist recovery functions deal with clients in default, collection or insolvency. Their mandate is to maximise shareholder value via the orderly and timely recovery of impaired debts. Accounts can stay in recoveries for up to two years unless a longer-term strategy has been agreed.

Within the retail portfolios, which tend to comprise homogeneous assets, statistical techniques more readily allow potential weaknesses to be monitored on a portfolio basis. The approach is consistent with the bank’s policy of raising a collective impairment provision as soon as objective evidence of impairment is identified. Retail accounts can be classified according to specified categories of arrears status (or cycle), which reflects the level of contractual payments which are overdue on a loan.

The probability of default increases with the number of contractual payments missed, thus raising the associated impairment requirement.

Once a loan has passed through the appropriate stages within the credit process it will enter recovery status, having been charged off. In most cases, charge-off will result in the account moving to a legal recovery function or debt sale. This will typically occur after an account has been treated by a collections function. However, in certain cases, an account may be charged off directly from a performing (up to date) status, such as in the case of insolvency or death.
4. Impairment provisioning

The accounting policy in respect of impairment on loans and advances to customers is set out in note 1. As property loans represent a significant concentration within the Bank’s advances, some key principles have been applied in respect of property collateral held by the Bank. For impaired property exposures, cash flows will generally emanate from the development and/or disposal of the assets which comprise the collateral held by the bank. The Bank’s preference is to work with the obligor to progress the realisation of the collateral although in some cases the bank will foreclose its security to protect its position. Bank typically holds various types of collateral as security for these loans, e.g. land, developments available for sale/rent and investment properties or a combination of these assets via cross collateralisation.

Where cash flows arising from the realisation of collateral held are included in impairment assessments, management typically rely on valuations or business appraisals from independent external professionals. However, in accordance with Internal Policy on Collateral Valuation, the Bank uses a number of methods to assist in reaching appropriate valuations for the collateral held, given the absence of a liquid market for property related assets in Ireland at present. These include: (a) consultations with valuers; (b) use of professional valuations; (c) use of internally developed residual value methodologies; (d) the application of local market knowledge in respect of the property and its location, and (e) use of internal guidelines. These are described below.

- Consultations with valuers would represent circumstances where local external valuers are asked to give verbal ‘desk top’ updates on their view of the assets’ value. Consultation also takes place on general market conditions to help inform the bank’s view on the particular property valuation. The valuers are external to the Bank and are familiar with the location and asset for which the valuation is being requested.
- Use of professional valuations would represent circumstances where external firms are requested to provide formal written valuations in respect of the property. Up to date external professional valuations are sought in circumstances where it is believed that sufficient transactional evidence is available to support an expert objective view. Historic valuations are also used as benchmarks to compare against current market conditions and assess peak to trough reductions. Available market indices for relevant assets, e.g. residential and investment property are also used in valuation assessments.
- The residual value methodology assesses the value in the land or property asset after meeting the incremental costs to complete the development. This approach looks at the cost of developing the asset to determine the residual value for the Bank, including covering the costs to complete and additional funding costs. The key factors considered include: (i) the development potential given the location of the asset; (ii) its current or likely near term planning status; (iii) levels of current and likely future demand; (iv) the relevant costs associated with the completion of the project; and (v) expected market prices of completed units. If, following internal considerations which may include consultations with valuers, it is concluded that the optimal value for the Bank will be obtained through the development/completion of the project; a residual value methodology is used. When, in the opinion of the Bank, the land is not likely to be developed or it is non-commercial to do so, agricultural/green field values may be applied.
- Application of local market knowledge would represent circumstances where the local bank management familiar with the property concerned, with local market conditions, and with knowledge of recent completed transactions would provide indications of the likely realisable value and a potential timeline for realisation.
- In valuing investment property, yields are applied to current rentals having considered current yields and estimated likely yields for a more normal market environment for relevant asset classes.

