WHITE PAPER

IFRS 9 in Asia-Pacific: The road to compliance – is there still time?

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When you have to be right

Since the beginning of the year, financial institutions, as a sector, have shifted focus to the different requirements for IFRS 9. In Asia-Pacific (APAC), however, there is no such thing as a uniform approach to IFRS 9 requirements – it varies from country to country.

This insight piece is divided into four sections:

1. an overview of the differing approaches of APAC countries to IFRS 9 implementation, and the reasons for this
2. a closer look at how IFRS 9 affects departments across a financial institution, and the consequent challenges and impacts they face
3. a status update on the progress of financial institutions' journey toward IFRS 9, and,
4. an outline of the steps still required for full IFRS 9 compliance by the 2018/2019 deadline.

Introduction – One destination. Many roads.

Unlike Europe's well synchronized journey to IFRS 9 compliance, Asian countries are taking many different roads to compliance. **Here's a quick overview:** Singapore, Hong Kong and Australia together form a group that, just like Europe did in 2005, adopted the IFRS standards aligned with those of the EU as well as the IASB timelines themselves. This group of countries is very clear about the 2018 deadline for IFRS 9, and believes there's no question of either postponement or partial adoption. Consequently, these three countries are 'full steam ahead' for constructing and executing their IFRS 9 convergence plans. The second group comprises countries in South East Asia – such as The Philippines, Thailand, Malaysia and Indonesia, among others – that have either partially or fully adopted IAS39 standards. Although these countries are part of the same group, each one of them has adopted a different approach to IFRS 9.

In Thailand, for instance, the authorities have already announced that they are aiming for IFRS 9 compliance by 2019. However, since they have not yet moved to IAS39, Thailand's financial institutions need more time to fully understand and implement the basics on classification and measurement, all of which are generally similar to IAS39, to be fully IFRS 9 compliant.

Other countries in the region are grappling with non-IFRS 9 problems first before announcing their deadlines for IFRS 9 compliance. It should be noted that these countries haven't adopt IAS39 as stipulated – rather, they have co-opted a significant amount of the IFRS texts within their local standards (FRS139, PSAK 55, TAS44, PAS39, and the like) albeit with additional guidance.

Since IFRS 9 is even more principle-based, it isn't yet clear whether accounting bodies in these countries will, as with IAS39 implementation, adopt a more rules-based approach over and above the principle-based IFRS 9 standards, so as to ensure better comparability.

The third and last group is comprised of countries that haven't adopted IFRS standards in their entirety. India, for instance, is planning to adopt them in 2016 and 2017. For countries in this group, the focus will be on the general adoption of the IFRS standard first before they move to specific data for an updated standard.

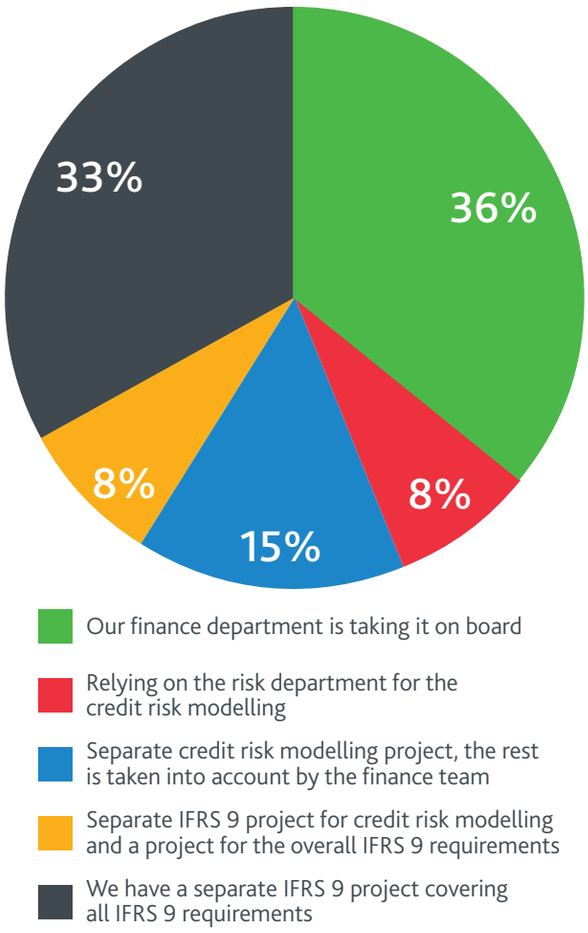
2) How IFRS 9 impacts departments in a financial institution

IFRS 9 is the biggest change for financial instruments since the implementation of IAS39 in 2005. IFRS 9 and IFRS13, together, will replace the bulk of the IAS39 standards (the only exception being accounting for dynamic risk management, which will be handled in a separate project). IFRS13, with its implementation deadline of 2014, handles the Fair Value measurement of financial instruments.

