

## EBA REPORT

### FIRST OBSERVATIONS ON THE IMPACT AND IMPLEMENTATION OF IFRS 9 BY EU INSTITUTIONS

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**EBA**

EUROPEAN  
BANKING  
AUTHORITY

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# Abbreviations

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<b>AC</b>	amortised cost
<b>AFS</b>	available for sale
<b>BCBS</b>	Basel Committee on Banking Supervision
<b>bps</b>	basis points
<b>CET1</b>	common equity tier 1
<b>COREP</b>	common reporting framework
<b>CRR</b>	Capital Requirements Regulation
<b>EBA</b>	European Banking Authority
<b>ECL</b>	expected credit loss
<b>EEA</b>	European Economic Area
<b>EFRAG</b>	European Financial Reporting Advisory Group
<b>EU</b>	European Union
<b>FINREP</b>	financial reporting framework
<b>FVOCI</b>	fair value through other comprehensive income
<b>FVPL</b>	fair value through profit or loss
<b>G-SII</b>	global systemically important institution
<b>HTM</b>	held to maturity
<b>IA</b>	impact assessment
<b>IAS 39</b>	International Accounting Standard 39 – Financial Instruments: Recognition and Measurement
<b>IASB</b>	International Accounting Standards Board
<b>IFRS 9</b>	International Financial Reporting Standard 9 – Financial Instruments
<b>IRB</b>	internal ratings-based
<b>ITS</b>	Implementing Technical Standards
<b>L&amp;R</b>	loans and receivables
<b>NPE</b>	non-performing exposure
<b>O-SII</b>	other systemically important institution
<b>POCI</b>	purchased or originated credit-impaired
<b>Q&amp;As</b>	questions and answers
<b>RWA</b>	risk-weighted asset
<b>SA</b>	standardised approach
<b>SICR</b>	significant increase in credit risk
<b>SPPI</b>	solely payments of principal and interest

# Executive summary

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Following the first application date<sup>1</sup>/period of IFRS 9 in the European Union (EU), the EBA is scrutinising the effective implementation of the standard by EU institutions<sup>2</sup> and its impact as initially observed. In this context, the EBA has conducted a new exercise on the standard's impact on EU institutions. This report is meant to provide preliminary observations on the first stages of implementation while a deeper analysis is still ongoing.

This post-implementation impact assessment builds on the previous exercises conducted by the EBA before the first application of the new standard (the first and second impact assessments, published in November 2016<sup>3</sup> and July 2017<sup>4</sup> respectively). The analysis is now based on actual data reported by banks to competent authorities (COREP/FINREP templates) and supplemented by public disclosures where possible. In order to collect and analyse these data, the EBA has considered a series of indicators relating to initial impact, classification and measurement, impairment and solvency, which were used to determine the effects of the new standard on a representative sample of EU credit institutions. The sample used for this exercise is the same as the one used in the two previous EBA impact assessments (consisting of 54 institutions across 20 Member States).

While this report is based on actual data provided by banks, and not forecasts as before, given the complexity of the new standard and the challenges still being faced by banks (in particular during the first periods after implementation), it is expected that data accuracy will increase over time. This also means that future and continuous monitoring of the impact of IFRS 9 will be needed. As part of these monitoring activities, the EBA will also continue the dialogue with representatives of banks and other stakeholders (such as auditors) in order to collect as much information as possible, considering as well the different perspectives and concerns raised by these different stakeholders.

## Content of the report

This report is structured in the following manner:

- Part 1 (Introduction) includes background information on this exercise, incorporating the objectives and limitations of the analysis conducted.

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<sup>1</sup> 1 January 2018.

<sup>2</sup> Note that this report uses the terms 'institutions' and 'banks' interchangeably to refer to institutions in the EEA banking sector.

<sup>3</sup> <https://www.eba.europa.eu/documents/10180/1360107/EBA+Report+on+impact+assessment+of+IFRS9>

<sup>4</sup> <https://www.eba.europa.eu/documents/10180/1720738/EBA+Report+on+results+from+the+2nd+EBA+IFRS9+IA.pdf>

- Part 2 (Main observations) of the report provides more information on the main conclusions of this exercise, mainly from a quantitative point of view as this is the focus of the assessment performed. Qualitative information is also presented whenever relevant and available.
- Part 3 (Areas of further work – next steps) describes planned future EBA initiatives in the short and medium/long term.

## Main observations

**While the observations in this report are consistent with the forecasts of the second EBA impact assessment report, in particular in terms of increase in provisions and CET1 initial impact, the monitoring of IFRS 9 is just starting and the effective impact and implementation of the standard will need to be reviewed through time. In addition, while this report is mainly factual and does not include recommendations at this stage, it already identifies some areas for ongoing scrutiny and areas for further work from an EBA perspective.**

The report does not include any specific recommendation, as it is intended to be mainly factual and it is considered that this is still an early stage, and while continuous monitoring of the implementation of IFRS 9 is just starting. However, the EBA believes that this assessment is a good first step to pave the way for the organisation of the future monitoring activities. Note that most of the indicators developed for this report will be used on an ongoing basis. Taking into account that the ECL outcome is closely linked to the current and expected macroeconomic circumstances, further assessment will be needed through time.

Following the completion of this third EBA exercise on IFRS 9, the main observations are described below:

- The IFRS 9 day-one impact on CET1 ratios is broadly consistent with the impact forecasted by banks at the time of the second EBA impact assessment (second IA). The negative CET1 day-one impact reported by a sub-sample of banks for which the information was available for both exercises (38 banks) corresponds to 47 bps on simple average and 27 bps on weighted average<sup>5</sup>. For the same sub-sample of banks, in the second IA report this negative impact corresponds to 42 bps on simple average and 31 bps on weighted average.
- Banks using mainly an IRB approach experienced a smaller negative impact in terms of the CET1 fully loaded ratio (19 bps on simple average) than banks mainly using an SA approach for credit risk (157 bps<sup>6</sup> on simple average), on the transition date. The increase in provisions on day one is higher for mainly IRB banks (11.4%) than for mainly SA banks (7.4%). The difference in relative terms between the impact on provisions and the

<sup>5</sup> The weighted average impact is consistent with the one calculated for the sample considered in the stress test exercise. The report with the stress test results can be found at the following link: <https://www.eba.europa.eu/documents/10180/2419200/2018-EU-wide-stress-test-Results.pdf>

<sup>6</sup> As presented in the respective section of the report, when excluding from the sub-sample the 4 banks with the highest day-one impact, the simple average impact is broadly aligned with the one estimated at the time in the second IA.

corresponding impact in CET1 terms could be mainly attributed to the differences in terms of regulatory calculations, where, for IRB banks, regulatory expected losses are already reflected in CET1. However, further analysis is still needed in this field.

- The classification and measurement impact on transition to IFRS 9 seems to be considered relevant only for a minority of banks in the sample. On simple average, the balance sheet structure for the banks in the sample remains broadly the same, with the amortised cost category being the most used for the classification of financial assets (on simple average, 80% of financial assets are measured at amortised cost). This observation is also aligned with the previous one under the second IA.
- Regarding the solely payments of principal and interest (SPPI) test, it seems to have a limited impact in terms of mandatorily classifying financial instruments in the residual category (fair value through profit or loss (FVPL)). Note that, in the second quarter of 2018, 96% of the non-trading debt instruments are classified in the amortised cost or fair value through other comprehensive income (FVOCI) categories, which means that these instruments passed the SPPI test.
- The supervisory data for the second quarter of 2018 indicates that 85% of on-balance-sheet exposures are allocated to stage 1, 8% to stage 2 and 7% to stage 3. In overall terms, some alignment was observed between the definition of non-performing exposures and the accounting definition of default.

In addition to these observations, considered to be aligned with previous expectations, the EBA have also identified some areas which called attention and will deserve some close scrutiny in the coming months/years.

- In some cases the '90 days past due' criterion does not lead to transfer to stage 3, as it was observed that some of the exposures more than 90 days past due are not classified in stage 3. Regarding the consideration of the '30 days past due' criterion for transfers to stage 2, the observation is similar. A more in-depth analysis seems necessary to better understand the practices followed by banks in this field.
- Regarding the transfers between stages, considering the supervisory data for the second quarter of 2018, the most frequent transfers occurred from stage 3 to stage 1 or 2. A summary of all the transfers is presented in the corresponding section of this report. Continuous monitoring and additional scrutiny in this field is deemed necessary.
- Regarding the application of IFRS 9 transitional arrangements, when analysing the supervisory reporting data for the second quarter of 2018, the CET1 impact resulting from the add-back of provisions for all the banks in the sample corresponds to 118 bps on simple average (48 bps on weighted average). The EBA will continue the monitoring activities in

this field to understand how these numbers change over time in order to ensure that the regulatory provisions are applied in a consistent and effective manner<sup>7</sup>.

### **Areas of further work – next steps**

The third part of this report describes in detail the EBA's next steps regarding the IFRS 9 post-implementation initiatives. While the third exercise is mainly focused on quantitative aspects, the EBA is planning to monitor some qualitative dimensions as well.

Regarding the regulatory reporting, the EBA will continue to assess the relevance of the indicators used and to reflect on which of these indicators could be used for the monitoring activity on a continuous basis. Following some limitations identified in the information available in FINREP/COREP templates, the EBA will also consider whether any limited amendments could be necessary. The driver for any potential amendment would always be the inclusion of information deemed useful for a continuous monitoring of IFRS 9 effects from a supervisory perspective.

As included in the EBA's work programme for 2019, further work on IFRS 9 modelling aspects will be carried out in order to better understand the practices banks are following and to assess which aspects would merit further investigation (in particular, the application of simplified approaches). In this exercise, greater attention may be granted to SA banks, given the lack of experience in this field. As a medium/long term action, the EBA will consider the possibility of conducting a benchmarking exercise.

Regarding the interaction between accounting/expected credit loss models and regulatory provisions, the EBA will continue to closely monitor and follow up on the work currently ongoing at the level of the Basel Committee on Banking Supervision (BCBS). As a result of this work, it will be further explored whether any changes to the current regulatory framework might be necessary to ensure a proper interaction between the regulatory capital framework and the new expected credit loss models for accounting. As previously stated by the EBA, conclusions on the potential increased volatility in own funds created by the new accounting model when compared to the incurred loss model cannot be made at this stage. For this reason, the EBA sees this as a potential long-term task, when sufficient evidence is available.

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<sup>7</sup> Regulation (EU) 2017/2395 on IFRS 9 transitional arrangements.

