IMPACT OF IMPLEMENTATION OF NEW ACCOUNTING STANDARD IFRS 9 (FINANCIAL INSTRUMENTS) ON SELECTED CZECH BANKS AND COMPARISON WITH THE EBA REPORT – "FIRST OBSERVATIONS ON THE IMPACT AND IMPLEMENTATION OF IFRS 9 BY EU INSTITUTIONS"

Antonín Kubíček

Abstract

The accounting standard IFRS 9 "Financial instruments" (hereinafter "IFRS 9") which replaced the accounting standard IAS 39 "Financial Instruments: Recognition and Measurement" (hereinafter "IAS 39") is effective for annual periods beginning on or after 1 January 2018. Implementation of IFRS 9 represented significant changes in comparison to previously used approach based on IAS 39.

The aim of this article is to provide overview of impact of IFRS 9 implementation on selected Czech banks for selected indicators. Moreover, European Banking Authority (hereinafter "the EBA") issued EBA report – "First observations on the impact and implementation of IFRS 9 by EU institutions" on 20 December 2018. This report provides impact assessments based on actual data reported by banks to competent authorities across 20 EU member states. However, the Czech Republic is not among the analysed EU member states and thus the second aim of this article is to compare selected indicators valid for selected Czech Banks with those mentioned in the EBA report.

Key words: IFRS 9, Financial instruments, Czech banking sector, EBA report, bank accounting

JEL Code: G21, M41

Introduction

Since November 2008 the International Accounting Standards Board (hereinafter "the IASB") has been working to replace IAS 39. The IASB structured the project in three phases:

- Phase 1: Classification and measurement of financial assets and financial liabilities
- Phase 2: Impairment

- Phase 3: Hedge accounting.

Although the IASB announced completion of IFRS 9 in July 2014, it has decided to separate the accounting for macro hedging from the accounting for general hedging and is still working on developing a new model for macro hedge accounting (KPMG, 2014). IFRS 9 offers companies the option to continue applying the existing IAS 39 hedge accounting requirements for all their hedging relationships until the IASB completes the project on accounting for macro-hedging.

The European Union has published a Commission Regulation (EC) No 2016/2067 of 22 November 2016 endorsing IFRS 9.

The significant changes of IFRS 9 in comparison to previously used approach based on IAS 39 (apart from not finalized hedge accounting requirements) are mainly driven by:

- introducing of a new accounting model for impairment, based on the expected losses instead of the previous approach based on the incurred losses;
- change to the classification and measurement of loans and debt instruments based on the "business model" and on the characteristics of the cash flows of the financial instrument (so called Solely Payments of Principal and Interest (hereinafter "SPPI") criteria) (UniCredit Group, 2018).
    - Thus, new classification and measurement categories under IFRS 9 are as follows:
        a) Fair Value Through Profit or Loss (hereinafter „FVPL");
        b) At Amortised Cost (hereinafter „AC"); and
        c) Fair Value Through Other Comprehensive Income (hereinafter „FVOCI").

The significant changes mostly affected a banking sector as IFRS 9 was intended to be a response to financial crisis that broke out in full with the bankruptcy of Lehman Brothers in September 2008.

The fiscal year 2018 is the first year when impact of implementation of IFRS 9 could be observed from publicly open sources issued by banks (e.g. half-year reports).

The aim of this article is to provide overview of impact of IFRS 9 implementation on selected Czech banks (7 Czech banks that issued half-year report as at 30 June 2018) for selected indicators (that could be observed in the half-year reports) and compare them with results presented in the EBA report – "First observations on the impact and implementation of IFRS 9 by EU institutions" as banks from the Czech banking sector are not included in the sample of the report.

1 Literature review

Many documents were issued accompanying, guiding the implementation or analysing the potential impact of the new standard prior effectiveness of IFRS 9 and reporting the transition to IFRS 9 after effectiveness of IFRS 9.

The documents accompanying IFRS 9 are Implementation Guidance IFRS 9 Financial Instruments (containing Illustrative Examples and Guidance on Implementing) and Basis for Conclusions on IFRS 9 Financial Instruments published by IASB. These documents accompany, but are not part of, IFRS 9 (IASB, 2014).

