

# Individually assessed ECL

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bankinter.



# C

## Content

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New  
components of  
the analysis



Governance  
& Processes



Methodology  
& calculations



Other  
considerations



# Contents

## New components of the analysis







- Governance & processes
- Methodology & calculations
- Other considerations

# S

## What remains the Same ...

Or nearly the same

.....





|                          |   |  |
|--------------------------|---|--|
| DCF methodology          |    | Substantially, the methodology remains valid                                   |
| Governance framework     |    | Overall framework remains the same but in needs new adaptations                |
| Scope                    |    | Individually assessment thresholds may need to be reviewed to address capacity |
| Level of authority       |   | No need to change delegation powers, authorities and approval processes        |
| Risk management          |  | In principle, IFRS9 aligns with existing credit risk management practices      |
| Organisational structure |  | New methodology and processes can be fit within the existing structure         |

# C

## ... And what do Change

More or less significantly

.....

|                                 |   |   |
|---------------------------------|---|---|
| Identification of SICR          |    | Expert criteria, alerts, credit approval reviews, etc             |
| Estimation on unimpaired assets |    | Assigning probabilities of impairment                             |
| Forward looking                 |    | Scenarios and idiosyncratic events                                |
| Increased judgement             |   | Enhanced documentation is required                                |
| Backtesting                     |  | As means to prove consistent application vs collective estimation |
| Training analysts               |  | To ensure consistent application across the organisation          |

# KC

## Key Considerations

Risk management

Risk management culture and practices do not have to change. Institutions do not have to change the way they do things for IFRS9

Application of individual assessment

The scope of application of individual assessment is to be aligned with risk management practices and business model

Governance

Individual assessment needs to fit within the existing governance framework of the organisation

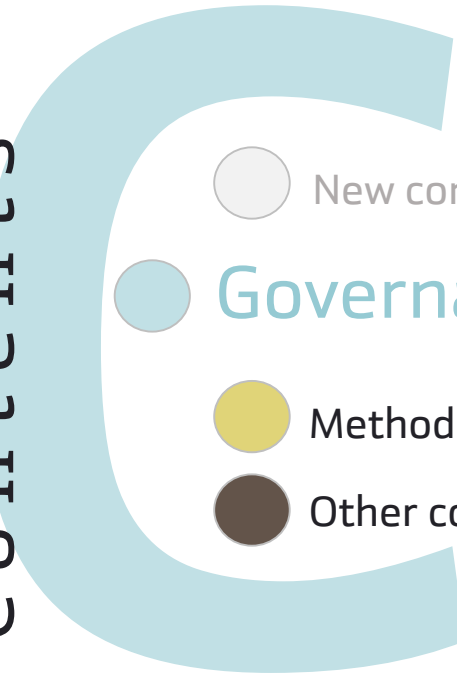


Banks need to fit though...

1. Stage 2
2. Forward looking information
3. Two step analysis: identification of SICR and estimation of ECL



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 New components of the analysis

