IFRS Accounting

Staff paper

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Introduction

1. At this meeting, the IASB will discuss feedback to the Request for Information Post-implementation Review of IFRS 9—Impairment (the RFI) and staff analysis on the IFRS 9 *Financial Instruments* requirements for measuring expected credit losses (ECL).

2. The purpose of this paper is to analyse feedback on the main requirements for measuring ECL—specifically, incorporation of forward-looking scenarios; use of post-model adjustments or management overlays (collectively referred as PMAs from hereon); and other matters related to measuring ECL.[1] This paper also provides staff analysis, recommendations, and questions for the IASB and is structured as:

   (a) a summary of staff recommendations and questions for the IASB;

   (b) a reminder of the requirements in IFRS 9;

   (c) a summary of feedback and staff analysis of that feedback; and

   (d) staff assessment of whether to take action in response to feedback.

[1] IFRS 9 does not include a definition for a PMA, however, entities use the terms 'post-model adjustments or management overlays' when referring to all overlays to statistical or other quantitative models, management overlays, model overrides or other adjustments made to model output when existing models do not adequately reflect risks and uncertainties.

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3. This paper has one appendix: Appendix A—Analysis of other feedback for which the staff conclude no further action is required.

Summary of staff recommendations and questions for the IASB

4. Based on the analysis in this paper, the staff recommend that the IASB takes no further action on matters raised by respondents regarding the use of forward-looking scenarios and PMAs in measuring ECL (see summary of staff conclusions in paragraphs 42−44 and 63−65 of this paper respectively).

Questions for the IASB
1. Does the IASB agree with staff recommendations summarised in paragraph 4 of this paper? 2. Does the IASB have any comments on the staff conclusions on other matters included in Appendix A?

Reminder of the requirements in IFRS 9

5. Paragraph 5.5.17 of IFRS 9 requires an entity to measure ECL of a financial instrument in a way that reflects:

   (a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

   (b) the time value of money; and

   (c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Summary of feedback and staff analysis

6. Almost all respondents provided feedback about measuring ECL and did not identify any fatal flaws with the principle-based requirements. However, they noted diversity in practice in some areas, primarily the incorporation of forward-looking scenarios and use of PMAs, where they think IFRS 9 does not provide sufficient application guidance and they suggested the IASB adds guidance to support greater consistency in application of the requirements in these areas.

Forward-looking scenarios

Summary of feedback

7. As noted in Spotlight 4.1 of the RFI, stakeholders told the IASB that they observe diversity in the number of scenarios entities identify, the variables they consider, and the weightings they attach to a particular scenario. The feedback to the RFI summarised below has been broadly consistent with this initial feedback.

   (a) ***Number of forward-looking scenarios and their probability weightings***

8. As noted in the Agenda Paper 27A for the IASB's November 2023 meeting, many respondents observed diversity in practice regarding the number of forward-looking scenarios entities use and the probability weighting they assign to each one of those scenarios.

9. For example, whilst acknowledging that many banks consider multiple forward-looking economic scenarios when measuring ECL, one prudential regulator observed that there is still diversity in how banks capture the impact of economic uncertainty when determining: (i) the range or severity of the economic scenarios that are to be considered; (ii) the probability weights assigned to those scenarios; and (iii) the approach for reverting to long-term averages for future periods for which detailed forecasts of economic conditions are not available at the reporting date.

10. Many of the respondents, including prudential regulators and accountancy firms, commenting on this topic said that, often, there is a non-linear relationship between different forward-looking scenarios and their associated credit losses. Consequently, using a single forward-looking scenario in such circumstances would not typically be appropriate. In their view, acknowledging the concept of non-linearity in IFRS 9 would be helpful in ensuring meaningful scenarios—that reflect the underlying non-normal distribution of credit losses—are selected.

11. They suggested that the IASB clarifies the objective of the scenario analysis—that is, clarify what entities are expected to achieve with the use of forward-looking scenarios and specify that entities need to consider significant non-linearities in the distribution of potential credit losses when defining and selecting scenarios.

