52. Application of IFRS 9 - Financial Instruments

This standard is included in the draft revision of IAS 39 and establishes the new requirements regarding the classification and measurement of financial assets and liabilities, the methodology for calculating impairment and for the application of hedge accounting rules.

IFRS 9 - Financial Instruments was endorsed by EU in November 2016 and come into force for periods beginning on or after 1 January 2018. IFRS 9 has replaced IAS 39 - Financial Instruments: Recognition and Measurement and provides new requirements in accounting for financial instruments with significant changes specifically regarding impairment requirements. For this reason, it is a standard that has been subject to a detailed and complex implementation process that has involved all the key stakeholders in order to understand the impacts and the changes in processes, governance and business strategy that may involve.

The requirements provided by IFRS 9 are, in general, applied retrospectively by adjusting the opening balance at the date of initial application (1 January 2018).

Financial Instruments IFRS 9

In July 2014, the IASB issued the final version of IFRS 9 - Financial Instruments. In October 2017, the IASB issued the document "Prepayment features with negative compensation (amendments to IFRS 9). The changes are effective for annual periods beginning on 1 January 2019, with early adoption allowed.

The Group applied IFRS 9 and adopted in advance the modifications made to IFRS 9 in the period beginning as at 1 January 2018. The impact of the adoption of IFRS 9 on the Group's equity attributable to shareholders of the Bank, with reference to 1 January 2018 was negative of Euros 345,207,000.

The accounting policies in force in the Group at the level of financial instruments after adoption of IFRS 9 as at 1 January 2018 are described in note 1B.

I. Classification of financial instruments

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model used in asset management, as well as the characteristics of the respective contractual cash flows.

The standard will have an impact at the level of the classification of the financial assets held as at 1 January 2018, as follows:

- Held for Trading and Derivatives held for risk management, which were classified as "Held-for-Trading" and measured at FVTPL under IAS 39, are measured at FVTPL under IFRS 9;
- Loans and advances to customers and to Financial Institutions measured at amortised cost under IAS 39 are generally measured at amortised cost under IFRS 9;
- Investments in held-to-maturity securities, measured at amortized cost under IAS 39, are measured, generally, at amortised cost under IFRS 9;
- Investments in debt securities that were classified as available for sale under IAS 39 may, under IFRS 9, be measured at amortised cost, FVOCI or FVTPL, depending on certain circumstances;
- Loans to customers and investment securities that were measured at fair value option under IAS 39 are measured at FVTPL under IFRS 9;
- Most of the equity instruments that were classified as available for sale under IAS 39 are measured at FVTPL under IFRS 9. However, some of these equity instruments are held under a long-term strategic investment and are designated at FVOCI, under IFRS 9.

Based on this analysis and in the strategy defined, no material changes occurred at the level of the measurement associated with financial assets of the Group (financial assets measured at amortised cost versus financial assets measured at fair value) with the impact on the transition to IFRS 9.

II. Impairment - Financial Assets, Commitments and Financial Guarantees

IFRS 9 replaces the "loss incurred" model in IAS 39 by a forward-looking model of "expected credit losses (ECL)", which considers expected losses over the life of financial instruments. Thus, in the determination of ECL, macroeconomic factors are considered as well as other forward looking information, whose changes impact expected losses.

The impact of the adoption of IFRS 9 in the Group's equity related to impairment losses on financial assets, guarantees and other commitments was negative of Euros 174,577,000.

III. Classification - Financial Liabilities

IFRS 9 generally maintains the requirements in IAS 39 regarding the classification of Financial Liabilities. However, under IAS 39 all fair value changes of financial liabilities designated to FVTPL (Fair Value Option) were recognised in the income statement, while under IFRS 9 these fair value changes arepresented as follows: the amount related to the variation in the fair value attributable to changes in the credit risk of the liability is presented in OCI and the remaining value of the change in fair value is presented in profit or loss.

The Bank has adopted the Fair Value Option for some of its own issues which contain embedded derivatives or associated hedging derivatives, or when this designation eliminates or significantly reduces the accounting mismatch of the operations. The fair value variations attributable to changes in the credit risk of these liabilities were recognised in profit or loss in 2017 under IAS 39. In adopting IFRS 9, these changes in fair value were recognised in OCI and the amount recognised in OCI in each year is variable. The accumulated amount recognised in OCI will be null if these liabilities are repaid at maturity, at the nominal value.

