POSITION PAPER

ESBG response to the IASB's Request for Information as a part of the Post-implementation Review ('PIR') of the impairment requirements in IFRS 9 Financial Instruments

ESBG (European Savings and Retail Banking Group)

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ESBG

QUESTIONS

IASB Question 1 - Impairment
Do the impairment requirements in IFRS 9 result in:
(a) more timely recognition of credit losses compared to IAS 39 and address the complexity caused by having multiple impairment models for financial instruments? Why or why not?

(b) an entity providing useful information to users of financial statements about the effect of credit risk on the amount, timing, and uncertainty of future cash flows? Why or why not?

Please provide information about the effects of the changes to the impairment requirements introduced by IFRS 9, including the ongoing costs and benefits of preparing, auditing, enforcing, or using information about financial instruments.

This question aims to help the IASB understand respondents' overall views and experiences relating to the IFRS 9 impairment requirements. Sections 2–9 seek more detailed information on specific requirements.

ESBG considers that the IFRS 9 expected credit loss impairment requirements result in a timely recognition of credit losses on financial instruments. The model has also proven to be resilient over the recent multiple crises period.

Principle-based requirements of the model enable our members to choose the appropriate application approach resulting in provision of a useful information to users about the effect of credit risk. This may come at a cost of certain loss of comparability of the information among banks. But we consider that relevance of the information from preparer perspective is superior to the issue of comparability.

IASB Question 2 - The general approach to recognising expected credit losses
(a) Are there fundamental questions (fatal flaws) about the general approach? If yes, what are those fundamental questions?

Please explain whether requiring entities to recognise at least 12-month expected credit losses throughout the life of the instrument and lifetime expected credit losses if there has been a significant increase in credit risk achieves the IASB's objective of entities providing useful information about changes in credit risk and resulting economic losses. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the general approach.

(b) Are the costs of applying the general approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?

If, in your view, the ongoing costs of applying the general approach to particular financial instruments are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those instruments.

(a) At this stage we are not aware of any fatal flaws regarding the general approach of IFRS 9 to recognise expected credit losses.

(b) We do not consider that the ongoing costs of applying the general approach are significantly greater than expected (being the initial expectation at the time of adoption of IFRS 9 much higher costs compared to IAS 39). However, financial entities face a continuous risk of incurring significant ongoing costs based on enforceable decisions made by supervisors and other enforcers in the context of their reviews or interpretations of IFRS 9 (e.g. the need to measure expected credit losses of financial assets in Stage 1 individually evaluated for a significant increase in credit risk individually).

Collective calculation of expected credit losses of financial assets in Stage 1

Reference

IFRS 9 5.5.4
IFRS 9 B5.5.1-6

Issue

IFRS 9 does not provide general guidance on when expected credit losses should be measured on an individual or collective basis. This lack of clarity is giving rise to interpretations among supervisors and enforcers: for those financial assets in Stage 1 that are evaluated for a significant increase in credit risk on an individual basis, its expected credit losses cannot be measured on a collective basis.

Fact patterns

IFRS 9 does not require an entity to measure expected credit losses individually for each risk exposure. However, it states that if an entity does not have reasonable and supportable information that is available without undue cost or effort to measure lifetime ECLs on an individual basis, then it recognises lifetime expected credit losses on a collective basis.

In supervisors' view, the fact that entities collect updated credit risk information that is routinely obtained and monitored to assess for a significant increase in credit risk preclude the entity to estimate expected credit losses on a collective basis.

We note that by collective measurement we mean using parameters which are derived from portfolio observations such as PD and LGD. From a practical point of view, financial assets in Stage 1 represent the vast majority of financial institutions' exposures. A cost-benefit analysis of calculating the expected credit losses individually for financial assets in Stage 1 would be negative:

- Individually calculation would imply a significant effort and the use of great amounts of resources, not fulfilling the requirement contained in the Standard of "without undue cost or effort";

- There would not be material differences between both methods in terms figures due to the fact that the information to be considered in performing the collective calculation would have been equivalent to that used for individual estimates.

Proposed solution

To explicitly clarify in the Standard that the evaluation for a significant increase in credit risk on an individual basis does not preclude to calculate expected credit losses on a collective basis.