# Introduction

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## Background

1. IFRS 9, which replaced the previous accounting standard for financial instruments (IAS 39), was published by the International Accounting Standards Board (IASB) in July 2014 and endorsed in the EU in November 2016. It is effective for periods beginning on or after 1 January 2018.
2. The EBA welcomed the move from an incurred loss model (under IAS 39) to an expected credit loss (ECL) model under IFRS 9 and the timely adoption of IFRS 9 in the EU, as mentioned in its advice to the European Financial Reporting Advisory Group (EFRAG) on the endorsement of this standard. IFRS 9 is, in overall terms, an improvement compared to IAS 39 in terms of accounting for financial instruments by banks. The changes in credit loss provisioning<sup>8</sup> should contribute to addressing the G20's concerns about the issue of 'too little, too late' in the recognition of credit losses, as well as improving the accounting recognition of loan loss provisions by incorporating a broader range of credit information.
3. This preliminary post-implementation impact assessment exercise builds on the results and analysis performed as part of the above-mentioned two impact assessments which were published in advance of the effective date for the new standard. Giving continuity to the monitoring of IFRS 9 implementation, this report is an own-initiative project from the EBA<sup>9</sup>.
4. The purpose of the previous impact assessments was to gain an understanding of the stage of preparation for the implementation of the standard, the estimated impact of IFRS 9 on regulatory own funds and the interaction between IFRS 9 and other prudential requirements. As IFRS 9 gives rise to many challenges for banks, the EBA is currently analysing further the impact as well as the main features of its implementation.

## Objective of the third exercise

5. This post-implementation impact assessment focuses on quantitative aspects (obtained mainly from banks' supervisory reporting templates – FINREP and COREP – and public disclosures) supplemented by some qualitative considerations of the main challenges encountered in the first period of mandatory application of the standard.
6. The purpose of the third EBA exercise is to gain a better understanding of the initial impact of the new standard following its first few months of application since the beginning of 2018, including financial assets classification and measurement, impairment and the impact on capital

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<sup>8</sup> Note that this report frequently uses the term 'provisions'. This should be read as 'expected credit losses/impairment allowances' under IFRS 9 and 'incurred credit losses/impairment allowances' under IAS 39.

<sup>9</sup> Also included in the EBA's work programme: <http://www.eba.europa.eu/about-us/work-programme/current-work-programme>.

requirements. The main objective of this publication is to provide more information to the relevant stakeholders on the initial impact of the new standard and on the interaction between IFRS 9 and prudential requirements.

7. This EBA report builds on the objectives of the previous reports but goes one step beyond by incorporating real data from banks to monitor and assess the effects of the implementation of IFRS 9, relying on several bespoke indicators.
8. Specifically, the EBA has worked with a particular set of indicators, for the purpose of this exercise, to closely monitor IFRS 9 implementation and its impact on both banks' financial statements and prudential figures. The list of indicators developed (and their link with the different parts of this report) are summarised in Annex III.

## Sample

9. To allow the comparison of data, the sample of institutions used for this third exercise is, as mentioned above, the same as the one used in the two previous EBA impact assessments (consisting of 54 institutions across 20 Member States<sup>10</sup>). The sample selected is considered representative of the banking sector in the EU and consists of a range of institutions in terms of size, business model and risk profile.
10. When data for certain banks in the sample was not available for the purposes of some of the analysis presented in this report, a clear reference was included with an indication of the number of banks considered. This is quite evident and particularly relevant when the analysis was making use of information collected via public disclosures where, because of the different level of detail provided in public statements on the impact of IFRS 9 implementation, information for some banks in the sample was not available.
11. In order to maintain consistency and ensure comparability with data collected and observations made before the first application date, the structure of the second EBA impact assessment report was largely preserved.
12. The sample includes institutions which have chosen to apply the IFRS 9 transitional arrangements in Article 473(a) of the CRR<sup>11</sup> as well as some institutions which are not applying those transitional arrangements. Where the information included in this report takes into consideration the effects that the transitional arrangements have on those banks applying them, this is clearly marked in the report (where this is not the case, the transitional arrangements effects are not considered). Note that, while 43% of the banks in the sample use the EU transitional arrangements for IFRS 9, a complete list of institutions applying these transitional arrangements by jurisdiction (for EU Member States) is also included in Annex II of this report.

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<sup>10</sup> The sample includes banks at the highest level of consolidation under the prudential scope of consolidation of the following countries: AT, BE, CY, DE, DK, ES, FI, FR, GB, EL, HU, IE, IT, MT, NL, NO, PL, PT, SE and SI.

<sup>11</sup> Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017.

13. In terms of the size of the banks in the sample, the total assets of the banks in the sample range from approximately EUR 12 billion to approximately EUR 2 200 billion. On simple average, banks included in the sample have total IFRS 9 financial assets of EUR 448 billion.
14. Most of the banks in the sample (94%) are identified as either global systemically important institutions (G-SIIs; 57%) or other systemically important institutions (O-SIIs; 37%). For the purpose of this analysis, and as per previous reports, it is assumed that banks with total financial assets below EUR 100 billion are smaller banks compared with the rest of the sample. These smaller banks are mainly O-SIIs (11 out of 14 smaller banks) and the remaining 3 are neither G-SIIs nor OSIIs.
15. Most of the banks in the sample use both the SA and the IRB approach for measuring risk-weighted assets (RWAs) for credit risk, except for eight banks that use only the SA.

Table A: Sample of banks

	Number of banks	%
<b>Smaller banks</b>	<b>14</b>	<b>26</b>
<i>Out of which using...</i>		
<i>mainly SA<sup>12</sup></i>	12	22
<i>...of which only SA</i>	8	15
<i>mainly IRB<sup>13</sup></i>	2	4
<b>Larger banks</b>	<b>40</b>	<b>74</b>
<i>Out of which using...</i>		
<i>mainly SA</i>	3	6
<i>mainly IRB</i>	37	68
<i>...of which almost entirely IRB<sup>14</sup></i>	19	35
<b>Total</b>	<b>54</b>	<b>100</b>

## Sources of information

16. The quantitative data used for the purpose of this assessment correspond mainly to the Q2 2018 supervisory data submitted by institutions (COREP and FINREP templates). As mentioned above, the quantitative data were analysed based on a set of indicators developed for the purposes of this exercise (presented in Annex III). These indicators were split into the four main areas covered by this report: initial IFRS 9 impact (3 indicators), classification and measurement (3

<sup>12</sup> For the purposes of the analysis in this report, banks with more than 50% of total credit RWAs under the SA are referred to as banks 'using mainly the SA'.

<sup>13</sup> For the purposes of the analysis in this report, banks with more than 50% of total credit RWA under the IRB approach are referred to as banks 'using mainly the IRB approach'.

<sup>14</sup> For the purposes of the analysis in this report, banks with more than 80% of total credit RWA under the IRB approach are referred to as banks 'using almost entirely the IRB approach'.

indicators), impairment (23 indicators) and impact on capital requirements (3 indicators). The indicators were built by combining different data points from COREP and FINREP templates to provide an overview of the effects of the new standard in the areas mentioned above. Please note that, while the reference date for most of the data is the end of Q2 2018, in some cases Q1 2018 data were also extracted for comparison purposes. Where this comparison was performed, it is clearly marked in the report.

17. Whenever possible, this main source of information was supplemented by data made available by banks in their public disclosures (annual or interim reports or other public disclosures). The information gathered from public sources was subject to the limitations inherent in this type of exercise (in particular the potential different format, detail and type of data disclosed by institutions). For those cases where information from annual or interim reports was not available (due to, for example, the reduced frequency of disclosures for certain institutions), the review of disclosures also covered other public disclosure information (such as IFRS 9 transition reports prepared by some of the banks included in the sample).

18. When considering the type of information captured from public reports, the EBA has given due consideration to the disclosure requirements in the EBA Guidelines on uniform disclosures with regard to the IFRS 9 transitional arrangements<sup>15</sup>, with which most competent authorities had given notification of their intention to comply.

## Structure of the exercise

19. As previously mentioned, the third EBA exercise on IFRS 9 implementation is mainly quantitative. For this purpose, the collection of quantitative data comprised two relevant steps:

- a. the development of a set of quantitative indicators and extraction of the relevant data points from FINREP and COREP;
- b. the collection of complementary available information using the review of the public disclosures made by the banks.

20. Following this data collection, and the quality assurance phase, the results obtained were assessed. The main conclusions of this analysis are presented in the 'main observations' section of this document. Wherever relevant (and possible) a comparison between the results of this exercise and the ones achieved with the second IA is presented in this report.

## Main assumptions and caveats

21. IFRS 9 implementation represents a significant change for banking entities not only in terms of modelling and the use of new processes to estimate loan loss provisioning but also in terms of internal controls and reporting. Significant judgement from banks is also required in areas such

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<sup>15</sup><https://www.eba.europa.eu/documents/10180/2084796/Final+Report+on+Guidelines+on+uniform+disclosure+of+IFRS9+transitional+arrangements+%28EBA-GL-2018-01%29.pdf>

as the use of forward-looking scenarios (e.g. the number of scenarios to use, the weighting of the different scenarios and the use of management overlays) and indicators to assess significant increase in credit risk (quantitative and qualitative), amongst others. Therefore, it is expected that the quality of the data reported by institutions following the first application of the new standard will increase in future reporting periods.

22. In addition, the indicators developed to perform the assessment presented in this report do not constitute an exhaustive list of reference points that could be used to analyse the impact of the standard.
23. Macroeconomic conditions and factors that are used as part of modelling by banks, and which are expected to change over time, influence the impact measurements. In this regard, monitoring the effects of the standard through time will be needed.
24. One particular challenge faced when using FINREP and COREP data to analyse the impact of IFRS 9 is the fact that supervisory reporting data does not capture the 'day one' (1 January 2018) impact in CET1, as it is based on quarterly reporting. In these cases, the analysis was supplemented with data obtained from banks' public disclosures (annual reports, IFRS 9 transition statements, etc.) in order to allow a better understanding of the 'day one' impact of the standard.
25. Where public disclosures were used as a source of information, the required information was not always available. The main reasons for this lack of availability related to (i) the bank not disclosing relevant information; (ii) information disclosed not being clear; and/or (iii) the lack of a maximum harmonised standardised format for public disclosures not allowing, in operational terms, a systematic and effective assessment of that information. Consequently, the sample size used for the analysis of public disclosure information was, in these cases, reduced to those banks for which the data were available. Every time this is the case, it is clearly mentioned in the respective paragraph/figure.
26. It is also important to highlight that supervisory data reported for 2018 periods (Q1 and Q2) and public disclosures, used as a basis to prepare this report, relate to financial information that was unaudited in most of the cases.

## Main observations

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27. This section includes the main observations from the assessment of the supervisory data submitted after the first application date of IFRS 9 and the analysis of the public disclosures made by the banks<sup>16</sup>. Similarly to previous exercises, the report includes specific information for smaller and larger<sup>17</sup> banks included in the sample. Where relevant, a distinction between institutions mainly applying SA on one hand and the IRB approach on the other for measuring credit risk is also considered.

