FIS Balance Sheet Manager: IFRS 9 Impairment

Unlock a streamlined approach across Impairment, ECL reporting and integrated risk planning

IFRS 9 impairment: Got it right the first time?

As the IFRS 9 standard came into force in 2018, the market observed a wave of time- and effort-intensive projects to accommodate for the new Expected Credit Loss (ECL) approach. However, evidence shows that the initial implementations have not always proven effective.

For example, the 2024 ECB report[1] highlights that most banks' provisions calculations fail to incorporate the short-term and long-term novel risks such as geopolitical events, inflation, interest rate hikes, energy supply, COVID and climate change. This raises concern that credit losses and capital requirements might be underestimated due to inadequate processes.

Further related concerns about IFRS 9 implementations are expressed by EBA[2] and the Bank of England,[3] mentioning improper inclusion of forward-looking information and overreliance on subjective overlays in modeling. The regulators encourage institutions to improve their ECL models to ensure more robust and consistent outcomes, as well as improve the transparency of ECL disclosures. The combination of ECL parameter and model error may result in a regulatory capital overlay to encourage banks to adopt a more robust impairment estimation model.

From a financial institution's perspective, the emphasis on accurate and timely loan loss provisioning is tightly linked to the accurate pricing of credit facilities (e.g. via inclusion of respective Cost of Credit), as well as closer integration across risk, accounting, finance and treasury to support the bank's portfolio management activities across stress testing and limit setting. The introduction of the forward-looking ECL model has driven a closer alignment across risk, finance and treasury, making ECL management an essential part of information support for firm-wide risk and budget decisions, requiring a high degree of automation, flexibility and quality of outputs.

Practice shows that the initial "tactical" IFRS 9 ECL tools often fail to address growing regulatory expectations and the internal management needs (such as what-if and attribution analysis) for asset quality management, provisions steering and the support of forward-looking strategic decisions for risk mitigation under changing economic conditions.

FIS® Balance Sheet Manager IFRS 9 Impairment solution helps financial institutions put their money to work to accommodate increasing ECL modeling, planning and reporting needs. The solution streamlines the ECL production process and helps build value for the business, leveraging the strong simulation and scenario toolset for "what-if" analysis, forecasting and stress testing of loss allowances. It also takes into consideration institution-wide credit-adjusted indicators under various business strategies and economic conditions.

1. IFRS 9 Overlays and Model Improvements for Novel Risks, ECB, July 2024
2. IFRS 9 Implementation by EU Institutions: 2023 Monitoring Report, EBA, November 2023
3. Thematic feedback on accounting for IFRS 9 ECL and climate risk, Bank of England PRA, September 2024

Supporting ECL and impairment processes with FIS Balance Sheet Manager

As an integrated part of the broader FIS Balance Sheet Manager platform, IFRS 9 Impairment functionalities provide support for the entire spectrum of impairment and impairment-related processes as depicted below.

Accounting/Analysis/Planning

ALM/ERM

ECL Production

- ECL calculation
- Segmentation and risk parameter allocation
- Collateral allocation (per user definable ECL periods)
- PD, LGD and EAD calculation
- Effective interest rate (EIR)
- Stage allocation (CQS)
- Results, reports and disclosures

What-if & Simulations

- Simulation of new deal acquisition
- Changes of scenario and model assumptions
- Quantitative impact on loss allowances

ECL Forecasting

- Alternative macro and new business dynamics
- Stage transition modeling
- Collateral modeling and reallocation
- Future loss allowances under various scenarios
- Management of loss allowance volatility

Integrated Planning

- Credit adjusted cash flow and liquidity forecast
- Credit adjusted income/NII
- Integrated P&L and capital planning
- Integrated stress testing across the institution

FIS Balance Sheet Manager: IFRS 9 Impairment functionalities

Impairment production: Improving operational efficiency

FIS Balance Sheet Manager helps financial institutions streamline the IFRS 9 ECL process, facilitating the calculation of booking and disclosure-relevant impairment information in a timely and reliable manner.