12. A few of these respondents commented that in practice, interpretation of paragraph 5.5.18 of IFRS 9 led to a view that the use of multiple scenarios is seeking to incorporate and capture the effects of significant downside scenarios in the probability weighted average calculation; resulting in entities having to consider loss scenarios that their own risk management functions would not have normally taken into consideration. In their view, the intended objective of this paragraph in IFRS 9 was to capture non-linearity between variables and scenarios, rather than significant downside scenarios *only* when selecting more than one scenario.

13. In addition, these respondents said that the discussions of the IFRS Transition Resource Group for Impairment of Financial Instruments (ITG) provided helpful conclusions relating to this topic (see Agenda Paper 1 for December 2015 meeting) and suggested that the IASB considers incorporating the key conclusion in paragraph 49 of the summary paper for the December 2015 meeting into the requirements in IFRS 9.[2]

[2] Paragraph 49 of that summary paper notes that: '…when there is a non-linear relationship between the different forward-looking scenarios and their associated credit losses, using a single forward-looking economic scenario would not meet this objective. Instead more than one forward-looking scenario would need to be incorporated into the measurement of expected credit losses.'

14. Some prudential regulators and accountancy firms explained that additional guidance on this topic would help achieve greater consistency and support them in challenging the instances in which multiple scenarios were warranted but not used or the scenarios used by an entity were not meaningful.

(b) ***Variables considered and incorporation of exposure to climate risk in forward-looking scenarios***

15. Respondents observed diversity in practice in how entities use macroeconomic variables in forward-looking information and scenarios, acknowledging that significant level of judgment is required to determine which macroeconomic variables are to be used, and the extent to which these variables might impact the entity's exposure to credit risk (for example, how and to what extent expected changes in unemployment rates, property prices or commodity prices would impact each entity and its different credit exposures).

16. Some respondents suggested that the IASB provides application guidance or illustrative examples about how particular risks should be reflected in the forward-looking information and scenarios when measuring ECL, in particular, how the impact of climate risk is incorporated in the forward-looking information. They explained that many stakeholders are increasingly looking to financial statements for disclosures of the impact of climate risk on the reporting entity, and consequently climate risk is becoming a high focus area for some preparers.

Staff analysis

(a) ***Number of forward-looking scenarios and their probability weightings***

17. Paragraph 5.5.18 of IFRS 9 requires an entity to consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low. However, when measuring ECL, an entity need not necessarily identify every possible scenario.

18. As explained in paragraph B5.5.41 of IFRS 9, the purpose of estimating ECL is neither to estimate a worst-case scenario nor to estimate the best-case scenario. Instead, an estimate of ECL shall always reflect the possibility that a credit loss occurs and the possibility that no credit loss occurs even if the most likely outcome is no credit loss.

19. Paragraphs BC5.262–BC5.263 of the Basis for Conclusions on IFRS 9 further explain that the estimates of cash flows required in paragraph 5.5.17 of IFRS 9 are expected values. Hence, estimates of the amounts and timing of cash flows are based on probability-weighted possible outcomes. The term 'expected' as used in the terms 'expected credit losses', 'expected value' and 'expected cash flow' is a technical term that refers to the probability-weighted mean of a distribution and should not be confused with a most likely outcome or an entity's best estimate of the ultimate outcome.

20. Accordingly, as explained in paragraph BC5.264(a) of the Basis for Conclusions on IFRS 9, applying paragraph 5.5.17 of IFRS 9, an entity is required to consider *multiple scenarios, possible outcomes and their probability of occurrence*. However, the calculation of ECL need not be a rigorous mathematical exercise whereby an entity identifies every single possible outcome and its probability. Instead, when there are many possible outcomes, an entity can use a representative sample of the complete distribution for determining the expected value. The main objective is that at least two outcomes are considered: the risk of a default and the risk of no default, as explained in paragraph B5.5.42 of IFRS 9 and paragraph BC5.265 of Basis for Conclusions on IFRS 9.

21. We note that determining which scenarios are representative of the many possible outcomes will depend on whether, and if so where, there are significant non-linearities between the probability of default and the credit losses for a range of different forward-looking scenarios.