IASB Question 3 - Determining significant increases in credit risk

(a) Are there fundamental questions (fatal flaws) about the assessment of significant increases in credit risk? If yes, what are those fundamental questions?

Please explain whether the principle-based approach of assessing significant increases in credit risk achieves the IASB's objective of recognising lifetime expected credit losses on all financial instruments for which there has been a significant increase in credit risk since initial recognition.

If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the assessment of significant increases in credit risk.

(b) Can the assessment of significant increases in credit risk be applied consistently? Why or why not?

Please explain whether the requirements provide an adequate basis for entities to apply the assessment consistently to all financial instruments within the scope of impairment requirements in IFRS 9.

If diversity in application exists for particular financial instruments or fact patterns,

please explain, and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements.

If you have identified diversity in application of the assessment, please provide your suggestions for resolving that diversity.

In responding to (a) and (b), please include information about applying judgement in determining significant increases in credit risk (see Spotlight 3).

(a) ESBG does not consider that there are fatal flaws in the requirements for the assessment of increases in credit risk since initial recognition.

(b) However, we would like to point out two topics related to significant increase in credit risk since initial recognition (SICR) that preclude to apply the SICR assessment consistently:

- Ambiguity of the concept of SICR;
- Financial instruments that have low credit risk at the reporting date.

Ambiguity of the concept of SICR

Reference

IFRS 9 5.5.9 - 5.5.11

Issue

1) The concept of SICR is very ambiguous and highly reliant on expert judgement. This gives rise to lack of consistency in what entities deem to be SICR:

   - PDs relative assessment on credit deterioration is subjective as similar entities on the same set of facts and circumstances and in the same context set different thresholds.

   - Quantitative and qualitative triggers to deem the existence of SCIR are subjective as similar entities on the same set of facts and circumstances and in the same context set different indicators.

2) Presentation is not relevant from the optic of a user because the border between stages 1 and 2 is unclear. The impairment classification and the allowance booked depends on the moment when the instrument was originated/acquired, giving rise to counterintuitive effects, such as exposures both in stage 1 and stage 2 with the same counterparty.

Fact patterns

1) The principle-based approach of assessing SICR is very much welcome as it allows flexibility and adaptation to accommodate the assessment to the different levels of sophistication of entities, the availability of data and the different practices entities manage their risks. However, as highlighted above, this excessive absence of guidance leads to lack of consistency in what entities deem to be SICR.

   Credit analysis is multifactor and holistic. This assessment entails a high degree of judgement. In practice there is a high dispersion of the variables used by entities to determine whether a SICR has taken place, their weights, whether a specific factor is relevant, the type of product, characteristics of the financial instrument, the customer, geographical region, the availability of such data, etc.

2) Financial institutions manage credit risk on a counterparty level instead of an individual instrument level. If a financial instrument from a counterparty experiences a SICR, the existing and future exposures to the same counterparty will be affected by this deterioration of the credit quality at instrument level. Assessing significant increases in credit risk on an instrument level leads to counterintuitive outcomes.

Proposed solution

1) To provide further clarification about "bright lines" and the information that needs to be considered in the mechanistic approach to determine the probability of default when assessing SICR.

2) To assess credit risk on a basis that considers a borrower's creditworthiness more holistically. This could be achieved by incorporating credit risk criteria at the borrower's level when applying the impairment model. This approach would enable to have a global assessment of the borrower's positions, the pricing of each individual operation and the pricing of the borrower itself and the cash flows that the entity will end up receiving.

Financial instruments that have low credit risk at the reporting date

Reference

IFRS 9 5.5.10

Issue

The use of the exemption that allows to assume that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk is challenging and increase operational complexity.

Despite this simplification was introduced to reduce the operational costs and to make the model more cost-effective, paradoxically in practice has led to the opposite effect.

Fact patterns

In practice it is not possible to apply to retail exposures due to the inability to perform an individual assessment demonstrating that the borrower has the required resilience of a widely understood definition of low credit risk, even if the PD at the reporting date is deemed to be low.

In addition, it is very subjective and highly reliant on expert judgement, giving rise to lack of uniformity among institutions.

The approach can only be applied to extreme situations where PDs are very low, e.g. increases of PDs from 0.001% to 0.007%.

Proposed solution

We propose the IASB to provide more guidance on how to extend the application of this exemption in credit institutions compatible with the pronouncements of the BCBS (Basel Committee on Banking Supervision).

