National Bank of Serbia

IFRS 9 Implementation in the Serbian Banking Sector

National Bank of Serbia
Administration for Supervision of Financial Institutions
Banking Supervision Department
Palić, December 7, 2017

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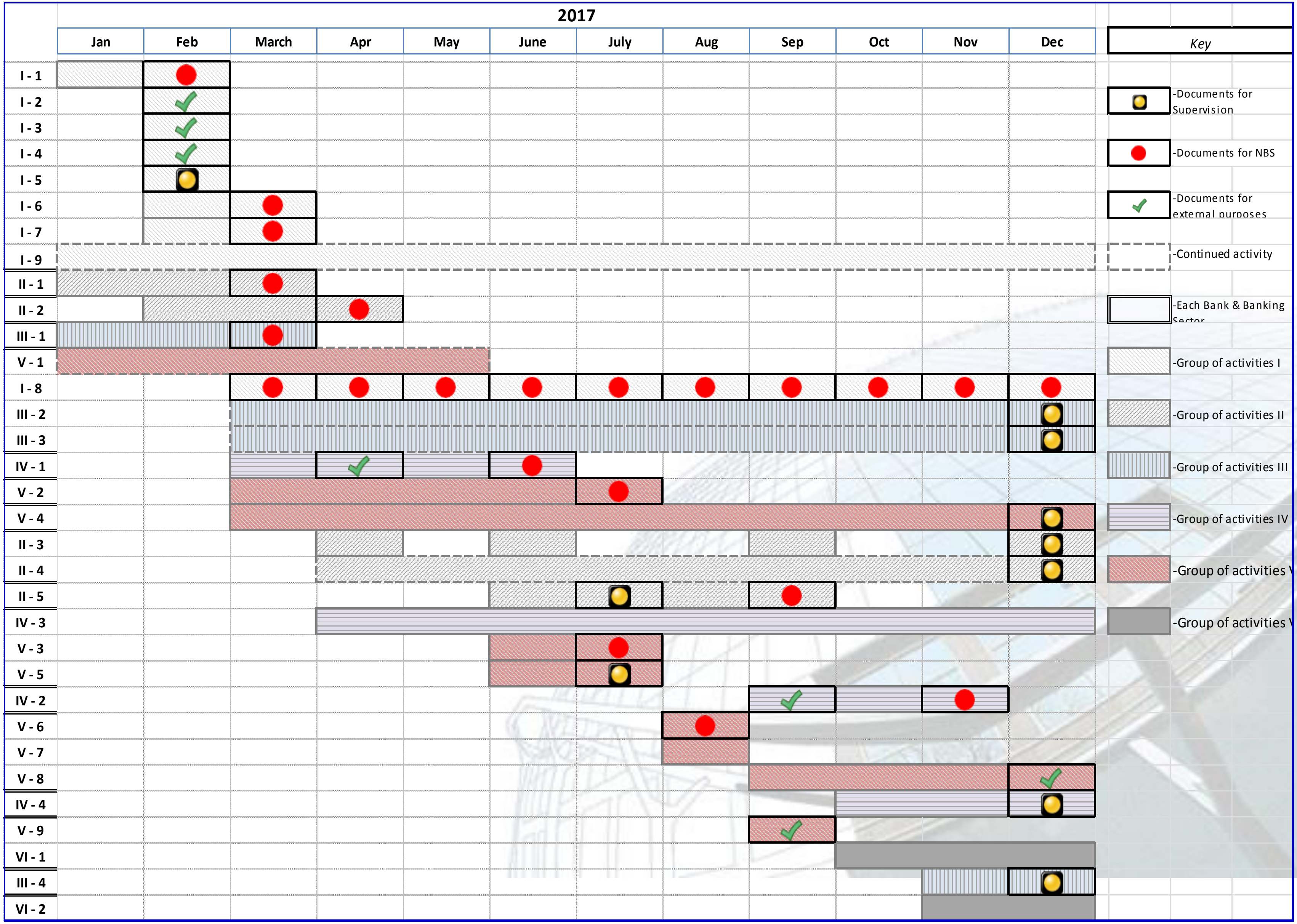
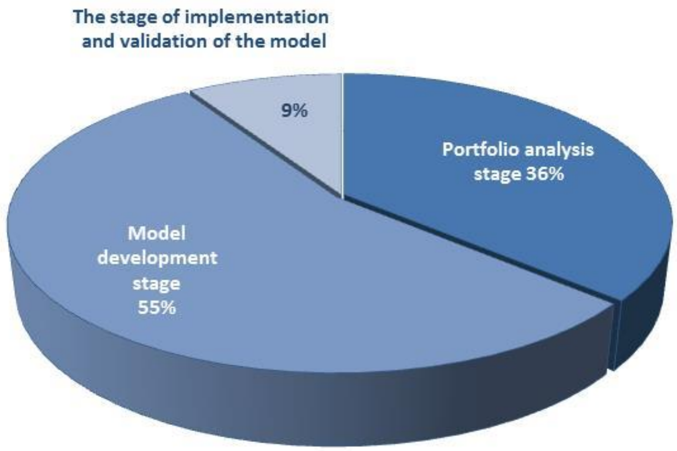
Activity Plan for IFRS 9 Implementation

