The new bank provisioning standards: Implementation challenges and financial stability implications

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Universidad de Navarra
Madrid – 19th October

- ## 41 Banks from 22 countries

Semi annual financial reports: Alpha Bank (GR), Bancolombia (CO) –limited-, Bank of Communications (CN), Bank of Ireland Group (IE), Barclays (GB), BBVA (ES), BNP Paribas (FR), BPM (IT), Caixabank (ES), China Merchants Bank (CN), China Minsheng Bank (CN), China Zheshang Bank (CN), Commerzbank (DE), CTBC Financial Holding (TW), Danske Bank Group (DK), Deutsche Bank AG (DE), DNB (NO), Erste Group (AT), First Abu Dhabi Bank (AE), FirstRand (ZA), Fubon Financial Holding (CN), Handelsbanken Group (SE), HSBC (GB), ING Groep (NL), Intesa Sanpaolo (IT), KB Financial Group (KR), KBC Groep (BE), Lloyds (GB), Malayan Banking Berhad (MY), Nordea (SE), Qatar National Bank (QA), Raiffeisen Bank International (AT), Sabadell (ES), Santander (ES), SEB (SE), Société Générale (FR), Standard Bank Group (ZA), Standard Chartered (GB), Swedbank (SE), Türkiye Is Bankasi (TR) and Unicredit (IT).