Applying one or a combination of the above methodologies, in line with bank’s Valuation Policy, has resulted in a wide range of discounts to original collateral valuations, influenced by the nature, status and year of purchase of the asset. The frequency, and availability, of such up-to-date valuations remains a key factor within impairment provisions determination. Additionally, all relevant costs likely to be associated with the realisation of the collateral are taken into account in the cash flow forecasts. The spread of discounts is influenced by the type of collateral, e.g. land, developed land or investment property and also its location. The valuation arrived at is therefore a function of the nature of the asset, e.g. unserviced land in a rural area will most likely suffer a greater reduction in value if purchased at the height of a property boom than a fully let investment property with strong lessees. The discounts to original collateral value, having applied our valuation methodologies to reflect current market conditions, can be as high as 95% for land assets where values have been marked down to agricultural/green field site values.

When assessing the level of provision required for property loans, apart from the value to be realised from the collateral, other cash flows, such as recourse to other assets or sponsor support, are also considered. The other key driver is the time it takes to receive the funds from the realisation of collateral. While this depends on the type of collateral and the stage of its development, the period of time to realisation is typically two to seven years but sometimes this time period is exceeded. These estimates are frequently reassessed on a case by case basis.
5. Loans and advances by asset quality

<table>
<thead>
<tr>
<th>Retail</th>
<th>Wholesale</th>
<th>Wealth &amp; International</th>
<th>Total</th>
<th>Split as:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mortgage</td>
<td>Other</td>
<td></td>
<td>Core</td>
</tr>
</tbody>
</table>

Neither past due nor impaired
Past due but not impaired
Impaired – no provisions required
Impaired – Provisions held

Gross
Provision for impairment losses
Net

The impaired loans above are held on a non-accrual basis i.e. no accrual of interest. Total interest income that would have been recorded during the year ended 31 December 2010 had interest on gross impaired loans been included in income amounted to €2 million (2009: €4 million).

Loans and advances which are neither past due nor impaired:

<table>
<thead>
<tr>
<th>Retail</th>
<th>Wholesale</th>
<th>Wealth &amp; International</th>
<th>Total</th>
<th>Split as:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Core</td>
<td>Non Core</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Strong
Satisfactory
Higher Risk
Total neither past due or impaired

If it is the bank’s practice to include in this table, those loans which have had their arrears capitalised, the bank should disclose that fact and explain the rationale.

Strong: There is a very high likelihood of the asset being recovered in full.

Satisfactory: whilst there is a high likelihood that the asset will be recovered and therefore, of no cause for concern to the Bank, the asset may not be collateralised, or may relate to retail facilities, such as credit card balances and unsecured loans, which have been classified as satisfactory, regardless of the fact that the output of internal grading models may have indicated a higher classification. At the lower end of this grade there are customers that are being more carefully monitored.

Higher risk: there is concern over the obligor’s ability to make payments when due. However, these have not yet converted to actual delinquency. There may also be doubts over value of collateral or security provided. However, the borrower or counterparty is continuing to make payments when due and is expected to settle all outstanding amounts of principal and interest.
For the purpose of analysis of credit quality, the following internal measures of credit quality have been used:

<table>
<thead>
<tr>
<th>Internal credit rating</th>
<th>Default grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong</td>
<td>1-3</td>
</tr>
<tr>
<td></td>
<td>4-5</td>
</tr>
<tr>
<td></td>
<td>6-8</td>
</tr>
<tr>
<td></td>
<td>9-11</td>
</tr>
<tr>
<td>Satisfactory quality</td>
<td>12-14</td>
</tr>
<tr>
<td></td>
<td>15-19</td>
</tr>
<tr>
<td>Higher risk</td>
<td>20-21</td>
</tr>
</tbody>
</table>

Loans and advances which are past due but not impaired:

<table>
<thead>
<tr>
<th></th>
<th>Retail</th>
<th>Wholesale</th>
<th>Wealth &amp; International</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fair value of collateral</td>
<td>Loan exposure</td>
<td>Loan exposure</td>
<td>Loan exposure</td>
</tr>
<tr>
<td>0-30 days</td>
<td>-</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>31-60 days</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>61-90 days</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>91-180 days</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>181-360 days</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>&gt; 360 days</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total past due not impaired</td>
<td>-</td>
<td>€</td>
<td>€</td>
<td>€</td>
</tr>
<tr>
<td>Fair value of collateral held</td>
<td>€</td>
<td>-</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

A financial asset is ‘past due’ if a counterparty has failed to make a payment when contractually due.

Collateral held against retail mortgage lending is principally comprised of residential properties; their fair value has been estimated based upon the last actual valuation, adjusted to take into account subsequent movement in house prices, after making allowance for indexation error and dilapidations. The resulting valuation has been limited to the principal amount of the outstanding advance in order to provide a clearer representation of the Bank’s credit exposure.

In respect of wholesale and wealth and international lending decisions are based on an obligor’s ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values for non-mortgage lending are assessed more rigorously at the time of loan origination or when taking enforcement action and may fluctuate, as in the case of floating charges, according to the level of assets held by the customer. Whilst collateral is reviewed on a regular basis in accordance with business unit credit policy, this varies according to the type of lending and collateral involved. It is therefore not practicable to estimate and aggregate current fair values of collateral for non-mortgage lending.

6. **Forbearance arrangements** (ROI only)

In 2011, we recognise that the below tables will include forbearance due to financial stress and may include forbearance due to non financial difficulties. Going forward, it is expected that the tables will only include forbearance due to financial stress.

Bank operates a number of mechanisms which are designed to assist borrowers experiencing credit and loan repayment difficulties, which have been developed in accordance with existing codes of practice. These are set out below.

**Residential Mortgages**

In accordance with the 2010 Code of Conduct of Mortgage Arrears (CCMA), Bank has defined a Mortgage Resolution Process (MARP) for mortgages which are secured on the primary residence of borrowers (owner occupier mortgages). This process is applies to Bank’s assessments of both borrowers in arrears and borrowers who, though not in arrears, have informed Bank about impending credit difficulties and potential future arrears (‘pre-arrears borrowers’).

18 A financial asset as defined in IAS 39(9)
Within this process, a full financial assessment of a borrower’s ability to pay, based upon both re-payment capacity and re-payment history, is performed by banks Arrears Management Unit in order to determine the most viable alternative re-payment or forbearance arrangement. Currently, Bank extends the following options to borrowers:

- Interest only payments for a period of up to 3 months;
- Interest and partial capital re-payment;
- Capital and /or interest moratorium
- Term extension
- Change of mortgage type (except in the case of tracker mortgages)
- Capitalisation of arrears and interest
- Deferred Interest scheme

The table below sets out the volume of loans to which forbearance arrangements have been applied.

The impaired balance noted represents the loan balances to which impairment charges have been raised due to either being 90 days or more in arrears, or showing evidence of impairment prior to reaching arrears of 90 days.

### Residential Owner Occupier Mortgages

The incidence of the main type of forbearance arrangements for owner occupied residential mortgages only is analysed below:

<table>
<thead>
<tr>
<th>31 December 2011</th>
<th>All Loans</th>
<th>Loans &gt; 90 days in arrears and/or impaired</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Balance € million</td>
</tr>
<tr>
<td>Interest only</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduced payment (less than interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduced payment (greater than interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment moratorium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Arrears capitalisation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term extension</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hybrid (term extension and interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Residential buy to let Mortgages

The incidence of the main type of forbearance arrangements for buy to let residential mortgages only is analysed below:

<table>
<thead>
<tr>
<th>31 December 2011</th>
<th>All Loans</th>
<th>Loans &gt; 90 days in arrears impaired</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>Balance € million</td>
<td>Number</td>
</tr>
<tr>
<td>Interest only</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduced payment (less than interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reduced payment (greater than interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment moratorium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Arrears capitalisation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Term extension</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hybrid (term extension and interest only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Impairment charge on loans and advances to customers by division

The balances in the preceding tables denoted impaired loan balances. The table below lists the impairment charges in respect of these balances, by lending type.

