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Notes on the European Banking Authority's Final Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses

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Governance,
Risk,
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A KnowCo regulatory digest: relevant to all PRA-regulated firms

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The EBA is clearly uncomfortable with some aspects of IFRS 9 as they may be adopted by EU credit institutions (CIs)

These final EBA guidelines seek to deter EU CIs from too readily adopting what the EBA calls the ‘practical expedients’ available in IFRS9

The IFRS9 ‘practical expedients’ include:

- The rebuttable presumption that past due 30+ days indicates a significant increase in credit risk (triggering accounting for Lifetime, rather than 12-month, ECL)
- Automatically regarding investment-grade exposures as having inherent low credit risk and
- Using forward-looking information only when it is available without undue cost or effort

A slightly different approach…

“Credit institutions should not read these statements restrictively and should develop systems and processes that use all reasonable and supportable information that is relevant to the group of exposures or individual exposure, as needed to achieve a high-quality, robust and consistent implementation of the accounting requirements.

Nevertheless, additional cost and operational burden do not need to be introduced where they do not contribute to a high-quality implementation of IFRS 9”

EBA Guidelines para.131

The ‘rebuttable presumption’

IFRS 9	EBA Guidelines
5.5.11 Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. An entity can rebut this presumption if the entity has reasonable and supportable information…that demonstrates that the credit risk has not increased significantly since initial recognition	135. Although the use of the more-than-30-days-past-due rebuttable presumption as a backstop measure is not precluded in accordance with IFRS 9 alongside other, earlier indicators for assessing significant increase in credit risk, credit institutions should avoid using it as a primary indicator of transfer to lifetime ECL

Investment-grade exposures

IFRS 9	EBA Guidelines
5.5.10 An entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have a low credit risk at the reporting date	132. …use of this exemption should be limited. In particular, credit institutions should conduct timely assessment of significant increases in credit risk for all lending exposures
B5.5.23 An external rating of 'investment grade' is an example of a financial instrument that may be considered as having low credit risk	134. …all lending exposures that have an 'investment grade' rating from a credit rating agency cannot automatically be considered low credit risk. Credit institutions should rely primarily on their own credit risk assessments…

Forward-looking information

IFRS 9	EBA Guidelines
5.5.17 An entity shall measure expected credit losses of a financial instrument in a way that reflects…reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions	129. Credit institutions should make limited use of those practical expedients as they have the potential to introduce significant bias and because — given their business — the cost of obtaining the relevant information is not likely to involve ‘undue cost or effort’

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KnowCo consultants can support and advise on all aspects of IFRS9 adoption. Most of our consulting assignments permit the use of KnowCo resource as-and-when required, so they are extremely flexible and cost-effective.

KnowCo's IFRS 9 Technical Solution, 'IFRS9 Manager' addresses all aspects of IFRS9 adoption and implementation including classification, measurement both collectively and individually, and regulatory (FINREP) reporting.

IFRS9 Manager functionality is parameterised and highly configurable, so as to enable users to set their own standards for a high-quality IFRS 9 implementation.

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For further information or a demonstration of KnowCo's IFRS9 Manager solution, please contact

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