22. In such circumstances, the ECL derived from using a single scenario based on a most likely outcome will not be the same as the ECL determined by taking into account a

range of different forward-looking scenarios as illustrated in the example considered in paragraph 23 of the Agenda Paper 1 for the December 2015 meeting of the ITG. As outlined in that paper, using the submitter's simple example of a range of forward-looking unemployment scenarios, and taking into account all three scenarios gave rise to a much larger expected credit loss (CU92) than one calculated using a single central forward-looking scenario (CU70).

23. As previously noted, paragraph BC5.265 of Basis for Conclusions on IFRS 9 explains that when there are many possible outcomes, an entity can use a representative sample of the complete distribution for determining the expected value of the credit losses—meaning, when developing the requirements in paragraph 5.5.17 of IFRS 9, the IASB anticipated that there could be non-linearities between the forward-looking scenarios however these would be captured when a *complete and representative sample* is selected. It is evident from the feedback to the RFI that measuring ECL by using probability-weighted multiple scenarios is generally a common and a well-established practice, especially for example in the banking industry (see paragraph 9 of this paper) and the objectives of the IASB are therefore well understood amongst banking industry peers.

24. In the staff's view, an entity is required to apply judgement when determining the appropriate number of scenarios and the probabilities assigned to each scenario that will provide an unbiased outcome which also captures significant non-linearities. Such judgements will depend on facts that are available and circumstances that are specific to that entity and its credit exposures, and will need to be periodically reassessed as facts and circumstances change.

25. For example, paragraph 5.5.17(c) of IFRS 9 requires measuring ECL in a way that reflects reasonable and supportable information available, thus, selection and probability weighting of scenarios would need to be consistent with other information available such as the forecasts used elsewhere in the entity, including those for budgeting and forecasting, pricing of financial assets, internal credit risk management and other related accounting estimates. This is also consistent with ITG discussions

(see paragraph 55 of Agenda Paper 1, summary of the ITG meeting of December 2015).

26. Consequently, the diversity observed by one prudential regulator (see paragraph 9 of this paper) could be considered as the natural outcome of a principle-based ECL measurement approach that requires a degree of judgement. Any amendment to IFRS 9 to elaborate on the objective of the requirements in paragraph 5.5.17(a) and to capture the impact of non-linearity would not eliminate this diversity because, application of the requirements would still require a degree of judgement.

27. Although acknowledging that the use of a single-forward looking scenario would not be appropriate in cases of non-linearity might be useful and might add additional clarity to the objective of the requirements in IFRS 9, in the staff's view, this could not be achieved by simply incorporating the wording in paragraph 49 of Agenda Paper 1 (summary of the ITG meeting of December 2015) into IFRS 9, as suggested by a few respondents. Doing so might lead to misinterpretation of the requirements.

28. For example, a consequence of such an amendment could be that entities might decide to use multiple economic scenarios in reporting periods when the economic uncertainty is elevated and the non-linearity is more prominent, then revert to using a single base-case scenario in subsequent reporting periods when the economic outlook has improved and is more stable, resulting in inconsistencies within an entity's application of the requirements from one reporting period to the other.

29. We note that any amendment to elaborate on the objective of the requirements in paragraph 5.5.17(a) of IFRS 9 and to capture the impact of non-linearity would require a standard-setting process. Based on the criteria included in the IASB's framework for post-implementation reviews, in our view, the cost of such a standard-setting activity would be expected to outweigh the benefits of the resulting improvement.

30. This is because, as noted in paragraph 26 of this paper, making this clarification would not automatically result in consistent outcomes and thus, it might not

significantly improve the usefulness of information provided to users of financial statements. Therefore, any incremental benefit of clarifying the requirements in IFRS 9 would not be expected to exceed the costs arising from such a change (ie extent of potential disruption and operational costs are expected to be high). Most entities have already developed accounting policies and established practices for scenario analysis, therefore any amendments to the requirements could lead to disruption in practice and result in additional costs because all entities would be required to review their accounting policies to ensure compliance with the potential amendments.

31. Therefore, the staff recommend that the IASB makes no amendments to the requirements or the application guidance in IFRS 9 for this matter.

