The IFRS 9 Confidence Report

How well prepared are firms to meet
IFRS 9 requirements on time?

JAYWING

Introduction

How organisations are preparing for IFRS 9 has moved on significantly since the IASB finalised the new rules over two years ago. Organisations are getting to grips with implementation, and many are now seeing value beyond the regulatory tick box.

As we move into the full implementation and testing phase, model designs are being re-examined, data requirements are being gathered and infrastructures are being improved. Although IFRS 9 implementation may pose numerous challenges to ways of working, it also provides many opportunities for organisations to benefit from improved business operations.

This report reveals the results from our 2016 IFRS 9 Implementation research study and includes our expert opinion based on our experience of working with many of the UK's leading banks and building societies on IFRS 9 implementation and other regulatory requirements.

Greater expectations
It is unclear if all lenders will meet the January 2018 deadline, but one thing is for sure, the regulators are sure to shine a spotlight on organisations who are seen to be lagging behind or adopting inadequate approaches.

Even with the risks of not meeting the requirements being high, many organisations are still not responding quickly enough.

New models and new ways of working
IFRS 9 has demanded new ways of working and new model design. Research shows many lenders have struggled in particular with the unique IFRS 9 modelling requirements. Help is on hand to show organisations how to succeed. In this report we also provide insight into a best practice approach to IFRS 9.

Organisations not only require analytical expertise to develop appropriate models, but becoming IFRS 9 compliant is also dependent on access to data, software and tools to support firms with the specific regulatory requirements.

Our research also reveals a skills gap, with a lack of analytical expertise being cited as the top challenge to implementing IFRS 9.

"Organisations recognise the critical role of data and analytics in becoming compliant with IFRS 9 and see fitting other regulatory requirements into an IFRS 9 framework as vital to their solution.

But the challenge is embedding IFRS 9 throughout the organisation and increasing model sophistication in-line with ambitions for growth."

About Jaywing

At Jaywing, we combine our traditional analytical and data science expertise with an acute understanding of today's big data and big data technologies, to deliver value from regulator satisfaction to optimised processes and customer profitability.

Whatever the challenge, we have the capability to deliver it – from managing structured and unstructured data to producing faster and more robust analyses and the algorithms that automate real-time decisions. Our approach gets the most out of all data and puts risk management at the pinnacle of data science.

We have a wealth of experience in the banking and lending sector and our team of expert analysts have developed industry-leading ways of using data and systems to help you manage credit and fraud risk and meet the ever-increasing regulatory demands of now.

Using our industry-leading expertise and trusted partner way of working, we've held many long-standing (10 years +), large-scale relationships with some of the UK's leading financial services names.

But we're just as happy serving smaller projects, as flexibility is one of our core strengths. You can use as much or as little of our expertise as you need and our team will scale up or down, from 1 to 100, changing to suit the requirements of specific projects.

We are credit risk experts and we are expert in IFRS 9 implementation, based on over 17 years' experience helping many of the UK's lenders with IFRS 9, IRB, stress testing, ICAAP and credit grading requirements.

Research methodology

We commissioned a study among Financial Services companies to better understand how ready firms are with implementing IFRS 9 requirements and what key challenges and opportunities organisations face.

The survey captures the views of 100 senior decisions makers responsible for IFRS 9 within their organisation. Sectors interviewed included UK banks, building societies and consumer, auto and SME finance.

We interviewed a range of different job functions to discover how each department views their progress towards compliance, including:

- Credit Risk
- Finance
- Regulation and Compliance
- Economics
- IT

So what did the results show?

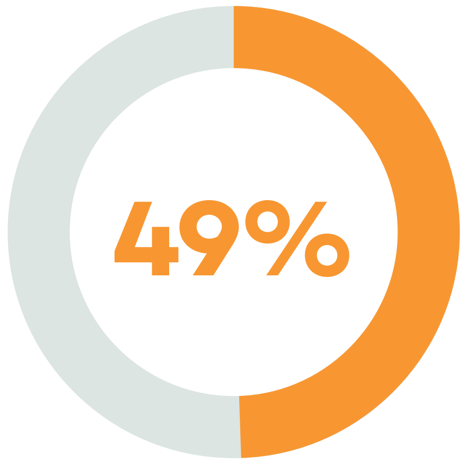
Research highlights

Our research found that banks are leading the way with their preparedness for IFRS 9 implementation, with smaller lenders somewhat lagging behind with both their progression towards implementation and their expectations of when they will start parallel run. Although banks seem somewhat ahead with their intentions to start parallel run in Q4 2016, there are some differences between different job functions with economics teams being far more confident in starting parallel run early. However, compliance and finance teams agree Q2 2017 is more realistic.

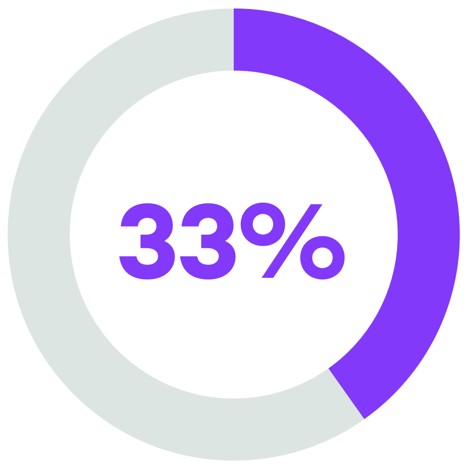
Jaywing expert opinion
The banks started implementation earlier and are therefore the most progressed, however **27%** stating they have a solution fully deployed seems higher than expected. Similarly, organisations being in the implementation and testing phase may find that work across different portfolios is at different stages; with **49%** of banks having some, if not all of their portfolios, in testing and implementation seems more in line with Jaywing's experience. "Solution Fully Deployed" may also be a misnomer, given models are likely to change during the parallel run phase which is planned to start during, or after, Q4 2016.

Key findings

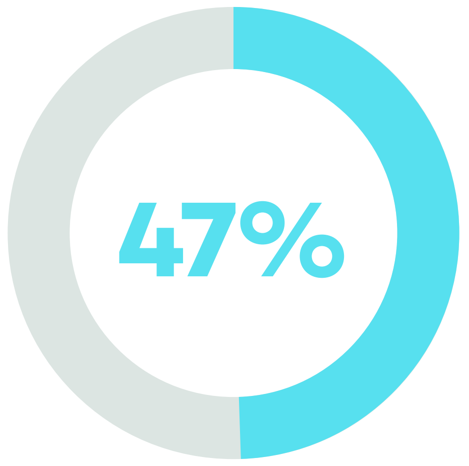
- Almost half of banks (**49%**) are in the implementation and testing phase, while building societies are lagging behind and are still preparing for designing and planning their solution.
- Just over a quarter of respondents intend to start parallel run during Q2 2017. However, **33%** of banks intend to commence parallel run as early as Q4 2016.
- Over half of lenders state a lack of analytical expertise as their biggest challenge to building IFRS 9 compliant models, closely followed by data availability/quality issues and infrastructure deficiencies.
- Lenders are optimistic about the additional benefits IFRS 9 will bring with **47%** of respondents saying the biggest benefit of implementing IFRS 9 will be an opportunity to improve the infrastructure and processes within their business.
- Conversely, only **17%** think the only benefit to implementing IFRS 9 will be solely for the purpose of complying with IFRS 9 requirements.
- Most UK lenders aim to develop an IFRS 9 solution that addresses other regulatory requirements alongside IFRS 9, for example stress testing and ICAAP.



of banks are prepared for the implementation and testing phase



of banks expect to commence parallel run in Q4 2016



say IFRS 9 compliance gives them an opportunity to improve the infrastructure and processes within their business

How far have organisations progressed towards implementation?