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	Alpha Bank	Bancolombia	Bank of Communications	Barclays	BBVA	BNP Paribas	BPM	Caixabank	China Merchants Bank	China Minsheng Bank	China Zheshang Bank	Commerzbank	CTBC Financial Holding	Danske Bank Group	Deutsche Bank AG	DNB	Erste Group	First Abu Dhabi Bank	FirstRand	Handelsbanken Group	HSBC	ING Groep	Intesa Sanpaolo	KB Financial Group	KBC Group	LLoyds	Malayan Banking Berhad	Nordea	Qatar National Bank	Raiffeisen Bank International	Sabadell	Santander	SEB	Société Générale	Standard Bank group	Standard Chartered	Swedbank	Unicredit
Alpha Bank		0,53	0,76	0,58	0,77	0,54	0,82	0,79	0,64	0,58	0,74	0,79	0,75	0,63	0,78	0,54	0,71	0,65	0,66	0,55	0,70	0,67	0,78	0,65	0,63	0,66	0,57	0,54	0,79	0,76	0,81	0,76	0,62	0,80	0,56	0,62	0,56	0,68
Bancolombia	0,53		0,54	0,47	0,61	0,39	0,58	0,53	0,54	0,48	0,57	0,56	0,51	0,65	0,60	0,60	0,61	0,40	0,59	0,63	0,56	0,53	0,61	0,70	0,68	0,56	0,44	0,72	0,55	0,60	0,60	0,58	0,63	0,54	0,59	0,53	0,52	0,47
Bank of Communications	0,76	0,54		0,56	0,77	0,52	0,75	0,79	0,87	0,77	0,89	0,77	0,74	0,66	0,79	0,59	0,68	0,69	0,75	0,53	0,70	0,68	0,74	0,55	0,63	0,77	0,63	0,56	0,78	0,71	0,78	0,80	0,58	0,74	0,61	0,65	0,54	0,73
Barclays	0,58	0,47	0,56		0,57	0,42	0,56	0,56	0,48	0,43	0,53	0,61	0,52	0,50	0,58	0,43	0,52	0,46	0,54	0,47	0,64	0,50	0,55	0,51	0,51	0,61	0,44	0,48	0,57	0,53	0,59	0,58	0,53	0,58	0,46	0,47	0,47	0,50
BBVA	0,77	0,61	0,77	0,57		0,56	0,83	0,86	0,66	0,60	0,72	0,79	0,76	0,63	0,74	0,56	0,71	0,68	0,70	0,56	0,69	0,71	0,77	0,69	0,71	0,74	0,60	0,57	0,80	0,77	0,86	0,86	0,64	0,81	0,57	0,63	0,54	0,72
BNP Paribas	0,54	0,39	0,52	0,42	0,56		0,59	0,58	0,43	0,37	0,49	0,57	0,53	0,41	0,54	0,38	0,54	0,45	0,49	0,40	0,50	0,52	0,54	0,49	0,51	0,50	0,41	0,39	0,55	0,50	0,60	0,59	0,48	0,64	0,39	0,44	0,36	0,50
BPM	0,82	0,58	0,75	0,56	0,83	0,59		0,84	0,65	0,59	0,73	0,81	0,75	0,60	0,76	0,55	0,77	0,67	0,66	0,54	0,69	0,75	0,88	0,68	0,67	0,72	0,58	0,54	0,80	0,81	0,88	0,83	0,63	0,85	0,53	0,68	0,54	0,74
Caixabank	0,79	0,53	0,79	0,56	0,86	0,58	0,84		0,67	0,61	0,74	0,80	0,78	0,61	0,75	0,55	0,75	0,69	0,70	0,53	0,67	0,77	0,78	0,67	0,68	0,77	0,61	0,55	0,78	0,75	0,89	0,88	0,61	0,86	0,56	0,64	0,54	0,73
China Merchants Bank	0,64	0,54	0,87	0,48	0,66	0,43	0,65	0,67		0,88	0,94	0,67	0,67	0,62	0,71	0,57	0,60	0,53	0,68	0,52	0,62	0,57	0,68	0,47	0,61	0,69	0,52	0,56	0,66	0,63	0,68	0,69	0,55	0,62	0,56	0,63	0,51	0,63
China Minsheng Bank	0,58	0,48	0,77	0,43	0,60	0,37	0,59	0,61	0,88		0,84	0,60	0,61	0,59	0,66	0,49	0,53	0,52	0,62	0,47	0,57	0,53	0,62	0,44	0,56	0,62	0,49	0,51	0,60	0,60	0,60	0,62	0,50	0,54	0,52	0,68	0,47	0,58
China Zheshang Bank	0,74	0,57	0,89	0,53	0,72	0,49	0,73	0,74	0,94	0,84		0,75	0,76	0,64	0,75	0,56	0,65	0,62	0,68	0,56	0,69	0,63	0,74	0,57	0,61	0,68	0,57	0,57	0,73	0,67	0,74	0,74	0,59	0,70	0,59	0,60	0,52	0,67
