Date: 09-02-2017  
Circular no.: 9/2017  
To: All banks operating in Qatar  
Subject: IFRS 9 Implementation Guidelines in connection with Classification and Measurement of Financial Assets and Liabilities and Derivatives

Introduction

The instructions of Qatar Central Bank (QCB) obligate all conventional banks to prepare their financial statements in accordance with International Financial Reporting Standards, and any new amendments and issues thereon. The Islamic banks are also obligated to adopt the same standards where the guidelines of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are not available.

The financial statements and results of operations of banks will be significantly affected once the new IFRS 9, which is replacing IAS 39, is applied effective from 1/1/2018. In particular, the application of new accounting requirement that will oblige all banks to establish precautionary provisions for expected future losses on all performing credit financial assets upon recognition and through their various life stages through deduction from income; and as this will require the current banking systems to be developed, and new systems may be established to evaluate all types of the banks’ financial assets, according to the requirements of IFRS 9.
Therefore, QCB is of the opinion that the attached implementation guidelines should be issued to regulate the banks' application of the new IFRS 9, and specify the requirements of the transitional phase that precedes application.

These implementation guidelines are not intended to develop methodologies, action plans and standardised systems and models for the standard to be applied at all banks, as this should be undertaken by the executive management of each bank and its board of directors, and falls under their duties and responsibilities.

Furthermore, it is the responsibility of the bank's external auditor to evaluate these methodologies, action plans and systems and to test their compatibility with the requirements of the International Financial Reporting Standards.

The purpose of these guidelines is rather to develop a regulatory framework that can assist QCB in its supervision and monitoring activities of the banks’ compliance with the application of IFRS 9 and adequacy of managing the risks of their financial assets, and to limit the major differences and variances that could result from the banks' use of judgements and estimates during the interpretation of how IFRS 9 is applied, so that, the guidelines reinforce transparency and objectivity of application. Ultimately, the guidelines impose a standard template for reporting the results of application to QCB to enhance its ability to read, compare and analyse these results; and assess the risks of the banks' financial assets through successive
periods of time at the level of each bank and the consolidated level of
the banking system.

Scope of application
1- The attached guidelines are comprised of two main sections:
   First Section: the classification and measurement of financial
   assets, financial liabilities and derivatives.

   The instructions in this section shall be applied by the
   conventional banks only, while Islamic banks should continue to
   apply the standards of AAOIFI in accordance with the instructions
   of QCB, pages (415-421) of Instructions to Banks – September
   2013, except for any issues not covered by AAOIFI's standards, in
   which case IFRS's will be adopted.

   Second Section: The Expected Credit Losses

   Instructions in this section shall be applied by all conventional and
   Islamic banks.

2- These guidelines shall be applied by each national bank at the
   bank's individual level inside Qatar and at the level of each of the
   bank's branches outside Qatar and each of its subsidiaries inside or
   outside Qatar and then on at consolidated level of the bank's
   Group. In case it is difficult to apply such guidelines, as is, to a
   branch outside Qatar or subsidiary due to the conflict of these
   guidelines with regulatory and accounting standards applicable in
   the host country, the bank should identify all the differences
   resulting from variances of standards applied; adopt the most
   precautionary estimations; record the resulting differences in the
bank's records in Qatar to reflect their impact on the consolidated financial statements of the bank; and advise QCB accordingly.

3- Branches of foreign banks operating in the State of Qatar should comply with these guidelines unless they have other guidelines from their parent companies, in which case these branches should obtain a no-objection letter from QCB in this regard.

Implementation Timeline and Reporting
As stated on page 27 of the attached guidelines, and based on the requirements of IFRS 9, the application of this standard will start as from the beginning of 2018. Banks shall comply with IFRS 9 transitioning rules, and their impact on the disclosures of the banks' financial statements as at 31/12/2017, and the opening balances as at 1/1/2018 through the retained earnings, as stated in paragraph 3/3 on page 27 of the attached guidelines.

As stated in paragraph (3/2) on the page 27, all banks should prepare the first report on the classification of their performing credit assets between stage 1 and stage 2, and their estimated precautionary provisions according to the attached forms and guidelines. This report should be provided to QCB no later than 1/9/2017. Banks should also start preparing that report as of the date of this circular, provided the balances and classification are updated according to the reviewed consolidated financial statements as at 30/6/2017.
Furthermore, banks should pay attention when preparing the first report and take into account the accuracy, professionalism and transparency of the process. The report should be approved by the board of directors for the national banks and the head office for the branches of foreign banks.

In light of the study of the results of first report, QCB will assess the need to introduce further clarifications and guidelines, set minimum provision thresholds to credit risks, or any other supervisory requirements. QCB will further determine the periodic deadlines to provide it with this report and any other necessary reports and submissions.

**The Auditor's Role and Responsibilities**

The auditor of each bank shall assume the responsibility for verifying the integrity of systems, methodologies and models used by the bank in terms of their relevance to the requirements of IFRS 9, and any other relevant standards as well as the instructions of QCB. The auditor will also be responsible for verifying the correctness of figures and information stated in the bank's financial statements and the reports that the bank provides to QCB relative to the application of IFRS 9.
Each bank shall assign the auditor with the following:

1- To audit the first report on the classification of credit assets in stage 1 and stage 2, the estimated precautionary provisions and any subsequent periodic reports.

2- To review the systems, policies and procedures introduced by the bank for the application of IFRS 9 and any other relevant standards; and to express opinion on the appropriateness of these policies, systems and procedures to the requirements of the standards and QCB's instructions.

3- To prepare a report in Arabic language on the results of the above mentioned audit and review, and to furnish the report to QCB, alongside with the first report sent by the banks no later than 1/9/2017.

**The impact of the application of the new standard on the relevant QCB's instructions**

Effective from 1/1/2018, which is the deadline to start the application of IFRS 9, and in addition to the requirements to be followed by banks during the transitional period that precedes the application as aforementioned; and as shown in the attached guidelines, these guidelines will replace the instructions relative to the application of the International Accounting Standard No. (39), or to the classification of performing credit facilities and specification of their provisions, wherever stated in QCB’s Instructions to Banks up to September 2013. QCB's instructions relative to the classification of
non-performing credit accounts, and all relevant provisions, treatments and reports will remain enforceable.
These instructions shall take effect as of the date of the circular.

**Abdullah Bin Saud Al-Thani**
The Governor
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**Scope**

These instructions will apply to all conventional banks. For Islamic banks, only “Section (2): Estimated Credit Losses” will apply to them while Accounting Standards issued by AAOIFI, and relevant instructions of QCB continue to be adopted.

Branches of foreign banks operating in Qatar should comply with the instructions contained in this document unless they have other guidance from its parent entities. In such cases, branches are required to inform QCB to obtain its objection.

In applying these instructions, banks shall make sure that consistent accounting policies are applied at group level including subsidiaries and branches outside Qatar. If the supervisory and accounting standards applied at the bank’s outside branches or subsidiaries are in conflict with these instructions, the bank should notify QCB accordingly, and list all the differences and the resultant impacts, so that QCB will issue its relative guidance to the concerned bank. In general, QCB instructs banks to treat these differences in their records in accordance with the most prudent instructions and standards.

**Definitions**

‘**Equity instruments**’

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities (as defined in IAS 32 Paragraph 11).

‘**Debt instruments**’

The instrument, which give rise to a financial liability (as defined in IAS 32 Paragraph 11). For applying these instructions, debt instruments include Islamic Sukuk that has the nature of debt instruments as defined by QCB, Page 417 of the Book of Instructions to Banks- September 2013.

‘**Principal**’

It is the fair value of the instrument at initial recognition. However, the principal amount may change over the life of the asset (for example, if there is a repayment).

‘**Interest**’

It is typically compensation for the time value of money and credit risk. However, interest can also include consideration for other lending risks (such as liquidity risk) and costs associated with holding the financial asset for a period of time, as well as a profit margin.

‘**Yield**’

It is the profit earned by Islamic banks for transactions of finance granted to the customers.

‘**Fair value**’

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
‘Derivatives’

A financial instrument or other contract within the scope of this IFRS 9 with all three of the following characteristics:

(a) Its value changes in response to the change in a specified interest/yield rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the ‘underlying’).

(b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

(c) It is settled at a future date.

‘Key management personnel’

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity (as defined in IAS 24 Paragraph 9).
1. Classification and Measurement Requirements

Section 1: Classification and measurement requirements for financial assets, liabilities and derivatives.

1.1. Financial assets

1.1.1. Initial measurement

All financial assets under this guidance should be initially recognised at fair value, plus, in the case of a financial asset that is not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Fair value is to be measured under International Financial Reporting Standard (“IFRS”) 13 ‘Fair Value’. Banks should refer to IFRS 13 for the relevant fair value measurement guidance.

1.1.2. Classification and measurement

Debt instruments fall into two measurement categories: amortised cost and fair value based on the business model in which the assets are held and the cash flow characteristics of the assets. However, equity instruments are always measured at fair value on the balance sheet. Banks should determine whether an asset is a debt instrument or an equity instrument based on the guidance and requirements contained in International Accounting Standard (“IAS”) 32 ‘Financial Instruments: Presentation’.

