EDTF guidelines for IFRS 9 impairment-related disclosures

April 2016

The Authors

Marc Labat

Adhurim Ruci

Abstract

In 2012, the Financial Stability Board set up the Enhanced Disclosure Task Force ("EDTF"), bringing together bankers, investors, analysts and auditors to develop enhanced standards for risk disclosures. The task force focused on the quality, comparability and transparency of these disclosures, particularly those flowing from IFRS 9 and US GAAP changes in Expected Credit Loss ("ECL") approaches. In December 2015, the EDTF issued detailed guidance, including templates, for the requirements relating to changes in disclosures under the IFRS's new ECL regime. The corresponding FASB standard is set to be issued mid-year, following a first meeting of the Transition Resource Group for Credit Losses, and is expected to be similar, while differing in the detailed guidance.

EDTF guidance on IFRS 9 disclosures

IFRS 9 requires finance, IT and risk management functions to source and disclose relevant data. At the same time, the EDTF wants financial institutions to reflect risks appropriately in their financial statements. ECL models require enhanced disclosures because of their:

- greater use of expert judgment;
- more complex modeling; and
- differences between accounting and regulatory values.

The way in which credit losses are recognized is of critical importance in determining financial performance. Key considerations in recognising losses include:

- the concepts, interpretations and policies used in ECL approaches, including the definition of what constitutes a significant increase in credit risk;
- the effects of moving from incurred credit loss to ECL;
- the methodologies and estimation techniques that are disclosed;
- the sensitivity of credit losses to changes in core assumptions;
- changes to governance in financial and regulatory credit risk management reporting; and
- differences between accounting and regulatory expected loss ("EL").

The EDTF says that it considers a progressive, phased approach to disclosure to be the most valuable to users of the information. As implementation progresses, such an approach provides clearer understanding of potential future changes, and enables the comparison of banks over time. This means that:

- earlier publication dates of information can be weighed against reliability; and
- the nature and extent of accompanying notes should develop over time.

The ETDF guidance, with its principles and recommendations, should help you to decide what additional information to disclose in the period leading up to the IFRS 9 approach. It also suggests best practice for annual report disclosures.

EDTF principles and recommendations

The EDTF lays down seven principles for IFRS 9-related disclosures. These disclosures should:

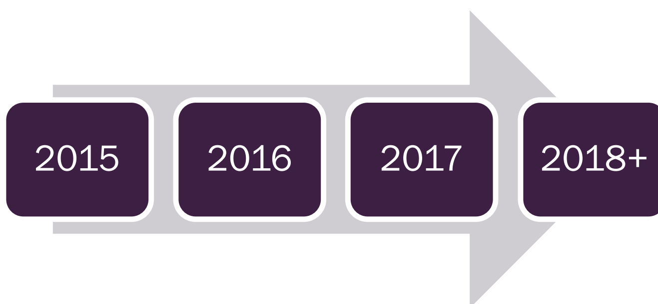
- be clear, balanced and understandable;
- be comprehensive, including key activities and risks;
- present relevant information;
- reflect how risks are managed;
- be consistent over time;

- be comparable across banks, especially during transition; and
- be provided on a timely basis.

While these seven original principles continue to apply, together with 32 recommendations, the EDTF is providing additional guidance before, during and after the transition to IFRS 9. Its December guidance recommends that disclosures provide:

- explanation of IFRS 9 implementation project governance and progress;
- interpretation and application of IFRS 9 requirements; and
- additional assessment of the potential effects of IFRS 9.

Timeline of recommended disclosures



More Granular

General concepts and implementation plan (rec.'.s 2, 3 and 5)	Risk management principles and capital planning impacts (rec.'s 2, 5 and 12)	Quantitative disclosures (rec.'s 2 and 6)	IFRS 9 ECL adoption in full
• Describe general concepts of IFRS 9 ECL approach • Explain current impairment methods and relate them to IFRS 9 ECL approach • Clarify implementation strategy, including timeline, milestones, responsibilities and accountabilities	• Describe implementation of main concepts and explain credit risk modeling methods • Clarify governance, processes and controls, and how they will relate to existing credit risk and other relevant governance, processes and controls • Explain how ECL requirements are expected to affect capital planning	• When practical and reliable (by 2017 annual financial report at latest), provide quantitative notes about prospective IFRS 9 ECL impacts	• Provide transition disclosures required by accounting standards in first interim financial information after initial adoption • Abide by all EDTF recommendations

General concepts and implementation plan

You should provide notes regarding implementation projects in 2015-2016 reports. The EDTF explicitly recommends a description of the approach for IFRS 9 roll-out and project governance, including the involvement of business lines, teams and roles. It would be beneficial not to delay the inclusion, if possible, of information about assumptions, methodologies and models used. One example would be to provide early descriptions of interpretations of significant IFRS 9 terms, such as significant increase in credit risk, default, and credit impairment.

