



HONG KONG BANKS' STUDY: IMPAIRMENT AND COVID-19

MAY 2020

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INTRODUCTION

We are pleased to release our 2nd edition on the application of HKFRS 9 by Hong Kong banks.

Our previous study focused on the First Time Application (“FTA”) of HKFRS 9 which has been effective in Hong Kong starting from 1st January 2018, and the required disclosures under HKFRS 7. It highlighted impacts and trends that arose from the application of HKFRS 9 and showed significant variations in reporting practices among banks locally incorporated in Hong Kong.

Banks are playing a central role in implementing government’s fiscal and monetary policies, and to finance the development of the real economy. Hence, banks need to ensure they maintain a robust credit risk framework to identify, monitor, measure and report credit risk to avoid accumulating non performing loans and preserve their financial health in the longer term.

Especially in the current period when there is higher volatility, banks need to continue refining their risk processes to ensure full compliance with HKFRS 9.

In this edition, we choose to focus on the impairment only. Indeed, we believe it is informative to have an overview of the change in credit risk reported by the banks under HKFRS 9 in the face of the challenging environment since the initiation of the US-China trade dispute in mid-2018.

The first part of this document presents the growing threat of credit risk for a pool of 22 licensed banks incorporated in Hong Kong between 31 December 2018 and 2019.

The second part of this study is for the attention of all authorized institutions that apply HKFRS/ IFRS 9 equivalent standard. It suggests an approach and several actions that banks are encouraged to take into consideration in improving their impairment process and be more agile in responding to the current Covid-19 environment.

Our approach draws on our experiences in supporting banks and supervisory authorities in managing non-performing loans and measuring credit risk.

We hope you find this study interesting, and we would welcome the opportunity to discuss it further.



Pierre Latrobe
Director - Financial Services

Columnists of the Hong Kong Banks’ HKFRS 9 Benchmark Study: Amanda Yeung and Pierre Latrobe

EXECUTIVE SUMMARY

KEY HIGHLIGHTS OF THE SURVEY

CREDIT RISK AS A GROWING THREAT

13 banks reported a higher overall impairment allowance covering stage 1 to 3 between 31 December 2018 and 31 December 2019



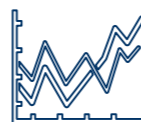
An increase in the allowance for credit impaired exposures (stage 3)

