BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Getting ready for IFRS 9 – a note for non-executive directors

Who should read this note?

Any non-executive director (NED) who sits on the board of a firm that is affected by the implementation of International Financial Reporting Standard (IFRS) 9 – particularly those who are also on the firm's audit committee. It is important that NEDs engage with IFRS 9 and have the support they need to challenge management effectively.

What is IFRS 9?

From 1 January 2018, most UK banks need to adhere to a new accounting standard called IFRS 9. Although it is an accounting change, IFRS 9 will also have wider implications for other aspects of a bank – including considerations relevant to the PRA.[1]

Why is implementation of IFRS 9 important?

It is an internationally agreed standard and part of a G20 commitment to post-crisis reform. The PRA has a particular interest in:

- the interaction of expected credit loss (ECL) with regulatory capital;
- the implications of ECL for credit risk management practices; and
- transparency and disclosure.

Four questions to discuss with your board

1. **What is your firm's approach to transitional arrangements?** European legislative bodies are examining the case for transitional arrangements to be applied to the impact of IFRS 9 ECL accounting on credit institutions' regulatory capital. If your firm has not done so already, it needs to decide whether it plans to use transitional arrangements and inform the PRA of that decision. Provided that the final CRR amendment establishes transitional arrangements broadly similar to those currently being considered, the PRA encourages UK firms to use them from the first day of IFRS 9 application (1 January 2018 for December year-end firms). A letter from Sam Woods to the CEOs of impacted firms sets out the rationale for transitional arrangements and the PRA's views on using them.

2. **Does your board understand the impact of the new provisioning for ECL and how it affects different types of lending and overall capital planning – both in business-as-usual and stressed conditions?** Your firm should be appropriately resourced to incorporate IFRS 9 into its stress testing and capital planning in 2018.

3. **Is your firm's governance upgraded sufficiently to cope with the higher volume of forward-looking credit risk data?** Attention should be drawn to the ability to source and manage risk data and the adequacy of IT.

4. **Will disclosures enable investors and other users of financial data to transition effectively to IFRS 9?** Disclosures on the move from IAS 39 to IFRS 9 and for IFRS 9 going forward need to be timely, complete, correctly focused and as harmonised as possible, so that users can navigate from firm-to-firm.

[1] www.bankofengland.co.uk/publications/Pages/news/2017/009.aspx.

If you are on the audit committee…

The PRA has an interest in audit committees being well prepared. We will continue to make use of the work performed by internal and external auditors in reviewing firms' credit risk assessment and how they measure ECL.

For those firms in scope, we will continue to supplement the close and continuous dialogue with auditors and audit committee chairs, with use of powers to request written reporting from auditors. The audit committee will need to determine what level of assurance the external auditor provides at key reporting dates between now and the first full set of IFRS 9 accounts. There may be some read across to capital, as interim profits need to be independently verified to count as regulatory capital.

A priority for 2018, and beyond, will be to identify and replace tactical solutions adopted to implement ECL on time where they may be unduly approximate, or might not hold in less benign conditions. We will be looking to audit committees to play an active role to monitor that this happens on a timely basis so that, at all times, the ECL is fit for purpose.

Essential reading

We set out our priorities through letters to CEOs, so, if you have not done so already, we encourage you to familiarise yourselves with those.

Additionally, we have selected three documents that you might find helpful:

i. Global public policy committee paper on IFRS 9, 2016 – which sets out the key questions for management on governance, controls and transition issues.
ii. Global public policy committee paper on IFRS 9, 2017 – addressed to the audit committee, this focuses on key risks of misstatement by estimates of ECL.
iii. EBA guidelines on credit risk management and ECL accounting – which sets out guidelines for sound credit risk management and implementation of ECL.

What next?

We consider 2018 to be merely the end of the beginning. Firms are expected to continue to work on their ECL methodologies for some years to come.

We'll continue working with firms, auditors and global accounting and auditing standards setters to identify any guidance needed for an orderly, prudent and consistent approach to implementation.

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