IFRS 9 Impairment Survey 2011
A changing landscape

How global banks are responding to the financial crisis accounting reforms
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Over the past few years significant effort has gone into the development of an entirely new financial instrument accounting standard. As we approach the finalisation of the standard that will replace IAS 39 within International Financial Reporting Standards (IFRS), a picture is emerging of the final body of rules that will come into force over the coming years.

Over the last few months the Deloitte Touche Tohmatsu Limited (DTTL) global financial services industry (GFSI) group has gathered the thoughts of 56 major banking groups on the topic of loan impairment, an area which we consider to be the single most significant area of accounting change to affect the financial statements of major banking groups in the foreseeable future.

As a result of the effort of a large number of individuals and member firms we are delighted to present to you the findings from the DTTL GFSI group’s first global banking IFRS 9 Impairment Survey. We hope that this document will provide you with insights into the current thinking across the industry and stimulate discussion both within your institution and with other key stakeholders.

It is the intention of DTTL and its network of member firms that this will be the first in a series of surveys in relation to IFRS 9 which we will revisit on a regular basis over the coming years as the standard is finalised and the process of implementation begins. We hope that our work will serve as a mechanism for informing and developing market consensus on the technical and operational practicalities of the new rules.

We are very grateful to all the institutions and individuals who have contributed to this survey and we would warmly welcome any feedback and any suggestions you may have for our follow up efforts in this area. Please do not hesitate to contact either of us (or your local representative) to discuss your thoughts on this topic.

Mark Rhys
Global IFRS 9 Banking Co-Leader

Jean-Marc Mickeler
Europe, Middle East & Africa Financial Services Audit Leader
The changing accounting landscape represents one of the biggest operational challenges for banks. Planning for implementation is the start of what is expected to be a large scale change programme. Even though the standards are not finalised, banks are, to varying degrees, focusing on the enormity of the challenge. As the standard setters get closer to finalising the requirements, banks are increasingly adapting their plans to make the implementation of an expected loss impairment model operational.

### Background

The International Accounting Standards Board and the US Financial Accounting Standards Board (the Boards), spurred on by the G20 and regulatory bodies, have set about reworking the key accounting standards that apply to banks following the financial crisis. The replacement of IAS 39 with IFRS 9 promises to be the biggest change in banks’ financial reporting under IFRS since its introduction.

The requirements are still being finalised and it is expected that the new rules will be mandatory in 2015 (with comparative data for 2014 to be published at that time). Whilst the final text is still being developed, banks are now starting to assess the likely impact of these rules and plan for their implementation.

### Loan impairment – what is being proposed?

Although changes to impairment represent only one component of the replacement of IAS 39, it is likely to have the biggest effect on the financial statements of banking businesses. The new rules will replace the current incurred loss model, which was criticised during the financial crisis for recognising loan losses too little too late and contributing to market uncertainty. The finalisation of the new impairment rules to be included in IFRS 9, which are expected to be published by the close of this year, will require banks to calculate expected losses on their loan portfolios. Based on the Boards’ proposals issued earlier in 2011, lenders would be required to spread lifetime expected losses over the weighted average life of each portfolio in their ‘good book’, subject to a floor based on all the expected losses in what each bank considers to be the ‘foreseeable future’. All losses expected to occur in a bank’s ‘bad book’ would be provided for immediately. Both Boards are reacting to constituents’ concerns about that model and are expected to make changes, however, we expect that both Boards will continue to develop their current ideas (that is some form of spreading of expected losses for good loans and recognising expected losses in full for bad loans).

### Background to the impairment survey

We have undertaken this survey in order to:

- help the industry better understand and generally to raise awareness of the size and scale of the impact of the proposed changes;

- help the industry understand the views of their peer group in this area;
We have sought to achieve a global reach with this survey by seeking responses from a large number of banking groups in different geographies and with varied loan portfolios. Responses were received from 56 participants, including responses from 7 of the top 10 global banking groups measured by total assets. Responses received span banks headquartered in Europe, Middle East & Africa, Asia Pacific and North America. In most cases, responses were co-ordinated from the accounting policy or finance area although many respondents sought the view of other key areas of the bank such as credit and risk.

We have sought to assist the industry in preparing for and planning for implementation; and

- help the DTTL network of member firms and the accounting profession prepare for the challenges that may occur in preparing and auditing bank financial statements under the new rules.