IASB Question 4 - Measuring expected credit losses

(a) Are there fundamental questions (fatal flaws) about requirements for measuring expected credit losses? If yes, what are those fundamental questions?

Please explain whether the requirements for measuring expected credit losses achieve the IASB's objective of providing users of financial statements with useful information about the amount, timing, and uncertainty of an entity's future cash flows. If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the measurement requirements.

(b) Can the measurement requirements be applied consistently? Why or why not?

Please explain whether the requirements provide an adequate basis for entities to measure expected credit losses consistently for all financial instruments within the scope of impairment requirements in IFRS 9.

If diversity in application exists for particular financial instruments or fact patterns, please explain, and provide supporting evidence about how pervasive that diversity is and explain what causes it. Please also explain how the diversity affects entities' financial statements and the usefulness of the resulting information to users of financial statements.

If you have identified diversity in application of the requirements, please provide your suggestions for resolving that diversity.

In responding to (a) and (b), please include information about forward-looking scenarios (see Spotlight 4.1), post-model adjustments or management overlays (see Spotlight 4.2) and off-balance-sheet exposures (see Spotlight 4.3), as relevant.

(a) ESBG does not consider that there are fatal flaws in the requirements for measuring expected credit losses.
(b) However, we would like to point out three topics related to forward-looking scenarios, post-model adjustments or management overlays and off-balance sheet exposures that preclude to measure expected credit losses consistently.

Forward-looking scenarios

The principle-based approach of considering multiple scenarios and possible outcomes for measuring expected credit losses is very much welcome as it allows flexibility and adaptation to accommodate to the different levels of sophistication of entities, the availability of data and the different macroeconomic variables that affect the geographic regions in which the entities operate. However, the excessive absence of guidance leads to situations in which similar entities on the same set of facts and circumstances and operating in the same regions come up with different macroeconomic scenarios.

The use of forward-looking information is multifactor and entails a high degree of judgement. Despite macroeconomic projections provided by the central banks are used, there are still a plethora of variables that are subject to the election of the entity. The following factors can be highlighted:

- macroeconomic variables;
- number of macroeconomic scenarios;
- time horizon of the macroeconomic scenarios;
- weights of the macroeconomic scenarios;
- granularity of the macroeconomic scenarios per region.

Evidence

The lack of consistency in application can be observed in the review of a sample of credit institutions' financial statements operating in the same geographic region, similar size and business model.

The following graphs show the high dispersion of number and weighting of macroeconomic scenarios even for sophisticated banks that operate in the same countries.

Source: EY, IFRS 9 year-end ECL benchmark webcast 5 April 2023

Proposed solution

To assist in the application of the use of forward-looking information and to fulfil the IASB's expectations, it could provide further application guidance, illustrative examples and be more prescriptive detailing "bright lines" about the type of information than an entity should consider.

Post-model adjustments or management overlays

IFRS 9 models struggle to reflect credit risk expectations for new risks in a fast-evolving environment. Expected credit loss provisioning models lack comparable historical references on emerging risks to estimate this calculation. Consequently, credit institutions need alternative approaches permitted by IFRS 9 to quantify these risks.

These alternatives in the shape of post-model adjustments and management overlays started to emerge in the light of the increased uncertainty caused by the global COVID-19 pandemic and the impact of public aid measures to mitigate its effects. Despite the effects of the pandemic are diminishing, other risks are being replaced with a shared feature with COVID-19: the lack of historical data. Five novel risks undermining the debtors' creditworthiness can be highlighted: inflation, supply of energy, supply chains, geopolitical and environmental risks.

Despite the level of flexibility included in IFRS 9 allowed that during the COVID-19 crisis this mechanism worked relatively well, there are still a number of unresolved implementation issues that need to be addressed to enable all credit institutions, including those with less level of sophistication, implement sound estimation mechanisms:

- Entities find feasible to increase the level of provisions given the rise of credit risk but struggle to estimate the corresponding transfer to stage 2 associated with the increased credit risk.

- The timing of derecognition of the overlay remains a great challenge:

  - How to offset the increase of the expected credit loss stemming from the model with the amount estimated through the post-model adjustment or the management overlay?