Commerzbank	0,79	0,56	0,77	0,61	0,79	0,57	0,81	0,80	0,67	0,60	0,75		0,71	0,63	0,80	0,56	0,74	0,63	0,68	0,60	0,77	0,69	0,77	0,66	0,69	0,72	0,56	0,61	0,76	0,76	0,82	0,79	0,69	0,82	0,54	0,64	0,63	0,73
CTBC Financial Holding	0,75	0,51	0,74	0,52	0,76	0,53	0,75	0,78	0,67	0,61	0,76	0,71		0,53	0,67	0,48	0,64	0,68	0,60	0,49	0,63	0,65	0,73	0,65	0,57	0,61	0,60	0,46	0,74	0,67	0,77	0,73	0,55	0,77	0,48	0,50	0,45	0,65
Danske Bank Group	0,63	0,65	0,66	0,50	0,63	0,41	0,60	0,61	0,62	0,59	0,64	0,63	0,53		0,70	0,61	0,61	0,49	0,62	0,57	0,61	0,58	0,64	0,58	0,68	0,68	0,53	0,62	0,62	0,66	0,65	0,68	0,60	0,60	0,56	0,60	0,57	0,59
Deutsche Bank AG	0,78	0,60	0,79	0,58	0,74	0,54	0,76	0,75	0,71	0,66	0,75	0,80	0,67	0,70		0,63	0,75	0,60	0,73	0,59	0,72	0,68	0,76	0,60	0,70	0,74	0,60	0,64	0,74	0,80	0,81	0,79	0,67	0,76	0,57	0,75	0,57	0,75
DNB	0,54	0,60	0,59	0,43	0,56	0,38	0,55	0,55	0,57	0,49	0,56	0,56	0,48	0,61	0,63		0,59	0,43	0,56	0,50	0,53	0,50	0,57	0,50	0,64	0,65	0,49	0,66	0,55	0,62	0,59	0,60	0,59	0,55	0,48	0,59	0,62	0,55
Erste Group	0,71	0,61	0,68	0,52	0,71	0,54	0,77	0,75	0,60	0,53	0,65	0,74	0,64	0,61	0,75	0,59		0,55	0,65	0,56	0,66	0,80	0,75	0,67	0,77	0,67	0,55	0,68	0,70	0,81	0,78	0,81	0,63	0,80	0,54	0,71	0,52	0,72
First Abu Dhabi Bank	0,65	0,40	0,69	0,46	0,68	0,45	0,67	0,69	0,53	0,52	0,62	0,63	0,68	0,49	0,60	0,43	0,55		0,53	0,42	0,56	0,66	0,59	0,53	0,47	0,55	0,55	0,39	0,74	0,61	0,67	0,65	0,47	0,62	0,43	0,46	0,42	0,58
FirstRand	0,66	0,59	0,75	0,54	0,70	0,49	0,66	0,70	0,68	0,62	0,68	0,68	0,60	0,62	0,73	0,56	0,65	0,53		0,53	0,65	0,62	0,67	0,59	0,66	0,76	0,56	0,59	0,68	0,67	0,73	0,73	0,60	0,68	0,64	0,68	0,53	0,63
Handelsbanken Group	0,55	0,63	0,53	0,47	0,56	0,40	0,54	0,53	0,52	0,47	0,56	0,60	0,49	0,57	0,59	0,50	0,56	0,42	0,53		0,59	0,50	0,55	0,58	0,59	0,54	0,43	0,63	0,54	0,54	0,58	0,57	0,82	0,55	0,48	0,46	0,73	0,48
HSBC	0,70	0,56	0,70	0,64	0,69	0,50	0,69	0,67	0,62	0,57	0,69	0,77	0,63	0,61	0,72	0,53	0,66	0,56	0,65	0,59		0,60	0,68	0,57	0,62	0,71	0,52	0,61	0,68	0,65	0,71	0,68	0,66	0,71	0,54	0,60	0,57	0,63
ING Groep	0,67	0,53	0,68	0,50	0,71	0,52	0,75	0,77	0,57	0,53	0,63	0,69	0,65	0,58	0,68	0,50	0,80	0,66	0,62	0,50	0,60		0,69	0,63	0,66	0,66	0,55	0,56	0,75	0,71	0,76	0,78	0,55	0,75	0,50	0,61	0,49	0,65
Intesa Sanpaolo	0,78	0,61	0,74	0,55	0,77	0,54	0,88	0,78	0,68	0,62	0,74	0,77	0,73	0,64	0,76	0,57	0,75	0,59	0,67	0,55	0,68	0,69		0,68	0,71	0,73	0,57	0,60	0,71	0,77	0,83	0,79	0,62	0,82	0,56	0,68	0,53	0,71
KB Financial Group	0,65	0,70	0,55	0,51	0,69	0,49	0,68	0,67	0,47	0,44	0,57	0,66	0,65	0,58	0,60	0,50	0,67	0,53	0,59	0,58	0,57	0,63	0,68		0,61	0,59	0,52	0,56	0,63	0,69	0,74	0,70	0,59	0,69	0,46	0,53	0,47	0,53
