



How to stop the next crisis

JOHN MONGELARD

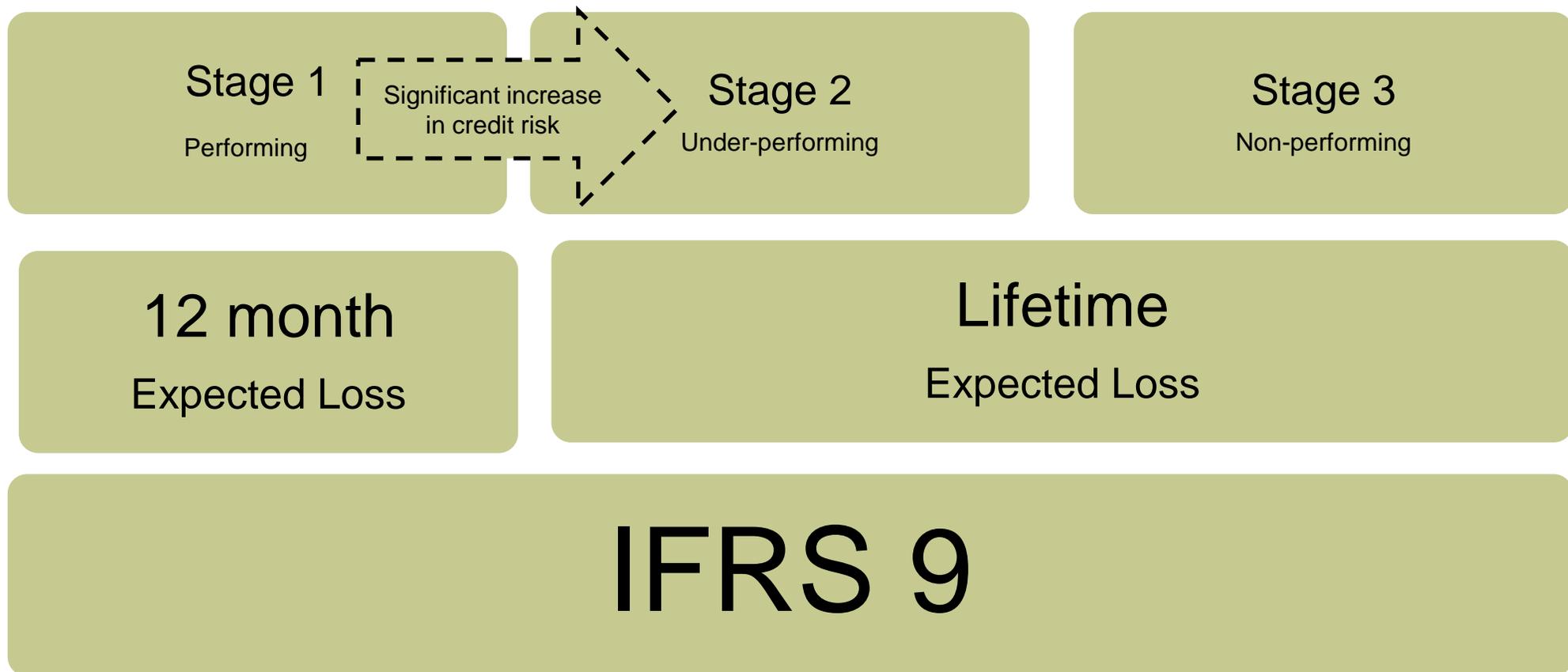
The Global Financial Crisis



Banks had too little capital and liquidity.