+8.33

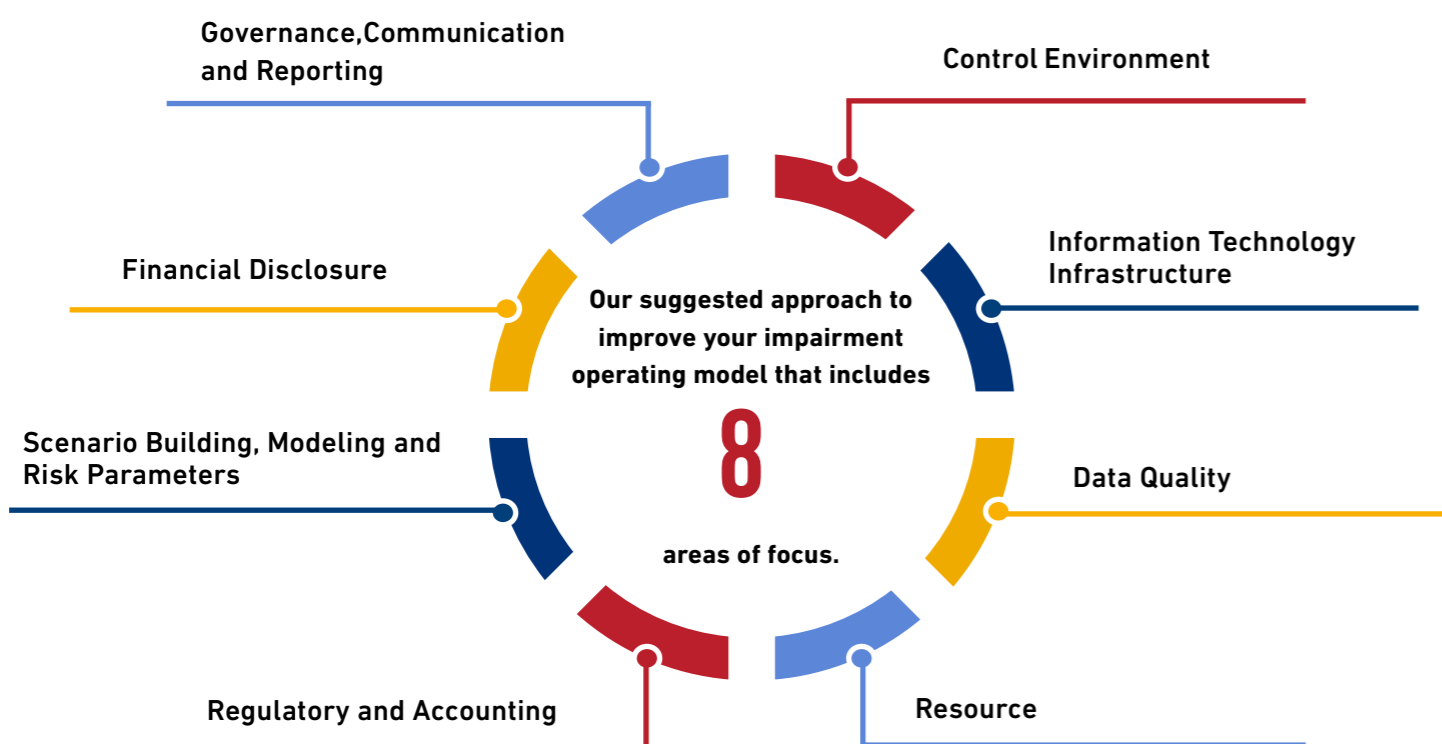
basis point



15 banks reports the use of at least 3 scenarios model to assess the significant increase in credit risk and compute expected credit losses



IMPROVING YOUR IMPAIRMENT OPERATING MODEL



Download our previous Study issued in November 2019
[Hong Kong banks' HKFRS 9: benchmark study](#)

THE ROLE OF BANKS IN SUPPORTING THE ECONOMY

The Hong Kong economy has been operating amid strong external and domestic headwinds in recent years. Downside factors that forced Hong Kong into its first recession in a decade in 2019 include the initiation of the US-China Trade war in July 2018, the domestic social unrest surrounding the possible passage of an extradition law in Hong Kong starting from June 2019, and the global Covid-19 outbreak in January 2020.

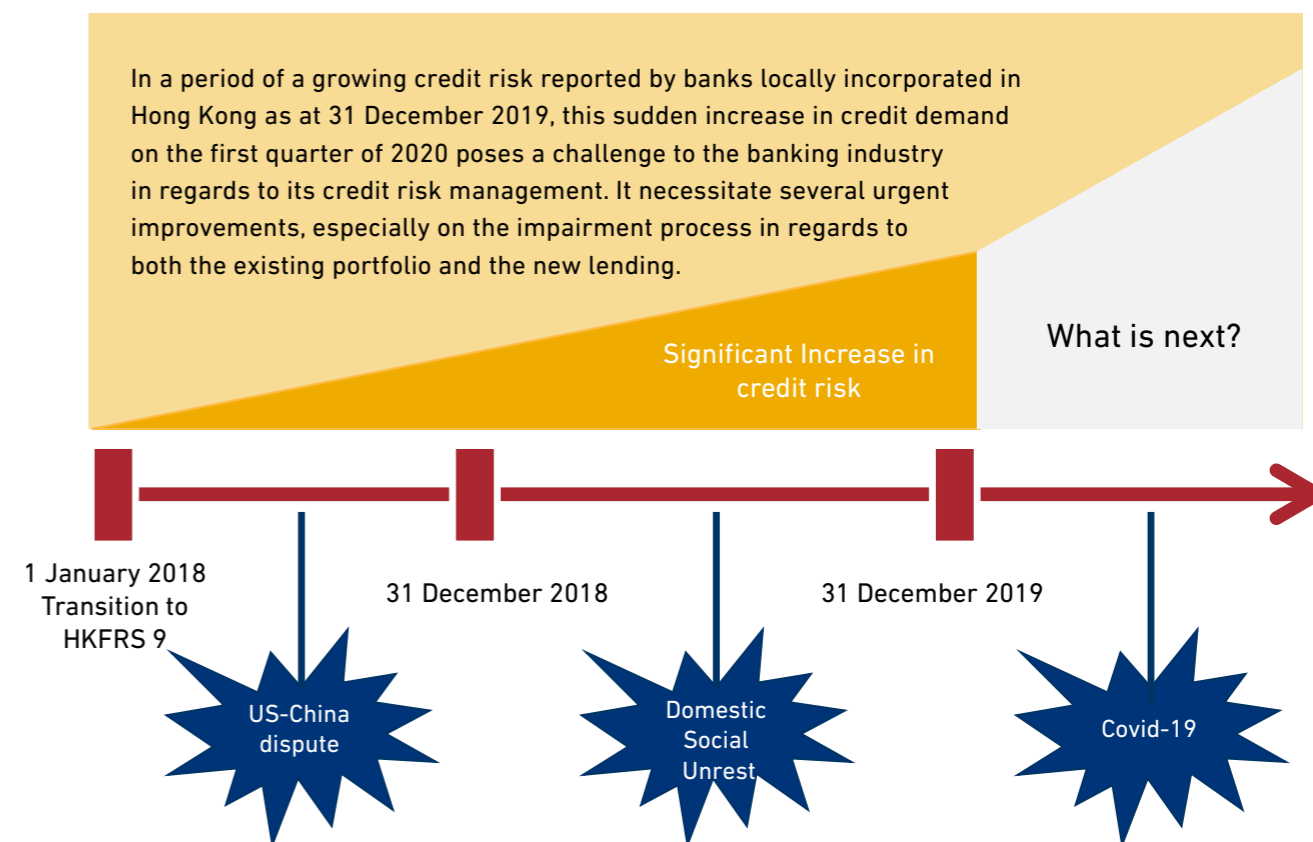
This challenging environment urged the Hong Kong government to react and implement policy interventions and temporary relief measures for retail, small and medium enterprise (SME) and corporates to support the real economy and alleviate pressure on cash flows faced by borrowers.