IV. Derecognition and modification of contracts

IFRS 9 incorporates the requirements of IAS 39 for the derecognition of financial assets and liabilities without significant changes.

V. Hedge accounting

As allowed by IFRS 9, the Group opted to continue to apply the hedge accounting requirements under IAS 39.

VI. Transition

Changes in accounting policies resulting from the application of IFRS 9 will generally be applied retrospectively, with the exception of the following:

- The Group applies the exception that allows the non-restatement of prior period comparative information regarding classification and measurement changes (including impairment). Differences in the balance sheet values of financial assets and liabilities resulting from the adoption of IFRS 9 are recognised in Reserves and retained earnings, as at 1 January 2018.

- The following assessment was made based on the facts and circumstances that existed at the time of the initial application:
a) the determination of the business model in which the financial asset is held;
b) the designation and revocation of prior designations of certain financial assets and liabilities designated at FVTPL;
c) the designation of certain equity instruments that are not held for trading as FVOCI; and
d) for financial liabilities designated at FVTPL (Fair Value Option), to assess whether the presentation of the effects in the credit risk variations of the financial liabilities in OCI would create or increase an accounting mismatch in profit or loss.

The impact of the adoption of IFRS 9 in the Group's financial statements is described below.

a) Impact of the adoption of IFRS 9 on the Bank's equity

The impacts on the Bank's equity arising from the implementation of IFRS 9 with reference to 1 January 2018 are as detailed below:

(Thousands of euros)

	Other equity items	Fair value changes	Reserves and retained earnings	Total equity attributable to bank's shareholders
Equity as at 31 December 2017 - Before IFRS 9	5,872,937	44,501	11,829	5,929,267
Impairment				
Loans and advances to credit institutions	-	-	(703)	(703)
Loans and advances to customers	-	-	(153,917)	(153,917)
Debt instruments	-	-	(4,784)	(4,784)
	-	-	(159,404)	(159,404)
Provisions	-	-	(9,079)	(9,079)
Changes in securities classification	-	(115,914)	109,838	(6,076)
Own credit risk	-	1,958	(1,958)	-
	-	(113,956)	(60,603)	(174,559)
Current and deferred tax assets	-	26,627	(197,275)	(170,648)
Total impact	-	(87,329)	(257,878)	(345,207)
Equity as at 1 January 2018 - After IFRS 9	5,872,937	(42,828)	(246,049)	5,584,060

In 2018, the Bank adopted IFRS 9 - Financial Instruments. Since there is no transitional regime that establishes the tax treatment to be applied to the transition adjustments to IFRS 9, the treatment given resulted from the interpretation of the general rules application of the IRC Code.

(b) Reconciliation of balance sheet amounts in IAS 39 and IFRS 9

The impacts on the Group's balance sheet arising from the implementation of IFRS 9 with reference to 1 January 2018 are detailed as follows:

(Thousands of euros)