- Incurred loss accounting made risk opaque
- Banks have to wait for loss events – ‘too little, too late’

Expected Loss Accounting



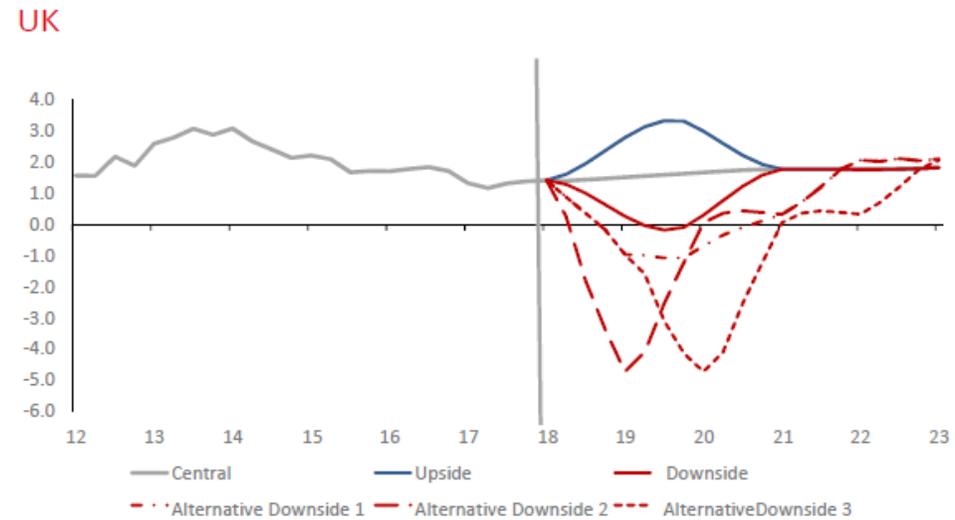
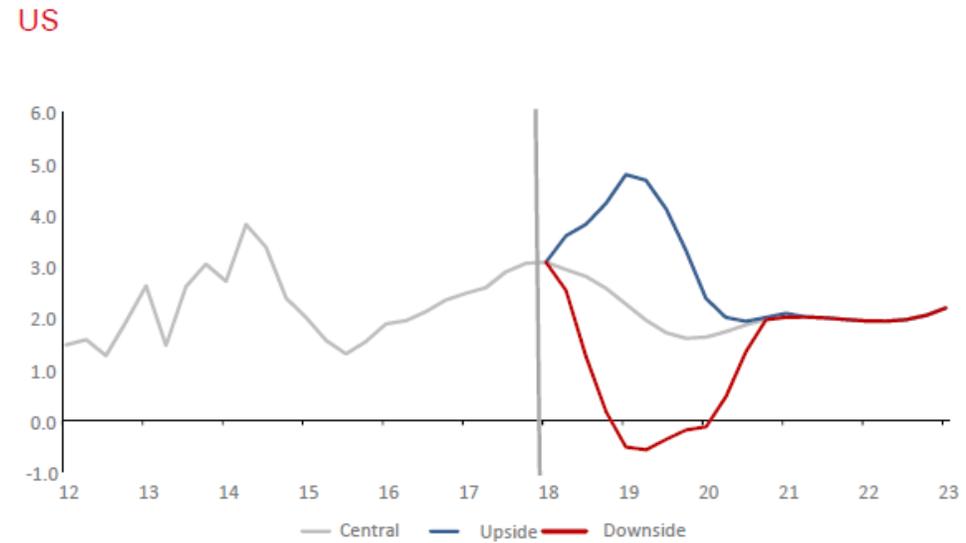
IFRS 9 Staging - example

Summary of credit risk (excluding debt instruments measured at FVOCI) by stage distribution and ECL coverage by industry sector at 31 December 2018