We have sought to achieve a global reach with this survey by seeking responses from a large number of banking groups in different geographies and with varied loan portfolios.

Figure 1. Global composition of respondents

25 questions were selected covering three main topic areas relating to the proposed new impairment rules:

- nature and timing of changing rules;
- awareness of changes and impact assessment; and
- implementation planning and progress.

Given the current state of development of the rules and the desire to obtain clear, comparable and useful information in the responses, we have not at this stage sought to obtain feedback on particular technical features of the rules. Rather, the aim was to draw out views in relation to the high level impacts and expectations based on current proposals.

The survey has provided very interesting data that is being fed back to participants to assist them as they prepare for the new accounting regime. It is our intention to follow this with a further iteration once more clarity has been obtained on the final text and banks have had a chance to consider the likely impact.
Summary of key findings

Nature and timing of changing rules

There was broad consensus that, even though the details of the new impairment requirements are not yet finalised, the expected loss approach should be the basis for the new impairment model. However, many respondents were not convinced that the introduction of an expected loss model would enhance the overall usefulness of financial statements.

Whilst convergence of IFRS and US Generally Accepted Accounting Principles (GAAP) is one of the key drivers behind the reforms, this is not the primary concern of respondents. Respondents’ primary concern is ensuring that the expected loss model will work (i.e. can be implemented within a complex and changing system and regulatory environment).

Awareness of changes and impact assessment

Overall, whilst cost and operational impacts also featured significantly, wider business and commercial impacts were of major concern to respondents. Despite this, awareness of the key issues at board level was not always significant.

Respondents were typically very concerned about the effect on capital and accounting reserves on transition to the new requirements with some respondents considering a capital impact which might require capital increases in excess of 10% in order to maintain current ratios.

Respondents were also very focused on the banking industry’s ability, first to make the financial results understandable in light of the interest in them from a wide range of stakeholders and, second, to ensure the approach taken is comparable with their competitors.

The incurred loss model has been accused of contributing to the over provision of cheap credit because, at the date of lending, there is no recognition of the losses that may arise. If this analysis is correct, one might expect that the introduction of an expected loss model which results in earlier recognition of losses might affect the way lending is priced. Yet views are mixed: half of respondents do not believe an expected loss model will change their approach to the way they price lending; 41% believe it might.

Implementation planning and progress

Not surprisingly, given the scale of the change, 89% of respondents will have started their impairment project by 2012. Many banks, working back from the expected IFRS 9 mandatory application date, realise the timeline to complete implementation will remain a challenge. A comprehensive impact assessment is key to understanding required project governance, budget and implementation skill sets required.

Most banks aim to implement IFRS 9 in parallel with their implementation of Basel III or other credit risk and finance transformation initiatives in order to minimise cost and maximise use of common data sets. Yet, currently, only a handful of banks believe that they have all the data readily available in order to implement an expected loss model. The biggest concern generally expressed is about gathering valid data on expected losses in the foreseeable future and on lifetime expected losses.

Where respondents were able to provide estimates of expected spend to implement the impairment proposals these varied widely from under EUR 10m to over EUR 100m.

There were mixed views about whether the likely impact of applying new standards would be communicated to investors prior to the issue of the first financial statements under the new rules. 34% do not intend to, yet 30% consider it likely or very likely they will. Some respondents are concerned that if competitor banks start making their impact assessments public all banks will be forced to follow.
Nature and timing of changing rules

The idea of moving from an incurred loss to an expected loss model has been debated for some time. Pressure from regulators and governments led to the first exposure draft issued in November 2009 and a subsequent supplementary document issued in January 2011.

The expected loss approach is a simple enough concept to say, and perhaps simple enough to understand in terms of what it might do, but is proving incredibly hard to put into words that the standard setters, banks, investors and regulators consider appropriate. The Boards have been working together since the close of last year to try and come up with an expected loss model that can accommodate the needs of both Boards. In short, the International Accounting Standards Board (IASB) has a preference for spreading expected losses on a ‘good book’ of loans over their expected life whereas the US Financial Accounting Standards Board (FASB) has a preference for taking expected losses immediately to income, potentially when the loans are first recognised. To date, their efforts have resulted in a compromise which partially achieves the primary objectives of the two Boards, but which has yet to capture the enthusiasm of wider constituents.