  - What happens if the overlay exceeds the loan loss provision estimated with the model? How much longer should be booked?

- The standard and its supporting materials are silent on the way the post-model adjustments and management overlays can be estimated to fulfil the IASB's expectations. The implementation guidance and illustrative examples could give orientations on the following approaches:

  - Identification of risks at PD, LGD or both levels.

  - Simulations, scenario analysis, sampling techniques to estimate collective allowances at sectorial level.

  - How banks can capture the effects of higher interest rates by increasing the probability of default.

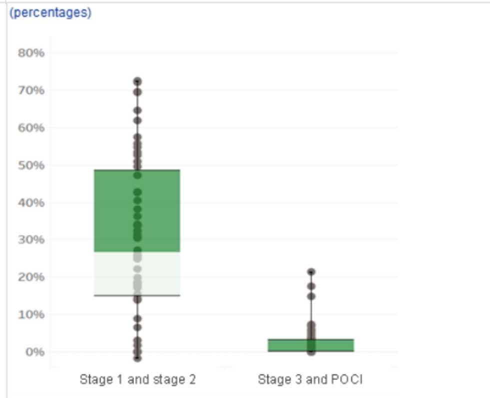
  - How banks can use historical data to simulate the stress of debt service capacity stemming from the increase in the cost of living.

  - How banks can include physical and transition risks associated with climate in the estimation of post-model adjustments or management overlays.

To sum up, the requirements do not provide adequate basis for entities to estimate post-model adjustments and management overlays and the corresponding transfers to stages 2 and 3 consistently because they are objective-based and lack of sufficient implementation guidance. The use of post-model adjustments and management overlays is highly reliant on expert judgement. Consequently, significant differences across banks are observed.

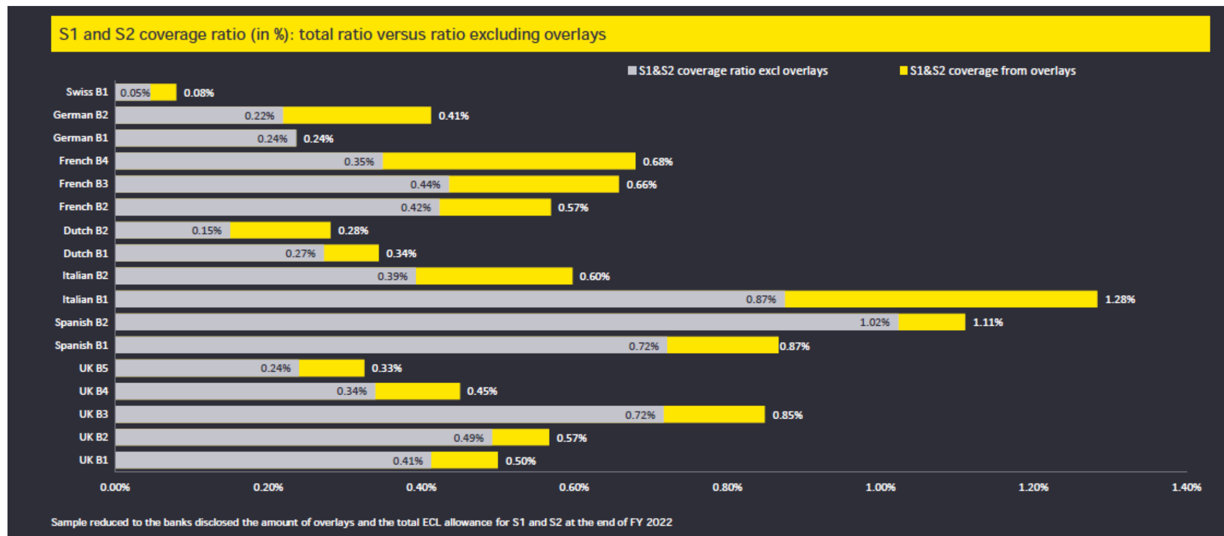
Evidence

According to the ECB, the use of overlays significantly differs across banks. The share of overlays in loan loss provisions for stage 1 and stage 2 exposures ranges from 0% to well above 70%, with a median value of 27%.