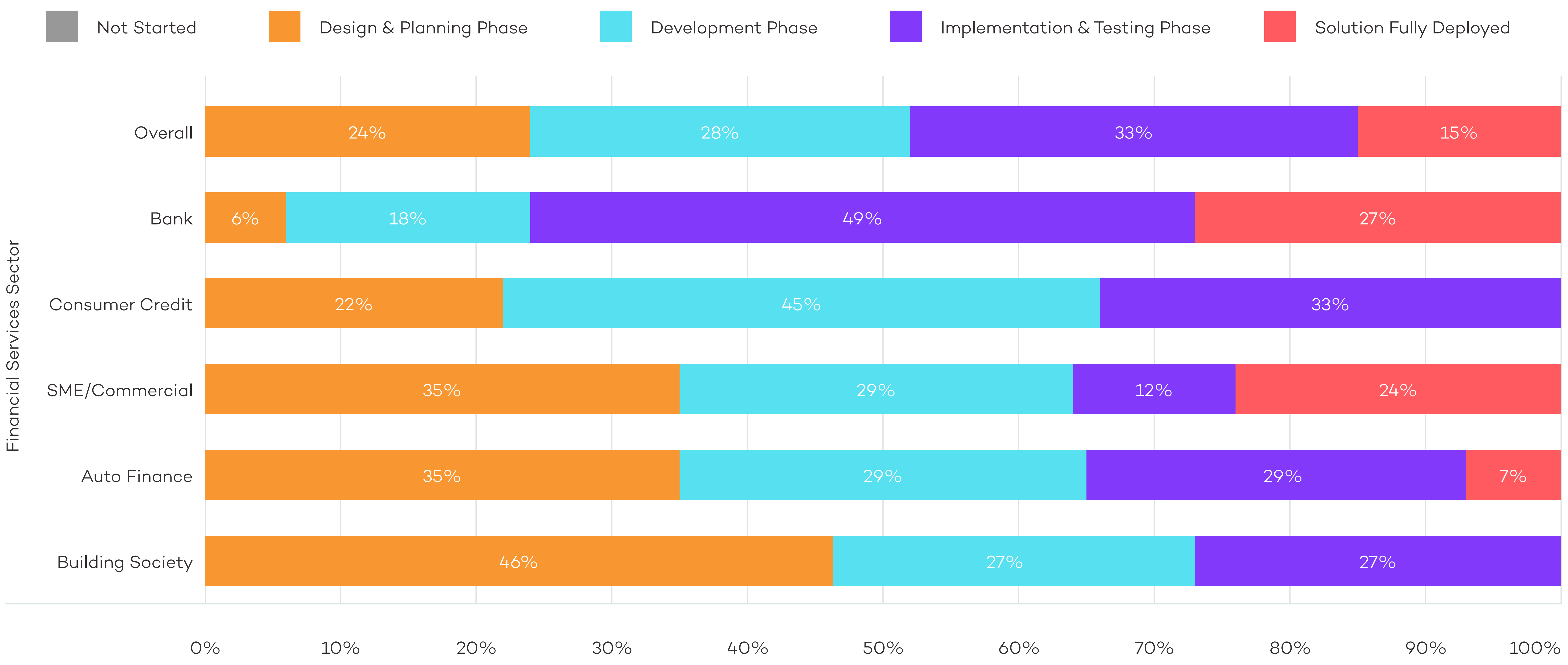
While all lenders in the study have started their journey to IFRS 9 implementation, there are some stark contrasts in how different sectors are progressing. Banks are clearly taking the lead with nearly half (**49%**) of banks within the implementation phase and 27% claiming to have a solution fully deployed.

Yet many other lenders feel they are lagging behind, with **46%** of Building Societies, **35%** of Auto Finance and **35%** of SME/Commercial Credit providers still in the design and planning phase.

Jaywing expert opinion
In our experience, we've found that many of the larger banks started work on IFRS 9 much earlier than other financial services sectors, and many of the banks we've worked with are indeed ready to start the implementation and testing phase. Yet it has required heavyweight analytical expertise to get organisations up to speed on the new requirements and to design models to a best practice standard.

Organisations that have started later will have to find alternative methods for speeding up design, development and implementation phases.

Figure 1: What stage are you currently at with IFRS 9 implementation? (By sector)



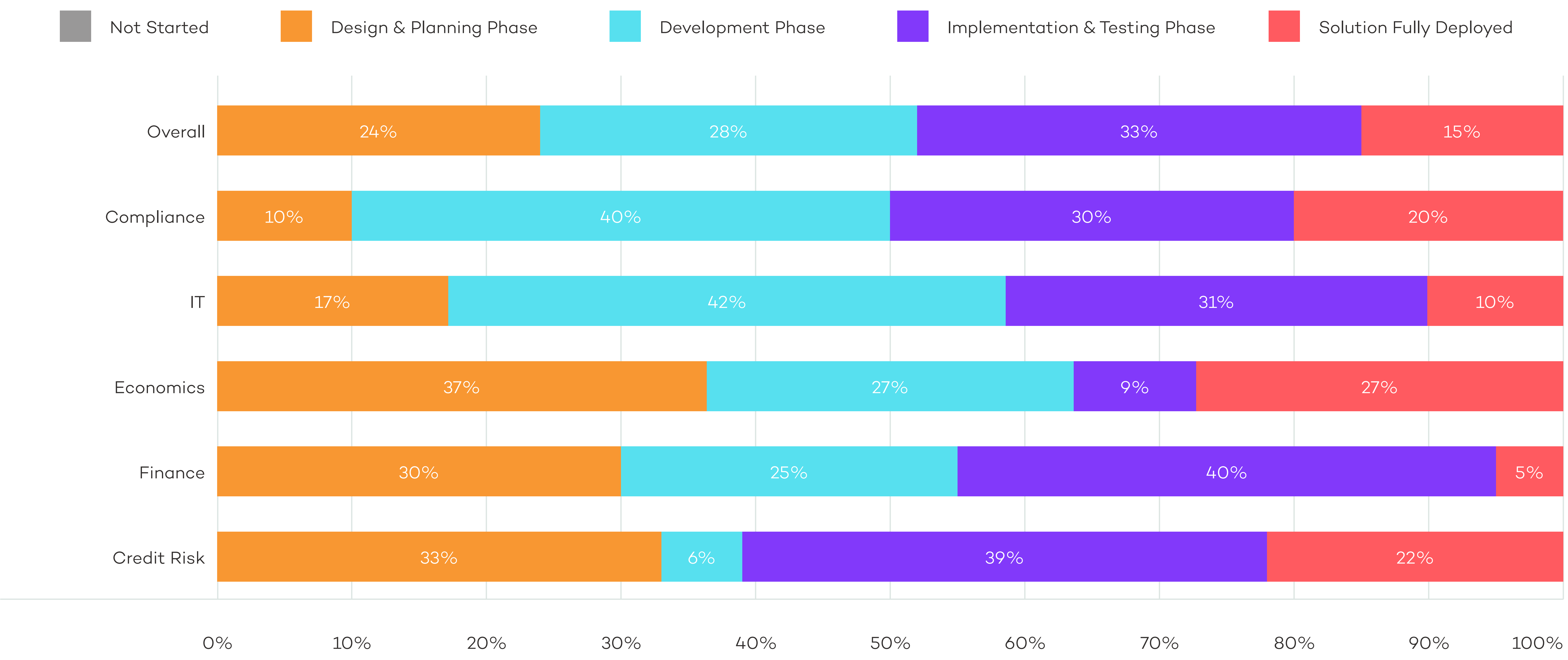
The disconnect between credit risk and finance teams

When we looked at the same question by job function, our research found that too often different job functions are viewing their organisations preparedness for IFRS 9 in isolation of other departments and without full visibility of the overall picture. For organisations to meet the requirements on time they must refine their current processes and ensure all teams are working together. The results that we see in our study seem to be more reflective of individual departments progress than the progress of the IFRS 9 programme in its entirety.

