Observations on IFRS 9 ECL impacts in Q1 2020 and challenges ahead
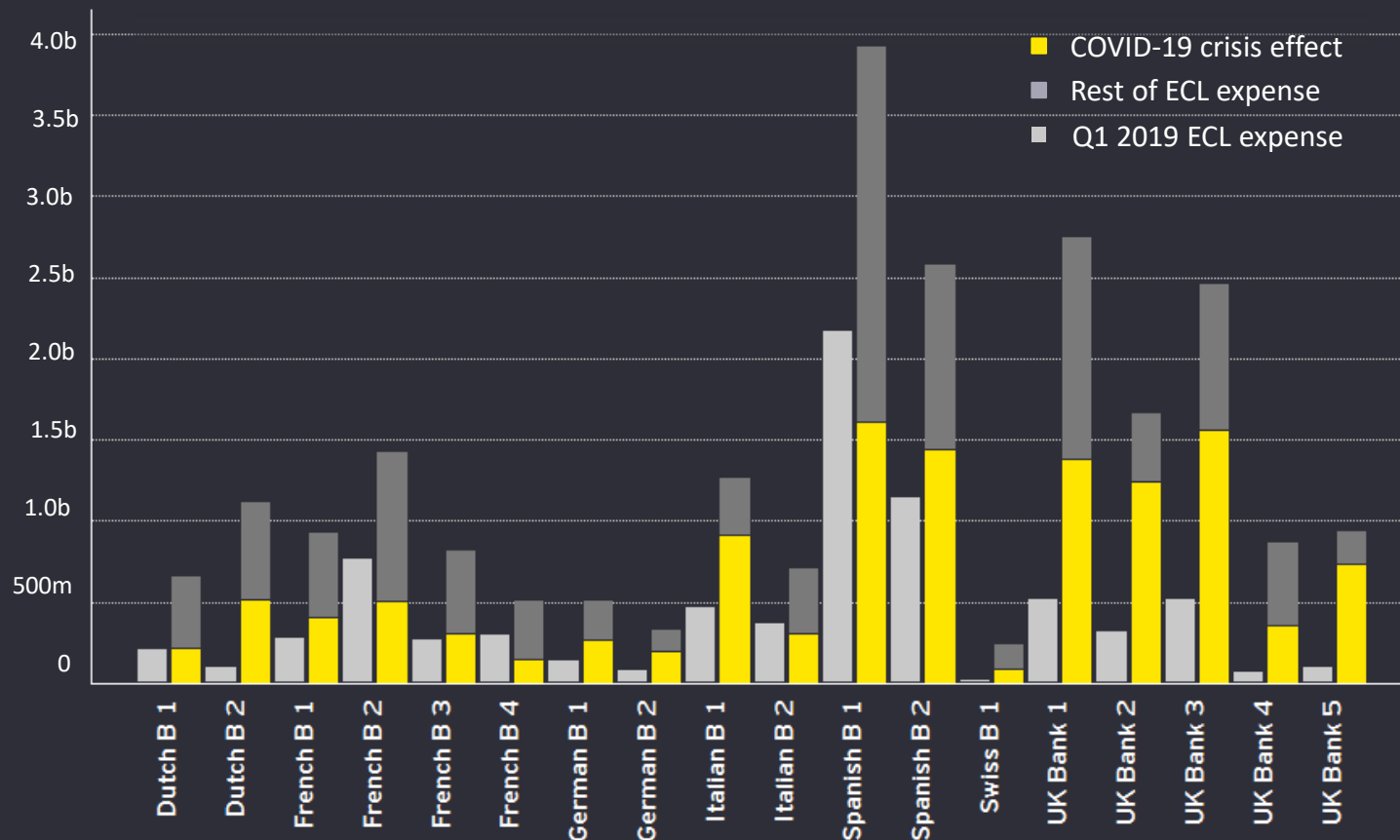
World Bank Workshop on IFRS for Regulators