Main role within the documents guiding the implementation played documents issued by six largest international accounting networks (BDO, Deloitte, EY, Grant Thornton, KPMG and PwC) separately or in joint cooperation within The Global Public Policy Committee.

The EBA issued 3 reports in relation to IFRS 9 of which 2 were meant as impact assessment prior effectiveness of IFRS 9 (issued in November 2016 and in July 2017) and 1 as observations on the impact of IFRS 9 after effectiveness issued in December 2018 (this report will be used for further comparison with selected banks from the Czech banking sector in next parts).

The Czech National Bank (hereinafter “the CNB”) analysed the impact of IFRS 9 implementation on the Czech Banking sector in its Report on Financial Stability 2017/2018 issued in July 2018 (CNB, 2018).

The European Systemic Risk Board (hereinafter “the ESRB”) analysed the impact of IFRS 9 on overall financial stability in its publication Financial stability implications of IFRS 9 issued in July 2017 (ESRB, 2017).

Moreover, several articles exist that analyse impact of IFRS implementation on banking sectors in countries such as Poland or Brazil (Andrzejewski et al, 2018; Bista et al, 2018; Dantas et al, 2017).

2 Methodology

EBA report analysed IFRS 9 impact on 54 banks from 20 EBA countries. The sample includes banks at the highest level of consolidation under the prudential scope of consolidation of the following countries: Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Malta, the Netherlands, Norway, Poland, Slovenia, Spain, Sweden and the United Kingdom (the same sample as in two previous EBA impact assessments) (EBA, 2018).

The EBA report on IFRS 9 impact is divided between following areas with particular indicators:

- IFRS 9 Initial impact
  - Impact on CET1 ratio
  - Increase in provisions
- Classification and measurement
  - Share of financial assets per IFRS 9 category
  - Most relevant reclassifications between categories
- Impairment
  - Allocation of on-balance-sheet items per stage
  - Allocation of non-credit-impaired financial assets to stage 2
  - Non-performing exposures allocated to stage 3
  - Allocation of loan loss allowances per stage
  - Coverage ratio per stage

The EBA report is based on actual data reported by banks to competent authorities (COREP/FINREP templates) that contain more detailed informed than half-year report as at 30 June 2018. However, COREP/FINREP templates are not publicly available and therefore not all indicators can be analysed in this article. On the other side, half-year reports as at 30 June 2018 are first publicly issued documents at which analysis of IFRS 9 impact can be carried out.

Out of mentioned indicators following were selected for performing analysis on selected Czech banks that issued half-year report as at 30 June 2018:

- Increase in provisions
  - Description used in the EBA Report: "Initial impact IFRS 9 impairment - increase in provisions between the closing IAS 39 and opening IFRS 9 balance", i.e. impact as at 1 January 2018.
  - Used calculation from the half-year report as at 30 June 2018:

    $$Percentage\ increase\ in\ provisions = \frac{increase\ in\ loan\ loss\ allowances\ due\ to\ implementation\ of\ IFRS\ 9}{loan\ loss\ allowances\ as\ at\ 31\ December\ 2017}$$

    The amount of provisions (as at 31 December 2017 and impact of IFRS 9) for off-balance-sheet amounts (mostly provisions for loan commitments) not taken into account due to the fact that these provisions are included within different FS line than loan loss allowances for on-balance-sheet amounts.

- Share of financial assets per IFRS 9 category
  - Description used in the EBA Report: The allocation of financial instruments to the different categories under IFRS 9 as at 30 June 2018.
  - Used calculation from the half-year report as at 30 June 2018:

$$Share\ of\ financial\ assets\ per\ IFRS\ 9\ category = \frac{amount\ of\ particular\ relevant\ category\ under\ IFRS\ 9}{total\ of\ categories\ under\ IFRS\ 9}$$

- Allocation of on-balance-sheet items per stage
  - Description used in the EBA Report: Percentage of allocation of on-balance-sheet items to Stage 1-3, as at 30 June 2018.
  - Used calculation from the half-year report as at 30 June 2018:

$$Percentage\ of\ particular\ stages = \frac{gross\ amount\ of\ particular\ stage}{total\ gross\ amount\ of\ stages\ 1-3}$$

