

Applying IFRS 9 in the Time of Covid

Service Offer



2021

managing
financial
institutions



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Background

Current Context

- The **pandemic has had a strong impact on economies**; financial institutions, banks and MFIs, have been directly affected
- The **risk profiles of loan portfolios have deteriorated**
- Immediate **measures** – internally decided or externally driven – **and views on the future economic environment affect repayment outlooks**

Future Developments

- **Further impact is still expected**, depending on the duration of the pandemic and severity of recessions
- **PAR30 levels are likely to surge when initial loan portfolio restructurings expire**
- **Future deterioration of loan portfolio quality needs to be assessed** to understand its potential impact on financial performance, financial covenants and capital levels

Challenges for Financial Institutions

- **How to understand covid's impact on LP quality** and the impact of support measures
- **How to amend pre-crisis classifications, provisioning methodologies, and ECL measurements** to reflect the new reality
- **How to amend staging criteria / recognize significantly increased credit risk (SICR) during payment holidays**
- **Probability of Default (PD)**: how to determine forward-looking considerations given the limited relevance of pre-crisis data
- **Loss Given Default (LGD)**: how to account for changes in recoveries (incl. workout period, collateral, guarantors)
- **How to determine adequate provisioning levels** for each portfolio segment and during different stages of the crisis
- **How to define and justify management adjustments**
- **How to avoid frequent adjustments to the LLP model**
- **How to develop action plans to address LLP implications** on financial performance, financial covenants and capital ratios
- **How to communicate the changes** and likely impact to stakeholders, in particular lenders and shareholders



Our Solutions

Analysis of Covid's Impact on LP Quality

- **(Re)segmentation of loan portfolios** based on common risk characteristics and the identification of risk concentrations
- **Analysis of covid's impact on collateral coverage** / expected recovery from collateral
- **Analysis of potential future developments**
- **Proposal of measures to be taken** with regard to:
 - **Client recovery**
 - **Underwriting rules and credit procedures**
 - **Client monitoring**
 - **Collateral valuation**

Management Support and Advisory

- **Understanding covid's implications on IFRS 9 provisioning**
- **Guidance on assessing covid's impact on financial performance and capital**
- **Facilitating discussions with external auditors**
- **Facilitating communication** with stakeholders

Review of LLP Models to Reflect a New Reality

Review and adjustment of:

- **Staging criteria** (SICR, default, POCI)
- **Criteria for individual and collective impairment assessments**
- The **ECL computation model** and assumptions used
- **Management adjustments** to the model
- **Macroeconomic scenarios** used in line with changed conditions
- **Accounting implications of modifications / restructurings**
- **IFRS 7 disclosures**

Outcome:

- **Covid adjustments are in line with IFRS 9 requirements** and include the impact of support measures
- **The model adequately reflects loan portfolio quality** and replaces the automated/mechanical use of pre-crisis criteria and assumptions
- **Management adjustments are well-reasoned and properly documented**
- **Adequate macroeconomic scenarios are used**
- **The impact of changes** to the LLP model on financial performance / capital **are well assessed**



Our Solutions

Irrespective of covid's impact, many financial institutions applying IFRS 9 are still questioning if all IFRS 9 requirements have been fully respected and if the model they've used is the best fit for their business model and loan portfolio structure. Some initially-developed models are difficult to validate and their update or adjustment are resource-intensive. Institutions that have not applied IFRS 9 so far have an even more challenging task: how to implement IFRS 9 in the current environment?

Implementation of IFRS 9

- **Conducting the business model and SPPI tests** (classification and measurement)
- **Computing PDs, LGDs and EADs**
- **Setting criteria for staging** (SICR, Default, POCI)
- **Incorporating forward-looking information**
- **Determining the implications of modifications**
- **Disclosure** of the change and its impact
- **Communication**

Revision of Existing Model

- **Fit of model** to the risk profile of the institution (PD, LGD, etc.)
- **Adjusting staging criteria** (SICR, Default, POCI)
- **Building in macroeconomic factors and management adjustments**
- **Processes and reporting**, automation and efficiency
- **Estimating the impact of proposed model changes**

Management Support and Advisory

- **Establishing business requirements for implementing IFRS 9**
- **Assessing the impact** on financial performance and capital
- **Facilitating discussions with external auditors**
- **Facilitating communication with stakeholders**

Our Objectives

- Development of a **provisioning model** that:
 - **Is compliant with all key IFRS 9** requirements
 - Has a level of **complexity that is adequate** for the institution's business model and organization
 - **Is easy to understand and apply**
- Comprehensive and concise **internal policies and procedures**
- **Focused reporting** on LP quality /provisioning that is customized for different management levels



Our Resources

Experienced professionals who combine detailed knowledge of banking standards and best practices, a highly analytical approach and a deep understanding of the operational reality of banks and MFIs. As previous managers and senior executives of MSME banks, our team is able to develop and implement practical concepts and solutions that can be well understood and applied.

Finance Team

- **Senior management backgrounds and operational experience** in MSME banks
- **Deep understanding of financial management** in difficult environments
- **Expert knowledge of IFRS** and extensive experience in guiding banks and MFIs in its practical application
- Conceptual and presentational strength and **strong communication skills**

Credit Team

- **Extensive operational experience** in recovery, underwriting, monitoring and collateral evaluation
- **Experience in managing lending operations in crisis situations**, both during the global financial crisis in 2008 and in subsequent, more localized crises
- **Ability to design swift and effective action plans in emergency situations**
- **Managerial and operational experience in increasing the readiness of an institution to deal with severely impacted borrowers**

Data Team

- Highly analytical approach and **high level of technical expertise**
- **Deep understanding of the operational reality** of banks and MFIs
- **Unique track record in portfolio analysis** and the identification of problematic loan portfolios
- **Experience in the quantification and assessment of crisis portfolios**, the identification of the main issues from a credit risk and business development perspective, and the assessment of expected credit losses
- **Ability to design and implement focused reporting on loan portfolio quality and provisioning** that is customized for different management levels



Contacts



Svetlana Tolmacheva

Senior Banker

tolmacheva@inspiring-development.com

+381 63 640 261



Vanessa Inacio

Principal Banker

inacio@inspiring-development.com

+351 919 374 394



Stephan Boven

Managing Partner

boven@inspiring-development.com

+49 152 327 300 17

Please contact us for:

- Further information on our services and our approach
- Possible packages or specific needs
- Information needed to be able to provide an individual offer



This document was compiled by:

I.D. Inspiring Development GmbH

Eschborner Landstrasse 42-50, Haus B
60489 Frankfurt am Main / Germany

Phone +49 69 678 30 79-0

Fax +49 69 678 30 79-99

info@inspiring-development.com

www.inspiring-development.com