Risk management principles and capital planning impacts

You should disclose detailed notes on triggers of changes in the three "buckets" of the IFRS 9 model for impairment[1] and practices for recognizing loans that have recovered. This is so that investors and regulators can understand IFRS 9 effects on capital planning. Although there is little guidance on how to reflect this relationship, disclosure should nevertheless provide the links. (See the EBA consultation / QIS.[2])

Quantitative disclosures

Quantitative disclosures, expected by early 2017, may use detailed EDTF templates or recommendations. You should quantify and disclose differences between IFRS 9 and regulatory capital EL modeling methodologies, including calibration. For example, when Basel Internal Ratings Based ("IRB") models are used for IFRS 9, you should explain how the IFRS 9 lifetime point-in-time Probability of Default ("PD") models are aligned with Basel through-the-cycle 12-month PD for portfolios. Vintage analysis is another area where disclosures could be improved – for example, in credit portfolios with accrued credit risk since origination.

IFRS 9 ECL adoption in full

You should source data and capture information both for ongoing descriptions and, during the transition period, for the specific disclosures regarded as temporary by IFRS and the EDTF. You also need to disclose significant movements in gross balances that contribute to variations in the IFRS 9 allowance. Where figures are restated, you should clearly explain the reasoning and basis for the change. The EDTF specifically recommends full reconciliation of opening to closing allowances for loan losses. Extensive disclosures are required to clarify the amounts in the financial

[1] *Three Buckets: 12-month expected credit losses, lifetime expected credit losses and credit-impairments*

[2] *[EBA consultation / QIS reference]*

statements that arise from ECL and the effects of changes in credit risk.

Examples of key disclosure requirements are:

Quantitative	Qualitative
Reconciliation of opening to closing balances of loss allowances (including key drivers of change)	Inputs, assumptions and estimation techniques for ECL
Reconciliation of opening to closing balances of gross carrying amounts (including key drivers of change)	Inputs, assumptions and estimation techniques to measure significant increases in credit risk and defaults
Gross carrying amounts by credit risk grade	Inputs, assumptions and techniques to determine credit-impaired assets
Write-offs, recoveries and modifications	Write-off and modification policies and collateral

Our recommendations

Prioritize a detailed review of your credit risk disclosures for your next annual report. Keep them under review throughout your IFRS 9 project, and ask whether your project plan can provide the data needed for appropriate disclosures when needed. We expect the date when best practice disclosures become available to vary between financial institutions, due to differences in their IFRS 9 implementation timetables.

As the EDTF's objective is to enhance disclosures, materiality should be a key consideration. Entity-specific relevant information should be provided where it adds value in understanding your firm's risks. So you should pay special attention to:

- detailed credit risk and risk management disclosures; and
- capital adequacy and RWA recommendations.

IFRS 9 is expected to have a major impact on the financial statements of financial institutions, notably via a material increase in impairment losses. This will affect performance and require major changes in IT systems.

ESMA plans to issue a statement later this year to encourage companies to provide timely information on these impacts. As IFRS enforcers work predominantly with financial statements, and with disclosures in particular, we believe banks should pay particular attention to this impending communication.

Contacts

Avantage Reply (Amsterdam)

The Atrium | Strawinskylaan 3051
1077 ZX Amsterdam
Netherlands
Tel: +31 (0) 20 301 2123
E-mail: avantage@reply.com

Avantage Reply (Brussels)

5, rue du Congrès/Congresstraat
1000 Brussels
Belgium
Tel: +32 (0) 2 88 00 32 0
E-mail: avantage@reply.com

Avantage Reply (London)

38 Grosvenor Gardens
London SW1W 0EB
United Kingdom
Tel: +44 (0) 207 730 6000
E-mail: avantage@reply.com

Avantage Reply (Luxembourg)

46a, avenue J.F. Kennedy
1855 Luxembourg
Luxembourg
Tel: +352 26 00 52 64
E-mail: avantage@reply.com

Avantage Reply (Milan)

Via Castellanza, 11
20151 Milano
Italy
Tel: +39 02 535761
E-mail: avantage@reply.it

Avantage Reply (Paris)

5, rue des Colonnes
75002 Paris
France
Tel: 33 (0) 1 71 24 12 25
E-mail: avantage@reply.com

Avantage Reply (Rome)

V.le Regina Margherita, 8
00198 Roma
Italy
Tel: +39 06 844341
E-mail: avantage@reply.it

Avantage Reply (Turin)

Via Cardinale Massaia, 83
10147 Torino
Italy
Tel: +39 011 29101
E-mail: avantage@reply.it

Xuccess Reply (Berlin)

Mauerstrasse 79
10117 Berlin
Germany
Tel: +49 (30) 443 232-80
E-mails: xuccess@reply.de

Xuccess Reply (Frankfurt)

Hahnstrasse 68-70
60528 Frankfurt am Main
Germany
Tel: +49 (0) 69 669 643-25
E-mail: xuccess@reply.de

Xuccess Reply (Hamburg)

Brook 1
20457 Hamburg
Germany
Tel: +49 (40) 890 0988-0
E-mail: xuccess@reply.de

Xuccess Reply (Munich)

Arnulfstrasse 27
80335 München
Germany
Tel: +49 (0) 89 - 411142-0
E-mail: xuccess@reply.de