IFRS 9 - Transition

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- IFRS 9 – Requirements
- Key Implementation Challenges
- Decisions based on available options
- Benefits
- Going Forward Considerations

Classification and Measurement of Financial Assets

Overview of three categories

Amortised cost	FV-OCI (Other Comprehensive Income - Equity)	FV-PL
• Business Model - Hold to collect; and • Contractual Cash Flows - Solely payments of principal and interest.	• Business Model - Hold to collect and sell; and • Contractual Cash Flows - Solely payments of principal and interest.	• Residual category.

Portfolio Mappings

• Loans & advances - Corporate, Commercial, Consumer, SME, Agri
• Investments classified as HTM - Sovereign Securities/ Bonds, Corporate debt instruments
	• Investments classified as AFS
	  • Sovereign Securities/ Bonds, Corporate debt instruments
	  • Equity investments – opted for FV-OCI treatment (non-recycle)
		• Investments classified as HFT
		• Derivative instruments

Expected Credit Loss (ECL)

Scope

- Financial assets at amortised cost
- Financial assets (debt instruments) at FVOCI
- Loan commitments
- Financial guarantee contracts

Expected Credit Loss – Staging Criteria

Risk Criteria (Facility-Level)	Stage 3 - Significant Credit Risk Non-performing/ Credit impaired assets	Stage 2 - Significant Increase in Credit Risk – since acquisition Underperforming assets	Stage 1 - Low credit Risk Performing assets
• Delinquent (>90 DPD) & Subjectively Classified as NPL	• All non-performing/ classified Loans & Investments • Loans with DPD >90 days however classified as performing under PR - Credit Cards, Agri, Housing etc.		
• DPD >30 days		• Stringent criteria – particularly corporate loans • Can be rebutted (exception claimed) – to be proved through internal analysis of portfolio performance	
• Deterioration in credit risk rating – since inception		• Ratings migration analysis • Decline by "n" notches in rating to be considered	
• Cross defaults		• Performing facility but default by borrower in other facility	
• Other risk criteria		• Watchlist • High Risk Industries • Loans restructured in last "x" years	
• None of the Above			Residual

Expected Credit Loss (ECL) – Recognition

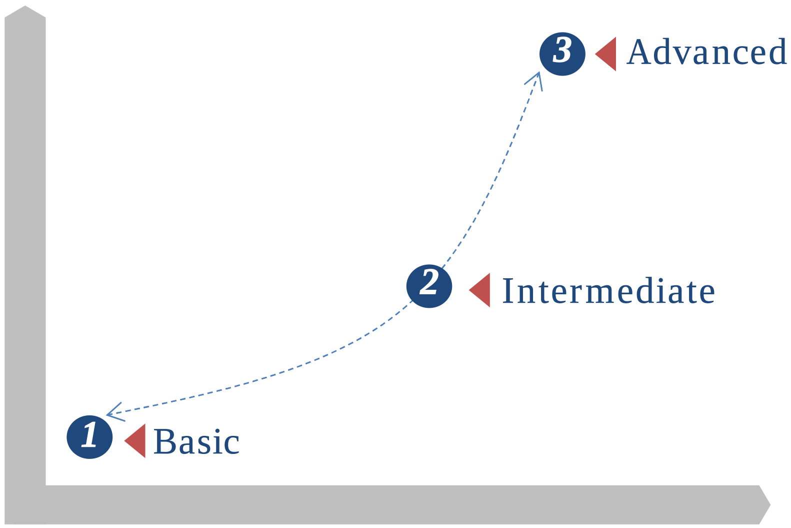
$$ECL = PD \times LGD \times EAD$$

ECL (PD & EAD) - to be calculated at facility-level and at each point (date) as per repayment schedule

12 month expected credit losses	Lifetime expected credit losses	Credit losses
Stage 1	**Stage 2**	**Stage 3**