June 30, 2020

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Building a better working world
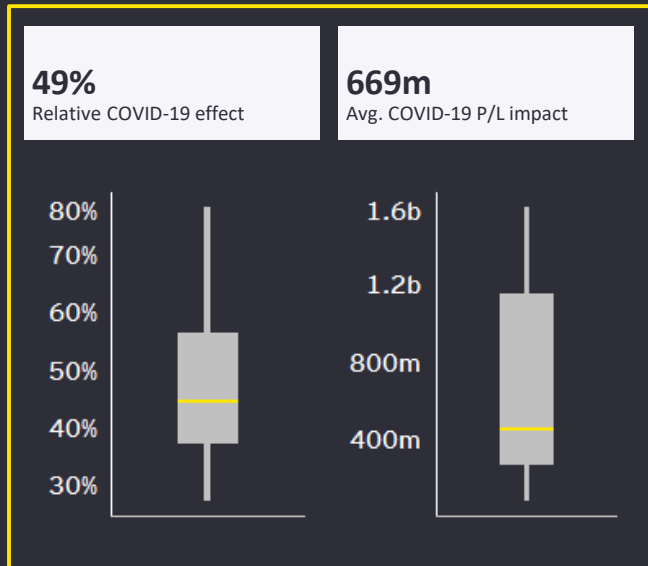
Q1 2020 ECL expense multiplied by 5 on average

► The COVID-19 crisis effect represents half of the Q1 ECL expense, with an average of €700m

► When identified, stage 3 losses represent between 50% and 80% of the total expense impact on average
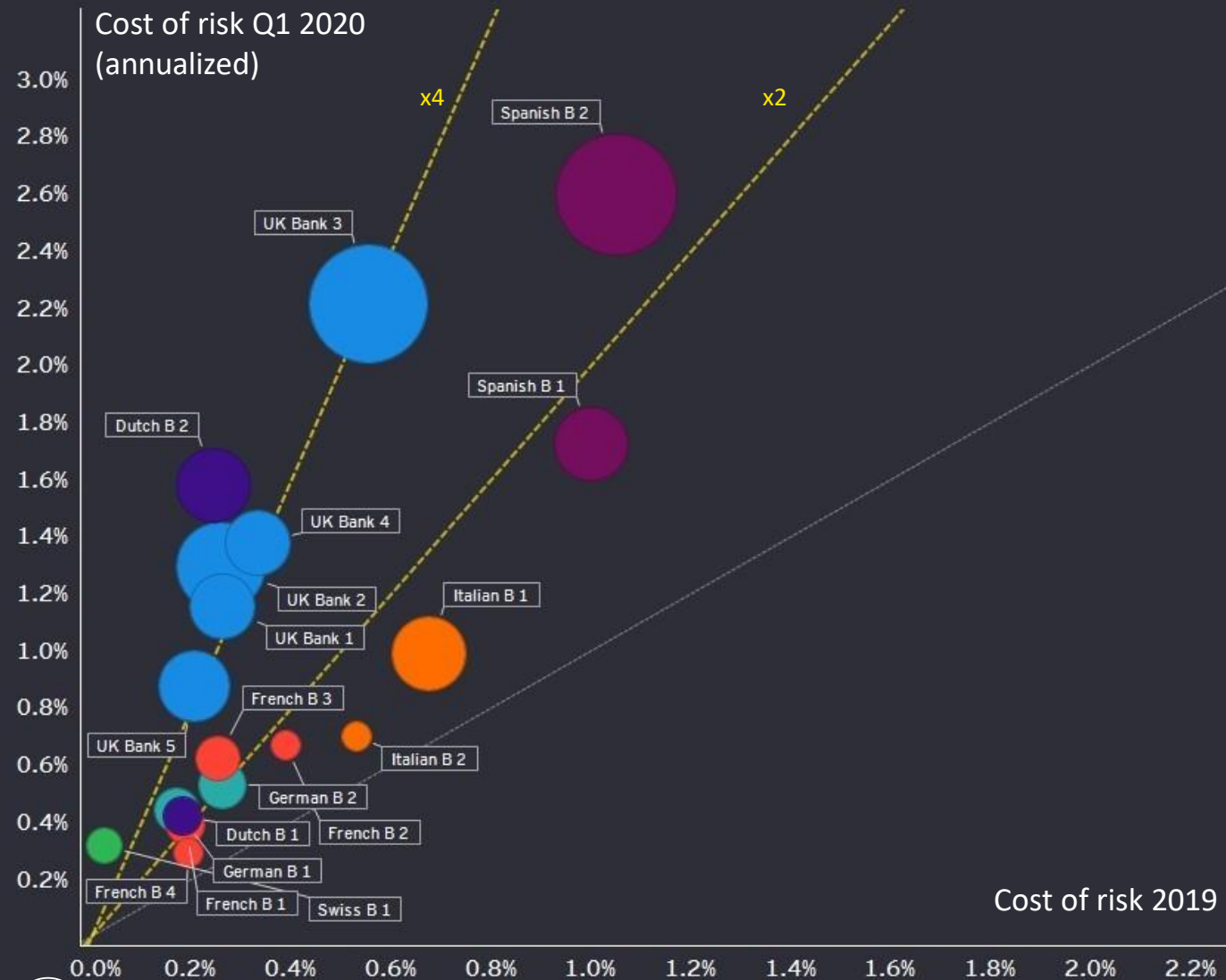