28. It is important to note that most of the observations detailed in this section refer to 53 banks included in the sample of 54 banks (one of the banks was excluded several times due to the lack of quality in the reported data). The number of banks considered for each single analysis is usually mentioned in the relevant paragraph. If not mentioned, the conclusions presented were based on the total sample (54 banks).

### IFRS 9 initial impact

29. Since the day-one impact of IFRS 9 implementation is not available in the supervisory templates (FINREP/COREP), the data were collected from the public disclosures made by the banks<sup>18</sup>. For the reasons explained before in this report, these data could not be collected for all 54 banks in the sample, but for 43 banks only<sup>19</sup>. For these banks, the reported negative day-one impact on a fully loaded CET1 ratio<sup>20</sup> was, on simple average, 51 bps<sup>21</sup>. Out of these 43 banks, only 38 had provided the forecasted impact in CET1 at the time of the second EBA IA. For these 38 banks, the simple average negative day-one impact corresponds to 47 bps, compared with 42 bps<sup>22,23</sup> under the second IA. The second IA used pre-defined ranges for reporting impact forecasts for which the simple average was calculated, taking into account the middle point of the range. This may explain some of the differences observed.

<sup>16</sup> Note that, when performing the quantitative analysis in this section, the effect of transitional provisions (other than IFRS 9 transitional arrangements) under (EU) Regulation No 575/2013 (CRR) has not been taken into consideration.

<sup>17</sup> For the purpose of this report, it is considered that banks with total financial assets below EUR 100 billion are smaller banks compared with the rest of the sample. The reference date considered was 30 June 2018.

<sup>18</sup> Note that the reference date for the information collected from public disclosures made by banks and used for this analysis is the first date of the application of IFRS 9. For banks with a December year end (which is the case for the vast majority of the sample used), this date corresponds to 1 January 2018.

<sup>19</sup> Relevant information in the public disclosures was missing for 43% of the smaller banks included in the sample and for 13% of the larger banks included in the sample.

<sup>20</sup> Meaning that the effect of the IFRS 9 transitional arrangements was not considered.

<sup>21</sup> Weighted average: 25 bps. For the purposes of this report, the weighted average was calculated as a function of the total financial assets of banks included in the sample. This means that the impact calculated by each bank receives a weight, used in the calculation of the weighted average, corresponding to its size (in terms of total financial assets).

<sup>22</sup> Weighted average: 27 bps.

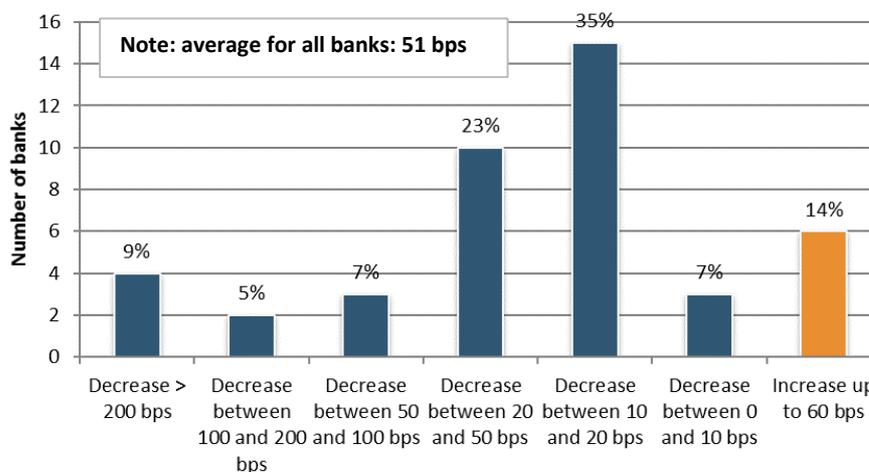
<sup>23</sup> 45 bps for the total number of banks that provided this forecast at the time of the second IA (49 banks).

30. As reflected in Figure 1, a second conclusion that can be drawn from this exercise is that there remains significant variability in the CET1 impact among the banks in the sample (with a relatively large contingent of observations at both ends of the distribution).

31. Banks using mainly an IRB approach experience a significantly smaller negative impact in terms of the CET1 fully loaded ratio (-19 bps on simple average<sup>24</sup>) than banks mainly using the SA for credit risk (-157 bps on simple average<sup>25</sup>). This conclusion is also consistent (although with a wider gap) with the second IA report, where IRB banks also forecasted a lower impact (-32 bps on simple average) than SA banks (-77 bps on simple average) on the first application of IFRS 9.

32. Regarding the banks mainly using the SA approach, if the four banks with the highest day-one impact are excluded from the analysis, the observed day-one impact on the CET1 fully loaded ratio would correspond, on simple average, to -48 bps (instead of -157 bps). This impact compares with -46 bps (instead of -77 bps) in the second IA when considering the same sub-sample of banks.

Figure 1: Impact on CET1 ratio without application of transitional arrangements (reference date: 1 January 2018)



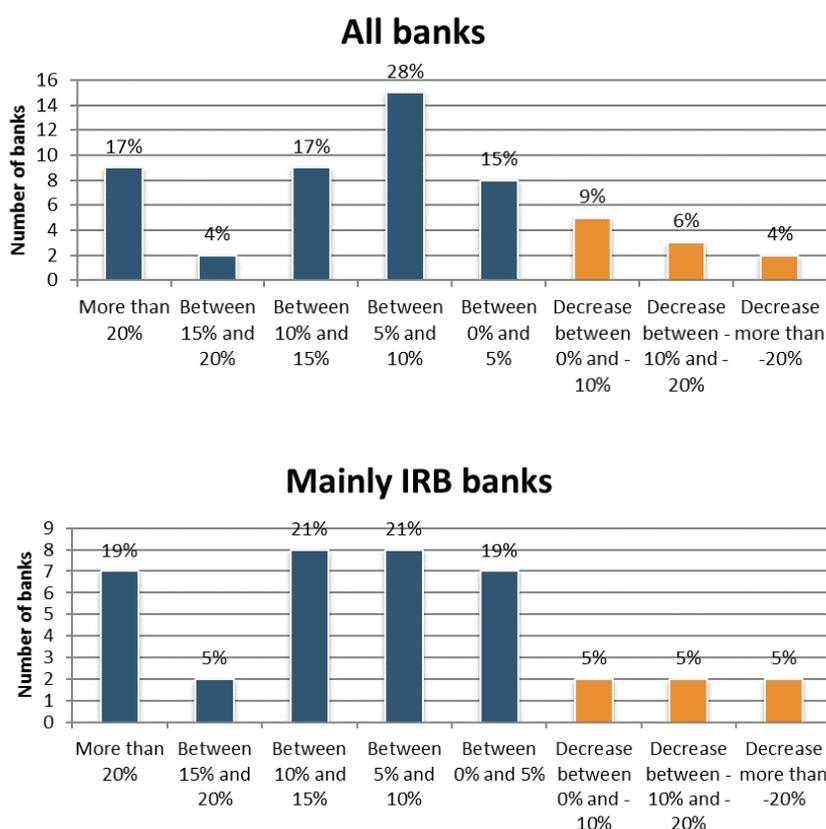
33. As shown in Figure 1, six banks experienced a positive impact on CET1. These banks belong to four different jurisdictions. For some of these banks, the positive impact on CET1 relates to a positive impact arising from classification and measurement or to a decrease in the level of impairment compared with IAS 39. However, the reason behind this disclosed positive impact is not always clearly explained. As such, this is an issue deserving further analysis.

<sup>24</sup> 21 bps on weighted average.

<sup>25</sup> 58 bps on weighted average.

34. The increase in provisions on the initial application of IFRS 9, considering the supervisory data reported by 53 banks in FINREP, amounts to 9% on simple average<sup>26</sup> (and up to 15% for the 75th percentile of banks<sup>27</sup>). The actual impact is lower than the amount estimated for the purpose of the second IA (13%<sup>28</sup> on simple average and up to 18% for the 75th percentile)<sup>29</sup>. It is important to highlight that results reported on the first application date do not indicate future trends (mainly because of changes in the expected economic conditions). For this reason, as highlighted in other parts of this report, continuous monitoring of IFRS 9 numbers is of the utmost importance.

Figure 2: Increase in provisions (simple average) – first-time application (reference date: 1 January 2018)

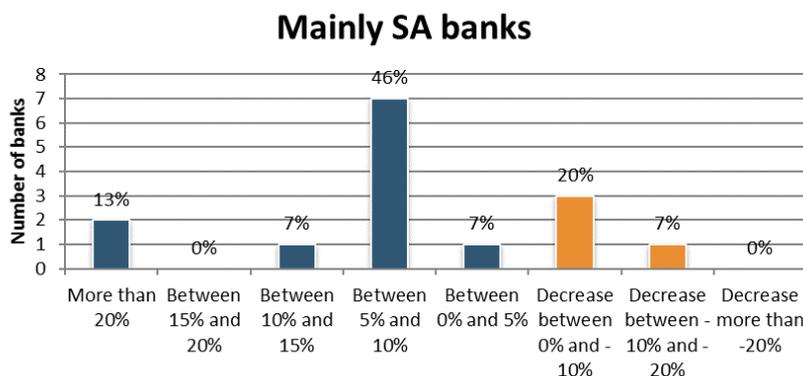


<sup>26</sup> 14% on weighted average.

<sup>27</sup> The value of the 75th percentile represents the value below which 75% of the data lies. For example, if the value of the 75th percentile is 90%, then 75% of respondents have reported a value up to 90% and 25% a value above 90%.

<sup>28</sup> 15% on weighted average. Second EBA Impact Assessment, page 44, Table 1.

<sup>29</sup> Second EBA Impact Assessment, page 40, paragraph 87.

