BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Please note: This letter has been prepared for the website. Versions of this letter were sent by Victoria Saporta to the CFOs of selected firms.

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15 January 2019

Dear CFO

Disclosures about International Financial Reporting Standard (IFRS) 9 expected credit losses

You will be aware, from letters Sam Woods wrote to your CEO in November 2016 and August 2017 and I wrote to you in January 2018,[1] of the importance we attach to good market disclosure about IFRS 9 expected credit loss accounting (ECL) at accounting period-ends. Indeed, good ECL disclosure is essential if your firm is going to be able to explain its ECL story in a way that users of your financial reports will be able to understand and use as the basis for their analysis.

However, although there seems to be widespread agreement that such disclosure needs to be comprehensive, appropriately focused, at the right level of granularity, noticeably similar from firm to firm and reliable, there seems to be much less agreement on what those terms mean in practice. This creates risks for market confidence, and possibly also financial stability. It is not our role to set, interpret or enforce accounting standards but, where the application of those accounting standards has an impact on our statutory objectives, we have an interest in how the standards are implemented. We therefore decided last year to ask preparers and market participants to work together (as the Taskforce on Disclosures about Expected Credit Loss) to try to reach a consensus on what good disclosure looks like. We, the Financial Conduct Authority, and the Financial Reporting Council have since been sponsoring the Taskforce's work. We are pleased that your firm nominated someone to participate in this initiative.

The Taskforce's first report 'Recommendations on a comprehensive set of IFRS 9 Expected Credit Loss disclosures'[2] was published in November. We have studied the report with interest and note the commitment your group and six others have given in the British Bankers' Association Code for Financial Reporting Disclosure[3] to assess, and reflect to the extent relevant to their business models and mixes, good practice recommendations such as those in the report. The Taskforce's recommendations will be relevant to your business model and mix, so those commitments mean we would expect your firm to be looking to adopt the report's recommendations in full.

The report explains that the recommendations are intended to be 'stretching'; in other words, although the Taskforce believes all the recommendations could be adopted in full within two or three years, it accepts that not all firms will be able to provide all the disclosures described in full initially. With that in mind, we encourage your firm to make as much progress as possible in adopting the recommendations in your next annual report. We will from time to time be asking your firm to update us on your adoption plans, and for a report of your firm's progress against those plans.

We have some additional comments on two matters the report specifically mentions as areas on which the Taskforce might develop more detailed recommendations in due course: disclosures around measurement uncertainty and sensitivity, and disclosures around the use of Monte Carlo approaches.

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[1] All these letters are available at: https://www.bankofengland.co.uk/prudential-regulation/letter/2017/transition-disclosures-for-ifrs9-financial-instruments.

[2] https://www.frc.org.uk/getattachment/dbd534bb-a25e-43f5-9c76-4319cf624c83/DECL-Report-November-2018.pdf.

[3] The seven groups are those headed by Barclays plc, HSBC Holdings plc, Lloyds Banking Group plc, Nationwide Building Society, Santander UK plc, Standard Chartered PLC and The Royal Bank of Scotland Group plc. The BBA Code for Financial Reporting Disclosure can be found at https://www.bba.org.uk/policy/financial-and-risk-policy/financial-reporting/uk-disclosure-group/bba-adopts-new-disclosure-code/.

Measurement uncertainty and sensitivity

When I wrote to you in January 2018, and as Section G of the Taskforce report explains, I explained the importance we attach to good disclosures about measurement uncertainty and sensitivity. Firms need to understand the sensitivity of their ECL-related estimates to the key drivers of the ECL estimates (in other words, the subjective elements and inputs that are or could become more fundamental to the provisioning levels), and to do that firms need to have quantitative information about that sensitivity available internally. It seems reasonable for market participants to expect to be put in a position where they too can understand the sensitivity of firms' ECL estimates to those key drivers. This will involve quantitative measurement uncertainty and sensitivity information being provided as part of the normal period-end reporting. For that reason, we expect all the firms to be providing useful quantitative measurement uncertainty and sensitivity information from their 2018 (or 2018/2019) annual reports and accounts.

The use of Monte Carlo approaches

When firms were designing their ECL methodologies, a commonly heard concern was that it would be difficult if Monte Carlo approaches were used to explain that usage to market participants in an informative way. We presume those firms that decided to use Monte Carlo approaches will have done so having concluded they would be able to provide, from their 2018 (or 2018/2019) annual reports, disclosures explaining that use and its implications in a comprehensive and appropriately focused way and at an appropriate level of granularity.

If you have any questions concerning this letter, please get in touch with me or your usual supervisory contact.

Yours sincerely