For debt instrument, according to the measurement category in which the financial asset is determined to be in, financial assets are subsequently measured at either amortised cost or fair value based on the bank’s business model for managing the financial assets and the cash flow characteristics associated with the assets. A bank assesses whether its financial assets meet this condition based on its business model.

The following three business models drive the accounting classification of debt financial assets or equivalent Islamic sukuk:

- **Held to collect**: Business model in which the assets are held to collect contractual cash flows;
- **Held to collect and sell**: Business model in which the assets are both held to collect contractual cash flows and sold; and
- **Trading**: Business Model in which the assets are held principally for trading.

The table below summarise the measurement techniques applicable for each business model (subject to the assessment of the cash flow characteristics- discussed below) based on nature of instrument:

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Amortized cost</th>
<th>Fair value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Through Other Comprehensive Income</td>
</tr>
<tr>
<td>Equity instrument</td>
<td>Not applicable</td>
<td><strong>One time choice at initial recognition</strong></td>
</tr>
<tr>
<td>Debt instrument</td>
<td>Held to collect business model</td>
<td>Held to collect and sell business model</td>
</tr>
</tbody>
</table>
If the financial asset is an investment in an equity instrument, management should consider the guidance for equity instruments in paragraph 1.1.3. If it is a debt instrument, management should consider the guidance for debt instruments in paragraph 1.1.4 onwards.

1.1.3. Equity instruments

Investments in equity instruments are measured at fair value on the balance sheet and are not subject to impairment testing. Only equity instruments that are traded in an active market can be categorised by banks as held for trading in accordance with QCB instructions. In general, changes in fair value of all equity instruments categorised as held for trading are recognised in the statement of profit or loss. However, the management has an irrevocable choice for only equity instruments that are not categorised as held for trading, i.e. to recognise changes in fair value in Other Comprehensive Income (“OCI”) rather than profit or loss. Dividends income should always be recognised in the statement of profit or loss for all equity instruments, irrespective of their classification.

Gains or losses accumulated within OCI are not allowed for recycling to profit or loss, even in the case where the equity investment is finally disposed or otherwise derecognised. Instead, the accumulated gains or losses within OCI, or proportion thereof, that relates to disposed or derecognised equity investment should be transferred within equity to retained earnings.

It is not allowed under IFRS 9 to measure unquoted equity investments at cost where fair value cannot be determined reliably. Accordingly, QCB requires banks to enhance their capabilities to arrive at fair value information for all of their equity investments covered in the scope of IFRS 9. QCB requires banks to immediately recognise any reduction in fair value of unquoted equity instruments; and to obtain pre-approval from QCB after communicating details of inputs, evidence, and methods used to arrive at fair value where the fair value of unquoted equity instruments is assessed to be more than its carrying amount (at date of valuation).

Banks are required to apply the requirements of IFRS 13 ‘Fair Values’ when determining the fair value of equity securities, both quoted and unquoted.

1.1.4. Investment funds

The definition of equity instruments in its entirety according to ISA 32 "Presentation" does not apply to many shares in investment funds. Shares in investment funds do not represent a debt instrument, which its cash flows are restricted to the principal and interest/yield. Therefore, Para. 1.3 “Derivative financial instruments” on page 9 should be referred to. In this case, shares in investment funds should be measured at fair value through profit or loss, and this is made on the basis of market value when the investment funds are listed on the stock exchange, or based on the amount that can be recovered at the time of exit from the fund.

1.1.5. Debt instruments

If the financial asset is a debt instrument (or does not meet the definition of an equity instrument in its entirety), management should consider both the following to determine the classification of the asset:

- The objective of the bank’s business model; and
- The asset’s contractual cash flows represent Solely Payments of Principal and Interest/Yield (“SPPI/Y”). Interest is consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of time. Yield is the profit earned by Islamic banks for granting credit and finance to its customers, whether directly or in form of Sukuk.
Depending on the above two tests, debt financial asset fall into the amortised cost or fair value through other comprehensive income (“FVOCI”) measurement category. If the financial asset does not pass either of the above tests, it is measured at fair value through profit or loss. Even if both tests are met, management also has the ability to designate, upon initial recognition of the asset, at fair value through profit or loss if doing so reduces or eliminates a measurement or recognition inconsistency (‘accounting mismatch’). This is discussed further in paragraph 1.1.8 “Designation option at fair value through profit and loss (“FVPL”)”.

1.1.5.1. Held to collect debt instrument business model

A held to collect business model refers to a practice whereby a bank intends to recover its investment in an asset by collecting the contractual cash flows. For example, this will be the case where a bank has advanced a credit facility, will only collect the contractual cash flows from the credit facility and will not sell the receivable, although some sales activity in the business model will not necessarily defeat the objective of a held to collect business model.

The following account types will typically fall within this business model:

- Deposits with QCB, central banks and equivalent
- Deposits with banks
- Credit facilities to banks and customers

Assets, which fall into this business model, will achieve amortised cost accounting, provided the cash flows relating to the assets comprise SPPI/Y. Other debt instruments such as treasury bills, notes and bonds, CD’s, and similar instruments can fit into the three business models, depending on the bank’s activities. Factors that should be considered when assessing sales activity within the held to collect business model include:

- The historical frequency, timing and value of sales;
- The reason for the sale; and
- Expectations about future sales activity.

Sales transactions alone do not determine the business model, and therefore should not be considered in isolation of other factors. Information about past sales and expectations about future sales provide evidence of a bank’s objective for managing the financial assets, and specifically, how cash flows are realised and value is created.

Credit risk management activities aimed at minimising potential losses due to credit deterioration are not inconsistent with the held to collect business model. Selling a financial asset because it no longer meets the credit criteria specified in the bank’s adopted investment policy is an example of a sale that has occurred due to an increase in credit risk.

QCB requires banks to develop accounting policies to determine the level of sales activity that will be deemed inconsistent with the objective of a held to collect business model. In doing so, banks may use either absolute amount, percentage of portfolio, number of securities, or number of transactions as relevant measures. Banks are required to communicate their policy concerning sales activities to QCB, before it is applied by the bank.

In all cases, the central bank requires banks to provide quarterly reports of sales transactions of financial instruments that are classified under held to collect business model. The bank should obtain No Objection from QCB before the completion of the sales transactions that would drive the total sales in the previous twelve months, to more than 5% of assets classified under held to collect business model.

1.1.5.2. Held to collect and sale business model

In this business model, assets are held to collect contractual cash flows from the assets contractual terms, however, they may also be sold. For example, this will be the case with a bank’s ‘liquidity portfolio, whereby it may collect contractual cash flows relating to an asset but may sell an asset in order to meet the banks liquidity needs.
Assets, which fall into this business model, will achieve FVOCI accounting provided the cash flows relating to the assets comprise SPPI/Y. See Section 1.3 “Derivatives” in page no. (9).

In this category, financial assets are measured subsequent to initial recognition, at fair value with fair value movements recorded in Other Comprehensive Income (“OCI”), with the exception of recognising impairment losses and reversals, interest/yield revenue and foreign exchange gains and losses in the statement of profit or loss. When the asset is derecognised, the cumulative gain or loss in OCI is recycled to the statement of profit and loss.

Impairment on assets held in this business model is calculated using the model outlined in “Section (2): Expected Credit Loss” of this document, i.e., banks will have to assess the relative credit quality of the assets held within this business model after initial recognition to assess whether a significant credit quality deterioration has occurred when determining whether 12 month or lifetime expected credit losses are required to be recorded. “Section (2): Expected Credit Loss” of this document provides further details about how the expected credit loss model is applied.

1.1.5.3. Trading business model

If any assets do not fall in the held to collect business model or held to collect and sale business model, they will fall into the trading business model, provided they are listed on stock exchange, where they will be measured at 'Fair Value Through Profit or Loss' (FVPL). In this category, financial assets are measured at fair value with all fair value movements being recorded in the profit and loss account.

This will generally include assets that are held for short-term profit taking. For assets held in this business model, an assessment of cash flow characteristics is not necessary, since the asset will be carried at fair value. Banks are required to comply with requirements of IFRS 13 when determining the fair value of an asset.

1.1.6. Level at which business model assessment is applied

Banks generally represent complex businesses and will have more than one business model for managing financial instruments. For example, a bank could have one portfolio of investments managed to collect contractual cash flows and another portfolio of investments managed to sell to realise fair value changes.

In certain circumstances, it may be appropriate to separate a portfolio of financial assets into sub-portfolios to reflect how a bank manages those financial assets. For example, this may be the case if a bank frequently invests in corporate debt instruments and manages some of the debt instruments with an objective of collecting contractual cash flows and manages others with an objective of selling them to satisfy liquidity requirements. In fact, it is possible that a bank will have similar assets held in all three-business models.

QCB requires banks to apply the business model test at a level that is consistent with the practices used to manage its assets.

1.1.7. Contractual cash flows that are ‘solely payments of principal and interest/yield’

For assets held in the held to collect business model or the held to collect and sale business model to achieve amortised cost and FVOCI accounting, the cash flows relating to the assets need to represent SPPI/Y.