Impairment and the broader IFRS 9 project

Both Boards are trying to create a new impairment model whilst, at the same time, trying to conclude a new comprehensive standard on financial instruments that will also include classification and measurement of financial assets and liabilities, hedge accounting and offsetting. Both Boards have publicly committed to finalising their comprehensive financial instruments standard by the close of the current calendar year. As the ink is not yet dry on the impairment project, the uncertainty over what the final text will be has cast doubt over the work the IASB has completed to date on developing IFRS 9. Although a final standard with respect to classification and measurement has been issued, it has yet to have the blessing of the European Commission and European Financial Reporting Advisory Group (EFRAG). As a result, for those banks listed in Europe, IFRS 9 is a standard that must be regarded as work-in-progress and, although some parts have been finalised, it cannot yet be applied.

Figure 2. What are your views around EU endorsement and how does this affect your IFRS 9 implementation project?

Of those surveyed, the question was applicable to 77% of participants as they operate inside the EU, the results were as follows:

- Expect proposals to be endorsed and are working on that basis: 30%
- Believe EU endorsement is uncertain but working on the assumption it will be endorsed: 40%
- Do not believe proposals will be endorsed in their current form, or uncertainty around endorsement – will not begin until endorsement is more certain: 30%

Even with the uncertainty surrounding EU endorsement more than half of participants are working on the assumption it will be endorsed.
Respondents are clear that transitioning to IFRS 9, although not yet a fully complete standard, will be a sufficiently large burden to require considerable thought at an early stage. Even with the uncertainty surrounding EU endorsement more than half of participants are working on the assumption it will be endorsed. We suspect that these respondents encompass both those who believe that Europe will endorse and those who believe that they may not. However, such is the scale of the project that it is necessary to assume endorsement in order to put forward an effective plan to deal with the endorsement decision.

We would expect the percentage of participants expecting EU endorsement to change over the coming months as the detail of the completed IFRS 9 becomes clear, along with the political landscape and response from key regulators.

**Lobbying efforts**
Making an expected loss model operational has been the primary concern of respondents and an area for which they have lobbied. Both Boards have certainly been aware of the need to provide a solution that is workable and this was the primary reason the standard setters set up an Expert Advisory Panel. Interestingly, the major lobbying efforts have been focused on making the new model work, rather than the technicalities of what the new model might be or indeed what the potential implementation costs may be. This may reflect support for an expected loss model or merely resignation that, post credit crisis, the incurred loss model is no longer appropriate and an expected loss model is here to stay.

Further, although the primary objective of both accounting standards setters is to get to a converged solution, it is of note that this is not the lead issue on which banks have been lobbying. One suspects that this is not due to a lack of support for a global solution, rather that some banks regard convergence as a given because the Boards are clearly working together on this politically sensitive joint project.

![Figure 3. Which areas have you been lobbying on in the past 12 months regarding impairment?](image-url)
Usefulness of an expected loss model in the financial statements

There is no doubt that making the information contained in financial statements more useful is the main objective of reforming accounting standards. However, there is not usually a clear consensus as to whether it will be achieved. In the case of introducing an expected loss model respondents’ views are mixed. It is interesting that over a quarter of respondents to the survey do not believe the financial statements will be more useful when applying an expected loss impairment model than they are currently when applying an incurred loss impairment model. Notably, over half of respondents believed that meeting the requirements of the proposed expected loss model would result in a lack of comparability between institutions. This conclusion reflects the need for greater judgement in applying an impairment model that is far more forward-looking than the current incurred loss approach. Some participants pointed to the disclosure regime incorporated into the changes as being key to helping users interpret financial statements.

Figure 4. Do you believe IFRS 9 impairment rules will improve the usefulness of the financial statements relative to their current status under IAS 39?

- Yes 43%
- No 27%
- Don’t know 30%

Figure 5. Do you believe the industry as a whole can meet the requirements of the standard to an adequate level, whilst still maintaining comparability?

- Yes 41%
- No 54%
- No comment 5%
Banks are facing a time of significant regulatory change as a result of the global financial crisis. A clear consensus emerged when participants were asked to consider what would affect their organisation in the medium term, with over 60% believing that Basel III would be the most significant challenge. However, there is also a significant level of concern over the impact that accounting change will have. Many rank accounting change second to Basel III with a surprising number ranking it first.

