



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

Panel 3: *Implementation issues – Model complexity and supervisory capacity*

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# EBA IFRS 9 implementation work-programme

## Main objectives:

- Help ensure that the IFRS 9 model is implemented in a prudent way with sufficient quality while maintaining suitable proportionality <sup>[A]</sup> <sup>[B]</sup> ;
- Help ensure that the outcomes of IFRS 9 implementation are consistent across different institutions for the same levels and types of risk (while conscious of the relative nature of the ECL model) <sup>[A]</sup> <sup>[B]</sup> ;
- Explore any changes necessary to the regulatory capital regime due to the effects of IFRS 9 implementation and actively participate in the Basel discussions <sup>[C]</sup>. Provide clarifications on the application of IFRS 9 EU transitional arrangements via the publication of Q&As;
- Assist prudential supervisors in the EU in assessing the implication of IFRS 9 in their own supervisory approach <sup>[D]</sup> .

### Summary of the EBA publications related to the work on IFRS 9:

[A] Guidelines on expected credit losses, following the BCBS Guidance: published in May 2017 (with application date 1 January 2018);

[B] Reports on 1<sup>st</sup> and 2<sup>nd</sup> impact assessment of IFRS 9 (published in November 2016 and July 2017, respectively);

[C] EBA Opinion on transitional arrangements and RTS Credit Risk Adjustments: published in March 2017;

[D] Guidelines on communication between competent authorities and auditors: published in July 2016 (with application date March 2017).

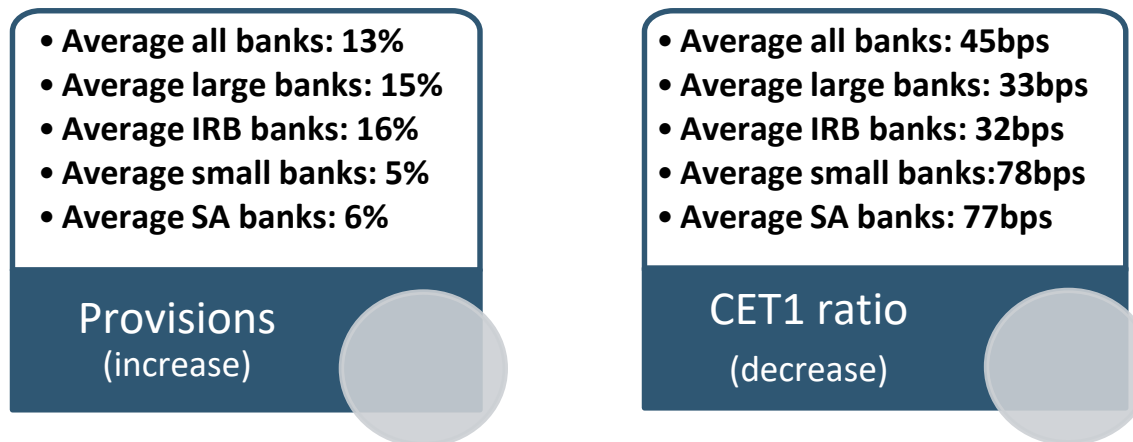
### In addition, specifically on reporting:

[E] ITS supervisory reporting (FINREP) – changes due to IFRS 9: published in November 2016 (with application date 1 January 2018);

[F] Guidelines on uniform disclosures under Article 473a of Regulation (EU) No 575/2013 (transitional arrangements) – published in January 2018.

# IFRS 9: pre-implementation estimated overall impact (EBA analysis and 2<sup>nd</sup> impact assessment, July 2017)

## *Estimated impact in provisions and CET1 ratio under IFRS 9:*



- Sample of **54 institutions** across 19 jurisdictions;
- **Average impact on CET1 ratio: 45bps decrease;**
- Smaller banks (which tend to use the SA) reported a smaller impact in provisions increase and a larger impact in own funds ratios decrease when compared to larger (IRB approach) banks – “*CET1 shortfall mechanism*”;
- Limited impact from classification and measurement, most of the impact arising from impairment;
- From the conducted exercise, it was concluded that IRB banks were in general more prepared. In the future, EBA actions will be more focused on SA banks with no modelling experience;
- The 2018 EU-wide stress tests take the impact of the introduction of IFRS 9 into account (in the starting point data and in the projections of banks).

