# IMPACT OF EXPECTED CREDIT LOSS APPROACHES ON BANK RISK DISCLOSURES

Report of the
Enhanced Disclosure Task Force

30 November 2015

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Mr. Mark Carney,
Chairman of the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
4051 Basel
Switzerland

Dear Mr. Carney,

On behalf of the Enhanced Disclosure Task Force (EDTF), we are pleased to present you with our report, *Impact of Expected Credit Loss Approaches on Bank Risk Disclosures*.

The introduction of the expected credit loss (ECL) approach by the International Accounting Standards Board and the new approach expected to be announced by the US Financial Accounting Standards Board will have a significant impact on bank reporting. Given the importance of these changes for the banking industry, the FSB requested the EDTF to consider disclosures that may be useful to help the market understand the upcoming changes as a result of ECL approaches (whether under US Generally Accepted Accounting Principles or International Financial Reporting Standards) and to promote consistency and comparability.

As a result of its considerations, the EDTF seeks to provide guidance on:

- the applicability of its existing fundamental principles;
- the application of its existing recommendations;
- additional considerations regarding the application of the existing recommendations in the context of an ECL framework including both temporary considerations which will cease to apply following the transition to an ECL framework and permanent considerations which will continue to apply following the adoption of the new accounting standards; and
- further application of these additional considerations specifically to IFRS 9.

Additional considerations are made in the following areas:

- general recommendations;
- risk governance and risk management / business model recommendations;
- capital adequacy and risk weighted asset recommendations; and
- credit risk recommendations.

The EDTF has extensively discussed the timing of providing disclosures in the transition period and believes that a gradual and phased approach would be most useful to users: this would give them clearer insights into the likely impacts of the new standards as implementations progress and would provide over time increasingly useful comparisons between banks. A gradual and phased approach means that: (a) the initial timing of information being provided, whether qualitative or quantitative, should be weighed against reliability; and (b) the nature and extent of disclosures will develop over time.

The timing of providing public disclosures to reflect the EDTF recommendations is likely to vary between banks due to differences in their individual timetables for developing and implementing ECL provisioning. However, the EDTF would encourage banks to take these considerations into account for annual reports for 2015 and subsequent years and has provided guidance on the chronology of implementation.

As with the 2012 report, our considerations have been developed with large international banks in mind, although they should be equally applicable to other banks that actively access the major equity or debt markets.

Sincerely,

Ralf Leiber | Russell Picot | Christian Stracke

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# 1. Introduction

## The EDTF and its role in enhancing disclosures

The Enhanced Disclosure Task Force (EDTF) was established by the Financial Stability Board (FSB) in May 2012. The EDTF aims to improve the quality, comparability and transparency of risk disclosures by uniquely bringing together a broad spectrum of private sector participants including banks, investors, analysts and auditors.

Over the last few years, accounting standard setters have been developing standards that will require banks to adopt new approaches for measuring and accounting for credit losses. In part, these changes respond to requests by the FSB and the G20 during the financial crisis, consistent with a widely shared view that the impairment methodologies should incorporate a broader range of credit information.

The International Accounting Standards Board (IASB) introduced a new credit impairment approach in International Financial Reporting Standard 9 *Financial Instruments* (IFRS 9) issued in 2014 to replace International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (IAS 39). The US Financial Accounting Standards Board (FASB) has substantially completed re-deliberations on its credit losses standard with issuance of a new standard expected in the first quarter of 2016. Although the new approaches are expected to differ in some details, both are based on the concept of measurement of expected credit losses (ECL).

To promote high quality implementation of these new accounting standards, the Basel Committee on Banking Supervision (BCBS) is finalising its own guidance on accounting for expected credit losses.

Given the importance of these changes to banks, the FSB requested the EDTF to consider disclosures that may be useful to help the market understand the upcoming changes as a result of using ECL approaches (whether under US Generally Accepted Accounting Principles (US GAAP) or International Financial Reporting Standards (IFRS)) and to promote consistency and comparability.

The EDTF is not a standard setter nor does it seek to provide accounting or disclosure requirements. Instead, it aims to help the users of financial statements better understand the risks taken by banks, through supporting banks in ensuring such risks are properly reflected in their financial statement and risk disclosures. The EDTF also aims to achieve greater consistency and comparability of disclosures across internationally active banks. The importance of high quality disclosures increases when using ECL models. This accounting model will include a greater degree of management judgement than before and will employ model based calculations that are inherently complex. Furthermore, the requirements for the calculation of accounting ECL will differ from those used for regulatory Expected Loss (EL) for capital adequacy purposes.

IFRS 9 requires an entity to base the measurement of its credit impairment allowance on ECL using a three stage impairment approach. This applies to debt instruments measured at amortised cost as well as at "Fair Value Through Other Comprehensive Income". [1] The measurement of ECL depends on the extent of the significant increase in credit risk since initial recognition as follows[2]: a) "12-month ECL" (Stage 1), which applies to all items (from initial recognition) as long as there is no significant increase in credit risk; and (b) "Lifetime ECL" (Stages 2 and 3[3]), which apply when a significant increase in credit risk has occurred, whether assessed on an individual or collective basis. The assessment of a significant increase in credit risk and the measurement of ECL must be based on "reasonable and supportable information that is available without undue cost or effort," and must reflect historical,

[1] For financial assets recognised at "Fair Value Through Other Comprehensive Income", the impairment charge is recognised in profit or loss, but an allowance is not included as an adjustment to the carrying amount of the asset because fair value is recognised on balance sheet.
[2] Excluding purchased or originated credit impaired financial assets and financial assets to which IFRS 9.5.5.15 applies (simplified approach for trade receivables, contract assets and lease receivables).
[3] Stages 2 and 3 represent items that are not credit impaired and are credit impaired respectively

current and forward-looking" information. IFRS 9 is effective for annual periods beginning on or after 1 January 2018[4], with early application permitted.

The FASB is expected to replace its existing incurred loss approach with a current expected credit loss (CECL) approach which requires entities to measure credit losses based on lifetime ECL for all loans and other debt instruments measured at amortised cost. The FASB has not yet determined an effective date, but it expects to issue a final standard in the first quarter of 2016. While the FASB's decisions on its impairment methodology may differ from the IASB's, both standards are expected to be based on ECL concepts.

It should also be recognised that, since the accounting requirements are new, leading practice will continue to develop both during the transition period and after the adoption of the accounting standards. Therefore this report is an early contribution to the development of leading practice disclosure and it should not be construed as a final consideration on the topic.

### Building on existing EDTF principles and recommendations

In the context of the new and forthcoming impairment approaches, the EDTF seeks to provide guidance on:

- the applicability of its existing fundamental principles;
- the application of its existing recommendations;
- additional considerations regarding the application of the existing recommendations in the context of an ECL framework including both temporary considerations which will cease to apply following the transition to an ECL framework and permanent considerations which will continue to apply following the adoption of the new accounting standards; and
- further application of these additional considerations specifically to IFRS 9.

The guidance is framed in terms of the existing EDTF principles and recommendations in the 2012 report[5], which remain applicable. The new accounting requirements should result in banks reconsidering their implementation of the 2012 report in light of key matters of interest to users resulting from ECL accounting[6].

### Scope of recommendations and disclosure frequency and location

The scope of the recommendations and the recommended frequency and location of disclosures are consistent with the EDTF's 2012 report as summarised below.

The fundamental principles are applicable to all banks. The EDTF has developed the recommendations and additional considerations with large international banks in mind, although they should be equally applicable to other banks that actively access the major public equity or debt markets. Some of the recommendations, therefore, are likely to be less applicable to smaller banks and some subsidiaries of listed banks and the EDTF would expect such entities to adopt only those aspects of the recommendations that are relevant to them. This report was not specifically developed for other types of financial services organisations, such as insurance companies, though the considerations contained herein may provide some appropriate guidance.

This report has been produced in the context of the existing legal and regulatory requirements for banks' public reporting. The EDTF believes that certain risk disclosures in relation to ECL accounting approaches should be made more frequently than in annual reports and therefore could be included

[4] Subject to endorsement by the European Union for banks within this jurisdiction.
[5] A copy of the 2012 EDTF report is available at: http://www.financialstabilityboard.org/source/edtf/
[6] Where banks are not subject to ECL accounting requirements under IFRS or US GAAP (or other equivalent standards), this guidance will not be relevant, although they should remain mindful of the 2012 report.

within interim reports. Specific recommendations have been made in relation to timing of transition disclosures following the initial adoption of the relevant accounting standard.