Credit Risk teams think implementation is slightly further ahead of the rest, with **61%** saying they are within the implementation phase or fully deployed, compared with **36%** of Economics teams and **45%** of Finance teams.

Jaywing expert opinion
IFRS 9 is a project that requires great co-operation across different departments within a lending organisation. While significant strides have been made in that collaboration, it appears that individual departments are still taking a modular view to task completion in IFRS 9. As well as harmonising the models, the parallel run phase should create greater alignment of IFRS 9 requirements across internal divisions, in support of the organisation's overarching goals.

Figure 2: What stage are you currently at with IFRS 9 implementation? (By job role)



Confident expectations for parallel run

Overall, our research reveals that the majority of organisations intend to start parallel run during Q2 and Q3 2017, however over a third of banks think they'll be ready as early as Q4 2016.

Interestingly, when we analysed the same question by job role, we found that Economics teams were the most confident in starting parallel run early, with **36%** saying they plan to start in Q4 2016, meanwhile, Finance (**43%**) and Compliance (**33%**) teams are in stronger agreement that Q2 2017 is more likely.

Jaywing expert opinion
The wide differences in responses about when the parallel run will start is symptomatic of IFRS 9 currently being 'a project' rather than a BAU process. Departments appear to be assessing their own readiness for parallel run, rather than their organisation's holistic requirement.

Credit risk teams view the parallel run as an important part of improving the models, hence the earlier start, while IT departments, who may view it only as an arena to test that the code works, have nearly half their number expecting a Q3 or Q4 2017 parallel run.

Figure 3: When do firms expect to parallel run (by sector)

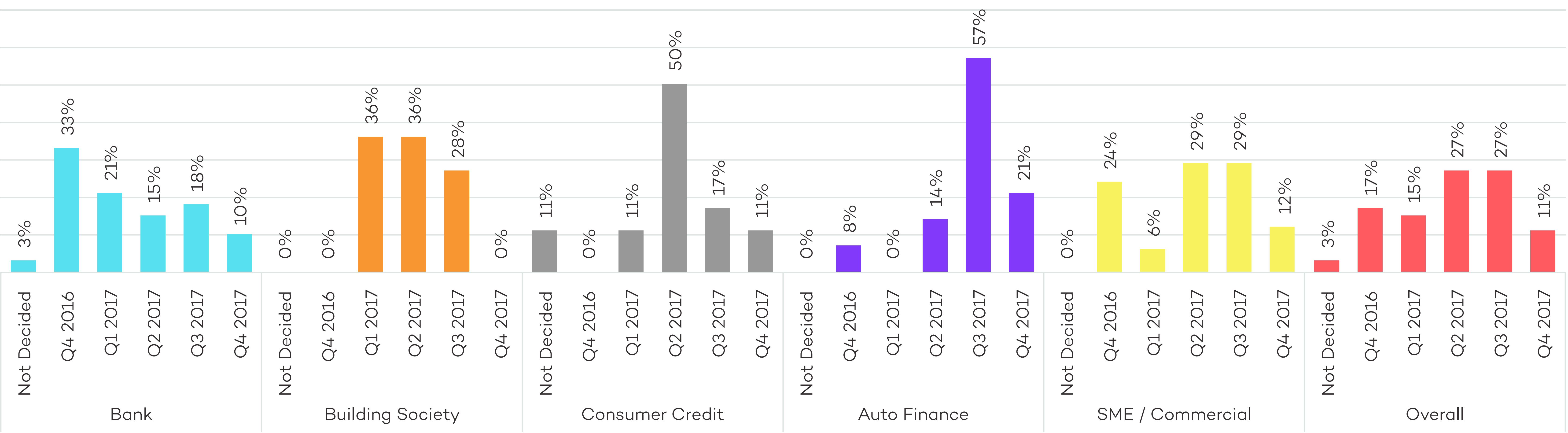
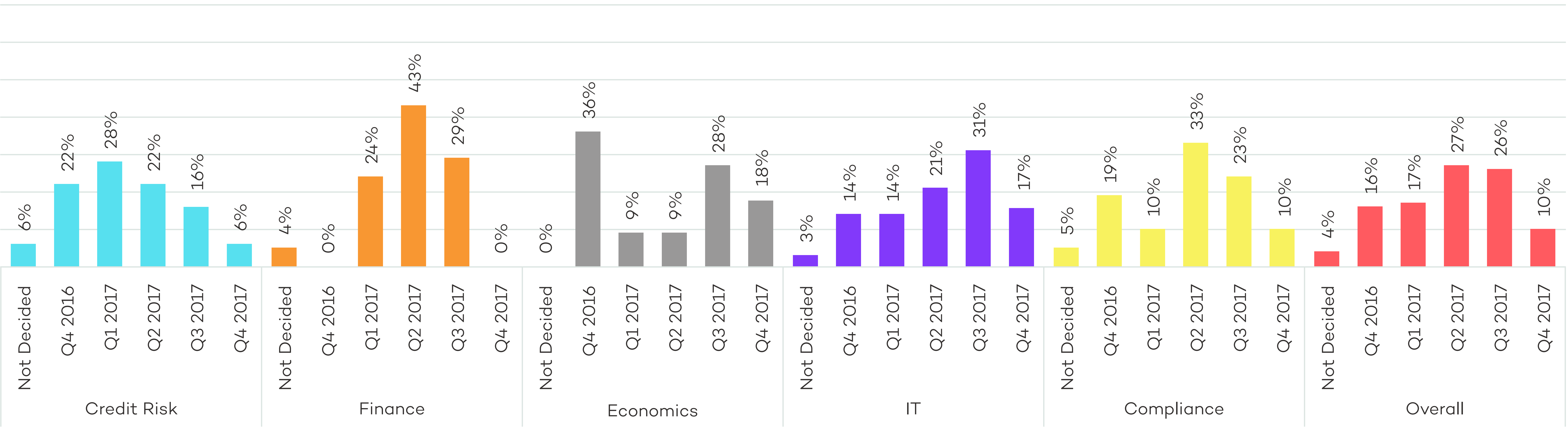


Figure 4: When do firms expect to parallel run (by job role)



