IFRS 9 CONSIDERATIONS FOR BANKS IN LIGHT OF COVID-19

Financial institutions are navigating through uncertain times. It is fair to say that significant lessons learned following the 2007-2008 global financial crisis have led to better management and control of capital and liquidity. The banking sector is not without its vulnerabilities, and systemically significant institutions must consider the risks that a shock like COVID-19 has had on financing the economy and compliant reporting of late.

Following the unprecedented effects of the COVID-19 pandemic, the International Financial Accounting Standards Board (IASB) and several prudential and securities regulators, such as the European Central Bank, published guidance on the International Financial Reporting Standard (IFRS) 9 for financial institutions. This guidance helps firms to produce reporting which is consistent and comparable across the banking sector, and will specifically aid institutions when accounting for expected credit losses (ECL). A key component of IFRS 9 is the impairment calculation, which must include forward-looking economic data in the calculation for ECLs and stage allocation for the generation of probability-weighted outcomes.

CONSIDERATIONS FOR BANKS

An area of substantial importance for reporting institutions as they prepare financial statements and disclosures is on model governance, including assumptions and methodologies in the approach to COVID-19. This will help to mitigate model impairment and support reliance and credibility on the economic data used to generate the probability of default (PD) provision calculation for ECL and whether there has been a significant increase in credit risk (SICR) on financial instruments.

The standard itself is a framework for reporting institutions to determine ECL, it is important to note that it will be difficult during this period to integrate the effects of COVID-19 on a reasonable and supportable basis.

The lack of historic economic data for a crisis of this magnitude, coupled with difficulty to forecast the economic disruption caused by COVID-19, will inevitability lead to an increase in significant judgements.

The use of macro-economic forecasts should avoid excessive procyclicality when determining ECL on financial instruments during the COVID-19 pandemic, particularly when there is limited economic data to reflect the current environment.
The forward-looking nature of measuring ECL creates further risks for banks when factoring the economic conditions of this pandemic.

It remains critical for reporting institutions to provide users of financial statements helpful and transparent information on the effects of COVID-19. Reporting institutions should plan their approach carefully to mitigate the risk of inappropriate volatility in regulatory capital and financial statements.

With lenders offering payment holidays to address the financial challenges faced by many in the wake of COVID-19, and with guidance still being finalized to support the banking sector accurately account for and report its regulatory capital and IFRS 9 requirements, it is paramount that banks review their approach to ensure consistency and transparency about credit risks and continue to manage their capability to absorb losses whilst lending to the economy in support of economic recovery.

The banking sector shouldn't prolong data gathering of financial and operational information to quantify costs and potential losses due to business interruption during COVID-19. Gathering this information will aid businesses to better understand the scale of the impact from COVID-19 whilst providing a mechanism for reviewing decisions made in the hope that lessons can be learned as banks build their roadmap to recovery.

Reporting institutions should review their forward-looking economic scenarios and consider limitations on borrower specific information and the potential need to apply judgement when assessing the treatment of payment deferrals for retail mortgages.

The degree of guidance published to aid comparability and consistency across reporting institutions emphasizes the enormity of COVID-19 on accounting and regulatory reporting.

Firms should refer to IFRS-9 COVID-19 guidance and manage identified risks through adequate risk mitigation planning whilst ensuring minimal disruption to financial and operational services during the pandemic.

For more information on how Capco can support your business through COVID-19 and beyond, please contact **Christine De Marco**.