In making its recommendations, the EDTF generally does not specify where any new disclosure should be made, nor does it suggest that banks change the current location of their reported information when adopting the enhancements. Banks should retain appropriate flexibility in where they choose to disclose information in their annual reports or in other stakeholder communications. However, as noted below, information required by accounting standards would need to be included in the scope of the audited financial statements.

### Relationship between requirements of accounting standards and EDTF recommendations

The EDTF recommendations may build on disclosure requirements in accounting standards, but do not amend or override these requirements. Therefore, preparers cannot rely on meeting these recommendations to fulfil the requirements of accounting standards. Preparers will need to use judgement to determine whether meeting the accounting standard requirements is sufficient to satisfy the EDTF objectives and will also need to apply judgement to avoid duplication where there are overlaps between EDTF objectives and the requirements of accounting standards. Banks should also be mindful of recommendation 1 in the 2012 report which suggests that all related risk information should be presented together or an index or an aid to navigation should be provided to help users locate disclosures within the report if this is not practicable. Areas where there may be similarities or overlap with the requirements of IFRS 7 *Financial Instruments: Disclosures* are highlighted in the footnotes to this report.

### Areas of focus in light of ECL

The recognition of credit loss is a key aspect of a bank's performance and the related disclosures are important to users. For many banks, the ECL approach is expected to increase the credit loss allowances on transition compared to the existing approach, and users want to understand the specific reasons for any such changes at transition and the ongoing drivers of variability in credit losses. Key areas of user focus include:

- concepts, interpretations and policies developed to implement the new ECL approaches, including the "significant increase in credit risk" assessment required by IFRS 9;
- the specific methodologies and estimation techniques developed;
- the impact of moving from an incurred to an expected credit loss approach;
- understanding the dynamics of changes in credit losses and their sensitivity to significant assumptions, including those as a result of the application of macro-economic assumptions;
- any changes made to the governance over financial reporting, and how they link with existing governance over other areas including credit risk management and regulatory reporting; and
- understanding the differences between accounting ECL and regulatory capital EL.[7]

Since the areas of focus are broad and credit losses are a key component of a bank's performance and financial position, it will be important that the disclosure is appropriately targeted at material aspects, particularly the bank's more significant portfolios and those factors and risks that create the greatest variability in ECL measurement.

### Gradual and phased approach and the aim to enhance comparability

The EDTF has extensively discussed the timing of providing disclosures in the transition period. Given that the changes introduced by the ECL approach are likely to require extensive data, systems and process changes within banks, a gradual and phased approach during the transition period (which is expected to be generally consistent for IFRS 9 and CECL) would be most useful to users, to give them clearer insights into the likely impacts of the new standards as implementations

[7] BCBS is currently reviewing the interaction of ECL accounting with the current Basel Accord. The results of this review and related proposals, if any, are not expected to be published until mid-2016.

progress and to allow users to make increasingly useful comparisons between banks. The initial focus should be on qualitative disclosures. The quantitative disclosures, which are identified in this report as additional considerations, should be added as soon as they can be practicably determined and are reliable[8] but, at the latest, in 2017 annual reports[9] for IFRS reporters. A gradual and phased approach means that: (a) the initial timing of information being provided, whether qualitative or quantitative, should be weighed against reliability; and (b) the nature and extent of disclosures will develop over time.

For many banks there may be substantial changes to systems and processes, including the need to obtain additional data, which will require substantial investment in time and resource to deliver. Some banks will also need to develop and enhance the governance over the recognition and measurement of credit losses, particularly to develop capability to make informed judgements about the use of forward-looking information (including macroeconomic factors). Therefore the timing of providing disclosures to reflect the EDTF recommendations in their external reporting is likely to vary between banks due to differences in their individual timetables for developing and implementing ECL provisioning.

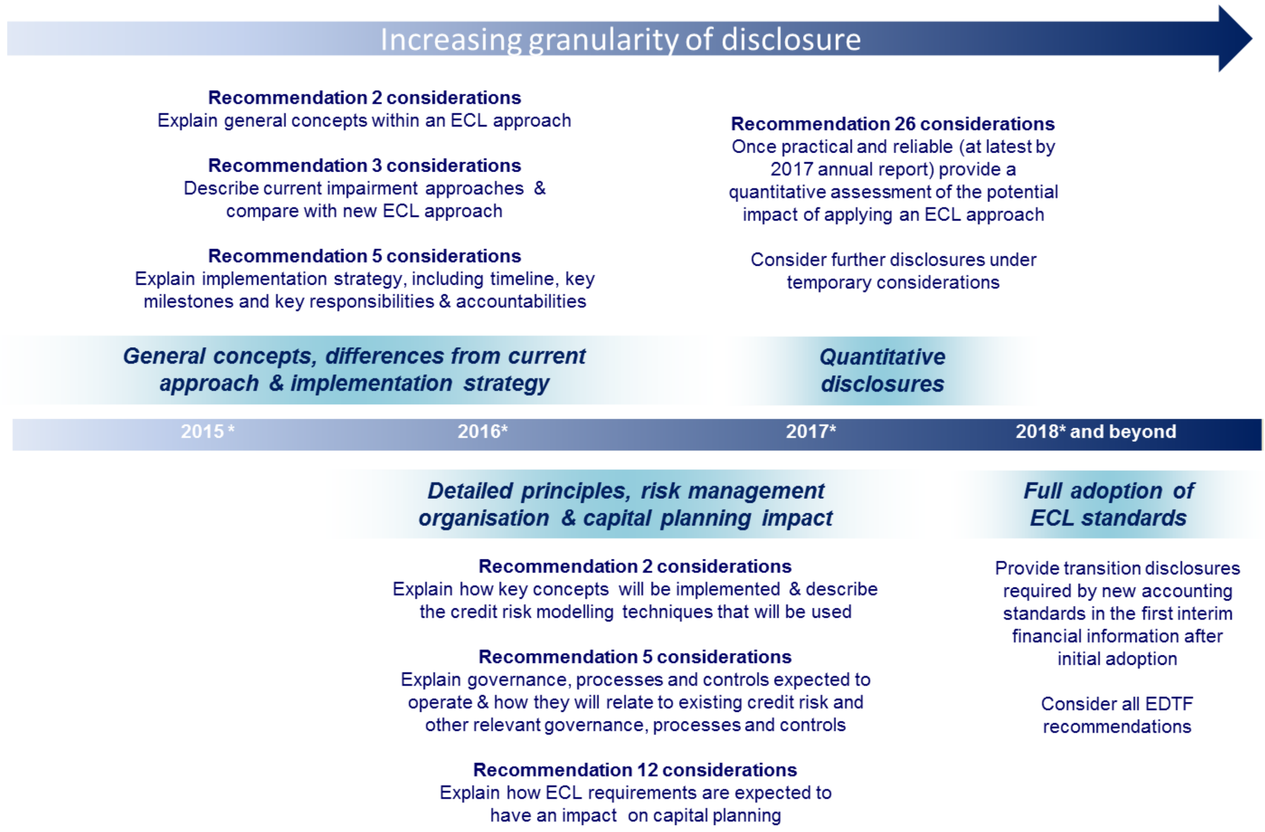
The information provided during the transition phase should be reliable and as comparable as possible across the industry. During transition, and on an ongoing basis, achieving comparability in ECL disclosures among the different banks will be a particular challenge given the extensive judgment involved in estimating provisions under the new standards, the differences between IFRS 9 and CECL, and banks' differing business models, risk approaches and risk appetites. By providing clear and sufficiently granular explanations about the concepts and estimation techniques used, banks can improve comparability. Users, however, will need to understand and adapt to the inherent limitations on comparability of forward-looking credit loss standards.

The discussion about timing has been framed in terms of banks with December year ends that are required to apply the new accounting standards from 1 January 2018. Banks with other year end dates and implementation dates are expected to adapt the indicative timeline as necessary for their circumstances.

[8] The use of the term 'reliable' in the context of this consideration is meant to be consistent with the term 'reasonably estimable' as envisaged by IFRS, US standards and other standard setters and securities regulators

[9] Paragraph 30 of IAS 8 applies when an entity has not applied a new IFRS that has been issued but is not yet effective. There are also US requirements with regard to disclosures of impending accounting changes (SAB Topic 11,M) and other jurisdictional requirements. These requirements continue to apply.

The following figure provides an indicative timeline that banks should consider for implementing the existing EDTF recommendations in light of ECL approaches.




*Suggested years of disclosure are based on implementation date of 2018 (as required by IFRS 9) for banks with December financial year ends and are consistent with timing of annual report (i.e. 2015 annual report which would be issued in early 2016).