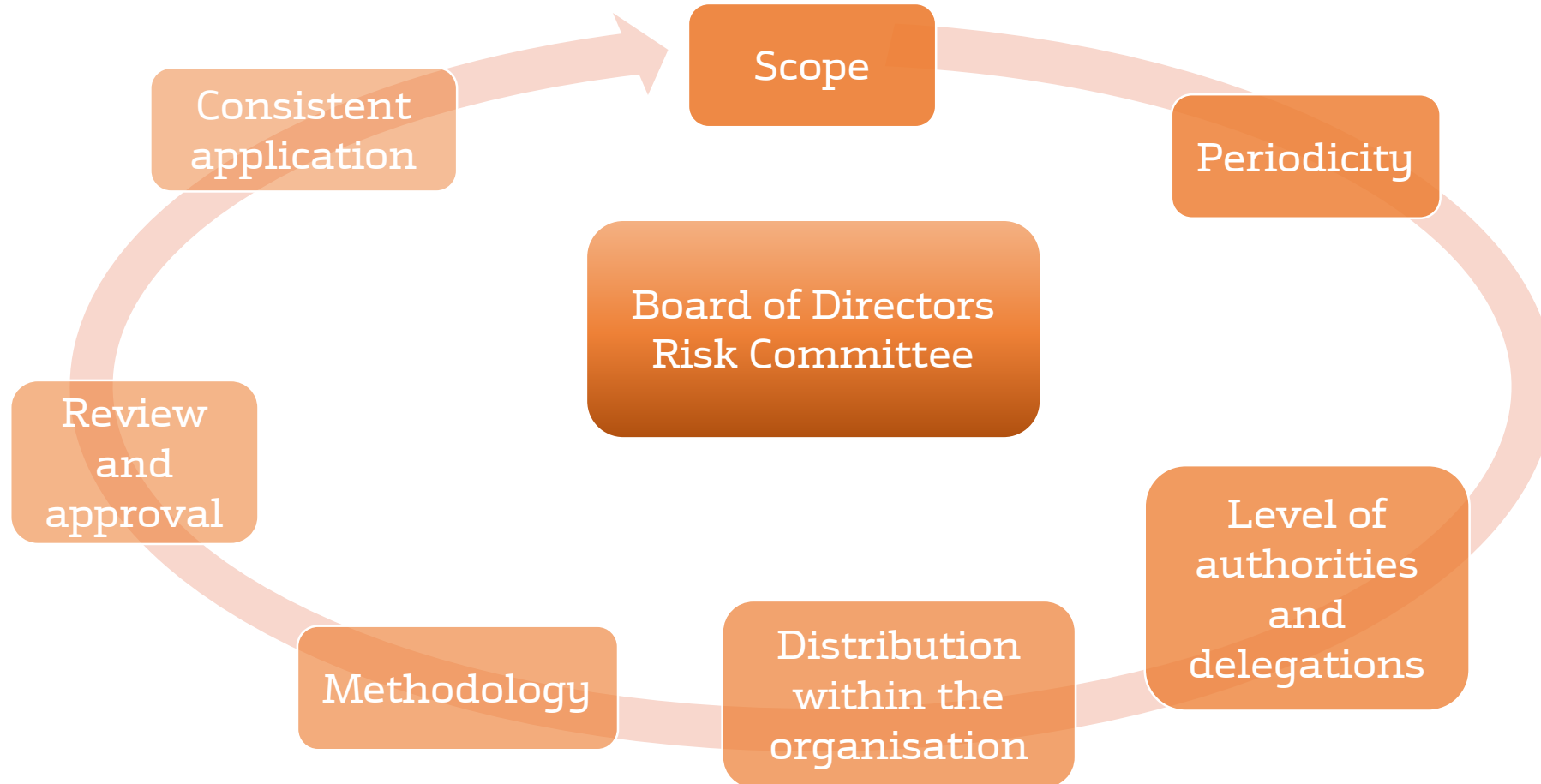
 **Governance & processes**

 Methodology & calculations

 Other considerations

# GC

## Governance Cycle





# SG

## Scope & Governance

|                              |   |
|------------------------------|---|
| Identification of population | Thresholds for individual assessment, population by category, stages included, capacity                                   |
| SICR                         | Policy for identification of SICR through individual assessment   |
| Periodicity                  | Periodicity of the SICR assessment and ECL estimation; cut off date   |
| Distribution                 | Distribution of analyses across the organisation (centrally, delegation to business units, etc), completion and reporting |
| Forward looking information  | Both for SICR and ECL estimation  |

# FL

## Forward Looking

It is **very difficult to justify the linearity** of ECL under different scenarios:

- Credit risk is asymmetric
- ECL as the product of PD and LGD – even if both were lineal, its product it is not

Baseline scenario

Generation of alternative scenarios

Selection of scenarios

Horizon of projections

Expert criteria:  
Idiosyncratic adjustments

### Multiple scenarios

- What IFRS 9 *doesn't* require and the ITG *didn't* say
  - You must use PDs
  - You must use three scenarios
  - You must always use multiple scenarios
- Key messages
  - You should *consider* multiple scenarios but may not always have to *use* them
  - There is no one right approach but one clear objective
  - ECL should reflect "reasonable and supportable information available without undue cost or effort"
  - Good quality disclosure is important

