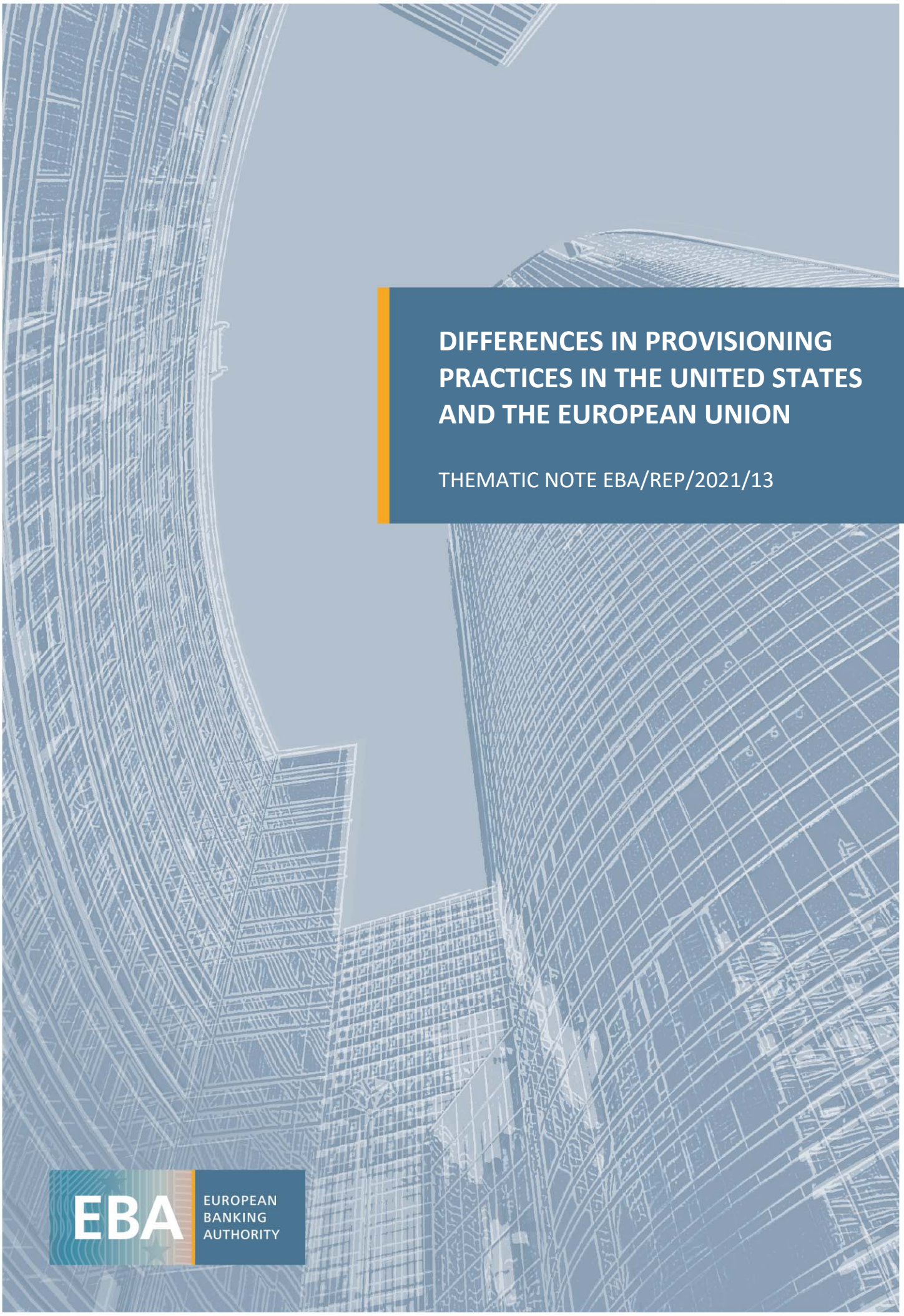


DIFFERENCES IN PROVISIONING PRACTICES IN THE UNITED STATES AND THE EUROPEAN UNION

THEMATIC NOTE EBA/REP/2021/13

EBA EUROPEAN BANKING AUTHORITY

Contents

Introduction

The spread of the COVID-19 pandemic and the ensuing containment measures have caused the greatest economic contraction globally since World War II. Although economies have recovered some of the lost ground since June 2020, GDP and employment levels are still well below pre-COVID levels and uncertainty about the evolution of the pandemic remains high.

Overall, European banks do not show major signs of asset quality deterioration, compared to previous years' heightened levels. The average non-performing loan (NPL) ratio has continued to decrease, albeit slightly, in recent quarters, driven by a decrease in NPL volumes (due to a few substantial securitisations and NPL sales deals), but also because of the increase of the denominator (total loans and advances). In addition to the usual lags between an economic shock and the formation of new NPLs, support measures implemented in the context of the current crisis might further delay any potential asset quality deterioration.

Nonetheless, some early indications of asset quality deterioration can already be observed. The volume of forborne loans, the share of stage 2 loans and the cost of risk (CoR)[1] increased materially in 2020. While before the global financial crisis (GFC) banks were widely required to recognise only their incurred losses, the new accounting frameworks (IFRS 9 in the EU, and CECL in the US) also require the recognition of expected credit losses (ECL). In fact, data shows that a substantial increase in accumulated loan loss allowances and provisions, mainly for performing loans, has already taken place[2].

