

IFRS 9: First Glimpse of the Actual Impact

Impact

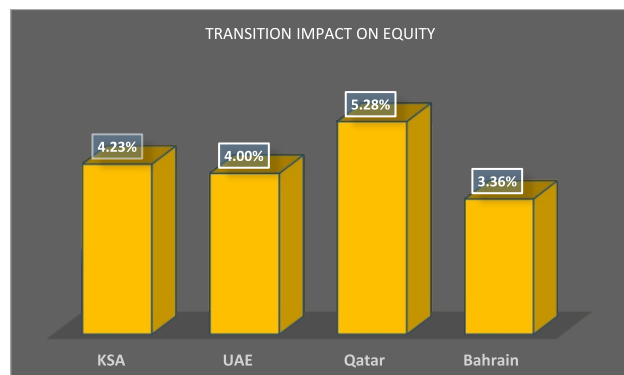
IFRS 9 has been high on the agenda of banks and their regulators for the past few years. Given the magnitude of change, all the stakeholders are curious and interested to know the actual effects of the new standard on the banking industry. As set by IASB, the standard became effective for reporting periods commencing 1st January 2018. In concurrence with the Accounting requirement, the Banking Industry as part of their December 2017 financial disclosures, divulged a range to indicate the probable IFRS 9 Impact on shareholders equity. Subsequently, as the reporting season gathered pace, the March 2018 quarter-end financials saw banks reveal the actual transition impact of IFRS 9.

On an average, the actual equity impact due to IFRS 9 transition is 4.35% of the total equity of banks, in the sample chosen for this report

During the IFRS 9 Implementation & impact assessment phase majority of the banks anticipated a negative impact on their balance sheets and the same was evident in the December 2017 financial disclosures. **In our previous blog, based on our analysis of December 2017 bank disclosures, we indicated that the expected transition impact may lead to erosion of approximately 3.56% of the total equity of the banks across KSA, UAE, Qatar and Bahrain. As per the March 2018 financials, the transition impact absorbed by banks on total equity is 4.35% across the same countries.** It is observed that the actual transition impact (4.35% of total equity) is higher than the expected impact disclosed by the bank in their December 2017 financials. Banks are not expected to publically disclose the underlying reason for this deviation, however one can infer that the deviation is largely due to modifications in the loss estimation methodology. Being a new

We have relied on the disclosures made by the banks as a part of the financial disclosures to assess the impact of on equity and other parameters. For our analysis (December 2017 disclosures impact), we have used the mid-point of the range as the ECL impact. Further, some banks had disclosed the impact of ECL (December 2017) in the financials as a % of equity or retained earnings. In such cases, the impact on other parameters is computed indirectly using absolute values of equity and or retained earnings etc.

