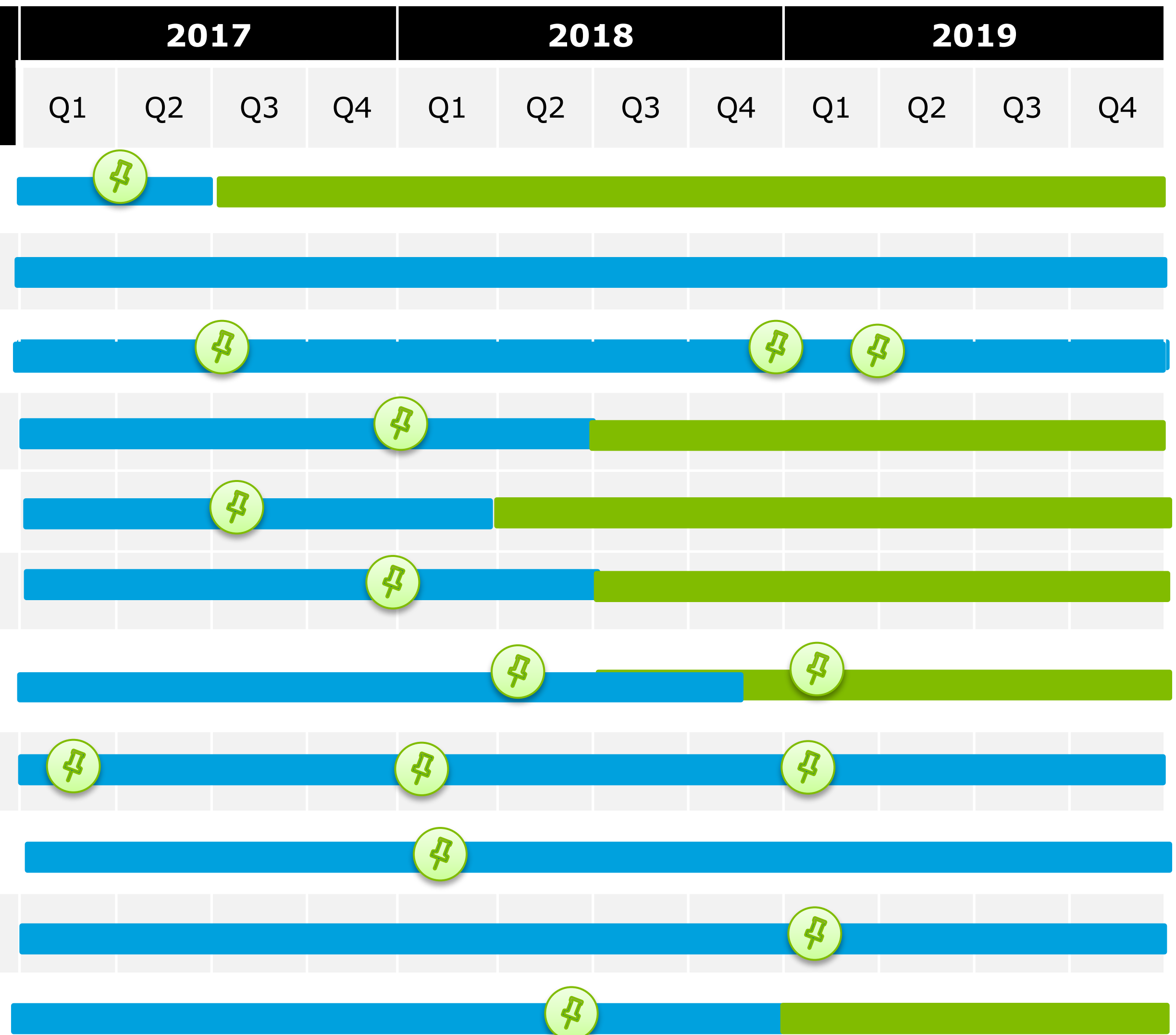
Summer Banking Academy

Dimitrios Goranitis

The EU banking regulatory transformation agenda

2017-2019 requires a significant commitment from the banking sector to transform, innovate and comply

