Out of the Ordinary

Investec plc silo

IFRS 9 Financial Instruments Transition Report

2018

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Introduction and objective of these disclosures

The objective of these transition disclosures is to provide an understanding of the impacts of the change in accounting standard from IAS 39 'Financial Instruments: Recognition and Measurement' to IFRS 9 'Financial Instruments', which became effective for the group on 1 April 2018.

The information in this document serves as a point-in-time bridge between IAS 39 and IFRS 9. This includes the day one impact on retained earnings and regulatory capital as well as changes to the classification and measurement of certain financial assets and liabilities as required under IFRS 9.

IFRS 9 requires a move from incurred loss methodology under IAS 39 to an expected credit loss (ECL) methodology. This disclosure document explains the new ECL methodology, what its implications are for the group and what the implications are of the main judgements the group has made in implementing ECL, as well as the impacts from reclassification of certain assets and liabilities.

The disclosures that follow reflect the impact of the adoption of IFRS 9 on the group's balance sheet and regulatory capital. Further details of specific IFRS 9 accounting policies (as well as previous IAS 39 policies) are described in more detail on page 29.

All references in this document to Investec or the group relate to Investec plc (i.e. excluding Investec Limited).

All information in this document is audited unless marked otherwise.

Proviso

Please note that matters discussed in this transition report may contain forward-looking statements which are subject to various risks and uncertainties and other factors, including, but not limited to:

- the further development of standards and interpretations under IFRS applicable to past, current and future periods, evolving practices with regard to the interpretation and application of standards under IFRS, particularly new standards such as IFRS 9.
- domestic and global economic and business conditions; and
- market-related risks.

A number of these factors are beyond the group's control. As a result these factors may cause the group's actual future results, performance or achievements in the markets in which it operates to differ from those expressed or implied in this transition report.

Overview of the group's IFRS 9 transition impact

The adoption of IFRS 9 has resulted to result in the following day one impact for Investec plc.

Balance sheet impairment allowance and provisions

Total balance sheet impairment allowance and provisions increased by £106 million from £158 million as at 31 March 2018 to £264 million as at 1 April 2018. This is driven by an increase in legacy impairments of £58 million and an increase in ongoing impairments of £69 million, partially offset by a reduction of £21 million as a result of changes in classification and measurement of certain of the group's financial assets to fair value. The increase in impairment allowance and provisions reduced Investec plc's common equity tier 1 (CET 1) ratio by approximately 66bps on full adoption of IFRS 9, or approximately 3bps on a day one impact transitional basis.

Changes in classification and measurement of certain financial assets

Changes in classification and measurement to fair value of certain of the group's other financial assets resulted in a decrease to equity of £11 million (post taxation), with an approximate 7bps impact on the Investec plc CET 1 ratio.

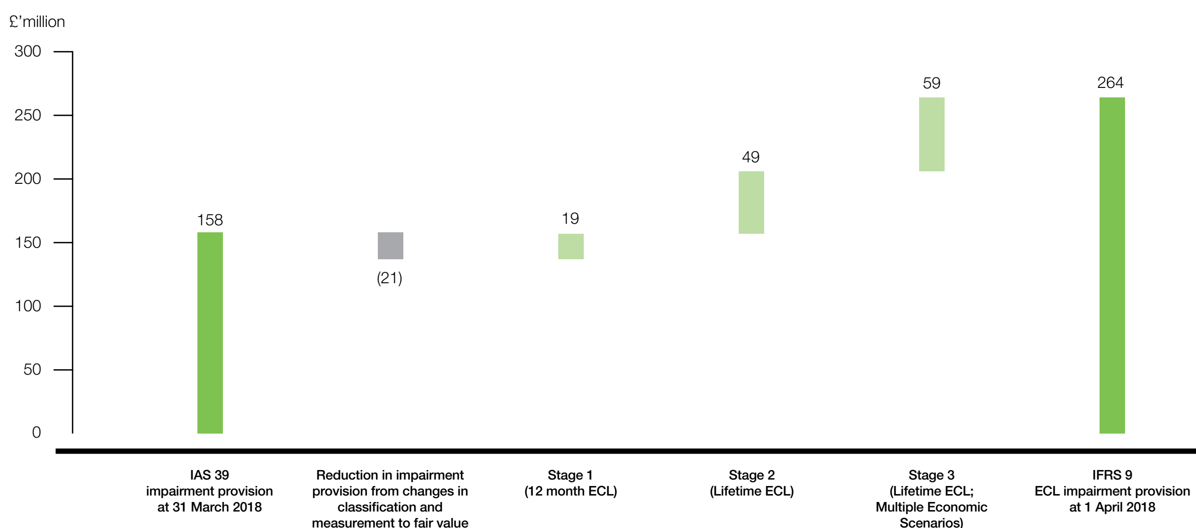
Reclassification of subordinated liabilities to fair value

Following the adoption of IFRS 9 Investec plc has elected to designate its subordinated liabilities to fair value. From this designation, the interest rate portion of the subordinated debt reduced equity by £48 million (post taxation) with an approximate 37bps impact on the day one transitional CET 1 ratio which will come back into retained earnings over the duration of the remaining term of the instrument (maturing February 2022). In addition, an amount of £55 million (post taxation) has been transferred to an own credit reserve which does not have an impact on capital ratios.

Taken together, the adoption of IFRS 9 resulted in a decrease in Investec plc's transitional CET 1 ratio of approximately 47bps from 10.6% to 10.1%, ahead of the Investec group target and in excess of minimum regulatory requirements. Investec plc confirmed to the PRA that it will use the transitional arrangements to absorb the full impact permissible of IFRS 9 in regulatory capital calculations.

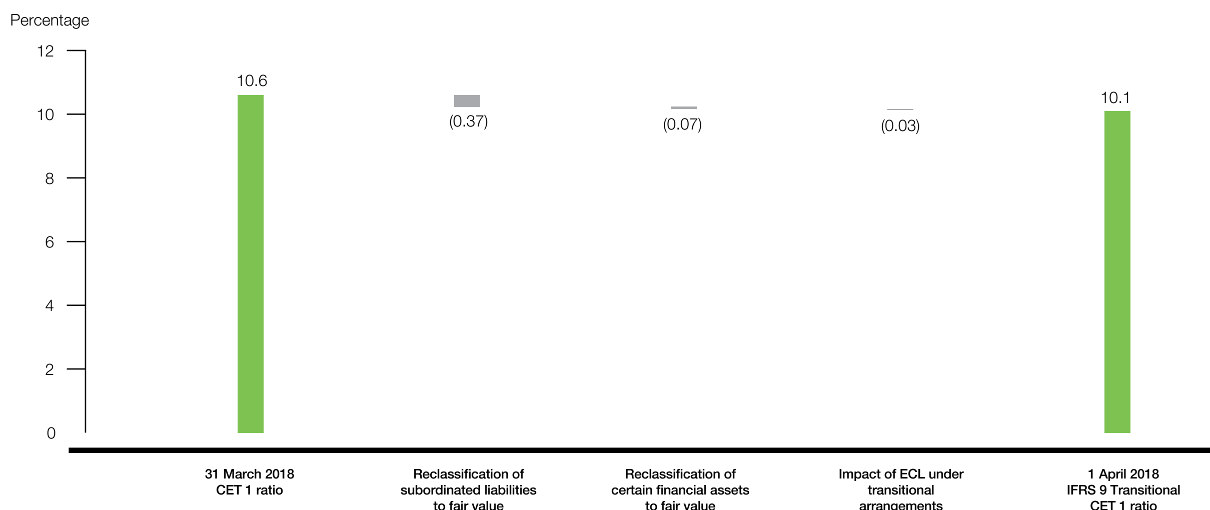
IAS 39 to IFRS 9 impairment allowance

The following chart highlights the key drivers of the overall increase in Investec plc's impairment provision under IFRS 9 relative to IAS 39.



Day one impact on CET 1 ratio

The following chart highlights the day one impact on CET 1 ratio.



Implementation of IFRS 9

The group established an IFRS 9 steering committee comprising of executive representation and key management from Risk, Finance, Analytics and IT. The committee is accountable for IFRS 9 implementation and is supported by working groups responsible for various work streams. The committee has provided regular updates on the status of the project to the appropriate board committees.

The group's approach to risk management has not changed substantially with the introduction of IFRS 9. Credit decisions are undertaken on a case-by-case basis and the quality of clients and underlying cash flows remain paramount in decision-making.

We have made a number of management judgements around subjective elements and inputs in order to implement IFRS 9. Some of these judgements relate to decisions made throughout the design and build of the ECL methodology, and others to the application of ECL methodology on an ongoing basis, which will result in inherent measurement uncertainty in our reportable ECL.

The key judgements made by the group upon the implementation of IFRS 9 are highlighted in this document and include changes to asset quality definitions, use of expert judgement and risks arising from the use of internal models and forward-looking macro-economic scenarios overlaying these models. These key judgements have been approved by the Board through the Board Risk and Capital Committee (BRCC) and Audit Committee, and ongoing decision-making is governed by the appropriate forums, which have been adapted to ensure they are enabled to implement IFRS 9.

The group has developed internal models to be suitable for use under IFRS 9. These models, which have been developed for all material asset classes, are subject to review and challenge by Models Forum, which is attended by members of Credit, Finance and Model Validation teams and mandated by the relevant Board approved Risk committees. This forum is mandated to review and approve model changes as required.

IAS 39 to IFRS 9 balance sheet

The adoption of IFRS 9, by applying the accounting policies and ECL methodologies outlined in this document, has resulted in a decrease of shareholders' equity of £212 million at 1 April 2018.