- Allocation of loan loss allowances per stage
  - Description used in the EBA Report: Percentage of total loan loss allowances allocated to Stage 1-3 on-balance sheet items, as at 30 June 2018.
  - Used calculation from the half-year report as at 30 June 2018:

$$Percentage\ of\ loan\ loss\ allowanes\ per\ stage = \frac{loan\ loss\ allowances\ of\ particular\ stage}{gross\ amount\ of\ particular\ stage}$$

Following Czech Banks are included in the analysis that issued half-year report as at 30 June 2018:

- Česká spořitelna, a.s.
- Československá obchodní banka, a. s.
- Equa bank a.s.
- Komerční banka, a.s.
- MONETA Money Bank, a.s.
- Raiffeisenbank a.s.
- UniCredit Bank Czech Republic and Slovakia, a.s.

3 Empirical analysis and findings

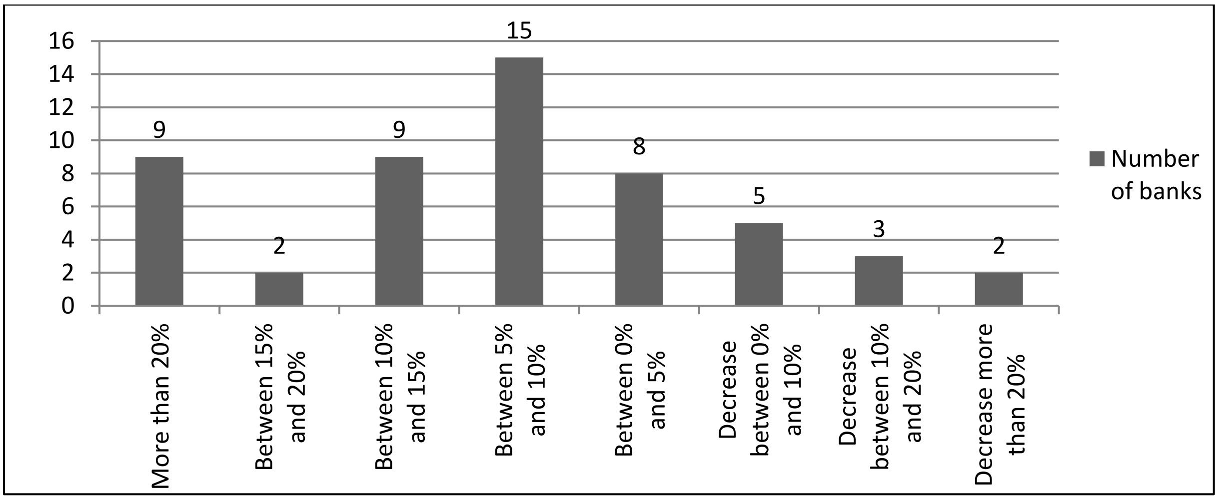
The results of selected indicators for the selected Czech Banks and comparison with the EBA report are analysed in this chapter.

3.1 Increase in provisions

Based on the EBA report the increase in provisions on the initial application of IFRS 9 amounts to 9% on simple average and the most common impact is between 5% and 10% - see the Figure 1 below.

Mentioned results could be interpreted that impact of IFRS 9 in relation to increase in provisions is insignificant. However, it must be highlighted that the results reflect relatively good economic conditions in the Europe and it does not indicate future trends (as provisions will be increased with worsening of the economic conditions with the expected losses approach, which means possible risk of pro-cyclical impact of IFRS 9 mentioned in the analysis by ESRB from July 2017).