KBC Group	0,63	0,68	0,63	0,51	0,71	0,51	0,67	0,68	0,61	0,56	0,61	0,69	0,57	0,68	0,70	0,64	0,77	0,47	0,66	0,59	0,62	0,66	0,71	0,61		0,70	0,51	0,71	0,65	0,73	0,70	0,76	0,64	0,73	0,59	0,67	0,60	0,59
LLoyds	0,66	0,56	0,77	0,61	0,74	0,50	0,72	0,77	0,69	0,62	0,68	0,72	0,61	0,68	0,74	0,65	0,67	0,55	0,76	0,54	0,71	0,66	0,73	0,59	0,70		0,61	0,61	0,69	0,73	0,79	0,78	0,63	0,73	0,62	0,75	0,61	0,68
Malayan Banking Berhad	0,57	0,44	0,63	0,44	0,60	0,41	0,58	0,61	0,52	0,49	0,57	0,56	0,60	0,53	0,60	0,49	0,55	0,55	0,56	0,43	0,52	0,55	0,57	0,52	0,51	0,61		0,45	0,64	0,59	0,63	0,63	0,48	0,57	0,78	0,52	0,42	0,54
Nordea	0,54	0,72	0,56	0,48	0,57	0,39	0,54	0,55	0,56	0,51	0,57	0,61	0,46	0,62	0,64	0,66	0,68	0,39	0,59	0,63	0,61	0,56	0,60	0,56	0,71	0,61	0,45		0,52	0,57	0,58	0,63	0,66	0,57	0,54	0,53	0,61	0,55
Qatar National Bank	0,79	0,55	0,78	0,57	0,80	0,55	0,80	0,78	0,66	0,60	0,73	0,76	0,74	0,62	0,74	0,55	0,70	0,74	0,68	0,54	0,68	0,75	0,71	0,63	0,65	0,69	0,64	0,52		0,72	0,79	0,77	0,64	0,75	0,57	0,63	0,55	0,68
Raiffeisen Bank International	0,76	0,60	0,71	0,53	0,77	0,50	0,81	0,75	0,63	0,60	0,67	0,76	0,67	0,66	0,80	0,62	0,81	0,61	0,67	0,54	0,65	0,71	0,77	0,69	0,73	0,73	0,59	0,57	0,72		0,81	0,79	0,61	0,74	0,54	0,78	0,57	0,71
Sabadell	0,81	0,60	0,78	0,59	0,86	0,60	0,88	0,89	0,68	0,60	0,74	0,82	0,77	0,65	0,81	0,59	0,78	0,67	0,73	0,58	0,71	0,76	0,83	0,74	0,70	0,79	0,63	0,58	0,79	0,81		0,89	0,66	0,88	0,57	0,72	0,56	0,76
Santander	0,76	0,58	0,80	0,58	0,86	0,59	0,83	0,88	0,69	0,62	0,74	0,79	0,73	0,68	0,79	0,60	0,81	0,65	0,73	0,57	0,68	0,78	0,79	0,70	0,76	0,78	0,63	0,63	0,77	0,79	0,89		0,63	0,87	0,59	0,69	0,56	0,74
SEB	0,62	0,63	0,58	0,53	0,64	0,48	0,63	0,61	0,55	0,50	0,59	0,69	0,55	0,60	0,67	0,59	0,63	0,47	0,60	0,82	0,66	0,55	0,62	0,59	0,64	0,63	0,48	0,65	0,64	0,61	0,66	0,63		0,64	0,51	0,56	0,75	0,56
Société Générale	0,80	0,54	0,74	0,58	0,81	0,64	0,85	0,86	0,62	0,54	0,70	0,82	0,77	0,60	0,76	0,55	0,80	0,62	0,68	0,55	0,71	0,75	0,82	0,69	0,73	0,73	0,58	0,57	0,75	0,74	0,88	0,87	0,64		0,56	0,67	0,54	0,71
Standard Bank group	0,56	0,59	0,61	0,46	0,57	0,39	0,53	0,56	0,56	0,52	0,59	0,54	0,48	0,56	0,57	0,48	0,54	0,43	0,64	0,48	0,54	0,50	0,56	0,46	0,59	0,62	0,78	0,54	0,57	0,54	0,57	0,59	0,51	0,56		0,56	0,47	0,51
Standard Chartered	0,62	0,53	0,65	0,47	0,63	0,44	0,68	0,64	0,63	0,68	0,60	0,64	0,50	0,60	0,75	0,59	0,71	0,46	0,68	0,46	0,60	0,61	0,68	0,53	0,67	0,75	0,52	0,53	0,63	0,78	0,72	0,69	0,56	0,67	0,56		0,52	0,64
Swedbank	0,56	0,52	0,54	0,47	0,54	0,36	0,54	0,54	0,51	0,47	0,52	0,63	0,45	0,57	0,57	0,62	0,52	0,42	0,53	0,73	0,57	0,49	0,53	0,47	0,60	0,61	0,42	0,61	0,55	0,57	0,56	0,56	0,75	0,54	0,47	0,52		0,50
Unicredit	0,68	0,47	0,73	0,50	0,72	0,50	0,74	0,73	0,63	0,58	0,67	0,73	0,65	0,59	0,75	0,55	0,72	0,58	0,63	0,48	0,63	0,65	0,71	0,53	0,59	0,68	0,54	0,55	0,68	0,71	0,76	0,74	0,56	0,71	0,51	0,64	0,50	