The following table sets out the IFRS 9 transition impact on the group on day one by balance sheet line item:

£'000	At 31 March 2018	IFRS 9 transition adjustments*	At 1 April 2018
Assets			
Cash and balances at central banks	3 487 769	(52)	3 487 717
Loans and advances to banks	1 003 796	(824)	1 002 972
Reverse repurchase agreements and cash collateral on securities borrowed	750 428	(326)	750 102
Sovereign debt securities	1 155 472	–	1 155 472
Bank debt securities	107 938	5 336	113 274
Other debt securities	278 474	(6 410)	272 064
Derivative financial instruments	597 264	(5 352)	591 912
Securities arising from trading activities	701 728	–	701 728
Investment portfolio	477 919	–	477 919
Loans and advances to customers	9 687 224	(123 524)	9 563 700
Other loans and advances	360 931	(2 067)	358 864
Other securitised assets	132 172	–	132 172
Interests in associated undertakings	77 059	–	77 059
Deferred taxation assets	98 156	64 036	162 192
Other assets	1 169 579	–	1 169 579
Property and equipment	54 493	–	54 493
Investment properties	14 500	–	14 500
Goodwill	356 265	–	356 265
Intangible assets	100 585	–	100 585
	20 611 752	**(69 183)**	**20 542 569**
Liabilities			
Deposits by banks	1 308 202	–	1 308 202
Derivative financial instruments	533 319	–	533 319
Other trading liabilities	103 496	–	103 496
Repurchase agreements and cash collateral on securities lent	168 640	–	168 640
Customer accounts (deposits)	11 637 497	–	11 637 497
Debt securities in issue	2 341 134	–	2 341 134
Liabilities arising on securitisation of other assets	127 853	–	127 853
Current taxation liabilities	152 355	–	152 355
Deferred taxation liabilities	21 892	–	21 892
Other liabilities	1 296 990	5 857	1 302 847
	17 691 378	**5 857**	**17 697 235**
Subordinated liabilities	579 673	136 891	716 564
	18 271 051	**142 748**	**18 413 799**
Equity			
Ordinary share capital	195	–	195
Perpetual preference share capital	29	–	29
Share premium	1 317 115	–	1 317 115
Treasury shares	(102 876)	–	(102 876)
Other reserves	(119 161)	(63 007)	(182 168)
Retained income	979 649	(148 924)	830 725
Shareholders' equity excluding non-controlling interests	**2 074 951**	**(211 931)**	**1 863 020**
Additional Tier 1 Capital	250 000	–	250 000
Non-controlling interests	15 750	–	15 750
– Non-controlling interests in partially held subsidiaries	15 750	–	15 750
Total equity	**2 340 701**	**(211 931)**	**2 128 770**
Total liabilities and equity	**20 611 752**	**(69 183)**	**20 542 569**

* *For the detailed impact on classification and measurement and ECL on transition refer to pages 21 to 28.*

Credit and counterparty risk management

Credit and counterparty risk is assumed through a range of client-driven lending activities with private and corporate clients as well as through other counterparties, such as financial institutions and sovereigns. These activities are diversified across a number of business activities.

Credit and counterparty risk governance structure

To manage, measure, monitor and mitigate credit and counterparty risk, independent credit committees exist in each geography where we assume credit risk. These committees operate under board-approved delegated limits, policies and procedures. There is a high level of executive involvement and non-executive review and oversight in the credit decision-making forums depending on the size and complexity of the deal. It is our policy that all centralised credit committees are comprised of voting members who are independent of the originating business unit. All decisions to enter into a transaction are based on unanimous consent.

In addition to the credit committees, the following processes assist in managing, measuring and monitoring credit and counterparty risk. The scope of these forums and committees have been adjusted where necessary to incorporate changes to governance processes arising from IFRS 9 implementation:

- Day-to-day arrears management and regular arrears reporting ensure that individual positions and any potential trends are dealt with in a timely manner.
- Watchlist committees review the management of distressed loans, potential problem loans and exposures in arrears that require additional attention and supervision. These committees review ECL impairments and staging at an asset level as well as potential fair value adjustments to loans and advances to customers and provide recommendations for the appropriate staging and level of ECL impairment if needed.
- Credit watchlist forum reviews and manages exposures that may potentially become distressed as a result of changes in the economic environment or adverse share price movements, or that are vulnerable to volatile exchange rate or interest rate movements or idiosyncratic financial distress.
- Arrears, default and recoveries forums specifically review and manage distressed loans and potentially distressed loans for private clients and corporates. These forums also review and monitor counterparties who have been granted forbearance measures.

Credit risk classification and provisioning policy

The group has incorporated IFRS 9 requirements into our group credit risk classification and provisioning policy. A framework has been established that incorporates both quantitative and qualitative measures. Any decisions in relation to significant increase in credit risk will be management decisions subject to approval by the appropriate committees. The policies for financial assets at amortised cost and at fair value through other comprehensive income (FVOCI), in accordance with IFRS 9, have been developed as described below:

Definition of default

The group has aligned the IFRS 9 and regulatory definitions of default, credit impaired and non-performing exposure. Assets that are more than 90 days past due, or considered by management as unlikely to pay their obligations in full without realisation of collateral are considered as exposures in default.

Stage 1

All assets that are considered performing and have not had a significant increase in credit risk will be reported as Stage 1 assets. Under IFRS 9 these Stage 1 financial assets have loss allowances measured at an amount equal to 12 month ECL.

Stage 2

Financial assets are considered to be in Stage 2 when their credit risk has increased significantly since initial recognition. The group was not required to hold specific impairments against these assets under IAS 39, however, a loss allowance equivalent to a lifetime ECL is now required to be held under IFRS 9.

The group's primary indicator for Stage 2 assets are distressed loans, potential problem loans and exposures in arrears that require additional attention and supervision from Watchlist committees and are under management review. This comprises exposures that may potentially become distressed as a result of changes in the economic environment or adverse share price movements, or that are vulnerable to volatile exchange rate or interest rate movements or idiosyncratic financial distress, or private clients who have undergone a significant deterioration in financial circumstances.

Assets that have been subject to forbearance are considered to be, at a minimum, Stage 2. Forbearance measures refer to concessions such as modification of the terms and conditions or refinancing that has been granted to a debtor in financial difficulties. These exposures are assessed on a case by case basis to determine whether the proposed modifications will be considered as forbearance. Where the credit committee considers it likely that the client will be able to return to perform against the original contractual obligations within a reasonable timeframe these assets will be considered performing and in Stage 2. Forbearance is distinguished from commercial renegotiations which take place as part of normal business activity and standard banking practice.

In addition to loans under management review, an asset may also move from Stage 1 to Stage 2 if the model calculated probability of default (PD) has significantly increased since origination. This is tested as both a relative and absolute measure to further inform whether a significant deterioration in lifetime risk of default has occurred.

As a backstop, the group does not rebut the presumption in IFRS 9 that all financial assets that are more than 30 days past due have experienced a significant increase in credit risk.

Exposures move back to Stage 1 once they no longer meet the criteria above for a significant increase in credit risk and as cure periods (specifically relating to forborne exposures) are met.

Stage 3

Financial assets will be included in Stage 3 when there is objective evidence of credit impairment. Under IFRS 9, the group assesses a loan as Stage 3 when contractual payments of either principal or interest are past due for more than 90 days, the debtor is assessed as unlikely to pay and credit impaired, or the loan is otherwise considered to be in default, for example due to the appointment of an administrator or in receivership. Forborne loans that are considered non-performing, for example if a loan is not expected to return to fulfil the original contractual obligations in a reasonable timeframe, will be classified as Stage 3.

The group's policy is not to rebut the presumption in IFRS 9 that loans which are more than 90 days past due are in default.

ECL

The assessment of credit risk and the estimation of ECL are required to be unbiased, probability-weighted and should incorporate all available information relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39, and the resulting impairment charge may be more volatile. IFRS 9 will result in an increase in the total level of impairment allowances, since all financial assets if not measured at fair value through profit and loss (FVPL) will be assessed for at least 12 month ECL and the population of financial assets to which lifetime ECL applies is larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

A management overlay of £25 million has been considered appropriate in addition to the group's calculated model-driven ECL. This is due to Investec plc's limited experience of utilising model output for reporting purposes and uncertainty over the models' predictive capability. The overlays have been designed to capture specific areas of model uncertainty during the initial adoption of IFRS 9. The group will continue to assess the appropriateness of this management overlay and expect that it will be unwound over time.

Write-offs

The group's policy on when financial assets are written off has not significantly changed on adoption of IFRS 9. A loan or advance is normally written off, in full, against the related allowance when the proceeds from realising any available security have been received or there is a reasonable amount of certainty that the exposure will not be recovered. Similarly the treatment and recognition of recoveries is unaffected by the implementation of IFRS 9. Any recoveries of amounts previously written off decrease the amount of impairment losses.

IAS 39 to IFRS 9 – increase in impairment allowance

Total balance sheet impairment allowance increased by £106 million from £158 million under IAS 39 at 31 March 2018 to £264 million under IFRS 9 at 1 April 2018. This increase is explained in the table below.

At 1 April 2018 £'million	Stage 1	Stage 2	Stage 3	Changes in classification and measurement	Total increase in impairment allowances
Ongoing	19	41	9	(8)	61
Legacy	–	8	50	(13)	45
Total	**19**	**49**	**59**	**(21)**	**106**

Stage 1 (12 month ECL): IFRS 9 requires that for financial assets where there has been no significant increase in credit risk since origination a loss allowance equivalent to 12 month expected credit losses should be held. Previously under IAS 39 these exposures would not be subject to a specific impairment allowance.