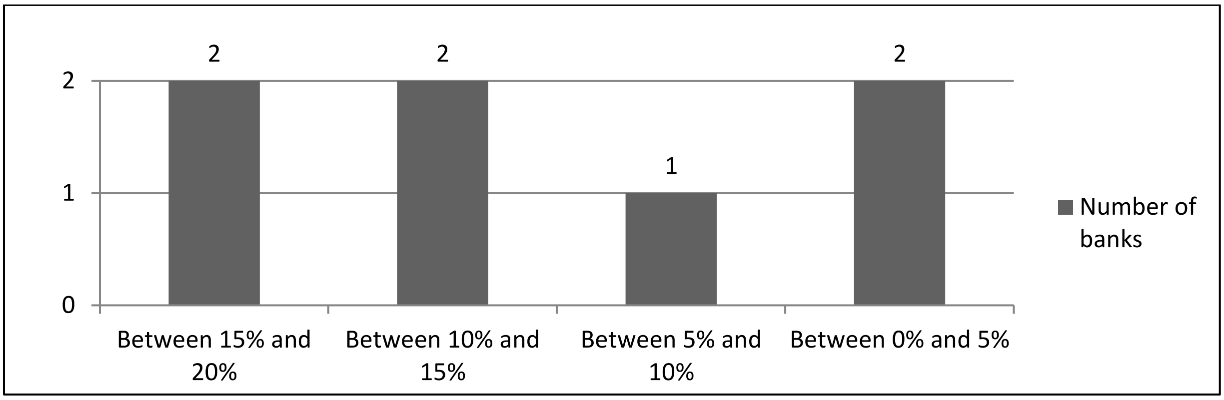
Fig. 1: Increase in provisions (simple average) – first-time application (reference date: 1 January 2018)



Source: EBA report, "First observations on the impact and implementation of IFRS 9 by EU institutions"

In the case of the selected Czech Banks the increase in provisions amounts to 10% on simple average which is in line with the EBA report. The increase is in the interval from 0,24% to 16,74%. In comparison to the EBA report there is no impact higher than 20% or negative impact in the case of the selected Czech Banks as can be seen in the Figure 2 below. CNB in its Report on Financial Stability 2017/2018 stated average increase of provisions on simple average by 12,9% based on real data from January 2018, which also corresponds to the EBA report and analysis presented in this article.

Fig. 2: Increase in provisions (simple average) - first-time application (reference date: 1 January 2018); selected Czech Banks



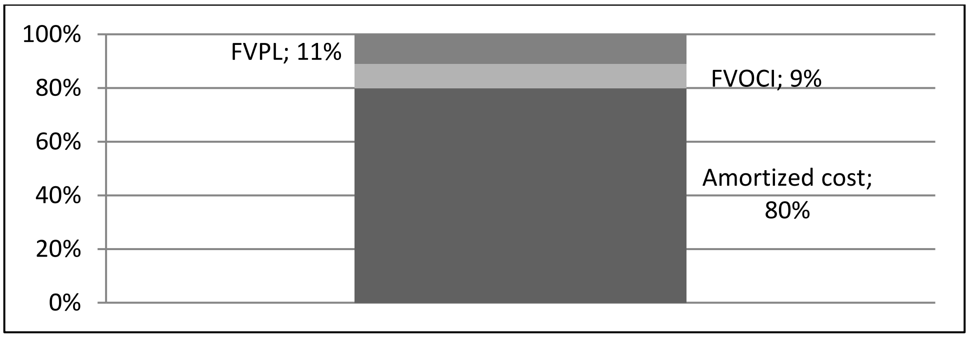
Source: own calculation from half-year report of particular bank as at 30 June 2018

3.2 Share of financial assets per IFRS 9 category

"The allocation of financial instruments to the different categories under IFRS 9 leads to an impact due to the changes in the measurement of those instruments" (EBA, 2018). However, it is stated in the EBA report that, on simple average, the impact of IFRS 9 measurement is, as expected, quite limited. This will be more analysed more deeply in the next indicator.

Based on the result presented in the EBA report the most financial instruments (80%) are represented by financial assets at amortised cost, which corresponds with most financial assets under IAS 39 represented by loans due from banks and clients.

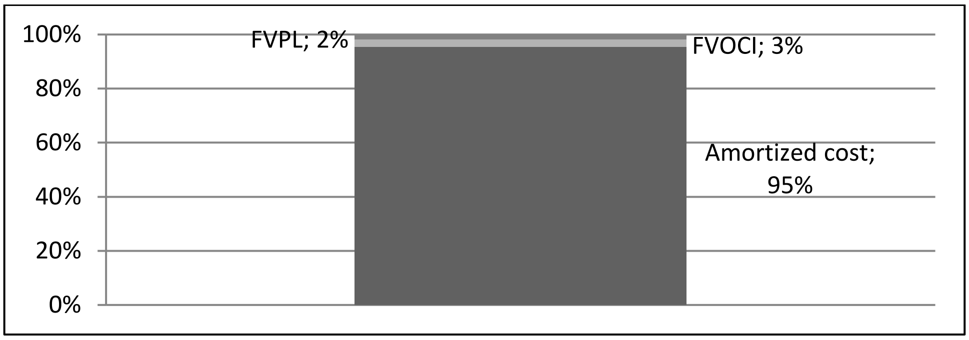
Fig. 3: Share of financial assets per IFRS 9 category (reference date: 30 June 2018)



