23 July 2019

Roadmap for IFRS 9 deliverables

1. Introduction

1. As previously communicated, the EBA is scrutinising the effective implementation of International Financial Reporting Standard 9 (IFRS 9) in the European Union. In doing so, the EBA has already conducted several exercises on the standard's impact on EU institutions and has communicated preliminary observations on the first stages of implementation, while a deeper analysis is ongoing.[1]

2. This roadmap is intended to provide an overview of the deliverables that the EBA plans to work on in the coming months and years. It also aims to prioritise them and to provide a timeline for their delivery.

2. Content of the main deliverables

3. IFRS 9 is a complex standard and, regardless of the impact assessment exercises performed by the EBA before its implementation, the post-implementation review is equally important because the full effects of IFRS 9 can be assessed comprehensively only when the standard has been fully implemented by institutions.

4. The challenge for regulators and supervisors is to ensure a high-quality and consistent implementation of the standard, since the outcome of the expected credit loss (ECL) calculation will directly impact the amount of own funds and regulatory ratios, despite the fact that regulators and supervisors are not in a position to validate the modelling aspects of IFRS 9, in contrast to the current situation in prudential areas such as credit risk or market risk. With this in mind, the EBA will continue monitoring and promoting a consistent application of IFRS 9 as well as working on its interaction with prudential requirements.

5. The EBA work will be organised around qualitative and quantitative monitoring. While the EBA has already communicated the rationale underpinning the qualitative monitoring, the purpose of this roadmap is to clarify further the next steps with regard to the quantitative monitoring.

6. An important aspect of the quantitative monitoring is the use of selected indicators extracted from regulatory reporting; these will be used in the monitoring activities to be carried out on a

[1] https://eba.europa.eu/documents/10180/2087449/Report+on+IFRS+9+impact+and+implementation.pdf; https://eba.europa.eu/documents/10180/1720738/EBA+Report+on+results+from+the+2nd+EBA+IFRS9+IA.pdf; https://eba.europa.eu/documents/10180/1360107/EBA+Report+on+impact+assessment+of+IFRS9

continuous basis. In 20 March 2019, the EBA updated its list of key risk indicators and its methodological guidance on risk indicators, integrating additional indicators based on IFRS 9 information[2]. Another major aspect of the quantitative monitoring is the benchmarking of the modelling techniques used by EU institutions for IFRS 9 purposes. This aspect is explained in more detail below.

Quantitative monitoring and modelling aspects

7. The objective of this benchmarking exercise is to understand to what extent the use of different methodologies, models, inputs and scenarios could lead to material inconsistencies in ECL outcomes, affecting own funds and regulatory ratios. In particular, further investigation needs to be carried out on the use of macroeconomic scenarios and variables, the adjustments to be made to internal ratings-based (IRB) models when they are used as a starting point and the ways in which banks are managing data shortages. In addition, where simplified approaches are used for ECL modelling, including proxies and overlays decided on by banks, this merits further investigation. Finally, while IRB and standardised approach (SA) banks will be included in the scope of investigation, greater attention may be paid to SA banks at a later stage, owing to their generally more limited modelling experience.

8. The link with prudential requirements reinforces the need for scrutiny from regulators and supervisors to achieve a high-quality implementation of this new accounting standard. The concept of a benchmarking exercise for IFRS 9 modelling builds on the reasoning that regulators and supervisors can leverage on their expertise on prudential models and on benchmarking these models to at least tackle some of the accounting models' sources of variability and the consequences in terms of prudential ratios. In addition, the analysis conducted as part of the benchmarking exercise will feed the post-implementation review of the IFRS 9 standard[3].

9. This is a medium- to long-term objective due to the inherent complexity and the time needed to understand the different implementation practices being followed by the EU institutions across different portfolios.

The current supervisory benchmarking exercise on credit risk

10. Since 2015, the EBA has been conducting an annual supervisory benchmarking exercise for credit risk models in particular. The underlying framework is mandated by Article 78 of the Capital Requirements Directive and is directly integrated into the reporting framework. Article 78 requires competent authorities to conduct an annual assessment of the quality of internal approaches used for the calculation of own funds requirements. The same article requires the EBA to produce a public report to assist competent authorities in this assessment. The benchmarking portfolios and reporting instructions are communicated by the EBA through

[2] https://eba.europa.eu/-/eba-updates-methodological-guidance-on-risk-indicators-and-analysis-tools
[3] See in particular the European Parliament resolution of 6 October 2016 on IFRS 9: http://www.europarl.europa.eu/doceo/document/TA-8-2016-0381_EN.pdf

a set of implementing technical standards (ITS) updated every year[4]. The ITS specify the benchmarking portfolios, templates, definitions and IT solutions that should be used as part of the annual benchmarking exercise. The ITS on benchmarking target only banks using internal models (banks under the SA approach are not covered).

11. The ITS on benchmarking are a both a supervisory tool (helping competent authorities to assess the quality of the internal approaches used by banks in their jurisdictions) and a policy tool (through the EBA public reports, which provide input that can be used in developing policy).