# IFRS 9: Some qualitative observations

(EBA analysis and 2<sup>nd</sup> impact assessment, July 2017)

## Staging assessment (including SICR)

- Mix of qualitative and quantitative indicators to assess Significant Increase in Credit Risk (SICR)
- Apparently, limited use of practical expedients (simplified approaches)
- Alignment with prudential definitions (“default definition”)

## Impairment

- IRB banks will leverage on existing models
- Main challenges
  - Availability of data
  - Incorporation of FLI
- Use of overlays in ECL estimations - expected to be reduced over time

# IFRS 9: Staging assessment (including SICR)

(EBA analysis and 2<sup>nd</sup> impact assessment, July 2017)

## Staging assessment (including SICR)

- Mix of qualitative and quantitative indicators to assess Significant Increase in Credit Risk (SICR):
  - All reasonable and supportable information that is available to the bank should be considered;
- Apparently, limited use of practical expedients (simplified approaches):
  - Materially different result in the estimation of ECL?
  - Low credit risk exemption for lending exposures should be supported by clear evidence;
  - 30 days past due simplification should be used as a backstop;
- Alignment with prudential definitions (“default definition”):
  - Definition of default (DoD) for accounting purposes vs DoD for prudential purposes;
  - The DoD was a key part of the EBA IRB road map (RTS and GL).

# IFRS 9: Impairment

(EBA analysis and 2<sup>nd</sup> impact assessment, July 2017)

## Impairment – SA Banks

- Challenging by definition, since these banks are not using an approved IRB model
- Main challenges
  - Availability of data
  - Estimation of PD and LDG
  - Incorporation of FLI
- Use of overlays in ECL estimations - expected to be reduced over time

## Impairment – IRB Banks

- Most IRB banks will leverage on existing models
- Main challenges
  - Availability of data: alignment of definitions (“default” and “loss”)
  - PiT PD estimation versus TTC PD
  - Conversion of 1-year PDs to lifetime PDs
  - Incorporation of FLI
- Use of overlays in ECL estimations - expected to be reduced over time.

The EBA IRB road map gives a comprehensive list of requirements for the credit risk estimation. Without these specifications some variability may be observed.

# EBA's work related to the introduction of IFRS 9:

## Future work

### On-going and future work

- Monitoring of implementation issues to understand whether the use of different methodologies, models, inputs, scenarios can conduct to material inconsistencies;
- IRB and SA banks included in the scope, but greater attention to SA banks regarding the application of credit judgement given the lack of modelling experience. The extent to which simplified approaches are applied will be scrutinised;
- Monitor the use of the IFRS 9 transitional arrangements in the EU and any related implementation issues;
- Monitoring the application of EBA Guidelines on ECL;
- Supervisors to discuss IFRS 9 with auditors in the context of the EBA Guidelines on supervisors and auditors communication;
- EBA Guidelines on ECL: Post-implementation review of effectiveness of guidelines (in conjunction with the participation in the BCBS work regarding the assessment of implementation practices);
- Capital provisioning rules : interaction of accounting and regulatory provisions (BCBS);
- Impact of IFRS 9 on volatility of own funds;
- EBA is reflecting on the work related to models that can be carried out with regard to the implementation of IFRS 9 (such as performing a benchmarking exercise). This kind of initiative is already being carried out by competent authorities outside the EU. However, it is clear that this activity implies a good understanding on all the relevant implementation aspects reason why this is a medium / long term objective.

# Final remarks

## Some relevant policy aspects in the EU:

- Supervisory expectations for application of IFRS 9 ECL provisioning: EBA Guidelines on ECL, following the BCBS Guidance. The need for any additional guidance will be assessed on an on-going basis, based on the EBA monitoring of the implementation of the standard, also following and participating in the BCBS work on this topic;
- Specific vs General provisions: EBA Opinion March 2017. The EBA believes that all IFRS 9 provisions should be treated as specific;
- The challenge is how to ensure a prudent implementation of the standard, by reference to 'safety nets' available to regulators/supervisors for models in other areas.

***Main aspect to keep in mind: how to ensure a prudent implementation of IFRS 9? Are additional prudential backstops needed?***



# Questions?



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