(b) ***Variables considered and incorporation of exposure to climate risk in forward-looking scenarios***

32. As required by paragraph B5.5.51 of IFRS 9, entities are expected to consider reasonable and supportable forward-looking information that is available without undue cost or effort that is indicative of a significant increase in the credit risk in their credit risk exposures since initial recognition and relevant to the estimate of ECL—focusing on underlying drivers of this risk such as factors that are specific to the borrower, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date.

33. Selection of macroeconomic variables is dependent on each entity's expectations of future economic conditions; as well as how and to what extent these conditions will impact its different credit exposures as at the reporting date, reflecting a point in time assessment. For example, an expected increase in the national unemployment rate could have a different impact on the ECL of a credit card portfolio than on the ECL of a residential mortgage portfolio.

34. In addition to the macroeconomic variables, applying paragraph B5.5.54, when considering all reasonable and supportable information that is available without undue

cost or effort in estimating ECL, an entity also considers observable market information about the credit risk of the particular financial instrument or similar financial instruments.

35. Measuring ECL would depend on how an entity manages its exposure to credit risk, including its risk appetite or tolerance (for example, the extent of the entity's use of mitigating measures such as reduction or removal of undrawn limits when there has been a significant increase in credit risk (SICR)). Even when entities have similar portfolios of credit risk exposures and are based in the same jurisdiction, it would be unlikely that they would have the same ECL measurements if they are managing their credit risk in different ways. Accordingly, it is possible that entities with similar portfolios of credit risk exposures may each have estimates of ECL that are unbiased, reasonable, and supportable, and yet might differ from each other.

36. As mentioned in the educational material published by the IASB in July 2023, climate-related matters could affect the range of potential future economic scenarios, the lender's assessment of SICR, whether a financial asset is credit impaired, and/or the measurement of ECL. For example, wildfires, floods or policy and regulatory changes could negatively affect a borrower's ability to meet its debt obligations to the lender (ie probability of default). Further, collateral assets could become inaccessible or uninsurable, affecting the value of collateral for lenders.

37. Therefore, entities are expected to consider the impact of climate risk in their expectations of future economic conditions and macroeconomic variables and incorporate it in their forward-looking scenarios to the extent that information about the impact of client risk is reasonable, supportable and available without undue cost or effort at the reporting date. In the staff's view, this is already captured by the requirements in paragraph 5.5.17(c) of IFRS 9.

38. However, as noted in paragraph B5.5.50 of IFRS 9, in estimating the impact of climate risk for the purposes of measuring ECL, an entity is not required to incorporate forecasts of future conditions over the entire expected life of a financial instrument for long term exposures. The estimate of ECL does not require a detailed

estimate for periods that are far in the future—for such periods, an entity may extrapolate projections from available, detailed information. In addition, as IFRS 9 requires for the ECL to be measured for an entity's credit risk exposures as at reporting date, the entity is not required to consider the impact of climate risk on future exposures that do not exist as at the reporting date.

39. Therefore, the staff recommend not to include any specific requirements about macroeconomic variables required, and the impact of climate risk, in measuring ECL.

40. However, the staff acknowledge that many stakeholders including prudential and securities regulators are increasingly looking to financial statements for disclosures of the impact of climate risk on the reporting entity, and consequently climate risk is becoming a high focus area for some preparers.

41. The staff are aware that, as part of the Climate-related and other uncertainties in the financial statements project, the IASB is considering to provide some illustrative examples, including a potential example illustrating disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* about the effects of climate-related risks on an entity's credit risk management practices and how these practices relate to measuring ECL. If the IASB were to add such an example to IFRS 7, we think that would also address some of the post-implementation review (PIR) feedback in this area.

Staff Conclusion

42. The staff recommend no amendments to the measurement requirements for ECL in IFRS 9, including no additional application guidance for incorporation of forward-looking scenarios. This is because the requirements in paragraphs 5.5.17−5.5.18 of IFRS 9, and the related application guidance provide an adequate basis for an entity to determine how to measure ECL for its credit exposures.