The solution accommodates individual ECL calculation needs of financial institutions with a high degree of flexibility in terms of probability of default (PD), loss given default (LGD) and exposure at default (EAD) calculation and modeling. The parameters such as PD, LGD or credit conversion factors (CCF) can be delivered externally or calculated within the models defined in the solution, which further facilitates what-if analysis and scenario simulation.

FIS Balance Sheet Manager supports flexible segmentation of portfolios based on relevant dimensions (either by sub-portfolio such as commercial real estate (CRE), or by product like credit cards). It can also deliver risk parameters or assign models at a facility, rating grade or portfolio level. The parameters then get automatically allocated to the individual contracts to facilitate the deal-level ECL calculation.

For accurate LGD estimation, the solution facilitates collateral allocation and valuation under inclusion of forward-looking scenarios. Within the solution's forecasting framework, collateral value can be modeled over time and stress-tested for potential changes in asset prices or broader macroeconomic scenarios.

The solution offers flexibly adjustable rules for allocating pledged collateral to different exposures, allowing support for a broad range of cases up to complex N:M relationships in corporate portfolios. Prioritization rules can be further structured to ensure that the riskiest exposures are secured first, considering factors such as customer rating, exposure remaining maturity and currency, while also defining the order of utilization for different collateral types and guarantees.

Intermediate steps of sequential collateral allocation process are also traceable for reconciliation purposes. LGD modeling takes into account the collateral allocation results to reflect the impact of different collateral types used to secure the exposure on LGD valuation.

To facilitate credit quality stage (CQS) allocation, the solution offers the flexibility to select relevant allocation criteria and define the staging logic through easily configurable rules and thresholds. The rules can be based on position characteristics (e.g. days past due, default flag, etc.), computed results (e.g. standardized PD), or observed changes over time (e.g. change in rating or PD, compared to origination) to reflect the credit quality deterioration. Additionally, based on the stage a contract is allocated to, either the 12-month expected credit loss (ECL) or the lifetime ECL is selected to determine the loss allowance values for booking in the general ledger.

To enable IFRS 9 disclosures as well as internal analysis, the solution keeps the history of both 12-month and lifetime ECL, along with intermediate results (e.g. PD, LGD, EAD). This facilitates outputs such as stage transition matrix between any given reporting dates, displaying the changes in total impairment amounts caused by contracts transitioning between stages and by other effects (such as matured or newly originated positions).

The multidimensional reporting framework of the solution supports automatic generation of institution-specific reports and dashboards, helping to monitor and proactively manage the impairment levels and overall asset quality, perform attribution analysis of ECL changes by period, and automatically export results at the defined level of details.

FIS Balance Sheet Manager Impairment dashboard examples

For a more robust and automated impairment calculation process, the solution enables required controls for security, auditability, approvals and 4-eye checks, plausibility validation and traceability of results. To facilitate reconciliation, an automatic process based on user-defined rules and thresholds helps to validate the provided inputs (e.g. against G/L values) or computed ECL results (e.g. comparison to past periods).

When a reconciliation test fails, users can be notified or processes suspended to trigger manual validation.

FIS Balance Sheet Manager IFRS 9 Impairment solution allows institutions to manage the entire ECL process chain, from the stage allocation of the contracts through ECL calculation, to disclosures, reports and outputs for general ledger booking.

What-if analysis and simulation

In addition to supporting IFRS 9 production, FIS Balance Sheet Manager helps to apply the relevant analysis for proactive ECL management across risk, treasury and finance, including:

- Analysis of “what-if” large exposures or alternative lending strategies, helping to define the respective impact on ECL, loss allowance and relevant metrics (such as cost of risk and cost of capital). See more details in the section covering integrated planning.
- Impact of shocks to model and scenario parameters to address the questions such as: ”What happens if PD for a given portfolio/segment increases by 10%?” or, “How would the alternative macro scenarios (inflation, GDP, interest rate changes) impact our ECL?”
- Model validation/analysis of alternative risk parameter segmentations and models, to justify potential changes of current production setup for decision-makers and auditors.