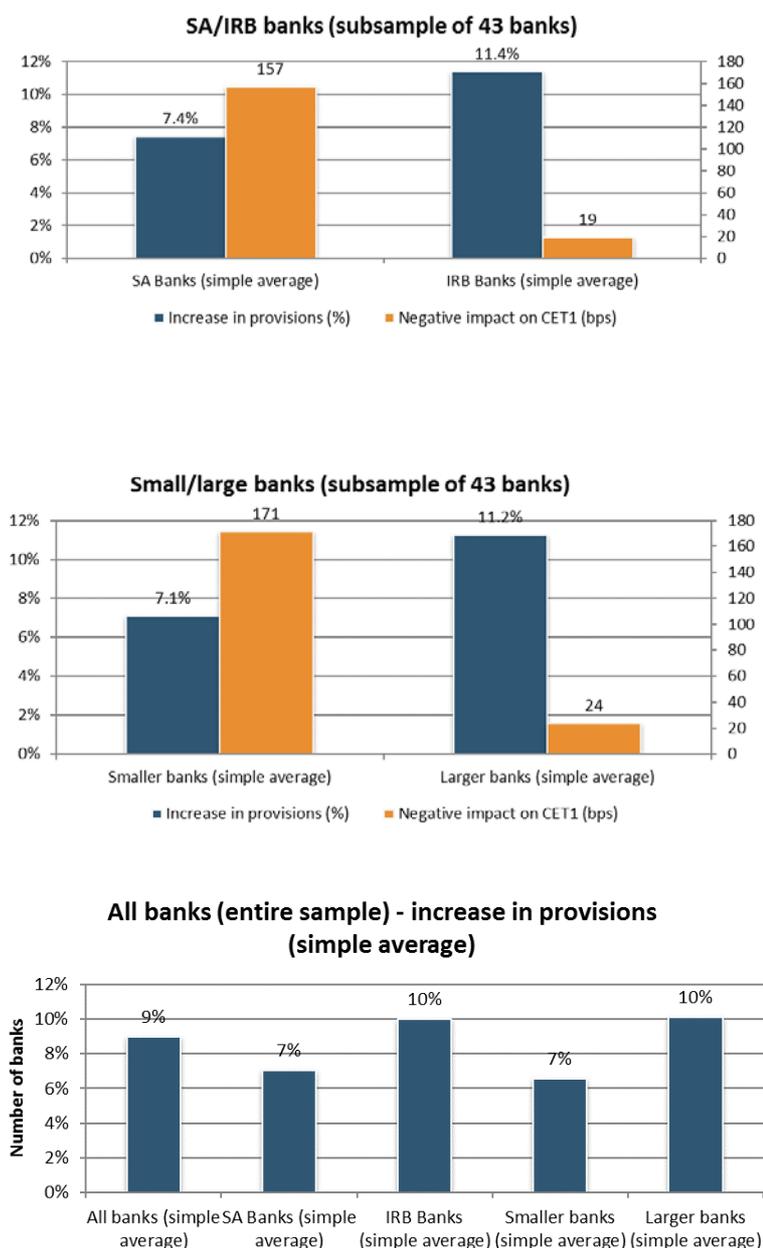


35. The difference between the increase in provisions and the related CET1 impact, in relative terms, for IRB and SA banks can be mainly attributed to the differences in terms of regulatory calculations where, for IRB banks, regulatory expected losses are already reflected in CET1. In practice, this means that the existing IRB shortfall under IAS 39 absorbs part of the increase in provisions when applying IFRS 9, as it was already being deducted from CET1. In Figure 3 the comparison of these effects for SA and IRB banks is presented (considering a subset of the sample of 42 banks for which this information is available, 32 banks using mainly IRB and 10 banks using mainly SA). A more detailed analysis of the impact of IFRS 9 on the regulatory shortfall/excess is provided in the 'impact of IFRS9 on capital requirements' section of this report.

36. The higher increase in provisions following the introduction of IFRS 9 for mainly IRB banks than for mainly SA banks (11.4% compared with 7.4% on simple average) confirms the indications from the second IA, where IRB banks already forecast a higher increase in provisions than SA banks (16% compared with 6%)<sup>30</sup>. These numbers correspond to the subset of the sample where information on the impact on provisions and CET1 is available.

<sup>30</sup> Second EBA Impact Assessment, page 44, Table 1.

Figure 3: Increase in provisions in percentage and impact on CET1 in bps for mainly SA banks and mainly IRB banks and for small and large banks – first-time application (simple average<sup>31</sup>) (reference date: 1 January 2018)



<sup>31</sup> Note: Figure 3 graphs refer only to the results for the subset of banks included in the sample for which information on the impact on provisions and CET1 is available.

37. The increase in provisions is mainly linked to performing financial assets (assets in stage 1 or 2), for which provisions increased 94% on simple average<sup>32</sup>. The high increase is due to the low initial stock of provisions for performing assets under IAS 39 requirements, and is in line with the intended effects of the new standard (addressing some of the criticisms of the previous model)<sup>33</sup>. For non-performing financial assets, a nil impact on the provisions is observed on simple average (and also a nil impact on weighted average; the 25th percentile shows a decrease of 4%, while the 75th percentile shows an increase in provision of 5%).

## Classification and measurement

38. The allocation of financial instruments to the different categories under IFRS 9<sup>34</sup> leads to an impact due to the changes in the measurement of those instruments<sup>35</sup>. This effect flows directly to the prudential figures, as it is not subject to any regulatory transitional arrangements. While the impact on day one of the reclassification is difficult to measure, as it is not reported on the supervisory templates, public disclosure information shows it as being relevant only for a minority of the banks in the sample (consistent with the forecast in the second IA<sup>36</sup>). However, due to the lack of a systematized set of data, it is not possible to estimate the simple average impact on day one arising from classification and measurement for the considered sample of banks.

39. As from the second IA, the measurement basis for financial assets and, therefore, the balance sheet structure remains broadly the same. Amortised cost is the measurement basis attributed to 80%<sup>37</sup> of total financial assets on simple average. Fair value through other comprehensive income (FVOCI) financial assets represent, on simple average, 9% of the total financial assets. Fair value through profit or loss (FVPL) stands at 11%<sup>38</sup>. With the broad alignment – see Figure 4 – of the observations for the second quarter of 2018 and the forecasts performed by the banks from the second IA, and under the previous caveats mentioned, it can be also inferred that, on simple average, the impact on classification and measurement is, as expected, quite limited.

<sup>32</sup> 93% on weighted average.

<sup>33</sup> Impairment loss allowances for performing assets related to losses incurred but not reported (IBNR) calculated in accordance with IAS 39 and reflecting impairments related to events expected to have occurred at reporting date but not yet notified to the institution.

<sup>34</sup> In summary, under IAS 39, financial assets were classified into four categories: (i) FVPL (measured at fair value with changes in fair value recognised in profit or loss); (ii) held to maturity (measured at amortised cost); (iii) loans and receivables (measured at amortised cost); and (iv) available for sale (measured at fair value with changes in fair value recognised in other comprehensive income). Under IFRS 9, financial assets are classified and measured according to three categories: (i) FVPL; (ii) amortised cost; and (iii) FVOCI.

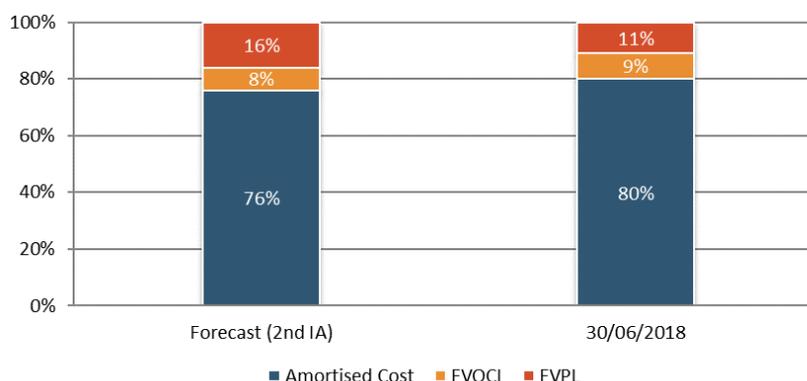
<sup>35</sup> For example, debt instruments measured at amortised cost under IAS 39 that under IFRS 9 will be measured at fair value will produce, on day one, an impact corresponding to this change in the measurement basis (which is applied retrospectively).

<sup>36</sup> Second EBA Impact Assessment, page 21, paragraph 40.

<sup>37</sup> Result obtained based on a sample of 50 banks.

<sup>38</sup> Second EBA Impact Assessment, page 39, paragraph 78.

Figure 4: Share of financial assets per IFRS 9 category (comparison with second IA)  
(reference date: 30 June 2018)



40. According to the public disclosures made by the banks and as shown in Figure 5, on the first application of IFRS 9, the most relevant reclassifications<sup>39</sup> observed were the transfer from amortised cost (AC) measurement to the FVPL category (relevant for 64% of the banks in the subset of the sample) and from the IAS 39 available for sale (AFS) category to the IFRS 9 AC category (relevant for 59% of the banks in the subset of the sample). Transfers from AC to FVOCI and from FVPL to AC are considered less relevant by the banks in the subset of the sample (33% and 21% respectively)<sup>40</sup>.

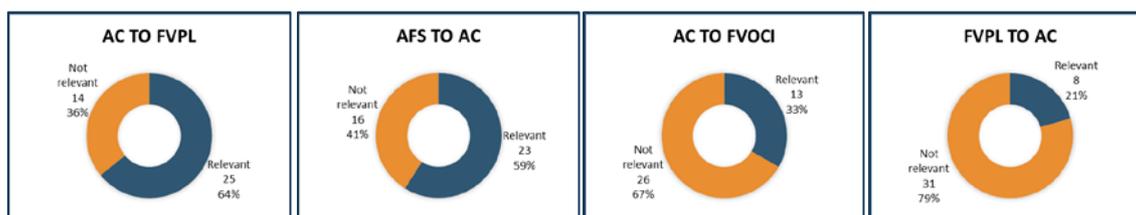
41. Figure 5 summarises the information collected regarding the relevance of transfers between categories for each one of the banks in the subset of the sample (based on the 39 banks for which this information could be obtained from public disclosures). The relevance of these transfers was identified on the basis of the quantitative impact generated by each type of reclassification and expert judgement. During the second IA, banks were forecasting reclassifications mainly from FVOCI (AFS under IAS 39) to FVPL (IFRS 9) and to a lesser extent either from FVOCI (AFS under IAS 39) to AC (IFRS 9) or from AC (L&R or HTM under IAS 39) to FVPL (IFRS 9)<sup>41</sup>.

<sup>39</sup> 'Most relevant reclassifications' in this context means those reclassifications between categories (when applying IFRS 9 for the first time) that most contribute to the total impact arising from classification and measurement.

<sup>40</sup> These results are based on a subset of 39 banks of the sample.

<sup>41</sup> Second EBA Impact Assessment, page 21, paragraph 40.

Figure 5: Most relevant reclassifications between categories (when moving from IAS 39 to IFRS 9) (reference date: 1 January 2018)



42. At the time of the second IA, banks forecasted most commonly that movements towards fair value through profit or loss would be due to instruments failing the SPPI test<sup>42</sup>.

43. In accordance with the supervisory data reported for the second quarter of 2018, on simple average, 96% of non-trading debt instruments are classified in the AC or FVOCI categories. From these numbers, it can be inferred that the SPPI test did not have a material influence on the classification of these instruments, as 96% of these instruments passed the test.

## Impairment

44. Some of the main issues mentioned as part of the second IA included the assessment of significant increase in credit risk, the incorporation of forward-looking information in the assessment of credit risk, the transfers across stages and the ECL estimation<sup>43</sup>. The EBA took these aspects into consideration when developing the indicators to be assessed, based on the supervisory data reported.