Of the three phases in IFRS 9, Classification and Measurement (Phase 1) and Impairment (Phase 2) are, by far and away, the most critical for the 2018/2019 deadline. This is not to suggest that Hedging (Phase 3) has no significant impact. Quite the contrary, in fact. It's just that, come 2018, this phase will still not be a mandatory application.

Hedging, however, presents numerous challenges: multi-department and timely delivery of IFRS 9 compliance, to name just two, which will be investigated further in a subsequent paper.

APAC: IFRS 9 Project Structure

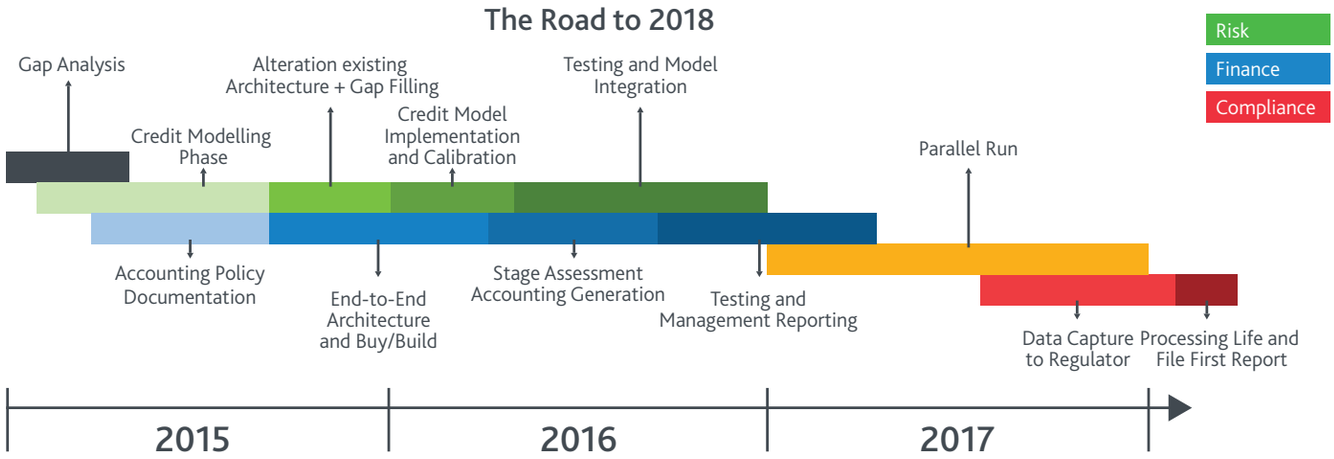


Given the fact that many of the new concepts, such as hedge accounting for dynamic risk management and expected loss model within the impairment are well-debated it is logical that there will be a multi-department impact to IFRS 9. The regulators' focus on the impairment implementation in many speeches and events seems to suggest an advocation for a "one model fits all" approach for both Basel as well as IFRS, despite the differences between the two. At the very least, the base model should be the same.

While the IFRS 9 intent of financial institutions is clearly in evidence, they are confronted with several challenges – internal model requirement, expected lifetime analysis, stage assessments, and practical expedients, to name a few – and all this in accordance not just with IFRS 9 but also with what the BCBS has stipulated for their expected loss guidance earlier this year. While IFRS 9 will admittedly impact each department differently, it is imperative that it all comes together at the end, fully reconciled and within a world of accounting and auditability.