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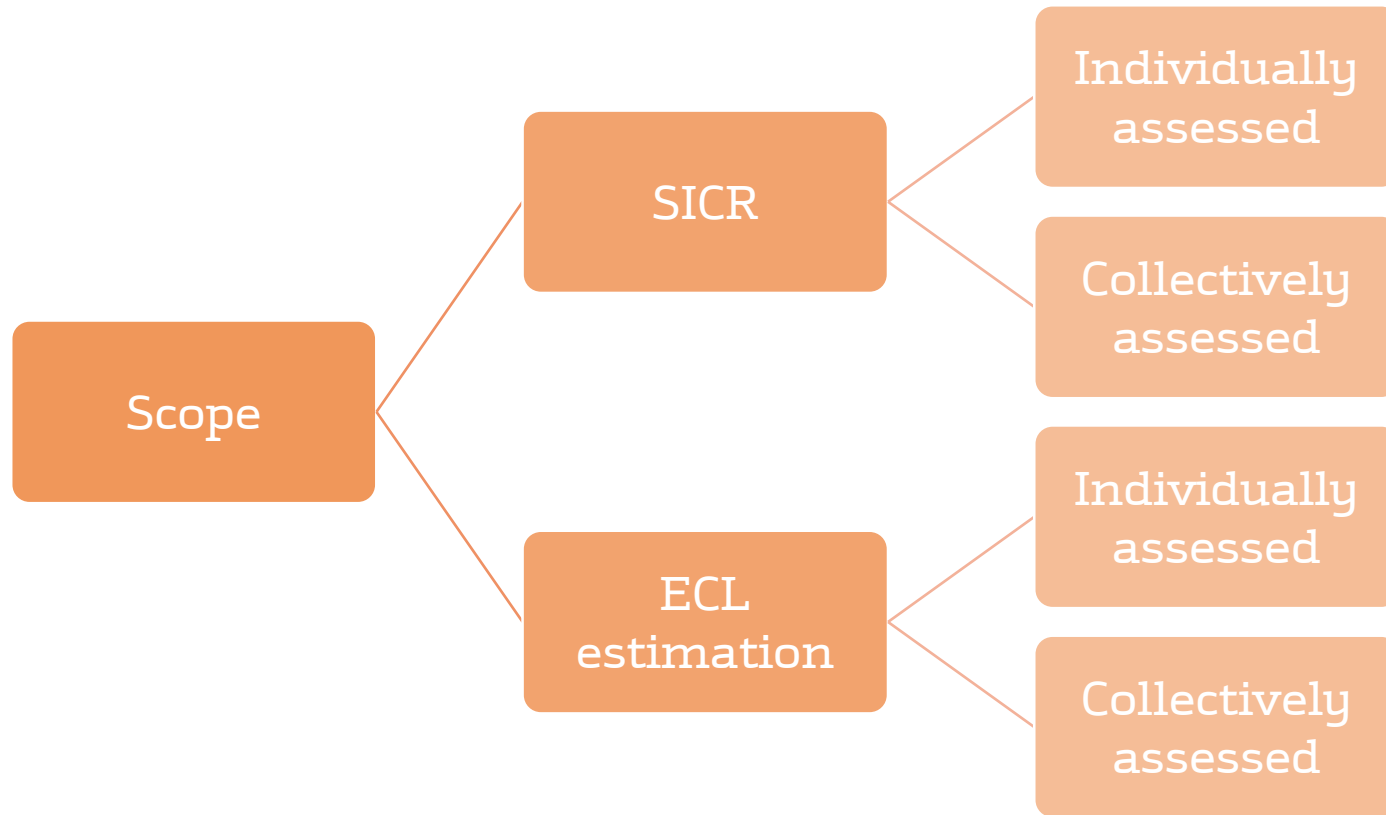
- Allocation of probabilities (reasonable; no-stress)
- The number of scenarios should maximise the approximation to the distribution dispersion
- Alternative scenarios should represent a median of a subset of the distribution that determines its probability

- Length that allows a minimum of precision in projections
- Then reversion to TTC / Economic central tendency

- Ad hoc adjustments to individually or collectively assessed positions

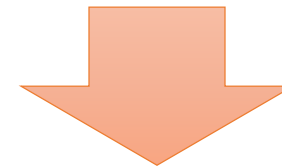
# S

## Scope



Determination of the **threshold**:

- For **SCIR**
- For **ECL** estimation
- By **portfolio/asset**



The institution must have the capacity to cover its scope for individually assessed

# SICR

## Significant Increase in Credit Risk

|             |   |
|-------------|---|
| PD          | Increase in <b>life time PD</b> since origination         |
| Assessment  | Expert criteria subsequent to an individual assessment    |
| Alerts      | CRM, external information,                                |
| DPD         | Days-Past-Due backstop                                    |
| Forbearance | Forbearance measures or the prospective of those measures |



### Policy and processes

#### Defined indicators:

- Increased debt;
- Decrease in turnover;
- Increase of debt service ratio:
- External/internal rating;
- Etc

#### Documentation & reporting

#### Approval

# SICR

## Significant Increase in Credit Risk

It is **relevant**:

- Establish a clear policy that is **applied consistently** across analysts;
- **Appropriate governance** through committees to approve and moderate application of the policy;
- **Maturity of assessments** both for expiration and change;
- **Forbearance** measures should ensure appropriate **cure periods**;