	IAS 39 31 Dec 2017	Reclassifications	Remeasurement	IFRS 9 1 Jan 2018
ASSETS				
Cash and deposits at Central Banks	1,291,663	-	-	1,291,663
Loans and advances to credit institutions repayable on demand	156,460	-	-	156,460
Financial assets at amortised cost				
Loans and advances to credit institutions	1,254,472	-	(703)	1,253,769
Loans and advances to customers	31,349,425	-	(153,917)	31,195,508
Debt instruments	2,007,520	437,130	(10,860)	2,433,790
Financial assets at fair value through profit or loss				
Financial assets held for trading	770,639	(6,623)	-	764,016
Financial assets not held for trading mandatorily at fair value through profit or loss	n.a.	1,832,687	-	1,832,687
Financial assets designated at fair value through profit or loss	142,336	-	-	142,336
Financial assets at fair value through other comprehensive income	n.a.	4,772,573	-	4,772,573
Financial assets available for sale	6,692,982	(6,692,982)	-	n.a.
Financial assets held to maturity	342,785	(342,785)	-	n.a.
Hedging derivatives	18,804	-	-	18,804
Investments in associated companies	3,370,361	-	-	3,370,361
Non-current assets held for sale	1,480,112	-	-	1,480,112
Other tangible assets	217,101	-	-	217,101
Goodwill and intangible assets	21,409	-	-	21,409
Current tax assets	7,208	-	-	7,208
Deferred tax assets	3,018,508	-	(170,648)	2,847,860
Other assets	1,434,731	-	-	1,434,731
TOTAL ASSETS	53,576,516	-	(336,128)	53,240,388
LIABILITIES				
Financial liabilities at amortised cost				
Resources from credit institutions	7,825,051	-	-	7,825,051
Resources from customers	32,135,035	-	-	32,135,035
Non subordinated debt securities issued	1,440,628	-	-	1,440,628
Subordinated debt	1,021,541	-	-	1,021,541
Financial liabilities at fair value through profit or loss				
Financial liabilities held for trading	381,380	-	-	381,380
Financial liabilities designated at fair value through profit or loss	3,843,645	-	-	3,843,645
Hedging derivatives	112,352	-	-	112,352
Provisions	269,057	-	9,079	278,136
Current tax liabilities	1,269	-	-	1,269
Other liabilities	617,291	-	-	617,291
TOTAL LIABILITIES	47,647,249	-	9,079	47,656,328
EQUITY				
Share capital	5,600,738	-	-	5,600,738
Share premium	16,471	-	-	16,471
Other equity instruments	2,922	-	-	2,922
Legal and statutory reserves	252,806	-	-	252,806
Reserves and retained earnings	(61,691)	118,021	(345,207)	(288,877)
Net income for the year attributable to Bank's Shareholders	118,021	(118,021)	-	-
TOTAL EQUITY	5,929,267	-	(345,207)	5,584,060
	53,576,516	-	(336,128)	53,240,388

The impacts of the implementation of IFRS 9 on the classification and measurement of financial instruments and the determination of impairment losses on financial assets are explained in more detail in the following notes.

(c) Classification and measurement of financial instruments

The table below shows the measurement category and the book value of financial assets, in accordance with IAS 39 and IFRS 9, as at 1 January 2018.

(Thousands of euros)

IAS 39			IFRS 9		
Category	Measurement	Book value	Category	Measurement	Book value
Cash and deposits at Central Banks	Amortised cost	1,291,663	Cash and deposits at Central Banks	Amortised cost	1,291,663
Loans and advances to credit institutions repayable on demand	Amortised cost	156,460	Loans and advances to credit institutions repayable on demand	Amortised cost	156,460
Loans and advances to credit institutions	Amortised cost	1,254,472	Loans and advances to credit institutions	Amortised cost	1,253,769
Financial assets at amortised cost - Loans and advances to customers	Amortised cost	31,349,425	Financial assets at amortised cost - Loans and advances to customers	Amortised cost	31,195,508
Financial assets at amortised cost - Debt instruments	Amortised cost	2,007,520	Financial assets at amortised cost - Debt instruments	Amortised cost	2,004,574
Financial assets held to maturity	Amortised cost	342,785	Financial assets at amortised cost - Debt instruments	Amortised cost	342,785
Financial assets available for sale	FVOCI (available for sale)	6,692,982	Financial assets at fair value through other comprehensive income	FVOCI	4,765,950
			Financial assets not held for trading mandatorily at fair value through profit or loss	FVTPL (mandatorily)	1,832,687
			Financial assets at amortised cost - Debt instruments	Amortised cost	86,431
Financial assets held for trading	FVTPL	770,639	Financial assets at fair value through other comprehensive income	FVOCI	6,623
			Financial assets held for trading	FVTPL	764,016
Financial assets designated at fair value through profit or loss	FVTPL (designated)	142,336	Financial assets designated at fair value through profit or loss	FVTPL (designated)	142,336
Hedging derivatives	FVTPL	18,804	Hedging derivatives	FVTPL	18,804

Notes:

FVOCI - Measured at fair value through other comprehensive income

FVTPL - Measured at fair value through profit or loss

There were no material changes regarding the measurement criteria associated with the Group's financial liabilities with impact on the transition to IFRS 9, except for changes in the fair value of financial liabilities at fair value through profit or loss that are attributable to changes in the credit risk of the instrument, which will be included in other comprehensive income as from 1 January 2018.