Area	Statutory deadline
AMLD IV	June 2017
ECB TRIM	2016-2020
EMIR	End in 2020
IFRS 9	1st January 2018
MAR	3rd July 2016
MiFID II	1st January 2018
PSD 2	1st January 2018
Basel III/IV	On-going
ECB NPL	1st January 2018
BRRD	Annual submission
GDPR	25th May 2018

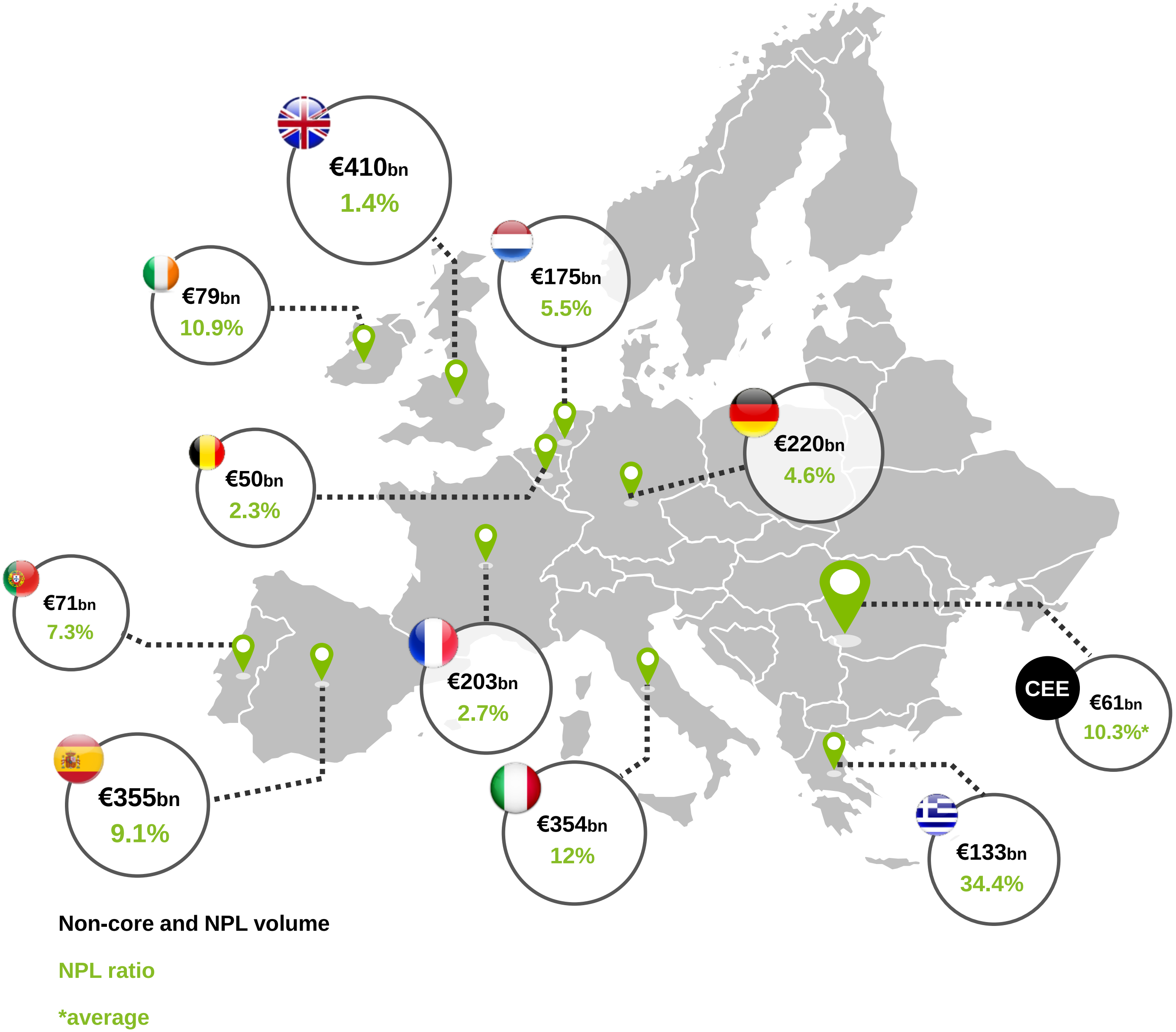