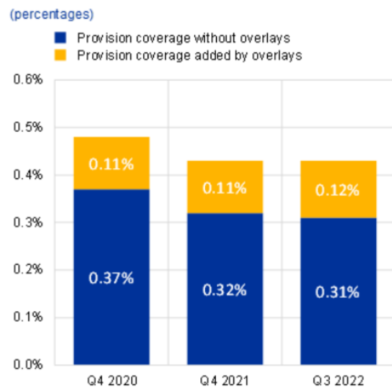
Source: ECB calculations based on data collected in the IFRS 9 questionnaire and supervisory reporting (FINREP). The panel shows the share of overlays in the stock of loan loss provisions. The boxes represent the interquartile range, showing the spread of the middle 50% of the data. The line inside the boxes represents the median. The whiskers extend from the boxes and indicate the range of the data. Reference date: 30 September 2022

The impact of overlays on coverage ratios continues to be significant for some credit institutions.



Source: EY, IFRS 9 year-end ECL benchmark webcast 5 April 2023

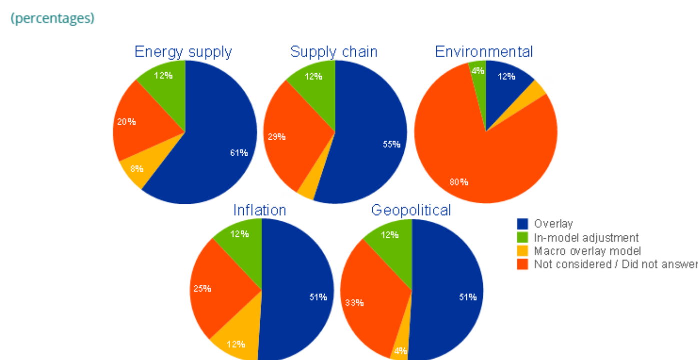
a) Coverage ratio of the sample for the performing loan book



Sources: ECB calculations based on data collected in the IFRS 9 questionnaire and supervisory reporting (FINREP).
Notes: Data shown are for FINREP template F18.00 row 0180 "Debt instruments at cost or at amortised cost". Panel a) shows the coverage ratio for stage 1 and stage 2 exposures at aggregated level for the 51 banks in the sample

A significant minority of banks are not able to capture novel risks even by using post-model adjustments and management overlays (red and yellow segments).

Proportion of respondents applying certain methods to capture different emerging risk factors



Sources: ECB calculations based on data collected in the IFRS 9 questionnaire.
Notes: Based on a sample of 51 banks. The pie charts show, for each risk factor considered in the questionnaire, the way in which banks say they capture that risk factor in their IFRS 9 provisioning framework.

Proposed solution

To assist in the inclusion of novel risks to post-model adjustments and management overlays calculations and to fulfil the IASB's expectations, it could provide further application guidance, illustrative examples and be more prescriptive detailing "bright lines" about the type of information than an entity should consider.

Off-balance-sheet exposures

(a) Loan commitments

Entities assess whether an instrument is in the scope of the exception in paragraph 5.5.20 based on the specific facts and circumstances, irrespective of whether the borrower is an individual or a corporate entity.

Generally speaking, the exception applies in those cases where credit risk of the facilities is managed by system-generated alerts on behavioural data, such as overdue status and utilisation of the facilities.

We consider it would be helpful to include the guidance provided by the 2017 educational video directly in IFRS 9. The existing Illustrative Example 10 in IFRS 9 does not provide much aid for implementation of the requirements from practical perspective. We also think that an additional clarity for derecognition of revolving credit facilities would be helpful since the derecognition moment sets the boundary for considering the behavioural life.

(b) Financial guarantee contracts and other credit enhancements

ESBG considers that the issues of financial guarantees and other credit enhancements and the distinction between integral of not-integral guarantees deserve further guidance in IFRS 9 since insufficient existing requirements may result in lack of comparability.

IASB Question 5 - Simplified approach for trade receivables, contract assets and lease receivables

(a) Are there fundamental questions (fatal flaws) about the simplified approach? If yes, what are those fundamental questions?

Does applying the simplified approach achieve the IASB's objective of reducing the costs and complexities of applying IFRS 9 impairment requirements to trade receivables, contract assets and lease receivables?

If not, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the simplified approach.

(b) Are the costs of applying the simplified approach and auditing and enforcing its application significantly greater than expected? Are the benefits to users significantly lower than expected?