### Staging assessment

45. In the supervisory data for the second quarter of 2018, banks have reported that 85%<sup>44</sup> of on-balance-sheet exposures (gross amount) are allocated to stage 1, 8%<sup>45</sup> to stage 2 and 7%<sup>46</sup> to stage 3. Regarding the off-balance-sheet exposures (commitments and financial guarantees), the allocation corresponds to 93%<sup>47</sup>, 5%<sup>48</sup> and 2%<sup>49</sup> in stages 1, 2 and 3, respectively. This allocation, per se, does not allow the assessment of the relevant aspects related to staging assessment/accounting policies applied for the transfer between stages. However, it will be relevant to monitor how these numbers change in future reporting periods.

<sup>42</sup> Second EBA Impact Assessment, page 23, paragraph 43.

<sup>43</sup> Second EBA Impact Assessment, page 24, paragraph 45.

<sup>44</sup> 90% on weighted average.

<sup>45</sup> 7% on weighted average.

<sup>46</sup> 3% on weighted average.

<sup>47</sup> 95% on weighted average.

<sup>48</sup> 4% on weighted average.

<sup>49</sup> 1% on weighted average.

Figure 6: Allocation of on-balance-sheet items per stage (simple average and weighted average) (reference date: 30 June 2018)

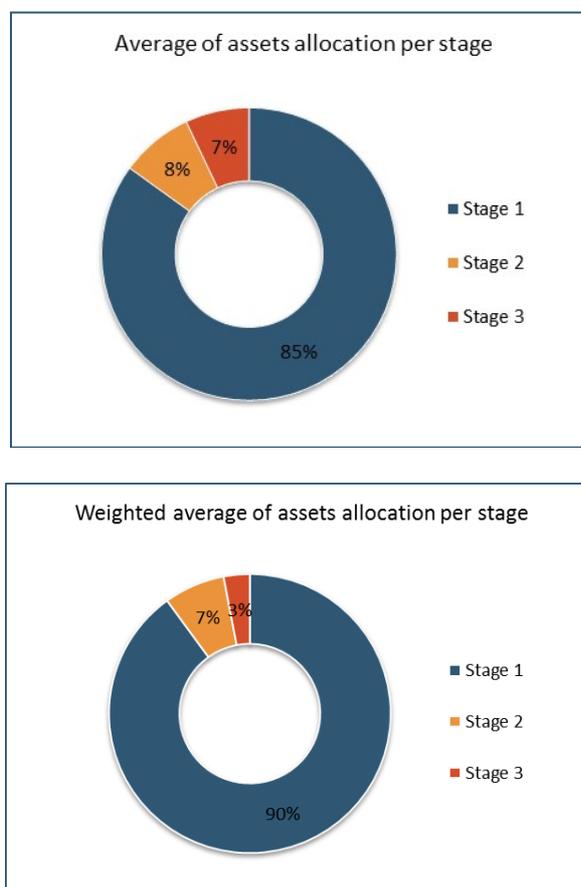


Table B: Percentage allocation of on-balance-sheet items per stage (simple average) – large and small banks (reference date: 30 June 2018)

Allocation per stage	All banks (simple average)	Large banks	Small banks
<b>Stage 1</b>	85%	90%	70%
<b>Stage 2</b>	8%	7%	10%
<b>Stage 3</b>	7%	3%	20%

46.Regarding the usage of the ‘30 days past due’ indicator as a backstop to transfer exposures from stage 1 to stage 2, it is important to highlight the following observations:

- a. Based on supervisory reporting data, 10 banks (corresponding to 19% of the sample) apparently used this criterion as an automatic factor to transfer their exposures from stage 1 to stage 2 (given that no ‘30 days past due’ exposures are classified in stage 1 for these banks);

- b. In contrast, 16 banks (corresponding to 30% of the sample) have reported more than 10% of their assets 30 days past due in stage 1. This might reveal that this indicator is not being used as a backstop because a relevant amount of these exposures is still classified in stage 1. According to the EBA guidelines on ECL, any rebuttal of the more than '30 days past due' presumption should be accompanied by a thorough analysis clearly demonstrating that 30 days past due is not correlated with a SICR<sup>50</sup>. This aspect deserves additional scrutiny going forward.
- c. The remaining banks included in the sample have reported less than 10% of exposures with more than 30 days past due in stage 1. Also in these cases, the previous reference to the EBA guidelines is relevant and should be considered as this classification, while not so material, needs to be properly justified.

Table C: Assets more than 30 days past due classified in stage 1<sup>51</sup> (reference date: 30 June 2018)

<b>30-days-past-due assets in stage 1</b>	<b>0%<sup>52</sup></b>	<b>Between 0% and 10%</b>	<b>More than 10%</b>
<b>Number of banks</b>	10	27	16

47. Regarding the usage of the '90 days past due' indicator as a backstop to transfer exposures from stage 2 to stage 3, the EBA would like to highlight the following:

- a. Based on supervisory reporting data, 14 banks (corresponding to 26% of the sample) have considered this criterion as an automatic factor for transferring exposures to stage 3 (no '90 days past due' exposures are included in stage 1 or 2 for these banks).
- b. On the contrary, 13 banks (corresponding to 25% of the sample) have reported more than 5% of their exposures 90 days past due in stage 1 or 2. In this context, it should be recalled that IFRS 9 includes a rebuttable presumption that default does not occur later than 90 days past due. In addition, as stated in the EBA guidelines on ECL, when adopting a definition of default for accounting purposes, credit institutions should be guided by the definition used for regulatory purposes

<sup>50</sup> Paragraph 136 of the EBA Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses:  
<https://www.eba.europa.eu/documents/10180/1842525/Final+Guidelines+on+Accounting+for+Expected+Credit+Losses+%28EBA-GL-2017-06%29.pdf>

<sup>51</sup> Based on a sample of 53 banks for which this information was available.

<sup>52</sup> This means that 0% of the total assets of these banks are classified in stage 1.

provided in Article 178 of Regulation (EU) No 575/2013 that considers the ‘90 days past due’ criterion<sup>53</sup>. This aspect deserves additional scrutiny going forward.

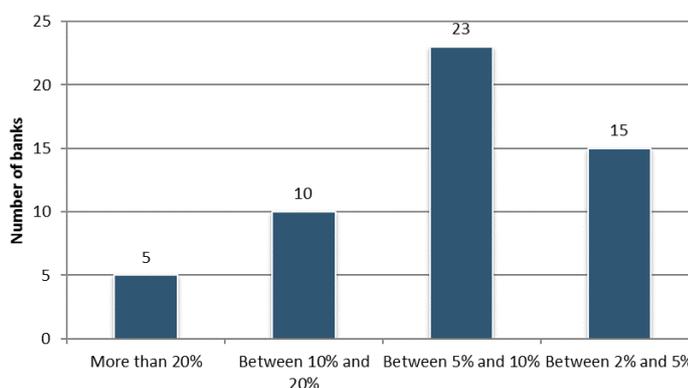
- c. The remaining banks included in the sample have reported less than 5% of exposures more than 90 days past due in stage 1 or 2. Also in this case, the EBA guidelines on ECL are relevant and should be considered.

Table D: Assets more than 90 days past due not classified in stage 3<sup>54</sup> (reference date: 30 June 2018)

90 days past due assets not classified in stage 3	0% <sup>55</sup>	Between 0% and 5%	More than 5%
<b>Number of banks</b>	14	26	13

48. When looking at the total amount of non-credit-impaired financial assets (stages 1 and 2 under IFRS 9), on simple average, 9%<sup>56</sup> of these assets are classified in stage 2 (i.e. assets for which the institution has concluded that the credit risk has increased significantly since initial recognition), 15% for smaller banks and 7% for larger banks. It is important to monitor these figures through time to understand how effective the SICR assessment criteria applied by the banks are.

Figure 7: Allocation of non-credit-impaired financial assets to stage 2 (reference date: 30 June 2018)



49. Regarding the alignment of the definition of default for accounting purposes with the EBA definition of non-performing exposures used for supervisory reporting purposes, it is observed that, for the second quarter of 2018, the total amount of financial assets classified in stage 3 corresponds, on simple average, to 96% of the non-performing financial assets. A similar percentage is observed when comparing the amount of exposures (including on- and off-

<sup>53</sup> Paragraph 89 of the EBA ‘Guidelines on credit institutions’ credit risk management practices and accounting for expected credit losses’.

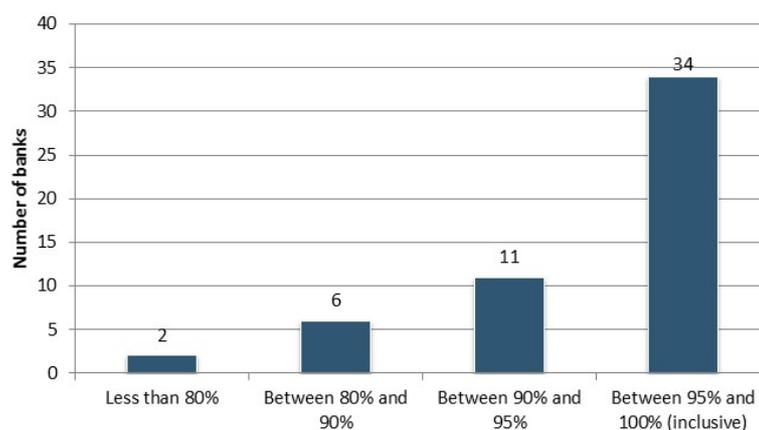
<sup>54</sup> Based on a sample of 53 banks for which this information was available.

<sup>55</sup> This means that all the 90-days-past-due assets are classified in stage 3.

<sup>56</sup> 7% on weighted average.

balance-sheet exposures) classified in stage 3 with the amount of exposures classified as non-performing exposures. These results are also observed when looking at the data reported for the first quarter of 2018. The supervisory expectation that there is an alignment between accounting and prudential definitions, as included in the EBA guidelines on ECL, is apparently being considered by the majority of banks included in the sample. Figure 8 represents these results for 53 banks.

Figure 8: Non-performing exposures allocated to stage 3<sup>57</sup> (reference date: 30 June 2018)



50. Based on information obtained from FINREP (where institutions would report the FVPL exposures that are either performing or non-performing), on simple average, 14% of the total exposures measured at FVPL correspond to non-performing exposures. For smaller banks this simple average corresponds to 36%, while for larger banks it represents 7%. Twelve banks (corresponding to 22% of the sample) included in the sample have not measured NPEs at FVPL. Conversely, for three banks (corresponding to 6% of the sample), more than 90% of their exposures at FVPL are NPEs. Given the dispersion observed in the figures, this may be an area which would require further investigation in the future.