43. For the reasons included in paragraph 33 of this paper, the staff conclude that there is no need to add any additional requirements or application guidance to IFRS 9 for selection of macroeconomic variables to be used in measuring ECL.

44. In regard to incorporation of climate risk in forward-looking scenarios, we think it is clear that in applying IFRS 9, an entity is required to identify to what extent (if any) climate risk would impact its existing credit risk exposures as at the reporting date, and consider whether its inclusion in measuring ECL is reasonable and supportable without undue cost or effort at that date. However, the staff acknowledge that developing an illustrative example, as described in paragraph 41 of this paper, could be helpful in providing users of financial statements with enhanced transparency about the effects of climate risks, if and when applicable.

Post-model adjustments or management overlays

Summary of feedback

45. As noted in Spotlight 4.2 of the RFI, stakeholders have told the IASB that the increased uncertainty in recent years, particularly economic conditions for which historical information is not necessarily representative of the future economic outlook, have given rise to an increase in the use of PMAs. The size and subjective nature of such adjustments and the reasons for their use vary significantly from entity to entity, reducing comparability of ECL between entities. The feedback to the RFI has been broadly consistent with this initial feedback.

46. As summarised in paragraph 25 of the Agenda Paper 27A for the IASB's November 2023 meeting, respondents across all stakeholder groups noted that, in recent years, the use of PMAs has significantly increased as a way to capture the impact of emerging risks. Most respondents who commented on this matter, including preparers, said these adjustments have been a helpful tool to support timely recognition of ECL because they compensate for the limitations of statistical models and the lack of historical information that would be representative of their future expectations.

47. One prudential regulator said that while the use of PMAs have been important in ensuring timely recognition of credit losses, there is limited guidance in IFRS 9 to support their appropriate use. It has observed weaker practices related to PMAs that,

in its view, may result in a potential underestimation of ECL and a delay in recognition of a SICR.

48. That prudential regulator further elaborated that such practices include:

    (a) the use of PMAs that are aimed at covering a broad spectrum of unrelated risks and/or multiple portfolios or borrower groups without a clear distinction of the amount related to each risk (ie so-called ‘umbrella overlays’). These approaches tend to be highly approximate and may not be sufficiently risk-sensitive to result in timely recognition and measurement of ECL.

    (b) the use of PMAs that increase ECL without a corresponding transfer of exposure to lifetime ECL stage. This includes instances where PMAs are applied at the level of the overall ECL amount only (ie an amount added at the end of the process to the quantitative model output), as opposed to at the risk parameter level (eg probability of default or loss-given-default), without risks being consistently considered as part of a collective SICR assessment.

49. In that prudential regulator’s view, when risk factors driving the use of PMAs at the ECL level are linked to the risk of default (eg uncertainty about the impact of high inflation on borrowers’ payment capacity), their effects should also be taken into account in the assessment of SICR. For these purposes, it suggested that the IASB explicitly requires that in such cases complementary measures, such as collective SICR assessments, are expected to be applied to ensure that the requirements of IFRS 9 are met.

50. Many respondents (including some accountancy firms, prudential regulators, and standard-setters) noted that, by nature, PMAs often involve a high degree of subjective management assessment and could have a significant effect on measuring ECL. They reported diversity in the way PMAs are recognised and a general lack of transparency about how a PMA is determined, reducing the usefulness of information about ECL to users of financial statements. This feedback is consistent with feedback by an organisation representing analysts.

51. A few respondents commented that, by nature, the use of PMAs should only be transitory and limited to a short period of time. However, in practice entities tend to 'repurpose' PMAs and not release them. For example, one respondent quoted the observations of a prudential regulator that pre-pandemic PMAs were repurposed to provide for risks and uncertainties that arose during covid-19 pandemic. Another respondent commented that the timing of the release or reversal of PMAs remains a great challenge.

52. Respondents acknowledged that IFRS 9 and IFRS 7 set out the requirements for the measurement and disclosure of ECL and the same requirements are applied regardless of how an entity estimates ECL. However, in the light of diversity in practice, they suggested that the IASB adds some application guidance to IFRS 9 around the use and release of PMAs (without including any specific suggestions) and additional disclosure requirements to IFRS 7 to help achieve greater consistency.