Many rank accounting change second to Basel III with a surprising number ranking it first.

Figure 6. In order, which of the following do you expect to have the greatest impact on the organisation over the next 5 years?

*Other includes: Solvency II, Restructuring of Government Sponsored Enterprises in the US, Financial Stability Board recommendations, Acquisitions, Independent Commission on Banking in the UK, Change to rating agency methodologies, Deleveraging

Of the various accounting rules currently in development by the IASB that affect banks the part of IFRS 9 relating to impairment appears to be broadly recognised as having the greatest impact on a bank’s business models and financial statements.
The degree to which upcoming accounting issues had been raised to a high level within organisations was broadly encouraging. This highlights the interest and concerns that many respondents have emphasised at an institutional level. It was notable that the degree of awareness at board level was significantly higher at the largest and most geographically diverse institutions. As we move closer to the time when institutions will need to apply the new rules we would expect this awareness to improve significantly.

Figure 7. In relation to accounting change, which of the following do you believe will have the greatest impact on your business model and/or financial statements?

Please assign an impact of “High”, “Medium” or “Low”.

*Other includes:
- IAS 1
- IFRS 4
- IAS 37 amendments
- Pensions corridor
- Leases

The degree to which upcoming accounting issues had been raised to a high level within organisations was broadly encouraging. This highlights the interest and concerns that many respondents have emphasised at an institutional level. It was notable that the degree of awareness at board level was significantly higher at the largest and most geographically diverse institutions. As we move closer to the time when institutions will need to apply the new rules we would expect this awareness to improve significantly.

Figure 8. How would you categorise the current level of involvement / awareness of upcoming accounting change at board and audit committee level?

... the part of IFRS 9 relating to impairment appears to be broadly recognised as having the greatest impact on a bank’s business models and financial statements.

... the degree of awareness at board level was significantly higher at the largest and most geographically diverse institutions.
Having a clear target information architecture is key to managing the impairment change programme successfully without adding additional complexity to existing operations. The top concerns of respondents, meeting the data/information requirements and the impact on information systems, reflect this. Respondents were also concerned about the initial impact on the financial statements as they transition to the new rules with a significant number focusing on the potential capital impact associated with the reduction in retained earnings once additional impairment allowances had been taken into account.

**Figure 9.** Which of the following areas concern you about the proposed requirements of IFRS 9 regarding impairment?

<table>
<thead>
<tr>
<th>Area</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
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<tbody>
<tr>
<td>Meeting the data / information requirements</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impact on information systems</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impact on financial results on transition</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Impact on capital</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Disclosure of potentially sensitive information</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Ability to compare approach to others</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Meeting the expected timetable</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Applying the required level of judgement</td>
<td></td>
<td></td>
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<tr>
<td>Impact on structure of group / booking model</td>
<td></td>
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<td></td>
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<tr>
<td>Impact on future results</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Impact on timing of tax position</td>
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</table>

Participants’ views on the consequences of the expected loss impairment model on pricing proved to be divergent, 50% of respondents believe that it is unlikely that pricing will be affected, whereas 41% of respondents feel that pricing will potentially be affected. As more work is done by institutions to understand and determine expected loss estimates for financial reporting purposes, this information will likely become more relevant to business decision making. Therefore, it is expected that the balance of views will change over time.

**Figure 10.** Do you think that an expected loss model will affect the pricing of products offered (e.g. through more transparent reporting of expected credit losses)?

- Certainly or probably: 9%
- Potentially: 50%
- Unlikely: 41%
The overwhelming sentiment is that a technical background will be required to get to grips with information relating to expected loss disclosures. Banks are concerned that the introduction of an expected loss model is likely to reduce the ease with which the financial statements can be understood by all but the most technically minded.

Figure 11. Do you believe users of the financial statements will easily be able to understand the information relating to expected loss, including the disclosures, based on the current requirements?

The demand for banks to provide more transparency (more information) is expected to continue unabated. Whilst the focus in previous years was on difficult to value assets we expect the demand to shift to greater disclosure of assumptions and judgements used in determining expected losses. These pressures will be great, especially so in times of financial stress.