51. The transfer between stages and the development of the respective accounting policies, was one of the challenges considered as moderate or high by respondents in the second IA. This includes the definition of criteria to transfer back exposures from stages 2 and 3. The data collected for the second quarter of 2018 show that, on simple average, 5.35% of exposures<sup>58</sup> were transferred from stage 3 to stage 1 or 2 (including 1.44% of stage 3 exposures which were transferred directly to stage 1<sup>59</sup>).

52. A summary of some of the stage transfers assessed on the basis of the supervisory data for the first half of 2018 is provided in Table E.

<sup>57</sup> Based on a sample of 53 banks for which this information was available.

<sup>58</sup> 5.83% on weighted average.

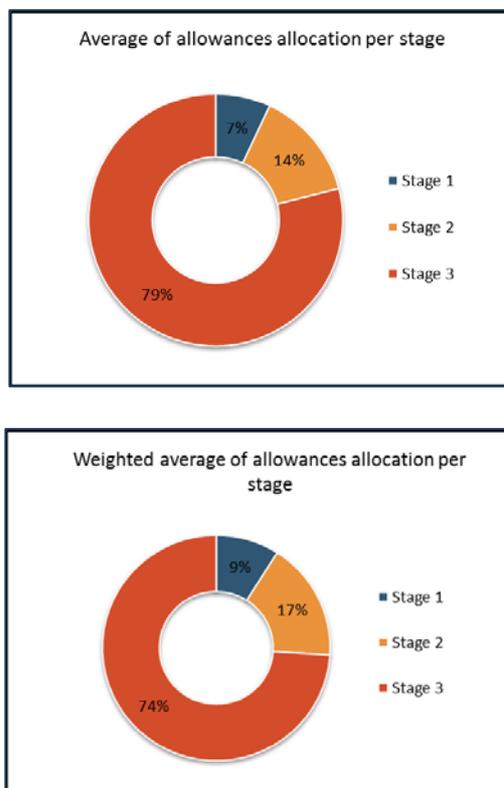
<sup>59</sup> 1.99% on weighted average

Table E: Transfers of financial assets between stages (reference date: 30 June 2018)

Transfer between stages	Average % of gross carrying amount of financial assets (FVOCI and AC)
From stage 1 to stage 2	1.6 (1.7 on weighted average)
From stage 1 to stage 3	0.15 (0.13 on weighted average)
From stage 2 to stage 3	0.28 (0.17 on weighted average)
From stage 2 to stage 1	1.37 (1.59 on weighted average)
From stage 3 to stage 2	3.91 (3.84 on weighted average)
From stage 3 to stage 1	1.44 (1.99 on weighted average)

53. The loss allowances for expected credit losses are allocated, as of the end of June 2018, as follows: 79% on simple average<sup>60</sup> to stage 3 exposures, 14%<sup>61</sup> to stage 2 exposures and 7%<sup>62</sup> to stage 1 exposures. In the second IA, the simple average forecast allocation of provisions per stage was 78%, 14% and 8% for stages 3, 2 and 1, respectively.

Figure 9: Allocation of credit risk allowances per stage (on simple average and weighted average) (reference date: 30 June 2018)



<sup>60</sup> 74% on weighted average.

<sup>61</sup> 17% on weighted average.

<sup>62</sup> 9% on weighted average.

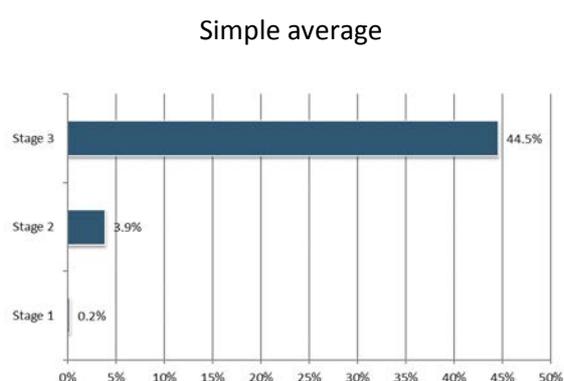
54. Smaller banks have allocated their provisions as follows (on simple average): 87% to stage 3, 7% to stage 2 and 6% to stage 1. For large banks the simple average allocation corresponds to 76% in stage 3, 16% in stage 2 and 8% in stage 1. These numbers reflect the diversity in results when looking separately at smaller and larger banks in the sample. The results are summarised in Table F.

Table F: Percentage allocation of credit risk allowances per stage – large and small banks (reference date: 30 June 2018)

Allocation per stage	All banks (simple average)	Large banks	Small banks
Stage 1	7%	8%	6%
Stage 2	14%	16%	7%
Stage 3	79%	76%	87%

55. The coverage of exposures with IFRS 9 ECL<sup>63</sup> (based on reported data for the second quarter of 2018) is, on simple average, approximately 0.2%<sup>64</sup> for stage 1, 3.9%<sup>65</sup> for stage 2 and 45%<sup>66</sup> for stage 3. The coverage ratio observed for the first quarter of 2018 is similar.

Figure 10: Coverage ratio per stage (reference date: 30 June 2018)



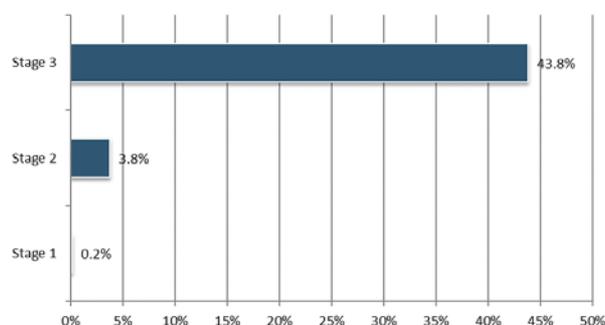
<sup>63</sup> Note that, to determine the coverage ratio of exposures per stage, the total amount of loss allowances for each stage was compared with the total gross exposure amounts per stage (based on supervisory reporting data extracted using the indicators in Annex III of this report).

<sup>64</sup> 0.2% on weighted average.

<sup>65</sup> 3.8% on weighted average.

<sup>66</sup> 43.8% on weighted average.

## Weighted average



56. For larger banks, the coverage ratios correspond to 0.1%, 3% and 43%, respectively, per stage. For smaller banks, coverage ratios of 0.5%, 6% and 50% were observed. Again, some diversity in the results is evident between smaller and larger banks. The coverage ratio for mainly IRB and mainly SA banks would be consistent with the results for large and small banks. Table G summarises these results.

Table G: Coverage ratio (%) per stage – large and small banks (reference date: 30 June 2018)

Coverage ratio	All banks	Large banks	Small banks
<b>Stage 1</b>	0.2%	0.1%	0.5%
<b>Stage 2</b>	3.9%	3%	6%
<b>Stage 3</b>	45%	43%	50%

## Other topics

57. Based on June 2018 supervisory data, the quantity of purchased or originated credit-impaired financial assets (POCIs<sup>67</sup>) is not material for all the banks in the sample. Only five banks in the sample have reported POCIs, representing in each case less than 0.001% of the financial assets subject to IFRS 9 impairment requirements. These results are also aligned with the reporting for the first quarter of 2018. The materiality of POCIs and the possible impact arising from these assets will continue to be monitored.

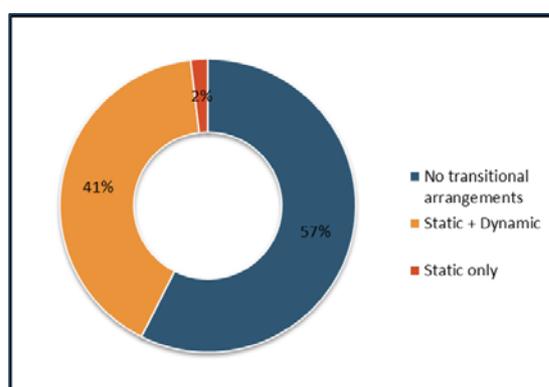
<sup>67</sup> Purchased or originated financial asset(s) that are credit impaired on initial recognition.

## Impact of IFRS 9 (including IFRS 9 transitional arrangements) on capital requirements

58. When analysing the supervisory reporting data for the second quarter of 2018, for all the institutions in the sample applying IFRS 9 transitional measures, the CET1 add-back<sup>68</sup> corresponds to 118 bps, on simple average. When considering a weighted average, this figure would correspond to 48 bps.

59. The information collected for all EU banks (included in Annex II) shows that largest institutions are using transitional arrangements to a lesser extent. The decision of applying transitional arrangements or not is generally related to the full implemented impact on day one and/or to the guidance provided at national level. When transitional arrangements are used, it is mainly under a combination of static and dynamic approaches. Overall, 44% of banks in the EU do not apply the IFRS 9 transitional arrangements (compared with 57% of banks in the sample used for the purposes of this report). In Figure 11, the percentage of banks in the sample applying transitional arrangements is presented.

Figure 11: Percentage of banks in the sample applying IFRS 9 transitional arrangements



60. The analysis conducted, based on the supervisory data reported for the second quarter of 2018, shows that the impact of the IFRS 9 ECL requirements corresponds to a decrease in the shortfalls of provisions and an increase in the excesses (compared to end of 2017), as expected. On simple average, the shortfall corresponds to 0.8%<sup>69</sup> of CET1 capital in June 2018 and to 1.8%<sup>70</sup> of CET1 capital at the end of 2017. At the same time, the increase in provisions associated with the implementation of IFRS 9 has led to a larger amount of excess, equal to 0.9%<sup>71</sup> of CET1 capital,

<sup>68</sup> Regulation (EU) No 2017/2395 on IFRS 9 transitional arrangements allows institutions, in summary, to partially neutralise (over a 5-year period) the day-one impact in CET1 of the increase in provisions due to the introduction of IFRS 9 (static component) as well as to partially neutralise (over the same 5-year period) the impact of the additional (post-day-one) increase in provisions for not credit impaired assets (stages 1 and 2 in IFRS 9) (dynamic component).

<sup>69</sup> 0.8% on weighted average.

<sup>70</sup> 1.7% on weighted average.

<sup>71</sup> 0.6% on weighted average.

on simple average, in comparison with 0.6%<sup>72</sup> at the end of 2017. The numbers are presented for all the banks that make use of IRB (whether they are mainly IRB or not), meaning 46 banks, of which 40 banks experienced a decrease in the amount of the shortfall.

## Other relevant aspects

61. The large majority of banks in the sample (91%) do not apply the IFRS 9 hedge accounting requirements, preferring to keep the application of the requirements under IAS 39<sup>73</sup>.

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<sup>72</sup> 0.4% on weighted average.

<sup>73</sup> Result based on the public disclosures made by 46 banks included in the sample.

