MOODY'S ANALYTICS

CLIENT SPOTLIGHT:

Mid-size Bank Implements an Off-the-Shelf Impairment Model to Address New Accounting Standards

Navigate the complexities of the regulation

Fast track implementation and get preliminary results

Ensure compliance with a highly accurate and granular expected credit loss model

Meet aggressive timelines for compliance

IFRS 9 requires alignment across finance and risk departments to measure financial assets according to guidance by the International Accounting Standards Board (IASB), generate contractual cash flows for varied instrument types, and consider macroeconomic scenarios. As with stress testing and scenario analysis for capital planning, financial institutions must rely on forward-looking modelling rather than current incurred loss for impairment calculations. To accommodate such significant modelling calculations, processes and infrastructure must be developed and implemented to support the new accounting approach. Capital requirements are likely impacted as a result, and volatility of calculated allowances can be a major concern.

The Challenge: Addressing IFRS 9 Requirements with an Off-the-Shelf and Validated Expected Credit Loss Calculation Tool

The bank was seeking an IFRS 9 Expected Credit Loss (ECL) calculation tool for their wholesale portfolio exposures. It had been using internal ratings and Basel-based probability of default (PD) and loss given default (LGD) models to manage its wholesale portfolio. With limited credit default data, the bank's initial focus was on improving models for IFRS 9 compliance and enhancing their credit modelling and data infrastructure. The bank had limited internal resources to fulfill requirements of the regulation, and so turned to Moody's Analytics.

The Solution: A Timely Implementation of An Impairment Model Applicable Across Asset Classes

To implement an IFRS 9 solution for modelling the bank's wholesale portfolio, including calculation of expected credit loss, provision, and allowance over the lifetime of each deal, IFRS 9 staging, and the necessary reports, Moody's Analytics proposed a solution that brought together:

» Off-the-Shelf Analytics and Modelling – ImpairmentCalc™ software enables the bank to convert their Through-the-Cycle (TTC) rating to a Point-in-Time (PIT) PD term structure which produces a credit cycle adjusted PD to be used for IFRS 9 impairment calculations. Using a scenario-based model, ImpairmentCalc software converts input PD and LGD to scenario-based conditional PD and LGD term structure for a single or multiple set of macroeconomic scenarios. These conditional PD and LGD values are used for IFRS 9 stage allocation and impairment calculations.

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- Advisory Expertise and Implementation – the Moody's Analytics team worked with the bank to analyze portfolios, review existing models, and customize their modelling framework for ECL modelling. These services improve credit portfolio risk management reporting and

Setting the Stage for Success

- The bank was able to implement ImpairmentCalc software within three months versus other impairment modeling solutions in the market that could require potentially up to six months of implementation work due to data configuration and IT resources.
- The bank now has a single framework to address IFRS 9 impairment, scenario analysis, and stress testing that is granular and flexible.
- ImpairmentCalc software can be applied to the bank's entire wholesale portfolio, including commercial & industrial, project finance, muni bonds, sovereign bonds, and small and medium enterprise loans.
- The bank is confident in communicating to auditors and regulators due to the level of service from the Moody's Analytics team to understand and implement impairment modelling capabilities based on best practices.
- The bank streamlined their data management process to capture contractual terms of financial instruments, such as usage and prepayment, within the portfolio. The bank was able to generate contractual cash flows for loss allowance, fair value, and gross carry amount calculations.

Looking Ahead

As banks are beginning to implement an IFRS 9 impairment model, the focus is shifting from meeting immediate compliance to managing the long-term impact on capital. Understanding the extent of the new loss accounting guidelines which might lead to more aggressive provisioning has a direct impact on earnings and capital. In addition, loan pricing and availability of credit can also be affected. The higher level of earnings volatility between IFRS 9 and IAS 39 is due to the difference in the impairment model itself. Banks are now looking into more effective ways to manage their credit portfolio and pricing by studying the earnings volatility within their portfolio.

ImpairmentCalc Software is part of Moody's Analytics Credit Loss and Impairment Analysis Suite

Moody's Analytics Credit Loss and Impairment Analysis Suite improves credit loss estimation analysis and calculations. Its data integrity, analytics, and regulatory reporting solutions provide a modular, flexible, and comprehensive IFRS 9 impairment solution that facilitates a bank's efforts to calculate, manage, and report expected credit losses.

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ImpairmentCalc software provides expected credit loss impairment calculations consistent with IFRS 9 and CECL guidance. It takes user-defined asset classifications, credit risk measures, including PD, LGD, and exposure at default (EAD) to produce loss allowance. The tool also provides fair value, gross carrying value, and amortized cost for reporting purposes. ImpairmentCalc software can convert an internal rating or a through-the-cycle PD to point-in-time PD term structure to facilitate calculation of lifetime expected credit losses. This calculation engine can run in a stand-alone mode or it can be integrated into Moody's Analytics Credit Loss and Impairment Analysis software as an end-to-end solution.

About Moody's Analytics

Moody's Analytics, a unit of Moody's Corporation, helps capital markets and credit risk management professionals worldwide respond to an evolving marketplace with confidence. The company offers unique tools and best practices for measuring and managing risk through expertise and experience in credit analysis, economic research and financial risk management. By offering leading-edge software and advisory services, as well as the proprietary credit research produced by Moody's Investors Service, Moody's Analytics integrates and customizes its offerings to address specific business challenges.

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