European Securities and Markets Authority

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PRESS RELEASE

ESMA issues statement on forbearance practices

The European Securities and Markets Authority (ESMA) has issued a Public Statement on the *Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions*. The statement deals with the definition of forbearance practices, their impact on the impairment of financial assets and the specific disclosures relating to forbearance activities that listed financial institutions should include in their IFRS financial statements for the year ending 31 December 2012.

The statement results from ESMA's concerns that a lack of consistency amongst issuers in this area raises issues over the transparency and accuracy of their financial statements. ESMA believes that the consistent application of IFRS principles promotes comparability among listed financial institutions' financial statements.

This forms part of broader work on forbearance practices undertaken by regulators, including the European Banking Authority (EBA) and the European Systemic Risk Board (ESRB), who are examining the issue in the context of prudential reporting and macro-economic risks respectively.

Steven Maijoor, ESMA Chair said:

> "ESMA and national authorities have become concerned at the lack of clarity in financial issuers' financial statements regarding their treatment of forbearance-related practices, and the potential impact this might have on issuer's financial performance and position, with consequences for investors and markets.
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> "We have seen the impact of an inadequate approach to forbearance and impairment in previous financial crises and our aim is to avoid a similar situation developing here in the EU. We believe that by promoting an appropriate and consistent approach to the definition of forbearance, measurement of impairment and related disclosures, investors

can be confident that issuers' financial statements accurately reflect credit risk exposures and the credit quality of their financial assets."

"A uniformly consistent approach on this issue in the EU will contribute to the proper functioning of financial markets, the maintenance of financial stability in the European Union and improved investor protection."

Forbearance and objective evidence of impairment

Forbearance occurs when the borrower is considered to be unable to meet the terms and conditions of the contract due to financial difficulties and, based on these difficulties, it decides to modify the terms and conditions of the contract to allow the borrower sufficient ability to service the debt or refinance. Therefore, forbearance measures constitute objective evidence of impairment under IFRS.

Forbearance and asset impairment

As forbearance measures are extended due to the financial difficulties of the borrower, ESMA expects that issuers would have when assessing the impairment of those loans:

- identified whether a loss event has had an impact on the estimated future cash flows;
- based impairment calculations on the estimated future cash flows and not the contractual cash flows; and
- applied a heightened level of scepticism when estimating the future cash flows, as well as other parameters used.

Required disclosures in the year-end IFRS financial statements

The disclosures to be provided by financial institutions, regarding their forbearance practices in their annual IFRS financial statements, should include the following qualitative aspects:

- details of the types of forbearance practices undertaken during the reporting period;
- description of the risks related to the forbearance practices undertaken, and how these risks are managed and monitored for internal management purposes;
- accounting policies applied in respect of the forborn assets; and
- description of any changes in these aspects from the prior period.

The issuers should also provide quantitative disclosures in order to enable users to evaluate the

impact of forbearance measures on the credit risk profile of their loan portfolios and their financial position and performance. ESMA expects such quantitative disclosures to be included in the 2012 financial statements as far as possible, and in any event they should be implemented and reflected in 2013's annual financial statements.

Next Steps

ESMA, together with EU national competent authorities, will continue to monitor the level of transparency that issuers provide in their financial statements on forbearance related measures and their impact on impairment, and will consider whether further action is required. The statement complements ESMA's common enforcement priorities for the 2012 year-end IFRS financial statements which were published in November 2012.

Notes for editors

1. *Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions*

2. Public Statement – *European Common Enforcement Priorities for* 2012 financial statements

3. ESMA Regulation no 1095/2010 states it shall act in the field of financial reporting, to ensure the effective and consistent application of European Securities and Markets legislation.

4. ESMA is an independent EU Authority that was established on 1 January 2011 and works closely with the other European Supervisory Authorities responsible for banking (EBA), and insurance and occupational pensions (EIOPA), and the European Systemic Risk Board (ESRB).

5. ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union (EU). As an independent institution, ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

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