Key focus — Ongoing work — Implementation dates

Non Performing Loans – EU's perspective and ESA's guidance

European market overview

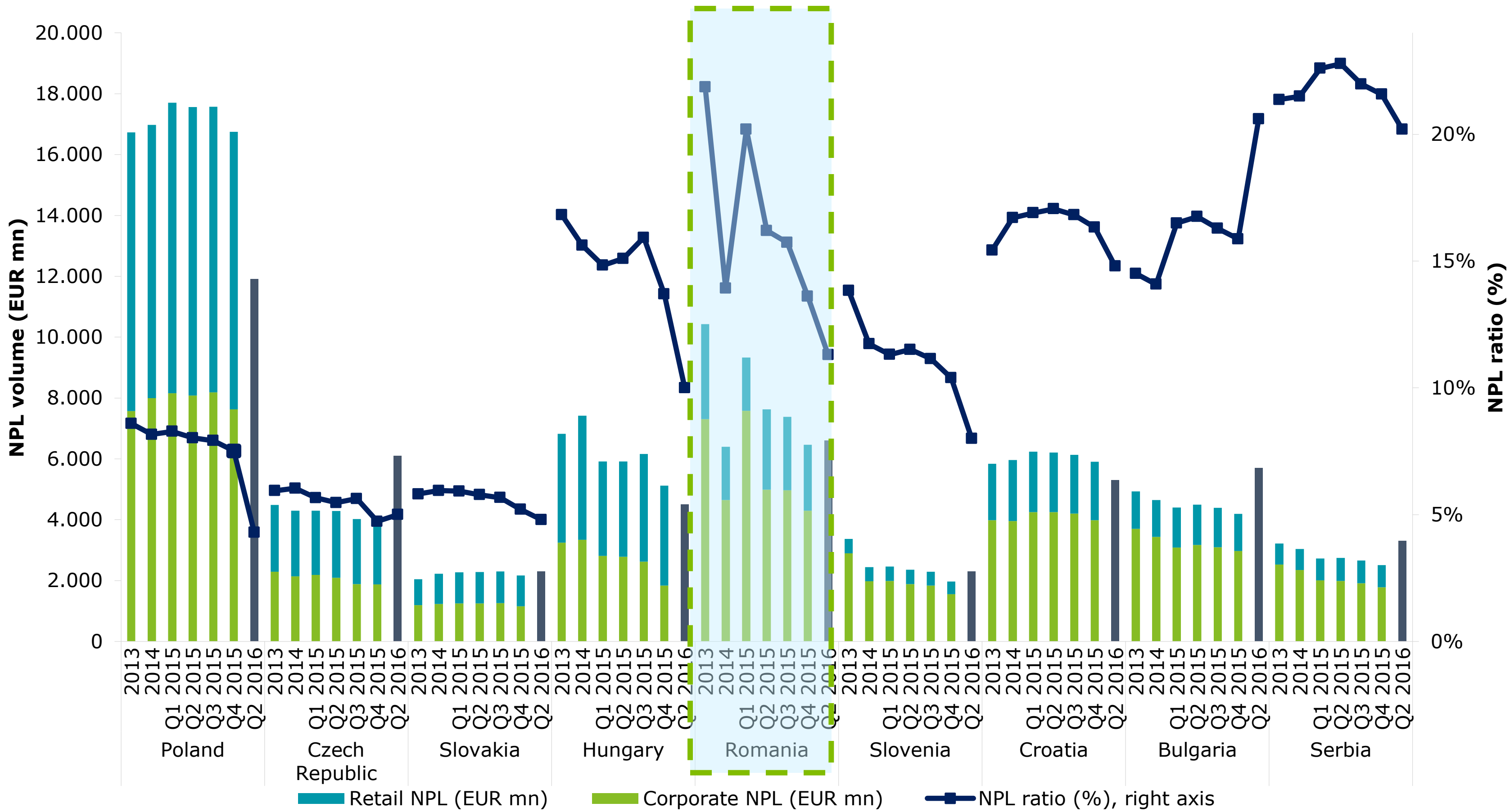
Maturing but growing NPL Western European markets and Emerging Southern European markets increase competition for lenders