If, in your view, the ongoing costs of applying the simplified approach are significantly greater than expected, or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment.

The application by credit institutions of the simplified approach for trade receivables, contract assets and lease receivables is very limited compared to the general approach applied to the loan portfolio. As a result, we are not in the appropriate position to assess its application.

However, it is worth pointing out that given the flexibility contained in IFRS 17 and IFRS 9 confirmed by the IFRS Interpretations Committee, we acknowledge that some members within ESBG apply a simplified approach of the impairment model contained in IFRS 9 to premiums receivable from an intermediary.

IASB Question 6 - Purchased or originated credit-impaired financial assets
Can the requirements in IFRS 9 for purchased or originated credit-impaired financial assets be applied consistently? Why or why not?

Please explain whether the requirements can be applied consistently to these types of financial assets and lead to accounting outcomes that faithfully reflect the underlying economic substance of these transactions.

If there are specific application questions about these requirements, please describe the fact pattern and:
(a) explain how the IFRS 9 requirements are applied;
(b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect);
(c) explain how pervasive the fact pattern is; and
(d) support your feedback with evidence.

We would like to highlight that over six years of IFRS 9 application the special model for purchased or originated credit-impaired (POCI) financial assets has proven not to be operational and may be the weakest part of IFRS 9 impairment requirements.

The specific approach contained in IFRS 9 to recognising and measuring expected credit losses and interest revenue for POCIs assets cannot be applied consistently to these types of financial assets and for many financial institutions do not lead to accounting outcomes that faithfully reflect the underlying economic substance of these transactions.

The root cause for this issue can be explained by the operational challenges financial institutions face in applying this specific accounting treatment that deviates from the general impairment model.

Fact patterns

Overall, we can distinguish two types of financial institutions that hold POCI financial assets in their balance sheets:

- Financial institutions with a business model of acquiring and managing distressed financial assets.

- Financial institutions where the occurrence of POCI financial assets is accidental to the business model. Two cases of POCI occurrence can be identified here.1) POCI financial assets are acquired in the context of a business combination. 2) Banks which derecognise substantially restructured non-performing loans and, as a result, the initially recognised loan after restructuring is POCI. In this respect we note that there is diversity in applying the derecognition requirements for restructured loans among banks.

In the former, the specific approach applicable to POCI financial assets provides a conceptually correct outcome and appropriately reflects the economics of the transaction and management's objective when acquiring or originating such assets. In addition, this type of banks has adequate IT systems that support the exceptional approach.

In the latter, the specific accounting treatment is hardly operable and does not faithfully reflect the underlying economic substance of these transactions and management's objective when acquiring such assets. In addition, it is worth pointing out that for most financial institutions business combinations are uncommon transactions that rarely take place. POCI financial assets require a parallel treatment different from the 3 stages general model that would rarely be used. For this reason, IT systems tend to struggle with these exposures and shortcuts and manual adjustments are commonly used to support the POCI financial assets treatment. The same is true for banks which derecognise restructured loans with substantially modified terms. Moreover, there is an issue that the fair value estimate for the initially recognised loans is largely based on unobservable inputs and so subjective that it can hardly be considered as a reliable measurement.

The benefits of this exceptional treatment outweigh the costs in terms of faithful representation of the management's objectives and IT systems expenditures.

Evidence

The above-mentioned reasons give rise to lack of consistency in practice by preparers. The following practices are observed by reviewing the financial statements of a sample of acquirers in the context of a business combination:

- POCI financial assets are classified separately from the 3 stages exposures.

- POCI financial assets are classified within the stage 3 category without distinction between both categories.

- POCI financial assets are not identified in the business combination.

Proposed solution

For those financial institutions that do not have a business model of acquiring and managing distressed financial assets to allow the application of a single impairment model for all financial assets:

- POCIs financial assets classified in stages with transfers between them permitted.
- Gross-up approach, whereby an allowance is recognised for initial expected credit losses and is used to gross-up the carrying amount of the POCI financial asset.
- For loans subject to restructuring which were and continue to be credit-impaired this would mean continuation in stage 3 accounting after the restructuring

IASB Question 7 - Application of the impairment requirements in IFRS 9 with other requirements

Is it clear how to apply the impairment requirements in IFRS 9 with other requirements in IFRS 9 or with the requirements in other IFRS Accounting Standards? If not, why not?