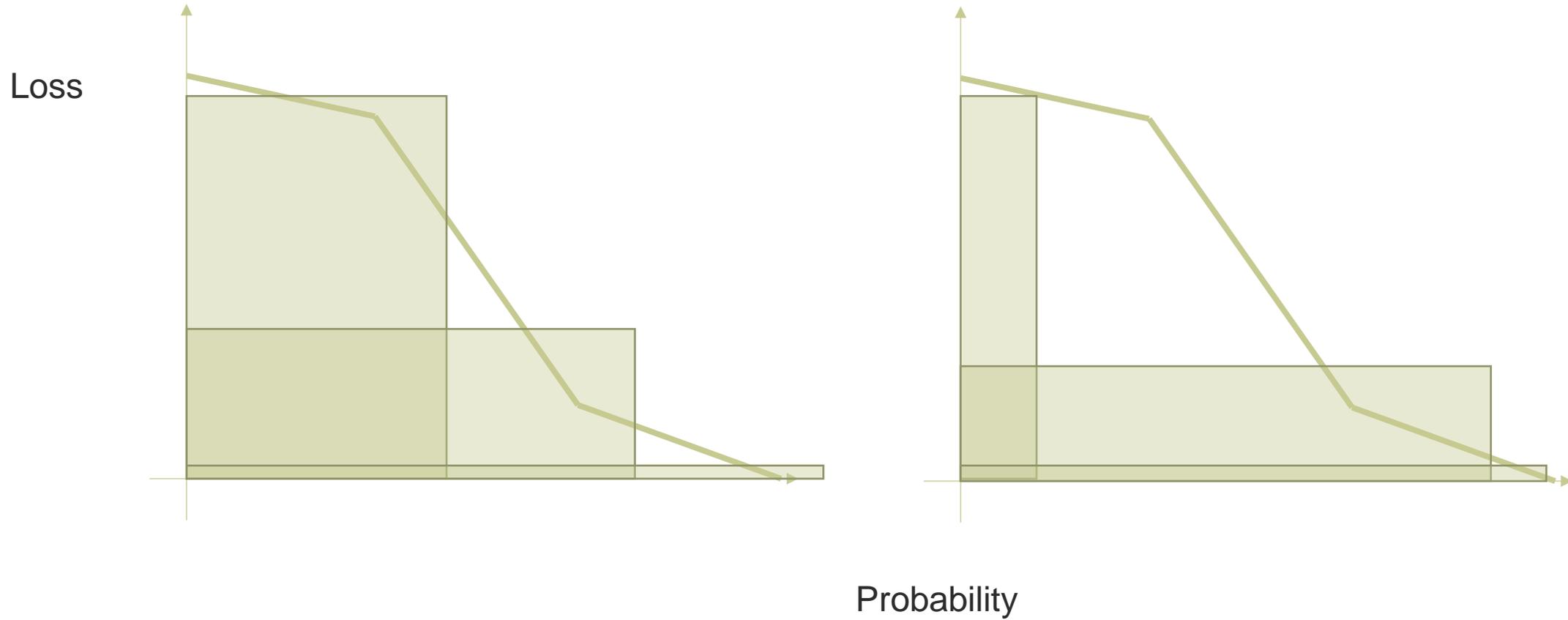
(Audited)

| | Gross carrying/nominal amount ⁹ | | | | | Allowance for ECL | | | | | ECL coverage % | | | | |
|---|--|---------------|---------------|--------------------|----------------|-------------------|----------------|----------------|--------------------|----------------|----------------|------------|-------------|--------------------|------------|
| | Stage 1 | Stage 2 | Stage 3 | POCI ¹¹ | Total | Stage 1 | Stage 2 | Stage 3 | POCI ¹¹ | Total | Stage 1 | Stage 2 | Stage 3 | POCI ¹¹ | Total |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | % | % | % | % | % |
| Loans and advances to customers at amortised cost | 915,188 | 61,786 | 13,023 | 324 | 990,321 | (1,276) | (2,108) | (5,047) | (194) | (8,625) | 0.1 | 3.4 | 38.8 | 59.9 | 0.9 |
| – personal | 374,681 | 15,075 | 4,581 | – | 394,337 | (534) | (1,265) | (1,148) | – | (2,947) | 0.1 | 8.4 | 25.1 | – | 0.7 |
| – corporate and commercial | 481,262 | 44,779 | 8,212 | 324 | 534,577 | (698) | (812) | (3,848) | (194) | (5,552) | 0.1 | 1.8 | 46.9 | 59.9 | 1.0 |
| – non-bank financial institutions | 59,245 | 1,932 | 230 | – | 61,407 | (44) | (31) | (51) | – | (126) | 0.1 | 1.6 | 22.2 | – | 0.2 |