Source: EBA report, "First observations on the impact and implementation of IFRS 9 by EU institutions"

In the case of the selected Czech Banks the share of financial assets at amortized costs is even higher (95%), which could be explained by conservative approach of the Czech banks aimed mainly on providing loans and with marginal other activities (see Figure 4 below).

Fig. 4: Share of financial assets per IFRS 9 category (reference date: 30 June 2018); selected Czech Banks



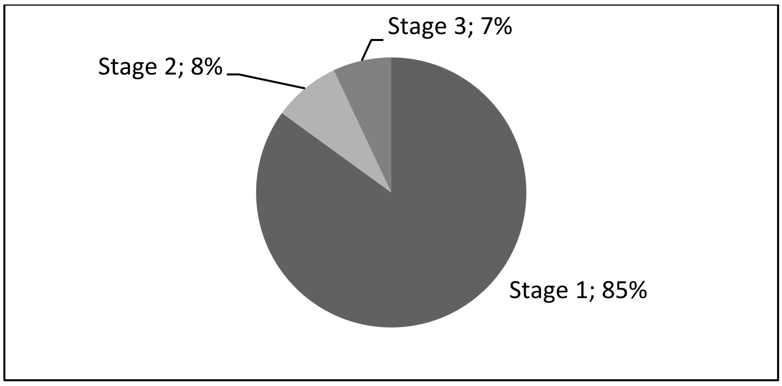
Source: own calculation from half-year report of particular bank as at 30 June 2018

3.3 Allocation of on-balance-sheet items per stage

In the EBA report majority of on-balance-sheet items per stage is represented by Stage 1 items (85% as it can be seen in the Figure 5 below). Such items represent items with insignificant increase of credit risk since initial recognition, items on Stage 2 represent items with significant increase of credit risk since initial recognition and items on Stage 3 represent defaulted items.

As it is stated in the EBA report this allocation does not allow the assessment of the relevant aspects related to staging. However, it is relevant to monitor how these numbers change in future reporting periods.

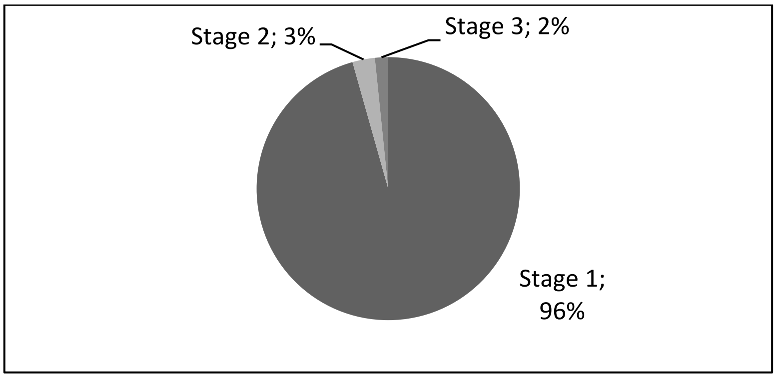
Fig. 5: Allocation of on-balance-sheet items per stage (simple average) (reference date: 30 June 2018)



Source: EBA report, "First observations on the impact and implementation of IFRS 9 by EU institutions"

In the case of selected Czech Banks the share of the on-balance-sheet items on Stage 1 is higher (96% as it can be seen in the Figure 6 below) which could be explained by higher credit quality of on-balance-sheet items of the selected Czech Banks. But in this case is valid as well the statement mentioned in the EBA report that it is relevant to monitor how these numbers change in future reporting periods.