Although shareholders are generally regarded as the primary user of audited financial statements, respondents believed that regulators, management and debt holders as well as peers would be more interested in the expected loss numbers and disclosures than shareholders. Views of the usefulness to management were mixed. Whilst some participants felt management already had access to sufficient information in relation to expected losses, many felt that the inclusion of expected losses in the financial statements would enhance business understanding.
Whilst the degree to which local regulators have previously taken an interest in financial reporting varies, the overriding sentiment was that expected loss provisioning would be of significant interest to local regulators in the future. In some jurisdictions, where regulatory involvement in bank provisioning is already high, this may not be considered anything new. However, we noted that a number of banks in other jurisdictions were expecting a very significant increase in the regulatory scrutiny in the area of loan provisioning.

Figure 12. Who do you expect the expected loss numbers to be useful to?

<table>
<thead>
<tr>
<th>Group</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulators</td>
<td>80%</td>
</tr>
<tr>
<td>Management</td>
<td>60%</td>
</tr>
<tr>
<td>Peers</td>
<td>50%</td>
</tr>
<tr>
<td>Debt holders</td>
<td>40%</td>
</tr>
<tr>
<td>Shareholders</td>
<td>40%</td>
</tr>
<tr>
<td>Government organisations and bodies</td>
<td>20%</td>
</tr>
<tr>
<td>Media</td>
<td>20%</td>
</tr>
<tr>
<td>Others (analysts, rating agencies)</td>
<td>10%</td>
</tr>
<tr>
<td>Employees</td>
<td>5%</td>
</tr>
</tbody>
</table>

Whilst the degree to which local regulators have previously taken an interest in financial reporting varies, the overriding sentiment was that expected loss provisioning would be of significant interest to local regulators in the future. In some jurisdictions, where regulatory involvement in bank provisioning is already high, this may not be considered anything new. However, we noted that a number of banks in other jurisdictions were expecting a very significant increase in the regulatory scrutiny in the area of loan provisioning.

Figure 13. What level of interaction are you anticipating with your local regulator(s) in the jurisdictions you operate in, with respect to the implementation of IFRS 9 impairment requirements?
Given the size and nature of the accounting change it is not a surprise that many banks have already commenced planning and initial evaluation of the impact and implementation effort required. Because of the broad nature of the project, budgets for implementation vary tremendously and cross-functional governance models are being put in place to determine impacts. Setting up change programmes to encompass IFRS 9 together with other requirements including broader Basel III, credit risk and finance transformation projects are being planned to deliver greater business value and leverage scarce resources. This section looks at where banks are in their projects, the thinking around the governance, size and scale of the change, and the most common anticipated challenges.

**Timing of Implementation Projects**

We observed that 71% of banks will have started projects on classification and measurement by the end of 2011, with this number rising to 93% by the end of 2012. The trend is mirrored when considering impairment with just over half of respondents having started their projects by the end of 2011, and 89% starting by the end of 2012.

Despite the fact that the mandatory effective date for IFRS 9 is likely to be 2015, the foundations for projects are already underway. We observed that 71% of banks will have started projects on classification and measurement by the end of 2011, with this number rising to 93% by the end of 2012. The trend is mirrored when considering impairment with just over half of respondents having started their projects by the end of 2011, and 89% starting by the end of 2012.
Many banks are planning to complete early assessments of the impact on the financial results for internal review purposes well in advance of external disclosure deadlines with 95% expecting to apply new requirements by the year ended 2015, in line with current expectation that the application of new rules will become mandatory by 2015. Some respondents have expressed concern that in the event their peers begin providing early disclosure then they will in turn be expected to follow suit.

Figure 15. Which of the following have you completed (based on the January 2011 impairment supplement)?

Of those surveyed, 55% had started their impairment project. The results were as follows:

- Gap analysis: 50%
- Initial business case: 10%
- Indicative financial statement analysis: 20%
- Capital implication: 5%
- Target design / build: 5%
- Other*: 5%

*Other includes:
- High level analysis has been performed as part of the response to the IASB
- High level analysis and simulation on samples
- Modelling

Figure 16. When do you envisage needing to be ready to apply the new requirements in external reporting?

- Year ended 2011: 5%
- Year ended 2012: 30%
- Year ended 2013: 25%
- Year ended 2014: 29%
- Year ended 2015: 9%
- Later: 2%
Strikingly though, 35% of survey participants still felt it was unlikely that they would disclose the results of IFRS 9 impairment in advance of issuing final results under the new rules. Only 30% of survey participants felt that it was at least ‘likely’ if not ‘very likely’ that they would disclose the likely effect of the new expected loss model prior to the required application of the new standard.