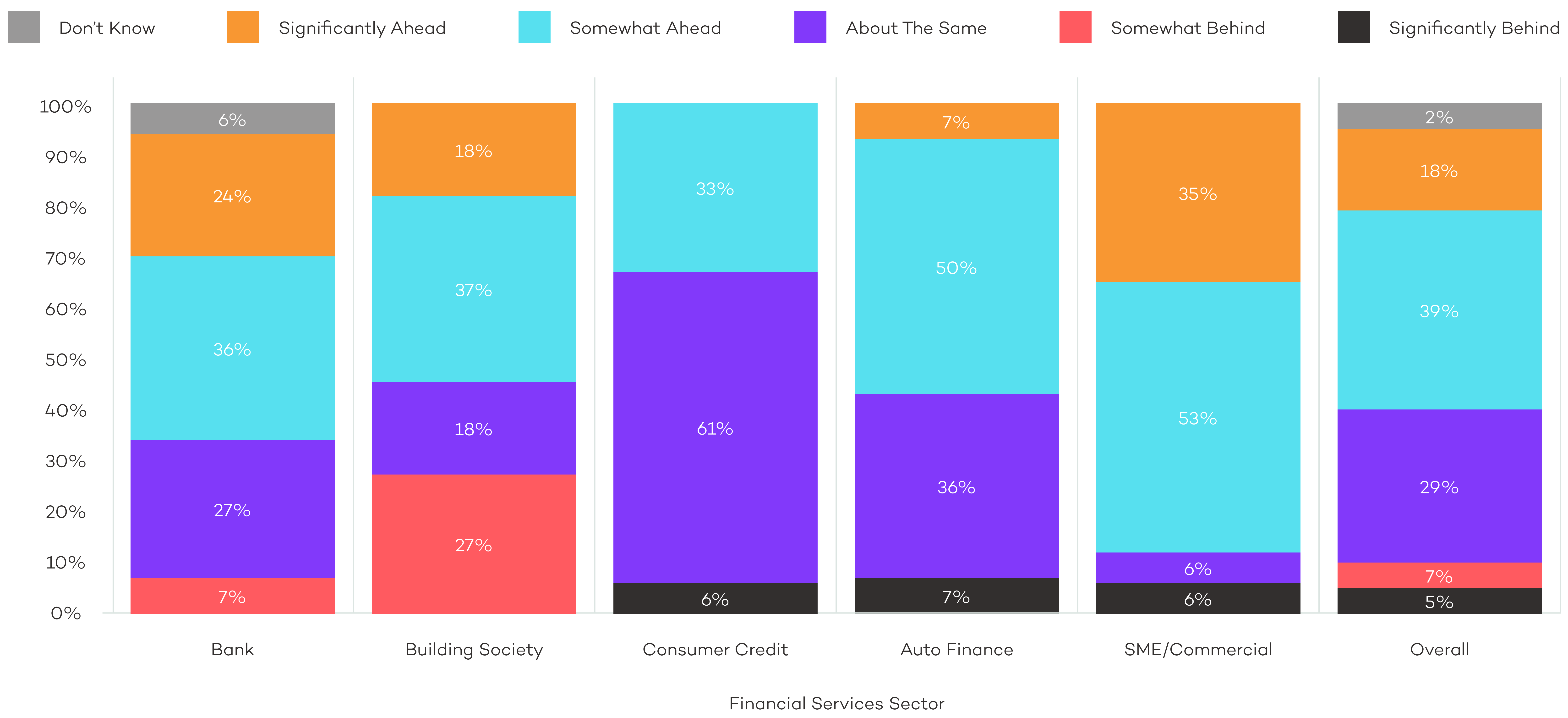
How do sectors compare?

To better understand how different financial services sectors are progressing towards their IFRS 9 goals, we asked each sector to rate how they are faring compared to their competitors and peers.

Overall, **57%** think they are ahead of their competitors and peers. Interestingly, Consumer Credit, and to a lesser extent Auto Finance companies, seem to be less confident about their IFRS 9 programmes than organisations in other financial services sectors.

Jaywing expert opinion
The study found that **88%** of SME/Commercial teams think they are somewhat ahead or significantly ahead of their competitors /peers – yet this does not align to our understanding of this market, especially when considering the commercial and wholesale portfolios.

Figure 5: How do you think you are progressing towards your IFRS 9 goals?



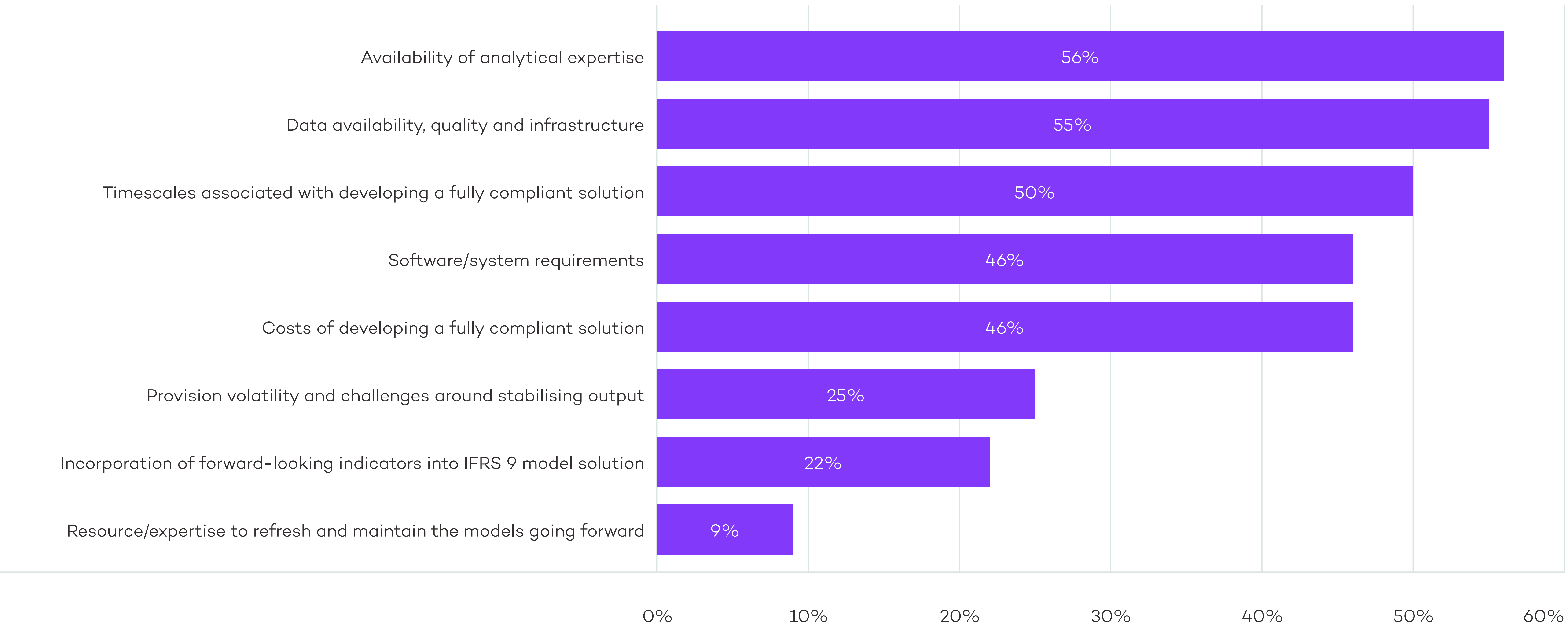
Firms are challenged with a lack of analytical expertise

IFRS 9 requires new capabilities to identify criteria indicative of significant credit risk deterioration and to calculate lifetime expected losses. This is clearly reflected in the survey results which cites availability of analytical expertise as the top challenge to building compliant models.

Jaywing expert opinion
It is clear that the new IFRS 9 guidelines are asking more demanding questions than ever before of risk, finance and economics teams, presenting them with difficult modelling challenges over longer time horizons.

This creates three clear needs that our study identifies: the need for skilled people (analysts and modellers), the need for long run loss data and the need to execute this complex project in specific, and concurrent timelines.

