PILLAR 4

Recommendations on a comprehensive set of IFRS 9 Expected Credit Loss disclosures
(23 September 2022)

Overview

UK regulators jointly established and sponsored a UK taskforce (the 'Taskforce'), who worked in order to prepare the third report regarding disclosures about expected credit losses (ECL). This report focused on several key areas, that include the most significant changes observed in assessments, identification of examples of good practice and the gaps and changes work.

Assessments

For the recommendations selected for assessment, the preparer group assessed full adoption at 96%. By contrast, the user-group assessed 91% full adoption of the recommendations. The following recommendations were assessed to have less than full rates of adoption by the Taskforce:

- Quantitative disclosure of the weighting assigned to each scenario and an explanation of the period-on-period changes in scenario weightings. The "partially adopted" assessment was based on preparers that had not disclosed the prior period comparatives for the scenario weightings.
- Quantitative disclosure of the ECL that would result using only the central scenario assumptions, by material portfolio.
- Qualitative and quantitative disclosure explaining the movements of the population between stages in the reporting period by gross exposure.
- Quantitative disclosure of credit rating by class.
- Multi-factor sensitivity analysis.

Two over-arching themes, identified as important in helping understanding disclosures about ECL, emerged across assessments performed for the recommendations in scope.

First, taskforce members noted the importance of disclosures that are sufficiently granular and comparable across banks. Three main aspects of granularity that would aid comparability were raised: Breakdowns by portfolio/type of exposure, Breakdowns by geography and Breakdown of recommendations by drawn and undrawn exposures (off-balance sheet).

Secondly, taskforce members noted that judgemental adjustments to modelled ECL (including overlays and post-model adjustments) were often an important element of ECL and saw a need for additional disclosure about such adjustments and where they have been included within a bank's disclosures about ECL.

Granularity and comparability – asset groupings and geographical breakdowns

- Credit risk characteristics differ between asset groupings, and stresses tend to impact different asset groupings in different ways. Therefore, the presentation of ECL disclosures split in different ways can often provide more useful information for users, from which more precise analysis can be made. In addition, more effective analysis can be carried out across the sector when the same minimum asset breakdowns are presented consistently by banks.

- The taskforce recommends more comparable granular breakdowns within banks' disclosures, primarily in relevant accounting standards that do not override reporting requirements.

- In par with the above point, the taskforce has introduced the concept of "Disclosures about Expected Credit Losses Groupings" ("DECL Groupings") to specify a minimum framework of granularity that it recommends to be used by banks to enable better comparability. This includes separate presentation of the UK business:

    1. Drawn (on-balance sheet) amounts to be presented for loans and advances to customers and disaggregated into: retail – mortgages, retail – credit cards, retail – other, corporate loans.
    2. Undrawn (off-balance sheet) amounts (where material) to be presented for loans and advances to customers and disaggregated into: retail – mortgages, retail – credit cards, retail – other and corporate loans, or else reconciled to relevant totals (where not material).

- to Banks may also disaggregate additional other regions or territories by product groupings if they are material or believe it to be useful for the users of their disclosures.

- Banks are encouraged to use these DECL Groupings for Judgemental assessments, coverage and exposure by credit risk rating and sensitivity analysis.

Recommended disclosures

Alignment between accounting for credit losses and credit risk management activities

- Risk appetite and credit risk management: Qualitative disclosure explaining whether the risk appetite and risk management strategy have changed as a consequence of the change in timing of reporting credit losses, and if so how (for example, affecting pricing and product strategy).
- Link between risk appetite/credit risk management and ECL*:* Qualitative disclosure explaining the use of ECL information made by management and qualitative disclosure explaining how the ECL requirements have been incorporated into the credit risk management practices, if at all.