IFRS 9 - Scenarios



IFRS 9 Scenarios and Non-linearity



Expected loss vs. management expectations

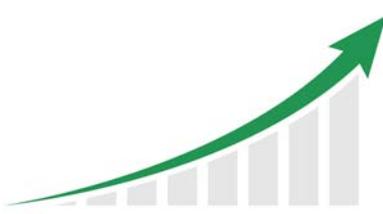
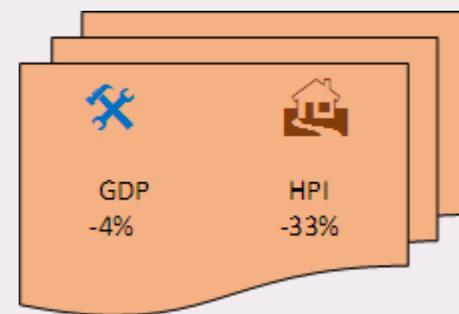


$$1 + 2 + 3 + 4 + 5 + 6 = 21$$

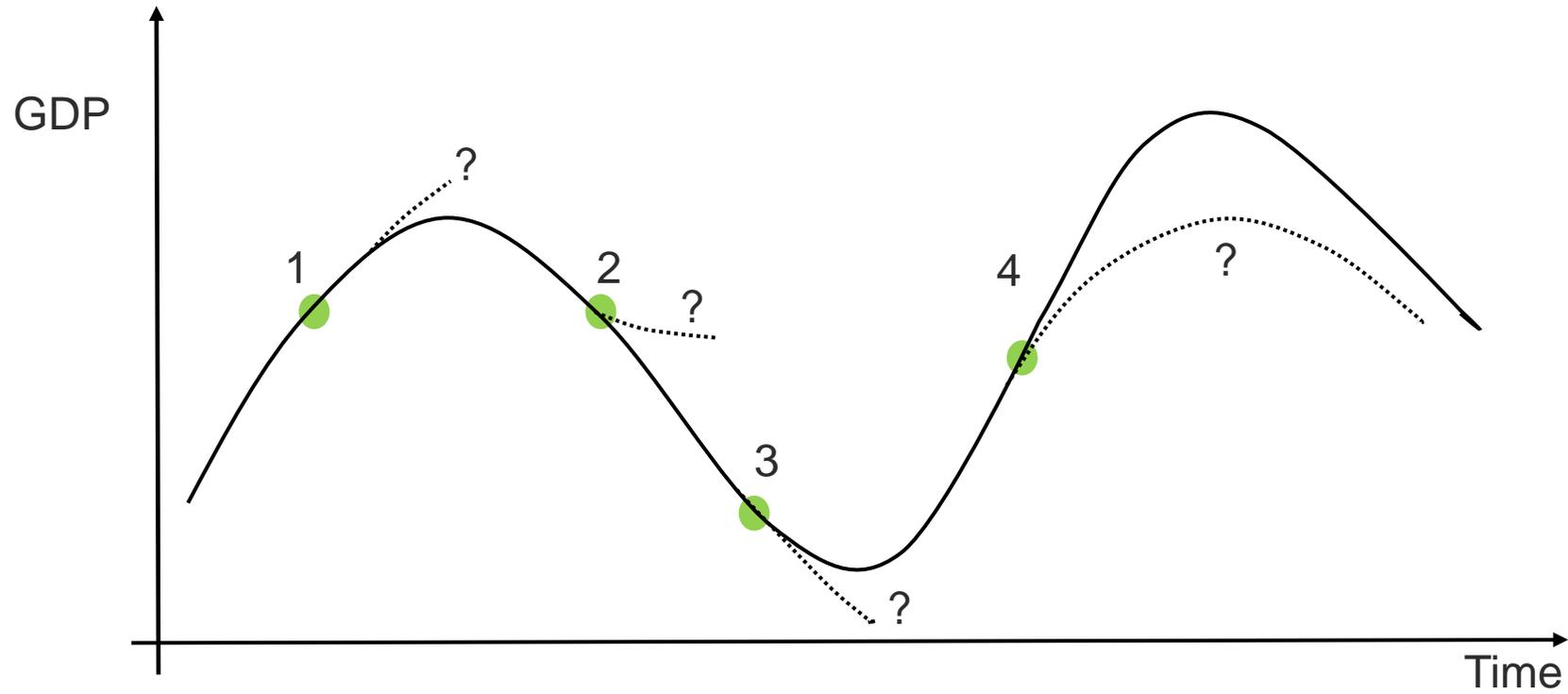
$$21 \div 6 = 3.5$$



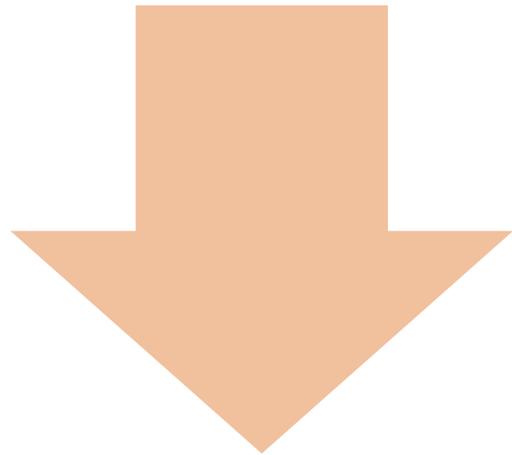
A subjective standard - Judgments