Stage 2 (Lifetime ECL): IFRS 9 requires financial assets that have experienced a significant increase in credit risk since initial recognition to carry a lifetime expected credit loss allowance. Under IAS 39, no specific impairment provision was held for Stage 2 assets.

Stage 3 (Lifetime ECL; Multiple economic scenarios): This relates to additional impairment allowances required on Stage 3 exposures already in default or impaired under IAS 39. This is due to the differences in the way ECL under IFRS 9 and incurred loss provisions under IAS 39 are calculated, including the introduction of a range of forward-looking, probability weighted macro-economic scenarios as opposed to an expected outcome. Assets are individually assessed using multiple economic scenarios under IFRS 9, whereas assets treated as impaired under IAS 39 carried a provision reducing the carrying value to the expected recoverable amount.

Changes in classification and measurement: Certain assets had specific impairments assigned under IAS 39, however under IFRS 9 these assets are now classified as fair value and are therefore no longer in scope of impairment allowances. These impaired assets are largely legacy property exposures and these impairments raised under IAS 39 have been used to reflect the assets at their fair value.

Credit risk – analysis of gross credit and counterparty exposures under IFRS 9

The table below indicates in which class of asset (on the face of the consolidated balance sheet) credit and counterparty exposures are reflected. Not all assets included in the balance sheet bear credit and counterparty risk.

The IFRS 9 impairment model is applicable to all financial assets at amortised cost, lease receivables, debt financial assets at fair value through other comprehensive income, loan commitments and financial guarantee contracts. This contrasts with the IAS 39 impairment model which was not applicable to loan commitments and financial guarantee contracts, which were covered by IAS 37.

At 1 April 2018 £'million	Total credit and counterparty exposure	of which FVPL	of which amortised cost and FVOCI	Expected credit losses^	Assets that we deem to have no legal credit exposure	Notes	Total gross assets
Cash and balances at central banks	3 480	–	3 480	–	8		3 488
Loans and advances to banks	1 004	–	1 004	(1)	–		1 003
Reverse repurchase agreements and cash collateral on securities borrowed	750	38	712	–	–		750
Sovereign debt securities	1 155	165	990	–	–		1 155
Bank debt securities	113	55	58	–	–		113
Other debt securities	278	137	141	(6)	–		272
Derivative financial instruments	512	512	–	–	80		592
Securities arising from trading activities	496	496	–	–	206		702
Investment portfolio	–	–	–	–	478	1	478
Loans and advances to customers	9 810	909	8 901	(248)	–		9 562
Other loans and advances	332	2	330	(3)	30		359
Other securitised assets	9	9	–	–	123	2	132
Interest in associated undertakings	–	–	–	–	77		77
Deferred taxation assets	–	–	–	–	162		162
Other assets	45	–	45	–	1 125	3	1 170
Property and equipment	–	–	–	–	54		54
Investment properties	–	–	–	–	15		15
Goodwill	–	–	–	–	356		356
Intangible assets	–	–	–	–	101		101
Total on-balance sheet exposures	**17 984**	**2 323**	**15 661**	**(258)**	**2 815**		**20 541**
Guarantees	22	–	22	–	–		22
Committed facilities related to loans and advances to customers	1 092	3	1 089	(6)	–		1 086
Contingent liabilities and other	121	–	121	–	64		185
Total off-balance sheet exposures	**1 235**	**3**	**1 232**	**(6)**	**64**		**1 293**
Total gross exposures	**19 219**	**2 326**	**16 893**	**(264)**	**2 879**		**21 834**

^ *Expected credit losses include £2 million ECL held against financial assets held at FVOCI, which is reported on the balance sheet within reserves. This will result in minor differences between certain balance sheet lines reported above (loans and advances to customers and sovereign debt securities) and the statutory balance sheet. Loans and advances held at FVOCI total £402 million at 1 April 2018 and relate to loans that we intend at origination to hold and collect, but that we may elect to sell down over time.*

1 *Largely relates to exposures that are classified as investment risk in the banking book.*

2 *While the group manages all risks (including credit risk) from a day-to-day operational perspective, certain assets are within special purpose vehicles that ring-fence the assets to specific credit providers and limit security to the assets in the vehicle. The table above reflects the net credit exposure in the vehicles that the group has reflected in the 'total credit and counterparty exposure' with the maximum credit exposure referenced to credit providers external to the group in the column headed 'assets that we deem to have no legal credit exposure'. This also includes cash in the securitised vehicles.*

3 *Other assets include settlement debtors which we deem to have no credit risk exposure as they are settled on a delivery against payment basis.*

Credit risk – analysis of gross credit and counterparty exposures under IFRS 9 (continued)

Total gross credit and counterparty exposure: Gross credit and counterparty exposure totalled £19.2 billion at 1 April 2018. Cash and near cash balances amount to £5.8 billion and are largely reflected in the following line items in the table above: cash and balances at central banks, loans and advances to banks and sovereign debt securities. These exposures are all Stage 1. Certain debt securities and other loans and advances are Stage 2 and Stage 3 exposures, however these exposures are small relative to the size of the balance sheet and loans and advances to customers (including committed facilities) account for greater than 96% of overall ECLs.

Loans and advances to customers: The tables that follow provide information with respect to the asset quality of our core loans and advances to customers, which account for the material ECL allowances.

Loans and advances to customers held at fair value through profit and loss (FVPL): The combined effect of the application of the business model and the contractual cash flow characteristics tests has resulted in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39. This has resulted in a £14 million reduction in Investec plc's loans and advances to customers primarily due to the reclassification of certain loans and advances to customers to FVPL, which now total £909 million at 1 April 2018.

Off-balance sheet exposures: IFRS 9 requires a loss allowance to be held against off balance sheet items such as undrawn lending commitments held at amortised cost or FVOCI. Previously, an impairment provision would only have been held for a commitment in the event that a loss event had occurred. Exposures that are undrawn but that are intended to be sold down to mitigate concentration risk will be classified as FVPL. Exposures that are undrawn and that could potentially be sold down will be classified as FVOCI.

Credit risk – analysis of gross core loans and advances under IFRS 9 – ongoing business

An analysis of the ongoing business (i.e. excluding legacy business) core loans and advances to customers and asset quality is shown in the table below.

£'million	1 April 2018
Gross core loans and advances to customers	**9 399**
of which subject to ECL	8 518
Gross exposure subject to ECL (£'million)	**8 518**
Stage 1	7 743
Stage 2	554
of which past due greater than 30 days	18
Stage 3	221
Gross exposure (%)	
Stage 1	90.9%
Stage 2	6.5%
Stage 3	2.6%
IFRS 9 ECL (£'million)	**(93)**
Stage 1	(15)
Stage 2	(33)
Stage 3	(45)
ECL coverage ratio (%)	**1.1%**
Stage 1	0.2%
Stage 2	6.0%
Stage 3	20.4%

A reconciliation of core loans and advances: statutory basis and ongoing basis

		Removal of:	
At 1 April 2018 £'million	**Statutory as disclosed**	**Legacy business**	**Ongoing business**
Gross core loans and advances to customers under IAS 39	**9 839**	**426**	**9 413**
Fair value adjustment on transition	(29)	(15)	(14)
Gross core loans and advances to customers under IFRS 9	**9 810**	**411**	**9 399**
of which subject to ECL	8 901	383	8 518
IFRS 9 ECL impairments	**(248)**	**(155)**	**(93)**
Net core loans and advances to customers subject to ECL	**8 653**	**228**	**8 425**

Legacy business – overview under IFRS 9

Following the implementation of IFRS 9, our exposure (net of impairments) to the legacy portfolio has further reduced from £313 million at 31 March 2018 to £256 million at 1 April 2018 as shown in the analysis below.

Impairments on legacy exposures under IFRS 9 have increased by £58 million, partially offset by a reduction of £13 million as a result of changes in classification and measurement of certain legacy assets to fair value. This has resulted in an overall net increase in legacy impairments of £45 million.

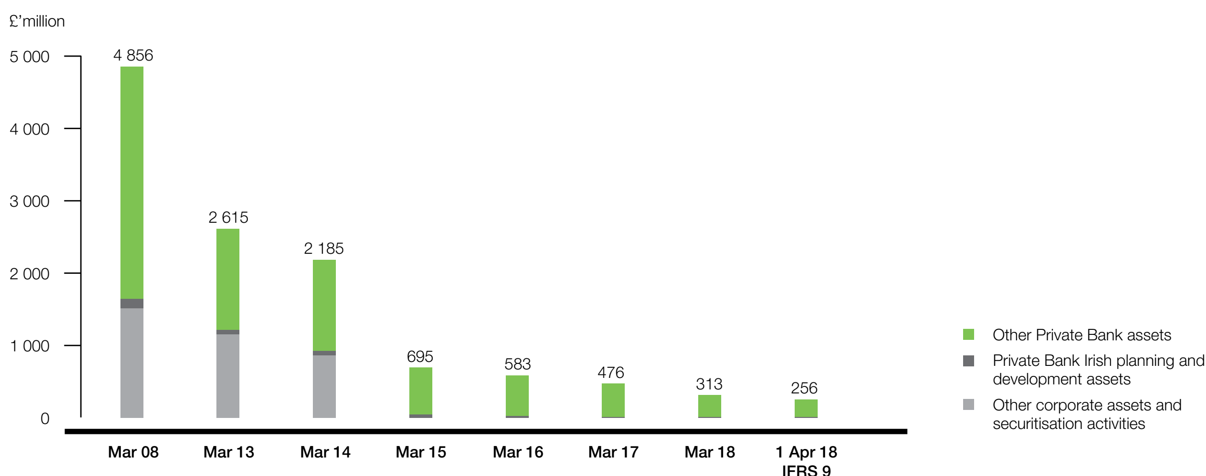
	Under IFRS 9	
At 1 April 2018 £'million	**Total net assets (after impairments)**	**Total balance sheet impairments***
Legacy assets at amortised cost	**228**	**(155)**
Stage 1	–	–
Stage 2	32	(8)
Stage 3	196	(147)
Legacy assets at FVPL	**28**	
Total legacy assets (net or at carrying value)	**256**	
Effective coverage ratio on total legacy assets (including FVPL)	40%	

* *Included in balance sheet impairments is a management overlay for legacy of £5 million. Excluded from balance sheet impairments is £3 million ECL held against committed facilities related to the legacy portfolio.*

Certain legacy assets have been reclassified to fair value, typically due to historic profit shares or equity conversion features. Under IFRS 9, these loan instruments are now classified and measured at FVPL. Related to these exposures were £13 million of IAS 39 provisions at 31 March 2018, which have been used to reduce the carrying value of these exposures as well as an additional £2 million of fair value adjustments taken through reserves. This has reduced the overall carrying value of FVPL assets to £28 million from £43 million at 31 March 2018.