- Strong activity levels seen in Southern Europe, led notably by Italy and Spain
- Improving economies are bringing better values for loan securities
- Regulatory pressures continue to push banks to resolve NPL and non-core issues
- Deal rate is expected to rise in 2017 as paused deals are completed
- Shift in the asset mix expected

Both NPL volumes and ratios fell in 2016 compared to 2014

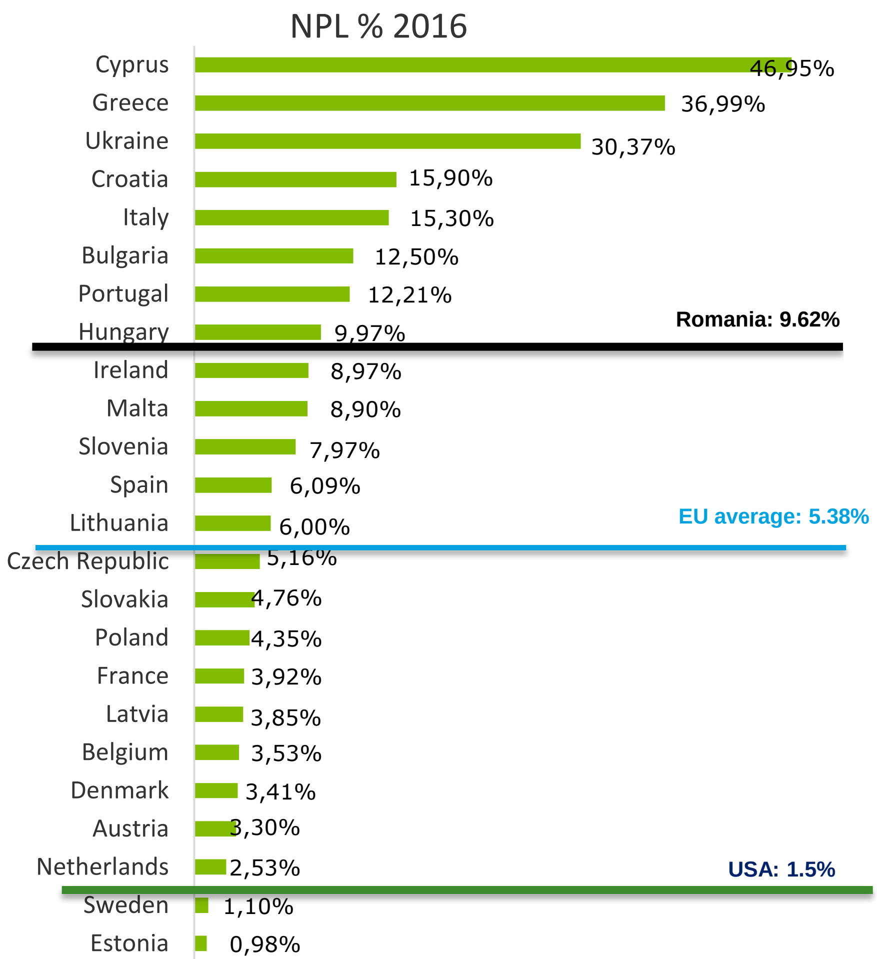
While first wave of NPL divestments Romania was completed there is increasing focus in emerging CE NPL markets



Source: National Banks, Deloitte analysis
Source of NPL volumes as of Q2 2016: NPL Monitor for the CESEE, 2H 2016. Breakdown of total NPL volume is not available.