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# P

## P r e m i s e s

|                      |  |
|----------------------|--|
| Debtor vs instrument | Most risk management practices evaluate an measure risk based on debtors rather than instruments for non-retail positions. This does not prevent from allocating provisions to financial instruments |
| DCF                  | DCF methodology remains unchained other than IFRS9 allows to use a proxy of original EIR as discount rate  |
| Forward looking      | DCF under alternative scenarios is required unless this is achieved through and adjustment to compensate for non-linearity   |
| Impairment           | Determination of impairment does not change i.e. difference between book value and the PV of CF  |

# M

## Methodology

|                       |   |
|-----------------------|---|
| Group vs solo         | Analysts should apply the assessment over the total group or subsets of the group depending of the risk characteristics (existence of a common treasury pool, inter-company guarantees, etc)            |
| Going or gone concern | Liquidations or potencial liquidation are assessed via gone concern estimation of DCF   |
| Stage 2/3             | Stage 2 requires the consideration of several scenarios, the probability of occurrence of these scenarios and the LT PD at each of the scenarios. Stage 3 does not require scenario analysis as PD is 1 |
| Collateral            | Needs to be value under both as collateral or disinvestment on a going concern approach   |
| EIR                   | Best proxy to the original EIR. Under group DCF, weighted proxy by transaction may be applied   |



# S

## Scenarios for stage 2

|                          |  |
|--------------------------|--|
| DCF by scenario          | DCF are estimated for the baseline scenario and the selected alternative scenarios. DFC methodology is replicated in each scenario |
| Scenario probability     | Scenarios need to be consistent with selected scenarios for collective assessment. Probability of the scenario is also consistent  |
| Cash Flows PD            | Resulting cash flows from the different scenarios should be adjusted by model PDs  |
| Projection of cash flows | Financials are projected by applying scenario variables to the financials projections and expert criteria.                         |

# DCF

## Discounted Cash Flows

### Free cash flows

|                                     |   |
|-------------------------------------|---|
| CF available to service debt (DSCF) | PnL projections should be translated into free cash flows that are available to service the debt. Historical data should be considered and projections referenced to the macro-scenario and additional scenario information produced internally |
| Length of projections               | Standard market practices includes a 5 year projection plus a residual value.   |
| Free cash flows                     | EBIT + depreciation and amortisation - Working Capital variation - CAPEX variation  |
| Cash criterion                      | DCF is based on how much cash enters that can service the debt hence accounting PnL is not enough   |
| EIR                                 | Best proxy to the original EIR. Under group DCF, weighted proxy by transaction may be applied. Conservative add on may be applied on the residual value   |

### Collateral

|                            |  |
|----------------------------|--|
| Eligible collateral        | Excludes wrong way risk.   |
| Valuation                  | The valuation of eligible collateral needs to take into account the market value, associated sale costs and other relevant costs (foreclosure, maintenance, etc), time to foreclose and sale, additional haircuts due to market conditions (past experience) |
| Validity of last appraisal | Outdated appraisals should be adjusted to current market appraisal value   |
| Core collateral            | Should only be considered on gone concern approaches   |
| EIR                        | Best proxy to the original EIR. Under group DCF, weighted proxy by transaction may be applied  |