The nature of the change and potential implementation effort is cross-functional by nature and the analysis of survey responses provides no definitive answer as to who will drive the implementation of IFRS 9. However, it quickly becomes apparent that credit risk and accounting / finance functions will play a key role and programmes will require strong sponsorship from both the Chief Risk Officer and Chief Accounting / Financial Officer.
Most participants expected their accounting policy and credit risk functions to be heavily involved. None of the respondents anticipated legal or compliance functions being involved at this stage, however, given the likely interest of regulators and debt holders this may change over time.

One of the key findings relating to planning for IFRS 9 implementation is the anticipation that a broad spectrum of stakeholders will be involved from an early stage.

Figure 19. Which of the following areas will be involved in the planning for IFRS 9 impairment implementation in 2011?

- Accounting policy
- Credit risk
- IT environment
- Model development
- Group risk
- Financial control
- Audit committee
- Investor relations
- Tax
- Board

Figure 20. Do you expect to manage IFRS 9 transition with respect to impairment in conjunction with any of the following?

- Basel III implementation
- Other credit risk model development / approval process
- IFRS 9 project will stand alone
- Finance transformation
- Do not know / not yet decided

Of the banks surveyed only 28% indicated that they would look to implement their IFRS 9 impairment solutions as a ‘stand alone’ project, whilst many suggested that they would look to manage the implementation alongside Basel III, credit risk or finance transformation initiatives, or a combination of these.
Uncertainty regarding the budget required to comply with the standard is perhaps the clearest indication of the ambivalence surrounding what the finalised impairment rules will look like. Over half of the respondents are still unsure about the total budget for their implementation projects. For those that attempted to quantify the total budget, the disparity in responses was startling. 21% believed that the project could be delivered for under EUR 5m and 14% anticipated a spend of EUR 5-25m whilst 2% thought a spend of EUR 25m-100m would be required, with a further 2% anticipating a spend of more than EUR 100m. Whilst a large number of institutions felt it was too early to accurately assess their budgets there was, unsurprisingly, a trend towards larger budget estimates in bigger institutions. As more work is done to assess the impact of changing rules we expect these estimates to change dramatically.

Figure 21. What do you estimate the total budget that you may require to meet IFRS impairment requirements?

For those that attempted to quantify the total budget, the disparity in responses was startling.

Figure 22. Do you have any existing budget currently being spent or committed to IFRS 9?

Leveraging the investment in regulatory projects to deliver clear business value was highlighted by the survey. Process and technology requirements for the sourcing and management of common data sets across Basel III, credit risk and finance functions represent obvious synergies for programmes. However, using one data source for the performance management of the business continues to present a key challenge in many organisations.
55% of banks have yet to allocate a specific budget for IFRS 9, but many banks had agreed broader regulatory budgets for 2012 / 2013 and anticipated funding would likely to be drawn from this. Specific budgets were already in place for the remaining 45% of respondents, however, these ranged from under EUR 500,000 to budgets of over EUR 100m.

Figure 23. How many full time employees do you anticipate being involved in the delivery of your IFRS 9 impairment solution?

There is no clear pattern emerging as to human resources required to execute the implementation of the new standard. Perhaps the greatest consensus was that respondents simply did not know how many full time employees will be required to implement the impairment solution, particularly as uncertainty remains around the details of the final standard.

Figure 24. What do you consider the key skill areas required to develop and deliver an IFRS 9 impairment solution for your bank?

Though participants were not asked to identify how great the skills gap is between their current position and their required position in order to deliver IFRS 9, it was evident that the vast majority anticipated a need to develop several skill sets. The need for further development of credit risk capabilities, accounting knowledge and modelling emerged clearly from the responses received whilst over two thirds identified the need to improve their IT capabilities to cope with the new reporting requirements.
Challenges

Figure 25. Which areas of the technical requirements are you concerned by with respect to practical implementation or operation?

Please assign an impact of “High”, “Medium” or “Low”.