## 2. Applicability of existing EDTF fundamental principles

The volume and complexity of banks' reporting has continued to increase in recent years, which has proved challenging for users seeking to understand the most significant items reported. The EDTF believes that increased volume of disclosure at the expense of clarity is unlikely to be helpful. Indeed, an emphasis on clarity of disclosure was captured in Principle 1 within the EDTF's existing seven fundamental principles for risk disclosures from their 2012 report which are as follows:

1. Disclosures should be clear, balanced and understandable.
2. Disclosures should be comprehensive and include all of the bank's key activities and risks.
3. Disclosures should present relevant information.
4. Disclosures should reflect how the bank manages its risks.
5. Disclosures should be consistent over time.
6. Disclosures should be comparable among banks.
7. Disclosures should be provided on a timely basis.

After consideration of all existing principles the EDTF concluded that the introduction of ECL based calculations would not create the need for any additional principles. However, existing principles should be carefully considered by preparers of financial statements as discussed below.

### Application to an ECL methodology

The EDTF reviewed the applicability of the existing principles against the new and forthcoming ECL requirements and it was emphasised that it will be more challenging for banks to explain and for users to understand ECL measurement compared to existing incurred loss measurement. The reasons for this include:

- Credit losses will be recognised for all lending activities, including newly recognised loans, which may represent a significant change for some banks.
- There will be increased judgement involved in determining forward-looking economic and credit assumptions over the life of a loan, and how those assumptions are incorporated into the measurement of ECL.
- The method used to calculate ECL is likely to be more complex, with a number of banks expecting to use models with comparable complexity to those used for their IRB advanced approaches for capital purposes.
- There will be more factors that create variability in expected credit losses. For example, if the approach outlined on pages 8 and 9 is applied, all movements in PDs will lead to changes in the quantum of credit loss recorded under an ECL approach, which was not necessarily the case under an incurred loss model.

These complexities in understanding ECL measurement compared to the existing accounting standards, reconfirmed to the EDTF the importance of all of the existing principles, in particular Principle 1 that "disclosures should be clear, balanced and understandable". As noted in our 2012 report, there should be "an appropriate balance between qualitative and quantitative disclosures" and they "should provide straightforward explanations of more complex issues".

The importance of Principle 3, that disclosures present relevant information, was also emphasised. Banks need to provide disclosures only if they are material and reflect their activities and risks. Banks should assess which factors and risks create variability in their measurement of ECL. Banks need to explain why those variables are the most significant and provide associated quantitative and qualitative disclosures for only those factors and risks. Disclosures should be eliminated if they are immaterial or redundant. Consideration should be given to the level of aggregation and disaggregation so that the information provided is meaningful and understandable.

Finally, Principle 6 was considered to be of particular importance because (i) banks will ground their ECL based allowances in methods and techniques tailored to their respective business models and needs, and (ii) different IFRS and US GAAP accounting requirements will hinder full comparability. In both cases, high quality disclosure can help users better understand and assess those differences.

# 3. Application of existing EDTF recommendations in light of expected credit loss accounting approaches

The EDTF reviewed the applicability of the existing thirty-two recommendations for enhancing banks' risk disclosures from the 2012 report against the new ECL requirements. The review concluded that recommendations made in the following areas were relevant for ECL approaches:

- general recommendations;
- risk governance and risk management / business model recommendations;
- capital adequacy and risk weighted asset recommendations; and
- credit risk recommendations.

The review found that additional considerations could be developed for these recommendations to support disclosures which will incorporate the new ECL requirements.

The EDTF confirmed that other aspects of the 2012 report remain applicable to other risk disclosures as appropriate.

## Additional considerations to existing recommendations in the context of new accounting ECL approaches

Additional considerations which are likely to be relevant to all ECL approaches are provided under the EDTF recommendation to which they relate; additional considerations which are IFRS 9 specific are provided in a separate box. The recommendations in the 2012 report remain unchanged, and this report should be read in conjunction with it.

Some additional considerations are temporary, relating only to the period before and upon transition to the ECL approach. The remaining considerations are expected to be permanent for continuous consideration in the context of ECL approaches. A number of permanent considerations should be considered in the pre-transition period while others are only applicable following adoption of an ECL approach.

In the pre-transition period, banks should clarify that disclosures anticipating the impact of ECL before the requirements are adopted are an indicative application of the new methodology to current portfolios, rather than an estimate of the future transition impact at the reporting date, based on the information currently available, including current economic conditions. Therefore the disclosures should be accompanied with meaningful cautionary statements identifying important factors that could cause actual results at transition to differ materially from those disclosed. For example it may be helpful to identify relevant transactions such as announced disposals likely to be completed before transition.

### A. General recommendations

### EDTF Recommendation 2

*Define the bank's risk terminology and risk measures and present key parameter values used.*

ECL approaches aim to measure credit losses that are expected to occur in the future based on information at the balance sheet date. The ECL concept already exists in regulatory frameworks, in pricing and underwriting processes and is now expected to be applied in both US and International accounting standards, but as the objectives of these approaches vary, so too does the manner in which ECL is calculated.

The regulatory capital framework is designed to ensure that banking organisations maintain capital resources in excess of minimum capital requirements, which reflect both expected and unexpected credit losses. Accounting loan loss allowances are incorporated into the framework and, under IRB approaches, compared to Regulatory EL with the shortfall or excess reflected as an adjustment to capital resources. As a result, regulatory capital EL (under Advanced and Foundation Internal Ratings Based methods) includes prudential floors and downturn estimates resulting in a measure not necessarily representative of the expected loss as at the balance sheet date, which is the objective of ECL.

An approach taken by many banks when measuring the quantum of expected losses is broadly a combination of four principal factors:

- a probability of default (PD) – an expression of how likely a default event is to happen;
- a loss given default (LGD) – an expression of how much loss may result on default;
- an exposure at default (EAD) – a measure of the outstanding balance when default occurs; and
- discounting – a measure of the time value of money

Although regulatory and accounting frameworks are likely to use calculations with *similar* concepts, their explicit objectives mean that the definitions of these concepts and other terms will differ. These differences may be subtle but can have a significant impact on the quantum of ECL and consequently on a user's understanding of the financial statements. In order to properly inform users when interpreting figures in expected loss calculations, it is vital that such terms are defined when they are used by individual banks.

Banks should make clear disclosures defining all significant terms used in the calculations of ECL, with a focus on explaining the differences between definitions as applied in determination of EL within the regulatory capital framework (for example as used in Pillar 3 disclosures) and those used in determining ECL for accounting purposes.

Banks also use terms that do not actually have a formal definition in official texts, such as "through the cycle", "point in time" and "behavioural life" when referring to risk parameters. Banks should define such terms in a manner that helps users understand and interpret each bank's quantitative disclosures and associated commentaries on movements and balances.

Where methodologies are adopted that do not rely on using the four principal factors noted above, such as loss rates, these should also be explained.

Permanent considerations to apply this recommendation in an accounting ECL framework include:

- **Describe how the bank interprets and applies the key concepts within an ECL approach.**

  It would be helpful to provide users with a description of the key concepts relating to the application of an ECL approach and how the bank interprets and applies these concepts. Material assumptions or estimates under each concept could be highlighted, particularly when there is a considerable level of uncertainty or subjectivity[10]. The EDTF expects that the granularity and specificity to a bank of the explanations provided will increase as the date of adoption of an ECL approach gets nearer.

  An example of a key concept, which is particularly relevant to IFRS 9, is the definition of default, where banks could consider describing how default is defined for use within an ECL model, including clarifying whether the accounting definition of default is consistent with the definition used for internal credit risk management purposes and how that compares to the regulatory definition of default[11.] A further example is the time horizon over which ECL should be measured for types of contracts where a specific interpretation is required, such as for current account (overdraft) or revolving credit facilities.

[10] IFRS 7.35B and 35G require disclosure of assumptions.
[11].IFRS 7.35F(b) and B8A require disclosure of the definition of default.

**IFRS 9 specific considerations**

Key concepts within the expected loss approach are critical to a user's understanding of a bank's implementation of IFRS 9. Where concepts exist in IAS 39 which are similar to those in IFRS 9, it would be helpful to explain if and how they differ from IFRS 9 and the impact of these differences, as relevant. To the extent that disclosure is not already required by IFRS 7, specific concepts that banks should consider include:

***Default*** In addition to the considerations on the definition of default set out above, banks could consider describing whether the 90 day rebuttable presumption[12] is intended to be used and in what circumstances.

***Credit-impaired*** Banks could consider explaining whether the concept of "credit-impaired exposures"[13] relates to the definition of default used for IFRS 9 purposes.