Figure 6: Top challenges to building IFRS 9 models



An integrated approach is key

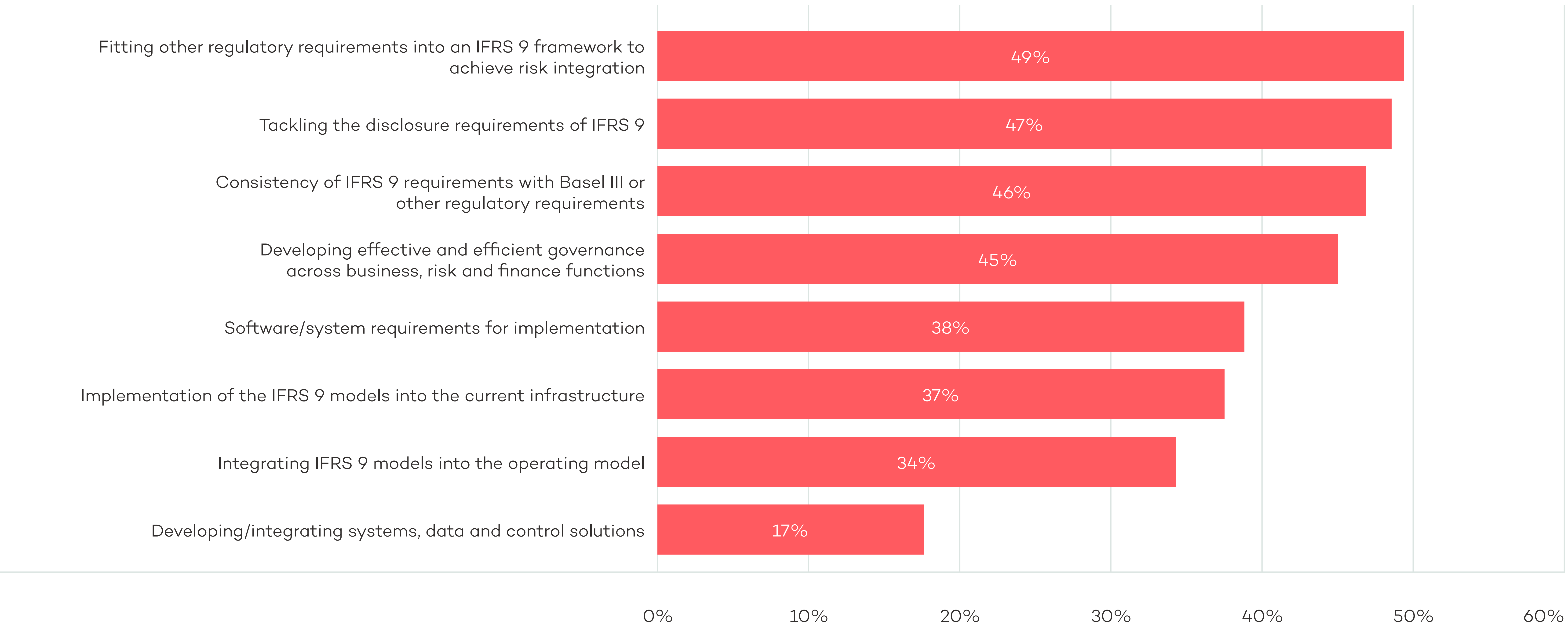
Once IFRS 9 models have been developed, and firms enter the full implementation phase, **49%** of organisations say the biggest challenge is integrating other regulatory requirements with IFRS 9. This is closely followed by **47%** saying tackling the disclosure requirements and **46%** saying they need to ensure consistency across the entire regulatory landscape.

Jaywing expert opinion
Jaywing thinks that while IFRS 9 regulation may be the catalyst driving change, organisations will see benefits well beyond the regulatory tick box.

We have long advocated closer risk integration across all expected loss disciplines: stress testing, loss forecasting, capital planning and now, provisioning under IFRS 9.

Organisations appear to be taking this on and using the challenge of IFRS 9 to build a better business.

Figure 7: Top challenges to implementing the requirements



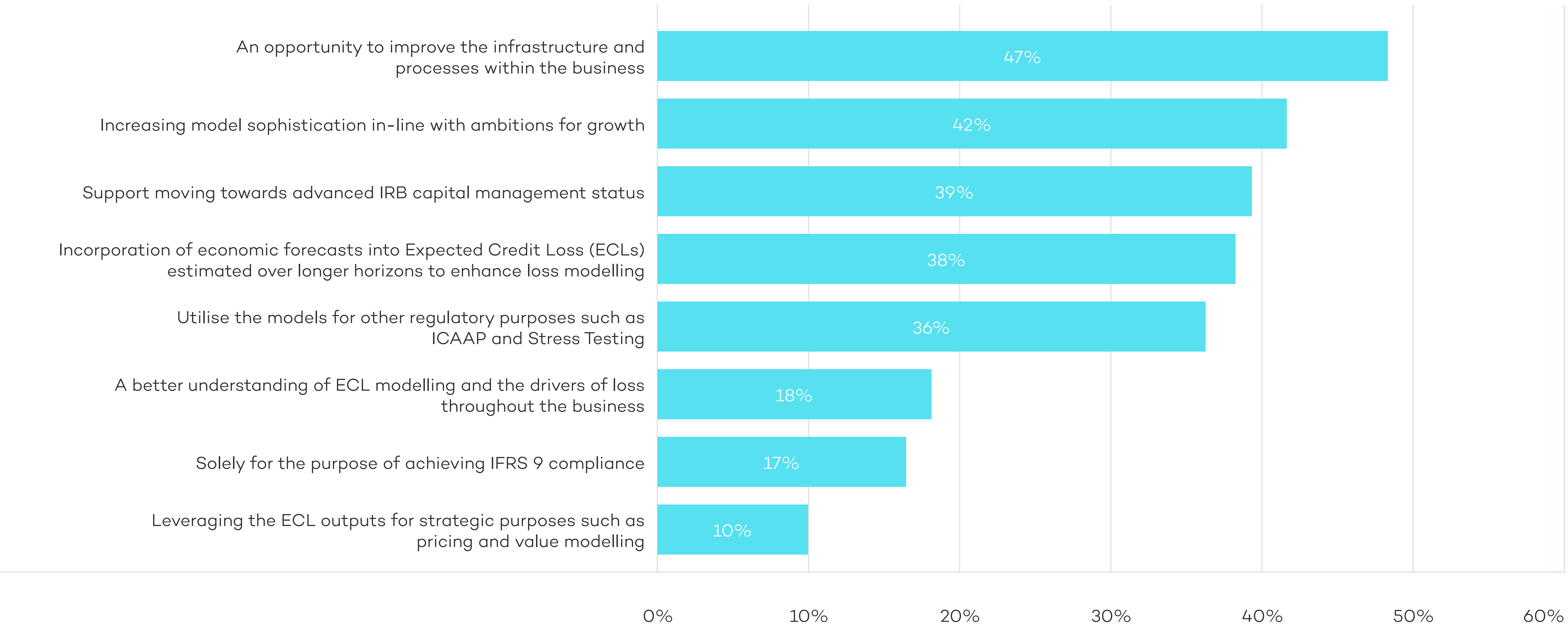
Organisations are gaining value beyond compliance

Although paved with challenges, the road to IFRS 9 compliance offers many upsides too, with **47%** or organisations saying IFRS 9 will give them an opportunity to improve infrastructure and processes within the business. This is closely followed by **42%** saying it will increase model sophistication in-line with ambitions for growth.

Jaywing expert opinion
It's encouraging to see that most firms are no longer viewing IFRS 9 as just a tick box exercise, but see value beyond complying with the requirements. The parallel run phase presents opportunities to embed this increased insight into business processes to drive greater customer and portfolio value.

In addition, it will help organisations to prepare for developments in IFRS 9 requirements and any new regulations.

Figure 8: What are the top benefits of implementing IFRS 9?