Staff analysis

53. When developing the requirements in IFRS 9, the IASB decided not to list acceptable methods that might rule out other appropriate methods for measuring ECL or be interpreted as providing unconditional acceptance of a particular method. Instead, as noted in paragraph BC5.242 and BC5.266 of the Basis for Conclusions on IFRS 9, the IASB kept the requirements for measuring ECL principle-based and concluded that each entity should determine the most appropriate technique(s) and methodologies to meet these requirements.

54. Regardless of the techniques used for measuring ECL, IFRS 9 requires that an entity adjusts its measurement approach in different circumstances to reflect reasonable and supportable information—that is, historical, current and forward-looking information—which is available without undue cost or effort as noted in paragraph 5.5.17 of IFRS 9.

55. The staff acknowledge that the use of PMAs might be an effective way of capturing emerging risks that are not adequately reflected in the models used for measuring

ECL. The necessity of PMAs arises from the fact that entities may encounter risks or events that are either not contemplated within their existing quantitative models or for which there is insufficient time or information to recalibrate the model. This is particularly relevant in rapidly evolving economic environments in which new risks can emerge with little historical precedent.

56. As explained in paragraphs 53 and 54 of this paper, IFRS 9 has well-described objectives of what an entity is required to achieve in measuring ECL but it does not prescribe specific techniques for measuring ECL and allows entities the flexibility to apply judgement and select methods that are most appropriate for their circumstances. This principle-based approach is designed to accommodate a wide range of circumstances, including the use of PMAs.

57. In the staff's view, determining whether the use or reversal of a PMA is necessary and directionally consistent with changes in credit risk requires judgement, and is required to be consistent with the objective and measurement requirements of ECL in IFRS 9. Such judgement is built upon an entity's credit risk management practices regarding its exposures, risk mitigation practices and how they may be affected by idiosyncratic events and conditions that cannot be easily captured by statistical or other quantitative models.

58. As noted in paragraph 48(b) of this paper, feedback to the RFI indicates that sometimes entities recognise PMAs as a 'substitute' for doing a collective assessment for SICR. However, we note that the requirements in IFRS 9 are clear that the assessment of SICR is different, and separate, to measurement of ECL. In our view, the use of PMAs cannot be a 'substitute' for an assessment of SICR, because:

    (a) as per paragraph 5.5.9 of IFRS 9, an entity is required to assess whether the credit risk on a financial instrument has increased significantly since initial recognition and, when making this assessment, use the change in the risk of a default occurring over the expected life of the financial instrument, and not the *change in the measurement amount of ECL*.

(b) the trigger for recognising lifetime ECL is a significant increase in credit risk. Therefore, a PMA that adjusts ECL measurement cannot be a substitute for an assessment of SICR, regardless of whether this assessment is done on an instrument-by-instrument, or on a collective, basis.

(c) measuring a lifetime ECL represents expected credit losses that result from all possible default events over the expected life of a financial instrument or a group of financial instruments, whilst a significant increase in credit risk indicates that the credit quality of a financial instrument or a group of financial instruments has deteriorated since initial recognition.

59. We considered feedback that some entities use ‘umbrella overlays’, however, we note that recognising general provisions is inconsistent with the objective of impairment requirements in IFRS 9. PMAs cannot represent general provisions, regardless of whether the ECL is measured on an instrument-by-instrument, or on a collective, basis.

60. As noted in paragraph B5.5.4 of IFRS 9, in circumstances whereby an entity does not have reasonable and supportable information available to measure lifetime ECL on an individual instrument basis, it can do so on a collective basis. However, when measuring ECL collectively, an entity is required to use comprehensive credit risk information to ensure the collective lifetime ECL recognised approximates the result of recognising lifetime ECL when there has been a SICR since initial recognition on an individual basis.

61. The principle-based approach of IFRS 9 does not prohibit the use of PMAs, as long as their use is consistent with the impairment requirements of the Accounting Standard and achieve their objective (ie to recognise a lifetime ECL for all financial instruments for which there has been a SICR since initial recognition—whether assessed on an instrument-by-instrument or collective basis, considering all reasonable and supportable information, including that which is forward-looking, see paragraph 5.5.4 of IFRS 9).