ECL planning and stress testing

The FIS Balance Sheet Manager ECL forecasting framework enables institutions to plan and stress-test impairment and ECL amounts under various scenarios including budget and alternative stress cases. The convenient scenario setup master helps to incorporate a range of drivers for complete projection of ECL for future periods.

- Business dynamic assumptions under various business strategies (loan portfolio growth, change of product mix, new products/investment strategies, customer behavior)
- Macroeconomic driver dynamics (constant rates, industry- or market-specific stress, recovery/recession, etc.) along with inclusion of relevant risk factors into point-in-time risk parameter models to reflect their impact on PD/LGD dynamics
- Collateral modeling and reallocation effects, reflected in time-dependent LGD valuation
- CQS transitioning of contracts over the course of the simulation, such as moves from Stage 1 to Stage 2 (significant increase in credit risk, SICR) and ultimately Stage 3 (impaired)

The solution's powerful cash-flow and scenario simulation engine enables the calculation of loss allowances at future reporting dates under inclusion of all defined drivers, incorporating the resulting changes to exposure, collateral valuation and credit risk parameters.

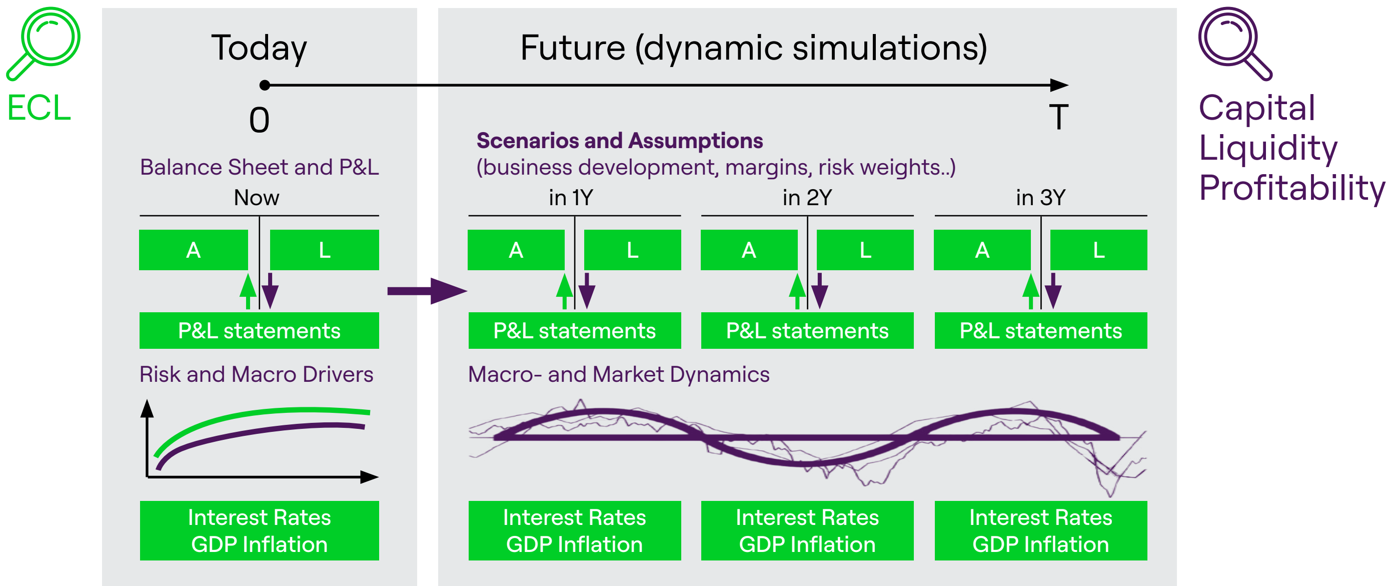
As such, FIS Balance Sheet Manager ECL forecasting toolset provides senior management with the ability to optimize the portfolio limits setting, helping institutions stay competitive in a volatile operating environment.