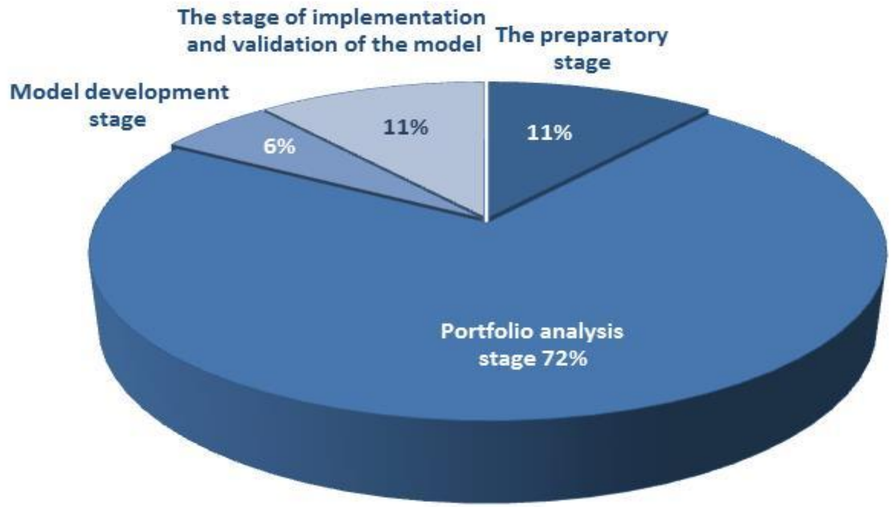


Qualitative aspects of IFRS 9 implementation

- In accordance with the Working Group Activity Plan, in March and September, the NBS developed and sent to banks two questionnaires about banks' activities related to IFRS 9 implementation.

- **IFRS 9 implementation project progress:**
  - Larger-sized banks are in more advanced stages of IFRS 9 implementation compared to smaller-sized banks;





  - There has been a significant progress in IFRS 9 implementation in September compared to March 2017.

Qualitative aspects of IFRS 9 implementation

- **Involvement of parent banks and/or consultants in the IFRS 9 implementation process:**
  - Banks which belong to cross-border banking groups – IFRS 9 implementation in cooperation with the parent bank, consultant engagement in several banks;
  - Banks which do not belong to cross-border banking groups – consultant engagement in all stages of IFRS 9 implementation.

- **Involvement of the relevant sectors, managers and external auditors in the IFRS 9 implementation process:**
  - Departments/staff responsible for IFRS 9 implementation in banks: finance and accounting department (the stage of classification and measurement of financial instruments) and risk management department (the stage of impairment of financial instruments);
  - Also involved in the process are the staff from ICT department and front office of organisational units;
  - Internal audit and compliance departments are involved to a limited extent;
  - Apart from involvement of the Executive Board in IFRS 9 implementation process, there is a notable rising involvement of the Managing Board and Audit Committee;
  - External audit is much less involved.

Qualitative aspects of IFRS 9 implementation

- **Classification and measurement:**
  - *Defining a business model* – no material risks or open issues have been identified, except in few banks – determining the method for conducting an analysis in case of individual, non-standardised contracts;
  - *Conducting SPPI test* – addressing disputable contract clauses which failed SPPI test.

- **Impairment:**
  - Basic risk – lack of data in the information system and/or inadequate quality of the data available;
  - Additional issues – treatment of government securities, inclusion of macroeconomic scenarios in model development and the issues regarding the effective interest method;
  - Problems may arise in the process of technical implementation of the model developed by the group or external software solution, as well as in the process of its validation.

Qualitative aspects of IFRS 9 implementation

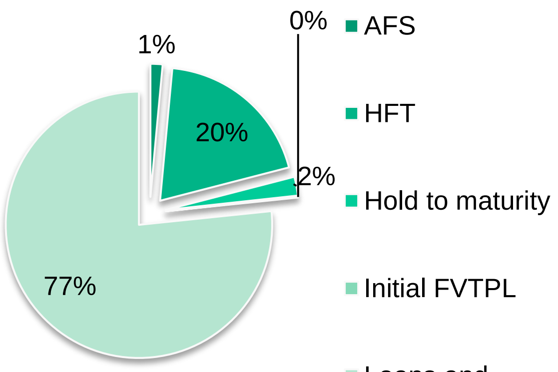
- **Criteria for transfers between impairment stages – from stage 1 to stage 2:**
  - Over 30 days past due;
  - Status of exposure (forborne/non-forborne);
  - Early warning indicators;
  - Change in the PD relative to the date of loan approval.
- **Distribution of forborne exposures (FBEs):**
  - 55% banks – 100% FBEs to stage 2 or 3;
  - 12% banks – over 90% FBEs to stage 2 or 3.
- **Criteria for transfers between impairment stages – from stage 2 to stage 3:**
  - Criteria for non-performing exposures
- **Distribution of non-performing exposures (NPEs):**
  - 65% banks – 100% NPEs to stage 3;
  - 15% banks – over 90% *of NPEs* to stage 3.
- **Effects of IFRS 9 implementation on loan approval and risk management processes:**

