IFRS 9 for banks

What's the impact on your business?

September 2016

The new financial instruments standard will be a momentous accounting change for banks.

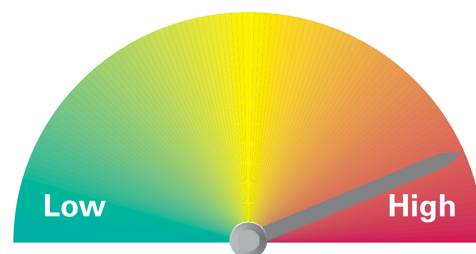
With the effective date looming, time is running out. Implementation of IFRS 9's forward-looking requirements may be challenging and will involve a high degree of judgement.

IFRS 9 will affect…

Credit losses	Reported credit losses are expected to increase and become more volatile under the new expected credit loss model. The number and complexity of judgements is also expected to increase.
Classification and measurement	How financial assets are classified becomes more judgemental and may affect how capital resources and requirements are calculated.
Hedge accounting	Hedge accounting is more closely aligned with risk management and is available for a broader range of hedging strategies.
Disclosures	Extensive new disclosures are required – system and controls changes will be necessary to capture the required data.

Engage now to address the challenges of IFRS 9's impairment and classification requirements.

Determining the impact



Credit losses

Potential impact

- IFRS 9 introduces an expected credit loss (ECL) model, which uses a dual measurement approach that requires recognition of either 12-month ECLs or lifetime ECLs: 12-month ECLs for those assets that have not suffered a significant increase in credit risk since initial recognition; lifetime ECLs for those that have.
- The new model relies on banks being able to make robust estimates of ECLs and establishing when significant changes in credit risk occur, increasing the level and complexity of judgement significantly.
- Equity, regulatory capital and KPIs may be significantly affected as they will reflect ECLs as well as incurred credit losses. Volatility will also increase as external data, such as ratings, credit spreads and predictions about future conditions, will be assessed in the calculation of ECLs.
- New systems and processes – and associated internal controls – will be needed to meet the ECL model's extensive new data and calculation requirements – e.g. estimates of 12-month and lifetime ECLs. Information will also be required to determine whether a significant increase in credit risk has occurred or reversed.

Actions to consider

- Decide how the ECL model will be applied to different financial assets and how key terms such as 'significant increase' and 'default' will be defined in the context of financial assets held.
- Develop appropriate methodologies and controls to ensure judgement is exercised consistently throughout the organisation.
- Design, implement and test new systems, databases and related internal controls to collect the additional data – e.g. historical loss data and economic forecasts.
- Incorporate the new requirements into capital planning and stress testing to ensure the potential impacts under adverse scenarios are properly understood and addressed.
- Identify KPIs and management information that will be used to monitor ECLs.
- Consider developing a plan to reduce potential volatility – e.g. by diversifying products within portfolios to reduce concentrations of credit risk or adjusting maturities of products.

Classification and measurement

Potential impact

- IFRS 9 requires financial asset classification to be based on contractual cash flow characteristics and the business model for managing the asset. Judgement may be required in determining whether the SPPI criterion is met – for example, if the interest rate resets every month to a one-year rate, then determining whether the SPPI criterion is met may require a quantitative assessment.
- How a bank classifies its financial assets could affect how its capital resources and capital requirements are calculated, and create volatility in profit or loss or equity.
- It may also influence product features in loan contracts, and processes such as loan underwriting and buying of securities.

Actions to consider

- Perform a comprehensive review of all financial assets to ensure they will be classified and measured appropriately.
- Upgrade accounting systems to ensure they can capture information needed for classification and measurement.
- Develop appropriate methodologies and controls to ensure judgement is exercised consistently throughout the organisation.
- Determine and assess the potential impact on regulatory capital.
- Consider changes to contractual terms or business models.

Hedge accounting

Potential impact

- IFRS 9 allows a bank to switch to a new hedge accounting model that is aligned more closely with risk management. The new model may allow additional hedging strategies; however, some current hedging strategies may be restricted.
- The new model is more principles-based: the bright-line effectiveness test under IAS 39 falls away and a more judgemental approach is required in the assessment of qualifying, rebalancing and discontinuing hedge accounting.