<table>
<thead>
<tr>
<th>Area</th>
<th>Impact Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimating credit losses for foreseeable future</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Disclosure requirements</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Establishing time horizon of foreseeable future</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Estimating lifetime expected credit losses</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Ability to apply forecast data to loan losses</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Transitional requirements</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Application to purchased assets</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Application to securities</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Open/Closed portfolios</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Single assets</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Good book/Bad book split</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
<tr>
<td>Scope (i.e. reclassification into amortised cost)</td>
<td>High: 60% Medium: 30% Low: 10%</td>
</tr>
</tbody>
</table>

It is clear that one of the greatest concerns in switching to an expected loss model is in making the estimates of lifetime expected credit losses and loan life estimates.

Considerable weight has also been attributed by respondents to disclosure requirements (91% ranked this with medium or high importance).

The transition to IFRS 9 will differ for each organisation depending on their existing capabilities and infrastructure and the diversity of their portfolios. This is especially significant for the development of credit risk models, which are required to estimate the expected loss within the ‘good book’. All respondents identified that further credit risk modelling resources will be required to develop and deliver the IFRS 9 impairment solution in their bank.

For financial institutions with an established credit risk management framework (e.g. Basel II internal ratings based approach), there are significant opportunities to use the skills and resources that are already in place. For these organisations, the focus during the IFRS 9 transition will be to identify, evaluate and utilise efficiencies from their current risk management and accounting frameworks. For financial institutions that have less developed credit risk frameworks, the transition to IFRS 9 will require them to overcome a number of challenges that more advanced banks have already spent a great deal of time and effort developing the experience to resolve.
Only 14% of respondents believe they currently have all the data required to implement an expected loss model. 46% of respondents believe they have all the data required albeit not readily available. A further 27% believe they do not currently have all the data required to comply with the standard whilst 13% simply do not know whether they do.

It is clear that respondents believe that smaller banks will find it most difficult to comply with the requirements of IFRS 9. It is noteworthy that a wide geographical spread was considered less of an issue. (However, when results were cut to exclude the largest banks (by gross lending) the smaller banks felt that, on average, banks with a wider geographical spread would find it more difficult to comply.)

Only 14% of respondents believe they currently have, readily available, all the data required to implement an expected loss model. 46% of respondents believe they have all the data required albeit not readily available. A further 27% believe they do not currently have all the data required to comply with the standard whilst 13% simply do not know whether they do.
Overcoming the operational challenges associated with sourcing and managing the data required will be key to efficient and effective implementation. Allowing finance and risk functions to operate from consistent data sets and one version of the truth will be key to avoid adding further complexity and cost to existing operations.

Over three quarters of respondents believe that they will have to take further action to obtain and manage the data needed to comply with the standard. It is clear from this that engagement of operations and IT departments to deliver the optimal operating model and technical infrastructure for data will be crucial for success.

There appears to be consensus that gathering data to compute expected losses in the foreseeable future and expected lifetime losses is likely to present the greatest challenge faced by banks when it comes to implementation, whilst participant banks displayed relative confidence that they would be able to deal with the weighted average life of a portfolio and weighted average age of assets in a portfolio.

A sound implementation plan can only be based on a rigorous impact assessment, which will clearly require a coherent vision of how data can be sourced and managed across operations, finance and risk. Such is the scale and complexity of the IFRS 9 implementation project that an integrated cross-functional project is key to delivering the requirements.
Contacts

Mark Rhys, UK  
*Partner – Global IFRS 9 Banking Co-Leader*  
+44 20 7303 2914  
mrhys@deloitte.co.uk

Tobias Menzel, Germany  
*Partner – Global IFRS 9 Banking Co-Leader*  
+49 403 2080 4857  
tmenzel@deloitte.de

Laurence Dubois, France  
*Partner – Europe, Middle East & Africa IFRS 9 Banking Leader*  
+33 1 4088 2825  
ladubois@deloitte.fr

Philip Goeth, China  
*Partner – Asia Pacific IFRS 9 Banking Leader*  
+86 10 8520 7116  
phgoeth@deloitte.com.cn

Tom Millar, UK  
*Director – Global IFRS 9 Impairment Survey*  
+44 20 7303 8891  
tomillar@deloitte.co.uk

Andrew Spooner  
*Partner – Global Head of IFRS Financial Instrument Accounting*  
+44 20 7007 0204  
aspooner@deloitte.co.uk

Jean-Marc Mickeler  
*Partner – Europe, Middle East & Africa Financial Services Audit Leader*  
+33 1 5561 6407  
jmickeler@deloitte.fr
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