Yet there are divergences in the CoR reported by banks. It is not only different across banks, but also across countries and regions. In particular, when compared to other jurisdictions, it is observed that there is a material difference between the reported CoR of EU and US banks.

There are several factors that could explain the observed differences. First, despite the global character of the pandemic, its impact has not been uniform across regions, countries or economic sectors. For example, the increase in US unemployment was bigger than in the EU, while the economic recovery is expected to be faster in the former. Similarly, on the fiscal and monetary front, governments and central banks have adopted unprecedented support measures whose magnitude varies substantially across regions.

Different loan portfolio composition might also play an important role. Banks more exposed to economic sectors highly affected by the pandemic and lockdown measures like hospitality, arts or entertainment or those whose loan portfolios are more concentrated in riskier segments such as consumer lending or commercial real estate (CRE) might also present higher cost of risk.

[1] The CoR is defined as the change in allowances and provisions as a ratio of total on-balance sheet loans and advances subject to impairment.

[2] See *EBA Risk Assessment Report*, December 2020.

In addition, accounting rules materially differ between the EU and the US. These rules are also based on principles, leaving some leeway for banks in the practices used for estimating expected credit losses and for the incorporation of forward-looking information.

This note looks first into the actual differences in provisioning levels between US and EU banks. It then analyses selected factors that might explain the observed differences, namely the macroeconomic environment, the composition of loan portfolios and the accounting framework.

For the EU, a sample of 160 European banks (unconsolidated number of banks, including 30 subsidiaries) as of 31 December 2020 is used. This sample is reviewed annually by competent authorities and adjusted accordingly.[3] For the US, the data is taken from the Quarterly Trends for Consolidated U.S. Banking Organizations of the Federal Reserve of New York (NY Fed), which uses consolidated financial data across all reporting US parent bank holding companies and intermediate holding companies, and individual banks not controlled by a bank holding company, or whose parent bank holding company does not report on a consolidated basis. The data excludes savings bank holding companies, and branches and agencies of foreign banks.[4]

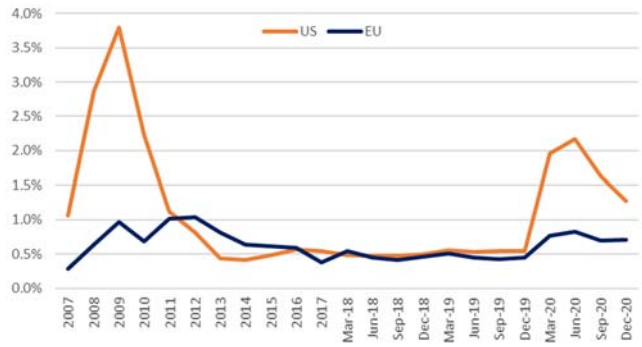
[3] See *EBA Risk Dashboard as of Q4 2020* and the list of reporting institutions.

[4] See the *NY Fed's Quarterly Trends for Consolidated U.S. Banking Organizations*.

1. Evolution of the cost of risk and other indicators

Historically, the CoR[5] has been more volatile in the US than in the EU. Although in non-crisis periods there are no substantial differences in this indicator, the CoR of US banks tends to rise much faster than that of EU banks during crisis episodes. For instance, at the peak of the GFC, the CoR of EU banks was significantly lower than in the US, although it was slightly higher during the years of the European sovereign crisis and its aftermath (2012-2015). Nonetheless, on average the CoR of US banks has been substantially higher than that of EU banks (Figure 1).

Figure 1: Cost of risk in the US and in the EU



Source: Quarterly Trends for Consolidated U.S. Banking Organizations, NY Fed; Statistical Data Warehouse (SDW), European Central Bank (ECB); and EBA supervisory reporting data
*EU data from 2007 to 2017 is based on SDW data

The spread of the COVID-19 pandemic induced banks to recognise increased amounts of ECL compared to previous years. As a consequence, the CoR of EU banks was almost double compared to the average of previous years. In comparison, data from the NY Fed shows that during the same period, banks in the US reported CoR levels more than twice those of their European peers (1.96% vs 0.77% in the first quarter of 2020 and 2.16% vs 0.82% in the second).

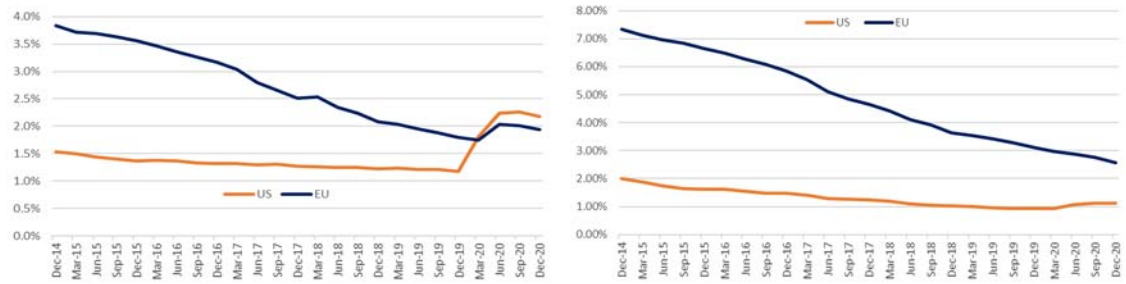
After peaking in June 2020, ECL fell in the third quarter of the year as confinement measures were gradually lifted and economic forecasts improved – also due to the COVID-19 vaccine announcements. This decrease was more acute in the US than in the EU. As of September 2020, the CoR stood at 1.62% and 0.70% respectively. In the fourth quarter, the CoR of EU banks stabilised at 0.70%, whereas it continued to fall for US banks (1.27%). Despite these differences, accumulated loan loss allowances and provisions over total loans and advances (performing and non-performing) were higher for EU banks until very recently. This might be explained by two main factors. On the