62. This was acknowledged by the IASB in the educational material published by the IASB in March 2020 regarding application of IFRS 9 in the light of the coronavirus uncertainty. In that material, the IASB noted that, applying the principles in IFRS 9, if an entity was not able to reflect the effects of covid-19 in its statistical or quantitative models, PMAs had to be considered in order to achieve the objective of impairment requirements in IFRS 9.

Staff Conclusion

63. In the staff's view, it is clear that IFRS 9 does not prohibit the use of PMAs, if doing so is consistent with the impairment requirements of the Accounting Standard and will help entities achieve the objective of these requirements.

64. The primary concern identified by respondents is the diversity in practice and the lack of transparency surrounding PMAs. This lack of transparency can hinder the ability of investors to understand and assess the impact of PMAs on ECL measurements. To address this issue, the staff will consider whether enhancing disclosures could provide a more effective solution. The IASB will discuss the feedback analysis on credit risk disclosures at a future meeting.

65. Therefore, the staff recommend that the IASB makes no changes to the requirements or the application guidance in IFRS 9 regarding this matter.

Staff assessment—Is further action needed?

Step 1—do the PIR findings evidence that action is needed?

66. The staff assessed the above topics against the PIR framework to determine whether any further action needs to be taken:

PIR evaluation requirements	**Staff assessment**	
	Incorporation of forward-looking scenarios	***Use of PMAs***
Are there fundamental questions (ie ‘fatal flaws’) about the clarity and suitability of the core objectives or principles in the new requirements?	**No.** Feedback to the RFI and the staff analysis in this paper on the matters identified indicated that the ECL measurement requirements regarding the use of forward-looking scenarios and PMAs are working as intended and that there are no fundamental questions about the clarity or suitability of the requirements in IFRS 9.	
Are the benefits to users of financial statements of the information arising from applying the new requirements significantly lower than expected?	**No.** Although, some respondents raised concerns that the diversity in practice relating to the incorporation of forward-looking scenarios and the use of PMAs in measuring ECL results in different ECL measurement outcomes and consequently reduce the usefulness of information provided to users of financial statements, we note that differences in measurement outcomes are inherent in principle-based requirements for measurement of ECL. As noted in paragraph 35 of this paper, measuring ECL would depend on how an entity manages its exposure to credit risk, including its risk appetite or tolerance. This means, the principle-based requirements allow an entity to reflect the effect of entity’s own credit risk management practices in the measurement of ECL. Ultimately, this results in a faithful representation of ECL and, thus, useful information being provided to users of financial statements.	

PIR evaluation requirements	Staff assessment	
	Incorporation of forward-looking scenarios	***Use of PMAs***
Are the costs of applying the new requirements and auditing and enforcing their application significantly greater than expected?	**No.** Although some respondents have indicated that the objective of incorporating forward-looking scenarios for the purpose of applying the requirements in paragraph 5.5.17(a) of IFRS 9 could be clarified to mitigate audit and enforcement challenges in some cases, in our view, that feedback does not suggest that the costs of applying the requirements and auditing and enforcing their application are significantly greater than expected. As explained in paragraphs 26–30 of this paper, while we acknowledge that such a clarification might be beneficial, we do not think that the incremental benefits would outweigh the costs of that amendment.	**No.** Feedback to the RFI did not provide any evidence that the cost of applying, auditing or enforcing the application of the ECL measurement requirements regarding the use of PMAs are significantly greater than expected.

Appendix A—Other feedback

The following table outlines the feedback that includes application questions for which the staff conclude no further action is required.