12-month expected credit losses	Are a *portion* of the lifetime *expected credit losses* and represent the amount of *expected credit losses* that result from default events that are possible within 12 months after the reporting date.
Lifetime expected credit losses	The *expected credit losses* that result from all possible default events over the life of the financial instrument.
Credit loss	The difference between all principal and interest cash flows that are due to an entity in accordance with the contract and all the cash flows the entity expects to receive discounted at the original EIR

Expected Credit Loss (ECL) – Basic vs. Advanced Approaches



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Advanced approach

- Robust models to incorporate forecasts of macroeconomic conditions used to adjust loss curves.
- Loss curves exist for PD, LGD and EAD and are updated both by internal and external data

Specific issues

- Challenging to explain to senior management and investors
- Consistence roll out of economic scenarios
- Significant overheads

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Basic approach

- A simplified approach to ECL by using management judgment to determine provision rates

Specific issues

- How to evaluate that management judgment is accurate and correlated to historical data
- Is it acceptable under the standards and with the regulators ?

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Intermediate approach

- Model PD using simple statistical averages.
- LGD assumptions are flat
- Loss curves are generated using external benchmarks
- Economic forecasts included as a management overlay

Specific issues

- Substantiate economic overlays
- Insufficient details in development of PD

Expected Credit Loss (ECL) – PD Estimation

Probability of Defaults (PDs)

- Use of Expert Judgment Rating Models instead of Statistical Models - ***Lack of availability of historical default data & corresponding financial information. Alternate approaches for PD estimations like Ratings Transition Matrix, DPD Bucket Role-Rate etc.***
- Low default portfolio – ***leading to use of expert judgment models.***
- Conversion of point-in-time PD to forward looking PD - ***determination of statistically significant relationship between Macro-economic factors (GDP, inflation, interest rate etc.) and default ratio and forecasting of macro-economic factors***

Expected Credit Loss (ECL) – LGD Estimation

Loss Given Default (LGD):

- Lack of availability of historical recovery data of defaulted customers (SAM & business)
- Challenges in collateral recourse/ liquidation
- Identification of direct/ indirect costs attributable to the recovery
- Use of contractual interest rate vs effective interest rate for discounting of cost and recovery

Judgmental/ Basel prescribed LGD is used – 45% or portfolio-level recovery estimate (in case portfolio recovery experience is lower than 65%)

Expected Credit Loss (ECL) – EAD Estimation

Exposure at Default (EAD)

- Classification into Revocable and Irrevocable commitments (for undrawn facilities) ***– contract terms + nature of facility (syndicates, CC, RF etc.)***
- Estimation of Credit Conversion Factors (irrevocable undrawn + OFF-BS) – ***limit utilization behavior before default + Basel CCF (where internal data not available)***
- Estimation of maturity for revolving facility – ***vintage/ behavioral analysis or subjective estimates (if internal data not available)***
- Repayment schedules to calculate exposures at future points **-** ***otherwise assumptions need to be applied***

IFRS 9 – Opportunities & Challenges

Business model	• Business models reflect the impact of the IFRS 9 • ECL models feedback into other strategic processes (e.g. capital management, pricing, stress testing, etc).
Systems	• Alignment of risk and finance systems (e.g. ORR model, semi-automated solutions for calculations, etc.) • Remapping of lines and accounts within the general and sub ledgers • Common chart of accounts and data definitions across all parts of the business.
Data quality	• Single data source at required granularity, with full drill down capability and validation of data • Frequent testing and maintenance of new data models • Automation of data controls
Process	• Fully defined processes for identifying the provisions and how they relate to the business units, product pricing and strategy. • New credit risk monitoring processes to incorporate system solution to the generation of accounting information.
Human Resource	• Scarcity of Skilled Human Resource – Quantitative / Statistics expert
Regulatory	• Required changes in Prudential Regulations (e.g. Charge on GoP's FCY bond, 7th Schedule of Companies Act and Taxation laws, relaxation of classification and provisioning to SMEs & Agriculture segment etc.)

Thank You