Here's a quick look at some of the challenges faced by the different departments:

- Risk Department: Although a recent survey reveals that not all financial institutions agree about a risk management department being part of an IFRS 9 project, there's also evidence to suggest that credit risk modelling, is a specific skill set that will be required. One of the challenges for the risk management department is having the ability to unite a flexible credit risk environment with an auditable finance environment in such a way that it meets both the understanding of the credit risk modeler as well as the finance auditor that will monitor the IFRS 9 lifetime expected credit loss model. The latter requirement is a separate challenge all by itself, since the model will no longer work on just a 12-month horizon; it will also need to take into account macro-economic factors, depending on the lifetime expected losses. Ultimately, the credit risk model will have to deliver a range of 12-month expected PDs, Lifetime expected PDs, and LGDs to be used over time.



- Finance Department: Even if Finance outsources the modelling part to Risk, the department will still have its hands full – it will have to adjust its current accounting policies to accommodate not just business models, cash flow characteristic tests, and benchmark testing, but also the actual expected loss calculation relying on the necessary stage transition rules based on quantitative and qualitative information in credit assessment, rebuttable presumptions and objective evidence for default.

On the road to compliance by 2018, Finance will also be confronted by other significant challenges: integrating credit modelling, accounting entries, and the necessary disclosure requirements, along with balance and financial statement adjustments.

- Reporting Department: While often forgotten amidst the IFRS 9 landscape, this department will be impacted by new regulatory reports adjusted from an IAS39 and IFRS 9 world.
- With three key departments already impacted by IFRS 9, the organization, as a whole, will also have to fit in the existing P&L and, consequently, performance as well as supporting departments hiring the right skillsets to accommodate for all these requirements.

Milestones on the road compliance by 2018/2019

Departmental challenges are, admittedly, only the tip of the iceberg. Come 2018, with IFRS 9 affecting the entire organization, a 'parallel run' will be required to inform all organization stakeholders about the one-off P&L effect, as well as the continuing and new impacts IFRS 9 will have on the numbers.

So, accounting for this parallel run and thinking back from 2018, how does an organization plan the IFRS 9 implementation? A study of the progress at different banks suggests that addressing all these separate challenges simultaneously is, in itself, a formidable challenge.

Since IFRS 9 impacts so many stakeholders, most financial institutions have pleaded for a year of parallel run. They will need this 12-month period to not just calibrate models but also to highlight the impact of the new accounting policies, models and P&L adjustments. Moreover, many financial institutions see this parallel run as a buffer to absorb any overruns from the previous planning.

It is to be noted that this parallel run is to view the collective impact of IAS39 and IFRS 9, rather than the actual regulatory reports that must be prepared in the first reporting period of 2018. That, on its own, will require new reports, new disclosures, and a test cycle using elements that were in the parallel run, from a Risk and Finance perspective.

All this leaves no more than two years for financial institutions to do the actual implementation after a gap analysis. Within these two years, financial institutions will, from a risk perspective, need to align the different models chosen for IFRS 9 requirements.

Financial institutions that use a standardized approach under Basel will, if they have not already started a track on internal models, need to build internal models, calibrate them, and so on. These financial institutions may be in the unique position to build the one model calibrated to generate both the Basel expected loss figures as well as the IFRS expected loss figures (given the differences outlines in the whitepaper "IFRS 9: Closing the gap between Risk and Finance, this will still be a dual-outcome model).

Additionally, these banks, of course, face difficulties around the validation of the model by the regulator - as is the case for all banks, the question is whether the regulator is actually going for a validation of the internal IFRS 9 model.

For IRB banks, the discussion is of an entirely different nature. Many financial institutions, having already invested to build a validated internal model, are discovering only now that the model has some shortcomings that hamper its compliance with IFRS 9. For these financial institutions, the main challenge now is building adjustments, new models or an additional layer on top of these models, along with implementing the different principles of the BCBS within an IFRS 9 context. And all this is without even considering the actual impact IFRS 9 is likely to have on the common equity ratio and tier 1 ratio within the capital requirements themselves.

For Finance departments adjusting the internal policy, setting up compliant business models, benchmark test and cash flow characteristic test for classification and measurement, the choice is between leveraging on IAS39 EIR implementations and assumptions, or 'lassoing' addressing all current IAS39 challenges and future IFRS 9 challenges in one go.

What also looms is the need to define the transition triggers at different stages. Finance departments will need the time to test this out for different segmentations or sub-portfolio segmentations, and to prepare a list of triggers using a single, unified bottom-up or top-down approach.