Panel 5: Implications for capital requirements, enforcement and disclosure

The Conceptual Framework for Financial Reporting

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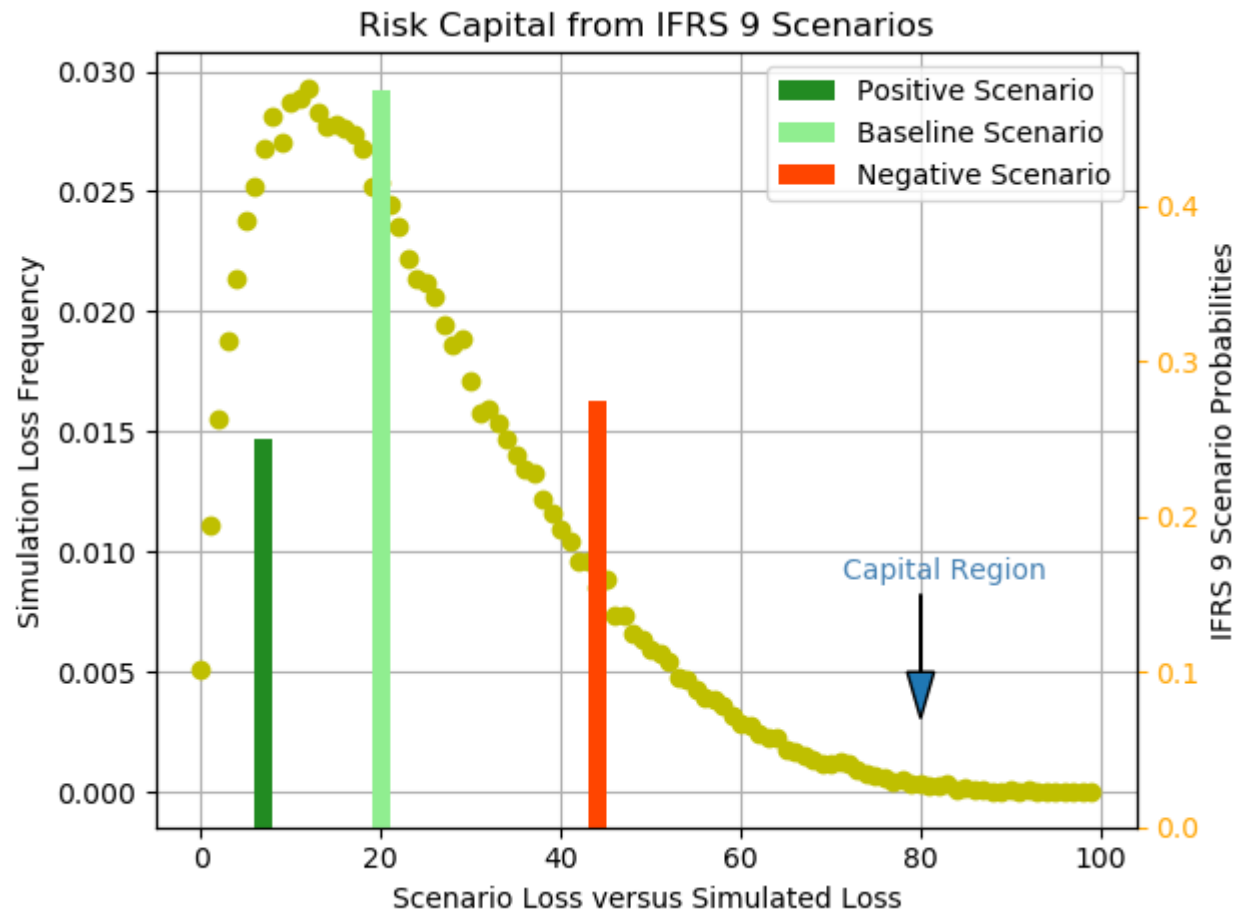School of Economics
& Business

QC19 Comparability, verifiability, timeliness and **understandability** are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict a phenomenon if both are considered equally relevant and faithfully represented.

Understandability

QC30 Classifying, characterising and presenting information clearly and concisely makes it understandable.

QC31 Some phenomena are inherently complex and cannot be made easy to understand. **Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading.**

QC32 **Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.**

Scenarios and IFRS 9

Source: https://www.openriskmanagement.com/ifrs-9-expected-credit-loss-and-risk-capital/

Useful databases for scenarios: Consensus Economics, WEO IMF, ECB, Federal Reserve, Economic Cycle Research Institute, World Bank.