***Significant increase in credit risk*** The concept of "significant increase in credit risk" in IFRS 9 will drive the timing of recognising lifetime ECL (i.e. those exposures assigned to Stage 2) as opposed to 12-month expected credit losses (i.e. Stage 1) in the measurement of the impairment allowance.[14] Users are very interested in the policies and approaches banks apply in determining a significant increase in credit risk that will result in a transfer to Stage 2[15]. Banks should consider:

(a) Describing how the significant increase in credit risk (and its reversal) is determined and implemented, distinguishing between individual assessments, portfolio assessments, and the application of any temporary collective adjustments. This involves defining how the concept is applied to portfolios or product types as appropriate, highlighting any significant differences in approach. This description should address:

- Risk indicators such as the use of credit risk ratings, past due status, probability of default, watch lists or other indicators used in the bank's risk management;
- Interpretation of "significant increase in credit risk" at an appropriate level of segmentation and granularity (e.g., depending on the portfolio and the initial credit quality, the magnitude of a change in rating or PD or the criteria for being on a watch list, or other criteria derived from the bank's risk management practices or a combination of factors);
- The bank's policies and procedures for incorporating forward-looking information and the types of information used.[16.]

(b) When a portfolio assessment is applied to identify a significant increase in credit risk, banks could consider explaining how they will identify the exposures to be moved to Stage 2. This may include, for example, the identification of specific exposures or specific sub-portfolios affected by a deterioration in macroeconomic conditions ('bottom-up approach'), or the application of a percentage to the entire portfolio ('top-down approach').

***Initial recognition***[15] For exposures where it may be difficult to determine credit risk at initial recognition (such as current accounts, revolving facilities and renewable exposures), banks could consider describing their approach to determining significant increase in credit risk.

***Modifications*** Banks should consider setting out:

- Their policies as to what circumstances should lead to de-recognition of loans as a result of modification of contractual terms and the recognition of new loans;
- How forbearance situations are treated under IFRS 9, including, where such exposures are transferred to Stage 2, their procedures for transfer of exposures back to Stage 1 where the

[12] IFRS 9.B5.5.37
[13] IFRS 9 Appendix A Defined terms. Disclosure of how an entity has determined that financial assets are credit impaired is required by IFRS 7.35F(d).
[14] The size of lifetime ECL may not materially differ from 12-month ECL. This may be the case, for instance, where lifetime of a credit exposure is less than 12 months, or if the credit exposure, is highly collateralised as part of its contractual terms.
[15] IFRS 7.35F and 35G(a)(ii) require disclosure of how an entity has determined that credit risk has increased significantly and the basis of the inputs and assumptions and estimation techniques used in making that determination.
[16] IFRS 7.35G(b) requires disclosure of how forward-looking information has been incorporated into ECL.

borrower's condition has recovered or problems with the exposure have been cured. This should include any specific criteria defined to determine when to transfer forborne exposures back to Stage 1.[17]

- An explanation of the circumstances in which forborne exposures are considered credit-impaired and the criteria used to assess whether they are no longer credit-impaired.

When specific regulatory pronouncements exist around modifications (for example BCBS or European Banking Authority guidance), the bank could explain how these are reflected in its IFRS 9 approach.

- **Disclose the credit loss modelling techniques developed to implement the ECL approach [18]**

Banks should consider describing the main techniques used for the measurement of credit losses under the new impairment approach. In particular, where relevant, banks could describe their techniques for determining credit risk measures such as the probability of default (PD), loss given default (LGD), exposure at default (EAD) and credit conversion factors (CCF) that are used to meet the requirements of ECL calculations. The information provided should include the types of inputs used, the most relevant assumptions and judgments made, and the uncertainty involved, where applicable.

The EDTF anticipates that the granularity and specificity of the explanations provided will increase as the date of adoption of an ECL approach gets nearer. Disclosures could be made in the following areas:

***Forward-looking information***[19]

Banks should consider describing the types of forward-looking information (including macro-economic factors) that are used to meet ECL requirements and how the impact of this information on ECL is determined. The information provided should include both discussion of the judgment required and how it is applied in determining the allowance.

***Leveraging existing sources***

For portfolios where advanced Basel models are used as the starting point, banks could consider explaining the extent to which they rely on these models and how they adapt the methodology to comply with the requirements of the new accounting standards. For example, users have indicated the importance of explaining how life time PDs are developed from Basel 12-month PDs, where applicable.

Differences in methodology that are likely to be relevant include:

- the use of floors, such as those that may apply to Basel measures to mitigate the risk of underestimating credit losses due to a lack of historical data;
- downturn adjustments, such as those that may apply to Basel measures, consistent with losses expected to be suffered during a severe but plausible economic downturn;
- time horizons, i.e. the differences between 12-month and life time expectations and any differences in the time period used for discounting; and
- discount factors used, i.e. the differences in discount rates between Basel measures and accounting requirements.

For portfolios where the parameters for accounting purposes are not based on Basel model parameters, banks should consider describing the techniques developed to arrive at the ECL for accounting purposes. For example, describing the methodology used, including the application of

[17] IFRS 7.B8A suggests that disclosure of assumptions about cure rate may be relevant.
[18] IFRS 7.35G(a)(iii) requires disclosure of the basis of inputs, assumptions and estimation techniques used.
[19] IFRS 7.35G(b) requires disclosure of how forward-looking information has been incorporated.

expert judgement where relevant, may be of particular interest to users for low-default or low-volume portfolios.

***Additional adjustments***

Banks could consider providing an explanation of the use and nature of material additional adjustments which are used to capture factors not specifically embedded in the models used. While many adjustments are part of the normal modelling process (e.g. to adjust PDs as defined for capital purposes to accounting requirements or to incorporate forward-looking information), management may determine that additional, post-modelling adjustments are needed to reflect macro-economic or other factors which are not adequately addressed by the current models. Such adjustments would result in an increase or decrease in the overall allowance on a collective basis.

## EDTF Recommendation 3

*Describe and discuss top and emerging risks, incorporating relevant information in the bank's external reports on a timely basis. This should include quantitative disclosures, if possible, and a discussion of any changes in those risk exposures during the reporting period.*

Investors and regulators have indicated that they want qualitative information as to the key drivers of change to a bank's most significant credit risks and the impact of those changes on credit losses.

The EDTF considered different types of disclosures that banks could provide to explain these drivers of change, including individual parameter sensitivities and alternative economic scenarios. In these discussions the EDTF highlighted that there are both benefits and limitations to different types of disclosures.

Additional permanent considerations to apply this recommendation include:

- **Consideration should be given to providing quantitative disclosures around the key drivers of change in credit losses, but only where they are meaningful and relevant to understanding material changes**

  It is important that all top and emerging risks are discussed and their impact (or not) on ECL calculations is addressed in disclosures, either quantitatively or qualitatively as appropriate.

  Sensitivity disclosures can provide useful quantitative information when they are meaningful and relevant to understanding how credit losses can change materially. This is most likely to be for portfolios where an individual risk parameter has a significant impact on the overall credit risk of the portfolio, particularly where these sensitivities are included in information that is used for internal decision making and risk management purposes by key management, the board or the board's risk committee.

  Examples of sensitivities that might usefully be disclosed include:

  - Variables that cause an impact to a loan portfolio on an ongoing basis. For example, the sensitivity to house price indices for a residential mortgage book.
  - Changes that emerge at a point in time for specific lending portfolios. For example, this could be where there has been an economic shock to either a specific country or industry.

  The complexity of ECL calculations means that a change in any individual parameter is often associated with correlated changes in other factors. Banks should consider whether it is helpful to disclose sensitivities to individual parameters if correlated changes in other factors would render the disclosure less informative. An alternative would be to model a different reasonably possible economic scenario, which would include changes in multiple underlying parameters. Modelling such an alternative economic scenario would require a much broader and more complex analysis of interrelated factors. This would be more akin to a stress test. Related considerations in relation to stress testing disclosures under an ECL approach are set out under EDTF recommendation 8.

Quantitative disclosures may be less appropriate for some risks, notwithstanding that they are relevant. This could be where it is concluded that such information cannot be included in ECL. Such risks could include potential economic or political developments. For these risks, it may be more appropriate to provide qualitative disclosures.

Additional temporary considerations to apply this recommendation in the context of upcoming accounting ECL framework include:

- **Provide disclosures describing how the concepts applied and modelling techniques under the current impairment approaches compare with the new ECL approach to highlight factors which may drive changes in ECL that may not have been relevant in current impairment approaches**

  In particular, the differences between collective assessment under existing standards[20] and an ECL approach should be discussed.