With its role of intermediation in the real economy, the banking sector is the cornerstone to implement these interventions and get credit flowing to the economy. Some of the temporary relief measures that have been rolled out to free up lending capacity include:

- Lending to borrower under the SME Financing Guarantee Scheme.
- Principal moratorium / repayment holidays for limited period.
- Fee waiver for late payments or several remittances.
- Conversion of unused trade lines into overdraft facility within limited period and amount.

These measures were accompanied by the relaxation of regulatory, liquidity and operational requirements on banks to stimulate further the efficiency of the lending measures.

And it works. The latest statistics released by the Hong Kong Monetary Authority (HKMA) showed a significant increase in the lending rate by Hong Kong banks, especially in March 2020.



CREDIT RISK AS A GROWING THREAT

The following section presents how impairment has been reported by 22 locally incorporated licensed banks in Hong Kong under HKFRS 9. We have excluded the virtual banks that were granted a licence in 2018 since they had no significant operations by the end of the first quarter of 2020. Although the information is public, we chose to present the information without mentioning the bank's name.

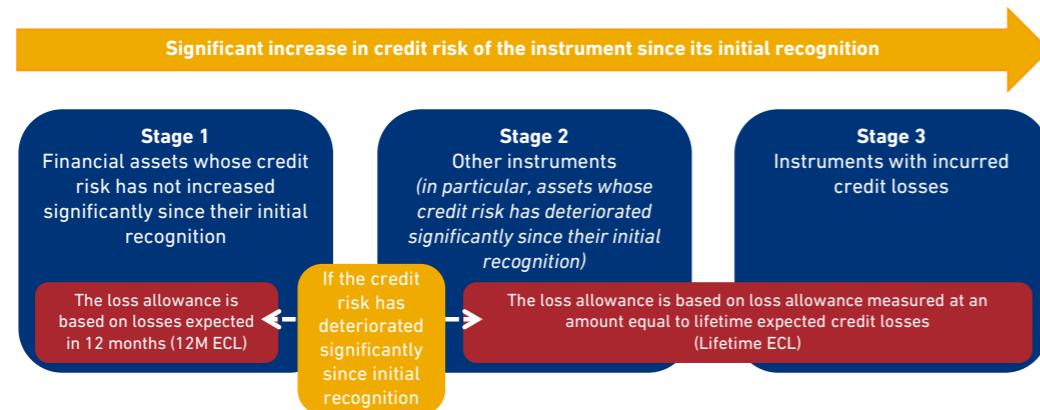
Banks analysed		
<ul style="list-style-type: none"> Industrial and Commercial Bank of China (Asia) Ltd The Hongkong and Shanghai Banking Corporation Ltd Hang Seng Bank Ltd Bank of China (Hong Kong) Ltd Standard Chartered Bank (Hong Kong) Ltd The Bank of East Asia Ltd 	<ul style="list-style-type: none"> China Construction Bank (Asia) Corporation Ltd DBS Bank (Hong Kong) Ltd Nanyang Commercial Bank Ltd Public Bank (Hong Kong) Ltd Tai Sang Bank Ltd Tai Yau Bank Ltd Citibank (Hong Kong) Ltd China CITIC Bank International Ltd 	<ul style="list-style-type: none"> Dah Sing Bank Ltd Chiyu Banking Corporation Ltd Chong Hing Bank Ltd Bank of Communications (Hong Kong) Ltd Fubon Bank (Hong Kong) Ltd OCBC Wing Hang Bank Limited Shanghai Commercial Bank Limited

Our analysis of the impairment is based on the published financial statements as of 31 December 2018 and 31 December 2019. It is worth noting that the impairment reported as at 31 December 2019 should not include the impact of the Covid-19 outbreak as per HKAS 10. Consequently, it is suggested that the growing credit risk is significantly driven by the US-China trade dispute and the ongoing social unrest amid weaker global economic growth. The quantitative impact of the Covid-19 outbreak will be captured by Hong Kong banks in the interim financial statements in 2020.