Panel 5: Implications for capital requirements, enforcement and disclosure

IFRS 9 Disclosure – Example 1

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*The models used to determine the hedging are based on internal experience of default and recovery in portfolios. They are regularly updated to be able to keep an account of the environment's economic situation at all times, and to constitute a representation of the current economic context at any given time. This makes it possible to reduce the differences between estimated loss and recent observations. They will include an unbiased view of the potential **forward-looking evolution of the economy to determine the expected loss, taking into account key factors: (i) GDP growth, (ii) the unemployment rate, (iii) 12-month EURIBOR and (iv) evolution of property prices. Following on from this, the Group generates a basic forward-looking scenario focused on the economic variables, as well as a range of potential scenarios that make it possible to adjust, based on the probability and incidence in each sector, the estimated expected loss.***

*The necessary improvements detected in the backtesting and benchmarking exercises are also inserted in the review cycles. Similarly**, the models developed are documented so they can be replicated by a third party**. The documentation contains key definitions, information regarding the process of acquiring samples and data processing, methodological principles and results obtained, as well as the comparison of said results with those of previous years.*

Questions: Macro literature has shown the power of yield curve to predict future economic activity. The variables in this model are not purely forward-looking. It is better to use the expected values not current values to predict estimated values. Expected values from consensus economics, IMF, World Bank etc. The model could only be replicated by the Supervisor not by any third party. There is no information about the way the scenarios are constructed and the associated probabilities.

IFRS 9 Disclosure – Example 2

(iv) Incorporation of forward-looking information

According to the different risk characteristics of assets, the Group divides assets into different asset groups, identifies macro indicators related to credit risks, and establishes regression models.

The Group uses forward-looking information that is available without undue cost or effort, and predict the macroeconomic assumptions. External information includes macroeconomic data, forecast information issued by government or regulatory agencies, for example, GDP, fixed asset investment, total social consumption, etc. The Group assigns different scenarios to different possibilities.

During the six months ended 30 June 2018, the Group did not make any changes to the predicted technology and important assumptions.

Questions: Macro literature has shown the power of yield curve to predict future economic activity. The variables in this model are not purely forward-looking. It is better to use the expected values not current values to predict future values. Expected values from consensus economics, IMF, World Bank etc. There is no information about the way the scenarios are constructed and the associated probabilities.

X Group utilises an **external consensus forecast as the baseline scenario**. In addition, **two adverse and two favourable scenarios are derived, with associated probability weightings**. The adverse scenarios are calibrated to a similar severity to internal stress tests, whilst also incorporating **IFRS 9 specific sensitivities and non-linearity**. The most adverse scenarios are benchmarked to the Bank of England's annual cyclical scenarios and to the most severe scenarios from Moody's inventory, but are not designed to be the same. The favourable scenarios are calibrated to be symmetric to the adverse scenarios, subject to a ceiling calibrated to relevant recent favourable benchmark scenarios. The scenarios include six core variables, (GDP, unemployment and House Price Index (HPI) in both the UK and US markets), and expanded variables using statistical models based on historical correlations. The probability weights of the scenarios are estimated such that the baseline (reflecting current consensus outlook) has the highest weight and the weights of adverse and favourable scenarios depend on the deviation from the baseline; **the further from the baseline, the smaller the weight**. A single set of five scenarios is used across all portfolios and all five weights are normalised to equate to 100%. The impacts across the portfolios are different because of the sensitivities of each of the portfolios to specific macroeconomic variables, for example, mortgages are highly sensitive to house prices and base rates, credit cards and unsecured consumer loans are highly sensitive to unemployment.

The table below provides a summary of the average, minimum and maximum values of the six core economic variables, for the baseline scenario between 2018 to 2022.

IFRS 9 Disclosure – Example 3

Baseline economic variables[1]

As at 30.06.18	Average %	Minimum %	Maximum %
UK GDP	1.8	1.5	1.9
UK unemployment	4.7	4.6	4.8
UK HPI	2.6	1.4	3.2
US GDP	2.0	2.0	2.2
US unemployment	4.2	4.1	4.2
US HPI	4.3	4.1	5.1
As at 01.01.18			
UK GDP	1.8	1.5	2.0
UK unemployment	4.6	4.6	4.6
UK HPI	2.8	2.0	3.2
US GDP	2.1	2.0	2.2
US unemployment	4.1	4.1	4.2
US HPI	3.4	3.2	4.1

1   GDP and HPI are annualised growth rates. Unemployment rate is a simple average.

Questions: This bank only provides information about the baseline scenario. There is no information about the probabilities associated to scenarios.

