

58. 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 came 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 373,656,000 (negative impact of Euros 403,767,000 Group's total equity, including non-controlling interests).

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 1C.

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 amortised 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 262,624,000.

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 are presented 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 Group 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 Group's equity

The impacts on the Group'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	Non-controlling interests	Total equity
Equity as at 31 December 2017						
- Before IFRS 9	5,932,554	82,090	66,171	6,080,815	1,098,921	7,179,736
Impairment						
Loans and advances to credit institutions	-	-	(703)	(703)	-	(703)
Loans and advances to customers	-	-	(194,385)	(194,385)	(41,163)	(235,548)
Debt securities	-	-	(5,163)	(5,163)	-	(5,163)
	-	-	(200,251)	(200,251)	(41,163)	(241,414)
Provisions	-	-	(14,714)	(14,714)	-	(14,714)
Changes in securities classification	-	(91,234)	90,522	(712)	4,164	3,452
Own credit risk	-	1,958	(1,958)	-	-	-
Investments in associates	-	(843)	(1,664)	(2,507)	-	(2,507)
	-	(90,119)	(128,065)	(218,184)	(36,999)	(255,183)
Current and deferred tax assets	-	26,150	(181,622)	(155,472)	6,888	(148,584)
Total impact	-	(63,969)	(309,687)	(373,656)	(30,111)	(403,767)
Equity as at 1 January 2018						
- After IFRS 9	5,932,554	18,121	(243,516)	5,707,159	1,068,810	6,775,969

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	IFRS 9 1 Jan 2018
ASSETS			
Cash and deposits at Central Banks	2,167,934	-	2,167,934
Loans and advances to credit institutions repayable on demand	295,532	-	295,532
Financial assets at amortised cost			-
Loans and advances to credit institutions	1,065,568	-	1,064,865
Loans and advances to customers	45,625,972	(263,397)	45,127,027
Debt securities	2,007,520	939,889	2,940,068
Financial assets at fair value through profit or loss			-
Financial assets held for trading	897,734	(6,623)	891,111
Financial assets not held for trading mandatorily at fair value through profit or loss	n.a.	1,382,151	1,382,151
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.	9,831,626	9,837,256
Financial assets available for sale	11,471,847	(11,471,847)	-
Financial assets held to maturity	411,799	(411,799)	-
Hedging derivatives	234,345	-	234,345
Investments in associated companies	571,362	-	568,855
Non-current assets held for sale	2,164,567	-	2,164,567
Investment property	12,400	-	12,400
Other tangible assets	490,423	-	490,423
Goodwill and intangible assets	164,406	-	164,406
Current tax assets	25,914	-	26,961
Deferred tax assets	3,137,767	-	2,988,136
Other assets	1,052,024	-	1,052,024
TOTAL ASSETS	71,939,450	-	71,550,397
LIABILITIES			
Financial liabilities at amortised cost			
Resources from credit institutions	7,487,357	-	7,487,357
Resources from customers	48,285,425	-	48,285,425
Non subordinated debt securities issued	2,066,538	-	2,066,538
Subordinated debt	1,169,062	-	1,169,062
Financial liabilities at fair value through profit or loss			
Financial liabilities held for trading	399,101	-	399,101
Financial liabilities designated at fair value through profit or loss	3,843,645	-	3,843,645
Hedging derivatives	177,337	-	177,337
Provisions	324,158	-	338,872
Current tax liabilities	12,568	-	12,568
Deferred tax liabilities	6,030	-	6,030
Other liabilities	988,493	-	988,493
TOTAL LIABILITIES	64,759,714	-	64,774,428
EQUITY			
Share capital	5,600,738	-	5,600,738
Share premium	16,471	-	16,471
Preference shares	59,910	-	59,910
Other equity instruments	2,922	-	2,922
Legal and statutory reserves	252,806	-	252,806
Treasury shares	(293)	-	(293)
Reserves and retained earnings	(38,130)	186,391	(225,395)
Net income for the year attributable to Bank's Shareholders	186,391	(186,391)	-
TOTAL EQUITY ATTRIBUTABLE TO BANK'S SHAREHOLDERS	6,080,815	-	5,707,159
Non-controlling interests	1,098,921	-	1,068,810
TOTAL EQUITY	7,179,736	-	6,775,969
TOTAL LIABILITIES AND EQUITY	71,939,450	-	71,550,397

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	2,167,934	Cash and deposits at Central Banks	Amortised cost	2,167,934
Loans and advances to credit institutions repayable on demand	Amortised cost	295,532	Loans and advances to credit institutions repayable on demand	Amortised cost	295,532
Loans and advances to credit institutions	Amortised cost	1,065,568	Loans and advances to credit institutions	Amortised cost	1,064,865
Financial assets at amortised cost - Loans and advances to customers	Amortised cost	45,625,972	Financial assets at amortised cost - Loans and advances to customers	Amortised cost	45,127,027
			Financial assets not held for trading mandatorily at fair value through profit or loss	FVTPL (mandatorily)	263,397
Financial assets at amortised cost - Debt securities	Amortised cost	2,007,520	Financial assets at amortised cost - Debt securities	Amortised cost	2,004,574
Financial assets held to maturity	Amortised cost	411,799	Financial assets at amortised cost - Debt securities	Amortised cost	415,695
			Financial assets at fair value through other comprehensive income	FVOCI	9,830,633
Financial assets available for sale	FVOCI (available for sale)	11,471,847	Financial assets not held for trading mandatorily at fair value through profit or loss	FVTPL (mandatorily)	1,118,754
			Financial assets at amortised cost - Debt securities	Amortised cost	519,799
Financial assets held for trading	FVTPL	897,734	Financial assets at fair value through other comprehensive income	FVOCI	6,623
			Financial assets held for trading	FVTPL	891,111
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	234,345	Hedging derivatives	FVTPL	234,345