Total effective coverage on the overall legacy portfolio (including FVPL, calculated as if fair value adjustments are equivalent to balance sheet impairments) has therefore substantially increased to 39.9% at 1 April 2018 from 26.6% at 31 March 2018 (2017: 17.6%).

Total legacy assets



Credit risk – analysis of gross core loans and advances under IFRS 9

The tables that follow provide information with respect to the asset quality of our core loans and advances on a statutory basis.

£'million	1 April 2018
Loans and advances to customers per the balance sheet	9 564
Net core loans and advances to customers	**9 562**
of which subject to ECL	8 653

£'million	1 April 2018
Gross core loans and advances to customers	**9 810**
of which subject to ECL	8 901
Gross exposure subject to ECL (£'million)	**8 901**
Stage 1	7 743
Stage 2	594
of which past due greater than 30 days	18
Stage 3	564
Gross exposure (%)	
Stage 1	87.0%
Stage 2	6.7%
Stage 3	6.3%
IFRS 9 ECL (£'million)	**(248)**
Stage 1	(15)
Stage 2	(41)
Stage 3	(192)
ECL coverage ratio (%)	**2.8%**
Stage 1	0.2%
Stage 2	6.9%
Stage 3	34.0%

Stage 1: 87.0% of gross exposure in scope for IFRS 9 is in Stage 1 and has not experienced a significant increase in credit risk since origination. Impairment is calculated based on a 12 month expected loss. Coverage for these performing, non-deteriorated assets is 0.2%.

Stage 2: 6.7% of gross exposure is in Stage 2 and has seen a significant increase in credit risk since origination. Under IFRS 9, these assets require a lifetime expected loss to be held, resulting in an increase in coverage to 6.9%. Only £18 million or 0.2% of gross core loans shown in Stage 2 are greater than 30 days past due. An asset reported in Stage 2 does not imply we expect a loss on these assets. Stage 2 assets are assessed relative to their expected performance at the point of origination. While assets may underperform original expectations, the level of ECL indicates that our expected losses from these positions remain low.

Stage 3: 6.3% of gross exposure is in Stage 3 which is made up of assets that are credit impaired. Coverage ratio totals 34.0%. UK Stage 3 ECL is predominantly driven by legacy.

Credit risk – an analysis of gross core loans and advances by risk category under IFRS 9

At 1 April 2018 £'million	Gross core loans and advances at Amortised cost and FVOCI*								Gross core loans and advances at FVPL	Gross core loans and advances
	Stage 1		Stage 2		Stage 3		Total			
	Drawn exposure	ECL	Drawn exposure	ECL	Drawn exposure	ECL	Drawn exposure	ECL		
Lending collateralised by property	**1 082**	**(1)**	**296**	**(23)**	**426**	**(145)**	**1 804**	**(169)**	**164**	**1 968**
Commercial real estate	586	(1)	255	(21)	225	(65)	1 066	(87)	72	1 138
Commercial real estate – investment	476	(1)	239	(19)	176	(40)	891	(60)	59	950
Commercial real estate – development	110	–	10	–	17	(7)	137	(7)	3	140
Commercial vacant land and planning	–	–	6	(2)	32	(18)	38	(20)	10	48
Residential real estate	496	–	41	(2)	201	(80)	738	(82)	92	830
Residential real estate – investment	135	–	17	(1)	39	(15)	191	(16)	46	237
Residential real estate – development	356	–	24	(1)	112	(43)	492	(44)	33	525
Residential vacant land and planning	5	–	–	–	50	(22)	55	(22)	13	68
High net worth and other private client lending	**1 841**	**(2)**	**36**	**(2)**	**26**	**(9)**	**1 903**	**(13)**	**13**	**1 916**
Mortgages	1 430	(1)	33	(2)	18	(3)	1 481	(6)	–	1 481
High net worth and specialised lending	411	(1)	3	–	8	(6)	422	(7)	13	435
Corporate and other lending	**4 820**	**(12)**	**262**	**(16)**	**112**	**(38)**	**5 194**	**(66)**	**732**	**5 926**
Acquisition finance	1 262	(5)	39	(1)	19	(6)	1 320	(12)	213	1 533
Asset-based lending	301	(1)	43	(2)	11	(1)	355	(4)	–	355
Fund finance	1 017	(1)	13	(1)	–	–	1 030	(2)	–	1 030
Other corporate and financial institutions and governments	418	–	13	(1)	–	–	431	(1)	216	647
Asset finance	1 422	(4)	100	(8)	78	(31)	1 600	(43)	272	1 872
Small ticket asset finance	1 294	(3)	79	(7)	14	(9)	1 387	(19)	–	1 387
Large ticket asset finance	128	(1)	21	(1)	64	(22)	213	(24)	272	485
Project finance	400	(1)	54	(3)	4	–	458	(4)	26	484
Resource finance	–	–	–	–	–	–	–	–	5	5
Gross core loans and advances	**7 743**	**(15)**	**594**	**(41)**	**564**	**(192)**	**8 901**	**(248)**	**909**	**9 810**

* *Legacy exposures are included in the table above and largely relate to lending collateralised by property. These exposures account for a significant portion of Stage 2 and Stage 3 assets. If these exposures were to be excluded from the table above, £89 million or 1.0% of total ongoing gross core loans subjected to ECL would be reported as Stage 3 lending collateralised by property.*

Key drivers of measurement uncertainty – subjective elements and inputs

The measurement of ECL under IFRS 9 has increased complexity and reliance on expert credit judgements. Key judgemental areas under the implementation of IFRS 9 are highlighted in this document and are subject to robust governance processes. Key drivers of measurement uncertainty include:

- the assessment of what constitutes a significant increase in credit risk;
- the introduction of a range of forward-looking probability weighted macro-economic scenarios; and
- estimations of probabilities of default, loss given default and exposures at default using models.

In addition to these drivers, some initial judgements and assumptions were required in the design and build of the group's ECL methodology, which are not considered to have a material impact. This includes the use of income recognition effective interest rates (EIRs) that are calculated under IAS 39 and used as the discount factor in the IFRS 9 ECL calculation as well as the use of contractual maturity to assess behavioural lives. In addition where we have experienced limitations on the availability of probability of default origination data for the historic book a portfolio average has been used in some instances.

We will continue to assess and monitor the group's measurement uncertainty and sensitivity to changes in economic credit conditions and expect to provide additional disclosures relating to sensitivities in the 2019 Annual Report.

Forward-looking macro-economic scenarios

The measurement of ECL also requires the use of multiple economic scenarios to calculate a probability weighted forward-looking estimate. These scenarios are updated at least twice a year, or more frequently if there is a macro-economic shock or significant shift in expectations. The weighting of these scenarios for IFRS 9 as well as the scenarios themselves are discussed and approved in Investec plc and IBP Capital Committee, which forms part of the principal governance framework for macro-economic scenarios.

A number of forecast economic scenarios are considered for capital planning, stress testing (including Investec specific stress scenarios) and IFRS 9, including an expected scenario, an upside scenario and two Investec specific downside scenarios.

IFRS 9 is likely to result in an increase in the volatility of provisions going forward, particularly for Stage 1 and Stage 2 assets as a result of macro-economic scenario changes. Sensitivities to macro-economic scenarios and factors will form part of our overall risk monitoring.

Management and measurement of credit and counterparty risk

Fundamental principles employed in the management of credit and counterparty risk include:

- A clear definition of our target market.
- A quantitative and qualitative assessment of the creditworthiness of our counterparties.
- Analysis of risks, including concentration risk (concentration risk considerations include asset class, industry, counterparty and geographical concentration).
- Decisions are made with reference to risk appetite limits.
- Prudential limits.
- Regular monitoring and review of existing and potential exposures once facilities have been approved.
- A high level of executive involvement in decision-making with non-executive review and oversight.
- Portfolio reviews and stress testing.

Within the credit approval process, internal and external ratings are included in the assessment of client quality.

A large proportion of the group's portfolio is not rated by external rating agencies. We place reliance upon internal consideration of counterparties and borrowers, and use ratings prepared externally where available as support in our decision-making process.