We do however include some comments on the way banks have included qualitative disclosure on the Covid-19 outbreak in their financial statements as at 31 December 2019 as this event is related to impairment.

HKFRS 9 IMPAIRMENT PHASE REMINDER

As a reminder, the HKFRS 9 standard on financial instruments has been applicable in Hong Kong starting from 1st January 2018. The impairment model under HKFRS 9 is moving from "incurred loss" to "expected loss".



HKFRS 9 requires one to account for the impairment of financial instruments base on three situations, depending on the significant increase in credit risk ("SICR") since initial recognition. However, the standard leaves a number of operational simplifications and rebuttable presumptions regarding the SICR assessment.

The measurement of ECLs reflects a probability-weighted outcome, considering all reasonable and supportable information, including that which is forward-looking. Forward looking means the inclusion of forecasts of future economic conditions.

CREDIT RISK AS A GROWING THREAT

IMPAIRMENT STAGE ALLOCATION AND ALLOWANCE

- Our analysis focus on the loans and advances to customers¹ (L&A to customers) rather than all the financial assets subject to impairment. Overall, there is a deterioration in credit quality of L&A to customers held by the 22 banks covered by this study. The computed² changes in overall impairment allowance percentage covering stage 1 to 3 reported by the banks increased for 13 banks.
- We noted a shift of -1.22 basis points of the total gross L&A to customers transferred from stage 1 to stage 2 which means there has been a significant increase in credit risk of the instrument since its initial recognition.
- We also noted that the percentage of gross L&A to customers under stage 3, which supposedly have incurred losses, stayed around the same for locally incorporated banks.

OVERALL TREND	NUMBER OF BANKS
Increase	13
Decrease	6
Unchanged	3

	2018	2019		Basis points ³
Stage 1	94.77%	→ 93.55%	III →	-1.22
Stage 2	4.71%	→ 5.96%	III →	+1.25
Stage 3	0.52%	→ 0.49%	III →	-0.03

The percentage of gross L&A to customers classified in stage 3 is broadly similar to all Authorized Institutions (AI) in Hong Kong according to HKMA statistics. The gross classified Loans that correspond to stage 3 under HKFRS 9 ([see our previous study for further information](#)) increased slightly from 0.55% as at December 2018 to 0.57% as at December 2019 as reported by all AI.

If the percentage of assets under stage 3 remains broadly the same, the impairment allowance as a percentage of gross exposures is significantly increased.

	2018	2019		Basis points ³
Stage 1	0.19%	→ 0.21%	III →	+0.02
Stage 2	2.55%	→ 2.21%	III →	-0.34
Stage 3	45.78%	→ 54.11%	III →	+8.33

¹ Banks in Hong Kong traditionally report in their communication to market on the impaired loan ratio that equals to "gross impaired loans and advances to customers / Total gross loans and advances to customers"

² The figures are computed by Mazars using the information available from the banks' published financial statements.

³ As 2 banks disclosed the total gross loans and the total ECL allowance without indicating the split by stage, both the staging shift and the impairment allowance change are computed on 20 banks only.

CREDIT RISK AS A GROWING THREAT

DISCLOSURE ON SCENARIOS

As a result of moving from 'incurred loss' to 'expected loss', the standard requires the incorporation of forward-looking information into the computation of Expected Credit Loss ("ECL").

The ECL is a probability-weighted estimate of credit losses over the expected life of the financial instrument. In order to measure ECL, an entity needs to evaluate a range of possible outcomes. This involves identifying possible scenarios.

As HKFRS 9 is principle-based, it only mentioned that changes in macroeconomic indicators are to be considered in computing the ECL, without specifying any criteria, parameters or weighting to be applied. In view of the US-China trade war and the social unrest in Hong Kong, the disclosure of scenarios employed has been reviewed by the banks analysed.

Generally, the banks mention that the impact of the above events have been incorporated into the forecast economic indicators used in the scenarios with the expectation returning to their long-term mean-reversion level after the forecast period.

- 15 out of 22 banks mentioned the **application of a 3 or more scenarios model** which includes at least one downside, one base and one upside scenario.
- 2 out of the 15 banks indicated the application of a 3 or more scenarios model had **taken into consideration 2 extra alternative scenarios** in their ECL estimation model as a result of the current condition of the economy in Hong Kong.
- The respective **weights applied to different scenarios are largely unchanged** compared to the published weighting as of 31 December 2018. **One bank allocated more weighting on the base scenario** and decreased the weighting on the upside scenario; and **one bank increased the weighting on both upside and downside scenarios** (with more weighting shifted to downside) which displayed a more polarized view on the economy as compared to the previous year.
- Among the banks with a weighting for each scenario published, **one of the banks started to publish this information for the first time.**
- The weighting of different scenarios is as follows:

BANK	As of 31 December 2018			As of 31 December 2019		
	STRESSED / DOWNSIDE	BASE / CENTRAL	OPTIMISTIC / UPSIDE	STRESSED / DOWNSIDE	BASE / CENTRAL	OPTIMISTIC / UPSIDE
BANK A	15%	60%	25%	15%	66%	20%
BANK H	28%	65%	7%	35%	55%	10%
BANK I	20%	70%	10%	20%	70%	10%
BANK L	10%	80%	10%	10%	80%	10%
BANK M	10%	80%	10%	10%	80%	10%
BANK N	N/A	N/A	N/A	36%	50%	14%
BANK S	20%	60%	20%	20%	60%	20%

- One of the banks indicated that due to their limited number of borrowers and their respective difference in nature and background, the **ECL are estimated on an individual case by case basis.**

CREDIT RISK AS A GROWING THREAT

IMPAIRMENT AND DISCLOSURE RELATING TO COVID-19

COVID-19 impacted Hong Kong starting from January 2020 and was classified as a pandemic on 11 March 2020, post-closing of the financial accounts for the year 2019.

As per HKAS 10, an entity shall not adjust the amounts recognised in its financial statements as at 31 December 2019 to reflect the events occurring after the reporting period unless such events call seriously into question the validity of the going concern assumption.

Consequently, unless the validity of the going concern assumption is questioned, the COVID-19 outbreak impact on financial statements at 31 December 2019 is limited to disclosures only.

Most banks incorporated disclosure of this matter in the notes to their financial statements.

- 18 out of 22 banks mentioned **COVID-19 as a non-adjusting post balance sheet date event** while the remaining 4 banks **did not refer to the outbreak** in the notes to their financial statements.
- 5 banks explicitly expressed that they had performed a stress-test or other form of analysis to **estimate the impact on the bank's financial resilience** and the results showed that the bank had enough capacity to deal with the potential impact.



IMPROVING YOUR IMPAIRMENT OPERATING MODEL

RESTATING THE IMPAIRMENT METHODOLOGY

Understandingly, some businesses will fall or will struggle to repay their loans in full in the short to medium term. As most of economies currently benefit from Government interventions, the real damage and the level of failure of the first wave of the outbreak is going to be apparent after the temporary relief measures fade. To make matters worse, the scale, the duration and the recovery shape are still uncertain. **These factors need to be considered by banks when assessing the significant increase in credit risk and measuring the expected credit losses.**

The International Accounting Standard Board (IASB) released a statement on 27 March 2020⁴ to address the accounting for expected credit losses under IFRS 9 in the light of current uncertainty resulting from the Covid-19 outbreak and clarified the following issues:

- **Adjust the approach in determining ECL to take into account evolving circumstances.** Banks should not apply their existing ECL methodology mechanically but adjust the assumptions and linkages that have been retained in determining ECL before the Covid-19 crisis⁵.
- **Assessing forecast conditions in the SICR approach and the measurement of ECL.** Banks are expected to develop estimates by considering the best available information of past events, current conditions and forecast of economic conditions as per HKFRS 9§5.5.17(c). Banks should include the effect of the Covid-19 outbreak and the response from government to support the economy in forecasting the macro economic scenarios and their weightings. Given that the current environment is rapidly evolving, this may prevent the ECL models from including the latest updated facts and circumstances, and post-model overlays or adjustments should therefore be applied.
- **Disclosures and transparency to address uncertainties.** Banks are expected to provide useful information in their financial notes to increase transparency of how they develop their estimates.

Given the rapidly evolving impact of COVID-19 and the uncertainty around the economic rebound in the mid-term, Hong Kong banks need to review the way they build their scenarios to determine their expected credit losses under HKFRS 9.

Whilst many see this as a challenge, it should also be seen as an opportunity to improve the impairment process and be more agile and responsive to the external environment.

⁴ The HKIPCA mentions this statement on its website, under section International bodies: <https://www.hkicpa.org.hk/en/News/COVID-19-CPA-Information-Centre>

⁵ <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200525e1.pdf>

IMPROVING YOUR IMPAIRMENT OPERATING MODEL

OUR APPROACH TO CHANGE

The "Business as Usual" (BAU) approach cannot cope with the sharp increase in lending volume, the frequent issuance of new regulatory measures, the extreme market volatility and the significant amount of new information.

Banks are advised to envisage a transformation and review their impairment operating model under a structured "Change the Bank" (CTB) approach. This is the best way to address the operational change imposed by the current circumstances.

Change the Bank Program

A dedicated CTB team leads the transformation program. The team is in charge of structuring, organising and steering the project; coordinating specialists; monitoring and reporting on progress, issues and results to the Management.

