FINANCIAL INSTRUMENTS
IFRS 9

Finance and Accounting Department

Bogotá D.C., April 2018

Schedule

1. Classification.
2. Measurement.
3. Impairment.
4. Hedge Accounting.
5. Analysis Colombian Central Bank Financial instruments.

Objetives

The purpose of this presentation is to explain in a general way
which are the main changes on financial instruments and identify their impacts on the financial statements for the Central Bank.

IFRS 9 “Financial Instruments,” introduces changes starting 2018 related mainly with:

- Financial Instruments classification
- Impairment of financial instruments based on “expected credit losses”.
- Hedge Accounting.

Classification and Measurement.

Classification of Financial Instruments

The new IFRS 9 includes a third category , regarding the last one version. In the new one, the classification depends on:

1. The business model assessment used to manage the financial instruments, in order to generate cash flows.
2. Whether financial assets generate contractual cash flows

The IFRS 9 categories are:

i) Amortized cost.
ii) Fair value through profit or loss.
iii) Fair value through other comprehensive income (equity).(New category)

Classification of Financial Instruments

Classification

Type of financial instruments	Classification
Assets held to collect contractual cash flows lifetime more than sell it before its maturity.	Amortized cost (maturity)
Assets for sale in a short term and used to collect benefits from changes in fair value. (Held for trading).	Fair value through profit or loss (P&L) (Marketable)
Assets held to collect (i) contractual cash flow and (ii) selling it before its maturity, but not in a short term.	Fair value through Other Comprehensive Income (Equity).

Classification of Financial Instruments

Financial Instruments will be measured according to:

1. On initial recognition to Fair Value.
2. After initial recognition will be measured according to their classification:
   - Amortized cost (Effective interest method- IRR)
   - Fair value, through profit or loss, or through other comprehensive income (equity).

Classification	Initial measurement	Subsequent measurement
Assets measured at Amortized cost (Effective interest method)	Fair value plus transaction costs	Amortized cost–Effective interest method. Measure impairment based on expected credit loss .
Assets measured at fair value through profit or loss	Fair value	Fair value
Assets measured at fair value through other comprehensive income (equity).	Fair value plus transaction costs	Fair value/ amortized cost (effective interest rate) Measure impairment based on expected credit loss

Measuring Impairment.

Measuring Impairment

Although, IAS 39 was based on incurred credit loss model; the new IFRS 9 version has introduce a forward-looking expected credit loss model; meaning that it requires an entity recognizes its expected credit losses along the financial assets lifetime that has increased significantly their credit risk, since initial recognition.

Incurred credit losses

- Not recognized until a credit loss event occurs .
- "too late"