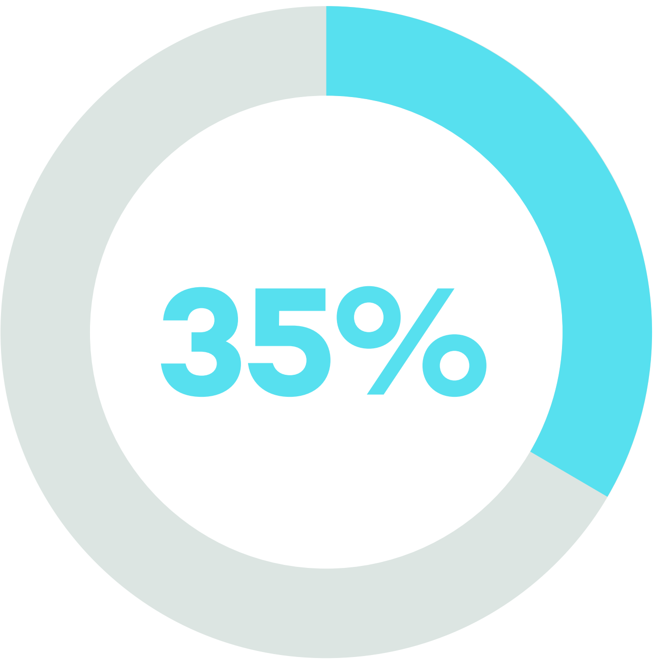
Organisations are looking for outside help to tackle model build

Not surprisingly, due to organisations citing the lack of in-house analytical skills as their biggest challenge to IFRS 9 compliance, the majority of organisations said they intend to either fully outsource the development of IFRS 9 models or use external software solutions, with only **20%** (the lowest percentage) saying they intend to build IFRS 9 models fully in-house.

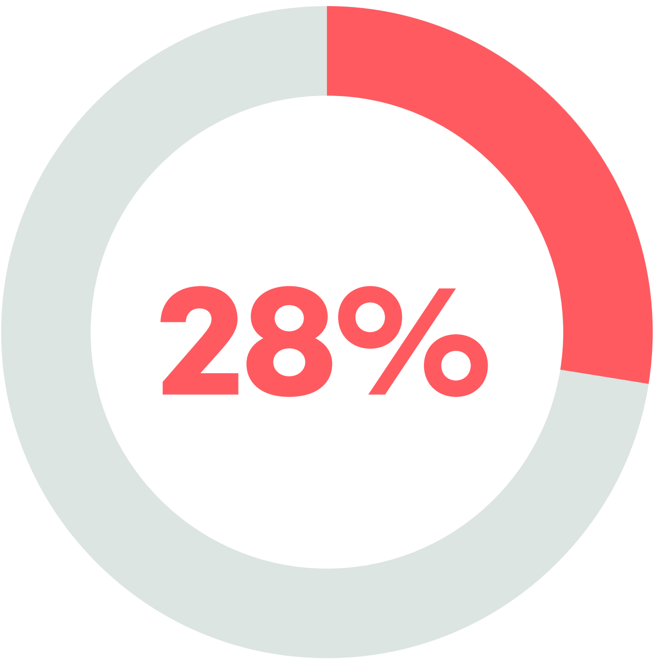
Jaywing expert opinion
It is understandable that a level of outsourcing and external help has been used heavily by the industry to help achieve IFRS 9 goals. This approach looks set to remain as IAS 39 provisions work will need to continue at the same time as IFRS 9 requirements are calculated within the parallel run.

Jaywing believes that training and handover processes are best done ‘in project’ rather than as a phase at the end and so we advise that you plan for these activities now to ensure success.

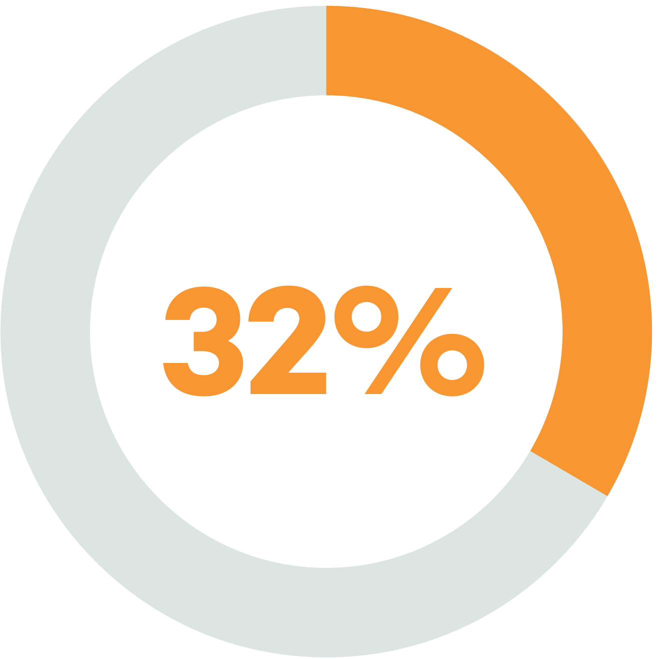
Figure 9: Are you building IFRS 9 models in-house, outsourcing or using external software*?



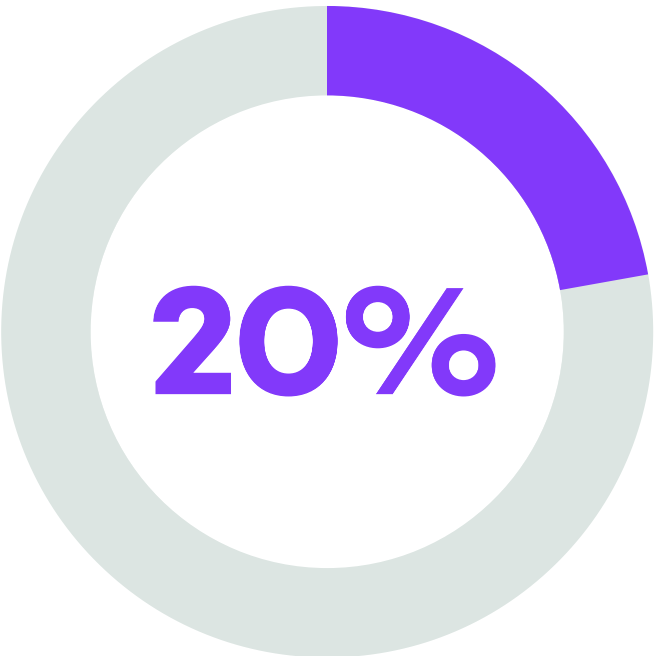
intend to fully outsource



intend to use external software



intend to partially outsource



intend to build fully in-house

*Respondants selected all that applied.