Actions to consider

- Assess whether to adopt the new IFRS 9 hedging model or remain with IAS 39 hedge accounting.
- Determine which newly permissible hedging strategies are in line with current risk management objectives.
- Assess whether current hedge accounting documentation provides a sufficient link between individual hedging relationships and the related risk management objective, and document the steps necessary to meet new effectiveness requirements.

Disclosures

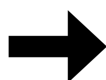
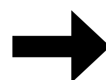
Potential impact

- Extensive new qualitative disclosures are required to explain how judgement is exercised as well as quantitative disclosures about financial assets.
- Extensive new disclosures are also required for impairment. Sourcing the additional information could be complex and time-consuming.
- Additional disclosure requirements will apply for hedge accounting.

Actions to consider

- Identify key policies, inputs and assumptions, and design disclosures that meet the requirements of IFRSs and investors/stakeholders.
- Assess current systems to identify data gaps that need to be filled to meet the new disclosure requirements.

How KPMG can help

Assess the impacts  Design a tailored approach  Help implement a future state

A robust assessment phase is critical to laying the framework for a successful project, and it is important to start the assessment early to provide flexibility during the implementation phase. KPMG member firms offer clients market-leading technical capability and thought leadership to help ensure successful implementation of IFRS 9. We can also provide access to KPMG's IFRS 9 accelerators, which are designed to help jump-start or fast-track areas of your IFRS 9 programme.

Activities	Actions	Deliverables
Accounting diagnostic	– Review existing accounting policies and discuss policy choices in light of KPMG's market insight. – Provide framework to analyse specific balance sheet areas for incremental and ongoing classification and measurement assessment. – Review impairment model methodologies and provide recommendations on capital planning implications.	– Pre-populated KPMG IFRS 9 Key Decision List – a broad-ranging list of technical accounting and risk modelling decisions, filled with various options and industry perspectives. – KPMG's Lending Tool enables the efficient assessment and documentation of SPPI criteria for loan portfolios. iRADAR is a KPMG service tool for securities' portfolios. – gCLAS – a credit loss accounting technology solution that can be used as a validation tool and/or provide insight into key components of an example IFRS 9 solution.
Process analysis	– Identify potential system change requirements.	– KPMG's IFRS 9 Operating Model – an operating model that takes into account the new key process steps to be considered under IFRS 9. – KPMG's IFRS 9 Change Requirements – an extensive list of approximately 90 business requirements for IFRS 9.
Broader impact evaluation	– Review existing IFRS 9 disclosure documentation. – Review approach to hedging and future business plans and provide industry insight on appropriate hedging options.	– KPMG's IFRS 9 Data Taxonomy – provides support for rapid production of financial disclosures and maps IFRS 9 data requirements to existing data within risk and finance systems.

KPMG member firms have helped a number of banks to understand the impact of the new standard and how to implement the necessary changes. These projects have given KPMG professionals a detailed understanding of how banks are likely to be affected and the steps that they can take now to help ease transition to IFRS 9. The following are just a few examples of how KPMG members firms' cross-functional teams of experts have helped with the accounting and operational challenges of IFRS 9.

Client	How KPMG members firms helped
A large global bank	We provided detailed recommendations on the design of IFRS 9 controls, processes and governance, as well as a view on possible synergies with regulatory programmes and existing regulatory reporting.
A large UK retail bank	We assessed the impact of the new impairment model on the bank's loan book, in particular we quantified the lifetime ECLs on their current 'bucket 2' assets and assessed the sensitivity of ECLs to different data assumptions.
An Italian bank	We assisted the client in designing and implementing IFRS 9's classification and measurement, and impairment requirements. This included providing technical knowledge, project management support, global and regional functional design assistance and user assistance for the IT implementation.

Contact us

If you have any concerns about the impact of IFRS 9, or any other accounting issues, please speak to your usual KPMG contact or any of the following.

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