12. The most challenging part of comparative studies of risk-weighted assets is distinguishing the influence of risk-based drivers from that of practice-based drivers. It is expected that exposures significantly different in their nature and their embedded level of risk will lead to different model outcomes. With regard to the IFRS 9 benchmarking exercise, the objective is to be able to assess, in relation to material inconsistencies in ECL outcomes from different banks' models, the extent to which the inconsistencies can be reasonably explained and the extent to which they should be further investigated. That being said, it is important to note that this exercise is focused on the quality of parameters and modelling choices and not on the risk appetite of banks' management bodies. In addition, the issue of the potential procyclical effects of IFRS 9 are outside the scope of this project.

13. It is to be noted that the process for a full benchmarking exercise is quite a lengthy one, taking generally 3 years, starting with the design of the template for data collection, taking in the integration of the exercise into the legal framework and ending with the publication of the horizontal report[5].

Combining the IFRS 9 benchmarking exercise and the current ITS on supervisory benchmarking

14. Given the commonalities between IRB models for credit risk and IFRS 9 models for IRB banks, there is a natural inclination to use the same benchmarking tools and therefore to build on the existing ITS on supervisory benchmarking in conducting the IFRS 9 benchmarking exercise.

15. The level of ambition of the exercise is a very important aspect. While the exercise will need to be of a minimum size to be representative and to make it possible to draw useful conclusions, it should not be too ambitious to begin with to avoid the risk that it will fail.

16. The exercise is composed of qualitative and quantitative aspects, as described below.

Qualitative aspects of the exercise

17. The first part of the exercise aims to collect qualitative information on the practices followed by institutions with regard to modelling (covering issues such as determining a significant

---

[4] https://eba.europa.eu/regulation-and-policy/supervisory-benchmarking-exercises/its-package-for-2019-benchmarking-exercise

[5] For instance, for the 2020 exercise, the first reflections on the design of the template started in early 2018, and the report on the data collected will be published at the end of 2020. The data collected will date from end 2019.

increase in credit risk, use of scenarios and forward-looking information, time horizon used, simplification or proxies or overlays used, etc.). This information will also serve to complement/inform the quantitative data collected.

18. The objective is in particular to understand better how IRB banks have adapted their IRB models and how smaller/SA banks are coping with IFRS 9 requirements given that their expertise in modelling may be limited. It is important to emphasise that, while SA institutions will be excluded from the quantitative phase of the benchmarking exercise at this stage (see below), they will be included in the qualitative phase.

19. This phase of the exercise relies on the responses to a detailed questionnaire provided to institutions.

Quantitative aspects of the exercise

20. As indicated above, the integration of the IFRS 9 parameters into the ITS on benchmarking is considered to be the steady-state solution for performing a benchmarking exercise on IFRS 9 modelling.

21. To proceed with due regard to proportionality aspects and the complexity of the exercise, it is envisaged that in the first stages only some parts of the ITS will be used. In particular, the EBA intends at first to collect data only at counterparty level (a ‘common sample’)[6] from a given list of counterparties defined by the EBA for low default portfolios (LDPs), defined as sovereign, institutions and large corporates in the benchmarking exercise[7]. Given that risk parameters on the same counterparties are collected (i.e. the risk is the same), the outcomes from the banks’ models should give a direct insight into the non-risk-based variability. The main limitation of this approach is the representativeness of the common sample in relation to the actual portfolio of each institution, which explains why the list of counterparties defined by the EBA for the benchmarking exercise can be no shorter.

22. The initial focus on LDPs is expected to allow an analysis of ECL without undue variability. It should create insights into the value of IFRS 9 parameters in particular for large corporates to which institutions have common exposures. Some additional IFRS 9 parameters will be collected for this purpose (e.g. probability of default (PD) under IFRS 9 by counterparty and by economic scenario/facility). In the first stage of the exercise, these new parameters will focus on PD; the integration of additional parameters (loss given default (LGD) and exposure at default (EAD)) will follow in due course.

23. The EBA is aware that this is only a starting point, since ultimately it should be more meaningful to focus on HDPs, in particular in relation to loans to small and medium-sized enterprises

[6] This means that only template C101 will be used. It collects data at counterparty level (12 000 counterparties were used for the 2019 exercise). Institutions are requested in the ITS to provide the individual risk parameters for those counterparties to which they have an exposure.

[7] As opposed to the high default portfolios (HDPs), defined as corporate other, SME retail, SME corporates and residential mortgages.

(SMEs). That said, collecting data on HDPs implies a change in the logic of the analysis: it would involve a comparison of the model outputs not for common counterparties but instead for commonly defined portfolios (e.g. 'SMEs in country X with no collateral'). This change is a substantial one, as those commonly defined portfolios do not necessarily have the same level of risk, and therefore the outputs of the internal models are less easily comparable than in the case of common counterparties. This change will also require more reflection and need more time for implementation due to its greater complexity.