Contractual features that introduce exposure to volatility in cash flows that are not consistent with basic lending arrangements, such as changes in commodity or equity prices do not give rise to cash flows that are SPPI/Y. For example, convertible bonds, profit participation credit facilities and shares of investment funds that are not covered in the definition of equity instruments, and will not meet the SPPI/Y condition.
The application of cash flow characteristics test (CCT) is inherently complex and depends on the contractual terms of the assets (or portfolios of assets). QCB requires banks to use the guidance provided above to judge if the cash flows represent SPPI/Y. In addition, banks are required to submit information to QCB about any significant judgment made when assessing SPPI/Y features for various types of cash flow features.

1.1.8. Designation option at fair value through profit and loss (“FVPL”)

IFRS 9 provides a mixed measurement model under which some financial instruments are measured at fair value and others at amortised cost; some gains and losses are recognised in profit or loss and others in other comprehensive income. This combination of measurement and recognition requirements can result in inconsistencies (sometimes referred to as an ‘accounting mismatch’) between the accounting for an asset (or group of assets) and a liability (or group of liabilities). An accounting mismatch occurs when assets and liabilities that are economically related (that is, share a risk) are treated inconsistently. This could occur where, in the absence of the fair value option, a financial asset is classified as FVOCI (with most changes in fair value recognised directly in other comprehensive income), while a related liability is measured at amortised cost (with changes in fair value not recognised). In such circumstances, the bank may conclude that its financial statements would provide more relevant information if both the asset and the liability were classified as at fair value through profit or loss.

It is possible that assets that would otherwise achieve amortised cost or FVOCI accounting will be designated at FVPL. Such a choice is only available at inception and is irrevocable thereafter and subject to the condition that designating an asset at FVPL would reduce or eliminate a measurement or recognition inconsistency (“accounting mismatch”).

For practical purposes, banks need not enter into all of the assets and liabilities giving rise to measurement or recognition inconsistency at exactly the same time. A reasonable delay between the acquisition of an asset and issue of liability is permitted provided that each transaction is designated as at fair value through profit or loss at its initial recognition and, at that time, any remaining transactions are expected to occur.

‘Reasonable delay’ should be assessed on a case-by-case basis, based as to what is reasonable in the circumstances. For example, a ‘reasonable delay’ could be a fairly short period in the case of entering into a derivative to offset some of the risks of an asset. A longer period could be justified if the delay arises from the need to assemble a portfolio of similar assets and arrange their funding. However, all financial assets and liabilities designated as at fair value through profit or loss must be accounted for on this basis from their initial recognition (and not only from the time any offsetting position is entered into).

The bank should notify QCB of any plans to exercise the option to designate financial instruments at FVPL to reduce or eliminate a measurement or recognition inconsistency ahead of such designation.

1.1.8.1. Reclassifications

Business models are not expected to have frequent changes resulting in changes in accounting classification of financial instruments. Reclassification of assets between the different accounting categories is only allowed when there is a change in the business model for managing the financial asset. QCB expects that such changes will be infrequent and does not foresee regular movement of assets between accounting categories.

At the approval of the board of director, a change in the business model is determined by a bank’s executive management, as a result of external or internal changes which must be significant to the bank’s operations and should be evident to external parties. QCB requires banks to develop relevant policies, control procedures and processes to ensure that any changes in business model resulting in a different accounting classification are assessed against IFRS 9 requirements and guidance provided in this document before such changes are applied. In all cases, no reclassification may apply to equity instruments after initial recognition.
Reclassifications should be accounted for prospectively from the reclassification date without restating any gains or losses recognized in previous periods. The following table shows the different reclassification scenarios and their accounting consequences:

<table>
<thead>
<tr>
<th>Original category</th>
<th>New category</th>
<th>Amounting impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amortised cost</td>
<td>FVPL</td>
<td>Fair value is measured at reclassification date. Difference from carrying amount should be recognised in profit or loss.</td>
</tr>
<tr>
<td>FVPL</td>
<td>Amortised cost</td>
<td>Fair value at the reclassification date becomes its new gross carrying amount. The effective interest/yield rate is determined based on fair value at the date of reclassification.</td>
</tr>
<tr>
<td>Amortised cost</td>
<td>FVOCI</td>
<td>Fair value is measured at reclassification date. Difference from amortised cost should be recognised in OCI. The effective interest/yield rate is not adjusted as a result of the reclassification.</td>
</tr>
<tr>
<td>FVOCI</td>
<td>Amortised cost</td>
<td>Fair value at the reclassification date adjusted for the cumulative gain or loss in OCI becomes its new amortised cost/carrying amount. i.e., the instrument is measured as if was always measured under the new category since initial recognition. However, the effective interest/yield rate determined at initial recognition and gross carrying amount are not adjusted as a result of the reclassification.</td>
</tr>
<tr>
<td>FVPL</td>
<td>FVOCI</td>
<td>Fair value at reclassification date becomes its new carrying amount. The effective interest/yield rate is determined based on fair value at the date of reclassification.</td>
</tr>
<tr>
<td>FVOCI</td>
<td>FVPL</td>
<td>Fair value at reclassification date becomes its new carrying amount. Cumulative gain or loss in OCI is reclassified to profit or loss at reclassification date.</td>
</tr>
</tbody>
</table>

Prior to implementing any changes under IFRS 9 for the classification of any financial assets, banks are required to obtain QCB’s No Objection after submission of the following information to QCB:
- Previous classification;
- Circumstances of change in Business Model;
- Time in previous classification category;
- New classification;
- Description of accounting consequences;
- Board’s approval; and
- Impact on financial statements and regulatory ratios;

### 1.2. Classification and measurement of financial liabilities

#### 1.2.1. Initial recognition

Consistent with current practice, all financial liabilities under this instructions should initially be recognised at fair value, minus (in the case of a financial liability that is not at fair value through profit or loss) transaction costs that are directly attributable to issuing the financial liability. Fair value is to be measured under IFRS 13, which is already effective since 1 January 2013. Banks should refer to IFRS 13 for the relevant fair value measurement guidance.
1.2.2. Classification and measurement

The classification and measurement of financial liabilities remains the same as current requirements contained in IAS 39, with the exception of the treatment of the bank’s own credit gains and losses, which arise where a bank has chosen to measure a liability at fair value through profit or loss. There continue to be two measurement categories for financial liabilities: fair value and amortised cost.

Financial liabilities are measured at amortised cost except for:
- Financial liabilities held for trading and financial derivatives.
- Where the bank opts to measure certain financial liabilities at fair value. The criteria to apply the fair value option is restricted to the following cases:
  - electing fair value will eliminate or reduce an accounting mismatch; or
  - the instrument is a hybrid that would require separation of an embedded derivative.

When a bank opt to designate a financial liability at FVPL using the fair value option, the changes in fair value of such liability related to changes in own credit risk (“own credit gains or losses”) are presented separately in OCI, and are not recycled to profit or loss, even when the liability is derecognised and the amounts are paid. Instead, own credit gains and losses should be reclassified to retained earnings within equity upon derecognition of the relevant liability.

Financial liabilities that are required to be measured at fair value through profit or loss (as distinct from those that the bank has chosen to measure at fair value through profit or loss) continue to have all fair value movements, including those related to changes in the credit risk of the liability, recognised in profit or loss. This includes all derivatives or a bank’s own liabilities that it classifies as ‘held for trading’.

In all the cases that would result in the measurement of financial liabilities at fair value, the bank is required to obtain QCB’s No Objection in advance.

1.3. Derivatives

Derivative financial instruments are required to be carried at fair value with movements in fair value recorded in profit and loss, unless the derivative is designated into a hedging relationship and hedge accounting is applied. In the case where a derivative is designated into a hedging relationship, then the hedge accounting rules in paragraph 1.4 “Hedge accounting rules” are applied to determine applicable accounting.

Additionally, as noted later, IFRS 9 removes the requirement of bifurcation of derivatives from host contracts. This means that the cash flows attaching to embedded derivatives (under IAS 39) will now be considered as part of the cash flow characteristics assessment to assess whether they constitute SPPI/Y. Depending on the significance of terms of the embedded derivatives, this change is likely to result in a change in the classification of host contracts relative to the accounting it would have achieved under IAS 39.

1.3.1. Embedded derivatives

IFRS 9 removes the requirement contained in IAS 39 relating to bifurcation of an embedded derivative from an asset host contract. However, banks are still required to separate derivatives embedded in financial liabilities where they are not closely related to the host contract. The separated embedded derivative continues to be measured at fair value through profit or loss and the residual debt host liability should be measured at amortised cost. Accordingly, banks are required to consider the cash flows relating to embedded derivative embedded in a debt assets host contract as part of the CCT to assess whether they represent SPPI/Y.
1.4. **Hedge accounting rules**

The purpose of this section is not to provide detailed guidance on how banks should apply the requirements of IFRS 9 in relation to hedge accounting. Instead, this section highlights the key changes introduced by IFRS 9 affecting accounting for derivatives.