[5] For the purposes of this note, the data on loan loss provisions provided by the NY Fed (annualised following the same approach of other EBA publications such as the Risk Assessment Report or the Risk Dashboard) is taken as the CoR for US banks. On grounds of comparability with US data, for EU banks, the CoR figures provided in this note exclude the amounts written off directly to the statement of profit or loss. Thus, they could differ from the CoR figures provided in other EBA publications such as the Risk Dashboard or the Risk Assessment Report.

one hand, EU banks bear comparatively higher NPL volumes (higher NPL ratios) which may have required higher provisioning levels. On the other hand, US banks are usually subject to tougher write-off requirements that prevent the accumulation of both NPLs and loan loss allowances and provisions (see chapter 4) (Figure 2).

It is also noteworthy that while the NPL ratio of EU banks kept decreasing in 2020, the Fed reported a slight increase for US banks. Nonetheless, US banks' average NPL ratio is still substantially lower than that of the EU (Figure 2).

Figure 2: Accumulated loan loss allowances and provisions over total loans (left) and NPL ratio (right)



Source: Quarterly Trends for Consolidated U.S. Banking Organizations, NY Fed; and supervisory reporting data

2. Macroeconomic environment

Among the main drivers that determine banks' decisions to recognise loss allowances and provisions are the current and expected macroeconomic factors. Although there might be substantial differences across banks in the weighting of relevant macroeconomic variables, GDP growth and unemployment ratios may play a major role in determining ECL.

According to Eurostat, overall, the impact of the pandemic on US GDP was somewhat softer than in the EU. All things being equal, EU banks should as such have recognised more loss allowances and provisions. Nevertheless, the evolution of the unemployment rate has been substantially different between the two regions (Figure 3).

In particular, the US unemployment rate increased from 3.5% in February 2020 to 14.7% in April 2020, while at the same time, the unemployment rate in the EU went up by only 0.1 p.p. (from 6.5% to 6.6%). The peak unemployment rate in the EU was reported during summer 2020, yet this has not exceeded 7.8%, not least because of temporary layoff programs. On the other hand, despite its fall since the reported peak in May, the US unemployment rate is still 2.6 p.p. above pre-COVID levels (0.9 p.p. in the case of the EU), yet slightly lower than EU average (Figure 3). These trends contribute to explain the lower provisioning needs for European banks in the first half of 2020 and the faster decrease in CoR in the US in the second half of the year.

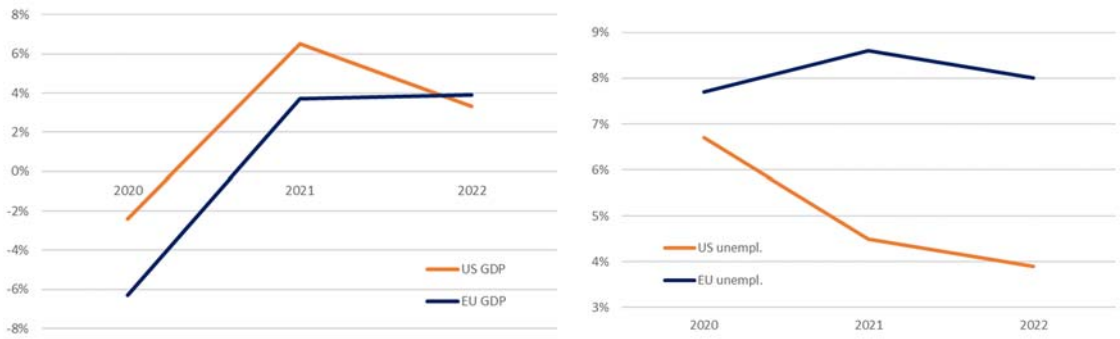
Figure 3: Recent GDP evolution (December 2019 = 100; left) and unemployment rate (right)

Source: Eurostat

Although support schemes implemented in the US and in EU countries have alleviated the sharp impact of the pandemic in the labour market, the comparison of the effects of these policies on the provisioning needs of EU and US banks is not straightforward. The labour safety nets and social measures already in place in the EU were complemented with loan-based and other instruments, like moratoria, public guarantee schemes, and suspension of insolvency or tax regimes. Meanwhile, the US government provided, for instance, support through direct stimulus payments to households but also through public guarantee schemes and forgivable loan schemes.

Going forward, the Federal Reserve projects a quicker economic recovery for the US than the European Commission's projection for the European economy. The differences in recovery speed are especially marked in terms of unemployment (Figure 4). This might be an important factor explaining why the CoR of US banks fell more rapidly than that of their EU peers in the second half of 2020.