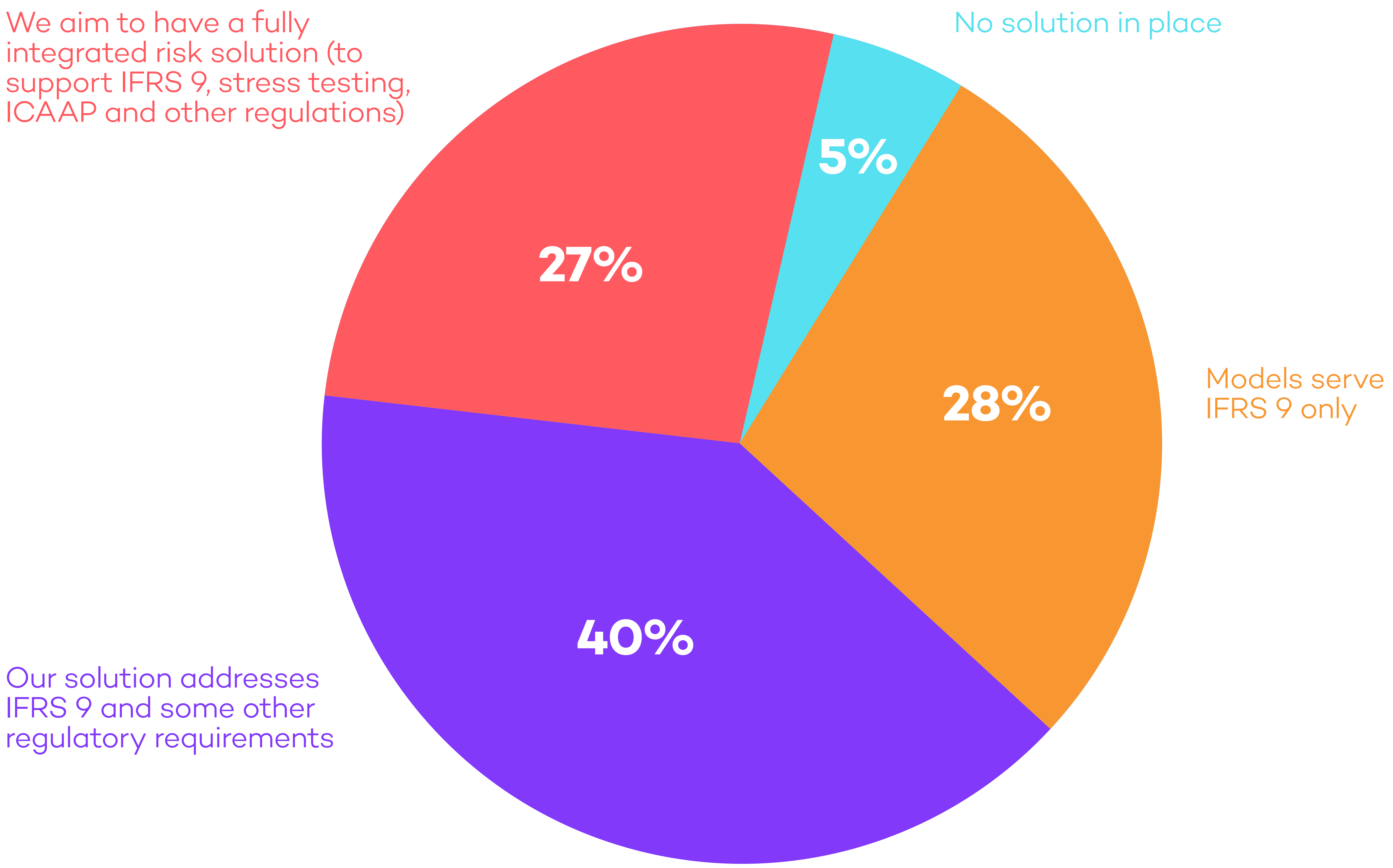
Integration with other regulations is critical

The large majority (**67%**) aim to develop or adopt a solution to IFRS 9 that addresses other regulatory requirements alongside IFRS 9. Only **28%** said they are developing models that address IFRS 9 alone.

Jaywing expert opinion
Jaywing promoted greater risk integration in our original IFRS 9 whitepaper published in 2015, aptly named 'Evolution not Revolution', and are pleased that the industry has moved in that direction.

We still strongly promote the need to continue greater integration of expected loss measurement and management across risk and finance to deliver benefits. Furthermore, Jaywing specialises in adapting these methodologies and incorporating lifetime forecasts and macro-economic modelling to benefit value attribution, customer profiling and marketing activity.

Figure 10: Does your IFRS 9 solution provide you with a fully integrated solution for all your regulatory requirements?



Organisations lack a holistic view on data requirements

While we found that overall organisations are confident in their data quality and availability for IFRS 9, it's clear that credit risk teams are less confident compared to their compliance, IT and finance colleagues.

Data quality rated as good or excellent:

- **94%** IT
- **86%** Compliance
- **81%** Finance
- **80%** Credit Risk

Jaywing expert opinion
From our experience, credit risk teams have a more granular view of the data in general and IFRS 9 requires more data in particular, and consequently they are more aware of underlying data issues than other business functions that only need to use aggregated data.

Given the importance of data required for regulations such as IFRS 9, we encourage organisations to review their data management strategy holistically, in order to gain a 'single version of the truth'. While this is a daunting challenge, it is one we have achieved for large-scale organisations.

Figure 11: To what extent are you confident in your data quality?

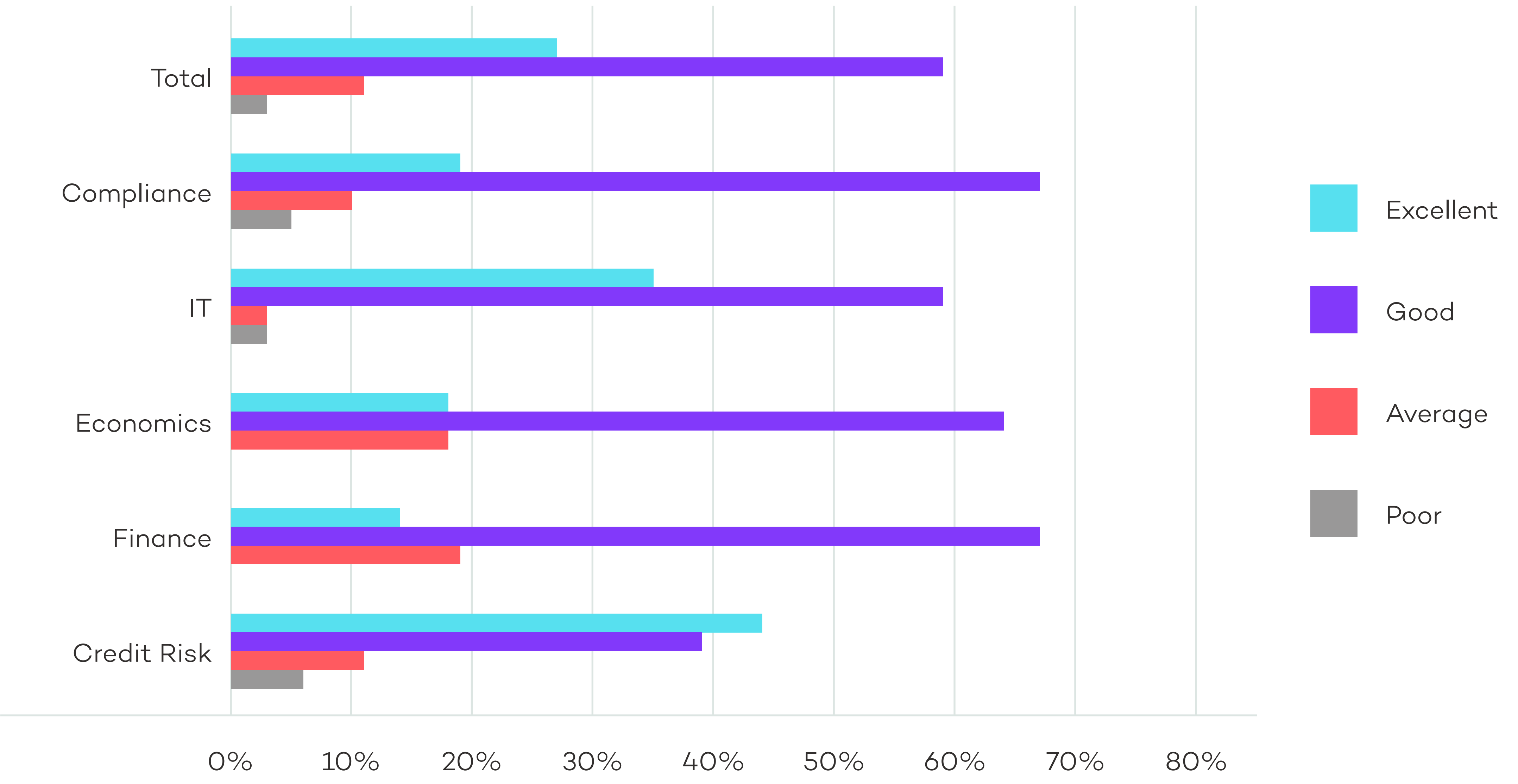
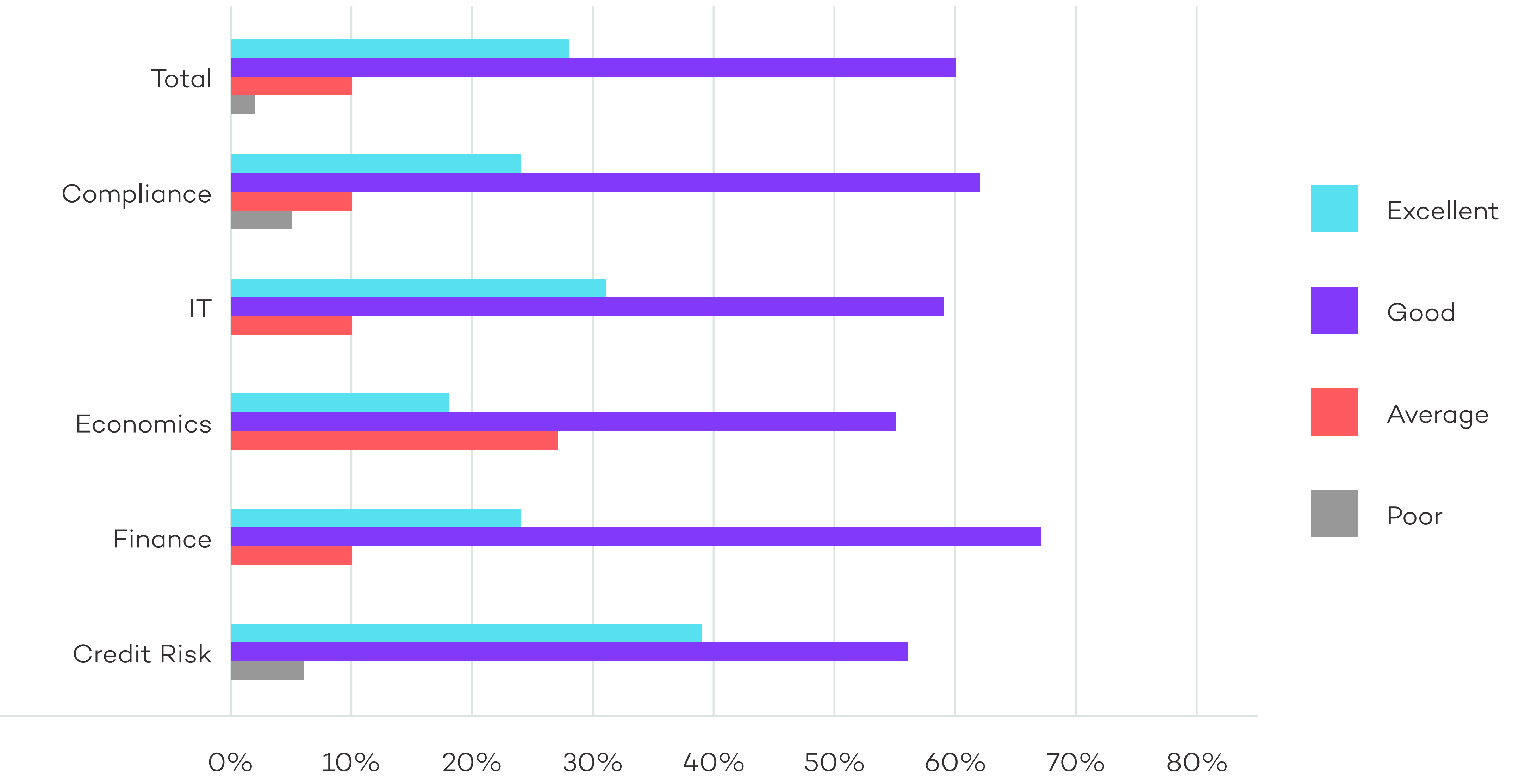