IFRS 9 Disclosure – Example 4

In addition, in compliance with the requirements of the standard, according to which the estimate of the ECL must be the result of weighting a series of **possible forward-looking scenarios (unbiased and probability weighted), the Group has developed a methodology for generating multiple macroeconomic scenarios with the associated probability of their occurrence.** More specifically, in addition to **the most likely (50%) baseline scenario** (i.e. the forecast macroeconomic scenario on the basis of which the Group develops its projections for economic/asset and risk data over the short and medium term), **alternative scenarios were developed to be better (positive with 20% probability and very positive with 5% probability) and worse (severe with 20% probability and very severe with 5% probability)**.

Questions: They do not disclose forward-looking variables they use.

Panel 5: Implications for capital requirements, enforcement and disclosure

IFRS 9 Disclosure – Example 5

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The expected credit loss is calculated for all individual facilities as a function of PD, EAD and LGD and incorporates forward-looking information. The forward-looking elements reflect the expectations of the Group's senior management and involves the creation of scenarios (base case, upside and down-side), including **an assessment of the probability for each scenario**. **Based on these assessments, the allowance account at 30 June 2018 amounted to DKK 21.7 billion. Forward-looking information is a key judgement. The allowance account would increase DKK 0.5 billion, if the downside scenario was assigned a probability of 100%. If instead the upside scenario was assigned a probability of 100 %, the allowance account would decrease DKK 0.5 billion.**

Questions: They inform about the impact on provisions but it seems linear. However, expected losses typically have a non-linear relationship to the many factors which influence credit losses, such that more favourable macroeconomic factors do not reduce defaults as much as less favourable macroeconomic factors increase defaults.

Central scenario (average 3Q18–2Q23)

	UK	France	Hong Kong	Mainland China	UAE	US	Canada	Mexico
GDP growth rate (%)	1.7	1.6	2.7	6.0	3.3	2.1	1.8	2.5
Inflation (%)	2.1	1.6	2.4	2.5	2.9	2.0	1.9	3.6
Unemployment (%)	4.8	7.7	3.2	4.0	4.2	4.0	6.1	3.8
House price growth (%)	2.9	2.8	4.1	5.6	3.9	3.4	3.1	5.7

Upside scenario

Globally, real GDP growth rises in the first two years of the Upside scenario before converging to the Central scenario. Improved confidence, accommodative monetary policy, fiscal expansion across major economies, including tax reform in the US, and diminished political risk are the key themes that support the Upside scenario.

Upside scenario (average 2018-2022)

	UK	France	Hong Kong	Mainland China	UAE	US	Canada	Mexico
GDP growth rate (%)	2.5	1.9	2.8	6.0	4.0	2.7	2.2	3.2
Inflation (%)	2.5	1.8	2.9	2.7	3.3	2.4	2.2	3.9
Unemployment (%)	4.8	8.3	3.2	3.7	3.6	4.1	6.1	3.6
House price growth (%)	4.0	4.6	4.0	6.9	7.7	4.9	4.3	6.8

The Upside scenario was generated for the adoption of IFRS 9 on 1 Jan 2018

Downside scenario

Globally, real GDP growth declines for two years in the Downside scenario before recovering to the Central scenario. House price growth either stalls or contracts, and equity markets correct abruptly. The global slowdown in demand drives commodity prices lower and inflation falls. Central banks remain accommodative. This is consistent with the risk themes of rising protectionism, central bank policy uncertainty, mainland China choosing to rebalance at a faster pace, and an absence of fiscal support.