IFRS 9 provides a new framework for hedge accounting, which improves decision usefulness of financial statements by better aligning hedge accounting with risk management activities of a bank. The IFRS 9 hedge accounting model applies to all types of hedges with the exception of fair value hedges for the interest/yield rate exposure of a portfolio of financial assets and liabilities (commonly referred to as ‘fair value macro hedges’). This exception was introduced as the IASB is currently working to develop a macro hedge accounting framework.

In the meantime, until the macro hedge accounting project is completed, banks are required to continue to apply the IAS 39 requirements for fair value macro hedges.
2. Section (2): Expected Credit Loss

2.1. Overview

On the application of these instructions, banks should adopt the expected credit losses (ECL) model that is introduced by IFRS 9 for the recognition of impairment losses on financial assets. The model should be applied to:

- Credit facilities and investments in debt instruments measured at amortised cost;
- investments in debt instruments measured at fair value through other comprehensive income (FVOCI);
- all credit commitments not measured at fair value through profit or loss;
- financial guarantee contracts to which IFRS 9 is applied and that are not accounted for at fair value through profit or loss;
- lease receivables that are within the scope of IAS 17, ‘Leases’, and trade receivables; and
- all debt-type Islamic finance products.

Any credit exposures to the Government of Qatar, represented by the Ministry of Finance and QCB are exempted from the application of expected credit loss model.

The expected credit loss model will not be applied to any credit exposures to the Government of Qatar, represented by the Ministry of Finance and QCB.

IFRS 9 contains a ‘three stage’ approach to recognise credit impairment, which is based on the changes observed in credit quality of financial assets since initial recognition. Assets move through the three stages as credit quality changes and the stages dictate the level of impairment losses to be recognised.

Extensive disclosures are required, including reconciliations from opening to closing amounts of the ECL provision, assumptions, and inputs.

‘Three-stage’ model (‘general model’) for recognition of credit impairment based on changes in credit quality since initial recognition:

<table>
<thead>
<tr>
<th>Change in credit quality since initial recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognition of expected credit losses</td>
</tr>
<tr>
<td>12-month expected credit losses</td>
</tr>
<tr>
<td>Interest/yield revenue</td>
</tr>
<tr>
<td>Effective interest/yield on gross carrying amount</td>
</tr>
<tr>
<td>Stage 1</td>
</tr>
<tr>
<td>Performing (Initial recognition*)</td>
</tr>
</tbody>
</table>
**Stage 1** includes financial assets on initial recognition and that have not had a significant increase in credit risk since initial recognition or that have low credit risk at the reporting date. For these assets, 12-month ECL are recognised and interest/yield revenue is calculated on the gross carrying amount of the asset (that is, without deduction for credit allowance). 12-month ECL is the expected credit losses that result from default events that are possible within 12 months after the reporting date. It is not the expected cash shortfalls over the 12-month period but the entire credit loss on an asset weighted by the probability that the loss will occur in the next 12-months.

**Stage 2** includes financial assets that have had a significant increase in credit risk since initial recognition but that do not have objective evidence of impairment. For these assets, lifetime ECL are recognised, but interest/yield revenue is still calculated on the gross carrying amount of the asset. Lifetime ECL are the expected credit losses that result from all possible default events over the expected life of the financial instrument. Expected credit losses are the weighted average credit losses with the lifetime probability of default (‘PD’) as the weight.

**Stage 3** includes financial assets that have objective evidence of impairment at the reporting date in accordance with the indicators specified in the QCB's instructions. For these assets, lifetime ECL is recognised and treated with the interests calculated on them, according to QCB’s instructions set forth in the Book of Instructions to Banks until September 2013. When transitioning financial assets from stage 2 to stage 3, the percentage of provision made for such assets should not be less than the percentage of provision made before transition.

In accordance with IFRS 9, the executive management and the board of directors, when determining whether the credit risk on a financial asset has increased significantly, should consider all reasonable and supportable information available, in order to compare the risk of a default occurring at the reporting date with the risk of a default occurring at initial recognition of the financial instrument.

It is expected that the new ECL model under IFRS 9 will result in higher provisions relative to the current QCB requirements and IAS 39 incurred loss model. One of the main drivers for that increase is that facilities and credit exposures will require provision for 12-month ECL for all assets on the first reporting date following initial recognition, which will result in level of provisions being raised. Additionally, when credit facilities transition to stage 2, lifetime expected losses will be recorded. This is also a significant change since at a comparable stage under IAS 39 performing assets would typically not be considered impaired and accordingly no provision would be recorded under IAS 39.

The new ECL model requires a significant amount of data in order to estimate the expected losses. In addition, it requires banks to make judgments about certain complex areas of accounting and other judgments related to credit risk management, which could materially affect the provision levels.

The next sections of these instructions focus on the key factors that banks should consider when preparing to apply the new requirements, QCB’s requirements on areas of accounting judgment and the modelling framework that banks should use to calculate ECL under IFRS 9.

### 2.2. QCB Instructions on Credit Facility Classification and Provision Determination

Instructions set forth in this section complement QCB Instructions to Banks – September 2013 – Pages 170-181, which specify credit facility classification and provision determinations. In applying these instructions, the following should be considered:

- Performing credit accounts: the instructions in stages 1 and 2 in this section will be applicable rather than the instructions provided for in Para. B/1 on Pages (171) of QCB Instructions to Banks - September 2013.
- Non-performing credit accounts: banks will continue to apply the instructions stated in Instructions to Banks – September 2013 and all relevant provisions, treatment and notifications.
2.2.1. Key considerations

This section describes some of the key areas affected by IFRS 9 and QCB’s requirements as to how banks will address the impact. The following are the areas of key impact:

2.2.1.1. Levels of provision

The exact impact of the absolute increase in provision levels will be affected by a number of factors including the credit quality of the assets held and the levels of impairment already recognised by a bank. QCB requires banks to quantify the impact of IFRS 9 provisioning on their credit exposures and assess the impact on their financial position and performance. It is almost certain that under all circumstances levels of impairment provisions will increase as a result of application of IFRS 9 ECL requirements relative to IAS 39 requirements. Accordingly, QCB requires that when exercising management judgment in the application of IFRS 9 ECL requirements, banks will be prudent and will not make any judgments that have the potential to decrease impairment levels.

2.2.1.2. Data requirements

To enable the calculation of ECL, banks will be required to develop IFRS 9 compliant ECL models. In order to apply these requirements, banks will have to gather historic data as well as develop forward-looking capabilities in their credit risk management systems and techniques.

For example, in order to judge significant deterioration in credit quality, banks are required to use life time PD as the relevant measure (See 2.4.1 “Measuring significant deterioration”, in page no. (21)). In practice this means that life time PD information is required on a year by year basis at origination and at IFRS 9 adoption date (and on an ongoing basis at each assessment date thereafter). This requires banks to develop capability to determine forward-looking PDs for each year of the life of a credit exposure. In addition, to calculate ECL forward-looking 12-month and lifetime PDs are required to be adjusted for the impact of macroeconomic factors that have an impact on PDs. This means that banks shall need to collect data on macroeconomic factors that affect particular exposures and calculate the sensitivity of PDs in respect of those factors, requiring advanced modelling techniques and relevant data.

QCB realises that this area is subjective and one bank’s assessment of these factors is likely to vary from another bank. To ensure alignment and consistency of macroeconomic factors used to create ECL models, QCB may require, at its discretion, banks to consider the possible effects of certain indexes and economic factors in a specific manner, from time to time.

In addition, banks will be required to develop or enhance their existing loss given default (“LGD”) and exposure at default (“EAD”) models based on forward-looking assumptions. All of this effort is based on availability and collection of data. QCB requires banks to prioritise data collection in their overall IFRS 9 implementation plans.

2.2.1.3. Systems and resources

Complying with the new requirements will likely mean investing in new systems. For example, to develop new IFRS 9 compliant ECL and PD models. In addition, IFRS 9 will require banks to train and upskill credit risk and finance teams in aspects of IFRS 9 affecting their operations to ensure they fully understand the requirements so that they are able to apply the requirements for the purposes of initial transition and on an ongoing basis under IFRS 9.
2.2.1.4. Alignment with risk management

Under IFRS 9, the information that is captured in credit risk departments will feed and directly impact the levels of impairment to be recognised. For example, PD information captured will directly impact the decisions to determine correct categorisation of exposures into various provisioning stages and the calculation of expected losses. Following the same principles, judgments made by financial reporting functions, such as what constitutes significant deterioration or thresholds to meet to achieve backward transition (See 2.4.2 “Backward transition” in page no. 21) will impact the data that credit risk teams will have to collect to aid decision making and expected loss recognition by finance departments.

Accordingly, QCB requires banks to review the interaction between credit risk and financial reporting departments and align the processes, policies, and procedures to ensure coordination between the two departments and alignment of approach to deliver a successful transition to and ongoing reporting under IFRS 9 after 1st January 2018.