If there are specific questions about how to apply the impairment requirements alongside other requirements, please explain what causes the ambiguity and how that ambiguity affects entities' financial statements and the usefulness of the resulting information to users of financial statements. Please describe the fact pattern and:
(a) indicate the requirements in IFRS 9 or in other IFRS Accounting Standards to which your comments relate;
(b) explain the effects of applying the requirements (for example, the quantitative effect on an entity's financial statements or an operational effect);
(c) explain how pervasive the fact pattern is; and
(d) support your feedback with evidence.
In responding to this question, please include information about matters described in this section of the document.

We do not have any further issues that the IASB could consider in how to apply the impairment requirements alongside other requirements.

IASB Question 8 - Transition

Were the costs of applying the transition requirements and auditing and enforcing their application significantly greater than expected? Were the benefits to users significantly lower than expected?

Please explain whether the combination of the relief from restating comparative information and the requirement for transition disclosures achieved an appropriate balance between reducing costs for preparers of financial statements and providing useful information to users of financial statements.

Please explain any unexpected effects or challenges preparers of financial statements faced applying the impairment requirements retrospectively. How were those challenges overcome?

ESBG memebrs did not have any unexpected effect from applying transition requirements retrospectively worth mentioning. However, the introduction of IFRS 9 entailed a significant increase of the fees paid to the audit firm for the audit of the impairment model. This sharp growth was not only a one-off effect experienced during the first application of IFRS 9, but also on annual ongoing costs.

The rise of initial costs were expected due to the fact that audit firms had to gain or enhance an understanding of the methodologies and processes behind the expected credit losses estimation. This initial work required a deep understanding as well as corrections and changes during the first year. However, ongoing audit costs persist to be high compared to IAS 39, particularly in those situations in which adjustments to the impairment model take place.

IASB Question 9 - Credit risk disclosures

(a) Are there fundamental questions (fatal flaws) about the disclosure requirements in IFRS 7 for credit risk? If yes, what are those fundamental questions?

Please explain whether the combination of disclosure objectives and minimum disclosure requirements for credit risk achieves an appropriate balance between users of financial statements receiving:

(i) comparable information—that is, the same requirements apply to all entities so that users receive comparable information about the risks to which entities are exposed; and

(ii) relevant information—that is, the disclosures provided depend on the extent of an entity's use of financial instruments and the extent to which it assumes associated risks.

If an appropriate balance is not achieved, please explain what you think are the fundamental questions (fatal flaws) about the clarity and suitability of the core objectives or principles of the disclosure requirements.

(b) Are the costs of applying these disclosure requirements and auditing and enforcing their application significantly greater than expected? Are the benefits to users significantly lower than expected?

If, in your view, the ongoing costs of providing specific credit risk disclosures are significantly greater than expected or the benefits of the resulting information to users of financial statements are significantly lower than expected, please explain your cost–benefit assessment for those disclosures. Please provide your suggestions for resolving the matter you have identified.

If, in your view, the IASB should add specific disclosure requirements for credit risk, please describe those requirements and explain how they will provide useful information to users of financial statements.

Please also explain whether entities' credit risk disclosures are compatible with digital reporting, specifically whether users of financial statements can effectively extract, compare, and analyse credit risk information digitally.

We believe that the current disclosures do not provide the necessary information to adequately understand the entities' models or are not comparable across entities.

Disclosure usually entails a trade-off between relevant and comparable information. Both situations can be found in practice. Although credit institutions expected credit losses disclosures are strictly compliant with IFRS 7 requirements, disclosures (i) do not provide the necessary information to adequately understand the entities' models or (ii) are not comparable across entities.

(i) *Ineffective communication of the information provided*. As highlighted by the IASB in the *Disclosure Requirements in IFRS Standards – A Pilot Approach*, this issue might arise given the fact that entities focus their efforts on complying with the specific disclosure requirements in IFRS 7. It is easier for preparers to disclose each item of information like a checklist including boilerplate information than to justify why any item is not disclosed. Disclosures are treated as a compliance exercise and often do not spend time applying judgement to assess whether the information disclosed is communicated effectively. This happens because entities sometimes do not understand the reason for particular disclosure requirements and so do not have a basis on which to exercise judgement.