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 were 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)					
	Notes	Financial assets at amortised cost (Amortised Cost)			
		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		2,167,934	-	-	2,167,934
Loans and advances to credit institutions repayable on demand					
Opening balance in IAS 39 and final balance in IFRS 9		295,532	-	-	295,532
Loans and advances to credit institutions					
Opening balance in IAS 39		1,065,568	-	-	1,065,568
Remeasurement: impairment losses	(A)	-	-	(703)	(703)
Final balance in IFRS 9		1,065,568	-	(703)	1,064,865
Loans and advances to customers					
Opening balance in IAS 39		45,625,972	-	-	45,625,972
Transfer					
to fair value through profit or loss (IFRS 9) - Gross Value	(G)	-	(283,463)	-	(283,463)
to fair value through profit or loss (IFRS 9) - Impairment	(G)	-	20,066	-	20,066
Remeasurement: impairment losses	(A)	-	-	(235,548)	(235,548)
Final balance in IFRS 9		45,625,972	(263,397)	(235,548)	45,127,027
Debt instruments					
Opening balance in IAS 39		2,007,520	-	-	2,007,520
Transfer of available financial assets for sale (IAS 39)	(E)	-	528,090	-	528,090
Transfer from held-to-maturity financial assets to maturity date (IAS 39)	(F)	-	411,799	-	411,799
Remeasurement: impairment losses	(A)	-	-	(5,163)	(5,163)
Remeasurement: fair value to amortised cost	(E)	-	-	(2,178)	(2,178)
Final balance in IFRS 9		2,007,520	939,889	(7,341)	2,940,068
Financial assets held to maturity					
Opening balance in IAS 39		411,799	-	-	411,799
Transfer for financial assets at amortised cost - debt securities (IFRS 9)	(F)	-	(411,799)	-	(411,799)
Final balance in IFRS 9		411,799	(411,799)	-	-
Total of financial assets at amortised cost		51,574,325	264,693	(243,592)	51,595,426

(Thousands of euros)

		Financial assets at fair value through other comprehensive income (FVOCI)			
		IAS 39			IFRS 9
	Notes	31 December 2017	Reclassifications	Remeasurement	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)	-	9,793,650	-	9,793,650
Transfer of financial assets held for trading	(D)	-	6,623	-	6,623
Final balance in IFRS 9		-	9,800,273	-	9,800,273
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)		31,353	5,630	36,983
Final balance in IFRS 9		-	31,353	5,630	36,983
		-	9,831,626	5,630	9,837,256
Financial assets available for sale					
Opening balance in IAS 39		11,471,847	-	-	11,471,847
Transfer Financial assets not held for trading mandatorily at fair value through profit or loss (IFRS 9)	(C)	-	(1,118,754)	-	(1,118,754)
Transfer for financial assets at amortised cost (IFRS 9)	(E)	-	(528,090)	-	(528,090)
Transfer to financial assets at fair value through other comprehensive income - debt instruments (IFRS 9)	(F)	-	(9,793,650)	-	(9,793,650)
Transfer to financial assets at fair value through other comprehensive income - equity instruments (IFRS 9)	(B)	-	(31,353)	-	(31,353)
Final balance in IFRS 9		11,471,847	(11,471,847)	-	-
Total financial assets at fair value through other comprehensive income					
		11,471,847	(1,640,221)	5,630	9,837,256

(Thousands of euros)

		Financial assets at fair value through profit or loss (FVTPL)			
		IAS 39			IFRS 9
	Notes	31 December 2017	Reclassifications	Remeasurement	1 January 2018
Financial assets held for trading					
Opening balance in IAS 39		897,734	-	-	897,734
Transfer to financial assets at fair value through other comprehensive income	(D)	-	(6,623)	-	(6,623)
Final balance in IFRS 9		897,734	(6,623)	-	891,111
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)	-	1,118,754	-	1,118,754
Transfer from financial assets at amortised cost - Loans to customers (IAS 39) - Gross value	(G)	-	283,463	-	283,463
Transfer from financial assets at amortised cost - Loans to customers (IAS 39) - Impairment	(G)	-	(20,066)	-	(20,066)
Final balance in IFRS 9		-	1,382,151	-	1,382,151
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		234,345	-	-	234,345
Total financial assets at fair value through profit or loss					
		1,274,415	1,375,528	-	2,649,943

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 and at amortised cost.

(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 participation units 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.

(G) The new classification and measurement model is mainly based on principles and requires the Bank to consider not only its business model for the management of financial assets but also the characteristics of the contractual cash flows of these assets (particularly if they represent solely payments of principal and interest ('SPPI')). Thus, a set of loans from customers previously classified as financial assets at amortised cost were transferred to financial assets not held for trading mandatorily at fair value through profit or loss.

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	3,279,046	8,508	235,548	3,523,102
Debt securities	42,886	-	5,163	48,049
Total	3,321,932	8,508	241,414	3,571,854
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	88,796	(83,646)	6,496	11,646
Commitments and financial guarantees issued	324,158	-	14,714	338,872
Total	3,734,886	(75,138)	262,624	3,922,372

(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 of impairment for securities that were transferred to FVTPL (fall within the scope of SPPI).