Figure 4: EU and US GDP growth (left) and unemployment rate (right) projections (March 2021)



Source: European Commission Winter (Interim) Economic Forecasts (for GDP growth) and Autumn Economic Forecasts (for unemployment), and Federal Open Market Committee Projections

Finally, it is noteworthy that the uncertainty around the evolution of the pandemic and its effect on macroeconomic performance of countries are still at heightened levels, making modelling of future loan performance and ECL a difficult task. In this regard, the EBA, in the context of the IFRS 9 benchmarking exercise, is investigating whether the sensitivity of the IFRS 9 estimates to the macroeconomic factors changed during the pandemic, and the extent to which the non-linearity in macroeconomic scenarios affects ECL estimates.

3. Loan portfolio composition

In general, the pandemic has taken a substantially different toll on economic sectors. Some sectors, such as hospitality, arts or entertainment are in the forefront of the most negatively affected sectors. On the other hand, e-commerce, technology or distribution have, for instance, rather benefited from the confinement measures and the alteration globally in work and lifestyle during the last year.

Table 1: Value added by economic sector (2018)

ECONOMIC SECTOR	US	EU
Agriculture, forestry and fishing	0.9%	1.6%
Mining and quarrying	1.7%	0.4%
Manufacturing	11.7%	16.0%
Electricity, gas, steam and air-conditioning supply	1.4%	1.7%
Water supply, sewerage, waste management and remediation activities	0.3%	1.0%
Construction	4.2%	5.5%
Wholesale and retail trade, repair of motor vehicles and motorcycles	9.9%	11.3%
Transportation and storage	3.4%	4.8%
Accommodation and food service activities	2.8%	2.9%
Information and communication	6.9%	5.2%
Financial and insurance activities	7.7%	4.9%
Real estate activities	12.7%	11.2%
Professional, scientific and technical activities	7.9%	6.8%
Administrative and support service activities	4.0%	4.7%
Public administration and defence, compulsory social security	8.5%	6.2%
Education	5.5%	5.0%
Human health and social work activities	7.7%	7.4%
Arts, entertainment and recreation	1.1%	1.4%
Other service activities	1.5%	1.6%
Act. of HH as employers, undif. G&S-producing activities of HH for own use	0.1%	0.4%
Activities of extraterritorial organisations and bodies	0.0%	0.0%

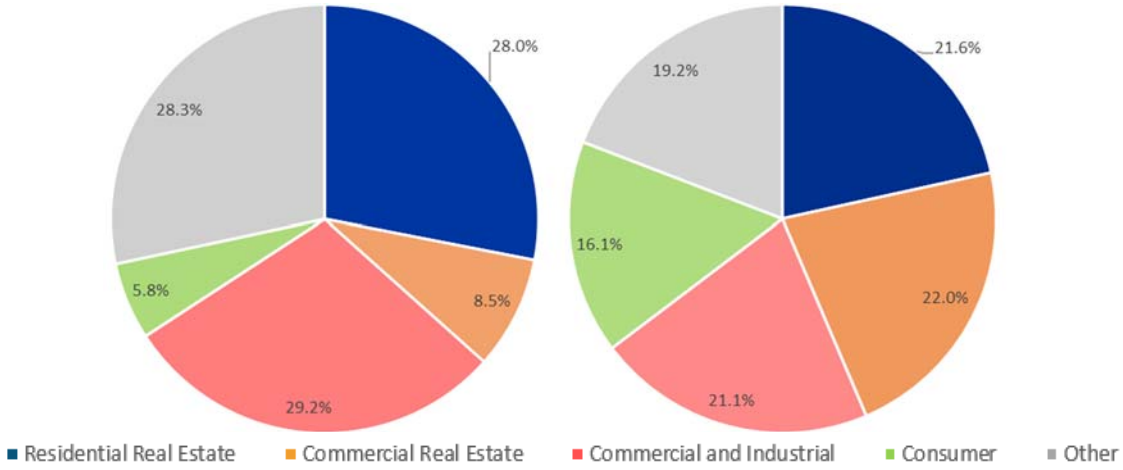
Source: OECD

Analysts have suggested that some US banks are particularly exposed to some of the sectors that were more affected in the early stages of the COVID-19 outbreak, such as oil & gas, transport and aviation. Nonetheless, aggregate exposures towards specific sectors of US banks are not publicly available, thus, as a proxy, the level of dependence of the two economies by sectors is compared (although this is also somehow reflected in economic growth projections) (Figure 4). At first sight, the slightly higher weight in the EU economy of sectors like transportation and storage, accommodation and food service activities, or arts, entertainment and recreation, would justify higher provisioning levels for EU banks. By contrast, the higher weight of mining and quarrying in the US could explain the initial sharp increase in the CoR when oil prices fell sharply. Yet the

contribution to both economies of the most affected sectors is comparatively low in most of the cases (Table 1).

A look at the composition of the loan book of EU and US institutions reveals a higher share of the riskiest loan categories in the latter. For example, consumer credit represents 16% of the US loan book, while the share of this loan portfolio for European banks is around 6%. It should also be noted that consumer loan defaults tend to be highly influenced by the performance of unemployment. Similarly, commercial real estate (CRE) loans, which might have been particularly affected by lockdown measures, represent 22% of US loans but only 8.5% of in the EU (Figure 5).