EU defines NPL rate as the main obstacle for EU’s economic growth

ESAs and EU set ambitious targets for EU’s NPL rates



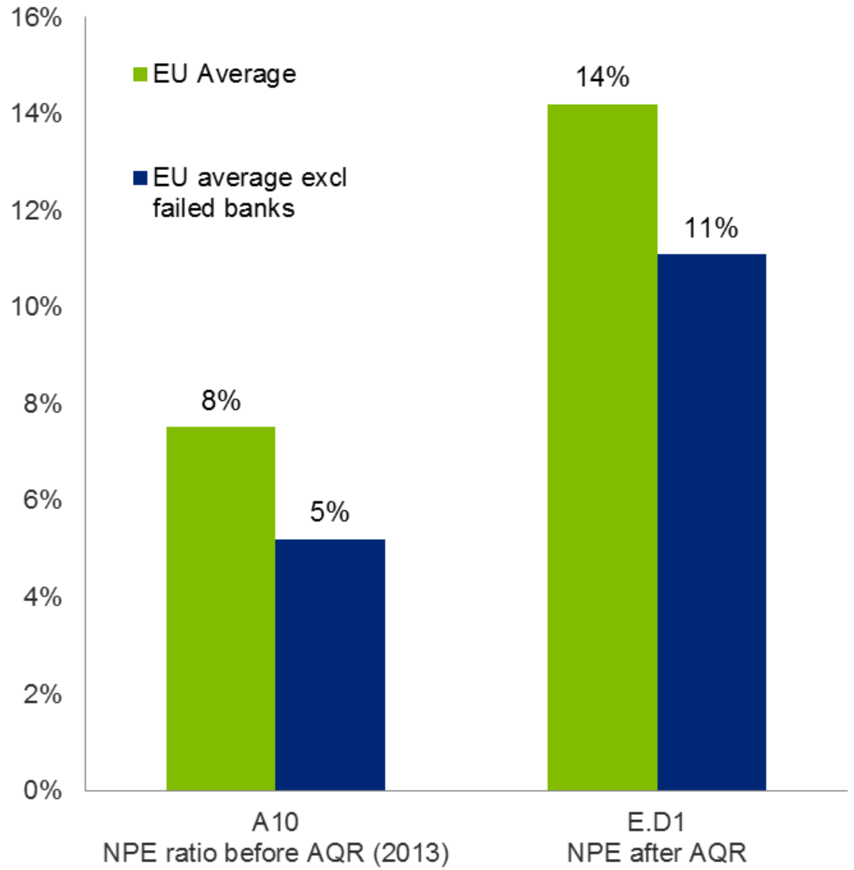
Source: World Bank

“We expect the institutions to apply it in full. We want banks to manage this issue much more proactively. Banks will need to explain any deviations from the guidance and non-compliance may trigger supervisory measures” *Sharon Donnery, Deputy Governor of the Central Bank of Ireland and Chair of the ECB’s High Level Group on NPLs*

What was the effect on AQR to Eurozone's NPL levels

How will 2018's AQR affect the Romanian NPL levels

AQR NPE ratios comparison



- The AQR resulted in aggregate adjustments of **€47.5 billion** to participating banks' asset carrying values as of 31 December 2013.
- Additionally, non-performing exposure (**NPE) stocks were increased by €135.9 billion** across the in-scope institutions, as NPE definitions were moved onto a harmonised and comparable basis, including the examination of forbearance as a trigger of NPE status.
- **Capital shortfall of €25 billion** detected at 25 out of 130 participant banks
- **Adverse stress scenario would deplete banks' capital by €263 billion**, reducing median CET1 ratio by 4 percentage points from 12.4% to 8.3%

Source: ECB's AQR results: https://www.bankingsupervision.europa.eu/banking/comprehensive/html/index.en.html

New ECB Guidance on non-performing loans

A strategy beyond transactions

Strategy

- Assess internal capabilities
- Set out a NPL Strategy to align the NPL ratio with EU average in 3 years, using annual targets
- Report in detail 6-monthly to Supervisor on performance to plan
- Require an Operational plan to implement the

Strategy

- “Embed” Operational plan and Strategy

Governance and operations

- Invest in policies, procedures, IT, reporting
- Monitoring through a framework of KPIs to measure progress regarding NPL workout activities

Collateral valuation

- Independent, qualified etc. market valuations for NPL collateral
- If collateral is part of a Going concern impairment then must be discounted for liquidation costs, time to cash, holding costs & use a “market price adjustment”
- Valuation of foreclosed assets
- Bank must monitor and control quality of the appraisals: selection, report level and back testing

Recognition

- Best practice for applying **NPE**, that is the expectation from now rather than NPL
- Detailed prescription of Unlikely to Pay criteria
- Forbearance refers to concessions and financial difficulties
- Forbearance would lead to Non performing classification
- Migration tightly restricted

