What the new Enhanced Disclosure Task Force report means for banks

Will your bank demonstrate best practice disclosure in its next annual report? Do you have the data you need to make the disclosures users would like to see in the next three years and beyond? Does your IFRS 9 project address expectations as set out in the 2015 Enhanced Disclosure Task Force (EDTF) report?

EDTF member Mark Rhys brings you up to speed with the latest developments.

Background

In the wake of the financial crisis the G20, through the Financial Stability Board, asked the International Accounting Standards Board to revise accounting requirements so that financial institutions' expected credit losses were captured as well as losses that had been incurred. The Financial Stability Board (FSB) also established the Enhanced Disclosure Task Force, a group comprising banks, analysts, investors and auditors. Its mission: to enhance the risk disclosures of the world's largest banks. The EDTF's 32 recommendations for banks were published in 2012.

Now, with IFRS 9 *Financial Instruments* issued and its application not far off (it is effective 2018, subject to endorsement for EU reporters), and an expected loss approach due from the US Financial Accounting Standards Board, the EDTF has supplemented its 2012 report to consider:

i) what additional information will be valuable in the run up to adoption of the new Expected Credit Loss (ECL) accounting approaches; and
ii) best practice disclosure following adoption of these approaches.

Banks should consider the EDTF guidance for their next annual reports; those with December year ends should act quickly to ensure appropriate implementation. In particular, banks' Chief Accountants need to consider their implementation projects in the light of the new recommendations to ensure that the appropriate data are available for their expected credit loss disclosures. The EDTF's report is aimed at both IFRS and US GAAP reporters; this summary is focussed on IFRS reporters.

2012 report remains fit for purpose

At the request of the FSB, the EDTF reconvened to consider whether the principles and recommendations in *Enhancing the Risk Disclosures of Banks*[1] will still be suitable when banks move to an expected loss approach and whether additional guidance is required ahead of implementation.

EDTF fundamental principles are that disclosures should

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

The consensus was that the original principles and 32 recommendations are still applicable. However the EDTF determined that there is a need for further guidance around disclosures to be made by major banks before, during and after transition to IFRS 9 – particularly given the importance of ECL to banks' financial performance and regulatory capital. Accordingly, the EDTF published in November 2015 a new report, *Impact of expected credit loss approaches on bank risk disclosures*. This includes temporary guidance relevant before or upon transition along with recommendations that will be relevant throughout the life of IFRS 9.

Impact of Expected Credit Loss approaches on bank risk disclosures

The EDTF's new report recommends disclosures that explain how the bank's IFRS 9 implementation project is being run; how IFRS 9 will be interpreted and applied and, as the implementation date draws nearer, quantification of the likely impact. These themes are organised with reference to the original EDTF recommendations to which they relate. The timing of the recommended disclosure milestones is summarised below:

Increasing granularity of disclosure

- Explain general concepts within an ECL approach
- Describe current impairment approaches and compare with new ECL approach
- Explain implementation strategy, including timeline, key milestones and key responsibilities and accountabilities

General concepts, differences from current approach & implementation strategy

- Once practical and reliable (at latest by 2017 annual report) provide a quantitative assessment of the potential impact of applying an ECL approach

Quantitative disclosures

2015* | **2016*** | **2017*** | **2018* and beyond**

Detailed principles, risk management organisation & capital planning impact

- Explain how key concepts will be implemented & describe the credit risk modelling techniques that will be used
- Explain governance, processes and controls expected to operate and how they will relate to existing credit risk and other relevant governance, processes and controls
- Explain how ECL requirements are expected to have an impact on capital planning

Full adoption of ECL standards

- Provide transition disclosures required by new accounting standards in the first interim financial information after initial adoption
- Consider all EDTF recommendations

*Suggested years of disclosure are based on implementation date of 2018 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).

1 Both the 2012 and 2015 reports are available from www.financialstabilityboard.org/publications/

General concepts, differences from current approach and implementation strategy

Implementing IFRS 9 successfully is a significant task for banks. Credit risk, finance and IT teams need to work together to capture and report the relevant data. This complexity, along with continued political interest in banks' reporting, means that information around implementation projects will be sought in 2015/2016 reports. Specifically, the EDTF recommends that banks consider describing the timeline for implementation and how the project is being governed. Information about the methodologies to be determined and the models to be built and tested, along with an outline of the business units and functions involved in the implementation efforts would also be valued by users of the financial statements. Early disclosures to aid understanding of the bank's interpretations of key IFRS 9 terms are recommended by the EDTF, including 'significant increase in credit risk', 'credit impaired' and 'default'.

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Detailed principles, risk management organisation and capital planning impact

The EDTF expects banks to provide more detail around the concepts and how these will be implemented in their 2016 and 2017 year end reports. Accordingly, where trigger points prompt movement between the different stages in the impairment model and the processes for returning 'cured' loans, are areas where disclosure is recommended. The impact on capital planning of IFRS 9 requirements should also be explained, as this is an area investors, analysts and regulators are keen to understand. Whilst currently there is uncertainty in relation to the capital treatment of IFRS 9, banks are encouraged to explain this rather than defer making disclosure about the linkages between IFRS 9 and capital.

Quantitative disclosures

Quantitative disclosures are expected no later than 2017. The EDTF report outlines a range of recommendations on this topic. Some of these are aimed at giving users an understanding of the dynamics of changes in credit losses and their sensitivity to significant assumptions, including those resulting from macro-economic expectations. Vintage analysis, referred to in the 2012 report, remains an area where banks could provide better information, particularly when there is a lending portfolio with heightened credit risk linked to the period in which it originated.

The EDTF also recommends disclosure to help users understand the differences between the IFRS 9 and regulatory capital expected loss modelling philosophies and methodologies, including point-in-time versus through-the-cycle calibrations. For example, for portfolios where Internal Ratings Based Basel (IRB) models are leveraged for the purposes of IFRS 9, the EDTF recommends that banks explain how the IFRS 9 point-in-time lifetime Probability of Default (PD) models link together with the Basel 12-month through-the-cycle PD.

Full adoption of ECL standards

Certain disclosures will be needed on transition but not thereafter; these include those required under the accounting standards. In addition, where restated comparatives are given, the EDTF recommends clear commentary that explains the basis on which they are prepared.

IFRS 9 implementation projects need to consider now how to capture information for the on-going disclosures sought by the EDTF under IFRS 9. In particular, a range of data will be needed to provide the reconciliation of opening to closing allowances for loan losses which the EDTF recommends, including:

- transfer to lifetime ECL, transfer to credit-impaired financial assets, and transfer back to 12-month ECL,
- financial assets that have been derecognised during the period (including write-offs),
- new financial assets originated or purchased,
- changes to models used for ECL calculation,
- changes in credit risk parameters (model inputs), and
- changes due to modifications that did not result in derecognition.

Banks should also be ready to disclose significant movements in gross balances that contribute to changes in the IFRS 9 allowance.

Our recommendations in light of new EDTF report

Revisit your credit risk disclosures for your next annual report as a matter of priority. Consider proposed credit risk disclosures throughout your IFRS 9 implementation and beyond and consider whether your current IFRS 9 implementation plan will deliver the data required to make these disclosures. But remember that materiality is relevant: the objective of the EDTF is to enhance disclosure, and information should only be provided where it gives useful insight into banks' risks.

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