2.2.1.5. Accounting policies and practices

IFRS 9 will have an obvious impact on existing accounting policies, processes, and procedures since existing policies will have to be replaced with IFRS 9 compliant policies. IFRS 9 is a principle based standard and includes a number of areas, which involve exercise of judgment. QCB illustrates some of the key accounting judgment areas, which banks should use in developing their approach to application of the new requirements (See 2.2.1 “Key considerations” in page no. 13). However, QCB requires that banks will not limit their assessment of key judgment areas to the ones highlighted in this paper and will assess all other areas where exercise of management judgment is required and document their judgment and reasoning for arriving at particular decisions and have those reviewed by their auditors and approved by their appropriate level of management.

QCB requires banks to develop new or update existing accounting policies and procedures manuals such that staff can use those manuals as reference material when reporting under the new requirements.

2.3. Shape of ECL Model

The IFRS 9 approach to calculation of ECL and assessment of deterioration of credit risk is highly complex and demanding in nature. This section provides the approach that QCB requires banks to use to calculate ECL under IFRS 9 and the steps that should be followed in doing so. Expected credit loss form will not be applied to balances with the Government of Qatar.

2.3.1. Define the population in each stage

As outlined earlier, IFRS 9 ECL requirements are driven by the provisioning stage in which a particular credit exposure is classified. Accordingly, the first step for any ECL calculation is to determine the population of credit facilities in each of the three stages, keeping in mind the information required to make such an assessment. This process can be summarised graphically as presented on next page: the first step is to determine whether any of the exposures meet the definition of low credit risk assets. It is important to isolate this population as these credit exposures will be classified in stage 1 and will always stay in that stage unless significant change occur to require movement to stage 2.
Banks are required to develop policies to determine assets that can be considered as ‘low credit risk’ as per the guidance and requirements contained in IFRS 9. However, QCB’s views noted in paragraph 2.4.4 “Low credit risk asset” in page no. (22) should be considered to be the minimum benchmark.

2.3.2. Deterioration of credit quality of the asset after initial recognition?

IFRS 9 ECL requirements provide that all exposures (with the exception of those with an explicit expectation of credit deterioration) will be classified in stage 1. Subsequent to initial recognition, IFRS 9 requires banks to make a relative assessment of deterioration of credit quality, i.e., an assessment of whether the quality of credit has deteriorated relative to the assessment of credit quality performed at initial recognition of the credit exposures.

In 2.4.1 “Measuring significant deterioration” in page no. (21), QCB’s requirements are provided regarding the measures that banks will use to make this determination and the allowable approaches to determine significance of deterioration. Banks are required to comply with these measures and report their key judgments and decisions to QCB.

Financial assets that demonstrate significant deterioration in credit quality since initial recognition but no objective evidence of impairment fall into stage 2 and require lifetime expected loss.

2.3.3. Non-performing asset

Assets where there is objective evidence that they are non-performing, are to be placed in stage 3 also requiring lifetime expected loss in accordance with QCB instructions.

2.3.4. Transition back between stages

IFRS 9 ECL requirements foresee that exposures can also transition backward from a higher credit risk stage into a lower credit risk stage. However, such backward transition can only be achieved if the credit exposure demonstrates evidence of improvement in credit quality. Paragraph 2.4.2 “Backward transition” in page no. (21), provides QCB’s requirements as to how such a transition should be determined and QCB’s requirements from banks in this regard.
2.3.5. Credit commitments and financial guarantees (payment guarantees)

Credit commitments include all the bank’s off balance sheet commitments to grant credit, under which the bank is bound to grant it customers different types of credit facilities where it is unutilised or not converted into cash facilities at the date of measurement. For credit commitments, the bank considers changes in the risk of a default occurring on the credit facility to which a credit commitment relates. For financial guarantee contracts, the bank considers the changes in the risk that the specified debtor will default on the contract. The date that the bank becomes a party to the commitment is considered to be the date of initial recognition for the purposes of applying the impairment requirements to both credit commitments and financial guarantee contracts.

ECL for credit commitments and financial guarantees represent a probability-weighted estimate of the difference, over the remaining life of the financial instrument, between:

\[
\text{Present value of contractual cash flows if the bank becomes obliged to extend} \quad - \quad \text{Present value of cash flows the bank expects to receive}
\]

An estimate of ECL on credit commitments should be consistent with expectations of draw-downs on that credit commitment. The bank should consider the expected portion of the credit commitment that will be drawn down within 12 months of the reporting date when estimating 12-month ECL, and the expected portion of the credit commitment that will be drawn down over the expected life of the credit commitment when estimating lifetime ECL.

For a financial guarantee contract, the bank is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder (the beneficiary) for a credit loss that it incurs, less any amounts that the bank expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee.

ECL on financial guarantee contracts, or on credit commitments for which the effective interest/yield rate cannot be determined, are discounted by applying the rate that reflects the current market assessment of the time value of money and the risks that are specific to the cash flows. In this case, risks should be adequately addressed by adjusting the discount instead of adjusting the cash flows.

Banks should recognise ECL in the balance sheet as a provision (that is, a liability) for credit commitments and financial guarantee contracts. To build expectations of draw-downs on credit commitments and cash shortfalls for the asset subject to financial guarantees, QCB requires banks to use the credit conversion factors established by Basel III and QCB Instructions in this regard.

2.3.6. Define the approach to prepare the ECL model

Once the financial assets have been categorised into relevant provisioning stages, banks are required to calculate 12-month expected losses for stage 1 and lifetime expected losses for stages 2 and 3.

\footnote{When determining the probability-weighted estimate, Islamic banks should use Sharia’ compliant methods to estimate the equivalent to present value of cash flows as input in the formula.}
QCB requires that banks use the following general model to measure the provision for ECL for assets in stage 1 and stage 2:

\[ \text{Probability of default (PD)} \times \text{Loss given default (LGD)} \times \text{Exposure at default (EAD)} \]

Below is how the inputs to the model are measured.

### 2.3.6.1. Probability of default (“PD”)

The IFRS 9 ECL emphasis on recording losses that are expected contrary to those that have already incurred, and it is generally required that PD information used when measuring impairment should be forward-looking. In measuring ECL for 12-month and lifetime of an exposure, a bank should consider all reasonably available information, especially forward-looking information about macroeconomic factors that have an impact on the PD of an exposure.

Banks may derive the lifetime PDs from models, which are already in place at banks. However, banks should ensure that the information produced by such models is fit for the purpose of IFRS 9 ECL measurement. For example, banks should ensure that PD models can provide forward-looking capabilities to calculate lifetime PDs. Should existing PD models not be fit for that purpose, QCB requires banks to either develop new PD models or enhance existing PD models ensuring IFRS 9 relevant information can be produced by these models.

The purpose of this document is not to determine how banks will calculate PDs as all banks will have their own credit risk estimation models and techniques. However, as outlined above the key requirement is that these models and techniques should be capable of providing forward-looking information.

The likelihood of PDs does not necessarily increase in the form of linear relationship with time, and therefore QCB requires banks to provide information about changes in PDs across different time periods.

QCB requires banks to estimate PDs prudently taking into account all the relevant information that can be gathered.

QCB requires banks to map their internal credit risk rating models to Moody’s credit rating (QCB accepts equivalent other credible credit rating systems). The following is the Moody’s Global Long-Term Rating Scale:

- **Aaa** Obligations rated Aaa are judged to be of the highest quality, and carry the lowest level of credit risk.
- **Aa** Obligations rated Aa are judged to be of high quality and very low credit risk.
- **A** Obligations rated A are judged to be upper-medium grade and carry a low credit risk.
- **Baa** Obligations rated Baa are judged to be medium-grade and carry a moderate credit risk and as such may possess certain speculative characteristics.
- **Ba** Obligations rated Ba are judged to be speculative and carry a substantial credit risk.
- **B** Obligations rated B are considered speculative with a high credit risk.
- **Caa** Obligations rated Caa are judged to be speculative of poor standing and carry a very high credit risk.
Ca  Obligations rated Ca are highly speculative and are likely for PDs, with some prospect of recovery of principal and interest/yield.
C  Obligations rated C are the lowest rated and are typically in default, with no prospect for recovery of principal or interest/yield.
D  Obligations rated D are in default, with little prospect for full recovery of principal or interest/yield.

When applying the above, the ratings C and D will include past due assets for 90 days or more that will be classified as non-performing in accordance with QCB instructions, so rating C represents sub-standard accounts, while rating D represents doubtful and bad accounts.

These ratings apply to long-term balances of banks, corporates and sovereign. However, the PD may differ according to the nature of client.

QCB requires banks to map their short-term credit rating system to the above Long-Term Rating Scale using the Moody’s linkage with its Short-Term Rating Scale.

Banks should ensure that the PDs that will be used for the purposes of applying the IFRS 9 ECL model, will be those that provide an estimate over the next 12 months and lifetime of the credit exposure and is forward-looking in nature.