24. All IRB banks will be automatically subject to the ITS in a mandatory manner, and will therefore fall within the scope of the quantitative analysis once the IFRS 9 modelling is included in the ITS.

25. The ITS look only at IRB banks; therefore, a different solution has to be found for SA banks. This will be investigated subsequently by the EBA. It should be noted that an exercise using common counterparties would in any case be of a less relevance for SA/smaller institutions.

Process before inclusion in the ITS

26. As indicated above, it will take time before the amended ITS can produce their full effects. In addition, it is necessary to have sufficient certainty about the IFRS 9 parameters before they can be reliably integrated into the ITS. For these reasons, the EBA is launching a temporary ad hoc quantitative data collection, accompanied by a qualitative questionnaire on modelling aspects as explained above. The sample of banks used for this first exercise is similar to that used for the previous EBA reports on IFRS 9 mentioned above (54 banks, including 39 'mainly IRB' banks and 15 'mainly SA' banks)[8].

27. This approach will allow for testing of the parameters to be collected before they are integrated into the ITS, creating an opportunity to reflect on the appropriate calibration of the data collection specified in the ITS for IFRS 9 purposes. It will also make it possible to get some preliminary benchmark results before the ITS can produce results (which will be in 2021 or possibly even 2022, depending on when the IFRS 9 parameters are integrated into the ITS). Until the IFRS 9 parameters are integrated into the ITS, the ad hoc data collection will be performed on a voluntary basis in the selected sample of institutions. It is expected that the institutions concerned will provide the information needed with due consideration for proportionality/materiality aspects where needed. For the EBA to be able to integrate the parameters into the next consultation paper for the ITS on benchmarking, as it ideally would, it will need to have sufficient certainty about the design of these parameters before the end of 2019.

28. Finally, the EBA will reflect further on how to provide feedback to the participating banks.

[8] The sample may not be exactly identical due to the presence of UK banks in the sample, which may not be included in the new exercise, while a couple of IRB or SA banks may be added.

Consultation with stakeholders

29. The EBA has organised some informal technical discussions with professional associations and selected banks as well as external auditors on the planned benchmarking exercise. The technical details of the data collection have also been shared and some bilateral meetings with selected banks from the sample (IRB and SA) have been organised. The EBA Banking Stakeholder Group has also been kept informed. The EBA will continue to engage closely with all stakeholders.

3. Tentative timeline for deliverables

30. Based on the above, the tentative timeline for EBA deliverables is set out in the table below. The areas of further work are organised following a staggered approach. Some of the proposed work will be implemented in the short to medium term, and other aspects will be implemented in the medium to longer term, depending on their complexity and the resources and time needed for their completion.

Quantitative monitoring	**Possible deliverable**	**Priority/expected timeline**
Phase 1		
Use of selected IFRS 9 indicators on the basis of regulatory reporting (FINREP/COREP) for all banks	Outcome of the indicator analysis to be integrated into the EBA follow-up reports on the general implementation and impact of IFRS 9 (see 'Qualitative monitoring' below) Publication of some selected indicators in the EBA Risk Dashboard at aggregated country level and on a quarterly basis	**Started and ongoing:** list of indicators already published, to be monitored over time
Testing of selected IFRS 9 parameters and ad hoc data collection for common counterparties for IRB banks, and qualitative questionnaire on modelling for IRB and SA banks (launch in July 2019, to end by November 2019)	Feedback to participating institutions (format to be determined)	H1 2020
Integration of selected IFRS 9 parameters (PDs) into the ITS on benchmarking for LDPs for IRB banks	Integration into the consultation paper (CP) on the general ITS on benchmarking	Ideally, CP published in December 2019 for final ITS in H1 2020

Follow-up work on the integration of additional IFRS 9 parameters (LGD and EAD) into the ITS on benchmarking for LDPs for IRB banks	Format to be confirmed	End 2020
Phase 2		
Integration of the SA/smaller institutions into the quantitative part of the benchmarking exercise	Format to be determined	**Not before 2021**
Phase 3		
Extension of the ITS on benchmarking to HDPs for IFRS 9 purposes	Integration into the CP on the general ITS on benchmarking	**Not before 2021**
Qualitative monitoring	**Possible deliverable**	**Priority/expected timeline**
Phase 1		
Monitoring of IFRS 9 implementation by EU institutions (pre-implementation preparation and expected impact, day-one impact)	Three reports published already	**Delivered**
Ongoing monitoring of IFRS 9 transitional provisions	Mainly Q&As	**Started and ongoing**.
Phase 2		
Monitoring of IFRS 9 implementation by EU institutions (medium-/long-term impact)	New reports to be published based on follow-up qualitative questionnaires (e.g. on governance, staging assessment, incorporation of forward-looking information, classification and measurement, etc.)	**Q3/Q4 2020**
Follow-up on the EBA Guidelines on expected credit losses and EBA Guidelines for communication between supervisors and auditors in the context of IFRS 9	To be determined	**Not before 2020**