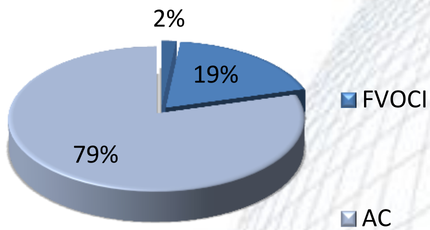
  50% of banks do not plan to change credit approval and risk management policies and procedures as a result of the standard implementation, 30% of banks implemented changes; 20% plan to introduce changes in 2017 or 2018.

Quantitative aspects of IFRS 9 implementation

Classification and measurement:

- Based on the data which banks supplied in the second quantitative questionnaire, as at 30 September 2017, it was established that in the case of IFRS 9 implementation, the aggregate net carrying amount of financial instruments could be broken down as follows:
  - *79% would be classified as financial instruments measured at amortised cost, 19% financial instruments measured at fair value through other comprehensive income and 2% financial instruments at fair value through profit or loss;*
  - *reclassification of loans and receivables to the category of financial instruments measured at FVPL is negligible:*





Reclassification From IAS 39	to IFRS 9	II Questionnaire (September 30, 2017) Share
HFT	→ FVPL	62.32%
	→ FVOCI	37.68%
AFS	→ FVOCI	94.06%
	→ FVPL	3.32%
	→ AC	2.62%
Held to maturity	→ FVOCI	1.90%
	→ AC	98.10%
	→ FVPL	0.00%
Initial FVPL	→ FVPL	100.00%
Loans and receivables	→ AC	99.91%
	→ FVPL	0.09%

  - *only in two banks the change in classification led to a change in the manner of measurement.*

Quantitative aspects of IFRS 9 implementation

Allocation of financial instruments to appropriate impairment stages and additional additional write-downs:

- 86.86% of total gross balance and off-balance sheet items are allocated to stage 1; 5.96% to stage 2; 7.18% to stage 3;
- gross NPL ratio at 30 September 2017 corresponds to stage 3 of loans and receivables item;
- almost the whole amount of government securities (97.55%) is allocated to stage 1, with the exception of: one bank that allocated a part of government securities to stage 2, and one bank to stage 3;
- Preliminary assessments as at 30 Sept. 2017 show that IFRS 9 implementation would increase the aggregate impairments by RSD 12.95 bn or 6.7%, 36.2% of mentioned increase would refer to stage 1, 50.62% to stage 2, and 13.18% to stage 3:

a. loans and receivables would account for the largest share of the additional aggregate impairments arising from IFRS 9 implementation (primarily in the household sector), followed by debt securities;

b. only two banks showed a decrease in expected credit losses, while the greatest absolute increases in these losses were identified in larger banks; however, increases in smaller-sized banks are not negligible either (particularly when a relative increase is observed),

c. the coverage of balance sheet exposure by allowances for impairments for Stage 1 equals 0.75%, for stage 2 – 6.43%, and for stage 3 – 64.22%;

- An additional increase in impairments is expected, given the fact that banks did not incorporate the impact of macroeconomic variables on impairment parameters and that small and micro banks lag behind in IFRS 9 implementation.

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Quantitative aspects of IFRS 9 implementation

Impact of additional impairments on capital and comparison between the EU and Serbia in terms of IFRS implementation:

- No material impact on regulatory capital is expected, owing to high capitalisation of banks and the required reserve for estimated losses on balance sheet assets and off-balance sheet items:

	Selected EU banks	Serbian banking sector
Classification		
AC	76%	79%
FVOCI	8%	19%
FVTPL	16%	2%
Capital adequacy ratios	0.35-0.5 pp	0.39 pp
Source of impact on bank capital	additional impairments, with lesser impact of classification	additional impairments, with almost non-existent impact of classification
Impact relative to the bank size	Greater impact in case of smaller banks	n/a
Total impairment under IFRS 9		
Stage 1	8%	10%
Stage 2	14%	6%
Stage 3	78%	84%

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The story goes on…

- Further development and recalibration of models internal models used for calculation of impairments
- Further development of macroeconomic indicators
- Consequently, further development of methodologies
- Potential changes to the process
- Work on IFRS 9 guidelines
- Work on disclosure guidelines
- New challenges – Guidelines of the European Central Bank (NPE vs. impairment and statutory prudential backstop)

Successful joint work on the project of
the NBS, banks, the Association of Serbian Banks and audit firms

TBC...

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Thank you for your attention!
Any questions?