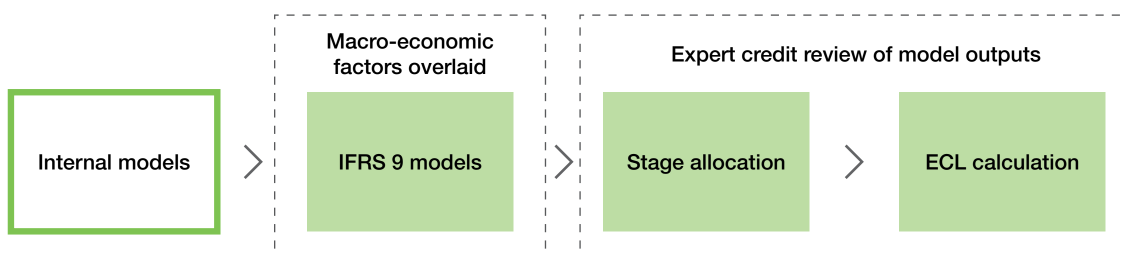
Regular reporting of credit and counterparty risk exposures within our operating units is made to management, the executives and the board at the group risk and capital committee (GRCC) and board risk and capital committee (BRCC). The board regularly reviews and approves the appetite for credit and counterparty risk, which is documented in risk appetite statements and policy documents. This is implemented and reviewed by the credit risk management teams in each jurisdiction. Credit policies have been updated and amended to include changes to reflect the implementation of IFRS 9.

Portfolio reviews and stress testing are undertaken on all material businesses, where the exposures are analysed to assess any migration in portfolio quality, highlight any vulnerabilities, identify portfolio concentrations and make appropriate recommendations, such as a reduction in risk appetite limits or specific exposures.

Internal credit rating models and ECL methodology

Internal credit rating models have been developed to cover all material asset classes. These internal credit rating models are then used for IFRS 9 modelling but adjusted for key differences. Internal credit models calculate through the economic cycle losses whereas IFRS 9 requires 12 month or lifetime point-in-time losses based on conditions at the reporting date and multiple economic scenario forecasts of the future conditions over the expected lives.

Process to determine expected credit loss



ECLs are calculated using three main components:

- a probability of default (PD);
- a loss given default (LGD); and
- the exposure at default (EAD).

Under IFRS 9, the 12 month and lifetime PDs represent the probability of a default occurring over the next 12 months or the lifetime of the financial exposures, respectively, based on conditions existing at the balance sheet date and future forecasted macro-economic conditions that affect credit risk.

The LGD represents losses expected on default, taking into account the mitigating effect of collateral, its expected value when realised and the time value of money. The forecast value for the collateral is also affected by the range of forward-looking probability weighted macro-economic scenarios.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdown of a committed facility.

The calculation of the 12 month ECL is based on the 12 month PD and LGD along with the EAD and effective interest rate (EIR) for the asset. Lifetime ECL is calculated using the lifetime PD curve, and the appropriate LGDs and EADs and discount rates derived from the EIR based on the remaining life of the financial asset.

Expert judgement models have also been utilised for certain portfolios where the ECL is judged to be minimal, either due to the portfolio's relative size or the highly-rated nature of these portfolios, such as cash and balances held at central banks.

Management adjustments are made to modelled output to account for situations where additional information and known or expected risk factors have not been captured in the modelling process.

A management overlay of £25 million has been considered appropriate in addition to the group's calculated model-driven ECL. This is due to Investec plc's limited experience of utilising model output for reporting purposes and uncertainty over the models' predictive capability. The overlays have been designed to capture specific areas of model uncertainty during the initial adoption of IFRS 9. The group will continue to assess the appropriateness of this management overlay and expect that it will be unwound over time.

Capital management *(unaudited)*

Investec plc applies the Standardised approach when calculating capital requirements. The impact of IFRS 9 on the group's CET 1 ratio is potentially more significant when compared to similar banks applying an Internal Ratings Based approach, who already deduct from CET 1 capital any excess expected losses over impairment allowances.

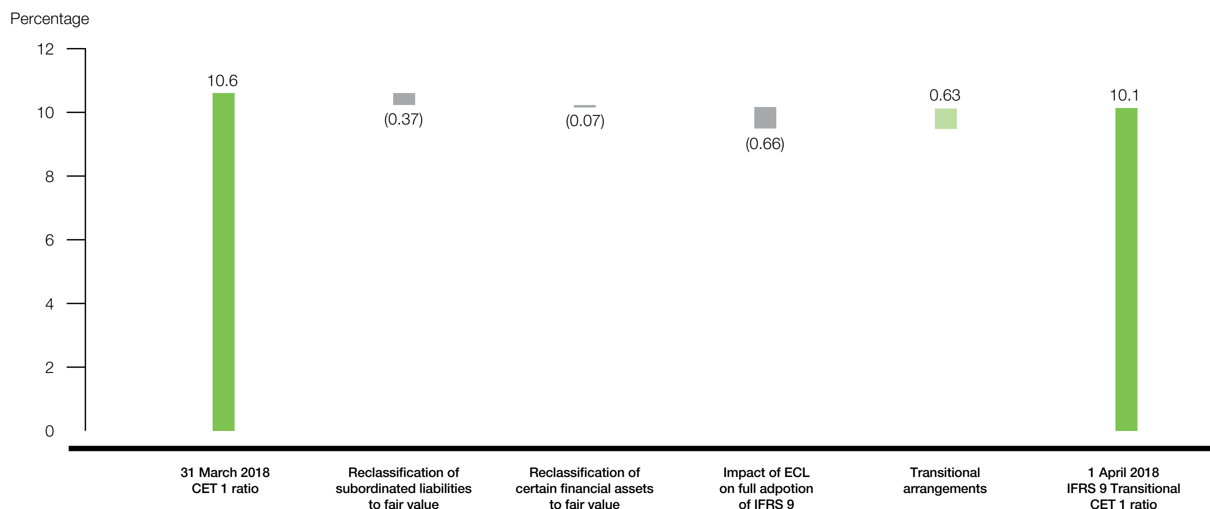
We remain lowly leveraged and target a leverage ratio in all our banking subsidiaries in excess of 6%.

The most recent capital plans have been prepared on an IFRS 9 basis to ensure the bank remains sufficiently capitalised under both normal and stressed market conditions.

In December 2017 the European Union issued the final regulation setting out the IFRS 9 transitional arrangements firms may apply to minimise the impact of the IFRS 9 expected credit loss accounting on regulatory capital.

The transitional arrangements allow the day one and any subsequent increases in Stage 1 and Stage 2 expected credit loss provisions to be phased in over five years, recognising 5% in 2018, increasing to 15% in 2019, 30% in 2020, 50% in 2021, and 75% in 2022, with full recognition in CET 1 capital ('full adoption of IFRS 9') in 2023. Investec plc notified the PRA in October 2017 of its intention to apply the IFRS 9 transitional arrangements, effective 1 April 2018.

The following chart highlights the day one impact on CET 1 ratio as well as the impact of ECL on full adoption of IFRS 9.



Capital impact

The impact on the composition of our regulatory capital on a CRD IV basis is provided in the table below:

	Investec plc*		
Capital ratios £'million	**31 March 2018 IAS 39**	**1 April 2018 IFRS 9 Transitional**	**1 April 2018 IFRS 9 Full adoption^**
Shareholders' equity excluding non-controlling interests	2 075	1 863	1 863
Gains or losses on subordinated liabilities valued at fair value^	–	55	104
Transitional add-back of ECL	–	94	–
Other deductions	(553)	(553)	(553)
Common equity tier 1 capital	**1 522**	**1 459**	**1 414**
Additional tier 1 capital	274	274	274
Tier 1 capital	**1 796**	**1 733**	**1 688**
Tier 2 capital	359	368	369
Total regulatory capital	**2 155**	**2 101**	**2 057**
Risk-weighted assets	**14 411**	**14 444**	**14 366**
Capital ratios			
Common equity tier 1 ratio	10.6%	10.1%	9.8%
Tier 1 ratio	12.5%	12.0%	11.7%
Total capital adequacy ratio	15.0%	14.5%	14.3%

	Investec plc*		
Leverage ratios £'million	**31 March 2018 IAS 39**	**1 April 2018 IFRS 9 Transitional**	**1 April 2018 IFRS 9 Full adoption^**
Tier 1 capital	1 796	1 733	1 688
Total exposure	21 772	21 771	21 675
Leverage ratio	8.2%	8.0%	7.8%

* *Investec plc includes the deduction of foreseeable charges and dividends when calculating common equity tier 1 capital as now required under the Capital Requirements Regulation and European Banking Authority technical standards. Excluding the impact of the foreseeable charges and dividends totalling £65 million for Investec plc, the ratios would be 45bps higher.*

^ *As a result of the adoption of IFRS 9 Investec plc has elected to designate its subordinated liabilities to fair value. By the time of full adoption of IFRS 9 in 2023, these subordinated liabilities will have reached maturity. Redemption at maturity is at par and so the interest rate portion of the fair value adjustment £48 million (post-tax) will come back into retained earnings. In addition, an amount of £55 million (post-tax) has been transferred to an own credit reserve, which does not have an impact on capital ratios and which on maturity of the subordinated liabilities would be released. Therefore, the day one transitional impact on 1 April 2018 of 37bps has been excluded from the capital ratios at full adoption of IFRS 9 shown above.*

Classification and measurement overview

From 1 April 2018, the group will classify all of its financial assets which fall within the scope of IFRS 9 in the following measurement categories:

- Amortised cost
- Fair value through other comprehensive income (FVOCI)
- Fair value through profit or loss (FVPL).