Q1 20 ECL expense (€b)

Legend:
- COVID-19 crisis effect
- Rest of ECL expense
- Q1 2019 ECL expense

Categories: Dutch B 1, Dutch B 2, French B 1, French B 2, French B 3, French B 4, German B 1, German B 2, Italian B 1, Italian B 2, Spanish B 1, Spanish B 2, Swiss B 1, UK Bank 1, UK Bank 2, UK Bank 3, UK Bank 4, UK Bank 5

1.3b
Average quarterly ECL expense

5
Multiplier compared to Q1 2019

49%
Relative COVID-19 effect

669m
Avg. COVID-19 P/L impact

IFRS observations on Q1 impacts and attention points for half year reports

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Cost of risk Q1 2020 (annualized)

x4   x2

Spanish B 2
UK Bank 3
Spanish B 1
Dutch B 2
UK Bank 4
UK Bank 2
Italian B 1
UK Bank 1
French B 3
UK Bank 5
Italian B 2
German B 2
Dutch B 1   French B 2
German B 1
French B 4   French B 1   Swiss B 1

Cost of risk 2019

Average CoR in 2019: 38bp

Average annualized CoR in Q1 20: 100bp

Significant dispersion from 30 bp to 260 bp

► Various drivers :
  ► Country trends
  ► Products
  ► Geographical footprint
  ► Macroeconomic outlook, scenarios and weights
  ► Government support measures
  ► Modeled versus non-modeled impacts
  ► Management judgment and overlays
► Significant impact of single-name defaults

Methodology:

Q1 20 cost of risk = Q1 ECL expense x 4/ gross loans 31 Mar 2020 (*)

2019 cost of risk = 2019 ECL expense/ gross loans 31 Dec 2019 (*)

(*) with some slight differences in methodology depending on data available

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Q2 perspective - Considerations in assessing macroeconomic scenarios and assumptions moving forward

▶ Macroeconomic forecasts remain very uncertain and represent a key area of judgement for Q2 reporting

▶ In June the ECB released new macroeconomic projections for the Eurozone which assume a 'swoosh' shape recession

▶ The impact of the shock varies significantly across sectors with hospitality, tourism, arts, leisure and entertainment, non-food retail and automotive being most exposed

Key considerations underpinning macroeconomic estimates

▶ Incorporation of Q2 actual data into base case and scenarios / simulations

▶ Consideration of:

  ▶ Possible medical developments/risk of second wave

  ▶ Back to work guidelines

  ▶ Government support programmes

  ▶ Consumer and corporate responses

▶ Time profile — year end, return to trend, level of trend given potential structural shifts

▶ Scenario weights, confidence in base case

▶ Sector specific analysis and reconciliation to scenario envelope

▶ Comparison to regulator 'scenarios'

▶ Process used to develop final view

ECB alternative scenarios for GDP (June 4, 2020)

(index: Q4 2019 = 100 (left-hand chart); year-on-year rate (right-hand chart))