| SIGNIFICANT INCREASE IN CREDIT RISK | INITIAL RECOGNITION | SCENARIOS | LIFETIME EXPECTED LOSS |
|---|--|---|---|
|  |  |  |  |

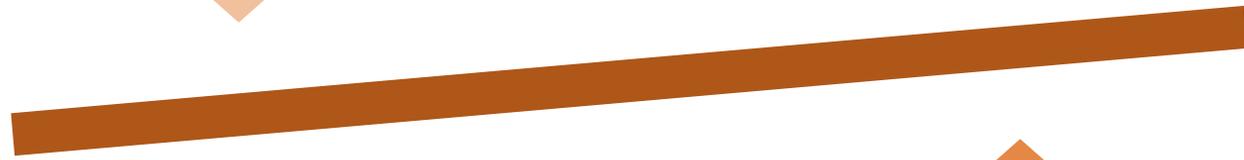
Predicting the future



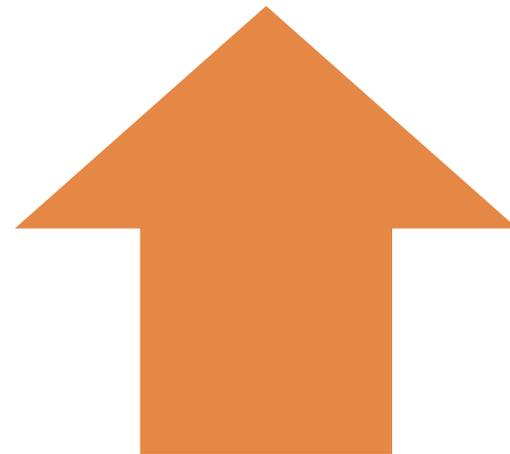
Primacy



Comparability



Forward
looking



Disclosures



<https://bit.ly/2DRp33K>

Recommendations on a
comprehensive set of IFRS
9 Expected Credit Loss
disclosures