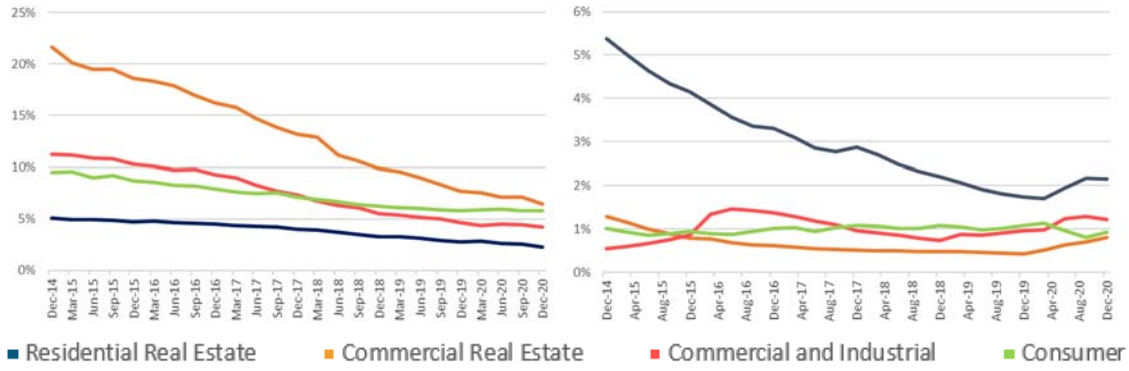
Figure 5: Loan share composition in the EU (left) and the US (right) (December 2020)



Source: Quarterly Trends for Consolidated U.S. Banking Organizations, NY Fed; and supervisory reporting data
*For the EU, Commercial and Industrial loans are estimated as loans to NFCs excluding CRE exposures.

Nonetheless, it is important to note that loan segments considered as low risk in the EU such as residential real estate lending have the highest NPL ratio in the US (2.2% in the US vs 2.5% in the EU as of September 2020). In contrast, the NPL ratios of commercial real estate or consumer lending are the lowest in the US (0.7% and 0.8%, respectively), while in the EU these are the categories with the higher NPL ratios (7.1% and 5.8%, respectively). These differences may not only be due to the riskiness of each portfolio, but also to factors such as stricter write-off rules (NPLs written off completely are no longer on the balance sheet; on write-offs see chapter 4) or a more liquid secondary market for NPLs in the US (Figure 6).

Figure 6: Evolution of the NPL ratio by type of loan in the EU (left) and the US (right)



Source: Quarterly Trends for Consolidated U.S. Banking Organizations, NY Fed; and supervisory reporting data
*For the EU, Commercial and Industrial loans are estimated as loans to NFCs excluding CRE exposures

4. Accounting framework

The EU and the US apply different ECL frameworks. In specific EU banks apply IFRS 9 as issued by the International Accounting Standards Board (IASB), while US banks apply the US Financial Accounting Standards Board's (FASB) current expected credit loss (CECL) requirements. Although both models are based on the recognition of ECL, there are significant differences between them.

The most relevant difference is the time horizon for calculating ECL. While the US CECL requires the recognition of lifetime ECL for all financial assets since their origination, the IFRS 9 ECL model is based on dual credit-loss measurement approach, according to which the loss allowance is measured at an amount equal to either:

- the 12-month ECL for those exposures that have not experienced a significant increase in the credit risk since their origination (Stage 1 exposures), or

- the lifetime ECL for those exposures classified in Stage 2 or Stage 3.

Given the requirement to recognise lifetime ECL for all financial assets, the accumulated loan loss allowances and provisions are expected to be higher under the US CECL (all things being equal). Nonetheless, assuming a static balance sheet, at the onset of a crisis, the IFRS 9 impairment model could result in a cliff effect in loan loss provisions due to a transfer of exposures from Stage 1 (12-month ECL) to Stage 2 or Stage 3 (lifetime ECL) and, thus, to a rise in CoR.

However, the first phase of the COVID-19 crisis was characterised not only by a loan migration from Stage 1 to Stage 2 but also by a material increase in lending. New lending in the EU might be subject to lower provisioning requirements and, thus, lower CoR, than in the US as EU banks normally classify new lending as Stage 1.

What if EU banks had to apply lifetime ECL to all their exposures analysis?