  Disclosures under this recommendation would include any changes in the scope of impaired assets as a result of the implementation of IFRS 9; changes in the timing of recognition of losses; and the impact of forward-looking information, including any anticipated increase in volatility in provisions and therefore earnings as compared to the incurred loss approach.

  Consistent with EDTF recommendation 2, banks could describe the techniques which will be used for the measurement of ECL under the new approaches. It is expected that the disclosures would become more detailed over time.

  A significant number of large internationally active banks use aspects of EL based measures to comply with existing standards[21]. They should disclose how these operate and what changes they intend to make to comply with ECL requirements.

  Banks should consider supplementing existing disclosures that describe their current provisioning policies and modelling approaches under incurred loss models (i.e. the starting point for transition to ECL) to allow users to better understand how they compare to ECL concepts, for example, how incurred but not reported approaches (IBNR) will compare to ECL requirements. A comparison of any emergence period used in the determination of incurred loss allowances to the 12-month EL would also be of particular interest to users for IFRS banks before IFRS 9 is implemented.

  Banks should consider disclosing in a qualitative discussion the expected effects of an ECL approach on the quantum of credit losses as compared to allowances determined under incurred loss standards. The quantitative effects should be disclosed in the 2017 annual report at the latest as set out under recommendation 26.

**IFRS 9 specific considerations**

Banks could also consider explaining how individual triggers and the consequent loss measurement under IAS 39 compares with the treatment of 'credit impaired exposures' under IFRS 9 together with any changes to the scope of financial assets subject to impairment requirements as a result of classification and measurement changes.

Users would like to understand which portfolios will be significantly affected by the transition to IFRS 9 and would welcome disclosure on:

(a) The key characteristics that could affect ECL, for example the expected life and amortisation profile of loans (allowing users to have a sense of the impact that lifetime ECL may have for Stage 2 exposures);

[20] For example, IAS 39 and FASB Accounting Standards Codification (ASC) Topic 310 and Topic 450
[21] For example, IAS 39 and FASB Accounting Standards Codification (ASC) Topic 310 and Topic 450

(b) The absolute level of credit risk of portfolios[22]; and

(c) How any wider developments expected in the bank's strategy or portfolio composition might affect the expected impact from IFRS 9[23].

### EDTF Recommendation 4:

*Once the applicable rules are finalised, outline plans to meet each new key regulatory ratio, e.g. the net stable funding ratio, liquidity coverage ratio and leverage ratio and, once the applicable rules are in force, provide such key ratios.*

Under the current regulatory framework (Basel II and III as implemented in most major jurisdictions), increased credit losses affect capital in different ways depending on the approach. Under the internal ratings based approach, where the balance of allowances determined for accounting purposes is less than the one-year regulatory expected loss amount, the difference is taken as a deduction from Common Equity Tier 1 capital. However, where the balance of accounting loan impairment allowances is greater than the EL, the surplus over the EL is allowable to count towards capital resources as a Tier 2 item, subject to a ceiling. In the case of the standardised approach, allowances treated as specific credit risk adjustments are netted against the exposure value whilst allowances treated as general credit risk adjustments are treated as a Tier 2 item subject to a ceiling.

In the absence of any amendments to regulatory rules, the new ECL approach may affect the quantum of regulatory capital resources and hence regulatory capital ratios. Banks should consider disclosing the impact that the revised accounting allowance for credit losses may have on regulatory capital (under current regulatory rules).

It is possible that existing regulatory capital requirements will be revised by the Basel Committee in due course as a result of the new ECL methodology. An assessment of the potential combined impact of any such changes should be provided once they become known with sufficient reliability.

## B. Risk governance and risk management strategies/business model recommendations

### EDTF Recommendation 5

*Summarise prominently the bank's risk management organisation, processes and key functions.*

The adoption of an ECL framework requires banks to carefully consider their implementation strategies. This may include changes to the bank's risk management organisation, systems and processes and key functions both in the transition period for the purpose of the implementation plan and after the transition date when the ECL methodology becomes the mandatory impairment approach.

Additional temporary considerations to apply this recommendation in the pre-transition period include:

- **Banks should consider describing the intended implementation strategy including current timeline for the implementation**

  Banks could consider describing how the implementation is being governed including a description of the main implementation steps, such as the methodologies to be determined and the models to be built and tested, including the businesses and functions involved in the implementation efforts.

Additional permanent considerations to apply this recommendation include:

- **Disclose how the risk management organisation, processes and key functions have been organised to run the ECL methodology**

[22] IFRS 7.35M requires disclosure of gross carrying amount of financial assets by credit risk rating grades.
[23] Bearing in mind EDTF Principle 4 with regard to commercially sensitive information.

Banks could consider highlighting how credit practices and policies form the basis for the implementation of the expected credit loss requirements[24]. Furthermore, banks could describe the impact of the new methodology on existing processes and the changes required to governance practices and processes.

### EDTF Recommendation 7

*Describe the key risks that arise from the bank's business models and activities, the bank's risk appetite in the context of its business models and how the bank manages such risks. This is to enable users to understand how business activities are reflected in the bank's risk measures and how those risk measures relate to line items in the balance sheet and income statement.*

Disclosure of a bank's business models is intended to provide users with a description of how it creates, delivers, and captures value. In order to enable users to understand how risk measures relate to line items in the balance sheet and income statement, banks may have to adapt their descriptions to reflect any changes resulting from revisions to accounting requirements.

### EDTF Recommendation 8

*Describe the use of stress testing within the bank's risk governance and capital frameworks. Stress testing disclosures should provide a narrative overview of the bank's internal stress testing process and governance.*

Additional temporary considerations to apply this recommendation to the new ECL framework include:

- **Describe the relationship, if any, between the stress testing programs and the implementation of ECL accounting requirements**

  Given the significant developments in stress testing in certain jurisdictions over the last few years, banks should re-evaluate the disclosures incorporated in their annual reports and consider how they could be linked to other disclosures made around credit risk and regulatory capital requirements to help users understand the risk factors the business is exposed to. Any links between stress testing methodology, assumptions and processes and the implementation of an ECL methodology should be explained.

## C. Capital adequacy and risk-weighted asset recommendations

### EDTF Recommendation 12

*Qualitatively and quantitatively discuss capital planning within a more general discussion of management's strategic planning, including a description of management's view of the required or targeted level of capital and how this will be established.*

The introduction of the new accounting standards will potentially affect capital measures as discussed above.

Additional temporary considerations to apply this recommendation in the pre-transition period to the new ECL framework include:

- **Banks should consider explaining how ECL requirements are anticipated to have an impact on capital planning, (particularly in meeting capital adequacy requirements) including any strategic changes expected by management, to the extent the impact is material. To the extent regulatory requirements are unclear or not yet fully determined, the effects of such uncertainty should be discussed.**

[24] IFRS 7.35B(a) requires disclosures about an entity's credit risk management practices and how they relate to ECL.

As the regulatory requirements become more clear and banks' implementation efforts progress, this is an area where disclosure is expected to develop over the transition period.

### EDTF Recommendation 15

*Tabulate credit risk in the banking book showing average probability of default (PD) and loss given default (LGD) as well as exposure at default (EAD), total RWAs and RWA density for Basel asset classes and major portfolios within the Basel asset classes at a suitable level of granularity based on internal ratings grades. For non-retail banking book credit portfolios, internal ratings grades and PD bands should be mapped against external credit ratings and the number of PD bands presented should match the number of notch-specific ratings used by credit rating agencies.*

Additional permanent considerations to apply this recommendation in the new ECL framework would include:

- **Banks should consider whether credit quality disclosures can be made that are similar to those used for regulatory capital purposes**

  Banks could provide credit quality disclosures for accounting purposes on a similar basis to those in recommendation 15 and the illustrative capital disclosures in Figure 3 (as presented in the EDTF 2012 report and reproduced below). Using the same number of PD bandings as in the bank's implementation of Figure 3 would allow sufficient granularity of an individual bank's loan portfolios by credit quality to facilitate comparison between banks (as envisaged with the original EDTF recommendation) for their lending portfolios. Banks should determine the appropriate bandings as necessary in order to convey the differences in credit quality across their lending portfolios at a reporting date.

- **Use of other approaches to measure ECL**

  PDs, LGDs and EADs might not be used by banks for measuring expected credit losses for all their portfolios. Disclosures consistent with Figure 3 are only relevant for balances where PDs, LGDs and EADs are used to calculate expected credit losses. If other approaches to measuring ECL are used, it would be helpful to analyse the balance sheet total between the different approaches used. Consideration should be given to how best to describe and analyse calculations using other approaches. Where material additional adjustments to the ECL as defined on page 12 are applied, these could also be described and analysed as appropriate.