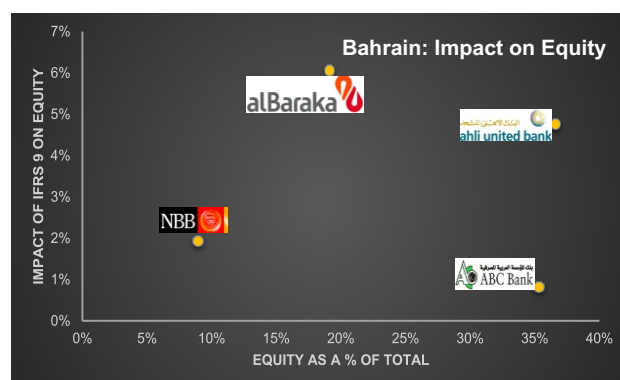
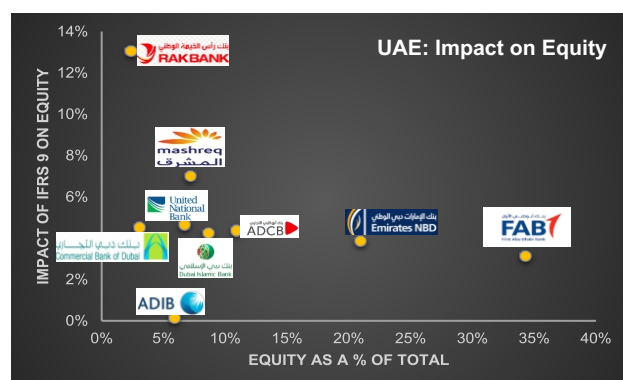
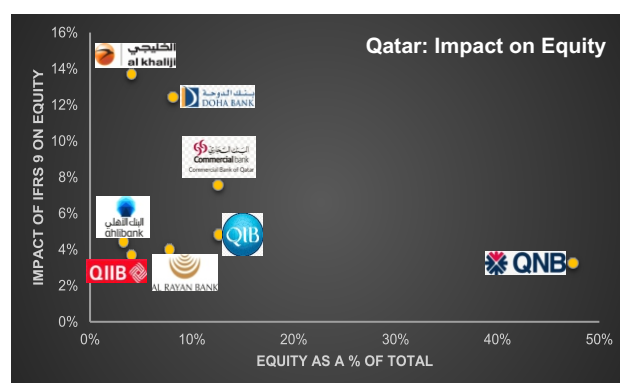
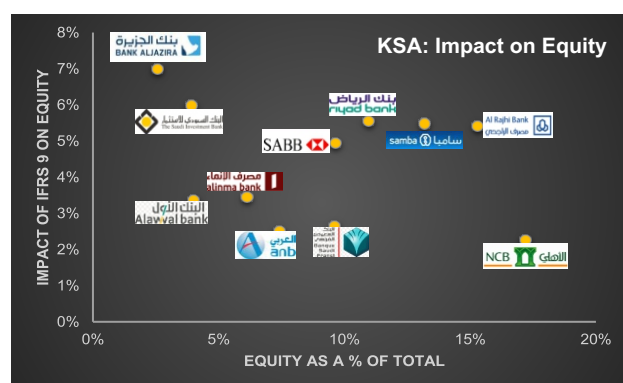
standard involving substantial amount of quantitative credit loss estimation across portfolios, it is expected that the estimation methodologies will take time before they stabilize in the long run. In addition, the equity Impact shows variability between banks essentially because IFRS 9 is non-prescriptive in terms of the methodology used for estimation of credit losses.



Of the countries selected for analysis, Qatar with an impact of 5.28% of the total equity has reported a higher impact as compared to other countries. UAE and Bahrain with an overall impact of 4.00% and 3.36% has the least effect on the total equity for the banking industry. In line with December 2017 disclosures, almost all banks chosen in the sample demonstrate an increase in the provisions under the ECL regime.

In general it is observed that smaller banks have experienced larger impact on equity as compared to some of the large banks. In the Kingdom of Saudi Arabia, as

evident from the graph below, top two banks holding total equity of 33% reported an average impact of 3.74% on equity whereas three smallest bank holding 11% of total equity have witnessed an average impact of 5.23% on equity.



In Qatar, the top two banks constitute 60% of the total equity with an average impact of 3.58% on equity whereas, the 3 banks constituting 11% of total equity have witnessed an average impact of 7.48%. Similar trend is observed in other countries in the sample indicating the transition impact has been more for small banks as compared to the bigger banks. In addition, it is observed that across banks, the range of equity impact is widespread. In case of KSA, the impact on equity reported by banks range from a minimum of 2.26% to 6.99%. In UAE, this range varies from minimum of 0.13% to a maximum of 13.08%. Similar extent of variation is observed for other countries in the sample indicating diverse loss estimation methodologies adopted across banks.

As noted above, the average actual impact on equity (for the sample countries considered for in this study) as per the March 2018 financial statements is higher than what banks disclosed in their December 2017 financials. Specifically, the actual average impact is 4.35% as against 3.56% disclosed in the December 2017 financials. The following graphs shows the average deviation at a country level. Majority of the banks considered for this

study have reported a higher impact on equity against their estimated impact disclosed in Q4 2017.

As apparent, the average actual impact on equity for Qatar and UAE is substantially higher (around 38% and 33% respectively) than that disclosed in December 2017. Other two countries (KSA and Bahrain) as well report higher equity impact (around 70 basis points or around 20%). It is important to note that the increase in impact on equity reported by banks may also have an impact on CAR based on the transition approach adopted by banks across the region.

Based on the transitional arrangements as recommended by local regulators, banks CAR may be impacted depending on the impact on equity for respective banks. In addition to the initial impact on equity, the banking industry may also experience volatility going ahead in their Profit & Loss statement due to variations in the estimated provisions (expected credit losses). Under IFRS 9, provisions are a function of both 12 month and lifetime expected credit losses based on the stage assessment. The migration of exposures between different credit stages (Stage 1, 2 and 3) may result in volatility and subsequently impact of profits. The following graph represents the impact on profit due to additional provisions provided by the banks in Q1 2018.

