

RISK MANAGEMENT

AMBIT FOCUS IFRS9 IMPAIRMENT

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Introduction

In July 2014 the International Accounting Standard Board (IASB) published IFRS 9 Financial Instruments, thereby finalizing the rules for the impairment model. While the declared objective of IFRS 9 is to move accounting processes for expected credit losses closer to the realities of risk management, the requirements represent an operational challenge that requires both automation and standardization.

The new IFRS 9 accounting standard requires financial institutions to progress from a backward-looking and observation-based impairment model to a forward-looking and expectation-based approach. According to this new model, institutions must determine an expected credit loss on the origination of each financial asset under the scope of the new impairment standard and recognize a corresponding loss allowance. During the whole lifetime of a financial instrument, the amount of the loss allowance needs to be updated regularly to reflect any changes in credit risk. This continuous accounting for expected credit losses not only provides more adequate and timely information for the management of credit risks, but also helps to further bridge the gap between finance, credit risk management and other relevant aspects of modern balance sheet risk management.

With IFRS 9 coming into force on January 1, 2018, FIS' Ambit IFRS 9 Impairment solution gives financial institutions the opportunity to adapt to the new impairment model in advance and to assess the impact on their balance sheet and profit-and-loss (P&L) results. With strong simulation capabilities, the solution enables financial institutions to quantify the impact of modified risk parameters and segmentations on the historic evolution of loss allowances. It also allows the forecasting of future loss allowances under various business scenarios and economic conditions.

TIMELINES

IFRS 9 Financial Instruments is effective from January 1, 2018, with an option for early application. Furthermore, the Basel Committee on Banking Supervision emphasizes in its "guidance on accounting for expected credit losses" the general importance of a high-quality, robust and consistent implementation of expected credit loss accounting frameworks across all jurisdictions. The appropriate determination of how, when and in what amount to recognize the effects of increases in credit risk should be a priority for all stakeholders in the banking industry.

SOURCES: IFRS 9 FINANCIAL INSTRUMENTS PROJECT SUMMARY, JULY 2014 GUIDANCE ON ACCOUNTING FOR EXPECTED CREDIT LOSSES, BCBS, APRIL 2015

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Calibration

The aim of the calibration process is to support the production process, by back-testing previously calculated expected credit losses against actual defaults over a certain time period. This in turn will improve the fit of the calibration model by taking into account the most recent insights gained from history.

Factoring additional information into the risk parameter calibration process will automatically alter risk parameter segmentation. In other words, loan portfolios will be grouped according to different or additional information, allowing you to obtain more reliable or meaningful estimators based on the available history of loan loss data. The most important question at this stage is: what impact would an alternative risk parameter segmentation, or an alternative set of stage allocation rules and thresholds, have had on the historic evolution of the loss allowances. To answer this question, the calibration process needs to provide sufficient flexibility and automation to verify the impact of using alternative sets of risk parameters or stage allocation rules on the historic evolution of impairments. Ambit Focus makes it possible to calculate the last x reporting dates for which impairment amounts were calculated and booked in the production process, using the alternative set of risk parameters. This will help show how historic impairment amounts have evolved in relation to the originally calculated values.

With such functionality credit risk analysts have an effective tool to help both validate impacts and justify a change of the current production setup to decision-makers and auditors.

Forecasting

The forecasting process enables banks to plan their balance sheet according to the various assumptions required for budgeting and planning. Since planning portfolio growth under the IFRS 9 accounting regime automatically means an increase in loss allowances, the forecasting process must also consider the evolution of future impairment balances alongside the planned scenarios. In addition to potential portfolio growth based on different business scenarios, changes in the macroeconomic environment as well as contracts transitioning from one stage to another will have a significant impact on impairment balances and therefore need to be taken into account.

FORECASTING

Referring to the consultative document "Guidance on accounting for expected credit losses," the Basel Committee on Banking Supervision stresses at several points the importance of strongly considering forward-looking information and macroeconomic factors. Under pressure to keep expected credit losses at an appropriate level, sophisticated simulation functionalities are imperative for a sophisticated financial institution.

SOURCE: GUIDANCE ON ACCOUNTING FOR EXPECTED CREDIT LOSSES, BCBS, APRIL 2015

Ambit Focus's powerful cash-flow and scenario simulation engine was originally built to forecast the net interest income of financial institutions under various business strategies and potential market scenarios. It supports the calculation of loss allowances at future reporting dates under various business strategies, such as loan portfolio growth, and market environments. For the simulation of the macroeconomic environment users can set up macro risk factors and define relationships between these factors and the point-in-time risk estimators. The transitioning of contracts between stages over the course of the simulation can be modelled with the help of stage transition matrices.

Income simulation

The ultimate goal of the impairment process is not only to forecast impairment amounts but also to further bridge the gap between credit risk management and other risk functions such as asset liability management (ALM) and liquidity risk management. In so doing, a financial institution can more easily incorporate available credit risk information into net interest income forecasts and liquidity stress tests.

Through its credit-adjusted ALM functionality Ambit Focus allows institutions to achieve these objectives, by reducing the value of a contract by the expected credit losses in each future period, calculations of net interest income and other risk metrics (e.g. the present value of a contract) will factor in any relevant credit defaults. With the help of these expected credit loss write-off and recovery amounts, credit risk can be comprehensively taken into account as required by current balance sheet risk management strategies.

Why choose Ambit Focus?

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Our solution provides following benefits:

- Fully integrated ALM, liquidity risk management, hedge accounting and expected credit loss, empowering risk measurement across different departments
- Best-of-breed liquidity and ALM solution
- Modular platform, allowing combinations of out-of-the-box solutions for:
 - ALM
 - Stochastic ALM
 - Liquidity risk
 - Market risk
 - IAS39/IFRS 9 hedge accounting
 - IFRS 9 impairment
 - Funds transfer pricing
- Intuitive and user-friendly interface
- Multi-dimensional planning and reporting



About FIS' Ambit Risk and Performance

FIS' Ambit Risk and Performance Management suite of solutions gives you a centralized view of risk, liquidity, capital and profitability across the enterprise so that you can be prudent in your decision making yet strategic for maximized returns. Ambit Risk and Performance Management offers modular solutions for asset liability and market risk management, liquidity risk management, regulatory compliance and economic capital management, operational risk management and credit risk management. For more information, please visit www.fis.com/ambit

About FIS' risk solutions

FIS' risk solutions cover collateral management, liquidity, asset and liability management, market and credit risk and capital management. As a complete solution suite that supports a firms end to end risk management requirements, these solutions help aggregate risk data, set the risk appetite and forecast enterprise-wide risk activities and performance. This helps firms better understand and forecast regulatory impacts on funding, trading and asset allocation across all risk classes to lower total cost of ownership and drive competitive performance from compliance. For more information, please visit www.fis.com/enterpiserisk

About FIS

FIS is a global leader in financial services technology, with a focus on retail and institutional banking, payments, asset and wealth management, risk and compliance, consulting and outsourcing solutions. Through the depth and breadth of our solutions portfolio, global capabilities and domain expertise, FIS serves more than 20,000 clients in over 130 countries. Headquartered in Jacksonville, Florida, FIS employs more than 55,000 people worldwide and holds leadership positions in payment processing, financial software and banking solutions. Providing software, services and outsourcing of the technology that empowers the financial world, FIS is a Fortune 500 company and is a member of Standard & Poor's 500® Index. For more information about FIS, visit www.fisglobal.com

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