A report prepared by
The Taskforce on Disclosures about Expected Credit Losses

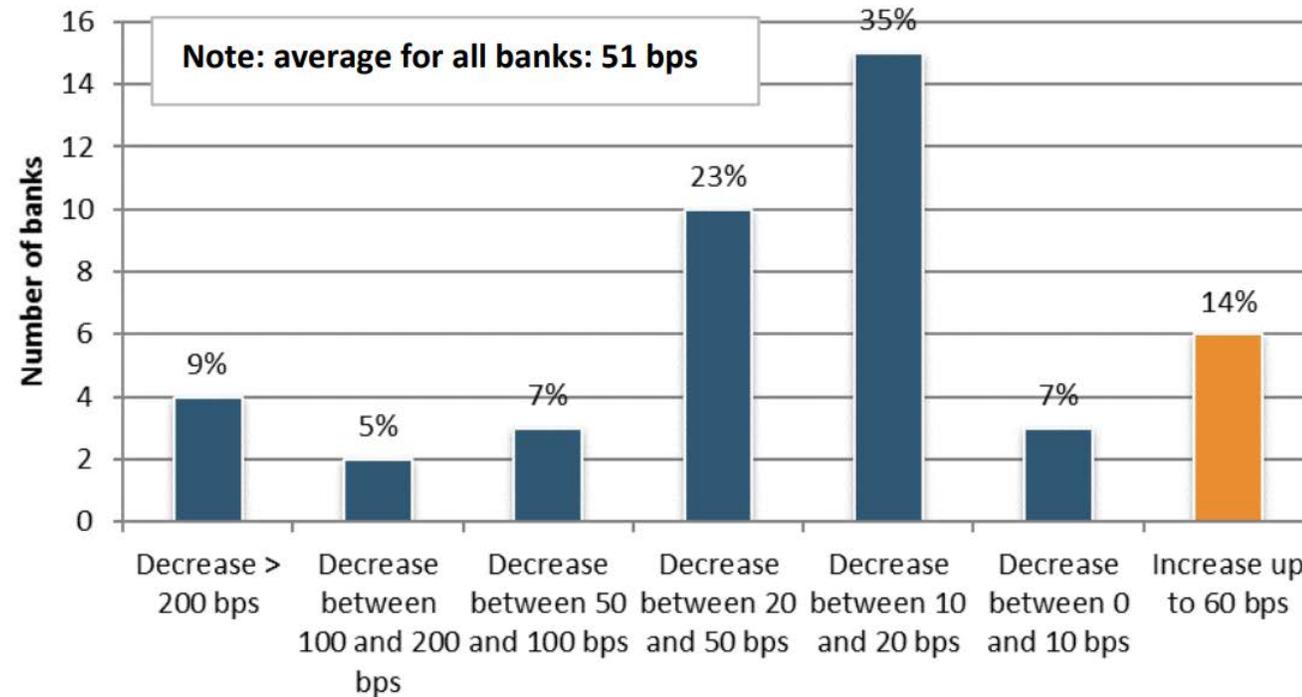
26 November 2018

Impact of IFRS 9 - UK

| No. of scenarios & probability | Scenario source | Bank | ECL | IAS 39 provisions | Delta |
|--------------------------------|--------------------------|---------------------------|----------|-------------------|-------|
| 5 | Consensus, BoE & vendor | Barclays | £7,531 | £4,769 | 58% |
| 3 (10,80,10) | Consensus & vendor | HSBC | \$10,201 | \$7,785 | 31% |
| 4 (30.30.30.10) | Stochastic model | LBG | £4,774 | £3,498 | 36% |
| 5 (5, 20,50,20,5) | Internal and Monte Carlo | RBS | £4,448 | £3,832 | 16% |
| 50 | Monte Carlo | Standard Chartered | \$6,908 | \$5,900 | 17% |
| 5 (10, 30,40,15,5) | Oxford Economics | Santander UK | £1,151 | £940 | 22% |