It is observed that the impact on profit due to additional provision ranges from about 10% to 20% for the countries considered in this analysis. It remains to be seen as to how this trend unfolds in the near future. Any deteriorating / improving credit portfolio of a bank or worsening / improving of economic conditions may lead to movement of exposures across different IFRS 9 stages resulting in volatile provision and income statements. From an on-going perspective, it will also be interesting to track the frequency with which banks modify & validate their existing loss estimation methodologies and the impact it has on the stakeholders.

Key issues

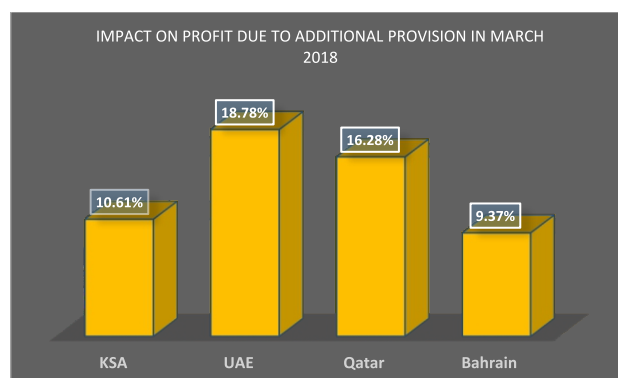
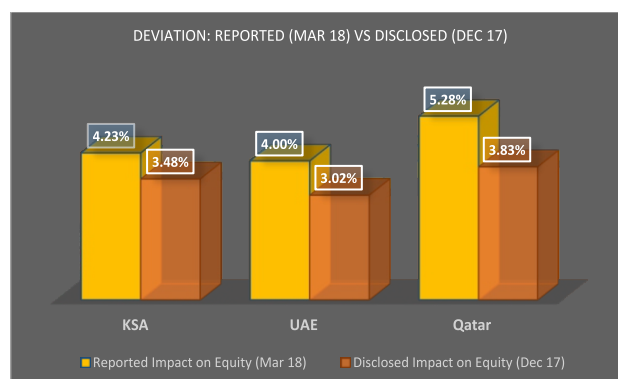
- Considering the principle driven nature of guidelines, it remains to be seen if some banks revise their loss estimation methodologies going ahead
- Increased emphasis on reviewing the ECL models and governance to manage model risk.
- Limited qualitative and quantitative disclosures in March 2018 reporting period. Banks haven't detailed all aspect of IFRS 9 like stage assessment criteria for different portfolios, detailed stage level disclosures, consideration of macro-economic scenarios and mode of computation (system/manual) to name a few.
- The Central Banks may alternatively prescribe minimum set of qualitative and quantitative disclosures which will set the minimum benchmark for ECL models under IFRS 9

Please send your suggestions and feedback in this regard at IFRS9.Insights@aptivaa.com

Assumptions and Limitations

- It would be pertinent to point out that the charts and numbers rely on financial disclosures made in March 2018, the non-standardization in metrics disclosed by banks across the region, has resulted in us using several approximations
- Significant assumptions are made to compute impact on equity and Impact on Profit in case those numbers aren't provided directly by the banks as part of their financials.
- The analysis is based on sample set of banks from Kingdom of Saudi Arabia, UAE, Qatar and Bahrain
- For our analysis as represented in this document, we have used publically available information obtained from sources we generally believe to be reliable; however, accuracy cannot be assured. We are not giving an opinion or any other form of assurance on information from these sources. Unless otherwise noted, the values calculated by us are derived using applicable market data parameters and generally accepted methodologies.

Disclaimer: For our analysis as represented in this document, we have used commercially available market data obtained from sources we generally believe to be reliable; however, accuracy cannot be assured. We are not giving an opinion or any other form of assurance on information from these sources. Unless otherwise noted, the values calculated by us are derived using applicable market data parameters and generally accepted valuation methodologies.





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- Rating and IFRS 9 Models Risk Management and Validation Solution (MONITRO)
- IFRS 9 ECL Solution to allow migration of excel spreadsheets model and rules to a robust and powerful IT platform to be able to do on the fly what-if analysis, multi-scenario ECL runs and automatic attribution of results of two different ECL runs
- Alignment of IFRS9 and ICAAP/Stress Testing Models
- Risk based pricing of loans with our easy-to-customize RAROC toolkit

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