## Areas of further work – next steps

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62. This part of the report includes the recent and future work of the EBA related to the implementation of IFRS 9 by banks.

63. 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 effect of IFRS 9 will be assessed comprehensively only when the standard is fully implemented by banks.

64. The challenge for regulators and supervisors is to ensure a high-quality and consistent implementation of the standard, since the outcome of the ECL calculation will directly impact the amount of own funds and the regulatory ratios, despite them not being in a position to validate the modelling aspects of IFRS 9 and contrary to what is currently the case 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 the interaction with prudential requirements.

65. The proposed areas of further work presented in this report will be part of a staggered approach. Some of the proposed work will be implemented in the short/medium term, while other aspects will be implemented in the medium/longer term, depending on their complexity as well as the resources and time needed for their completion.

### Follow-up of the implementation of IFRS 9 standard

66. This report deals with the first observations on the impact and implementation of IFRS 9 by EU institutions mainly from a quantitative perspective. There are also some qualitative dimensions that will be monitored by the EBA going forward.

### Use of indicators based on regulatory reporting

67. The EBA will monitor the ongoing quantitative impact of the application of IFRS 9 through selected indicators as presented in this report, using mainly COREP/FINREP templates. The EBA will continue to assess the relevance of the indicators used herein when looking at the impact of IFRS 9 on institutions and, in particular, will reflect on which of these indicators could be used for continuous monitoring of the effects of the new standard. Some of the indicators used for the purposes of this report could therefore also be included in the public list of EBA risk indicators for future reference<sup>74</sup>.

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<sup>74</sup> The EBA methodological guide and list of indicators used as part of its detailed risk analysis tools is available here: <https://www.eba.europa.eu/-/eba-updates-its-methodological-guide-on-risk-indicators-and-detailed-risk-analysis-tools>. Note that the last risk assessment report published by the EBA can be found here: [https://eba.europa.eu/documents/10180/2518651/Risk\\_Assessment\\_Report\\_December\\_2018.pdf](https://eba.europa.eu/documents/10180/2518651/Risk_Assessment_Report_December_2018.pdf)

68. On a related note, the data extracted for the purpose of this report have shown some (limited) gaps in the information provided in FINREP/COREP templates whereas this information is deemed useful for supervisory needs in order for competent authorities to assess on a continuous basis the effects/implementation of IFRS 9. The EBA will consider if some (limited) amendments to the supervisory reporting framework may be desirable, giving due consideration to cost and benefit aspects.

### Modelling aspects

69. As published in its work programme for 2019, the EBA will work further on understanding the modelling aspects of IFRS 9, as implemented by EU institutions, and their related impact on capital. In particular, further investigation would be performed on the use of macroeconomic scenarios and variables, the adjustments to IRB models when used as a starting point and the way banks are building databases and managing data shortages. In addition, where simplified approaches are used for ECL modelling, aspects relating to the main simplifications used, including proxies and overlays considered by the banks, will merit further investigation. Finally, while IRB and SA banks would be included in the scope of investigation, greater attention may be granted to SA banks with regard to their generally lesser modelling experience.

70. With this in mind, as a medium/long term action, the EBA will reflect on the possible development of benchmarking activities. The objective of a benchmarking exercise would be in particular to understand to what extent the use of different methodologies, models, inputs and scenarios could lead to material inconsistencies in ECL outcomes for different EU institutions and could impact own funds and regulatory ratios. Such activities are already being carried out by competent authorities outside the EU. However, it is clear that this activity implies a very good understanding of all the relevant implementation aspects and that this is a complex project to undertake, so this is a medium/long term objective. Due consultation with all concerned stakeholders will also be made while developing the project.

### Qualitative implementation of IFRS 9 standard

71. In addition to the quantitative scrutiny of IFRS 9 implementation, the EBA will continue to monitor some qualitative aspects of the implementation. This would cover governance (state of play of the IFRS9 project, internal processes and documentation including validation and back-testing, main challenges encountered), staging assessment (assessment of the SICR, triggers/indicators considered, transfers to stage 3 and definition of default), incorporation of forward-looking information (including but not limited to macroeconomic factors), and classification and measurement (business model assessment, SPPI test, benchmarking test).

72. In order to achieve this objective, the EBA will reflect further on the possibility of developing a questionnaire which would cover the more technical details of these different aspects of the implementation. In this context, the EBA will pursue its continuous dialogue with banks and auditors.

73. It is also the EBA's intention to follow up on the implementation of the EBA guidelines for communication between supervisors and auditors in the context of IFRS 9 and of the EBA guidelines on expected credit losses, in terms of the effectiveness of both sets of guidelines. The need for any potential amendment to the guidelines or for any additional guidance would be assessed on an ongoing basis, based on the EBA's monitoring.

### Interaction with prudential requirements

#### EBA work in relation to the transitional arrangements for IFRS 9

74. Regulation (EU) No 2017/2395 on transitional arrangements for mitigating the impact of the introduction of expected credit loss accounting (ECL, required by IFRS 9) ('the Regulation') entered into force on 1 January 2018.

75. On the basis of the Regulation, institutions can either phase in the impact of the implementation of IFRS 9 and analogous ECLs on capital and leverage ratios or recognise the full impact of IFRS 9 and analogous ECLs on capital and leverage ratios from 1 January 2018 or before the end of the transitional period.

76. The EBA is collecting Q&As from stakeholders in its single rule book Q&A tool and has published to date 13 Q&As on the application of the transitional arrangements in order to help institutions apply the regulatory provisions in a consistent and effective manner.

77. In addition, the EBA intends to monitor the use of transitional provisions. According to paragraph 9 of the Regulation, an institution may reverse once (subject to prior approval by the competent authority) during the transition period its initial decision regarding the application of the transitional arrangements. Recital 6 of the Regulation states that the competent authority 'should ensure that such decision is not motivated by considerations of regulatory arbitrage'. In this context, competent authorities would take into account the facts and circumstances in each individual reversal case (and the level of documentation provided to justify the request for approval) when deciding whether a regulatory arbitrage issue might arise. The EBA intends to monitor at EU level these possible reversal cases in order to ensure consistency of approaches taken by competent authorities and a common understanding of the notion of regulatory arbitrage.

#### Interaction between accounting and regulatory provisions

78. The EBA is also closely monitoring and following up on the impact on regulatory own funds for IRB and SA banks in the context of the medium/long-term work that is currently taking place at the international level (BCBS), to explore further if any changes to the current regulatory framework on the treatment of accounting provisions might be necessary to ensure the proper interaction of the capital framework with the new expected credit loss model for accounting.

79. As previously expressed by the EBA, the potential volatility of own funds merits assessment in the longer term. While it is expected that IFRS 9 will lead to a higher level of provisions, the

behaviour of ECL provisions with changes in the economic cycle needs to be explored over time. This is a long-term task, as sufficient observations would be necessary. In addition, it needs to be highlighted that there may be other aspects leading to the potential volatility of own funds, such as the removal of prudential filters for unrealised gains, in relation to which the EBA delivered technical advice to the European Commission in December 2013.

80. Finally, the EBA will continue monitoring the interactions with requirements related to the definition of default for prudential and accounting purposes, taking into account the Guidelines on the application of the definition of default<sup>75</sup> and the ITS on forbearance and NPEs.

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<https://www.eba.europa.eu/documents/10180/1597103/Final+Report+on+Guidelines+on+default+definition+%28EBA-GL-2016-07%29.pdf/004d3356-a9dc-49d1-aab1-3591f4d42cbb>

# Annex I – Summary of main impacts

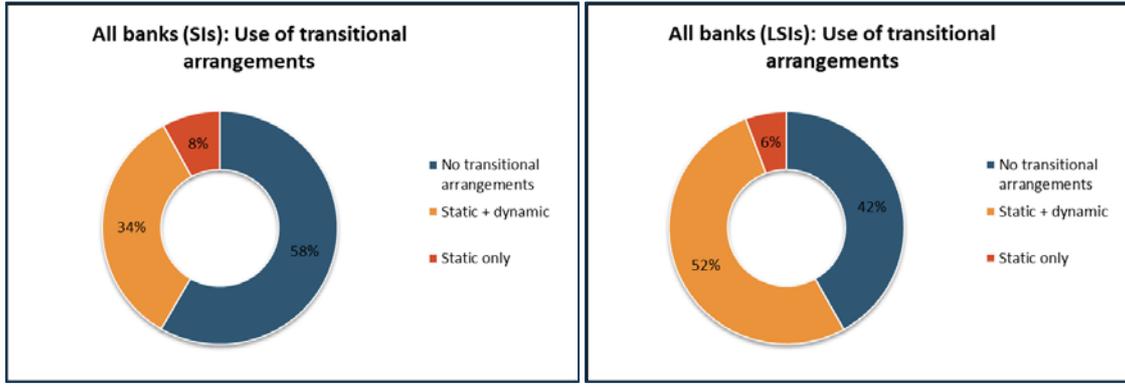
2nd impact assessment 2017		2018 Report	
Estimated increase of provisions IFRS 9 <sup>1</sup>		Increase in provisions IFRS 9 (average) <sup>1</sup>	
<i>in %</i>		<i>in %</i>	
<b>Median</b> <sup>3</sup>	8%	<b>Median</b> <sup>3</sup>	8%
<b>Simple average - all banks in sample</b>	<b>13%</b>	<b>Simple average - all banks in sample</b>	<b>9%</b>
Small banks	5%	Small banks	7%
Large banks	15%	Large banks	10%
SA banks	6%	SA banks	7%
IRB banks	16%	IRB banks	10%
<b>Weighted Average</b> <sup>4</sup>	<b>15%</b>	<b>Weighted Average</b> <sup>4</sup>	<b>14%</b>
Estimated impact on CET1 ratio IFRS 9 <sup>1</sup>		Impact on CET1 ratio IFRS 9 <sup>1</sup>	
<i>In bps</i>		<i>In bps</i>	
	<b>Total impact of IFRS 9</b>		<b>Total impact of IFRS 9</b>
<b>Median</b> <sup>3</sup>	-50	<b>Median</b> <sup>3</sup>	-20
<b>Simple average - all banks in sample</b>	<b>-45</b>	<b>Simple average - all banks in sample</b> <sup>5</sup>	<b>-51</b>
Small banks	-78	Small banks	-171
Large banks	-33	Large banks	-24
SA banks	-77	SA banks	-157
IRB banks	-32	IRB banks	-19
<b>Weighted Average</b> <sup>4</sup>	<b>-29</b>	<b>Weighted Average</b> <sup>4</sup>	<b>-25</b>
Classification and measurement <sup>2</sup>		Classification and measurement <sup>2</sup>	
	<b>% per category</b>		<b>% per category</b>
<b>Category (simple average)</b>		<b>Category (simple average)</b>	
Amortised Cost	76%	Amortised Cost	80%
FVOCI	8%	FVOCI	9%
FVPL	16%	FVPL	11%
<sup>1</sup> With reference to date of initial application of IFRS 9 <sup>2</sup> With reference to 30 June 2018 <sup>3</sup> Median refers to the "middle" value within the distribution (for which 50% of the data would be lower and 50% higher) <sup>4</sup> Weighted average is calculated on the basis of the % of the total assets of each bank in the sample <sup>5</sup> Note: based on a sample of 43 banks for which this information was available			