— June 2020 projections
— Mild scenario
— Severe scenario
— March 2020 projections

a) Alternative GDP scenarios

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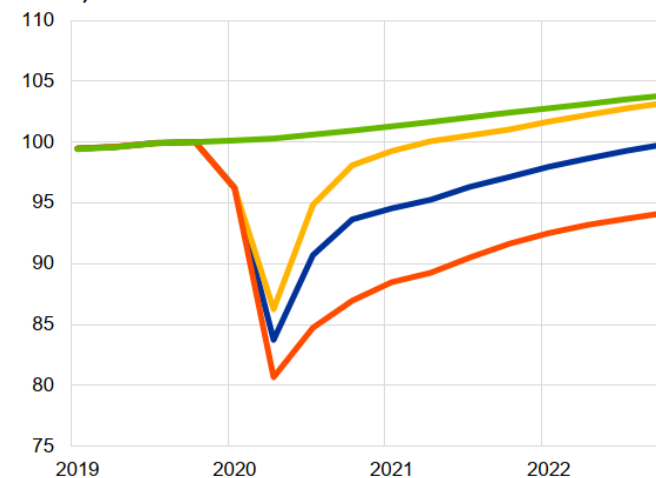
Q2 perspective - How to assess significant deterioration of risk?

Individual risk analysis

Because large-scale moratoria and guaranteed loans tend to "turn off" usual SICR backstops (forbearance, days past due), banks need to:

- ► Consider other indicators to determine whether the borrower's difficulties are temporary (eg forced leave) versus longer-term (eg he has been made redundant)

- ► Define appropriate monitoring for new guaranteed loans

- ► Assess implementation of governmental initiatives and to what extent they will limit the defaults

- ► Banks are likely to have less information for retail than wholesale customers and need to design a holistic approach :
  - ► Economic conditions
  - ► History of missed payments or adverse credit bureau scores
  - ► Current data (employment status, current account activity etc)
  - ► Use of portfolios approaches and application of expert judgment

- ► For wholesale exposures, ratings tend to react more quickly based on updated financial information. However, portfolio and sectorial approaches remain critical

Collective or sectorial approaches

- ► Pooling of loans should consider factors such as:
  - ► Products: mortgages vs. retail unsecured loans, etc.
  - ► Type of relief measures granted, initially and subsequently
  - ► Whether the borrower is asking for a renewal of a payment holiday or is a first request
  - ► Geography (e.g., country-wide support measures)
  - ► Industry (travel, hospitality, entertainment and services industries)
  - ► Behavioural information (historic and current)
  - ► Information collected when granting or renewing payment holidays

- ► Revised macroeconomic assumptions should be incorporated in the assessment

- ► Overlay approaches may be needed

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Q2 perspective - key areas of IFRS 9 ECL disclosures

Macroeconomic scenarios and assumptions:

- ▶ How the COVID-19 crisis has been incorporated in the macroeconomic scenarios
- ▶ How new scenarios compare to the previous ones
- ▶ Weights and underlying rationale
- ▶ Sensitivity analysis and outlook for the full year
- ▶ How government relief measures have been reflected
- ▶ Overlays (articulation with stage 2 transfers and risk parameters)
- ▶ If and how the usual IFRS 9 ECL estimate process and governance of the bank has been adjusted for the purpose of the half-year accounts

COVID-19 crisis loans and government relief measures:

- ▶ Main features of the schemes implemented by the bank: state-guaranteed loans, public / private moratoria (with or without waiver of interests)
- ▶ Accounting analysis of the schemes :
  - ▶ Initial fair value (FV) of the loans
  - ▶ Effective interest rate calculation
  - ▶ Effect of guarantees (integral or not)
  - ▶ Modification accounting
- ▶ Related exposures for the bank
- ▶ Specific risk monitoring approaches
- ▶ Expected effect of unwinding of public and private moratoria
  - ▶ Expected impact on arrears
  - ▶ Expected impact on stage 2 transfers

ECL movements and outlook

- ▶ Stage 3 losses (including single names)
- ▶ COVID-19 crisis scenarios
- ▶ Movements in "Days Past Due" and articulation with moratoria
- ▶ Vulnerable sectors : concentrations, portfolio approaches, overlays
- ▶ Stage 2 transfers:
  - ▶ How much and why ?
  - ▶ Triggers: delinquency? forbearance? Other?
  - ▶ Exceptions applied to usual indicators
- ▶ Portfolio approaches
  - ▶ Segmentation
  - ▶ Stage 2 transfers / adjusted risk parameters
- ▶ Overlays
  - ▶ Why, how and how much?
  - ▶ Product / business allocation
  - ▶ Movements

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