Arrangements for mitigating the impact of IFRS 9

The legislative proposal regarding transitional arrangements for mitigating the impact of international financial reporting standard (IFRS) 9 on financial institutions' regulatory capital is scheduled to be voted in the November II plenary session. These arrangements should enter into force before the start of the mandatory application of IFRS 9, on 1 January 2018. Therefore, the European Parliament and the Council had agreed to adopt them using a rapid procedure.

Background

In July 2014, the International Accounting Standards Board (IASB) published international financial reporting standard (IFRS) 9, an international accounting standard for financial instruments, which responded to the G20's call to move to a more forward-looking model for estimating expected credit losses on financial assets. The most significant innovation introduced by IFRS 9 is the change from an incurred credit loss (ICL) approach to an expected credit loss (ECL) approach. Application of IFRS 9 could lead to a sudden increase in ECL provisions and a consequent fall in regulatory capital ratios.

Commission proposal

On 23 November 2016, the European Commission adopted its review of the current legislation on bank capital requirements (the fourth Capital Requirements Directive (CRD 4) and the Capital Requirements Regulation (CRR)). The package included transitional arrangements aimed at preventing any unwarranted impact of the introduction of IFRS 9 on EU banks' regulatory capital (proposal for new Article 473a of the CRR). The European Commission proposes a five-year phase-in period, based on decreasing reliefs in the additional provisioning requirements arising from the application of IFRS 9. The phasing-in period would also provide time to observe the possible pro-cyclicality effects of the revised approach, as well as to agree internationally harmonised prudential treatment of the expected credit losses under IFRS 9 and the US equivalent, the revised generally accepted accounting principles (GAAP) standard on financial instruments, which will enter into force in 2020. As the new arrangements must enter into force before the start of the mandatory application of IFRS 9, the European Parliament and Council agreed to treat the relevant provisions separately from the remainder of the proposal, and adopt them through a fast-track procedure.

European Parliament position

Following trilogue discussions, Parliament and Council reached a compromise on 25 October 2017, which confirms the five-year phase-in period, during which banks will be allowed to add a portion of the additional provisions, due to the application of IFRS 9, back onto their regulatory capital (Common equity tier 1, CET1). The adjustments refer to provisions arising at the point of transition. Some capital relief for post-transition additional provisions is granted, in line with the Parliament's position. The portion of additional provisions that can be added back onto CET1 decreases over time from 95 % to zero, to deliver full implementation of the new regime on the day immediately after the end of the transitional period. Consistent with the standard on regulatory treatment of accounting provisions of the Basel Committee, the impact of the new impairment model on CET1 is never fully neutralised. The agreed text also envisages a three-year phase-out of provisions on the treatment of certain banks' large exposures to public-sector debt denominated in non-domestic currencies of Member States (new Articles 493(4) and (5) of the CRR).

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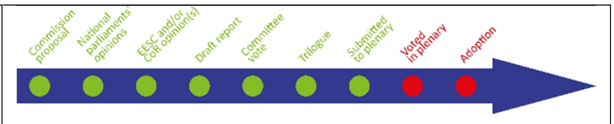

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