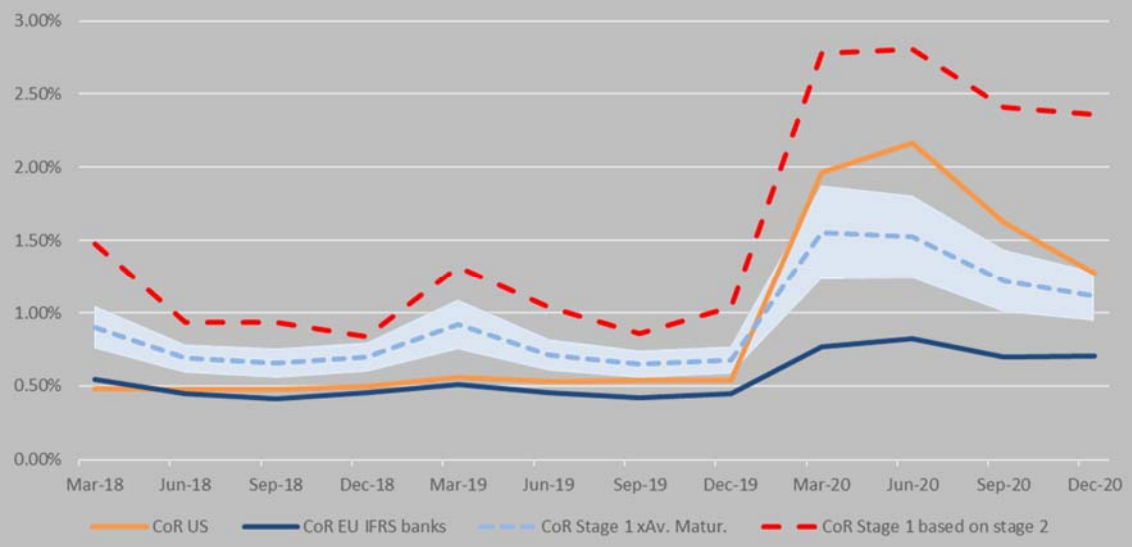
If EU banks had to recognise lifetime ECL on their loans classified under Stage 1, they would face additional provisioning needs. Although a precise assessment of these extra provisions would require very granular inputs, a proxy could be obtained by assuming an average remaining maturity of loans of 5.8 years[6] and a proportional ECL increase with maturity. In such a hypothetical scenario, the CoR of IFRS EU banks would have gone from 0.67% in December 2019 (vs actual 0.45%) to 1.55% in March 2020 and 1.52% in June 2020 (vs actual 0.77% and 0.82%, respectively). In any case, the CoR of EU banks would still be below the actual CoR of US banks.

In the very extreme case where the CoR of Stage 1 loans would be the same as Stage 2 loans, the overall CoR for December 2019 and June 2020 would have been 1.04% and 2.81% respectively.

[6]The average maturity is estimated as the weighted average maturity of retail and corporate exposures of the sample of EU banks subject to the 2018 EBA stress test.

However, these figures should be only taken as a reference since, in contrast to Stage 2 loans, the loans under Stage 1 have not experienced a significant increase in credit risk (Figure 7).

Figure 7: Actual CoR of US and EU banks, and CoR simulations of EU banks



Source: Quarterly Trends for Consolidated U.S. Banking Organizations, NY Fed; and supervisory reporting data
*The shaded area corresponds to a range of +/-2 years of average maturity.

Supervisory guidance might have also played an important role. In this regard, the EBA guidance issued in the context of the COVID-19 pandemic[7] might have softened potential cliff effects by highlighting that the application of general public or private moratoria meeting specific requirements should not be considered as an automatic trigger to conclude that a significant increase in credit risk has occurred. The EBA also recommended that when determining if a loan should be classified as non-performing, banks should distinguish between obligors whose credit standing would not be significantly affected by COVID-19 in the long term, and those that would be unlikely to restore their creditworthiness. Against this backdrop, in the first half of 2020, EU banks' Stage 1 loans increased by only 0.4% (+EUR 52.7bn) while Stage 2 loans rose by 29.1% (+EUR 272.7bn). In the same period, Stage 3 loans fell by 0.1% (-EUR 266mn).

Similarly, US authorities confirmed[8] that short-term modifications in response to COVID-19 to borrowers that were performing prior to any relief would not be considered troubled debt restructurings. In addition, US authorities made it clear that banks were not expected to designate loans with deferrals granted due to COVID-19 as past due because of the deferral. Nonetheless, since CECL does not envisage different stages for loan loss recognition, the overall impact of this guidance might have been more limited than in the EU.

[7] See *EBA statement on the application of the prudential framework regarding Default, Forbearance and IFRS9 in light of COVID-19 measures*, March 2020.

[8] See *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus*, March 2020.

It is also important to note the differences between the date of entry into force of IFRS 9 and CECL. While the former has been applicable since 2018, the latter has only applied since 2020[9]. Therefore, US banks' accumulated loan loss allowances and provisions in 2020 were not only affected by the COVID-19 shock but also by the migration from the incurred losses methodology to CECL requirements. Nonetheless, the CoR should not be affected by the first-time adoption, since it covers only provisions that are recorded via the statement of profit or loss, and first-time adoption of the CECL should be recorded directly in equity[10].

In any case, in March 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law. This Act provides banks with optional temporary relief from complying with CECL ending on the earlier of (1) the termination date of the current national emergency, declared by the US President, or (2) December 2020[11]. However, anecdotal evidence suggests that only some small US banks may still be using an incurred loss model to determine their provisions.[12]

Finally, loan write-off rules can also play an important role. US banks are usually required to write-off 'loss assets' within the period in which the loss is recognised, i.e. within one or two quarters[13]. At EU level, write-off requirements are more principle-based. IFRS 9.5.4.4 requires 'an entity [to] directly reduce the gross carrying amount of a financial asset when [it] has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof'. This rule also acknowledges that 'a write-off constitutes a derecognition event'. This might also affect CoR since US banks might be required to recognise losses earlier than their EU peers.

In addition to accounting rules, it is worth noting that in the EU, specific CRR prudential backstops[14] have introduced a minimum loss coverage for non-performing exposures (NPEs) requiring a deduction from own funds where NPEs are not sufficiently covered by accounting provisions or

[9] The standard is effective for most SEC filers in fiscal years and interim periods after December 15, 2019, and for all others, it takes effect in fiscal years after December 15, 2022.