(ii) *Lack of comparability*. Users struggle to understand credit risk models. Significant diversity in practice with different level of detail about the assumptions taken, credit risk management policies,

methodologies and models applied. The structure of disclosures also varies significantly.

Proposed solution

In our opinion it is not only necessary to consider additional credit risk disclosures, but also to complement them with more disclosure objectives. An appropriate balance between disclosure objectives and minimum disclosure requirements for credit risk should be achieved. These measures can be complemented with additional guidance and illustrative examples.

(i) *Effective communication* through:

a. the development of specific disclosure objectives that provide entities with a basis for making better materiality judgements. By enabling entities to understand the user needs that disclosed information satisfies, they will be better equipped to assess which information is material; and

b. requiring entities to apply judgement to achieve compliance with disclosure requirements. Entities will be required to satisfy disclosure objectives and, therefore, be required to assess whether the user needs described in the specific disclosure objectives have been satisfied.

(ii) *Comparability of information between entities* for which similar information is material by developing entity-specific disclosure requirements, especially in the following fields where significant judgements are used:

a. Determining significant increases in credit risk

   i. and its interaction with modification and forbearance measures;

   ii. quantitative thresholds;

   iii. cure periods;

   iv. Assessment of exposures affected by economic support and relief measures.

b. Post-model adjustments or management overlays

   i. Rationale and methodology applied;

   ii. Significant changes in methodologies and assumptions.

c. Defining the format and level of granularity of the assumptions taken and methodologies applied that allow users to understand the entities' models;

d. Incorporating climate-related risks disclosures

   i. Significant judgements made by management;

   ii. main areas impacted by climate-related risks;

   iii. basis for inputs and assumptions;

   iv. how forward-looking has been incorporated;

   v. the key climate-related areas of estimation uncertainty impacting ECL, among others.

e. Adding particular illustrative examples.

IASB Question 10 - Other matters

(a) Are there any further matters that you think the IASB should examine as part of the post-implementation review of the impairment requirements in IFRS 9? If yes, what are those matters and why should they be examined?

Please explain why those matters should be considered in the context of this post-implementation review and the pervasiveness of any matter raised.

Please provide examples and supporting evidence.

(b) Do you have any feedback on the understandability and accessibility of the impairment requirements in IFRS 9 that the IASB could consider in developing its future IFRS Accounting Standards?

Climate-related risks

Issue

IFRS 9 does not set bright lines on how to incorporate climate and other ESG related factors in recognising and measuring expected credit losses.

Fact patterns

Climate-related matters may affect a lender's exposure to credit losses by influencing its ability to meet its debt obligations to the lender. Examples of these negative effects are wildfires, floods, regulatory changes, higher costs of doing business, increased product obsolescence, loss of market capitalisation,

etc. In addition, exposures secured by mortgages on immovable property may also be affected by the declining value of inaccessible or uninsurable assets.

The previous effects can affect (i) the lender's assessment of significant increase in credit risk since initial recognition, (ii) the expected cashflows to receive from a loan and the potential future economic scenarios, among others.

The following challenges must be tackled:

- *Macroeconomic scenarios*. Adjusting macroeconomic variables such as GDP and unemployment rates is challenging, as it is difficult to predict and relies on the severity, probability and timing of such events. These effects will likely be more evident in the medium or long term.

- *Model adjustments*. The results of the model need to be adjusted based on expert credit judgement.

- *Physical risk*. How to take into account physical risk in the valuation of the collateral that will most likely arise in the longer term.

- *Double counting*. These risks might be double counted through (i) pricing via credit spreads (ii) ECL model inputs – e.g. PDs, LGDs and other parameters.

Proposed solution

More guidance and illustrative examples should be provided on how to properly incorporate climate-related risk factors (or ESG factors in general) in the measurement of ECL, due to wide variety of practices to calculate ECLs.

About ESBG (European Savings and Retail Banking Group)

ESBG is an association that represents the locally focused European banking sector, helping savings and retail banks in 17 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 885 banks, which together employ 656,000 people driven to innovate at 48,900 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion billion in corporate loans, including SMEs, and serve 163 million Europeans seeking retail banking services. ESBG members commit to further unleash the promise of sustainable, responsible 21st century banking. Learn more at www.wsbi-esbg.org.

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