ECL as part of integrated planning: Credit-adjusted ALM, ICAAP, Cost of Risk

While providing the possibility to project and stress test the impairment amounts, FIS Balance Sheet Manager integrated planning framework allows to consider the expected credit loss effects within broader risk management and planning scope. Selected use cases include:

- Calculation of credit-adjusted cash flows and income, incorporating the effects of credit risk parameter changes (such as PD/LGD) on the institution's liquidity and NII, e.g. change in cash flows due to borrowers' defaults or recovery, or projection of expected NPL dynamics with the respective impact on income/NII.
- Integrated capital planning, which includes the impact of impairment and loan loss provisions on retained earnings and available capital. The solution facilitates forecasting and stress testing of the firm's balance sheet, profit and loss (P&L) statements, capital ratios and related metrics such as cost of risk, cost of capital and RAROC. The comprehensive scenario framework of FIS Balance Sheet Manager allows projection of core KPI dynamics under broad range of management and regulatory scenarios, among others for ICAAP, Recovery Capacity (as part of recovery planning), and Valuation in Resolution (ViR) support (as part of resolution planning).
- Risk-based pricing that leverages ECL results to incorporate credit risk costs into pre-deal product pricing through margin or spread calculations. Banks can then set the right incentives for business lines, facilitating profitability and risk management processes.

FIS Balance Sheet Manager solution helps bridge the gap between credit risk management and other functions such as asset liability management (ALM), liquidity management, financial planning and integrated stress testing. With this solution, a financial institution can more accurately incorporate available credit risk information into firm-wide strategic decision making.



ECL as part of Integrated Planning

Why choose FIS Balance Sheet Manager for IFRS 9 Impairment?

In current dynamic markets, where both growing regulatory attention to quality of ECL implementations and increasing collaboration needs between departments put higher demands on risk management and planning processes, institutions need streamlined IFRS 9 Impairment systems that provide the flexibility, transparency and basis for integration across departments.

The FIS Balance Sheet Manager IFRS 9 Impairment solution helps financial institutions make their money work harder to resolve common challenges around ECL calculation and management, improve process efficiency and leverage the synergies between risk, finance and accounting.

About FIS Balance Sheet Manager

As a trusted partner of 600+ financial institutions, FIS Balance Sheet Manager is actively used by treasury, finance and risk departments around the globe, providing an integrated modular platform for the following subject matters:

- ALM/IRRBB/CSRBB
- Hedge accounting
- Liquidity risk (incl. LCR, NSFR, ALMM)
- Market risk and stochastics
- IFRS 9 impairment
- Funds Transfer Pricing (FTP)
- Credit VaR
- Capital management

With an intuitive, user-friendly interface, out-of-the-box functionalities or custom setup, and multi-dimensional planning and reporting capabilities, Balance Sheet Manager is suitable for institutions of various size and complexity.

Our team is experienced in configuring the platform to comply with regulatory standards and meet internal needs. The solution can be easily customized to accommodate internal management and reporting, risk appetite exercises, financial planning and budgeting, as well as stress tests and recovery and resolution planning (RRP).

Learn more: fisglobal.com/products/fis-balance-sheet-manager

FIND YOUR UNLOCK

FIS Balance Sheet Manager allows you to manage material risks to make money work harder, driving sustainable growth.

Our technology powers the global economy across the money lifecycle.

Money at rest

Unlock seamless integration and human-centric digital experiences while ensuring efficiency, stability, and compliance as your business grows.

Money in motion

Unlock liquidity and flow of funds by synchronizing transactions, payment systems, and financial networks without compromising speed or security.

Money at work

Unlock a cohesive financial ecosystem and insights for strategic decisions to expand operations while optimizing performance.

About FIS

FIS is a financial technology company providing solutions to financial institutions, businesses and developers. We unlock financial technology that underpins the world's financial system. Our people are dedicated to advancing the way the world pays, banks and invests, by helping our clients confidently run, grow and protect their businesses. Our expertise comes from decades of experience helping financial institutions and businesses adapt to meet the needs of their customers by harnessing the power that comes when reliability meets innovation in financial technology. Headquartered in Jacksonville, Florida, FIS is a member of the Fortune 500® and the Standard & Poor's 500® Index. To learn more, visit FISglobal.com. Follow FIS on LinkedIn, Facebook and X (@FISglobal).

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