Policies and methodologies

- Definition(s) of default and credit-impaired: 1) Qualitative disclosure explaining whether there are any differences between the accounting definition of default, the definition used for internal credit risk management purposes and the regulatory definition of default where relevant and why and how the definitions differ. 2) Qualitative disclosure explaining to what extent the definition of default aligns to the definition of credit impaired, highlighting any material differences. 3) Qualitative disclosure explaining the policies adopted with respect to staging. 4) Qualitative disclosure explaining the quantitative, qualitative and backstop criteria that have been applied in assessing whether a financial asset is in stage 2, including any 'cure' and/or 'probation' criteria applied for transfers from stages 2 or 3 to stages 1 or 2.
- Low credit risk expedient and use of 30 days past due backstop*:* To the extent that the low credit risk expedient has been used to decide whether financial instruments are in stage 1, disclosure explaining where this has been applied and the quantitative and qualitative criteria used to define what 'low credit risk' is.
- Grouping for the purposes of collective assessments: Qualitative disclosure explaining the key shared risk characteristics used to group financial instruments together for assessment purposes.
- Measuring 12-month and lifetime ECL: Quantitative information regarding key parameters of the ECL calculation, presented in a tabular format.

- Judgemental adjustments: An explanation, for each material judgemental adjustment made to the modelled ECL, of the reason for the adjustment; how its amount is determined; the approach used for its estimation; and a description of where the judgemental adjustment has been included in the credit risk disclosures. The amount of each material judgemental adjustment should also be disclosed, together with the circumstances in which an adjustment would be utilised or released.

Forward-looking information

- Description of how scenarios are chosen and weighted and how ECL outcomes are linked to those scenarios: 1) Qualitative disclosure explaining how forecasts of future economic conditions are determined as inputs to the measurement of ECL. 2) Qualitative disclosure explaining how representative ECL outcomes are selected from a range of possible outcomes to ensure an unbiased estimate of ECL. 3) Where an approach based on discrete scenarios is used, tabular disclosure of the weightings assigned to each scenario together with an explanation of any changes in scenario weightings from the comparative period presented. For banks using a Monte Carlo approach, a disclosure explaining how the Monte Carlo approach has been used and period-on-period changes in its use.
- Key parameters used in the central scenario and alternative scenarios: 1) Qualitative and quantitative disclosure describing the key parameters of the central scenario. Quantitative information about alternative scenarios or adjustments for uncertainty including descriptions of the characteristics of the range of alternative scenarios or the scalar adjustments used to adjust the central scenario. 2) Qualitative information on significant changes in the central scenario compared to the previous period, with explanations of the reasons for those changes.
- Impact of using multiple scenarios: Quantitative disclosure of the ECL that would result using only the central scenario assumptions, by material portfolio.

Movement and coverage across stages

- Movements in amounts reported including changes in the balance sheet ECL estimate: A single table comprising the quantitative information required by IFRS 7.35H and IFRS 7.35I and containing reconciliations of opening to closing balances of:
  a) the loss allowance, and
  b) gross carrying value, including the effect of modifications.

  Qualitative disclosure explaining the movements of gross balances and loss allowance between stages in the reporting period.
- Coverage: Quantitative disclosure of ECL coverage in accordance with the DECL Groupings and guidance thereon, as set out in paragraph 48, as part of the credit risk exposure disclosures required by IFRS 7.35M.

Changes in the balance sheet ECL estimate

- Disclosure in the reconciliation of the movements between the opening and closing balance of the loss allowance of:
  a) the income statement charge for the period; and
  b) the movements in ECL that are not caused by movements in gross carrying amount, separately identifying amounts attributable to changes in risk parameters and risk models.

Credit risk Profile

- Credit risk exposure: 1) Quantitative disclosures analysing the period-end balance sheet position by credit risk rating grade for each stage as required by IFRS 7.35M in a tabular format that includes corresponding ECLs and gross carrying amounts. The disclosure should also include the range of Probability Defaults (PDs) corresponding to each of the internal credit risk rating grades.

Banks should provide an explanation of the PD used in the disclosure. Information should be provided in accordance with the DECL Groupings and guidance thereon.

2) Quantitative disclosures analysing the period-end balance sheet position should be linked to Basel PDs through disclosure of the range of Basel PDs for the different credit risk ratings by asset class.

3) To the extent that cure concepts are adopted in banks' staging criteria, quantitative disclosures of the portion of stage 3 financial instruments in a cure period before they can be moved back to stage 2.

4) To the extent that 'non-performing loans' (NPLs), or a similar concept, is used by the bank:

(a) an explanation of how this is calculated, and
(b) where the difference between the NPL or similar concept used and the stage 3 gross loan population is material, a reconciliation between the two accompanied by an explanation of the nature of the reconciling items.

5) Stage 2 balances analysed by the reason (or where there is more than one reason, one of those reasons) for inclusion, at the balance sheet date, in stage 2.

