

# IFRS 9 implementation in the banking system of Ukraine

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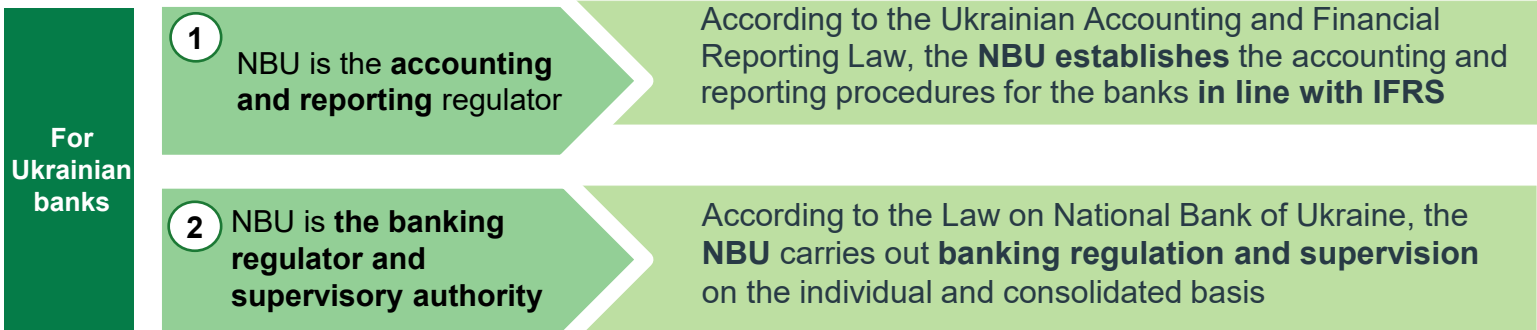
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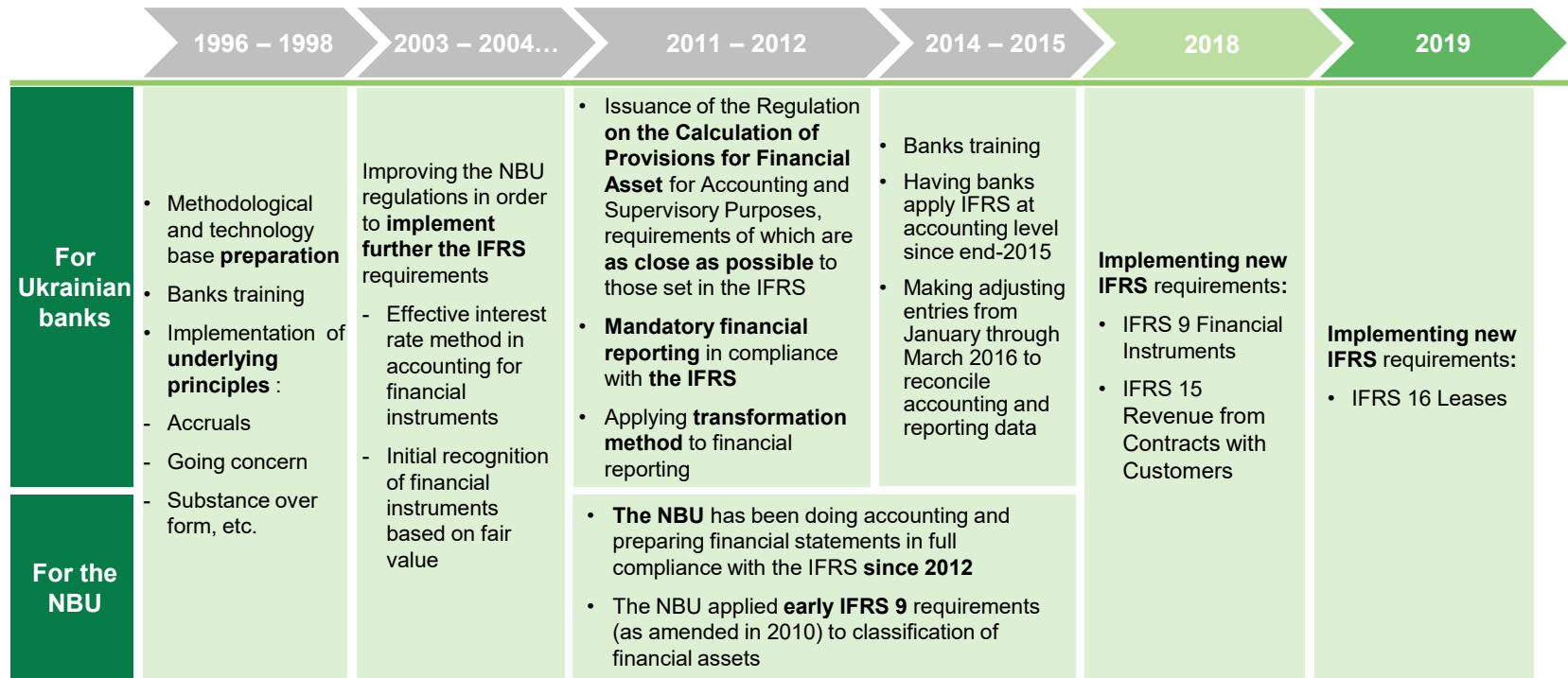
# Ukrainian Legal Framework determines the functions of the National Bank of Ukraine in the accounting

