Most banks across the world have completed the implementation projects over the last few months, if not years, under the much-awaited International Financial Reporting Standards (IFRS) 9. The conceptual transition from incurred loss to expected credit losses has been completed. IFRS 9 has impacted banks across the world and changed the way they approach and view the impairment process. The standard has brought about far-reaching changes in many areas such as financial reporting, risk management, capital management, regulatory reporting, data sourcing and collection, governance framework and IT systems. The standard has, in many ways, integrated the Risk, Finance and IT functions of bank.

In the UAE, when we analyze the FY2017 results from the top 5 banks, we see the increase in provisions is substantial. While the rise is not as severe as in many European banks, it is still likely to bring changes to the way banks conduct business. Technically, most banks have been able to meet the date of initial implementation, but we believe it will take a while before IFRS 9 becomes business as usual. Current IT systems need to change significantly to calculate and record changes requested by IFRS 9 in a cost-effective and scalable way, and data sources and models need to be further enhanced.

Adequate infrastructure and systems should be made available for data, for example, recording collateral information, costs and recoveries used in loss given default (LGD) calculation. Models that have been implemented need to be validated and monitored continuously to ensure smooth transition now, and effectiveness in future. All these changes include substantial investment in terms of resources and time from the bank’s perspective.

**Reinforcing sound governance**

The inter-dependency between the IT, Finance and Risk functions puts forward the need for a revised governance policy. This includes a structure comprising a board of directors, steering committee, working group committee and technical working group committee. The Central Bank of the UAE (CBUAE), Basel Committee for Banking Supervision (BCBS) and Global Public Policy Committee (GPPC) and other such bodies have all recommended minimum standards of governance to ensure that the implementation of IFRS 9 is appropriately supported. The implementation of these governance measures will need careful consideration and time.

IFRS 9 is expected to result in some of the business lines and the products becoming less viable than others. Provisions under IFRS 9 are point-in-time, thereby being closely related to the economic cycle. Banks are expected to reconsider the lending to those sectors that are sensitive to the economic cycle. Likewise, loans with longer duration and bullet payments are likely to come under increased pressure due to the effect of higher expected credit loss (ECL). Portfolio strategy ought to be adjusted in order to prevent this increase in volatility.

Profitability is affected currently and will be impacted in various ways in the future as well. Increased current provisions lead to decreased profitability. The implementation of Basel III, together with IFRS 9, will lead to increased cost of capital for banks since the capital adequacy ratio will increase to 16% by 2019 with an additional capital conservation buffer. Additionally, Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) requirements make liquidity more expensive, affecting profitability and hence capital. This has implications for the pricing of products, deal origination, maturity and amortization of products offered.
Credit management

Credit management practices will also be impacted in the future as banks will have to estimate forward-looking expected loss over the life of the financial facility and monitor for ongoing credit-quality deterioration. The credit benchmarks have become higher and more relevant; costs and recoveries will have to be captured and monitored frequently.

Banks may have to revise performance indicators, incentives and compensation schemes to reflect IFRS 9 adjusted profitability. Collections team would have to start their work sooner, considering the 30 days past due (DPD) threshold for significant increase in credit risk (SICR). Shocks on the economy would require vigorous monitoring and transferring of borrowers from stage 1 to stage 2. Such monitoring will lead to an increase in collection and recovery costs.

The relationship manager has a pivotal role in an IFRS 9 scenario. She or he has a role in structuring and pricing the product for the obligor, collecting the instalments and being the first point of contact to obtain credit information from the customer.

The role of the business teams is likely to be more onerous with the incentive structures tied to an appropriate risk-adjusted profitability metric, such as return on risk-weighted assets, return on risk-adjusted capital or economic value added.

Given the hard work invested by banks in the earlier stages of IFRS 9 implementation, banks should start afresh setting up a project plan for the next phase to make it become business as usual. The plan should also include provisions to ready the bank for regulatory scrutiny. The date of implementation is a job well begun but only partially done.

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Bhaskar’s responsibilities include: leading clients through emerging accounting challenges, specifically IFRS 9, IFRS 15 and IFRS 16; advising on difficult accounting transactions, especially during mergers and acquisitions; and guiding senior stakeholders on accounting matters. His focus is on the integration of the risk and financial data to achieve business outcomes while meeting compliance requirements.

He has extensive experience in revenue recognition, financial instruments, business combinations and lease accounting, and has worked in India, Australia and the UAE.

“Banks should start setting up a project plan for the next phase to make it become business as usual”