(d) Reconciliation of balance sheet amounts in IAS 39 and IFRS 9

The following table shows the reconciliation between the book values of financial assets according to the measurement categories of IAS 39 and IFRS 9, as at 1 January 2018 (transition date).

(Thousands of euros)

		Financial assets at amortised cost (Amortised Cost)			
	Notes	IAS 39 31 December 2017	Reclassifications	Remeasurement	IFRS 9 1 January 2018
Cash and deposits at Central Banks					
Opening balance in IAS 39 and final balance in IFRS 9		1,291,663	-	-	1,291,663
Loans and advances to credit institutions repayable on demand					
Opening balance in IAS 39 and final balance in IFRS 9		156,460	-	-	156,460
Loans and advances to credit institutions					
Opening balance in IAS 39		1,254,472	-	-	1,254,472
Remeasurement: impairment losses	(A)	-	-	(703)	(703)
Final balance in IFRS 9		1,254,472	-	(703)	1,253,769
Loans and advances to customers					
Opening balance in IAS 39		31,349,425	-	-	31,349,425
Remeasurement: impairment losses	(A)	-	-	(153,917)	(153,917)
Final balance in IFRS 9		31,349,425	-	(153,917)	31,195,508
Debt instruments					
Opening balance in IAS 39		2,007,520	-	-	2,007,520
Transfer: of available financial assets for sale (IAS 39)	(E)	-	94,345	-	94,345
Transfer: from held-to-maturity financial assets to maturity date (IAS 39)	(F)	-	342,785	-	342,785
Remeasurement: impairment losses	(A)	-	-	(4,784)	(4,784)
Remeasurement: fair value to amortised cost		-	-	(6,076)	(6,076)
Final balance in IFRS 9		2,007,520	437,130	(10,860)	2,433,790
Financial assets held to maturity					
Opening balance in IAS 39		342,785	-	-	342,785
Transfer: for financial assets at amortised cost - debt securities (IFRS 9)	(F)	-	(342,785)	-	(342,785)
Final balance in IFRS 9		342,785	(342,785)	-	-
Total of financial assets at amortised cost		36,402,325	94,345	(165,480)	36,331,190

(Thousands of euros)

	Notes	Financial assets at fair value through other comprehensive income (FVOCI) IAS 39 31 December 2017	Reclassifications	Remeasurement	IFRS 9 1 January 2018
Financial assets at fair value through other comprehensive income - debt instruments					
Opening balance in IAS 39		-	-	-	-
Transfer: of available financial assets for sale (IAS 39)	(F)	-	4,734,385	-	4,734,385
Transfer: of financial assets held for trading	(D)	-	6,623	-	6,623
Final balance in IFRS 9		-	4,741,008	-	4,741,008
Financial assets at fair value through other comprehensive income - equity instruments					
Opening balance in IAS 39		-	-	-	-
Transfer: of available financial assets for sale (IAS 39)	(B)	-	31,565	-	31,565
Final balance in IFRS 9		-	31,565	-	31,565
		-	4,772,573	-	4,772,573
Financial assets available for sale					
Opening balance in IAS 39		6,692,982	-	-	6,692,982
Transfer: Financial assets not held for trading mandatorily at fair value through profit or loss (IFRS 9)	(C)	-	(1,832,687)	-	(1,832,687)
Transfer: for financial assets at amortised cost (IFRS 9)	(E)	-	(94,345)	-	(94,345)
Transfer: to financial assets at fair value through other comprehensive income - debt instruments (IFRS 9)	(F)	-	(4,734,385)	-	(4,734,385)
Transfer: to financial assets at fair value through other comprehensive income - equity instruments (IFRS 9)	(B)	-	(31,565)	-	(31,565)
Final balance in IFRS 9		6,692,982	(6,692,982)	-	-
Total financial assets at fair value through other comprehensive income		6,692,982	2,820,599	-	9,513,581

(Thousands of euros)