The core CTB team is constituted of limited, but experienced, staff. This team should have access to and be in constant communication with specialists sitting in various departments across the bank including, but not limited to, business, risk, finance, economist, internal audit, and IT.

One of the first prerogatives of the CTB team identify key stakeholders and perform an analysis of the current state (As-Is) of the process with the support of specialists to build a mapping of the areas of focus required to improve the impairment operating model. In our view, the likely immediate areas of focus are as follows.

EIGHT AREAS OF FOCUS	
Scenario Building, Modeling and Risk Parameters	Information Technology Infrastructure
Financial Disclosure	Data Quality
Governance, Communication and Reporting	Resources
Control Environment	Regulatory and Accounting

Once all areas of focus are mapped, the roles and responsibilities can be allocated, and the target operating model and the roadmap for implementation and deployment can be designed. During the program, the CTB team will act as project manager office to:

- Facilitate communication between departments to design and implement solutions.
- Identify and prioritize the tasks requiring immediate action.
- Document the decision-making process for each area of focus.
- Identify and escalate issues and ensure remediation actions are applied.
- Track and report progress and results.

How we see it?

There is a wide range of experience and capabilities between banks in defining scenarios and computing expected credit losses.

Large banks regularly perform supervisory macro stress tests to assess resilience to shocks. They have been building robust tools, strong capabilities, efficient data capture systems. Yet, this unprecedented crisis requires adjustments to existing operating model: it is a global crisis impacting all jurisdictions where banks operate.

Small and medium banks need to invest significant effort to move the scenario building and ECL

IMPROVING YOUR IMPAIRMENT OPERATING MODEL

Scenario Building, Modelling and Risk Parameters (1/2)

Banks should determine forward-looking scenarios to consider when assessing the SICR and estimating ECL on the existing loan portfolio and new production.

Banks are required to develop estimates based on the best available information about past events, current conditions and forecasts of economic conditions. Given the evolving environment, the limited availability of reasonable and supportable forward-looking information on the impact of COVID-19 and the uncertainty around the economic rebound in the mid-term, defining reliable forecasts is a challenging exercise. Banks should focus on the following actions:

- **Avoid excessively procyclical assumptions in the ECL estimations during the COVID-19 pandemic.** The HKMA encourages bank to exercise informed judgement and to use the flexibility inherent in HKFRS/IFRS 9⁶. It is also suggested to consider guidance that is compliant with HKFRS 9 requirements provided by other supervisory authorities:
 - **Collective assessment of the SICR.** The current downgrading of the GDP outlook may lead to an increase in the probability of default (PD). This increase, among other indicators, may trigger the transfer of financial assets from stage 1 to stage 2. In some cases, the resulting increase in the PD might indicate that portfolios assessed collectively have suffered a SICR as a whole even if this increase will, most likely, not affect all clients equally. Under certain conditions, the standard enables banks to recognise lifetime expected credit losses on a portion of the overall portfolio for which credit risk is deemed to have increased significantly (ie, a 'top down' approach can be used).
 - **Use of long-term macroeconomic forecasts⁷.** Where there is no reliable evidence for specific forecasts, long-term macroeconomic outlooks will provide the most relevant basis for estimation. In some cases, banks may use available historical information as far as this information is representative for the long-term horizon as per HKFRS 9 §B5.5.52 and free of bias.
 - **Use of macroeconomic forecasts for specific years provided by supervisory authorities.** Banks may
- **enrich available periodic macroeconomic forecast with projections that reflect both the lockdowns and the social distancing restrictions imposed in the various economies as well as the substantive public support measures announced and implemented across countries.**
- **Consider a range of different impacts and recovery shapes by sector, and where possible by individual clients.** Some sectors will be more affected than others by the Covid-19 outbreak, such as tourism, airline, hospitality, oil & gas... Other sectors may benefit from the current crisis such as telecom, internet services and online retail.
- **Review the weight of the scenario.** Weight reflects the likelihood that a scenario will materialize. As per HKFRS 9, an entity has to measure expected credit losses of a financial instrument in a way that reflects an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. The determination of the weights may rely on a representative sample of the complete distribution of outcomes between downside, baseline and upside scenarios.
- **Build scenarios with various durations of Covid-19 impacts and assumptions in regarding the duration of the packages of relief measures, i.e. 3 months, 6 months and 1 to 5 years.**

⁶ <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200525e1.pdf>

⁷ https://www.bankingsupervision.europa.eu/press/letterstobanks/shared/pdf/2020/ssm.2020_letter_IFRS_9_in_the_context_of_the_coronavirus_COVID-19_pandemic.en.pdf?b543f9408a8480e04748a3b0185d8cf3

IMPROVING YOUR IMPAIRMENT OPERATING MODEL

Scenario Building, Modelling and Risk Parameters (2/2)