**Figure 3. Example of advanced IRB credit exposures by internal PD grade (reproduced from EDTF 2012 report)**

| Internal ratings grade (or band of grades) | PD range | Exposure at default | Average PD | Average LGD | RWAs | Average risk weighting | External rating equivalent |
|---|---|---|---|---|---|---|---|
| | 0.000% | US$m | % | % | US$m | % | |
| 1 | 0.000 to 0.010 | 500 | 0.010 | 21 | 25 | 5 | AAA |
| 2 | 0.011 to 0.020 | 1,000 | 0.018 | 22 | 90 | 9 | AA+ |
| 3 | 0.021 to 0.030 | 500 | 0.029 | 21 | 55 | 11 | AA |
| 4 | 0.031 to 0.040 | 2,000 | 0.035 | 26 | 300 | 15 | AA |
| 5 | 0.041 to 0.050 | 100 | 0.047 | 28 | 18 | 18 | A+ |
| 6 | 0.051 to 0.070 | 500 | 0.061 | 33 | 100 | 24 | A |
| 7 | 0.071 to 0.110 | 800 | 0.078 | 41 | 200 | 25 | A– |
| 8 | 0.111 to 0.180 | 750 | 0.122 | 38 | 210 | 28 | BBB+ |
| 9 | 0.181 to 0.300 | 1,000 | 0.292 | 45 | 310 | 31 | BBB |
| 10 | 0.301 to 0.500 | 1,250 | 0.400 | 48 | 475 | 38 | BBB– |
| 11 | 0.501 to 0.830 | 1,500 | 0.650 | 47 | 780 | 52 | BB– |
| 12 | 0.831 to 1.370 | 1,750 | 1.112 | 46 | 1,033 | 59 | BB |
| 13 | 1.371 to 2.270 | 500 | 2.001 | 51 | 370 | 74 | BB– |
| 14 | 2.271 to 3.750 | 100 | 2.500 | 57 | 94 | 94 | B+ |
| 15 | 3.751 to 6.190 | 250 | 4.011 | 42 | 280 | 112 | B |
| 16 | 6.191 to 10.220 | 150 | 7.020 | 47 | 204 | 136 | B– |
| 17 | 10.221 to 16.870 | 750 | 12.999 | 55 | 1,312 | 175 | CCC+ |
| 18 | 16.871 to 27.840 | 500 | 20.020 | 49 | 1,560 | 312 | CCC |
| 19 | 27.841 to 99.999 | 200 | 75.020 | 75 | 1,282 | 641 | CCC– |
| 20 | 100.000 | 200 | 100.000 | 75 | 100 | 50 | Default |
| Total | | 14,300 | | | 8,798 | | |

*Note:*

*The above Figure is for illustrative purpose only, as the number of internal rating grades, the PD range for each grade and the respective external rating equivalent will differ for each institution.*

## D. Credit risk recommendations:

### EDTF Recommendation 26

*Provide information that facilitates users' understanding of the bank's credit risk profile, including any significant risk concentrations. This should include a quantitative summary of aggregate credit risk exposures that reconciles to the balance sheet, including detailed tables for both retail and corporate portfolios that segment them by relevant factors. The disclosure should also incorporate credit risk likely to arise from off-balance sheet commitments by type.*

Additional temporary considerations to apply this recommendation in the context of the upcoming accounting ECL framework include:

- **Banks should consider whether existing segmentation for disclosure purposes is sufficiently granular to appropriately understand credit risk under an ECL approach**

  The EDTF's discussions on ECL reaffirmed the need for quantitative disclosures in respect of a bank's credit risk exposures at a reporting date. The impact on the financial statements should be described with sufficient granularity to allow users to understand how the adoption of the ECL approach contributes to a change in the allowance balance compared to the previous incurred loss approach and how the impact varies across the bank's portfolios. On initial application, banks could revisit their existing disclosure segmentation to consider whether it continues to be appropriate. When determining the appropriate level of disclosure segmentation, banks should give consideration to whether their internal reporting has become more granular in response to moving to an ECL approach.

On an ongoing basis, disclosures could break down portfolios by geography, line of business, product, credit quality and vintage.

As specific risks emerge, banks should consider providing separate disclosures segmented for the affected lending. Such emerging risks could relate to a specific territory, industry or type of lending. Any disclosure provided should be designed to highlight the relevant risks. Banks should ensure that such disclosures are removed as the identified risks diminish.

The consideration is also relevant for banks' transitional disclosures.

- **Once practical and when disclosures would be reliable[25], provide users with a quantitative assessment of the potential impact of applying an ECL approach**

  The quantitative assessment of the potential impact can only be based on current portfolios and information. Businesses, portfolios and economic conditions will continue to evolve but such changes cannot be fully anticipated prior to transition. It should therefore be made clear that any quantitative assessment disclosed ahead of transition is not an estimate of the future transition impact but rather an indicative application of the new methodology to current portfolios based on current circumstances and available forecasts as at a particular date. The reliability of the information should be assessed and understood on this basis.

  Where quantification is not yet possible, it would be helpful for banks to indicate when they expect to be able to provide initial impact assessments based on current portfolios.

**IFRS 9 specific considerations**

The quantitative disclosures which are included in this report as additional considerations should be added as soon as practicable and reliable impacts can be determined and, at the latest, in 2017 annual reports[26]. The extent and nature of quantitative disclosures provided will be dependent upon progress and milestones reached in the bank's implementation project and therefore should be consistent with the timetable and milestones described under recommendation 5.

- **Provide the transition disclosures required by the new accounting standards as soon as practicable following the initial application of the standard**

  The provision of disclosures as soon as practicable after transition will help users understand the impact of the adoption of the new accounting standards.

  The type of disclosures provided ahead of the transition date and on initial application should be consistent. That is, the disclosures provided following the date of initial application should enable users to understand how the changes in methodology described during the pre-transition period have been translated into the financial statements.

**IFRS 9 specific considerations**

The transition disclosures required by IFRS 7[27] include reconciling the ending allowance in accordance with IAS 39 and IAS 37 *'Provisions, Contingent Liabilities and Contingent Assets'* to the opening

[25] The use of the term "reliable" in the context of this consideration is meant to be consistent with the term "reasonably estimable" as envisaged by IFRS, US standards and other standard setters and securities regulators.
[26] Paragraph 30 of IAS 8 applies when an entity has not applied a new IFRS that has been issued but is not yet effective. There are also US requirements with regard to disclosures of impending accounting changes (SAB Topic 11, M) and other jurisdictional requirements. These requirements continue to apply.
[27] IFRS 7.42P.

IFRS 9 allowance. This disclosure is required to be provided for each measurement category in accordance with IAS 39 and IFRS 9 and to show separately the effect of the changes in the measurement category on the loss allowance at that date.

In addition, banks could consider describing:

- the stage allocation (1, 2 or 3) at the date of initial application and which exposures were considered impaired under IAS 39, whether on an individual or collective basis;
- the changes in allowance balance introduced by the new standards for particular product or business portfolios; and
- any simplified approach applied on transition that would not be applicable permanently (e.g. if the transition provisions under IFRS 9 have been applied resulting in lifetime ECL being recognised for all financial instruments unless they were low credit risk).

- **When restated comparatives are prepared, clarify the basis upon which they were prepared and the limitations of their information content**

  Disclosures on the basis of measurement underlying the comparative figures are necessary to avoid potential confusion on the part of users of financial statements, as the application of the transition provisions may require the information for comparative periods to be prepared on a mixed basis.

  Banks which provide restated comparative figures outside the financial statements that do not fully comply with the transition requirements of accounting standards should consider disclosing that fact and explaining how the underlying assumptions used for these non-GAAP restated comparatives compare with the transition requirements.

**IFRS 9 specific considerations**

When a bank provides accounting comparatives that are compliant with the transition provisions of IFRS 9, it needs to clarify the basis of measurement as the application of the transition provisions of IFRS 9 would require the information for comparative periods to be prepared on a mixed basis, with some financial assets measured under IFRS 9 and some under IAS 39. This is because IFRS 9 requires the “business model assessment” to be performed at the date of initial application and applied retrospectively and prohibits retrospective application for assets de-recognised before the date of initial application.

- **Where it aids understanding of credit risk exposures, provide disclosure of vintage**

  One permanent consideration within this recommendation concerns vintage analysis. As noted in the 2012 report, vintage might be a factor relevant to a portfolio,[28] particularly when there is a lending portfolio with heightened credit risk, and the period in which it was originated has a bearing on the extent of that credit risk and the resulting ECL.