The classification into one of these categories is based on the entity's business model for managing the assets and the contractual cash flow characteristics of the assets.

The standard sets out three types of business models:

- **Hold to collect:** it is intended to hold the asset to maturity to earn interest; collecting repayments of principal and interest from the customer. These assets are accounted for at amortised cost.
- **Hold to collect and sell:** this model is similar to the hold to collect model, except that the entity may elect to sell some or all of the assets before maturity as circumstances change. These assets are accounted for at FVOCI.
- **Hold to sell/managed on a fair value basis:** the entity originates or purchases an asset with the intention of disposing of it in the short- or medium-term to benefit from capital appreciation or the portfolio is managed on a fair value basis. These assets are accounted for at FVPL.

Solely payments of principal and interest (SPPI)

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the group assesses whether the assets' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the group considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related asset is classified and measured at FVPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payments of principal and interest.

Designation at fair value

The adoption of IFRS 9 also necessitates a review of the designation of financial instruments at fair value. IFRS 9 requires that the designation is revoked where there is no longer an accounting mismatch at 1 April 2018 and permits designations to be revoked or additional designations created at 1 April 2018 if there are accounting mismatches at that date.

As a result:

- fair value designations for financial liabilities have been created where there is an accounting mismatch, as permitted by IFRS 9; and
- fair value designations have been revoked for certain assets where accounting mismatches no longer exist as a result of the adoption of the classification rules of IFRS 9.

For the detailed accounting policies adopted by the group on the adoption of IFRS 9 refer to page 29 .

Analysis of financial assets and liabilities by measurement basis under IAS 39 and measurement category IFRS 9

The tables below shows an analysis of assets and liabilities under IAS 39 at 31 March 2018 and under IFRS 9 on 1 April 2018:

IAS 39 measurement basis

	At fair value through profit or loss		
At 31 March 2018 **£'000**	**Trading**	**Designated at inception**	**Available-for-sale**
Financial assets			
Cash and balances at central banks	7 784	–	–
Loans and advances to banks	–	158 161	–
Reverse repurchase agreements and cash collateral on securities borrowed	37 878	–	–
Sovereign debt securities	165 090	–	990 382
Bank debt securities	–	–	–
Other debt securities	–	56 869	22 230
Derivative financial instruments	597 264	–	–
Securities arising from trading activities	244 334	457 394	–
Investment portfolio	–	442 080	35 839
Loans and advances to customers	–	133 740	–
Other loans and advances	–	–	–
Other securitised assets	–	132 172	–
Interests in associated undertakings	–	–	–
Deferred taxation assets	–	–	–
Other assets	57 218	58 238	–
Property and equipment	–	–	–
Investment properties	–	–	–
Goodwill	–	–	–
Intangible assets	–	–	–
	1 109 568	**1 438 654**	**1 048 451**
Financial liabilities			
Deposits by banks	–	–	–
Derivative financial instruments	533 319	–	–
Other trading liabilities	103 496	–	–
Repurchase agreements and cash collateral on securities lent	34 886	–	–
Customer accounts (deposits)	–	–	–
Debt securities in issue	–	471 886	–
Liabilities arising on securitisation of other assets	–	127 853	–
Current taxation liabilities	–	–	–
Deferred taxation liabilities	–	–	–
Other liabilities	–	–	–
Subordinated liabilities	–	–	–
	671 701	**599 739**	**–**

Total instruments at fair value	Loans and receivables	Financial liabilities at amortised cost	Total instruments at amortised cost	Non-financial instruments	Total
7 784	3 479 985	–	3 479 985	–	3 487 769
158 161	845 635	–	845 635	–	1 003 796
37 878	712 550	–	712 550	–	750 428
1 155 472	–	–	–	–	1 155 472
–	107 938	–	107 938	–	107 938
79 099	199 375	–	199 375	–	278 474
597 264	–	–	–	–	597 264
701 728	–	–	–	–	701 728
477 919	–	–	–	–	477 919
133 740	9 553 484	–	9 553 484	–	9 687 224
–	360 931	–	360 931	–	360 931
132 172	–	–	–	–	132 172
–	–	–	–	77 059	77 059
–	–	–	–	98 156	98 156
115 456	847 659	–	847 659	206 464	1 169 579
–	–	–	–	54 493	54 493
–	–	–	–	14 500	14 500
–	–	–	–	356 265	356 265
–	–	–	–	100 585	100 585
3 596 673	**16 107 557**	**–**	**16 107 557**	**907 522**	**20 611 752**
–	–	1 308 202	1 308 202	–	1 308 202
533 319	–	–	–	–	533 319
103 496	–	–	–	–	103 496
34 886	–	133 754	133 754	–	168 640
–	–	11 637 497	11 637 497	–	11 637 497
471 886	–	1 869 248	1 869 248	–	2 341 134
127 853	–	–	–	–	127 853
–	–	–	–	152 355	152 355
–	–	–	–	21 892	21 892
–	–	891 556	891 556	405 434	1 296 990
–	–	579 673	579 673	–	579 673
1 271 440		**16 419 930**	**16 419 930**	**579 681**	**18 271 051**

Analysis of financial assets and liabilities by measurement basis under IAS 39 and measurement category IFRS 9 *(continued)*

IFRS 9 measurement categories

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the group. Further details of the specific IFRS 9 policies (as well as previous IAS 39 policies) are described in more detail on page 29 .

	At fair value through profit or loss		
	IFRS 9 mandatory		
At 1 April 2018 **£'000**	**Trading**	**Non-trading**	**Designated at initial recognition**
Financial assets			
Cash and balances at central banks	–	7 784	–
Loans and advances to banks	–	–	–
Reverse repurchase agreements and cash collateral on securities borrowed	37 878	–	–
Sovereign debt securities	–	165 090	–
Bank debt securities	–	54 685	–
Other debt securities	–	136 652	–
Derivative financial instruments	591 912	–	–
Securities arising from trading activities	244 334	6 754	450 640
Investment portfolio	–	477 919	–
Loans and advances to customers	–	909 024	–
Other loans and advances	–	2 451	–
Other securitised assets	–	–	132 172
Interests in associated undertakings	–	–	–
Deferred taxation assets	–	–	–
Other assets	20 872	94 584	–
Property and equipment	–	–	–
Investment properties	–	–	–
Goodwill	–	–	–
Intangible assets	–	–	–
	894 996	**1 854 943**	**582 812**
Financial liabilities			
Deposits by banks	–	–	–
Derivative financial instruments	533 319	–	–
Other trading liabilities	103 496	–	–
Repurchase agreements and cash collateral on securities lent	34 886	–	–
Customer accounts (deposits)	–	–	–
Debt securities in issue	–	–	471 886
Liabilities arising on securitisation of other assets	–	–	127 853
Current taxation liabilities	–	–	–
Deferred taxation liabilities	–	–	–
Other liabilities	–	–	–
Subordinated liabilities	–	–	716 564
	671 701	**–**	**1 316 303**

At fair value through other comprehensive income					
Debt instrument with dual business model	Total instruments at fair value	Amortised cost	Non-financial instruments	Total BS
–	7 784	3 479 933	–	3 487 717
–	–	1 002 972	–	1 002 972
–	37 878	712 224	–	750 102
990 382	1 155 472	–	–	1 155 472
–	54 685	58 589	–	113 274
–	136 652	135 412	–	272 064
–	591 912	–	–	591 912
–	701 728	–	–	701 728
–	477 919	–	–	477 919
402 340	1 311 364	8 252 336	–	9 563 700
–	2 451	356 413	–	358 864
–	132 172	–	–	132 172
–	–	–	77 059	77 059
–	–	–	162 192	162 192
–	115 456	847 659	206 464	1 169 579
–	–	–	54 493	54 493
–	–	–	14 500	14 500
–	–	–	356 265	356 265
–	–	–	100 585	100 585
1 392 722	**4 725 473**	**14 845 538**	**971 558**	**20 542 569**
–	–	1 308 202	–	1 308 202
–	533 319	–	–	533 319
–	103 496	–	–	103 496
–	34 886	133 754	–	168 640
–	–	11 637 497	–	11 637 497
–	471 886	1 869 248	–	2 341 134
–	127 853	–	–	127 853
–	–	–	152 355	152 355
–	–	–	21 892	21 892
–	–	897 413	405 434	1 302 847
–	716 564	–	–	716 564
–	**1 988 004**	**15 846 114**	**579 681**	**18 413 799**

Reconciliation of movements and revaluation

The table below reflects the impact of IFRS 9 implementation on the balance sheet lines and shows movements between amortised cost and fair value:

Only assets and liabilities which have changes are shown.

£'000	IAS 39 carrying amount 31 March 2018	Reclassifications (in)	Reclassifications (out)	Remeasurements and ECLs	IFRS 9 carrying amount 1 April 2018
Financial assets at amortised cost (previously loans and receivables)					
Cash and balances at central banks	3 479 985	–	–	(52)	3 479 933
Loans and advances to banks	845 635	158 161	–	(824)	1 002 972
Reverse repurchase agreements and cash collateral on securities borrowed	712 550	–	–	(326)	712 224
Bank debt securities	107 938	–	(49 301)	(48)	58 589
Other debt securities	199 375	29 098	(87 887)	(5 174)	135 412
Loans and advances to customers	9 553 486	–	(1 190 755)	(110 395)	8 252 336
Other loans and advances	360 931	–	(2 454)	(2 064)	356 413
Other assets	847 659	–	–	*	847 659
Financial assets at fair value through profit or loss (mandatory and designated)^					
Loans and advances to banks	158 161	–	(158 161)	–	–
Bank debt securities	–	52 044		2 641	54 685
Other debt securities	79 099	87 893	(29 098)	(1 242)	136 652
Derivative financial instruments	597 264	–	(5 352)	–	591 912
Loans and advances to customers	133 740	1 193 364	–	(15 740)	1 311 364
Other loans and advances	–	2 454		(3)	2 451
Financial liabilities at amortised cost					
Other liabilities	(891 556)	–	–	(5 857)	(897 413)
Subordinated liabilities	(579 673)	–	579 673	–	–
Financial liabilities at fair value					
Subordinated liabilities	–	(579 673)	–	(136 891)	(716 564)
Financial liabilities at fair value					
Guarantees	–	–	–	(139)	(139)
Committed facilities related to loans and advances to customers	–	–	–	(5 715)	(5 715)

1 ECL on off balance sheet exposures is booked as a provision in other liabilities.

^ Includes £402 million of sell down exposures held at fair value through other comprehensive income.

