Consistency in disclosure of expected credit losses

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Global IFRS Institute

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"Providing more comparable and more granular information, and improving disclosure on adjustments management makes to modelled ECL outputs, will help banks produce ECL disclosures that are more useful to users. ECL disclosures were a key area of focus during the coronavirus pandemic and continue to attract significant attention in the current economic environment."

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Associate Partner in KPMG in the UK

Recommendations for large banks to enhance ECL disclosures to meet investors' needs

Highlights

- **DECL Taskforce's third report amends its existing recommendations**
- **Enhancing disclosure of 'judgemental adjustments' and improving granularity and comparability of certain ECL disclosures**
- **Recommendations aimed at large UK banks but expected to have global influence**

The UK Taskforce on Disclosures about Expected Credit Losses (DECL Taskforce) has issued its third report, which amends its recommendations for a complete set of high quality ECL disclosures.

DECL Taskforce's third report amends its existing recommendations

Building on its previous reports, this third report from the DECL Taskforce makes no new recommendations but:

- amends the existing recommendations in two key areas to improve the granularity and comparability of certain ECL disclosures;
- provides examples of what it considers to be good practice to help banks improve their disclosures; and
- notes a high level of adoption of the recommendations in its second report.

Enhancing disclosure of 'judgemental adjustments' and improving granularity and comparability of certain ECL disclosures

Judgemental adjustments

In practice, management commonly applies judgement to adjust modelled ECL outputs. For example, in the current high-inflation environment, management may adjust modelled ECL outputs to reflect current macroeconomic conditions, where these conditions are not reflected in the historical data that the ECL models have been developed from.

Banks may disclose these adjustments differently, often depending on whether they categorise the adjustment as an 'in-model', 'post-model' or 'overlay' adjustment. To tackle this, the DECL Taskforce introduces the broader concept of a judgemental adjustment. This is an adjustment to the ECL estimate that reflects management's judgement and is made outside of the bank's regular modelling process.

A new illustrative example shows how banks might present quantifiable and material judgemental adjustments – i.e. by reconciling ECL before judgemental adjustments to reported ECL.

New disclosure framework to enhance granularity and comparability

Credit risk characteristics typically differ between:

- product groupings – e.g. secured vs unsecured lending and retail vs wholesale lending; and
- geographies – which may exhibit differences in customer behaviour and macroeconomic conditions.

Providing more granular information that separately presents groups of exposures with different credit risk characteristics improves its usefulness.

Further, the comparability of this information is enhanced when different banks present their disclosures on a consistent basis. This allows users to understand more precisely the relative credit quality of different banks' lending books and the effectiveness of their credit management practices.

Therefore, the DECL Taskforce proposes a minimum framework of granularity that it recommends banks use on a consistent basis to enhance the usefulness and comparability of certain ECL disclosures.

Recommendations aimed at large UK banks but expected to have global influence

The recommendations enhance or add to the existing requirements set out in IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures*, and aim to reflect the disclosures that analysts and investors would like to see in banks' annual reports.

Although the recommendations are aimed at large UK banks, it is anticipated that they may become best practice for other banks in the UK and globally.

To find out more, read the **Recommendations on a comprehensive set of IFRS 9 ECL disclosures** or speak to your usual KPMG contact.

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