		Financial assets at fair value through profit or loss (FVTPL)			
	Notes	IAS 39 31 December 2017	Reclassifications	Remeasurement	IFRS 9 1 January 2018
Financial assets held for trading					
Opening balance in IAS 39		770,639	-	-	770,639
Transfer: to financial assets at fair value through other comprehensive income	(D)	-	(6,623)	-	(6,623)
Final balance in IFRS 9		770,639	(6,623)	-	764,016
Financial assets not held for trading mandatorily at fair value through profit or loss					
Opening balance in IAS 39		-	-	-	-
Transfer: of available financial assets for sale (IAS 39)	(C)	-	1,832,687	-	1,832,687
Final balance in IFRS 9		-	1,832,687	-	1,832,687
Financial assets designated at fair value through profit or loss					
Opening balance in IAS 39 and final balance in IFRS 9		142,336	-	-	142,336
Hedging derivatives					
Opening balance in IAS 39 and final balance in IFRS 9		18,804	-	-	18,804
Total financial assets at fair value through profit or loss		931,779	1,826,064	-	2,757,843

Notes:

(A) Under the IFRS 9 criteria, additional impairments were calculated resulting from the application of the concept of expected loss and registered in Other reserves and retained earnings, for:

- financial assets at amortised cost (Loans and advances to credit institutions);
- financial assets at amortised cost (Loans and advances to customers);
- and debt instruments at fair value through other comprehensive income.

(B) Designation of equity instruments at fair value through other comprehensive income: The Group opted for the irrevocable designation of equity instruments that are neither held for trading nor contingent retribution recognised by a buyer in a business combination to which it applies IFRS 3 as at fair value through other comprehensive income, as allowed by IFRS 9. These instruments were previously classified as "Financial assets available for sale". Changes in the fair value of these instruments will not be reclassified to profit or loss when derecognised.

(C) Classification of debt securities previously classified as "Financial assets available for sale ", which do not fall within the definition of SPPI and of units of participation in funds that do not fall within the definition of equity instruments: The portfolio of debt instruments that do not fall within the scope of SPPI definition was classified under " Financial assets not held for trading mandatorily at fair value through profit or loss " on the date of the initial application.

(D) Classification of debt securities previously classified under "Financial assets held for trading", whose business model is "held to collect and sell" and whose characteristics of contractual cash flows fall within the scope of SPPI definition.

(E) Classification of debt securities previously under "Financial assets available for sale ", whose business model is "held-to-collect" and whose characteristics of contractual cash flows fall within the scope of SPPI definition.

(F) Changes occurred in the categories provided for in IAS 39, without changing the measurement basis: In addition to the aforementioned, the following debt instruments were reclassified to new categories in accordance with IFRS 9, following the elimination of previous categories of IAS 39 , without changes in its measurement basis: (i) Instruments previously classified as available for sale, currently classified as financial assets at fair value through other comprehensive income; (ii) Instruments previously classified as held to maturity, currently classified as financial assets at amortised cost.

The table below presents the reconciliation between the book values of impairment / provisions in balance sheet according with the measurement categories of IAS 39 and IFRS 9 as at 1 January 2018 (initial application date):

(Thousands of euros)

Measurement category	Impairment for credit IAS 39 / Provision IAS 37	Reclassifications (A)	Revaluation	Impairment loss / Provision in accordance with IFRS 9
Loans and accounts receivable (IAS 39) / Financial assets at amortised cost (IFRS 9)				
Cash and deposits at Central Banks	-	-	-	-
Loans and advances to credit institutions repayable on demand	-	-	-	-
Loans and advances to credit institutions	-	-	703	703
Loans and advances to customers	2,742,244	-	153,917	2,896,161
Debt securities	42,886	-	4,784	47,670
Total	2,785,130	-	159,404	2,944,534
Held to maturity (IAS 39) / Financial assets at amortised cost (IFRS 9)				
Debt securities	-	-	-	-
Available-for-sale financial instruments (IAS 39)/ Financial assets at fair value through other comprehensive income (IFRS 9)				
Debt securities	87,368	(83,646)	6,094	9,816
Commitments and financial guarantees issued	269,057	-	9,079	278,136
Total	3,141,555	(83,646)	174,577	3,232,486

(A) The reclassification recorded in impairment for financial assets at fair value through other comprehensive income (Debt securities) in the negative amount of Euros 83,646,000, refers to the write-off impairment for securities that were transferred to FVTPL (fall within the scope of SPPI).