Forbearance

- Only “viable” forbearance to be conducted
- Sound forbearance processes and mandatory affordability assessment
- Disclosure of credit quality of forborne exposures, quality of forbearance, net present value impact

Impairment and write off

- Back-testing of provisioning models
- Going Concern method
- Collective provisioning more tightly controlled: models will have to be revisited
- Timely write off of provisioned loans whether legal processes finished or not

IFRS 9 – A transformation beyond accounting

The IFRS9 transformation

Key findings from the Sixth Global IFRS banking survey

Total estimated programme budgets continue to increase. However, more than **three quarters** of these budgets have yet to be spent, with less than 2 years to transition date.

Almost **half** of banks think they do not have enough technical resources to deliver their IFRS 9 project and almost a **quarter** of these do not think that there will be sufficient skills available in the market to cover shortfalls.

60% of banks either did not or could not quantify the transition impact of IFRS 9. Of the banks who responded, the majority estimate that total impairment provisions will increase by up to **25%** across asset classes.

70% of respondents anticipate a reduction of up to **50 bps** in core tier 1 capital ratio due to IFRS 9. The vast majority does not know yet how their regulators will incorporate IFRS 9 numbers into regulatory capital estimates.

Most price makers expect that moving to an ECL model will have an **impact on product pricing**, while most price takers still think that this is unlikely to have an impact on product pricing.

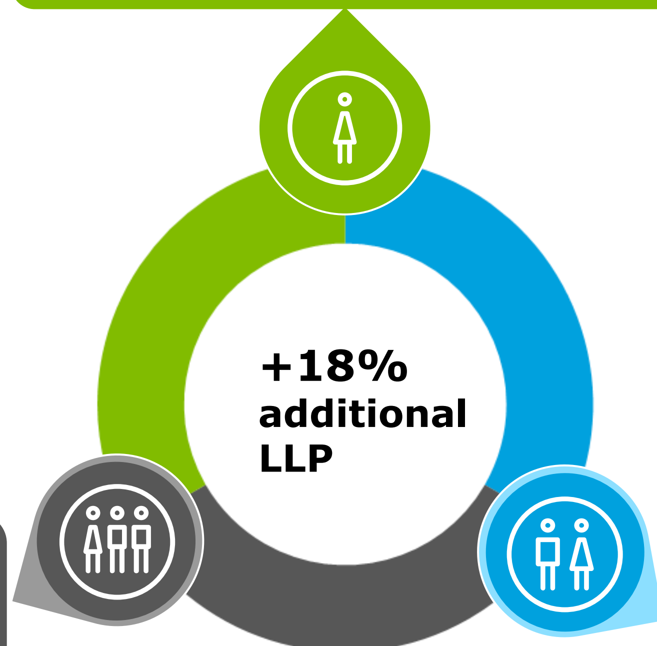
In general, approximately **half** of participants are unsure of the answer to many key modelling design questions, which may delay banks' IFRS 9 programmes.

Data quality and, in particular, the **availability of the origination lifetime PD**, is the biggest data concern for the majority of banks.

Despite IAS 8 requirements and EDTF recommendations, over **40%** of banks do not plan to disclose quantitative information before 2018.

EBA impact assessment of IFRS 9 estimates 18% increase in provisions for EU banks

The smaller banks surveyed are lagging behind in their preparation compared to larger banks



75% of the banks included in the survey anticipate that IFRS 9 impairment requirements will increase volatility in profit or loss.

Data quality and availability are the most significant challenges for banks. Specifically, risks to data quality primarily stem from the expected use of different sources of data from different departments - compliance with BCBS 239 principles.

