MFSA MALTA FINANCIAL SERVICES AUTHORITY

Circular

25 March 2020

ESMA Public Statement - Accounting implications of COVID-19 on the calculation of expected credit losses in accordance with IFRS 9

1.0 Background

The Authority would like to draw your attention to the Public Statement issued by the European Securities Markets Authority ('ESMA') on 25 March 2020 (hereinafter referred to as the 'Public Statement').

The European Banking Authority ('EBA') has also issued a statement on the application of the prudential framework in relation to COVID-19 related measures on 25 March 2020. ESMA and EBA have ensured that both statements are consistent in relation to financial reporting aspects. Furthermore, the CEAOB has published a statement pertaining to the impact of COVID-19 on the audit of financial statements.

The Public Statement was issued in order to ensure consistency in the application of IFRS 9 *Financial Instruments* in light of the specific context of the COVID-19 outbreak. It specifically addresses the considerations that have to be made when accounting for economic support and relief measures that are being granted by European governments in order to ensure consistency with the requirements of IFRS 9.

2.0 Accounting Implications

In the Public Statement, ESMA has made recommendations to financial market participants, on the following areas:

i. **Accounting for the modifications resulting from the introduction of support measures**
ESMA outlines that the impact of economic support and relief measures on recognised financial instruments should be carefully assessed and should include both qualitative and quantitative criteria. Reference is also made to disclosure requirements to be made by issuers.

ii. **Assessment of significant increase in credit risk ('SICR')**
The SICR assessment should consider the impact of any economic support program designed to reduce the lifetime default risk on a financial instrument. Issuers should distinguish between measures that impact credit risk and those addressing temporary liquidity constraints.

iii. **Expected Credit Loss ('ECL') estimation**
To ensure the correct functioning of the ECL model under IFRS 9, issuers should assess the extent to which the degree of uncertainty and any immediate changes in the short-term economy are expected impact the entire life of the financial instrument.

iv. **Public Guarantees on Issuer's exposures**
In the event of public guarantees being provided on issuer's exposures, ESMA notes that the value of the guarantee will not affect the SICR assessment, however, the existence of such credit enhancements

may impact the ECL measurement itself. Further guidance is provided on measuring ECL where there is evidence of collateral and other credit enhancements.

v. **Transparency**
In order to ensure compliance with IFRS 7 *Financial Instruments: Disclosures,* ESMA has recommended that issuers provide all the related disclosures and any additional information to enable the users of financial statements to understand the actual and potential impacts of COVID-19 on the application of IFRS 9.

Contacts

Should you have any queries relating to the above, kindly contact the Authority on transparency@mfsa.mt.