## EDTF Recommendation 27

*Describe the policies for identifying impaired or non-performing loans, including how the bank defines impaired or non-performing, restructured and returned-to-performing (cured) loans as well as explanations of loan forbearance policies.*

EDTF recommendation 27 specified that a bank should define what it considers to be an impaired or non-performing loan. The use of an expected credit loss framework means that all financial assets will have a loss allowance of some kind. Therefore, under an ECL approach, this recommendation should be

[28] 2012 EDTF report page 53.

interpreted as defining non-performing and credit-impaired loans, including when financial assets are no longer considered to be non-performing or credit-impaired. Overall risk terminology is considered under recommendation 2.

## EDTF Recommendation 28

*Provide a reconciliation of opening to closing balances of non-performing or impaired loans in the period, and the allowance for loan losses. Disclosure should include an explanation of the effects of loan acquisitions on ratio trends and qualitative and quantitative information about restructured loans.*

Additional permanent considerations to apply this recommendation in the new ECL framework include banks considering providing information about significant movements in loan balances where this is helpful in understanding the credit losses, consistent with the practices the bank uses internally for risk management.

### IFRS 9 specific considerations

- IFRS[29] requires a reconciliation of the opening to closing balances of loan loss allowances and explanation of how significant changes in the gross carrying amount of financial assets contributed to the loan loss allowances. It would be helpful if the reconciliation and explanation separately disclosed and discussed:
  - transfer to lifetime ECL;
  - transfer to credit-impaired financial assets;
  - transfer to 12-month ECL;
  - financial assets that have been derecognised during the period (including write-off);
  - new financial assets originated or purchased (or another measure of increase in book size such as net increase/decrease);
  - changes to models used for ECL calculation;
  - changes in credit risk parameters (model inputs);
  - changes due to modification that did not result in derecognition; and
  - others.

An example reconciliation of both gross carrying amounts and allowance for loan losses is set out below in figure A[30]. Such a presentation could be a convenient means of explaining the key drivers of changes in the loss allowances as they relate to the gross carrying amounts, although other presentations may also be effective.

Where models are used for determining expected credit losses, there may be a lack of clarity between model changes and changes to credit risk parameters. Users have indicated they would like to see more information from banks about the quantitative impact that changes to models and risk parameters have on their reported numbers.

A risk parameter is an input to a credit risk model. Examples include macro-economic conditions such as interest rates, the arrears status of a loan or overdraft usage. These parameters will change from period to period, and will result in changes in modelled ECL. In contrast model changes are expected to be less frequent.

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[29] IFRS 7.35H requires a reconciliation of the loss allowance. IFRS 7.35I requires an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance.

[30] This is modelled on the example provided in IFRS 7.IG20B and therefore includes the gross carrying amount of financial assets as part of the illustration in IFRS 7 and is not required.

Banks should clearly define their risk parameters and models as part of their overall explanation of their expected credit loss methodology as set out in Recommendation 2.

Given the nature of the process by which banks make model changes, it might not always be feasible to provide a precise split between the impact of model changes and the impact of credit or economic risk parameter changes. If a bank is able to distinguish this split at the reporting date, then changes in risk parameters and models should be separately disclosed in the allowance reconciliation. Where a bank is unable to do this, separate disclosures on the impact of material model changes should be provided based on the information available, which may not be at the reporting date. The disclosures around any material model changes should explain the nature of the change and why management chose to make the change.

The sequencing of movements is important when preparing an allowance reconciliation. Changes in the sequencing can affect the quantification of each movement. For example, if transfers between stages are considered to take place at the start of the period, the amount transferred could be based on the closing balance from the previous period, which would not include any difference in measurement as a result of the change in stage or as a result of any change in assumptions. Alternatively, if transfers between stages are considered to take place at the end of the period, the amount transferred could be based on the period end balance which may or may not include any difference in measurement as a result of the change in stage but could include the effect of changes in assumptions. Similarly, if changes in measurement due to movements in risk parameters are the first in the sequence, this will give a different amount for the transfer as a result of change in stage than if the change in stage is first in the sequence.

Banks should consider outlining the basis of preparation of their allowance reconciliation, including the order in which movements have been calculated, as well as any other key assumptions made in preparing the disclosure.

- **Explanations should be given for significant movements in gross balances that contribute to changes in the allowance measured using expected credit losses** [31]

  Users find understanding significant changes in gross balances (for example new lending, write-offs, etc.) important when assessing the allowances against those balances. It is helpful to distinguish the effect of changes in the amount of lending versus changes in credit risk on the ECL.

**IFRS 9 specific considerations**

It will be important to explain the significant flows of balances between 12-month ECL, Stage 2 and credit-impaired (Stage 3), as well as the required disclosures around allowance movements.

In determining the disclosures made, consideration should be given to the flows experienced both ways, particularly from 12-month ECL to lifetime expected loss (LEL) and from LEL to 12-month ECL. If these gross flows are significant, disclosures should be made to explain them (even if the net flow between 12-month ECL and LELs is relatively stable).

[31] IFRS 7.35I requires disclosure about movements in gross carrying amount.

## Figure A – *Example reconciliation of gross carrying amounts and allowances*

# Movement table

| **Financial assets at amortised cost** | **Not credit-impaired** | | | | **Credit-impaired** | | | | **Total** | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Subject to 12-month ECL** | | **Subject to lifetime ECL** | | **Subject to lifetime ECL - Excluding purchased/ originated credit-impaired** | | **Purchased/ originated credit-impaired** | | | |
| | **Gross carrying amount** | **Allowance for ECL** | **Gross carrying amount** | **Allowance for ECL** | **Gross carrying amount** | **Allowance for ECL** | **Gross carrying amount** | **Allowance for ECL** | **Gross carrying amount** | **Allowance for ECL** |
| | US$m | US$m | US$m | US$m | US$m | US$m | US$m | US$m | US$m | US$m |
| As at 1 January | X | X | X | X | X | X | X | X | X | X |
| Transfer to lifetime ECL (N1) | (X) | (X) | X | X | (X) | (X) | (X) | (X) | - | X |
| Transfer to credit-impaired financial assets (N1) | (X) | (X) | (X) | (X) | (X) | (X) | - | - | - | X |
| Transfer to 12-month ECL (N1) | X | X | (X) | (X) | (X) | (X) | - | - | - | (X) |
| Financial assets that have been derecognised during the period (including write-off) | (X) | (X) | (X) | (X) | (X) | (X) | (X) | (X) | (X) | (X) |
| New financial assets originated or purchased | X | X | - | - | - | - | X | X | X | X |
| Changes to model used for ECL calculation | - | X | - | X | - | X | - | X | - | X |
| Changes to risk parameters (model inputs) | - | X | - | X | - | X | - | X | - | X |
| Changes due to modification that did not result in derecognition | X | X | X | X | X | X | X | X | X | X |
| Others | X | X | X | X | X | X | X | X | X | X |
| Foreign exchange | X | X | X | X | X | X | X | X | X | X |
| As at 31 December | X | X | X | X | X | X | X | X | X | X |
| Carrying amount as at 31 December | | X | | X | | X | | X | | X |
| Total amount of undiscounted ECL for financial assets initially recognised during the year | | | | | | | | X | | |
| Contractual amounts outstanding written off that are still subject to enforcement activities (N2) | X | | X | | X | | X | - | X | |

N1 –Depending on the disclosure policy, the amounts disclosed in these transfer lines could differ depending on whether transfers are disclosed before any re-measurement or whether transfer and re-measurement are included in the same row. Therefore transfer may or may not have an impact on profit or loss. Similarly the re-measurement effect arising from changes in stages could be shown separately from the effect of changes in estimation of cash flows.

N2 –Depending on the disclosure policy loans in stages 1 and 2 could be written-off before any deterioration or all loans or loans may all be reclassified in stage 3 before write off.

## Appendix A: Temporary versus permanent considerations

The following table provides guidance on the timing of disclosure of each additional consideration under the existing EDTF recommendations. The considerations fall into the following three categories:

- disclosures made in the pre-transition period and on transition which should continue to be made following adoption of an ECL framework (permanent considerations);
- disclosures made in the pre-transition period and on transition (or only at transition) which should cease to be made following adoption of an ECL framework (temporary considerations); and
- disclosures made following adoption of an ECL framework only (post ECL adoption permanent considerations).