IFRS 9 impairment modelling

Internal alignment will be required

Strategic impact of IFRS 9 impairment modelling

Impact of new loan loss provisioning

- Loan Approval Process
- Credit portfolio management

Lifetime PD, LGD, EaD models

Macro economic scenarios

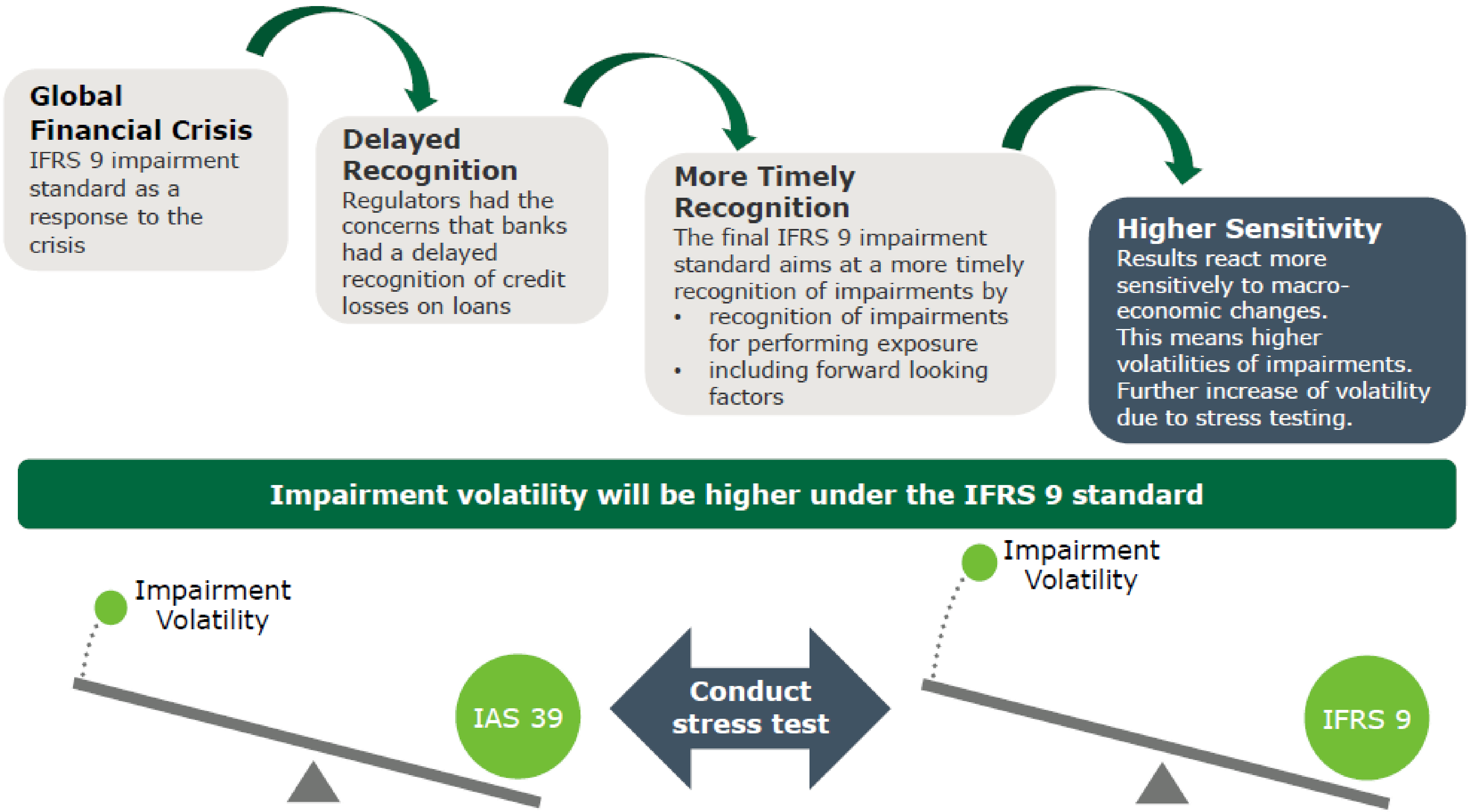
Issues of Bank steering

- Loan Approval Process
- Pricing of loans
- Capital Planning
- Stress-testing
- Asset Manage-ment
- Portfolio steering

- Life time PD, LGD and EaDs or macroeconomic forecasts should also be used for these bank steering issues
- The regulator expects a harmonized model landscape within the bank (e.g. ICAAP)
- This will also save time and resources because forecasts and stress tests scenarios have to be generated only once