[10] See Board of Governors of the Federal Reserve System's *Frequently Asked Questions on the New Accounting Standard on Financial Instruments--Credit Losses*, for instance questions 5 and 35.

[11] In December 2020, the Consolidated Appropriations Act extended this deadline to January 2022.

[12] See for instance Thomson Reuters' *Big Banks Didn't See Benefit of Deferring Adoption of Credit Loss Accounting Rules* from November 2020.

[13] US authorities typically refer to five buckets of credit risk based on the borrower's expected performance. The first two buckets ('pass' and 'special mention') are also referred as 'loans not adversely classified'. In contrast, 'loans adversely classified', which could be identified with non-performing assets, comprise the 'substandard', 'doubtful and 'loss categories.

In loss assets, the underlying borrowers are often in bankruptcy, have formally suspended debt repayments, or have ceased normal business operations. Thus, realising any value of the loan or the collateral would require long-term litigation or other lengthy recovery efforts. For these reasons, US authorities considered loss assets 'uncollectible and of such little value that their continuance as bankable assets is not warranted', and even if it does not mean that the asset has absolutely no recovery value, US authorities expect banks not to maintain loss assets on the balance sheet and record the losses 'in the period an obligation becomes uncollectible'.

For instance, retail loans in bankruptcy should be classified as loss assets within 60 days of receipt of notification of filing from the bankruptcy court. They should be written down to the value of the collateral, less the cost to sell. Any loan balance not written off should be classified as substandard.

For additional information, see *Comptroller's Handbook: Rating Credit Risk;* Office of the Comptroller of the Currency; April 2001 (updated June 2017).

[14] *Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures*.

other adjustments. Moreover, the ECB has also issued an addendum to its guidance on NPLs[15], including supervisory expectations for prudential provisioning of NPEs which are applicable to significant banks directly supervised by the ECB. Whilst these measures would not affect accounting provisions, they would complement them through the recognition of prudential or own deductions on an institution's own funds, aimed at achieving a minimum level of coverage for NPEs. However, these calendars envisage, in general, longer periods for EU banks to fully cover their NPEs compared to the periods allowed for US banks to write off loss assets.

[15] *Addendum to the ECB Guidance to banks on nonperforming loans: supervisory expectations for prudential provisioning of non-performing exposures*, March 2018, and *Communication on supervisory coverage expectations for NPEs*, August 2019.

Conclusion

Following an economic shock, loan loss provisions of EU banks tend to be less volatile than those of US banks. During the GFC, the CoR was significantly higher for US banks than for their EU peers. It was only during the euro area sovereign debt crisis that loan loss provisions recognised by EU institutions were higher. In the first two quarters of 2020, the CoR of US banks was much higher compared to EU banks. However, in the second half of 2020, the CoR of US banks fell more rapidly compared to their EU peers.

The initial higher increase in unemployment in the US and the faster economic recovery might help explain the sharp reaction of the CoR of US banks in the early stages of the pandemic and its rapid fall in the second half of 2020. The drop in GDP following the first wave of the pandemic was more acute in the EU than in the US. Although this would have justified higher provisioning levels (all things being equal) for EU banks, it should also be noted that the impact on unemployment was much lower in the EU than in the US. Later on, the faster US recovery might explain the rapid decrease in the CoR of US banks.

A preliminary analysis reveals a riskier loan portfolio composition of US banks. In comparison to EU banks, the share of commercial real estate and consumer credit over total loans granted by US institutions is for instance substantially higher.

Different accounting rules can lead to differences in the level of provisions. In principle, given the requirement to recognise lifetime ECL for all financial assets, the accumulated loan loss allowances and provisions are expected to be higher under the US CECL (all things being equal). Nonetheless, assuming a static balance sheet, at the onset of a crisis, the IFRS 9 impairment model is expected to result in a rise in CoR because of loan migrations from Stage 1 (12-month ECL) to Stages 2 or 3 (lifetime ECL). However, the substantial increase in lending at the beginning of the pandemic, which, at origination, banks presumably classified as Stage 1, would have required less provisioning in the EU than in the US.

The evolution of the CoR in the US and the EU should be closely monitored and analysed. The current economic scenario represents the first real test for ECL provisioning models. A revisit of this note in the medium term could in practice provide a better overview of the functioning of IFRS 9 and CECL, including their potential procyclical effects.

Annex: Other differences in accounting requirements

Some other differences in provisioning policies should also be taken into consideration. As regards the scope of application, while the IFRS 9 model applies to both financial instruments measured at amortised cost and at fair value through other comprehensive income (FVOCI), the US CECL model is not applicable to available-for-sale (AFS) debt securities[16].

Second, the estimate of ECL under both standards should consider historical information (past events), information about current conditions, and reasonable and supportable forecasts of future events and economic conditions. However, while IFRS 9 requires 'an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes' to be considered for the purpose of ECL measurement, under the US GAAP CECL model, there is no similar requirement. Therefore, under US CECL, it is acceptable to use a single forward-looking scenario, even though anecdotal evidence shows that in practice some US banks also apply more than one scenario for the purpose of ECL measurement[17].

Third, under IFRS 9, in the case of credit cards and similar revolving credit facilities, the ECL shall be measured over the period in which the entity is exposed to credit losses, which could be even longer than the maximum contractual period[18]. This could result in some measurement differences compared to the US CECL, since there is no requirement under the latter to recognise an allowance for ECL beyond the point at which a loan commitment may be unconditionally cancelled by the issuer, even if the entity has historically never exercised its cancellation right.