  Within these categories, consideration should be given to the level of detail of quantitative disclosures which are appropriate to the stage of implementation or ongoing application of new accounting standards. For example, at the early stages of implementation, when policy and design decisions are still being made, there may be less information available for disclosure than when the policies are defined. Similarly, once the new accounting standards have been implemented, explaining how policies differ from those under the old accounting standards will be less relevant.

| | |
|---|---|
| **Recommendation 2: Define the bank's risk methodology and risk measures and present key parameter values used** | |
| Describe how the bank interprets and applies the key concepts within an ECL approach | Permanent |
| Disclose the credit loss modelling techniques developed to implement the ECL framework | Permanent |
| **Recommendation 3: Describe and discuss top and emerging risks** | |
| Consideration should be given to providing quantitative disclosures around the key drivers of change in credit losses, but only where they are meaningful and relevant to understanding material changes | Post ECL adoption permanent |
| Provide disclosures describing how the concepts applied and modelling techniques under the current impairment approaches compare with the new ECL approach to highlight factors which may drive changes in ECL that may not have been relevant in current impairment approaches | Temporary |
| **Recommendation 4: Outline plans to meet each new key regulatory ratio and once the applicable rules are in force, provide such key ratios** | **Temporary** |
| **Recommendation 5: Summarise prominently the bank's risk management organisation, processes and key functions** | |
| Banks should consider describing the intended implementation strategy including the current timeline for the implementation | Temporary |
| Disclose how the risk management organisation, processes and key functions have been organised to run the ECL methodology | Permanent |
| **Recommendation 7: Describe the key risks that arise from the bank's business model and activities, the bank's risk appetite in the context of its business models and how the bank manages such risks** | **Post ECL adoption permanent** |
| **Recommendation 8: Describe the use of stress testing within the bank's risk governance and capital frameworks.** | |
| Describe the relationship, if any, between the stress testing programs and the implementation of ECL accounting requirements | Temporary |
| **Recommendation 12: Qualitatively and quantitatively discuss capital** | |

| | |
|---|---|
| **planning** | |
| Banks should consider explaining how ECL requirements are anticipated to have an impact on capital planning, (particularly in meeting capital adequacy requirements) including any strategic changes expected by management, to the extent the impact is material. To the extent regulatory requirements are unclear or not yet fully determined, the effects of such uncertainty should be discussed | Temporary |
| **Recommendation 15: Tabulate credit risk in the banking book showing average probability of default (PD) and loss given default (LGD) as well as exposure at default (EAD), total RWAs and RWA density** | |
| Banks should consider whether credit quality disclosures can be made that are similar to those used for regulatory capital purposes<br><br>Use of other approaches to measure ECL | Post ECL adoption permanent |
| **Recommendation 26: Provide information that facilitates users' understanding of the bank's credit risk profile including any significant risk concentrations.** | |
| Banks should consider whether existing segmentation for disclosure purposes is sufficiently granular to appropriately understand credit risk under an ECL approach | Temporary |
| Once practical and when disclosures would be reliable, provide users with a quantitative assessment of the potential impact of applying an ECL approach | Temporary |
| Provide the transition disclosures required by the new accounting standards in the first interim financial statements following the initial application of the standard | Temporary (on transition only) |
| When restated comparatives are prepared, clarify the basis upon which they were prepared and the limitations of their information content | Temporary (on transition only) |
| Where it aids understanding of credit risk exposures, provide disclosure of vintage | Permanent |
| **Recommendation 27: Describe the policies for identifying impaired or non-performing loans, including how the bank defines impaired or non-performing, restructured and returned-to-performing (cured) loans as well as explanations of loan forbearance policies** | **Permanent** |
| **Recommendation 28: Provide a reconciliation of opening to closing balances of non-performing or impaired loans in the period, and the allowance for loan losses** | Post ECL adoption permanent |

## Appendix B: Abbreviations

The following abbreviations are used in this report:

| | |
|---|---|
| ASC | Accounting Standards Codification |
| BCBS | Basel Committee of Banking Supervisors |
| CCF | Credit Conversion Factors |
| CECL | Current Expected Credit Loss |
| EAD | Exposure at Default |
| EBA | European Banking Authority |
| ECL | Expected Credit Loss |
| EDTF | Enhanced Disclosure Task Force |
| EL | Expected losses |
| FAS | Financial Accounting Standard |
| FASB | Financial Accounting Standards Board |
| FSB | Financial Stability Board |
| GAAP | Generally Accepted Accounting Principles |
| IBNR | Incurred But Not Reported |
| IAS | International Accounting Standard |
| IASB | International Accounting Standards Board |
| IFRS | International Financial Reporting Standard |
| IRB | Internal Ratings-Based |
| LEL | Lifetime Expected Loss |
| LGD | Loss Given Default |
| PD | Probability of Default |
| RWA | Risk-Weighted Assets |

# Appendix C: Members of the Enhanced Disclosure Taskforce

## Co-Chairs

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|---|---|
| Deutsche Bank | Ralf Leiber<br>Managing Director<br>Head of Group Capital Management |
| HSBC | Russell Picot<br>Group General Manager and<br>Group Chief Accounting Officer |
| PIMCO | Christian Stracke<br>Managing Director, Member of Investment Committee and<br>Global Head of Credit Research Group |

## Additional members

| | |
|---|---|
| Aberdeen Asset Management | Paul Lee<br>Head of Corporate Governance |
| Allianz SE | Tom Wilson<br>Chief Risk Officer |
| American Century Investments | Derek De Vries<br>Senior Analyst - Global Financials |
| AXA Group | Emmanuelle Nasse-Bridier<br>Group Chief Credit Officer |
| Banco Santander | Javier Torres<br>EVP, Global Head of Model Risk Management |
| BlackRock | Simon Martin<br>Director, Fixed Income, Credit – Financial Institutions |
| BNP Paribas | Gérard Gil<br>Senior Advisor |
| Citi | Jim Padula<br>Managing Director, Head of Corporate Regulatory Advisory |
| CFA Institute | Vincent Papa<br>Director, Financial Reporting Policy |
| Commonwealth Bank of Australia | Greg Mizon<br>Chief Risk Officer, International Institutional Banking and<br>Markets Risk Management |
| CreditSights, Inc. | Pri de Silva<br>Senior Analyst, US Banks and Brokers |
| DBS | Mikkel Larsen<br>Head of Tax and Accounting Policy, Managing Director |
| Deloitte | Mark Rhys<br>Global IFRS for Banking Co-Leader |
| Ernst & Young | Karen Golz<br>Global Vice Chair, Professional Practice |
| Fidelity Management and Research | Kana Norimoto<br>Research Analyst, Fixed Income |

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|---|---|
| Fidelity Worldwide Investment | Katsumi Ishibashi<br>Senior Credit Analyst |
| Fitch Ratings | Bridget Gandy<br>Managing Director, Co-head EMEA Financial Institutions |
| IIF | David Schraa<br>Regulatory Counsel |
| Independent Banking Consultant | James Alexander |
| Independent Banking Consultant | Derek Ovington |
| Independent Banking Consultant | Simon Samuels |
| ING Group | Norman Tambach<br>Group Controller |
| International Banking Federation | Dirk Jaeger<br>Managing Director – Banking Supervision, Accounting, Association of German Banks; Chairman of Accounting Working Group of IBFed |
| Institutional Investment Advisors Limited | Crispin J. Southgate<br>Director |
| JPMorgan Chase | Robin Doyle<br>Managing Director, Regulatory Strategy and Policy |
| KPMG | Walkman Lee<br>Head of Insurance (China) |
| Mitsubishi UFJ Financial Group | Masamichi Yasuda<br>Director, Managing Executive Officer, Group Chief Risk Officer |
| Moody’s | Mark LaMonte<br>Managing Director, Chief Credit Officer, Financial Institutions |
| PGGM | Eloy Lindeijer<br>Chief Investment Management |
| PricewaterhouseCoopers | Robert P. Sullivan<br>Global Banking and Capital Markets Leader;<br>Global Regulatory Leader |
| Royal Bank of Canada | Rod Bolger<br>Executive Vice President, Finance & Controller |
| Societe Generale | Severin Cabannes<br>Deputy Chief Executive Officer |
| Standard & Poor’s | Osman Sattar<br>Director – Accounting Specialist, EMEA Financial Institutions |
| UBS | Steffen Henrich<br>Managing Director, Head Group Accounting |

### EDTF Secretariat

| | |
|---|---|
| Deutsche Bank | Katrin Boy<br>Finance Director Group Reporting |
| HSBC | Sondra Tarshis<br>Head of Accounting Developments, Global Accounting Policy |
| PIMCO | Del Anderson<br>Senior Vice President, Credit Research Analyst |

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