KPMG

IFRS 9 for Banks

What is the expected impact on the Bank?

The International Accounting Standards Board ('IASB') has now issued the completed version of IFRS 9 *Financial Instruments* ('IFRS 9' or the 'standard'), which substantially brings to a close the challenging project launched in 2008 to replace IAS 39 *Financial Instruments: Recognition and Measurement*. The new financial instruments standard will be a momentous accounting change for Banks.

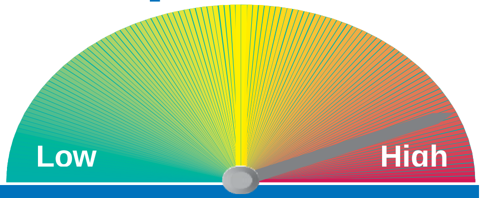
The standard will be effective for annual periods beginning on or after 1 January 2018, and will be applied retrospectively with some exemptions. It is therefore first applicable in Antigua Commercial Bank's financial statements for the year ending September 30, 2019.

The standard is expected to have a pervasive impact on ACB's financial statements. In particular, there is expected to be an increase in the overall level of impairment allowances across the Bank's financial assets (including loans and receivables, investments and other assets).

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 judgmental and may affect how capital resources and requirements are calculated.
Disclosures	Extensive new disclosures are required – system and controls changes will be necessary to capture the required data.

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 (Key Performance Indicators) 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.
- 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.

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.

The Bottom Line – Overall Considerations

Potential impact

- Credit risk is at the heart of a bank's business, so the standard is likely to have a significant impact on banks and similar institutions.
- Larger and more volatile bad debt provisions are likely.

Actions to consider

- Implementation could be challenging, with far-reaching implications for banks' credit systems and processes, including interaction with the regulatory requirements.
- Companies need to start planning for transition, to understand the time, resources and changes to systems and processes needed.