In relation to the treatment of purchased and originated credit impaired exposures, the accounting models for these types of assets under the two frameworks are different. Under US GAAP, the purchase price of the asset is increased by the amount of the allowance for credit losses at the acquisition date. However, the creation of this allowance is not recognised through a charge to the income statement. By contrast, under IFRS 9, no allowance is recorded on the initial recognition of the asset.

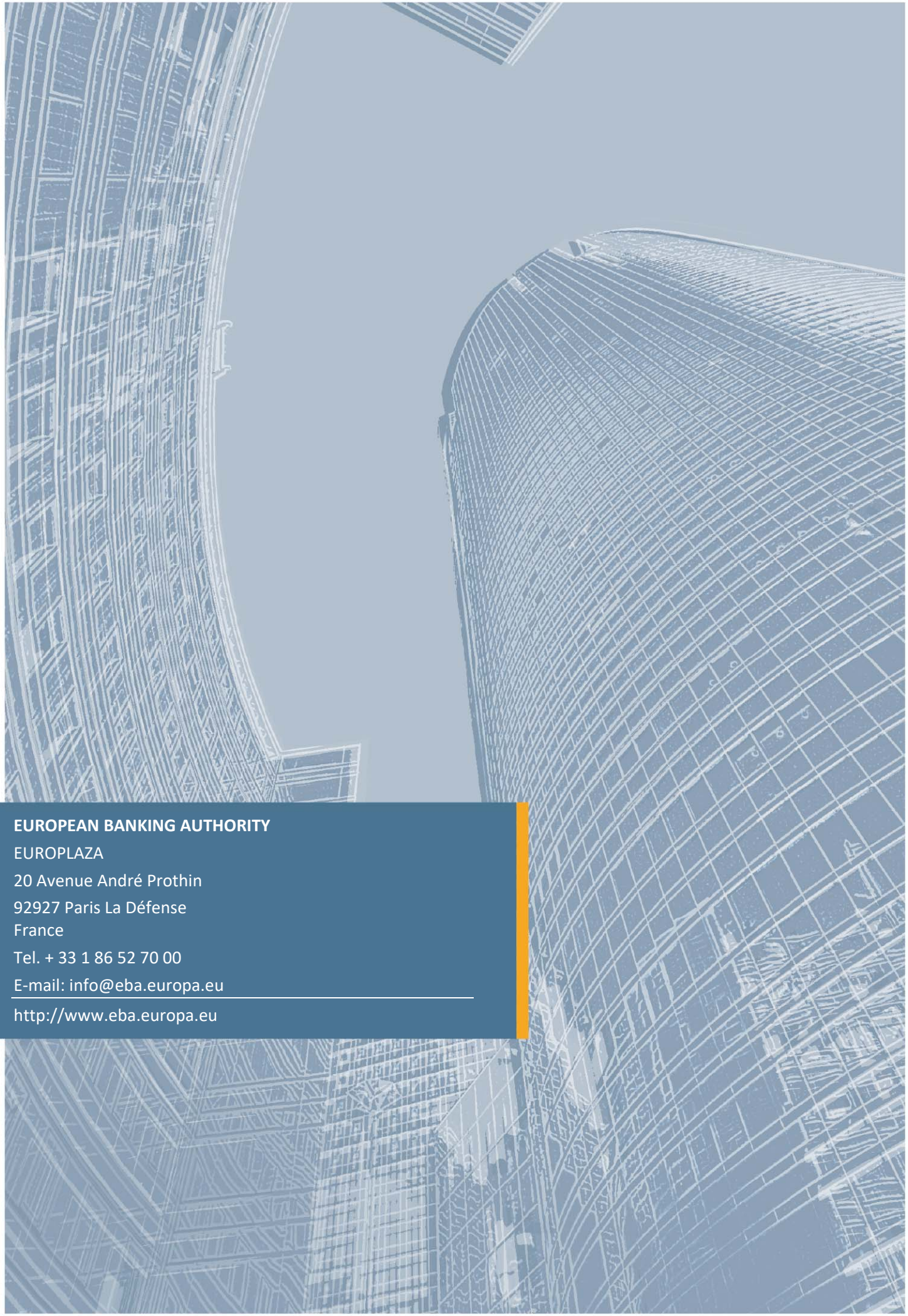
Other minor differences between the two impairment models deal with the use of collective assessment for the purpose of ECL measurement. While the US CECL requires collective evaluation of credit losses when similar risk characteristics exist, under IFRS 9 collective evaluation of credit

[16] Nevertheless, if an individual AFS debt security is impaired (i.e. its fair value is below its amortised cost), any credit loss must be recognised. Available-for-sale securities (including a residual amount corresponding to equity securities and mutual funds) accounted for 13.6% of US total assets as of September 2020

[17] It should be noted that under IFRS 9, the use of a single scenario (without a scalar adjustment or a management overlay) would not be acceptable, except when there is a linear relationship between the economic scenarios and the associated credit losses.

[18] For further detail, see IFRS 9.5.5.20 and IFRS 9 B5.5.30 and 40.

losses is allowed but not required. However, when no reasonable information on an individual basis is available (as for instance in the case of retail customers), collective evaluation is mandatory.



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