Reflecting climate-related risks in ECL calculations

Talking points for episode 120

Although climate change is not mentioned explicitly in IFRS Standards, the effects of climate change on financial statements still need to be considered. In particular, climate-related risk needs to be considered in measuring expected credit losses (ECL) applying IFRS 9.

IFRS 9 requires entities to use reasonable and supportable information in measuring ECL. While there is uncertainty over how climate change will unfold and uncertainty over how companies respond to it, there is ever increasing data about the effects of climate change that would be considered reasonable and supportable information in the context of IFRS 9.

Available data available includes economic forecasts reflecting various climate scenarios, external ratings that reflect ESG risks, and information on borrowers released through the voluntary disclosures developed by the Financial Stability Board Task Force on Climate-related Financial Disclosures, or other similar disclosures that can be incorporated into the assessment of the borrower's credit risk. Historical information, such as data on physical risk events like extreme weather, may prove reasonable and supportable when attempting to quantify the impacts of climate risk, especially in terms of magnitude.

Entities need to analyze and understand the potential impacts of climate change risk on ECLs to assess whether such effects are material today. The effect of climate risks will vary within portfolios depending on the nature and composition of those portfolio and entities need to ensure effective identification of relevant climate risks.

There is also an increasing focus from regulators on the consistency of disclosure between the financial statements and information disclosed elsewhere. For example, the European Securities and Markets Authority (ESMA) and the Office of the Superintendent of Financial Institutions in Canada have indicated the importance of transparency about ECL measurement, and consistency between the information disclosed within financial statements and non-financial information about climate-related matters and risks, disclosed elsewhere.

2021-01-12_RITM4431934