



Further PRA guidance on IFRS9 and Capital

Framework for a Holistic Assessment of Loans Subject to Payment Deferrals

Following the PRA's initial publication to ensure a consistent and robust application of the Expected Credit Loss (ECL), the regulator published further guidance regarding IFRS9 and capital requirements on 4th June, which introduces a holistic framework to assess the riskiness of payment deferrals. Similarly, the FCA finalised its operational directive on payment deferrals.

PRA's initial guidance

The PRA's accounting guidance, issued on 26th March, is still **seen as critical** for implementing the IFRS9 "ECL" requirements.

1. ECL should be **implemented** on the basis of the most **robust, reasonable and supportable information** in the current environment.
2. **Forward-looking assessment** should take into account a **balanced view** of the impact of covid-19 and the level of support from the governments.
3. **Assumptions** used for implementing ECL prior to covid-19 **should not be used automatically** as they do not hold in the current environment.

FCA Guidance on payment deferrals

- Under the final guidance published on 4th June, it is **not necessary to tailor** the payment deferral to the individual **financial circumstances** of the borrower.
- The borrower can decide to take additional, full or partial deferral payments, which lenders **are required to grant**.
- There is **no expectation** that lenders must **investigate the borrower's circumstances** or gather further information during the payment deferral application.
- Lenders can **offer additional options** tailored to the borrower's best interest.
- Based on the FCA's guidance, taking a payment deferral **tends not to be an effective indicator of SICR** or credit impairment.
- It would **not be appropriate** for lenders to assume that **all deferred loans have necessarily suffered a SICR**, but it is unlikely that none of these loans would be transferred to stage 2 or 3.

PRA's proposed Framework

The PRA has set up a holistic assessment of loans subject to payment deferrals that is beyond the sole use of past due information and combines the following four elements:

1) Consideration of economic conditions

- The treatment of payment deferrals should be considered in the context of the current economic conditions. It is important to assess temporary financial difficulties in the context of the duration of lockdown measures and job retention schemes.
- When assessing SICR, firms should consider the impact of updating economic scenarios and weights on loan-level PDs, which will likely result in some transfers to stage 2.

2) Use of historical information that firms hold on borrowers

- Due to the limited information available, firms should perform additional analyses to assess the level of risk associated with borrowers that have benefited payment deferrals.
- Firms should use historical information (e.g. payment history and last known industry the borrower is exposed to), in order to determine if any segments of the portfolio have suffered SICR.

3) Information gathered from customers using payments deferrals

- It is clear from the FCA's guidance that there is no expectation that firms must gather borrower-specific information or investigate the deferral payment request. However, firms should gather additional information when granting payment deferrals (e.g. borrower employment status or the change in household income).

4) Application of judgement

- Based on their analysis, firms can either perform adjustments to allocate some segments in different ECL stages or confirm that the current SICR criteria are working effectively.



Contact

Fintegral

Frankfurt | London | New York | Zurich

www.fintegral.com

Dilbagh Kalsi

Partner, Head of UK Practice
Fintegral UK Ltd

+44 (0)7703 788 016
dilbagh.kalsi@fintegral.com

Fintegral UK Ltd
City Tower, 40 Basinghall St
London EC2V 5DE
United Kingdom

Samuele D'Altri

Senior Manager
Fintegral UK Ltd

+44 (0)7494 855 102
samuele.daltri@fintegral.com

Fintegral UK Ltd
City Tower, 40 Basinghall St
London EC2V 5DE
United Kingdom

Dinh Pham

Manager
Fintegral UK Ltd

+44 (0)7450 984 677
dinh.pham@fintegral.com

Fintegral UK Ltd
City Tower, 40 Basinghall St
London EC2V 5DE
United Kingdom