<table>
<thead>
<tr>
<th>2011 € million</th>
<th>2010 € million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>Loans in Forbearance Performing</td>
</tr>
<tr>
<td>Retail</td>
<td></td>
</tr>
<tr>
<td>- Owner occupier</td>
<td></td>
</tr>
<tr>
<td>- Buy to let</td>
<td></td>
</tr>
<tr>
<td>- Other Consumer</td>
<td></td>
</tr>
<tr>
<td>Total impairment charge</td>
<td></td>
</tr>
</tbody>
</table>
7. Repossessed collateral

Overall repossessions

<table>
<thead>
<tr>
<th>31 December 2011</th>
<th>Number of repossessions</th>
<th>Balance outstanding € million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential repossessions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner occupier</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buy to let</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total residential repossessions</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In respect of retail portfolios, the Bank does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Bank takes physical possession of assets held as collateral against wholesale lending. In such cases, the assets are carried on the Bank’s balance sheet and are classified according to the Bank’s accounting policies.

In the course of the year, 95% of properties repossessed by value for residential mortgages and 90% for wholesale were disposed of by 31 December 2010 and the remaining 5% are in the process of disposal. The table below sets out details of the sales on disposal of repossessed properties.

<table>
<thead>
<tr>
<th>31 December 2011</th>
<th>Number of disposals</th>
<th>Balance outstanding at repossession €m</th>
<th>Gross sales proceeds €m</th>
<th>Costs to sell €m</th>
<th>Loss on sale* €m</th>
<th>Weighted average LTV at sale price %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner occupier</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buy to let</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total residential</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale repossessions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial real estate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Calculated as gross sale proceeds – (balance outstanding at repossession + costs to sell)
8. **Loan-to-value ratio (‘LTV’) of mortgage lending (index linked)**

Loan to value is the relationship between the loan and the appraised value of the mortgaged property.

<table>
<thead>
<tr>
<th>Analysis by loan-to-value ratio of the Bank’s residential mortgage lending which is neither past due nor impaired:</th>
<th>2011 € million</th>
<th>2010 € million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 50%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>50%-70%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>71% to 80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>81% to 90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>91% to 100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>101%-120%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>121% to 150%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greater than 150%</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Actual and average LTVs across principal mortgage portfolios**

<table>
<thead>
<tr>
<th>31 December 2011</th>
<th>Owner occupier %</th>
<th>Buy to let %</th>
<th>Total %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 50%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>50%-70%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>71% to 80%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>81% to 90%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>91% to 100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>101%-120%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>121% to 150%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greater than 150%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

**Average LTV:**
- Stock of residential mortgages at year end
- New residential mortgages during year
- Impaired mortgages in total

**Arrears profile of loans and advances which are past due but not impaired (only for residential mortgages)**

<table>
<thead>
<tr>
<th>31 December 2011</th>
<th>Owner occupier € million</th>
<th>Buy to let € million</th>
<th>Total € million</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-30 days</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>31-60 days</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>61-90 days</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>91-180 days</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>181-360 days</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Over 360 days</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total loans and advances which are past due but not impaired</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Analysis by loan-to-value ratio of the Bank’s residential mortgage lending which are 90 days past due