QCB requires banks to report the PD levels that are likely to be achieved (including the process used, which will derive the PDs) for all of their credit exposures in accordance with the requirements of IFRS 9 and the guidance provided in this document (See paragraph 3.2 “Implementation timeline” in page no. 26). Banks are required to use the format provided in the appendices to:

- Present how their internal credit rating system is mapped to Moody’s credit rating definitions (or equivalent); and
- provide 12 months and lifetime PD for each of the credit ratings.
- group outstanding balances and related provisions according to these credit ratings of Moody’s for ECL Stages 1 and 2; and

Based on the information provided by banks, QCB will review the PD levels and may provide, from time to time, any additional guidance or minimum limits on PD levels for specific portfolios or assets as it sees fit.

MACROECONOMIC FACTORS

In order to derive forward-looking PD information, banks are required to overlay specific macroeconomic information to the PD information. This can be achieved, for example, by adjusting the PD information for its sensitivity to changes of certain macroeconomic factors.

Banks will be required to perform their own analysis to assess the impact of such macroeconomic factors on their credit exposures and determine forward-looking PD information to be used for ECL calculations. However, QCB does not expect significant discrepancies across the banking sector when calculating the effect of macroeconomic factors on PD. However, it is highly subjective and complex and will require banks to develop models that can be used to convert macroeconomic factors into forward-looking PD indicators. QCB expects that banks will invest in such infrastructure to ensure expected risk in an exposure is appropriately captured and recorded.

RETAIL AND PERSONAL CREDIT

QCB expects banks to provide information about the internal credit risk rating systems for retail lending and the techniques used to estimate 12 month and lifetime PDs.
Banks can be guided by the credit assessment provided by the Qatar Credit Bureau for personal facilities. Until instructions of QCB are issued by coordination with the Qatar Credit Bureau, banks can estimate PD and ECL at the level of each portfolio of retail facilities that has identical credit risk characteristics (such as portfolio of salary loans for Qataris and another for non-Qataris, or salaries of the government and non-government sectors, etc.), after QCB’s No Objection is obtained.

For the purpose of these instructions, qualifying retail facilities are balances that meet the following criteria:

- Small and medium entities credit portfolio: all types of credit extended to entities within the unified definition, as included in QCB instructions.
- Portfolio of credit against salary: credit extended to individuals against their salaries within the limit of QR 2 million in accordance with QCB instructions, including credit cards, overdrafts, personal loans and finance lease contracts (e.g., instalment credit, car loans, finance lease contracts, student credit, and education credit).
- Personal finance portfolio: credit extended to individuals that is outside the cap set for credit against salary.

### 2.3.6.2. Exposure at Default (“EAD”)

EAD represents the amount of potential exposure that is at risk. Generally, calculating EAD will be a straightforward task when measuring ECL. However, since ECL is a forward-looking measure, EAD input will be forward-looking as well as based on the time period when the default is likely to occur. Therefore, it includes all outstanding in and off balance sheet exposures after adjustment with contractual cash flows to reflect the exposure expected when default occurs. In addition, EADs will also include any prepayments the bank expects, in accordance with documentary evidence and historical experience, to be made before the due date.

However, EAD will exclude any unearned/deferred in respect of any Shariah compliant financing arrangements.

### 2.3.6.3. Loss Given Default (LGD)

LGD is the percentage that determines the amount of loss that will arise if the borrower was to default. This is calculated by looking at the collateral and other resources available to the bank that can be used to recover the asset in case of default. However, the value of the collateral should consider the various factors as noted below:

LGD is calculated as follows:

\[
\text{EAD} - \text{Expected recovery} \over \text{EAD}
\]

The amount of expected recovery is calculated based on the present value of the amounts expected to be received from foreclosure of collateral less cost of recovery, and based on the estimated future value of the collateral and other reliable resources according to documented experience of the bank.

The following table summarizes the derivation of these assumptions:

---

Islamic banks should use Sharia’ compliant methods to estimate the equivalent to present value of expected amounts from foreclosure of collateral less cost of recovery.
## Assumption | Description
--- | ---
**Forward collateral projection** | Banks should determine the value of the collateral at expected time of foreclosure of the collateral.
**Government collaterals** | Collaterals extended by the Qatari Ministry of Finance that are fully deducted without reduction with any haircuts.
**Haircut** | Banks should apply reduction to the value of the collateral due to forced/distressed foreclosure. The haircut applied should be based on the banks past experience and the credit rating of the guarantor (PD), provided haircut percentages of in-kind guarantees are not less than those given on pages 175-176, relative to haircuts applied to guarantees of provisions calculated under QCB’s Instructions to Banks Book 2013.
**Cost of recovery** | The costs incurred to possess and sell the collateral, e.g. legal fees, agent fees, etc. should be deducted when measuring the amounts recoverable.
**Time to recovery** | Banks should be guided by their past experiences as to the time required between default and recovery of collateral.
**Interest/yield rate** | The discount rate used should be the original effective interest/yield rate (EIR) of the instrument

QCB expects that banks can leverage their existing credit risk systems and techniques to be able to provide such information for the ECL calculation. However, since ECL is a forward-looking estimate, banks will be required to ensure that accurate forward-looking collateral information can be provided for the purpose of calculating ECL under IFRS 9. This will be influenced by a number of factors such as the nature of collateral, availability of forward-looking information about the value of the collateral and ability to sell, etc. However, QCB requires banks to gather all relevant and supportable information to enable them to arrive at accurate information about value of the collateral at a future point in time.

### 2.3.6.4. Use of scenarios

The identification of scenarios that specify the amount and timing of the cash flows for particular outcomes and the estimated probability of those outcomes will be needed. QCB requires banks to at least use two scenarios when estimating ECL. This typically includes various scenarios of LGD loss rate, e.g. execute mortgage on the collateral or restructure of facility, or refrain from taking any action. However, banks are free to use up to five scenarios. QCB requires these scenarios to be applied at an overall PD level to simplify the implementation effort.

### 2.4. Accounting judgment

In this section, QCB provides its views on some of the complex areas where IFRS 9 requires the executive management and the board of directors of a bank to exercise significant management judgment. In order to guide banks in making those judgments and to achieve highest degree of consistency of application across the banking industry in Qatar, QCB has provided its views with which banks are required to comply as a minimum standard. However, banks should not consider these requirements as exhaustive. Banks are required to identify and consider other complex areas where exercise of management judgment is required and ensure that any key decisions made are well documented, reviewed by their auditors and approved by the board of director.
QCB expects that banks and their auditors will work to ensure consistent application of IFRS 9 requirements on key areas of accounting and practical judgment arising in the implementation of IFRS 9. In this regard, QCB’s requirement is that all audit firms will hold joint periodic meetings, as required, whereby they will discuss key issues arising in the implementation of IFRS 9 or any other relevant standards; strive to achieve consensus of views; and report to QCB the agreed upon results and proposals. This will provide QCB the comfort that all issues are resolved using views that are consistently applied across the financial services sector and are carefully considered.

2.4.1. Measuring significant deterioration

IFRS 9 requires that credit exposures in stage 1 (where only a 12-month ECL is required) should transition to stage 2 (where lifetime expected losses are required), when a significant deterioration takes place in the credit quality of the exposure. The standard provides guidance as to what measures can be used to assess deterioration in credit quality or the magnitude of deterioration that would be considered as significant.

IFRS 9 also requires banks to use forward-looking information when assessing the occurrence of significant deterioration in the credit quality of any exposure. Banks should also use information on defaults to conduct such assessment. IFRS 9 assumes deterioration of credit quality of any financial asset substantially when payment of instalments is past due for more than 30 days, unless the bank has reasonable and backed up information to use longer periods of delay, which will not exceed 60 days in all cases.

2.4.1.1. Benchmark

QCB requires banks to report how the significant deterioration in credit quality is determined. In all cases, QCB requires to consider the below changes in credit quality grades as a minimum cause to determine any significant change in PD unless there is delay in payment of due instalments is past due as indicated above:

<table>
<thead>
<tr>
<th>Credit quality grade according to Moody's rating scale at initial recognition – Stage 1</th>
<th>Significant change in credit quality grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aaa</td>
<td>Two notch downgrade</td>
</tr>
<tr>
<td>Aa</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td></td>
</tr>
<tr>
<td>Baa</td>
<td>One notch downgrade</td>
</tr>
<tr>
<td>Ba</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td></td>
</tr>
<tr>
<td>Caa</td>
<td></td>
</tr>
</tbody>
</table>

2.4.2. Backward transition

2.4.2.1. stage 3 to stage 2

Under IFRS 9 requirements, credit exposures can also transition from higher credit risk categories to lower credit risk categories, i.e., from stage 3 to stage 2 (‘backward transition’). Banks should comply with the instructions stated in clause (second), on Page (179) of Instruction to Banks Book- September 2013.

2.4.2.2. stage 2 to stage 1

Credit exposures may transition back from stage 2 to stage 1 when the credit quality of the credit facility shows sign of significant improvement in lifetime PD. Set out below are considerations to be used in determining whether an exposure should transition back from stage 2 to stage 1:

- Up-to-date with payments: All outstanding payments on the credit facility are made on time and no payments are in arrears.
Probation period: The PD has remained below the threshold that is considered a 'significant increase' for a minimum period of 12 month.