## Annex II – Application of IFRS 9 transitional arrangements in the EU

### Application of transitional arrangements by country

Country	Number of banks not applying transitional arrangements	Number of banks applying the static component only	Number of banks applying both the static and dynamic components	Total number
Austria	16	0	2	18
Belgium	12	0	1	13
Bulgaria	2	2	3	7
Croatia	14	5	4	23
Cyprus	3	0	7	10
Czechia	57	3	3	63
Denmark	47	8	16	71
Estonia	7	1	1	9
Finland	13	0	1	14
France	17	0	2	19
Germany	15	0	0	15
Greece	1	2	14	17
Hungary	10	1	4	15
Ireland	9	0	4	13
Italy	28	17	340	385
Latvia	8	2	6	16
Lithuania	6	1	0	7
Luxembourg	10	1	0	11
Malta	5	1	9	15
Netherlands	29	3	0	32
Poland	10	4	16	30
Portugal	16	3	10	29
Romania	15	1	12	28
Slovakia	3	1	0	4
Slovenia	8	0	0	8
Spain	4	3	14	21
Sweden	107	5	10	122
UK	2	0	49	51
<b>Total</b>	<b>474</b>	<b>64</b>	<b>528</b>	<b>1066</b>
<i>Total (%)</i>	<i>44%</i>	<i>6%</i>	<i>50%</i>	

Application of transitional arrangements by larger institutions<sup>76</sup> and smaller institutions<sup>77</sup> in the EU:



<sup>76</sup> Note that for the purposes of this information, for Single Supervisory Mechanism (SSM) countries, the list of significant institutions (SIs) as determined by the European Central Bank (ECB) has been used (through the SSM Framework). For non-SSM jurisdictions, SIs refers to the highest level of consolidation for G-SIIs and O-SIIs within each jurisdiction.

<sup>77</sup> Note that, for the purposes of this information, the list of less significant institutions (LSIs) as determined by the ECB has been used (through the SSM Framework). For non-SSM jurisdictions, LSIs refer to the highest level of consolidation for non G-SIIs or non O-SIIs within each jurisdiction.

## Annex III – List of indicators

IFRS 9 initial impact			
Number	Description	Source	Report
1	Initial impact IFRS 9 impairment - increase in provisions between the closing IAS 39 and opening IFRS 9 balance	FINREP	Figures 2 and 3
2	Increase in provisions for performing financial assets	FINREP	Analysis in paragraph 37
3	Increase in provisions for non-performing financial assets	FINREP	Analysis in paragraph 37

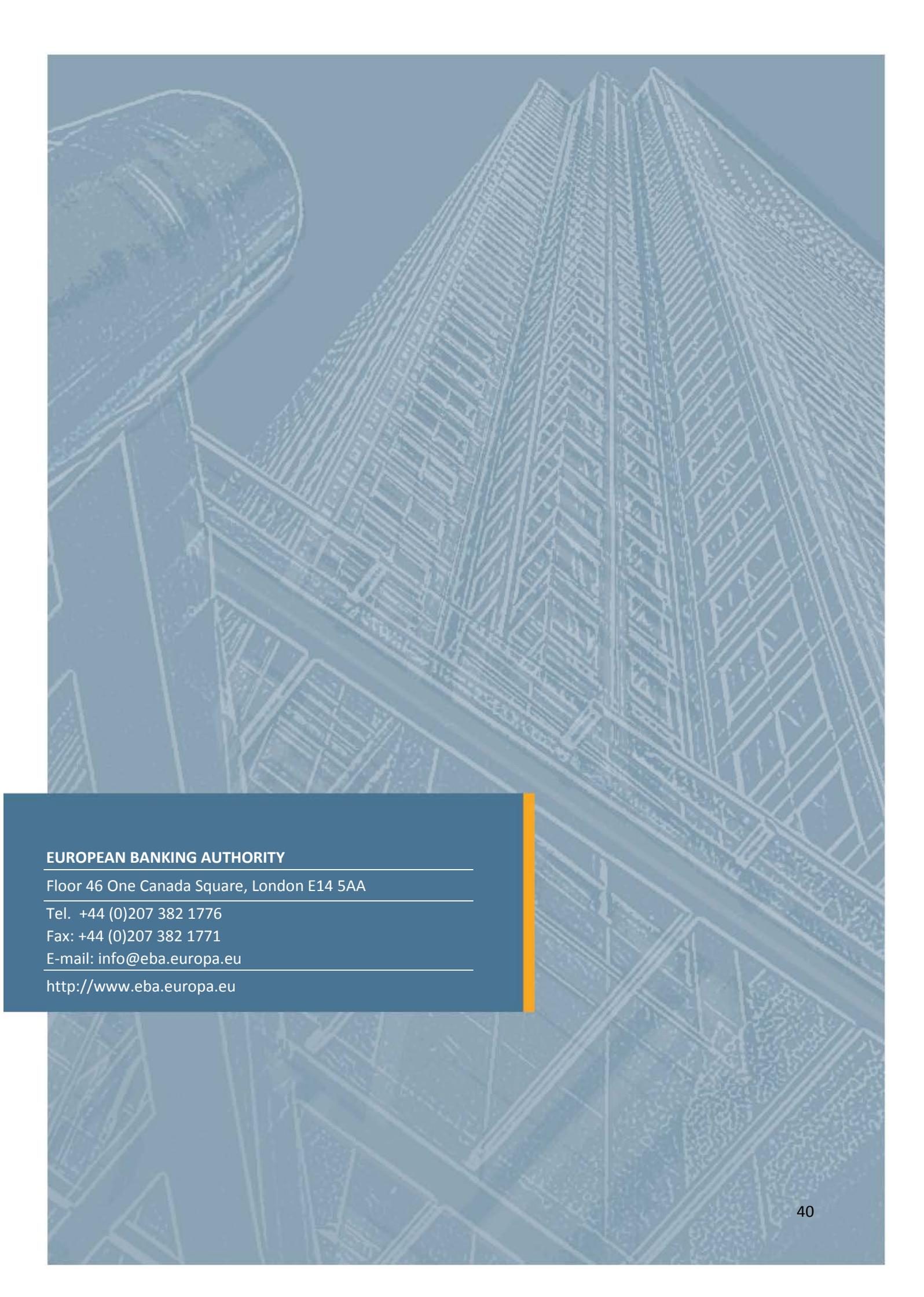
Impairment			
Number	Description	Source	Report
1	Allocation of on-balance-sheet items per stage - stage 1 allocation	FINREP	Figure 6 and Table B
2	Allocation of on-balance-sheet items per stage - stage 2 allocation	FINREP	Figure 6 and Table B
3	Allocation of on-balance-sheet items per stage - Stage 3 allocation	FINREP	Figure 6 and Table B
4	Allocation of non-credit impaired financial assets to stage 2	FINREP	Figure 7
5	Coverage ratio for stage 1 (calculated as the percentage of provisions in stage 1 compared to the gross amount of on-balance sheet items in stage 1)	FINREP	Figure 10 and Table G
6	Coverage ratio for stage 2 (calculated as the percentage of provisions in stage 2 compared to the gross amount of on-balance sheet items in stage 2)	FINREP	Figure 10 and Table G
7	Coverage ratio for stage 3 (calculated as the percentage of provisions in stage 3 compared to the gross amount of on-balance sheet items in stage 3)	FINREP	Figure 10 and Table G
8	Transfers of financial assets from stage 1 to stage 2	FINREP	Table E
9	Transfers of financial assets from stage 1 to stage 3	FINREP	Table E
10	Transfers of financial assets from stage 2 to stage 1	FINREP	Table E
11	Transfers of financial assets from stage 2 to stage 3	FINREP	Table E
12	Transfers of financial assets from stage 3 to stages 1 and 2	FINREP	Table E
13	Transfers of financial assets from stage 3 to stage 1	FINREP	Table E

Impairment (continued)			
Number	Description	Source	Report
14	Stage 3 assets over total non-performing financial assets	FINREP	Analysis in paragraph 49 and Figure 8
15	Percentage of total credit risk allowances allocated to Stage 1 on-balance sheet items	FINREP	Figure 9
16	Percentage of total credit risk allowances allocated to Stage 2 on-balance sheet items	FINREP	Figure 9
17	Percentage of total credit risk allowances allocated to Stage 3 on-balance sheet items	FINREP	Figure 9
18	Share of off-balance exposures and provisions by stages	FINREP	Analysis in paragraph 45
19	Non-performing financial assets at FVPL over total debt instruments measured at FVPL	FINREP	Analysis in paragraph 50
20	Stage 3 assets over total non-performing exposures (including on-balance sheet and off-balance sheet exposures)	FINREP	Analysis in paragraph 49 and Figure 8
21	30 days past due backstop	FINREP	Analysis in paragraph 46 and Table C
22	90 days past due backstop	FINREP	Analysis in paragraph 47 and Table D
23	POCIs	FINREP	Analysis in paragraph 57

Classification and measurement			
Number	Description	Source	Report
1	Share of assets at FVP&L over financial assets subject to IFRS 9	FINREP	Figure 4
2	Share of assets at FVOCI over financial assets subject to IFRS 9	FINREP	Figure 4
3	Share of assets at amortised cost over financial assets subject to IFRS 9	FINREP	Figure 4

Impact on capital requirements			
Number	Description	Source	Report
1	IFRS 9 ECL add-back to CET1 for institutions applying the IFRS 9 transitional arrangements	COREP	Analysis in paragraph 58
2	IRB shortfall relative to Common Equity Tier 1 Capital (calculated for both end June 2018 and end of 2017 for comparison purposes)	COREP	Analysis in paragraph 60
3	IRB excess relative to CET 1 Capital (calculated for both end June 2018 and end of 2017 for comparison purposes)	COREP	Analysis in paragraph 60

Public disclosure information			
Number	Description	Source	Report
1	The "day 1" impact in CET 1 without application of transitional arrangements	EBA template for collecting information from public disclosures (internal template)	Figure 1 and Figure 3
2	Most relevant reclassifications between IAS39 and IFRS 9 categories	EBA template for collecting information from public disclosures (internal template)	Figure 5
3	Application of IFRS 9 hedge accounting requirements	EBA template for collecting information from public disclosures (internal template)	Analysis in paragraph 61



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