Versus

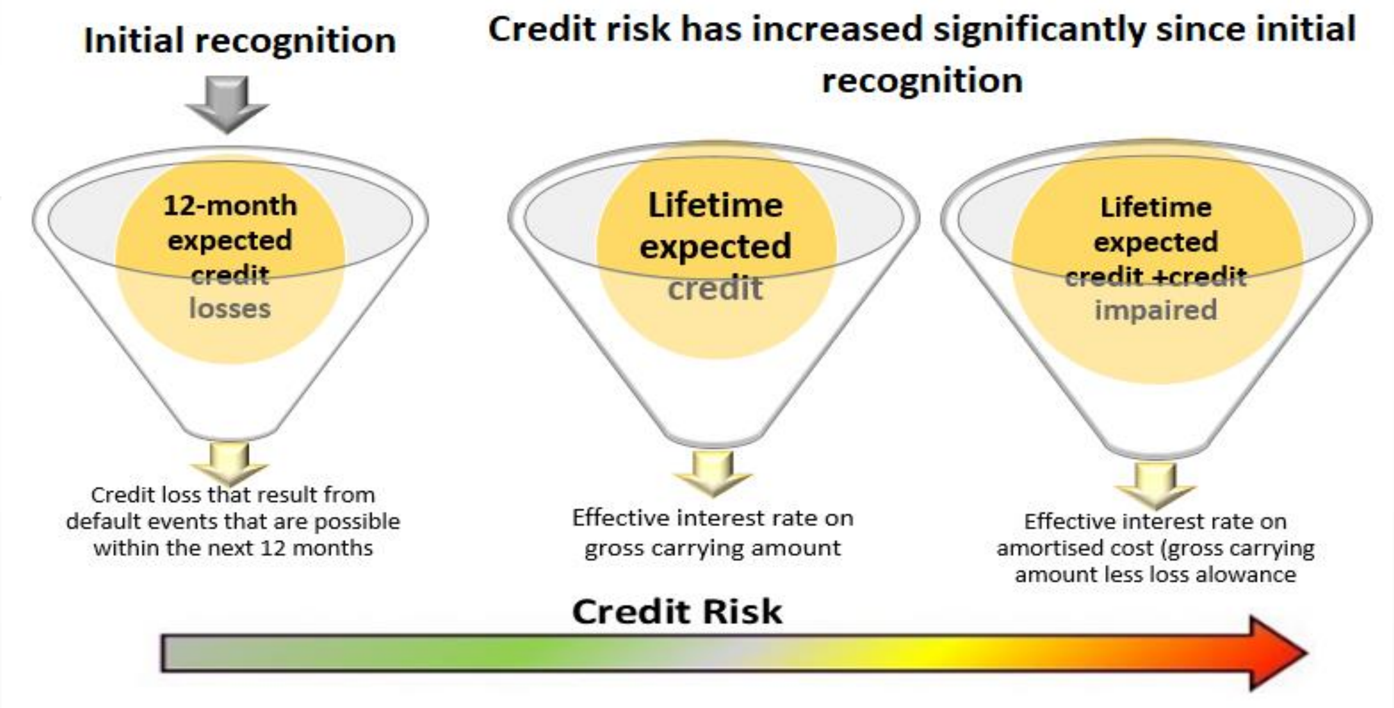
Expected credit losses

- "Expected credit loss" is recognized at origination.
- Impairment loss recognition for default events that are possible within the next 12 months.

Impairment

The guiding principle of the expected credit loss model is to reflect the general pattern of deterioration or improvement in the credit quality of financial instruments. The expected credit loss approach has been commonly referred to as the three-bucket approach, although IFRS 9 does not use this term.

- 12-month expected credit losses.
- Significant evidence of default for the next year.
- Full lifetime asset credit risk.



Hedge Accounting

Main differences between IFRS 9 – IAS 39

Hedge accounting requirements in IFRS 9 are OPTIONAL. When an entity first applies IFRS 9, it may choose to continue to apply the hedge accounting requirements of IAS 39, instead of the requirements in IFRS 9, to all of its hedging relationship.

Banco de la República does not apply hedge accounting

Analysis of Colombian Central Bank Financial Instruments.

Financial assets assessment under IFRS 9

Portfolio	Previous category	New category
International Reserves(IR).	**Fair value through profit or loss.**	IR are assets that belong to the nation and are held in foreign accounts , but they are under control of Colombian authorities. They can be used in any time to correct imbalances in the balance of payments, through Central Bank market operations. **CLASSIFICATION** ❖ **Fair value through OCI** Fixed income instruments represent 95% of the IR investment´s portfolio (Bonds, comercial and discount papers and CDs). They fulfilled the requirements of this category. ❖ **Fair value through P&L** They are financial assets that do not have contractual cash flows or their lifetime is less than one year.

Operational Impacts

Legal constraints

Colombia’s Central Bank Act. stablishes in its “numeral 4 del artículo 62 del Decreto 2520 de 1993 (modificado mediante el Decreto 2386 de 2015)” as follows:

"4. International Reserves must be recorded by mark-to-market calculations. The Foreign exchange adjustment for international reserves due to fluctuations in exchange rates COP vs other currencies should be recorded as a surplus. Losses should be applied in this surplus. Fluctuations in the market value of the international reserves portfolio will be recorded as Central Bank´s profits or losses.”

Financial assets assessment under IFRS 9

Portfolio	Previous category	New category
Monetary policy TES.	**Fair value through profit or loss.**	These securities are purchased under resale agreements according to the monetary policy by the board of directors and for this reason, they are not subject to maximum return constraints, so it is not necessary to hold them until maturity, but they are used to provide liquidity to the financial system. **Classification** **Fair value through other comprehensive income (FVTOCI)** It has implicit contractual cash flows

Financial and Operational Impacts

Financial Impacts

Profit and Loss Impacts for the new measure implementation

Year 2016

Porfolio	Currency	Fair value at the end of period	Previous treatment Fair value through profit or loss (1) P&L (fair value)	Assessment of new requirement under IFRS 9 Fair value through Other Comprehensive Income OCI (Equity) (a)	 (2) P&L (Amortised cost) (b)	 Total (a) - (b)	Impact on profit and loss (2) - (1)
International Reserve	Millions USD $	**39,122**	**298**	(34)	332	298	**(34)**
Monetary policy TES	Billion Cop $	**8,893**	**1,007**	354	654	1,007	**354**

Note: Data displayed corresponds to both annual flows and yearly portfolio accrual.

Operational Impacts

Effects of the new classification

1. Legal constraints analysis over international reserve portfolio.
2. Adjustment of IT software in order to calculate amortised cost (accrued interest measure by IRR) and new accounts opening.
3. Definition and parameterization of new accountancy schemes for implementing the new accountancy policy retrospectively and its manages starting up January 2018.
4. Implementation of the expected loss model with all categories of financial instruments classified as: (i) amortised cost and (ii) fair value through other comprehensive income

Thank you