Downside scenario (average 2018-2022)

	UK	France	Hong Kong	Mainland China	UAE	US	Canada	Mexico
GDP growth rate (%)	1.2	1.1	2.0	5.5	3.0	1.3	1.6	2.1
Inflation (%)	1.8	1.2	2.2	2.0	2.6	1.8	1.9	3.1
Unemployment (%)	5.6	9.0	3.8	4.2	4.6	5.1	6.7	4.5
House price growth (%)	0.9	0.8	1.7	3.0	4.5	1.1	0.6	5.4

The Downside scenario was generated for the adoption of IFRS 9 on 1 Jan 2018

Panel 5: Implications for capital requirements, enforcement and disclosure

IFRS 9 Disclosure – Example 6

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For most portfolios, HSBC has adopted the use of three economic scenarios, representative of our view of forecast economic conditions, sufficient to calculate unbiased ECL. They represent a 'most likely outcome' (the Central scenario) and two, less likely, 'outer' scenarios, referred to as the 'Upside' and 'Downside' scenarios. **Each outer scenario is consistent with a probability of 10%, while the Central scenario is assigned the remaining 80%.**

...

Using **externally available forecast distributions helps ensure independence in scenario construction**.

...

Expected losses typically have a non-linear relationship to the many factors which influence credit losses, such that more favourable macroeconomic factors do not reduce defaults as much as less favourable macroeconomic factors increase defaults.

Good information. Questions: Thresholds used in order to determine whether an increase in the PD compared with the initial recognition date is "significant" and the impairment provision impact of significant increase in credit risk.

IFRS 9 Disclosure – Example 7

			Impairment provision impact of		Recognised credit impairment provisions 30 June 2018	Share of total portfolio (%) in terms of gross carrying amount 30 June 2018
Internal risk rating grade at initial recognition	PD band at initial recognition	Threshold, rating downgrade[1) 2) 3)]	Increase in threshold by 1 grade	Decrease in threshold by 1 grade		
13-21	< 0.5%	3 - 8 grades	-6.0%	13.9%	937	52%
9-12	0.5-2.0%	1 - 5 grades	-9.4%	13.1%	873	12%
6-8	2.0-5.7%	1 - 3 grades	-5.4%	5.0%	337	4%
0-5	>5.7% and <100%	1 - 2 grades	-2.4%	0.0%	221	1%
			-7.0%	10.8%	2 367	70%
		Financial instruments subject to the low credit risk exemption			11	19%
		Stage 3 financial instruments			3 497	1%
		Financial instruments with initial recognition after 1 January 2018			272	11%
		Total provisions[4)]			6 147	100%

Interesting information about the impairment provision impact.

The absolute measure of increase in credit risk is used to capture instances where the PDs on exposures are relatively low at initial recognition as these may increase by several multiples without representing a significant increase in credit risk. Where PDs are relatively high at initial recognition, a relative measure is more appropriate in assessing whether there is a significant increase in credit risk, as the PDs increase more quickly.

For Corporate & Institutional Banking and Commercial Banking clients, the **relative threshold is a 100 per cent increase in PD and the absolute change in PD is between 50-100 basis points**.

For Retail Banking clients, the **relative threshold is a 100 per cent increase in PD and the absolute change in PD is between 100-350 basis points depending on the product**. Certain counties have a higher absolute threshold reflecting the lower default rate within this portfolio compared with the Group's other personal loan portfolios.

Private Banking clients are assessed qualitatively, based on a delinquency measure relating collateral top-ups or sell-downs.

Debt securities with an internal credit rating mapped to an investment grade equivalent are allocated to stage 1 and all other debt securities to stage 2.
…
PDs is non-linear (e.g. a one-notch downgrade in the investment grade universe results in a much smaller PD increase than in the sub-investment grade universe)…

This bank provides very good information.

Some interesting results from the sample - Conclusions

→ **Less Relevant Information:**

✓ **Transition disclosures: Good.**

✓ **Amount of expected losses in accordance with IFRS 9 stages of impairment: Good.**

❑ **Stage transfers: Only 10 Banks.**

→ **Forward-looking Information:**

❖ **Good information about the scenarios and probabilities they use for ECL model: Only 7 Banks.**

❖ **Thresholds used in order to determine whether an increase in the PD compared with the initial recognition date is "significant": 1 Bank.**

❖ **Impairment provision impact of significant increase in credit risk: 1 Bank.**

❖ **Sensitivity Analysis or impact on the allowance account if the downside scenario was assigned a probability of 100%: 1 Bank.**

The disclosure should improve on the annual financial statements. Banks must disclose the scenarios, the associated probabilities, the thresholds and the impairment provision impacts.