Fig. 6: Allocation of on-balance-sheet items per stage (simple average) (reference date: 30 June 2018); selected Czech Banks

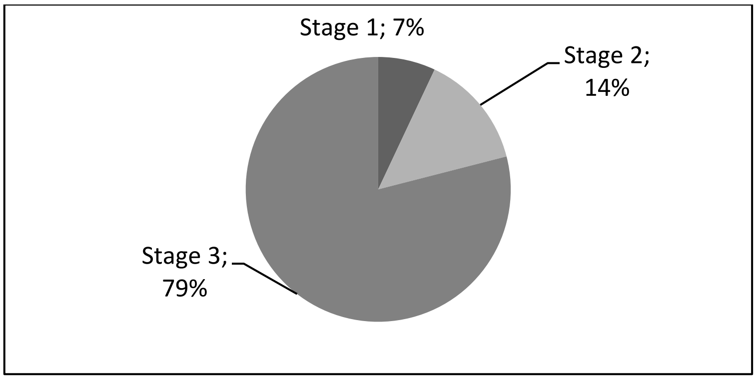


Source: own calculation from half-year report of particular bank as at 30 June 2018

3.4 Allocation of loan loss allowances per stage

The average allowances allocation corresponds with the credit quality of particular stage with the highest allowances allocation for the items on Stage 3 (79% as it can be seen in the Figure 7 below) representing defaulted items, lower allowances allocation for the items on Stage 2 (14%) and the lowest (7%) the items on Stage 3.

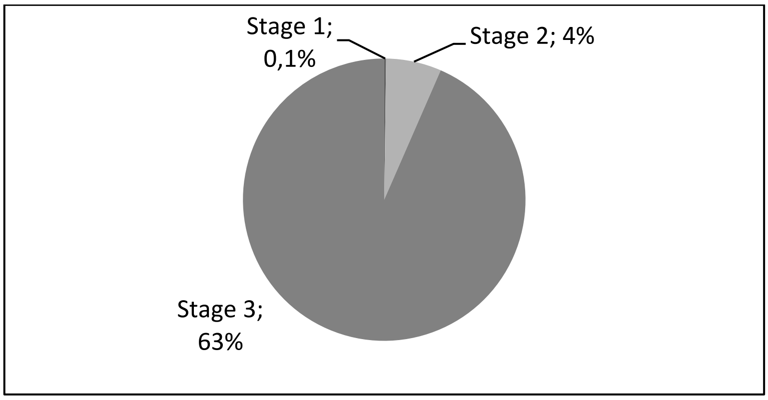
Fig. 7: Allocation of loan loss allowances per stage (simple average) (reference date: 30 June 2018)



Source: EBA report, "First observations on the impact and implementation of IFRS 9 by EU institutions"

The average allowances allocation in the case of selected Czech Banks is lower than in the EBA report (as it can be seen in the Figure 8 below) that could be explained by more collateralized credit exposures. The allowances allocation on Stage 3 (63,12%) is slightly higher than the allowances allocation for defaulted credit exposures mentioned in CNB Report on Financial Stability 2017/2018 of 55,6% based on real data from January 2018.

Fig. 8: Allocation of loan loss allowances per stage (simple average) (reference date: 30 June 2018); selected Czech Banks; selected Czech Banks



Source: own calculation from half-year report of particular bank as at 30 June 2018

Conclusion

From the methodology point of view the implementation of the new accounting standard IFRS 9 represented big theoretical and practical issue for all companies reported using IFRS standards.

However, the actual impact on profitability of European Banks is not so significant due to limited increase of loan loss allowances (increase in provisions on the initial application of IFRS 9 amounts to 9% on simple average). The same conclusion could be provided for the selected Czech Banks (increase in provisions amounts to 10% on simple average).

Nevertheless, it is important to remind that it is relevant to monitor impact of IFRS 9 on profitability in future reporting periods.

Regarding other indicators that were analysed in this article (measurement and classification categories, allocation per stages and allocation of loan loss allowances per stage) the same pattern in the indicators is observable in the selected Czech Banks as in the case of European Banks. However, the indicators in the case of selected Czech Banks show higher share of measurement category “At Amortized Cost” which could be explained by conservative approach of the Czech banks aimed mainly on providing loans and with marginal other activities. Share of on-balance-sheet items per Stage 1 is higher in the case of selected Czech Banks as well which could be explained by higher credit quality of these items.

References

Basis for conclusions on IFRS 9, Financial instruments. (2014) International Accounting Standards Board.