Ultimately, of course, the whole IFRS 9 implementation should be integrated. This is underpinned by the fact that, increasingly, regulators are aligning the different Finance and Risk reporting.

3) IFRS 9 in APAC – A Progress Report

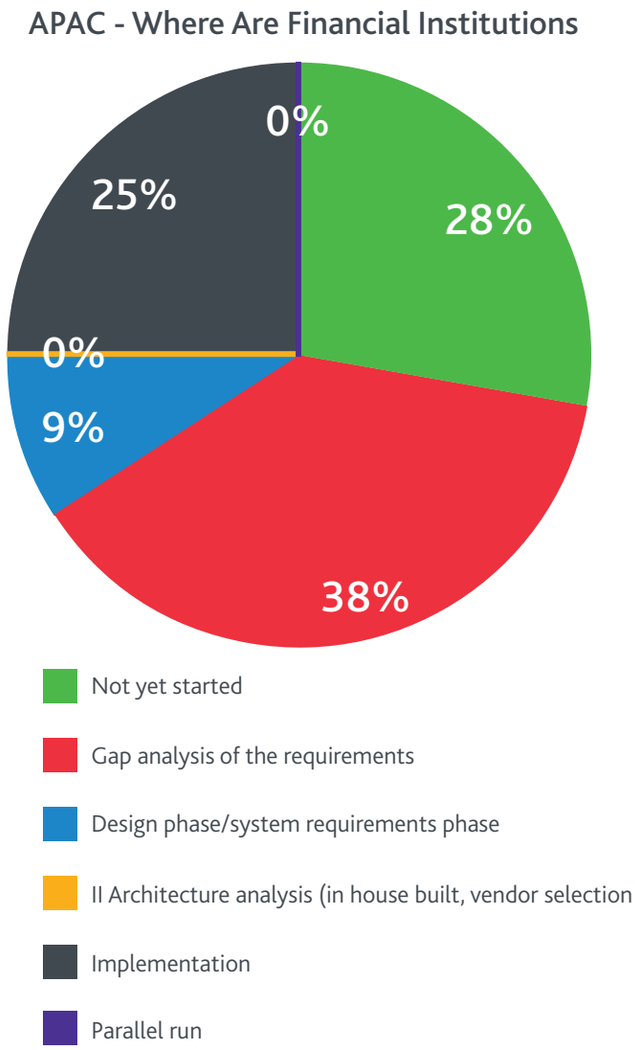
Now, working backwards from the timeline, it appears that the deadline is approaching faster than anticipated. A Wolters Kluwer Financial Services study undertaken with 530 respondents worldwide reveals that as high as 66% of them in the Asia-Pacific region have not even begun IFRS 9 implementation – they are still attending to other priorities or are conducting a gap analysis.

This is also a first sign that financial institutions, again as a sector, will have to come up with interim solutions while they get IFRS 9-ready. It also seems that, in APAC, none of the study's 530 respondents is either ready or conducting a parallel run. Moreover, only 25% of the respondents have actually started IFRS 9 implementation – which, in this case, is generally defined as the first preparation of the data, different policies and SOPs, before actually pursuing a practical implementation.

At the last IFRS foundation held in Paris, it also became clear that big banks – such as Societé Générale which was invited to speak at the event – have, in the course of IFRS 9 analysis and implementation, encountered several difficult issues that need to be addressed. Being clear about timelines, they have already forewarned that they will need the better part of 2017 for implementation.

Even disregarding, for a moment, the attention IFRS 9 programs command within the organization (since they impact profitability and timing of losses), it seems clear that the IFRS 9 process using excel spreadsheets is no longer an option – management judgment and auditability will be one of the key imperatives demanded by both the BCBS as well as the IASB.

Although the road to IFRS 9 is still long, it seems that many financial institutions continue to face quite a few challenges in adopting a Risk and Finance compliant infrastructure to meet the 2018 deadline. Wolters Kluwer Financial Services, a market leader in IFRS solutions, can help financial institutions in meeting this deadline by offering the different modules that they need to fill the gaps. Having an end-to-end modular solution will offer financial institutions the assurance that they can fulfill all IFRS 9 requirements or close the gaps within their current IFRS 9 architecture.



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