** Less than £1 000.*

Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles prior year's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 April 2018:

£'000	Loan loss allowance under IAS 39/Provision under IAS 37	Reclassification	Remeasurement	ECL under IFRS 9
Loans and receivables (IAS 39)/Financial assets at amortised cost (IFRS 9)				
Cash and balances at central banks	–	–	(52)	(52)
Loans and advances to banks	–	–	(824)	(824)
Reverse repurchase agreements and cash collateral on securities borrowed	–	–	(326)	(326)
Bank debt securities	–	–	(48)	(48)
Other debt securities	(5 087)	4 803	(5 174)	(5 458)
Loans and advances to customers	(151 840)	15 980	(110 395)	(246 255)
Other loans and advances	(822)	–	(2 064)	(2 886)
Other assets	–	–	–	–
	(157 749)	**20 783**	**(118 883)**	**(255 849)**
Available for sale/Financial assets at FVOCI (IFRS 9)				
Sovereign debt securities	–	–	(461)	(461)
Loans and advances to customers	–	–	(1 687)	(1 687)
	–	**–**	**(2 148)**	**(2 148)**
Loan commitments and financial guarantee contracts				
Guarantees	–	–	(139)	(139)
Committed facilities (core loans)	–	–	(5 715)	(5 715)
	–	**–**	**(5 854)**	**(5 854)**
Total	**(157 749)**	**20 783**	**(126 885)**	**(263 851)**

The impact of transition to IFRS 9 on equity

Only components of equity which have changed are shown.

£'000	Other reserves	Retained income	Total
Closing balance under IAS 39	**(119 161)**	**979 649**	**860 488**
Recognition of ECL including those measured at FVOCI	2 148	(126 886)	(124 738)
Remeasurement impact of reclassifying financial assets held at amortised cost to FVPL	–	(14 356)	(14 356)
Impact of recognising credit risk for financial liabilities designated at FVPL in own credit reserve	(73 100)	–	(73 100)
Remeasurement impact of the reclassification of financial liabilities at amortised cost reclassified to FVPL	–	(63 791)	(63 791)
Investment securities from AFS to FVPL	(9 004)	9 004	–
Debt securities from AFS to amortised cost	(244)	244	–
Deferred taxation^	17 193	46 861	64 054
Opening balance under IFRS 9	**(182 168)**	**830 725**	**648 557**

^ *A UK corporation tax deduction will be available on ECLs generated with the UK entities over the next 10 years. Accordingly, a deferred tax asset has been recognised at the tax rate which it is expected to unwind in the future.*

Accounting policies

This transition document has been prepared based on IFRS 9's transition requirements and these disclosures compare the closing balance sheet at 31 March 2018 (under IAS 39) to the opening balance sheet at 1 April 2018 (under IFRS 9). These disclosures enable the reconciliation between:

- the balance sheet line items under IAS 39 and IFRS 9;
- the measurement category under IAS 39 and IFRS 9; and
- the class of financial instrument as required by IFRS 7.

The group accounting policies, related to financial instruments which have been significantly changed as the result of the implementation of IFRS 9, are applicable with effect from 1 April 2018, and are set out below. The full set of accounting policies is set out in the 2018 integrated annual report.

Standards adopted during the year ending 31 March 2019

The requirements of IFRS 9 'Financial Instruments' were adopted from 1 April 2018. IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting, which the group has exercised.

The adoption of IFRS 9 includes the adoption of 'Prepayment Features with Negative Compensation (Amendments to IFRS 9)' which is effective for annual periods beginning on or after 1 January 2019 with early adoption permitted. This amendment was endorsed by the EU in March 2018 and the group has decided to apply the amendment from 1 April 2018 in order to reflect all of the effects of IFRS 9 at the same time.

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The group is not restating comparatives on initial application as permitted by IFRS 9.

Financial instruments

Financial instruments are initially recognised at their fair value. For financial assets or financial liabilities not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial assets or financial liabilities are included in the initial measurement. All other transaction costs are recorded in the income statement immediately. Regular way purchase and sales transactions in respect of financial assets that require delivery of a financial instrument within the timeframe established by market convention are recorded at trade date.

Business model assessment

For financial assets, IFRS 9 requires that a business model assessment is carried out which reflects how the group manages the assets in order to generate cash flows. The assessment is at a portfolio level, being the level at which the portfolio is managed. Factors considered by the group in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the assets' performance is evaluated and reported and how risks are assessed and managed.

The standard sets out different types of business model:

- **Hold to collect:** it is intended to hold the asset to maturity to earn interest, collecting repayments of principal and interest from the customer. These assets are accounted for at amortised cost.
- **Hold to collect and sell:** this model is similar to the hold to collect model, except that the entity may elect to sell some or all of the assets before maturity to achieve the objectives of the business model. These assets are accounted for at FVOCI.
- **Hold to sell/managed on a fair value basis:** the entity originates or purchases an asset with the intention of disposing of it in the short or medium term to benefit from capital appreciation or the portfolio is managed on a fair value basis. These assets are accounted for at FVPL.

However, the group may make the following irrevocable election/designation at initial recognition of a financial asset on an asset-by-asset basis:

- elect to present subsequent changes in fair value of an equity investment that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies, in OCI; and
- a debt instrument that meets the amortised cost or FVOCI criteria as measured at FVPL if doing so eliminates or significantly reduces an accounting mismatch (referred to as the fair value option).

The classification into one of these categories is based on the entity's business model for managing the assets and the contractual cash flow characteristics of the assets.

Accounting policies *(continued)*

Solely payment of principal and interest (SPPI)

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the group assesses whether the assets' cash flows represent solely payments of principal and interest (the SPPI test). In making this assessment, the group considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related asset is classified and measured at FVPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payments of principal and interest.

Financial assets and liabilities measured at amortised cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise to cash flows that are solely payments of principal and interest, such as most loans and advances to banks and customers and some debt securities, are measured at amortised cost. In addition, most financial liabilities are measured at amortised cost.

The group may commit to provide a loan which has not yet been drawn. When the loan that arises from the lending commitment is expected to meet the criteria to be measured at amortised cost the undrawn commitment is also considered to be and is included in the impairment calculation below.

The carrying value of these financial assets at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income, unless the loan is credit impaired.

Financial assets and liabilities measured at fair value through other comprehensive income (FVOCI)

Financial assets held for a business model that is achieved by both collecting contractual cash flows and selling and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at FVOCI. They are recognised on the trade date when the group enters into contractual arrangements to purchase and are normally derecognised when they are either sold or redeemed.

They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as 'Gains less losses arising from derecognition of debt instruments measured at fair value through other comprehensive income'.

Financial assets measured at FVOCI are included in the impairment calculations set out below and impairment is recognised in profit or loss.

Impairment of financial assets held at amortised cost or FVOCI

At each balance sheet date each financial asset or portfolio of advances categorised at amortised cost or at fair value through other comprehensive income, issued financial guarantee and loan commitment is measured for ECL impairment. Loss allowances are forward-looking, based on 12 month expected credit losses where there has not been a significant increase in credit risk rating, otherwise allowances are based on lifetime expected losses.

Expected credit losses are a probability-weighted estimate of credit losses. The probability is determined by the risk of default which is applied to the cash flow estimates. On a significant increase in credit risk, credit losses are rebased from 12 month to lifetime expectations. A change in credit risk is typically but not necessarily associated with a change in the expected cash flows.

The costs of loss allowances on assets held at amortised cost are presented as impairments in the income statement. Allowances in respect of financial guarantees and loan commitments are presented as other liabilities and charges recorded within income statement impairments. Financial assets held at amortised cost are presented net of allowances except where the asset has been wholly or partially written off.

Financial assets where 12 month ECL is recognised are considered to be 'Stage 1', financial assets which are considered to have experienced a significant increase in credit risk are in 'Stage 2', and financial assets for which there is objective evidence of impairment are considered to be in default or otherwise credit-impaired are in 'Stage 3'.

Accounting policies *(continued)*

Financial assets and liabilities held at fair value through profit or loss

Financial instruments held at fair value through profit or loss include all instruments classified as held-for-trading those instruments designated as held at fair value through profit or loss and those financial assets which do not meet the criteria for amortised cost or FVOCI.

Financial instruments classified as FVPL are initially recorded at fair value on the balance sheet with changes in fair value subsequently recognised in the income statement. Financial instruments are classified as trading when they are held with the intention of short-term disposal, held with the intention of generating short-term profit, or are derivatives which are not designated as part of effective hedges. Financial instruments designated as held at fair value through profit or loss are designated as such on initial recognition of the instrument and remain in this classification until derecognition.