EBA Report - First observations on the impact and implementation of IFRS 9 by EU institutions. (2018) European Banking Authority Available at: https://eba.europa.eu/documents/10180/2087449/Report+on+IFRS+9+impact+and+implementation.pdf [online 2019-05-05].

Credit in Expected Credit Loss Model According to IFRS 9. Implications for Banks. (2018) Bista, A; Pawlowska-Szawara, E. 6th International Scientific Conference on IFRS *IFRS: GLOBAL RULES & LOCAL USE*, 315-327.

Credit Losses in Brazilian Banks: Expected Losses and Incurred Models and Impact of IFRS 9. (2017). Dantas, JA; Micheletto, MA; Cardoso, FA; Freire, AAPFD. *REVISTA DE GESTAO FINANCAS E CONTABILIDADE*, 7(2), 156-175. doi: 10.18028/2238-5320/rgfc.v7n2p156-175

Financial stability implications of IFRS 9. (2017). European Systemic Risk Board. doi: 10.2849/597293 [online 2019-05-05].

First Impressions: IFRS 9 Financial Instruments. (2014). KPMG IFRG Limited. Available at: https://assets.kpmg/content/dam/kpmg/pdf/2015/06/first-impressions-IFRS9-O-201409.pdf [online 2019-05-05].

Implementation guidance: IFRS 9. (2014). International Accounting Standards Board.

Annual report of selected Czech Banks. (2018):

- Česká spořitelna, a.s.,
  - Available at: https://www.csas.cz/static_internet/cs/Obecne_informace/FSCS/CS/Prilohy/2018_0213_cs_pololetni_zprava_2018__cz_09.pdf [online 2019-05-05];
- Československá obchodní banka, a. s.
  - Available at: https://www.csob.cz/portal/documents/10710/444804/csob-pololetni-zprava-1h2018.pdf [online 2019-05-05];
- Equa bank a.s.
  - Available at: https://www.equabank.cz/download/1214-pololetni-zprava-emitenta-k-30062018.pdf [online 2019-05-05];

- Komerční banka, a.s.
    - Available at: https://www.kb.cz/getmedia/88c4058a-4e7a-4395-b372-9cd2970740c7/KB-Half-year-report-2018-CZ-F.pdf.aspx [online 2019-05-05];
- MONETA Money Bank, a.s.
    - Available at: https://investors.moneta.cz/documents/1596084/4000875/MONETA+-+Consolidated+report+2Q__MASTER__CZ_FINAL.pdf/55ca2553-7cfc-8fa1-36a4-7aa0f6ffa48a [online 2019-05-05];
- Raiffeisenbank a.s.
    - Available at: https://www.rb.cz/attachments/pololetni-zpravy/pololetni-zprava-rb-18.pdf [online 2019-05-05];
- UniCredit Bank Czech Republic and Slovakia, a.s.
    - Available at: https://www.unicreditbank.cz/content/dam/cee2020-pws-cz/cz-dokumenty-2017/o-bance/vyrocni-zpravy/Pololetni_zprava_UCB_2018.pdf [online 2019-05-05].

Report on Transition to "IFRS 9: Financial Instruments" of UniCredit Group. (2018). Unicredit Group. Available at: https://www.unicreditgroup.eu/content/dam/unicreditgroup-eu/documents/en/investors/financial-reports/2018/1Q18/Report-on-transition-to--IFRS-9---Financial-Instruments--of-UniCredit-Group.pdf [online 2019-05-05].

The Effect of Implmentation of IFRS 9 in Financial Statements of Banks in Poland. (2018) Andrzejewski, M; Dunal, P; Ozga, P. 6th International Scientific Conference on IFRS *IFRS: GLOBAL RULES & LOCAL USE*, 104-114.

Zpráva o finanční stabilitě 2017/2018. (2018). Česká Národní Banka. Available at: https://www.cnb.cz/export/sites/cnb/cs/financni-stabilita/.galleries/zpravy_fs/fs_2017-2018/fs_2017-2018.pdf [online 2019-05-05].

Contact

Antonín Kubíček

UniCredit Bank Czech Republic and Slovakia, a.s.

Železavská 1525/1, 14092 Praha 4 - Michle

antonin.kubicek@unicreditgroup.cz