- Risk concentrations: Where there is a link between concentrations of credit risks and top and emerging risks, the disclosures required by IFRS 7.35B and the disclosures implementing EDTF recommendation 26 on concentrations of credit risks should be linked to top and emerging risks identified and discussed by management in response to EDTF recommendation 3.

- Credit enhancements: The quantitative disclosure of information on credit enhancements required by IFRS 7.35K should be sufficiently granular to give an understanding of different material credit risk concentrations, including differentiating LTV bands where relevant.

Measurement uncertainty, future economic conditions, and critical judgements and estimates

- Sources of estimation uncertainty: A quantitative multi-factor analysis of sensitivities to key assumptions in forecasts of future economic conditions should be presented, based on the same economic scenarios that are modelled for the purposes of estimating ECL.

  a) The disclosure should show information resulting from applying a 100% weighting for at least three scenarios, alongside weighted ECL.
  b) For exposures and ECL included in the sensitivity analysis, the disclosure should show for each of those scenarios the effect on ECL and the gross exposure separately for each of stage 1 and stage 2. ECL and gross exposure for stage 3 exposures should also be included if they are materially sensitive to changes in macro-economic assumptions.
  c) The disclosure should be given at an entity-wide level for total loans and advances to customers including both drawn and undrawn exposures with further disaggregation by the DECL Groupings appropriate where each grouping individually contributes a significant proportion of the overall sensitivity.
  d) The disclosure should explain the limitations of the multifactor sensitivity disclosure.
  e) A reconciliation should be presented reconciling i) the actual reported ECL provision amounts to ii) the total amount of weighted ECL that is sensitised in the above analysis.

- Single-factor sensitivity analysis: Any single-factor sensitivity disclosures provided should be accompanied by an explanation of their limitations.

Regulatory capital

- Use of the ECL-related transitional relief available under regulatory capital rules: Disclosure explaining whether the IFRS 9 transitional arrangements for regulatory capital have been applied and, if so:

    a) Qualitative disclosure summarising how the regulatory capital impact on Common Equity Tier 1 (CET1) and Tier 2 (T2) is calculated.
    b) Qualitative disclosure explaining the impact of the IFRS 9 transitional arrangements on risk weighted assets (RWAs) and regulatory capital ratios, where significant.
    c) Disclosure of key regulatory capital metrics including CET1, RWAs, leverage and capital ratios both with and without the IFRS 9 transitional arrangements, together with the amounts of each of the (i) static and (ii) dynamic transitional adjustments.
    d) Quantitative disclosure of the impact of the ECL transitional arrangements on regulatory capital, achieved by including, in the reconciliation of accounting capital to regulatory capital, a reconciliation between the resulting amounts under the transitional arrangements and the 'fully loaded' amounts without transitional arrangements.
    e) Where a bank has elected to apply the ECL transitional arrangements for regulatory capital, clear labelling of all regulatory capital amounts or ratios disclosed as either on a fully loaded basis or applying the transitional arrangements.

- Capital planning: To the extent that IFRS 9 ECL is a key driver of decisions in capital management and the strategic direction of the bank, qualitative disclosure explaining the broad implications of IFRS 9 ECL on capital management and strategy.

Governance and Oversight

- Risk management organisation, processes, and key functions
  Qualitative disclosure explaining:

    a) how the credit risk management organisation, processes and key functions have been organised to manage and report ECLs, bearing in mind the new concepts introduced by IFRS 9;
    b) how it has been ensured that an effective system of internal controls ensures a consistent determination of accounting allowances under IFRS 9;
    c) how and to what extent credit risk management strategy, practices and policies are aligned with the governance of ECL estimation;
    d) what level of oversight exists over the key judgements and assumptions applied in estimating ECLs, including for example, multiple economic scenarios, the definition of a significant increase of credit risk, probabilities of default, use of post-model adjustments or overlays, and estimates of the lives of revolving credit facilities;
    e) the governance framework over the development of models, their validation and approval, their subsequent maintenance, back-testing, recalibration, and any subsequent changes.

- Qualitative information describing how the performance of the ECL estimation process is assessed

- An explanation of the governance arrangements over the origination, measurement and release of each material post-model adjustment or overlay.

- As it becomes available, quantitative information on the reasonableness of estimates. This may include information on the back-testing of ECL or components of the calculations