Own credit risk on financial liabilities designated at fair value is recognised in other comprehensive income.

Financial assets and liabilities are designated as held at fair value through profit or loss only if:

- they eliminate or significantly reduce a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- a group of financial liabilities or both financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy and information about the group is provided internally on that basis to the group's key management personnel; or
- a financial liability contract contains one or more embedded derivatives (which significantly modifies the cash flows that would be required by the contract and is not clearly prohibited from separation from the host contract) and the group has designated the entire hybrid contract as a financial instrument at fair value through profit or loss.

Securitisation/credit investment and trading activities exposures

The group makes use of securitisation vehicles as a source of finance, as a means of risk transfer and to leverage returns through the retention of equity tranches in low default rate portfolios. The group predominantly focuses on the securitisation of lease receivables. The group also trades in structured credit investments.

The structured entities are consolidated under IFRS 10 Consolidated Financial Statements when the group has exposure to or rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Loans and advances that are originated are transferred to structured entities, and the structured entities issue debt securities to external investors to fund the purchase of the securitised assets. When the group consolidates the structured entity, the group recognises the assets and liabilities on a gross basis. When the group does not consolidate the structured entity, the securitised assets are derecognised and only any position still held by the group in the structured entity is reflected.

Day-one profit or loss

When the transaction price differs from the fair value of other observable current market transactions in the same instrument or based on the valuation technique whose variables include only data from observable markets, the difference between the transaction price and fair value is recognised immediately in the income statement.

In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the income statement when the inputs become observable, or when the instrument is derecognised or over the life of the transaction.

Derecognition of financial assets and liabilities

A financial asset, or a portion thereof, is derecognised when the group's rights to cash flows have expired or when the group has transferred its rights to cash flows relating to the financial assets and either (a) the group has transferred substantially all the risks and rewards associated with the financial assets or (b) the group has neither transferred nor retained substantially all the risks and rewards associated with the financial assets but has transferred control of the assets.

The treatment of a renegotiation or modification of the contractual cash flows of a financial asset depends upon whether the modification is done for commercial reasons, in which case if they are significant the old asset is derecognised and a new asset recognised, or because of financial difficulties of the borrower.

A financial liability is derecognised when it is extinguished, that is when the obligation is discharged, cancelled or expired. When an existing financial liability is replaced or modified with substantially different terms, such a replacement or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the income statement.

Accounting policies *(continued)*

Reclassification of financial instruments

Financial assets are only reclassified where there has been a change in business model. Financial liabilities cannot be reclassified.

Derivative financial instruments

All derivative instruments of the group are recorded on the balance sheet at fair value. Positive and negative fair values are reported as assets and liabilities respectively.

Derivative positions are entered into either for trading purposes or as part of the group's asset and liability management activities to manage exposures to interest rate and foreign currency risks. Both realised and unrealised profit or losses arising on derivatives are recognised in the income statement as part of trading income (other than circumstances in which cash flow hedging is applied as detailed in the hedge accounting section below).

Derivative instruments entered into as economic hedges which do not qualify for hedge accounting and derivatives that are entered into for trading purposes are treated in the same way as instruments that are held-for-trading.

Credit derivatives are entered into for trading purposes. Credit derivatives are initially recognised at their fair values, being the transaction price of the derivative. Subsequently the derivatives are carried at fair value, with movements in fair value through profit or loss, based on the current market price or remeasured price. The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment (CVA).

Hedge accounting

The group applies either fair value or hedge of net investments in foreign operations accounting when the transactions meet the specified hedge accounting criteria. To qualify for hedge accounting treatment, the group ensures that all of the following conditions are met:

- At inception of the hedge, the group formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objectives and the strategy in undertaking the hedge transaction. Also at the inception of the hedge relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. A hedge is expected to be highly effective if the changes in fair value attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.
- The effectiveness of the hedge can be reliably measured, i.e. the fair value of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured.
- The hedge effectiveness is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

For qualifying fair value hedges, the change in fair value of the hedging instrument is recognised in the income statement. Changes in fair value of the hedged item that is attributable to the hedged risk are also recognised in the income statement.

Embedded derivatives

To the extent that a derivative may be embedded in a hybrid contract for a financial liability and the hybrid contract is not carried at fair value with changes in fair value recorded in the income statement, the embedded derivative is separated from the host contract and accounted for as a standalone derivative if and only if:

- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; and
- A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

Offsetting of financial assets and liabilities

Financial assets and liabilities are offset when there is both an intention to settle on a net basis (or simultaneously) and a currently enforceable legal right to offset exists.

Issued debt and equity financial instruments

Financial instruments issued by the group are classified as liabilities if they contain a contractual obligation to deliver cash or another financial asset.

Financial instruments issued by the group are classified as equity where they confer on the holder a residual interest in the group, and the group has no obligation to deliver either cash or another financial asset to the holder. The components of compound issued financial instruments are accounted for separately with the liability component separated first and any residual amount being allocated to the equity component.

Equity instruments issued by subsidiaries of Investec plc are recorded as non-controlling interests on the balance sheet. Equity instruments are initially measured net of directly attributable issue costs.

Treasury shares represent Investec plc shares repurchased by the group which has not been cancelled. Treasury shares are deducted from shareholders' equity and represent the purchase consideration, including directly attributable costs. Where treasury shares are subsequently sold or reissued, net proceeds received are included in shareholders' equity.

Dividends on ordinary shares are recognised as a deduction from equity at the earlier of payment date or the date that it is approved by Investec plc shareholders.

Sale and repurchase agreements (including securities borrowing and lending)

Securities sold subject to a commitment to repurchase, at a fixed price or a selling price plus a lender's return, remain on balance sheet. Proceeds received are recorded as a liability on balance sheet under 'repurchase agreements and cash collateral on securities lent'. Securities that are purchased under a commitment to resell the securities at a future date are not recognised on the balance sheet. The consideration paid is recognised as an asset under 'reverse repurchase agreements and cash collateral on securities borrowed'.

The difference between the sale and repurchase prices is treated as interest income/expense and is accrued over the life of the agreement using the effective interest method.

Securities borrowing transactions that are not cash collateralised are not included on the balance sheet. Securities lending and borrowing transactions which are cash collateralised are accounted for in the same manner as securities sold or purchased subject to repurchase commitments.

Financial guarantees

Financial guarantee contracts issued by the group are those contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specified debtor fails to make a payment when due, in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at fair value, adjusted for the transaction costs that are directly attributable to the issuance of the guarantee.

Subsequent to initial recognition, the liability under each guarantee is measured at the higher of the initial amount recognised less cumulative revenue and the initial amount less any impairment calculated as set out above. Subsequent to initial measurement, all changes in the balance sheet carrying value are recognised in the income statement.

Special purpose auditor's report on the preliminary statement of financial position of Investec plc as at 1 April 2018

To the Board of Directors of Investec plc

Opinion

We have audited the accompanying information identified as audited in the opening balance sheet, and financial tables, and the accounting policies and the key IFRS 9 terms and differences to current accounting and regulatory framework (referred to as the "Preliminary Statement of Financial Position") of Investec plc (the 'Group') as at 1 April 2018. The preliminary statement of financial position has been prepared as part of the Group's adoption of IFRS 9: *Financial Instruments* issued by the International Accounting Standards Board as adopted by the European Union.

In our opinion, the preliminary statement of financial position as at 1 April 2018 is prepared, in all material respects, in accordance with the accounting policies set out from pages 29 to 33.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)). Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the preliminary statement of financial position section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the preliminary statement of financial position in England and Wales, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – basis of accounting

Without qualifying our opinion, we draw attention to;

- pages 29 to 33 of the preliminary statement of financial position, which describes the basis of accounting. As a result, the preliminary statement of financial position may not be suitable for another purpose.
- the fact that the accounting policies set out from page 29 to page 33 explain the assumptions management has made about the standard and interpretations expected to be effective and the policies expected to be adopted when management prepares its financial statements as of 31 March 2019.
- the fact that, under IFRS only a complete set of financial statements comprising a statement of financial position, income statement, statement of comprehensive income, statement of changes in equity, and cash flow statement, together with the related notes thereto, can provide a fair presentation of the Group's financial position, results of operations, and cash flows in accordance with IFRS.

Our opinion is not modified in respect of this matter.

Use of our report

This report is made solely to the Group's directors, as a body, in accordance with our engagement letter dated 7 June 2018. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Group and the Group's directors as a body, for our audit work, for this report, or for the opinions we have formed.

Responsibilities of management and those charged with governance for the preliminary statement of financial position

Management is responsible for the preparation of the preliminary statement of financial position in accordance with the accounting policies set out from page 29 to page 33, and for such internal control as management determines is necessary to enable the preparation of the preliminary statement of financial position is free from material misstatement, whether due to fraud or error.

In preparing the preliminary statement of financial position, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

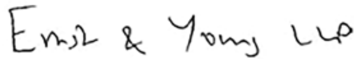
Auditor’s responsibilities for the audit of the preliminary statement of financial position

Our objectives are to obtain reasonable assurance about whether the preliminary statement of financial position is free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this preliminary statement of financial position.

A further description of our responsibilities for the audit of the schedule is located on the

Financial Reporting Council’s website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor’s report.

The engagement partner on the audit resulting in this independent auditor’s report is Andrew Bates.



Ernst & Young LLP
London

15 June 2018

Notes:

1 *The maintenance and integrity of the Investec web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the schedule since they were initially presented on the web site.*

2 *Legislation in the United Kingdom governing the preparation and dissemination of the schedule may differ from legislation in other jurisdictions.*