

Complying with International Financial Reporting Standard (IFRS) 9

The Client: A national bank in South East Asia

Users: The business, risk management, and finance groups

The IFRS 9 accounting standard now requires firms to factor in future expected credit losses to calculate provisions for investment portfolios, loan books, and trade receivables. This change calls for forward-looking analytics, introducing new challenges in terms of data availability, modeling, and reporting. A South East Asian bank needed to comply with IFRS 9 by the end of 2018, and was looking for a viable solution that could be quickly implemented and used to credibly explain its credit risk assessments to regulators and auditors.

Pain Points:

To reflect the IFRS 9 approach, the bank needed to convert historical probabilities of default (PDs) to ones that were point-in-time, incorporating various macroeconomic scenarios. As a smaller-sized financial institution, the bank didn't have the internal resources nor adequate default data by sector to meet this requirement. It was critical that it identify an off-the-shelf solution that represented a well-recognized methodology for handling IFRS 9, and enabled its internal team to confidently defend their risk management process.

The Solution:

S&P Global Market Intelligence ("Market Intelligence") met with business executives at the bank and discussed a framework that could provide a globally-accepted methodology to transparently and effectively calculate underlying credit risk.

The suggested approach used Market Intelligence's **Credit Assessment Scorecards**, which are Excel®-based tools that use forward-looking qualitative factors, converging trends, and relationships between key drivers to derive a credit score. The scores are mapped to long-term,

through-the-cycle PDs that are based on approximately 37 years of S&P Global Ratings default, transition, and recovery history¹.

By using these Scorecards, it was possible to cover low-default asset classes to obtain an assessment of the credit quality of the bank's counterparties and their respective PDs. In addition, this approach enabled the bank's team to input qualitative information based on their own expert judgement, making the output more bank and regional specific.

The IFRS 9 standard requires firms to use forward-looking PDs to calculate expected losses. Given this, the bank needed to adjust the long-term, through-the-cycle PDs, which are smooth, using different macroeconomic scenarios to create point-in-time and lifetime PDs, which move up or down depending on the credit cycle. The bank's team utilized Market Intelligence's Credit Cycle Projection Overlay to make this adjustment.

This overall approach using Market Intelligence's Scorecards along with the Credit Cycle Projection Overlay enabled the bank to meet two reporting needs: one that adhered to the regulatory capital requirement, and one that adhered to IFRS 9. For regulatory capital, the long-term PDs using the Scorecards determined the provisioning that was necessary. For IFRS 9, the additional step of the credit cycle adjustment using the Overlay captured the potential impact on the bank's profitability to provide a more forward-looking view of provisioning needs.

Key Benefits:

Scorecards are an 'out-of-the-box' solution, which facilitated a speedy implementation for the bank to comply with IFRS 9. In addition, the bank valued three important aspects of the Market Intelligence solution:

- 1. An approach that is useful and relevant for low default portfolios.** Scorecards can be used when there is a lack of internal data available to construct statistical models that can be calibrated and validated.
- 2. Transparency.** The bank team needed to demonstrate to their internal stakeholders, regulators, and auditors that they had a good understanding of how the credit assessments were derived. Since the Scorecards are Excel based, the bank team was able to view the entire credit scoring process, including the use of parameters, weights, etc. In addition, in-depth model development and maintenance documentation provided by Market Intelligence helped explain how the Scorecards were developed, the use of data, any limitations, and overall performance.
- 3. On-going support.** The Market Intelligence team provided on-site training to ensure that there was knowledge transfer on methodologies and applications. Support continues to discuss the implementation of the scorecards into the bank's risk framework and any queries that may arise in helping the bank meet its regulatory requirements.

The bank needed transparent models they could understand and defend and that utilized a sound methodology respected by market participants.

¹S&P Global Ratings does not contribute to or participate in the creation of credit scores generated by S&P Global Market Intelligence. Lowercase nomenclature is used to differentiate S&P Global Market Intelligence PD credit scores from the credit ratings issued by S&P Global Ratings.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.