QCB requires banks to provide to QCB before the end of each quarter details about all the exposures that they intend to transfer from stage 2 to stage 1, and the value of change in credit loss provision and its impact on the statement of profit or loss, in order to obtain QCB's relevant No Objection. In this regard banks should provide all necessary information that was considered in arriving at the decision to backward transition the exposure from stage 2 to 1 including any policy prepared by the bank.

2.4.3. Classifications for amounts due from banks

Moody’s rating scale discussed earlier applies to non-short term balances due from banks. For practicality, it is QCB’s view to categories all types of short term balances due from banks into the impairment stages based on external credit rating of the banks. In case of absence of external credit rating, internal credit rating should not exceed Ba. Balances of such banks are categorized in stage 2 at initial recognition, or on the first application of these instructions, unless it meets the definition of non-performing, in such case it will be categorized in stage 3. In addition, the PD used by the external credit rating agency can be used for each category.

2.4.4. Low credit risk assets

When determining the classification of different financial assets during provisioning stages related to these assets, IFRS 9 provides an exception for the general model of low credit risk assets, as at the date of reporting. Under this exception, financial assets classified as having ‘low credit risk’ will only be covered in 12-month expected losses form. Accordingly, it is not required to assess whether there are any significant increase in credit risks. The use of this practical method is not mandatory, and a bank will have the option to apply the general form of those assets.

According to QCB, the assets with low credit risks include:

- Local sovereign that carry credit rating of (Aaa) or (Aa), and these assets carry (zero) credit weight in accordance with capital adequacy instructions.
- Externally rated debt instruments of rating (Aaa) or (Aa).

If banks classify other assets in this category, they are required to obtain QCB’s No Objection together with the reasoning they consider for such rating.

Simplifying low credit risk is not intended to be a standard drive to recognise a 12-month ECL. Rather, if credit risk is no longer low, banks should assess whether there has been a significant increase in credit risk to determine whether they should recognize the expected credit losses over the instrument lifetime. This means that if the credit risks of the instrument increases to the extent that they are no longer classified as low credit risks, these risks are not included automatically within the stage (2). Bank should assess whether the credit risk has appeared before calculating the expected credit losses over the instrument lifetime.

2.4.5. ‘Lifetime’ for revolving credit facilities

IFRS 9 provides that the maximum period to consider when measuring expected credit losses is the maximum contractual period over which the bank is exposed to. Generally assessing lifetime for a fixed maturity credit exposure is easier to determine. However, these requirements give rise to a question as to what would be considered to be the maximum contractual period for credit facilities which are issued for a period of, say, 12 months, and at the end of the contractual maturity may be extended if both parties agree on revised terms. In practice, such credit facilities may be renewed many times.
In QCB’s view, the period that the bank should consider for measuring expected credit losses is the remaining period to maturity of the contract, i.e., 12-months in the previous example, unless the nature of the project being financed make it obligatory that the bank will renew contractual term for a period that matches the estimated cash flows of such project, as well as credit facilities extended by Islamic banks to their customers, which are set to short maturity periods. Yield on credit facility is then re-priced, but it is understood that aggregate period of the facility is extended to longer periods.

Another exception to this principle is with respect to those financial assets, which include an undrawn commitment, whereby the bank may be exposed to periods beyond the contractual maturity of the asset. An example of such is a facility would be a credit card, which may be cancelled at a relatively short notice by the bank but in actual practice, exposes the banks to credit risk beyond the contractual maturity.

In this regard, QCB requires banks to consider expected credit losses on assets with undrawn commitments over a period that may be longer than the actual contractual period. Banks will be required to clearly document such a longer period over which expected losses would be estimated and the information that supports such a decision.

2.4.6. Requirements of presentation and disclosure

IFRS 9 requires retrospective application with certain exceptions as stated in the standard. Retrospective application assumes that the standard is applied as if the requirements of the new standard have been applied on a permanent basis. However, IFRS 9 contains a number of diversions from retrospective complete application. QCB expects banks to take into account the transitional disclosure requirements as set forth in IFRS 9 upon the preparation of the first IFRS 9-compliant financial statements. In addition, banks should ensure they are compliant with the requirements of disclosure relative to the use of financial instruments in accordance with the requirements provided for in IFRS 9 and IFRS 7.

Qatar Central Bank requires the following:

ECL Provision is presented, including the relevant movement, as a separate item in the statement of income. The bank should recognize ECL in the balance sheet (i.e. under liabilities) for off-financial position obligations. For financial assets that are measured at FVOCI, provision of ECL will not be presented separately in the statement of financial position. However, the bank should disclose the provision in the notes to the financial statements. For financial assets carried at amortized cost and lease receivables, IFRS 9 does not describe how the ECL is presented in the financial statements, and does not mandatorily state the presentation of impairment loss separately in the statement of financial position. Banks are required to present the ECL provision, net of related financial assets, unless notes to the standard state otherwise. The disclosures required under IFRS 9 and IFRS 7 standard will be enough to present ECL of financial assets within the Stage 1 and Stage 2, and the provision for impairment of financial assets in Stage (3).

2.5. Governance requirements

To ensure a successful, well thought through and managed transition from IAS 39 to IFRS 9, banks are required to put in place a robust governance structure that is aligned to the Guidance on credit risks and accounting for expected credit losses’ issued by Basel Committee on Banking Supervision. Banks are required to comply in this regard with the following requirements as a minimum:

**IFRS 9 project steering committee**

Banks are required to form an IFRS 9 project steering committee to, at least manage the implementation process of IFRS 9. The steering committee should be comprised of members from the following departments:

- Credit department;
- Risk management department;
- Compliance department;
- Internal audit department;
- IT department; and
The steering committee will be responsible for the overall implementation of IFRS 9, including the following:

- performance of initial diagnostic and quantitative impact analysis to determine gaps;
- develop a granular transition plan for the application of IFRS 9;
- periodic reporting to the Board of Directors and to inform QCB in respect of the progress made and key issues that need to be addressed;
- assess the existing infrastructure and provide recommendations on the required changes or upgrades to be able to develop ECL infrastructure;
- develop ECL and PD models;
- make judgments on key areas where policy decisions are required;
- collect required data and other risk inputs;
- liaise and co-ordinate with senior management to ensure adequate adherence to the transition plan required by QCB;
- assess the role of auditors in the overall implementation effort;
- hold discussions with QCB where necessary;
- manage communication and information flows;
- monitor progress against timetables; and
- track issues and escalate reporting.

**Board of Directors**

QCB requires the Board of Directors, either through a sub-committee constituted for this purpose, or assign one of its committees, to play an active role in the decision making of the implementation process of IFRS 9. The Board of Directors will be required to discuss in their periodic meetings the progress in line with the preparation timeline provided by QCB. The responsibility of the Board of Directors in that regard is to:

- ensure the selection and appointment of qualified and competent members of the steering committee to administer the project;
- ensure the development of appropriate staffing and training strategies required for the application of IFRS 9;
- ensure compliance with the requirements of QCB in respect of IFRS9 implementation;
- review and approve the Bank’s transition plan; and
- quarterly review the progress report against the transition plan.

QCB’s requires that banks will take personal responsibility for their IFRS 9 implementation plans. Accordingly, QCB wants governance structures of a bank to be involved in key decisions and in ensuring that key milestones in IFRS 9 implementation as noted in Section 3 Effective date and transition rules are achieved, and QCB is kept abreast of progress about their implementation of IFRS 9.

### 2.5.1 Leveraging existing infrastructure

As discussed in Section 2.3, Shape of ECL Model, in page no. (14), the application of IFRS 9 requirements relating to calculation of ECL, requires banks to collect significant data, particularly in relation to lifetime PD at credit facility origination and at the impairment assessment date. This would require banks to have models for the calculation of PDs. Additionally; banks are required to calculate losses on an expected basis. This requires banks to calculate 12-month and lifetime forward-looking PDs, which can be achieved by adjusting lifetime PDs by applying the effect of macroeconomic factors. Accordingly, models will be required to convert lifetime PDs into forward-looking PDs. This presents significant challenges in development of the models and collection of data.

QCB considers it appropriate that banks may use some of their existing PD infrastructure to assist in the application of IFRS 9 ECL model. However, there may be basic conceptual differences in the existing PD infrastructure relative to the requirements of IFRS 9, which would need to be addressed before such infrastructure is used for IFRS 9 purposes. Below is some of the common differences between PD requirements under IFRS 9 and any existing PD models, which would need to be addressed before being used in the application of IFRS 9.
• **Time horizon:** Generally, existing PD models would provide 12-month PD estimates. However, under IFRS 9, banks would also require lifetime PD information. Accordingly, banks would be expected to make adjustments to any existing PD models to ensure that they are able to provide life time as well as 12 months PD estimates.

• **Definition of 12 month PD:** Generally, losses calculated under a regulatory model would cover 12-month ECL, which are generally considered to be “the expected cash shortfalls that could occur in the next 12-months”. However, IFRS 9 definition of 12-month PD is the “portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date”. Accordingly, where an existing PD models is used to calculate 12 month expected losses (i.e., for stage 1), banks should ensure that the definitions of 12 month ECL are aligned to IFRS 9 definition.