- **Consider regulatory clarifications** regarding forbearance, default identification, mechanistic triggers of IFRS 9 Stage assignment, and the way this impacts the SICR and the move to stage 3 (i.e. incurred loss) and the related estimation of ECL.
- **Review model calibration and perform back testing** to understand the correlation between risks factors that were not previously identified in order to update internal models.
- **Re-work the risk parameters to estimate ECL, i.e.** Exposure at default (EAD), Probability of default (PD) and LGD (Loss Given Default). For example, EAD are expected to increase due to the holiday payment and principal moratorium relief measures and the conversion of off-balance sheet (ie, trade finance exposure converted into overdraft, additional withdrawals of overdraft). LGD should be negatively impacted due to the decrease in value of certain collateral (share and bond prices, real-estate, credit worthiness of guarantors). However, under certain conditions, support relief measures such as state guarantee should impact positively the LGD. PD are expected to increase due to a deterioration of current conditions and forecasts of future economic conditions.

How we see it?

More synergies between departments and more reliance on the input of economists, business lines and other departments are of particular importance to supplement external data. Banks benefit from the experience, expert judgment and early warning signals identified by departments facing borrowers. Moreover, technical advice from the regulatory and accounting teams to risk departments regarding the relief measures and regulatory clarifications will help understand of the impact on the risk parameters. Economists have a key role in forecasting economic conditions.

Financial Disclosures

HKAS 34 Interim Financial Reporting requires banks to include in their interim financial statements an explanation of events and transactions that are relevant to understand changes in financial position and performance since the end of the last annual reporting period. Banks should notably report on:

- changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost;
- the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years.

How we see it?

We recommend banks disclose key assumptions and judgments applied in assessing the SICR and estimating ECL. This includes but is not limited to:

- Macroeconomic input data values used in the scenario analysis and related probability weights
- Approach to forward looking information
- Collective approach for certain industries, including the top down-approach
- Any change to SICR criteria
- Post-model adjustments and Management override
- Nature and impact on banks relating to the relief measures offered to borrowers

IMPROVING YOUR IMPAIRMENT OPERATING MODEL

Governance, Communication and Reporting

Banks need to review their existing governance, communication and reporting processes to make this more responsive to immediate needs and rapid changes in the environment. Banks should:

- **Assess the adequacy of the roles and responsibilities** of those responsible for operating on a daily basis (first line), controlling (second line) and overseeing (Senior Management) the impairment framework.
- **Set more frequent reporting to the Board** that retains ultimate responsibility in the decision-making process.
- **Assess the relevance of information** shared with the Board to focus on meaningful information.
- **Enhance the communication channel** to successfully communicate top down, bottom up and across the bank.
- **Update policies and procedures and other documents** pertaining to the bank's impairment operating model.

How we see it?

Decisions should be taken in a dynamic environment ready to adjust continuously. Implementing more effective corporate governance will make the bank more agile in responding to rapid changes in the environment.

A more effective decision-making process will be enhanced by avoiding too much reliance on imperfect information.

Control environment

Board and Audit Committees have a central role to play in adjusting the chain of controls around the impairment operating model. Banks should:

- **Re-prioritise the control plan** for both the 2nd and the 3rd lines of defence. It is likely that the top risks in the risk register no longer relate to the most severe risks the bank is facing. The current situation requires a re-assessment of the risks and adjustment to the work/audit plan accordingly.
- **Ensure that key controls are in place, properly designed and effective.** In particular, lines of defence should cover the technical aspects such as scenario development and approval, model development, update and validation, as well as overlays and expert judgement applied to the SICR assessment and ECL measurement.

Information Technology Infrastructure

Information Technology infrastructure is at the core of banks' activities. Banks should focus on the following actions to address the additional needs:

- **Improve IT resilience.** Since banks are encouraged to work remotely for the time being, it is necessary to review the infrastructure capacity to avoid disruption in building scenarios, capturing data and computing ECL. The review also aims at addressing cyber security concerns that are becoming more pressing.
- **Review the IT architecture.** Banks need to increase the systems' flexibility by reviewing the way data flows, is organised and captured. The aim is to get an overview on all data available, rather than in a silo view, to enhance the impairment decision-making process.

IMPROVING YOUR IMPAIRMENT OPERATING MODEL

Data Quality

The impairment operating model needs to rely on up-to-date information to develop estimates based on the best available information about past events, current conditions and forecasts of economic conditions. It is especially important for banks to focus on the following actions:

- **Enhance the granularity of data.** Banks need to get a deeper view of the data collected by geographies and sectors.
- **Widen the scope of data collected.** As the Covid-19 impacts are still uncertain, data collected should be gathered from various sources to drive rapid convergence and ease the scenario building process and allocate scenario weighting. Sources may be both internal and external (rating agencies, supervisory authorities, government statistics, macroeconomic research, social media, public data such as equity and CDS prices etc). Data analytics can be a powerful tool to capture more data. Banks should redouble efforts towards digital transformation.
- **Improve data integrity.** The data must be of sufficient quality. Automated and manual checks on the data set should be run.
- **Enrich the scenario to be analysed.** Banks should review the impact of the Covid-19 outbreak on macroeconomic variables (such as labour, GDP, inflation...) or financial indices to develop more plausible and robust scenarios and identify additional correlations.
- **Shorten the required time to gather data.** The decision-making process should rely on more timely information without sacrificing the quality of the data set.