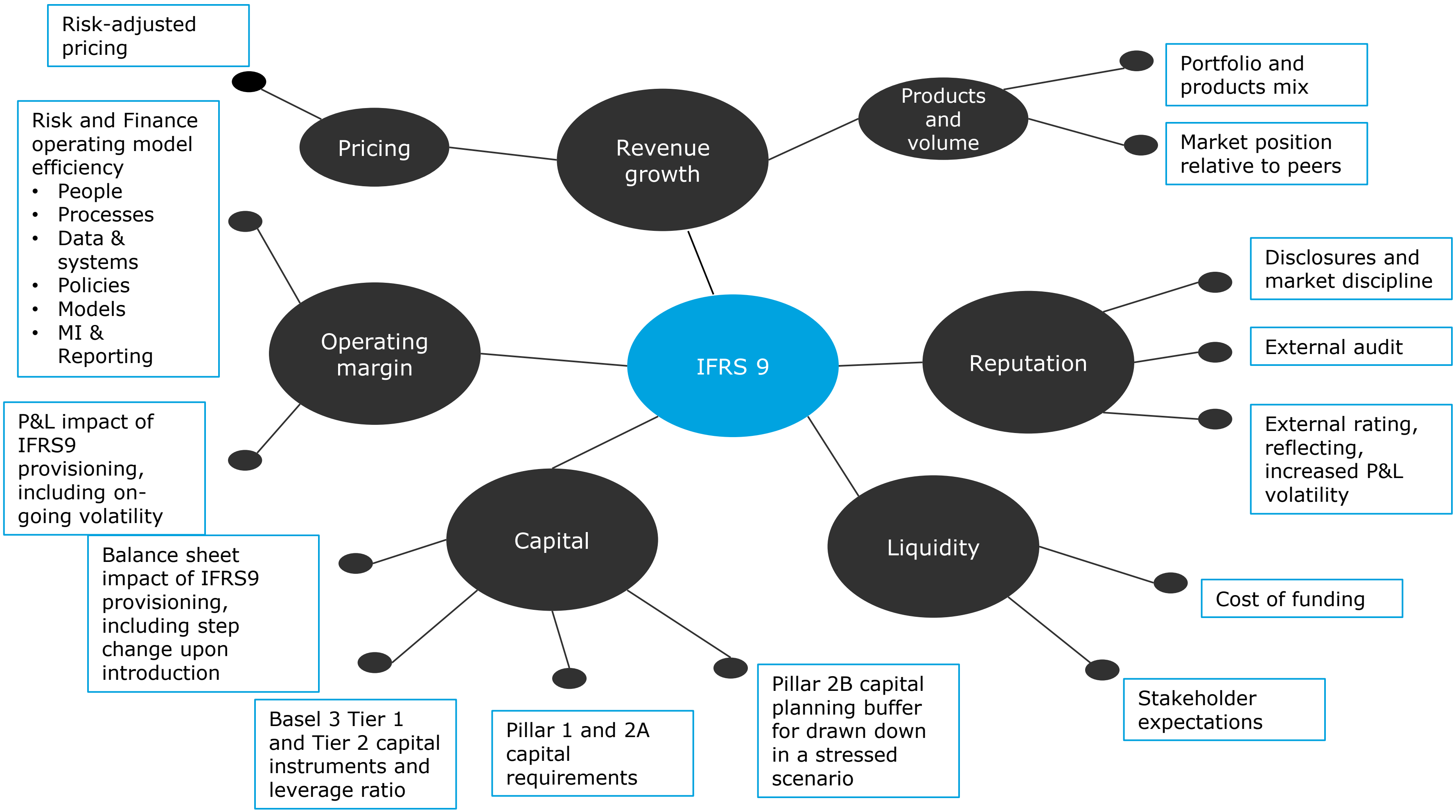
IFRS 9 impairment: Under EBA's focus

The IFRS 9 standard aims to increase impairment volatility



IFRS 9 – A change beyond impairment modelling

IFRS 9 creates wider challenges for organisations beyond the direct, quantifiable impact on impairment and P&L with indirect but material impacts on a wide range of factors contributing to shareholder value.



Dimitrios Goranitis
Romania – Financial Services Industry Leader
Partner, Deloitte Central Europe
Tel: +40 751 250 884
Email: digoranitis@deloittece.com