A1. Forecast collection costs

Requirements
Paragraph B5.5.55 of IFRS 9 states that for collateralised financial instruments, the estimate of expected cash shortfalls reflects the amount and timing of cash flows that are expected from foreclosure on the collateral less the costs of obtaining and selling the collateral, irrespective of whether foreclosure is probable (ie the estimate of expected cash flows considers the probability of a foreclosure and the cash flows that would result from it).
Application question
A few respondents said that there is no similar guidance on the accounting for collection costs relating to uncollateralised financial assets (eg commission payable to a debt-collection agency), resulting in inconsistency in practice.
Staff analysis
In the staff's view, collection costs are part of the fees incurred for servicing a financial asset. As per the requirements in paragraph B5.4.3 of IFRS 9, servicing fees are not an integral part of the effective interest rate of a financial instrument, and therefore not taken into account in estimating the future cash flows of the instrument when determining its effective interest rate. By way of an analogy, it might not be appropriate to consider these costs as integral to the recovery of future expected cash flows of a financial asset for measuring its ECL either. **The staff recommend that no action is taken on this question, as the matter is not widespread or expected to have a material effect.**

A2. Impact of collateral on definition of 'credit-impaired'

Requirements

As per Appendix A of IFRS 9, a financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:

- significant financial difficulty of the issuer or the borrower;
- a breach of contract, such as a default or past due event;
- the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired.

Application question

A few respondents noted that when financial assets are highly or fully collateralised, but are in default (eg payments are more than 90 days past due), it is not clear if the financial assets would qualify as credit–impaired. In their view, this is because the definition of credit–impaired in Appendix A of IFRS 9 refers to 'a detrimental impact on the estimated future cash flows' but it is not clear whether this should be read to include any recoveries from the realisation of collateral.

Staff analysis

Paragraph B5.5.12 of IFRS 9 clarifies that an entity separates the changes in the risk of a default occurring from changes in other drivers of ECL, such as collateral. Therefore, when assessing whether a significant increase in credit risk has occurred, an entity does not take into account the value of the collateral. Similarly, the definition of credit-impaired does not take into account

recoveries from the realisation of the collateral. Recovery of outstanding cash flows via realisation of collateral suggests that a breach of the contract such as default or a past due event has occurred and the financial asset is credit-impaired as per the definition in Appendix A of IFRS 9.

Because measuring ECL considers the amount and timing of payments, as per paragraph B5.5.28 of IFRS 9, a credit loss arises even if the entity expects to be paid in full (ie the instrument is fully collateralised) but later than when contractually due. Therefore, an entity is required to take into account the amount and timing of the realisation of the collateral that is not recognised separately when measuring ECL, as per paragraph B5.5.55 of IFRS 9.

The staff recommend that no action is taken on this question, as IFRS 9 provides an adequate basis to determine whether and when fully collateralised financial assets are considered credit-impaired.

A3. Interest revenue recognition for credit-impaired financial assets

Requirements
Paragraph 5.4.1(b) of IFRS 9 requires that for financial assets that are not purchased or originated credit-impaired, but subsequently have become credit-impaired, an entity applies the effective interest rate to the amortised cost of the financial assets in subsequent reporting periods.
Application question
A few respondents noted that based on the wording in paragraph BC5.78 of the Basis for Conclusions on IFRS 9, it is not clear whether the change in interest calculation from the beginning of the subsequent reporting period is a requirement or a practical expedient. Some of those who view this as a practical expedient consider that the revised interest calculation from earlier dates/periods is acceptable, if practicable.
Staff analysis
The staff note that paragraph 5.4.1 (b) of IFRS 9 says '…the entity shall apply the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.' The use of 'shall' indicates that this is a requirement. Paragraph BC5.78 of Basis for Conclusions on IFRS 9 does not override the requirement in paragraph 5.4.1(b) of IFRS 9. Consistent with the nature of a basis for conclusions explanation, paragraph BC5.78 simply provides insights into the IASB's rationale

behind the requirements in paragraph 5.4.1(b) of IFRS 9, and it neither provides a practical expedient nor a policy choice.

Therefore, in the staff's view, it is clear that for financial assets that become credit-impaired, entities are required to measure the interest revenue on the basis of the net carrying amount (gross carrying amount less ECL) from the start of the reporting period after they became credit-impaired. In the staff's view, no further clarification to the requirements of IFRS 9 is considered necessary.

The staff recommend that no action is taken on this question, as IFRS 9 provides an adequate basis to determine when interest revenue is measured based on a net carrying amount.