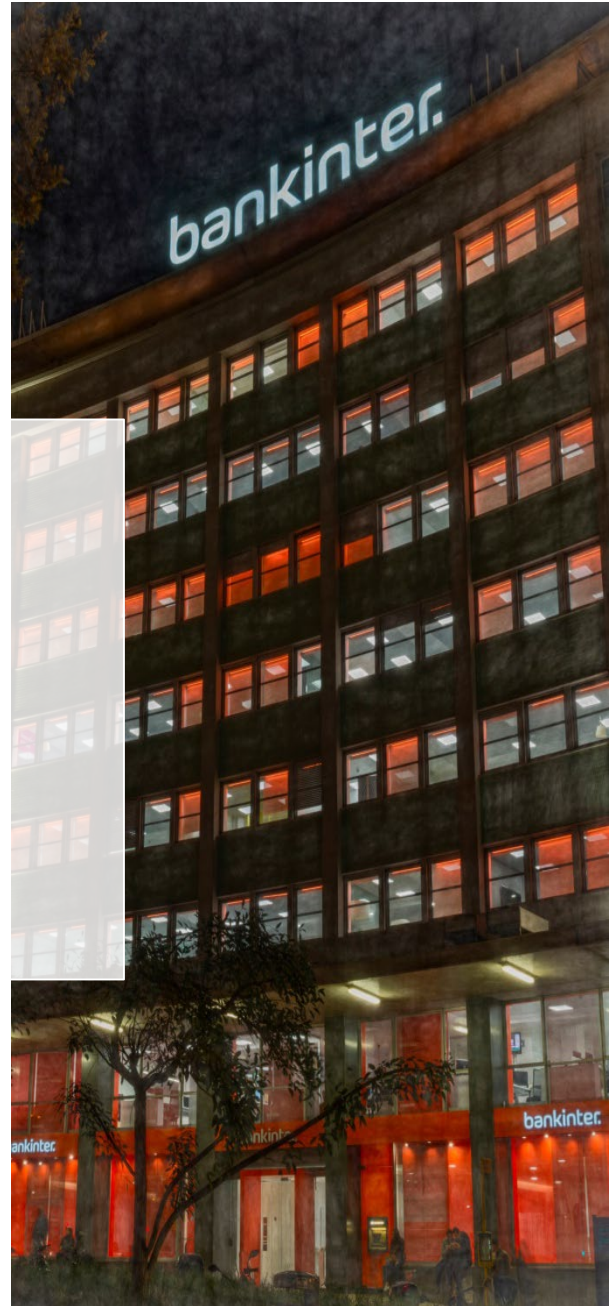
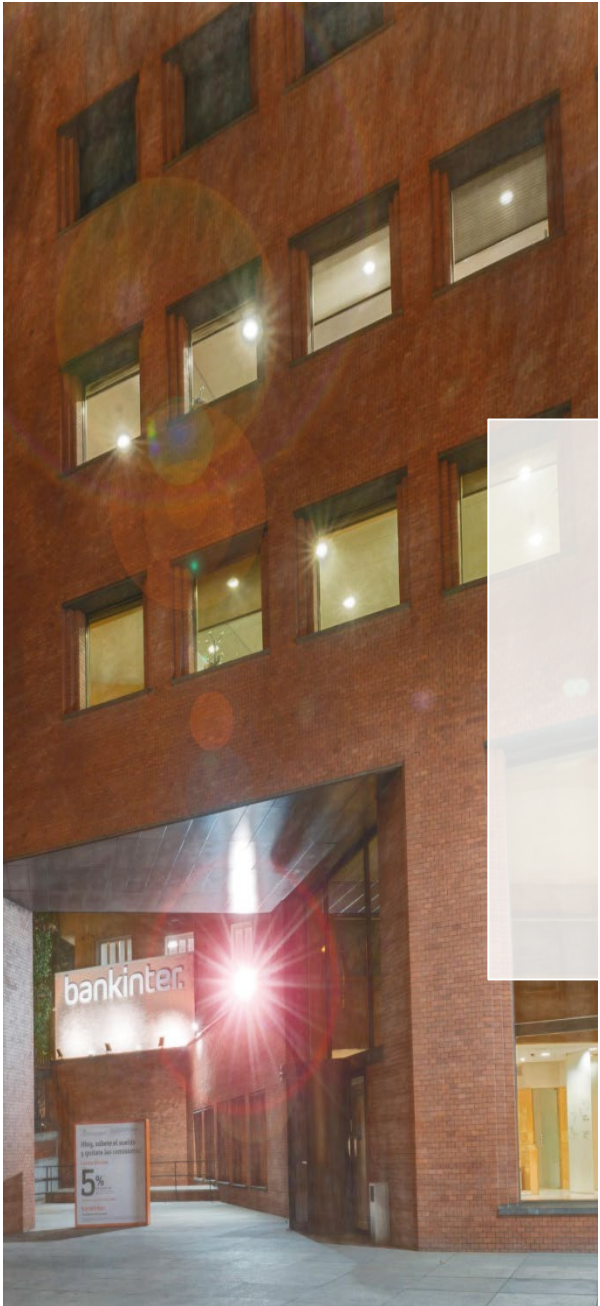
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# RB

## Review and Backtesting

|                                   |  |
|-----------------------------------|--|
| Process review                    | Individual assessment requires consistent application through time hence review of the process is required. Review process includes: 1) consistent application of the institutions methodology; 2) feedback and training to analysts; and 3) retrospective tests |
| Individual vs collective ECL      | Regular comparison between in individually and collectively estimations of ECL should be performed and significant variations should be analysed   |
| Individual estimation vs realised | Additional analysis of estimated losses versus realised losses   |
| Governance                        | Review and retrospective test should be part of the process governance and approved/reported accordingly   |



Thank you  
Individually  
assessed ECL

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