How we see it?

Some decisions might need to be taken on the basis of limited information. The more the process to gather data is efficient and timely, the more the ECL estimates will be based on a reasonable and supportable basis as per HKFRS 9 requirements.

Resources

Banks need to assess whether they have adequate resources internally or should access external resources to help improving the impairment analysis process. Banks should:

- **Assess their technical capabilities in dealing with each area of focus.** All areas covered are technical and require specialist input.
- **Assess whether additional resources are required.** Areas of focus may trigger temporary resource needs to deal with tasks in addition to normal operations.

Regulatory and Accounting

Banks need to stay abreast of the regulatory environment and the supporting measures announcements that are evolving very fast. Banks should:

- **Assess the impact of the clarifications and temporary relief announcements on several dimensions.** Some initiatives that impact risk parameters should also be analysed in light of accounting standards and regulatory requirements. As an example, the HKMA published an annex⁸ that clarifies the treatment of certain extraordinary support measures related to Covid-19, in particular on the payment holiday granted. Scrutiny should be put on the interactions between the relief measures and the definition of default which shall be consistent with the definition used for internal credit risk management purposes.

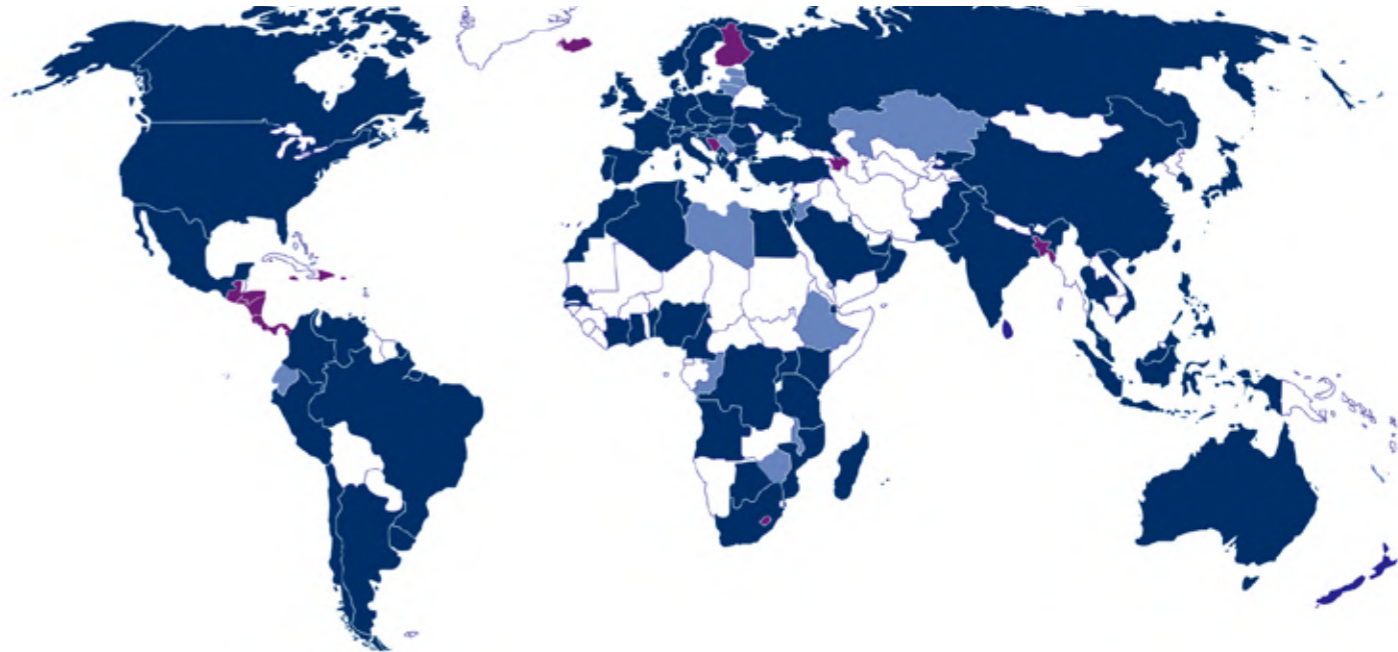
⁸ <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200525e1a1.pdf>

GUIDING YOU THROUGH CHANGE



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