Figure 12: To what extent are you confident that you have enough data availability?



The keys to IFRS 9 success

We are working with lenders who have made significant headway towards IFRS 9 implementation. This experience and our new market research study has given us considerable insight into the challenges and opportunities in implementing IFRS 9.

Here are our nine keys to success:

1. Ensure all internal teams are working together under a unified approach
Our research revealed a disconnect between different job functions, yet getting everyone on the same page is crucial to success.

2. Assess long-term data requirements and adopt a best practice approach to data management
Modelling the new requirements is data intensive, and much of the data required for IFRS 9 provisions is held in seperate systems. The best approach is to have one centralised data store - a single version of the truth. A best practice approach to data management will not only help with IFRS 9, but many other regulatory requirements.

3. Design IFRS 9 models using the most appropriate methodologies
IFRS 9 requires loss forecasts that are more sophisticated and predict further into the future than ever before. Moreover, they require constant updates to ensure they remain accurate. That's why many firms are looking to adopt automated modelling software.

4. Build prototype models to test and learn methodologies and assess expected impact
Building or validating prototype models will enable the pros and cons of multiple methodologies to be identified in a manageable timeframe.

5. Refine models and adjust parameters to suit your organisations needs
A review of the figures from the prototype modelling and initial impact assessment stage may raise adequacy or stability questions. Automated software solutions allow firms to quickly and easily adjust parameters on models to refine models with agility.

6. Adopt clear, focussed model governance processes
Firms will need to make sure they are focusing on the right areas, with the right teams behind them who have a clear focus on what needs to be done now.

7. Begin implementation and testing phase early
The models must be implemented onto your systems and run in parallel alongside IAS 39 models for at least one year. Those that get a head start can identify issues early and put an appropriate remediation plan in place.

8. Consider ongoing model monitoring and impairment forecasting as part of the design
Models must be monitored regularly to ensure they remain fit for purpose. Ensuring your model solution incorporates monitoring from the start will ease the burden later on.

9. Incorporate IFRS 9 processes into business as usual during the parallel run
The key to success is to minimise the impact on your 'business as usual' teams. This can most easily be achieved by seeking outside help through expert advice and/or external software solutions.

Summary

IFRS 9 is demanding significant change. With the need for more sophisticated models to be developed and ran more frequently under more scenarios than ever before. In addition, continuing macro-economic volatility means models will need to be refreshed on a regular basis. And firms will need to respond to ad-hoc regulatory requests in a timely manner.

While regulations are placing greater accountability on firms, it's encouraging to see organisations becoming smarter in addressing regulatory requirements and using compliance as the catalyst to achieve business benefits beyond the regulatory tick box.

Organisations say the top benefits to achieving IFRS 9 implementation are:

- An opportunity to improve the infrastructure and processes within the business.
- Increasing model sophistication in-line with growth ambitions.

In addition, organisations are placing a lot of focus on the need for an integrated approach to IFRS 9, to ultimately achieve a cohesive risk environment.

Our research also revealed that while different financial services sectors are at differing stages in implementing IFRS 9 requirements, firms are confident in their progress to date compared to their peers. This may be due to many saying they are bringing in outside help, whether through expert advice or by adopting external software solutions.

This report concludes that while many organisations desire to achieve parallel run during Q2 2017, all departments need to adopt a more holistic and integrated approach and organisations need to ensure IFRS 9 models are built to a best practice standard to make this a reality.

Investing in the right software, tools and expert advice will not only help organisations achieve compliance, it will provide greater agility in their decision making process, ultimately enhancing efficiency and competitiveness and the ability to respond to changing conditions in the marketplace.

To see how we can help you turn this into a reality visit **risk.jaywing.com** to find out more about Horizon and our market leading IFRS 9 consultancy services.

IFRS 9. All wrapped up.

Horizon encapsulates years' of regulation and credit risk expertise into one affordable, fully integrated and automated IFRS 9 modelling solution.

Horizon can help you manage all aspects of IFRS 9 impairment modelling, or be used as a validation tool. It covers PD, LGD and EAD models, forecasts of future losses and allocation of assets into the impairment stages, as well as advanced reporting dynamics.

This integrated approach to IFRS 9 compliance leverages fully adjustable model parameters, transparent and auditable modelling components and a user-friendly interface.

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