Impact of IFRS 9 – Europe

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



Impact of IFRS 9





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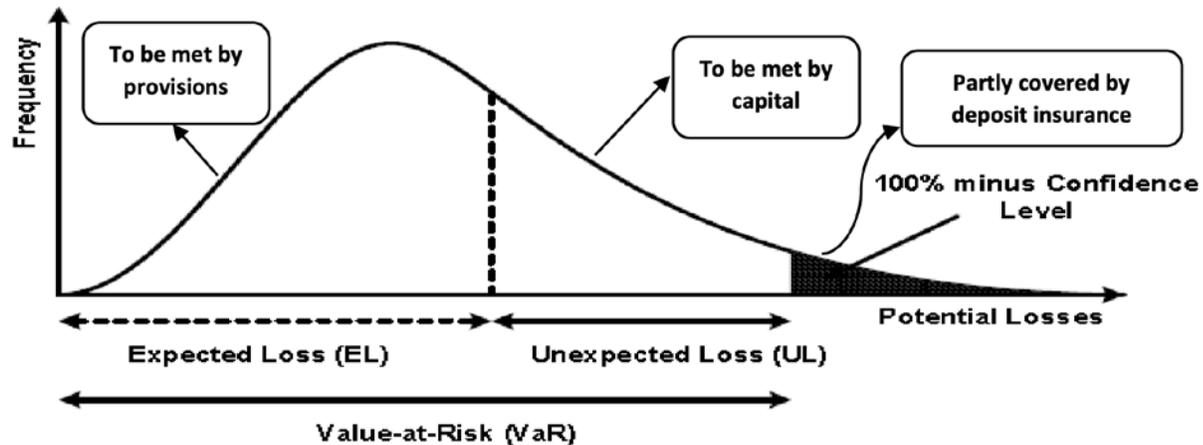
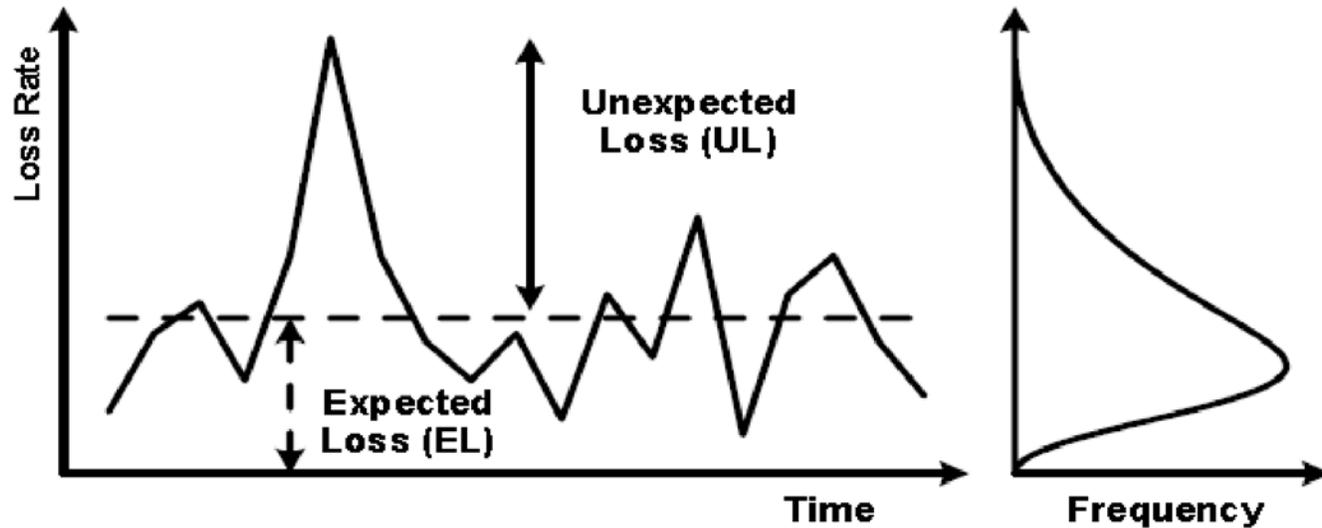
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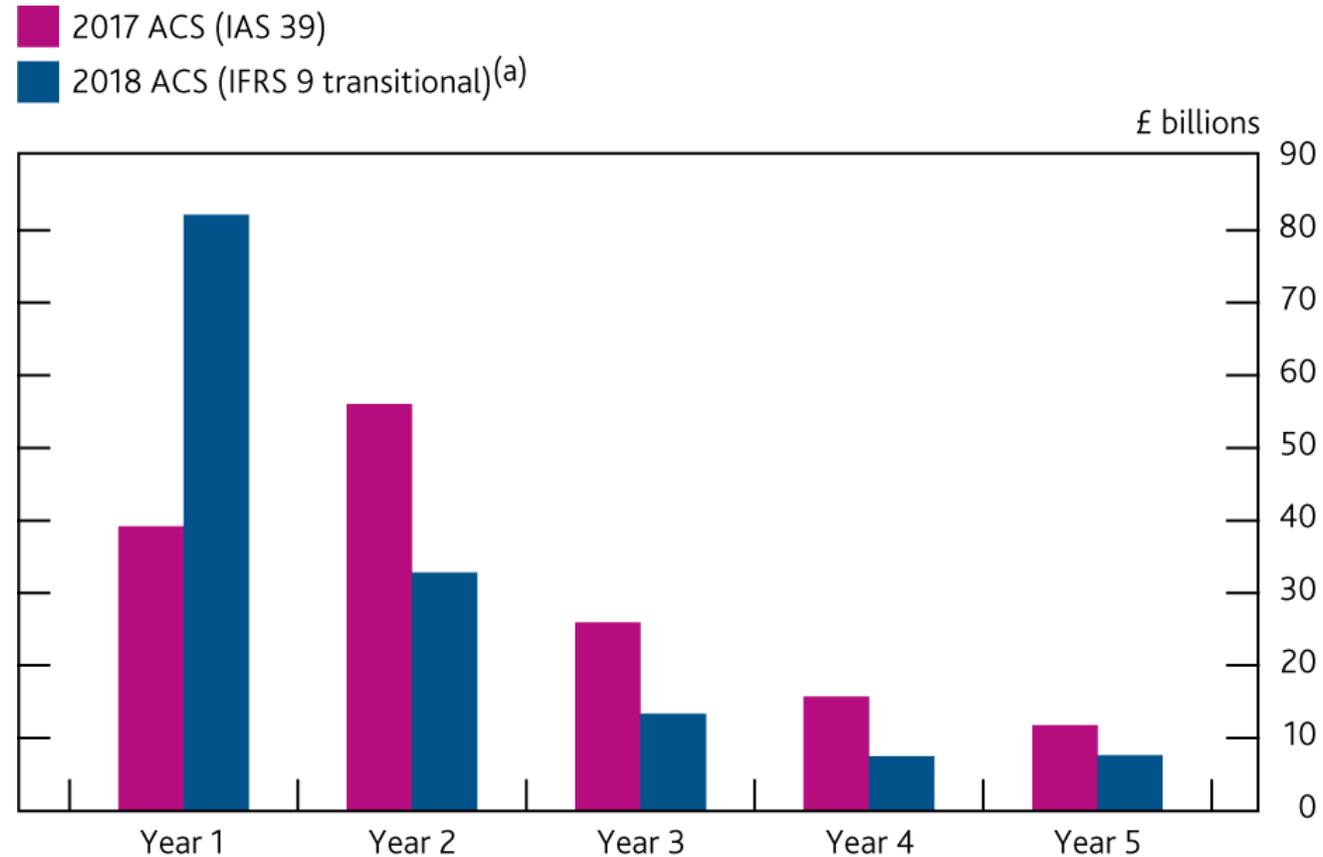


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Capital & Provisions



IFRS 9 – timing of provisions



Sources: Participating banks' STDF data submissions, Bank analysis and calculations.

(a) Transitional relief is calculated as the impact of IFRS 9 on credit losses but is applied directly to capital (ie transitional relief does not affect figures shown in this chart).

Comparison – IFRS9 vs. Regulatory

| PARAMETER | IFRS 9 | REGULATORY (Basel II) Internal Rating Based Approach |
|-----------------------------|---|---|
| Probability of Default (PD) | Point in time | Through the cycle (floor 0.03%) |
| Timescale | One year and lifetime | One year |
| Loss Given Default (LGD) | Unbiased estimate of LGD | Downturn LGD |
| Exposure at Default (EAD) | Present value over lifetime for Stage 2 and 3 | One year estimate |
| Expected Loss Calculation | $PD \times LGD \times EAD$ | Probability weighted estimate |
| Auditing | Auditors | Bank |