<table>
<thead>
<tr>
<th>Loan-to-value Ratio</th>
<th>Owner occupier %</th>
<th>Buy to let %</th>
<th>Total residential mortgage portfolio %</th>
<th>Total loan portfolio %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 50%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>50% - 70%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>71% - 80%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>81% - 90%</td>
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<tr>
<td>91% - 100%</td>
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<tr>
<td>101% - 120%</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>121% - 150%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greater than 150%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*The ‘Total Loan Portfolio’ column represents the percentage of the aggregate portfolio within these LTV categories, and is not restricted to those exposures 90 days or more in arrears.
9. Loan origination profile of the residential mortgage loan portfolio as at 31 December 2011 before provision for impairment

<table>
<thead>
<tr>
<th>Year</th>
<th>Residential mortgage loan book</th>
<th>Impaired mortgage loan book</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Balance €million</td>
</tr>
<tr>
<td>1996 and before</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td></td>
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<tr>
<td>2006</td>
<td></td>
<td></td>
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<tr>
<td>2007</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix 2 – Definitions

**Past due (arrears):** A financial asset is past due when a counterparty has failed to make a payment when contractually due (IFRS 7: Appendix A).

Loans where repayment of interest and/or principal are overdue by at least one day are past due.

In the case of overdrafts, past due days are counted once a borrower:
- has breached an advised limit;
- has been advised of a limit lower than the then current outstandings; or
- has drawn credit without authorisation.

When a borrower is past due, the entire exposure is reported as past due, rather than the amount of any excess or arrears.

**Impairment exposure:** A loan is impaired and impairment losses are incurred if, an only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a ‘loss event’) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. (IAS39)

**Forborne exposure:** Forbearance measures occurs when a bank, for reasons relating to the actual or apparent financial stress of a borrower, grants a concession whether temporarily or permanently to that borrower. A concession may involve restructuring the contractual terms of a debt (such as a reduction in the interest rate or principal due, or an extension of the maturity date or any weakening of the security structure or adjustment/non enforcement of covenants) or payment in some form other than cash, such as an equity interest in the customer.

**Interest income recognition on impaired exposures (IAS 39 AG93):** IAS 39 requires impairment losses to be calculated based on discounted future cash flows (principal and interest). Given IAS 39 requires all cash flows (principal and interest) to be taken into account for calculating the impairment loss, IAS 39: AG93 does not allow for non-accrual of interest following an impairment as it is unnecessary. Following an impairment, IAS 39 requires interest revenue to be recognised using the contractual EIR (i.e. the rate that was used for discounting the future cash flows for the purpose of measuring the impairment loss) applied to the carrying amount (which is net of the impairment amount). (IASB Staff Paper 4C, week beginning 11 April 2011).

**Non-accrual of interest:** When the ‘trigger event’ occurs, if the loan is considered to be worthless and there are no future cash flows expected, the impairment provision would amount to the carrying value of the asset and there would be no further interest income recognised in this scenario.

**Amortised cost of a financial instrument:** The amount at which it was measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the ‘effective interest method’ of any difference between that initial amount and the maturity amount, and minus any write-down (directly or through the use of an allowance account) for impairment or uncollectability. (IAS 39)
**Carrying Amount of a loan:** The principal amount of the loan, taking into account payments applied to reduce principal, and adjusted to reflect accrued but uncollected interest, write-offs, unamortised premium or discount, and unamortised loan fees and costs, and reduced by any impairment provision.

**Credit risk concentration:** Risk based on similar or positively correlated risk factors, which, in times of stress, have an adverse effect on the creditworthiness of each of the individual counterparties making up the concentration.

**Contractual amounts due:** Principal and interest payments outstanding as set out in the loan contract.

**Effective interest rate:** The rate that exactly discounts estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the instrument's net carrying amount. (IAS 39)

**Emergence Period:** Spanning the time between the occurrence of a loss event and the date that loss event is identified.

**Estimated Future Cash Flows:** Forecasted principal and interest payments (not necessarily contractual amounts due) as well as any cash flows from foreclosure of collateral.

**Exposure:** The total potential loss which a Covered Institution could incur in the event of non-payment by a counterparty. An exposure includes an amount outstanding on a loan, both principal and interest.