• **Point-in-Time (PIT) and Through-the-cycle (TTC):** Generally existing PD models would calculate PDs using ‘through the cycle’ measures, which are neutral to changes in conditions over the economic cycle covering the lifetime of the exposure. Under IFRS 9, probability of default should be ‘point in time’. The probability is estimated in current economic conditions and changes as the bank moves through the economic cycle. For the calculation of ECL under IFRS 9, PIT PDs are then adjusted to reflect impact of macroeconomic factors to arrive at forward-looking PDs. Accordingly, QCB instructs banks that such differences should necessarily be adjusted before using any existing PD models for IFRS 9 application.

The differences discussed in this section relate only to calculation of 12 month and lifetime PDs. One of the defining features of IFRS 9, as discussed in Section 2.2.1 Key considerations, in page (13), is that impairment losses are calculated based on forward-looking PDs. Section 2.3 Shape of ECL Model, in page (14) discussed in detail the approach that banks should adopt to calculate forward-looking PDs.

**2.5.2. Alignment of finance and risk management functions**

IFRS 9 ECL requirements dictate that risk information captured by credit risk team will feed directly into the ECL calculation. For example, PD and LGD information will be captured in the risk department. However, these inputs will have a direct impact on the provision levels calculated by finance. Of the same token, some of the accounting requirements will impact the information that credit risk teams will have to capture which they previously may not have. For example, the IFRS 9 calculation requires banks to capture lifetime PD information. Credit risk teams previously will not have captured this information, since it was not required to do so under the financial reporting or current regulatory requirements.

Finance department and credit risk management department should work together under the approved planning framework for IFRS 9 implementation, clearly identifying relevant data requirements, systems and IT enhancements, risk and accounting policies and procedures that need to be developed and/or enhanced and human and other resources required for a successful implementation of IFRS 9 and ongoing operation under IFRS 9.

**2.5.3. Testing the validity of ECL forms**

ECL requires under IFRS 9 the use of several accounting estimates that do not only include the previous experience, but sometimes involve the expectations of future events. Therefore, the bank should regularly test the safety and accuracy of the models used in order to develop these estimates and compare them with real results. The bank’s internal audit department and external auditor are required to conduct such tests at least once a year, and to submit to QCB the reports of the bank’s internal audit department the external auditor inclusive of any amendments that may be required on the bank’s systems to be align with the latest information.
3. **Effective date and transition rules**

3.1. **Effective date**

The full implementation of IFRS 9 is effective for financial reporting periods starting on or after 1st January 2018.

3.2. **Implementation timeline**

One of the key purposes of issuing the instructions document is for QCB to ensure that the transition to IFRS 9 will be achieved in a planned manner in the banking industry in the State of Qatar. This is important to ensure that relevant preparatory effort is timely and well thought out to avoid any issues at a later stage when banks may not have the time to address key issues.

This section provides QCB’s requirements for banks when implementing the requirements of IFRS 9 for the first time, in respect of timing of key actions and milestones to be achieved. QCB requires that banks will adhere to these timelines in order to ensure that a smooth transition can be achieved. As noted in this section, banks will be required to report periodically to the QCB about their progress in key areas and identify any issues arising that may need to be addressed.

Banks should prepare the first report on the credit rating of performing balances between the first and second stages according to the models attached and requirements stated in these instructions, as at June 30, 2017. QCB should be provided with the report no later than the 1 September 2017, together with a report from the bank’s external auditor on the bank’s compliance with the requirements of IFRS 9 and QCB instructions. It should be taken into account that the bank’s required tables and forms are prepared on a consolidated level and bank’s level individually in addition to each branch outside Qatar and each subsidiary inside and outside Qatar.

3.3. **Transition rules**

Banks shall apply IFRS 9 retrospectively, in accordance with the transition requirements and guidance contained in IFRS 9. That means 2018 comparative numbers, i.e., balance sheet numbers as at 31 December 2017, will be restated to reflect the effect of implementing IFRS 9. However, it shall not be applied to items that have already been derecognised at the date of initial application, i.e., 1 January 2018. Accordingly, the differences arising on initial application of IFRS 9 shall be adjusted though the opening retained earnings of the reporting period of initial application at 1 January 2018 without restating the comparative figures for 2017.

**CLASSIFICATION OF CREDIT ASSETS**

When starting to apply IFRS 9, the bank should classify all performing assets of debt instruments between the first stage and the second stage depending on the credit rating and the relevant changes on the rating between the date the credit is extended and the date IFRS 9 is applied. Provisions of ECL are estimated under the principles and guidance provided in these instructions.

When starting application, all debts are classified under the category of ‘special mention’ within the second stage in the category of ‘Ca’ unless they conform to any indication of default according to QCB’s instructions. If so, they are then classified under the third stage as non-performing assets, and appropriate provisioning is made in coordination with QCB, as currently applicable under the instructions of the classification of non-performing accounts and the provisions made therefore.
4. Appendices

Appendix a - Mapping internal credit risk ratings to Moody’s Long-Term Rating Scale

Separate from should be presented for each type of debtors

<table>
<thead>
<tr>
<th>Moody’s Rating</th>
<th>Moody’s detailed rating</th>
<th>Internal Rating</th>
<th>Definition</th>
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Ratings C and/or D are classified as non-performing credits according to QCB instructions and the ECL model does not apply to them. Banks should link their own internal ratings with Moody’s ratings taking into account the methodology of classification and definition that applies to the degrees of internal risk rating. It should be ensured, through this linking, that all Moody’s ratings have corresponding internal ratings that have been identified, to the maximum extent possible.
**Appendix b -12 Months and Lifetime PDs**

Separate form will be prepared for corporates and equivalents, banks, and sovereigns

<table>
<thead>
<tr>
<th>Moody’s Rating</th>
<th>Moody’s detailed rating</th>
<th>Internal Rating</th>
<th>PD %</th>
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<td>Aaa</td>
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</table>

- PD should represent the marginal possibility of default for the purposes of this Appendix (change in probability) for each time tier.
- A separate form should be prepared for each of the customers’ following categories:
  - Banks
  - Governments (other than the Government of Qatar represented by the Ministry of Finance, Qatar Central Bank only)
  - Institutions and companies (other than small and medium)
  - Individuals (other than retail)
Appendix c - Report\textsuperscript{3} of Credit exposure and provisions\textsuperscript{4}

(Form 1) Stage classification and ECL provisions, which is a form for extraction of data that depends on detailed assistive forms (Form 2), by each type of customer, age category, as indicated below\textsuperscript{5})

<table>
<thead>
<tr>
<th>Credit rating</th>
<th>Performing loans</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Stage 1</td>
</tr>
<tr>
<td>Moody’s Detailed Rating</td>
<td>Internal</td>
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<td>Aaa</td>
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\textsuperscript{3} Below detailed forms should be combined in one form.

\textsuperscript{4} Forms 1 and 2 are required at the level of the bank in Qatar, and the level of each external branch and the level of each subsidiary inside and outside Qatar, as possible, with one consolidated form for the banks and its group.

\textsuperscript{5} Separate forms are filed for credit commitments and financial guarantees that are presented off the financial position. Balances are analysed at least among the following categories:

1. Inside Qatar
2. Outside Qatar
3. Investments
4. Loans portfolio
5. Governments
6. Non-financial institutions

\textsuperscript{6} Analysis of debts in stage 2 on lifetime basis appears in form (2)
(Form 2) Stage classification and ECL provisions 7 (to be prepared separately for each type of custom-
er 8 and for each lifetime group)

<table>
<thead>
<tr>
<th>Moody’s Detailed Rating</th>
<th>Internal Rating</th>
<th>Performing credit facilities</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Exposure balance 30/6/2017</td>
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<tr>
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<tr>
<td>Total</td>
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</tbody>
</table>

7 These assistive forms should be analysed by the type of each customer and age category for exposures. These forms should be maintained with the banks and given to QCB when request at any time.
8 Separate forms are filed for credit commitments and financial guarantees that are presented off the financial position. Balances are analysed at least among the following categories:
1.1 Inside Qatar
1.2 Outside Qatar Investments
2.1 within held to collect business form
2.2 within held to collect or sale business form
Loans portfolio
3.1 Governments
3.2 Non-financial institutions
   3.2.1 Public sector (a. real estate, b. contracting, c. oil and gas, d. others)
   3.2.2 Private sector (a. real estate, b. contracting, c. others)
3.3 Individuals (other than retail)
3.4 Non-banking financial institutions
3.5 Retail
   3.5.1 Medium and small companies
   3.5.2 Individual against salaries
(Form d) Retail credit exposures and related provisions

<table>
<thead>
<tr>
<th></th>
<th>Stage 1</th>
<th>Stage 2(^9)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Exposure Balance as at 30/6/2017 (PD)</td>
<td>(EAD)</td>
<td>Average LGD</td>
</tr>
<tr>
<td>Medium and small Companies</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Individual against salaries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Qataris</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Qataris</td>
<td></td>
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</tbody>
</table>

\(^9\) Analysis of debts in stage 2 based on debt’s lifetime is presented in separate forms.