In Ukraine the banking system is **two-tiered**



NBU functions determine its key role in IFRS implementation in the Ukrainian banking sector

# IFRS implementation was phased in several stages in Ukraine



## IFRS 9 requirements implementation and application cover two areas

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1. Provisioning for the expected credit losses according to IFRS 9, the impact of Covid-19
2. Special aspects of IFRS 9 requirements application in terms of recognition and measurement



# **Provisioning for the expected credit losses under IFRS 9**

# Currently, Ukraine has separate frameworks on credit risk calculation for accounting and supervisory purposes

For accounting and financial reporting purposes



For banking supervision purposes

under **IFRS 9**

Based on **Basel Committee** Principles and Recommendations

**ECL = PD × CL**

$$\Rightarrow ECL_{s(i)} = GCA - \sum_{i=1}^n p(s_i) \cdot PV_i$$

Regulation 351/ 30.06.2016 *Identifying the amount of credit risk on asset-related banking transactions by the Ukrainian banks*

Regulation 14/ 21.02.2018 *Accounting for transactions with financial instruments by the Ukrainian banks*

**CR = PD × LGD × EAD**

**Banks** are obliged to develop **internally** their own specific methodologies for ECL measurement

**The Regulator** has developed the detailed methodology for credit risk assessment

The difference between:

- The amount of credit risk (under Regulation 351) and
- The amount of provisioning (under IFRS 9)

is the amount of the **credit risk exposure** which is accounted by the bank in calculating the economic ratios (**capital ratios**)

## Cooperation with external auditors and consultants is becoming more and more relevant

**The banks** are obliged to develop **internally** their own specific methodologies for ECL measurement under IFRS 9

- **The annual financial statements** are subject to the statutory audit
- Banks as public interest entities are obliged to do accounting and prepare financial reporting **under IFRS**
- **External audit** shall be performed under **the International Standards on Auditing**

### At the same time

NBU sets certain requirements to the audit firms:

- Regulation on the procedure of rejection (suspension) by the **National Bank of the audit firm** selected by the bank for the external audit (#89/ 02.08.2018)

## During pandemic NBU has taken a number of steps related to the requirements to the banks on credit losses calculation

### From the perspective of accounting and financial reporting

#### NBU guidance (May 2020):

- The impact of the credit relief measures
- ECL measurement
- Disclosures under IFRS 7 application
- Disclosures in the interim reporting

### From the perspective of banking supervision

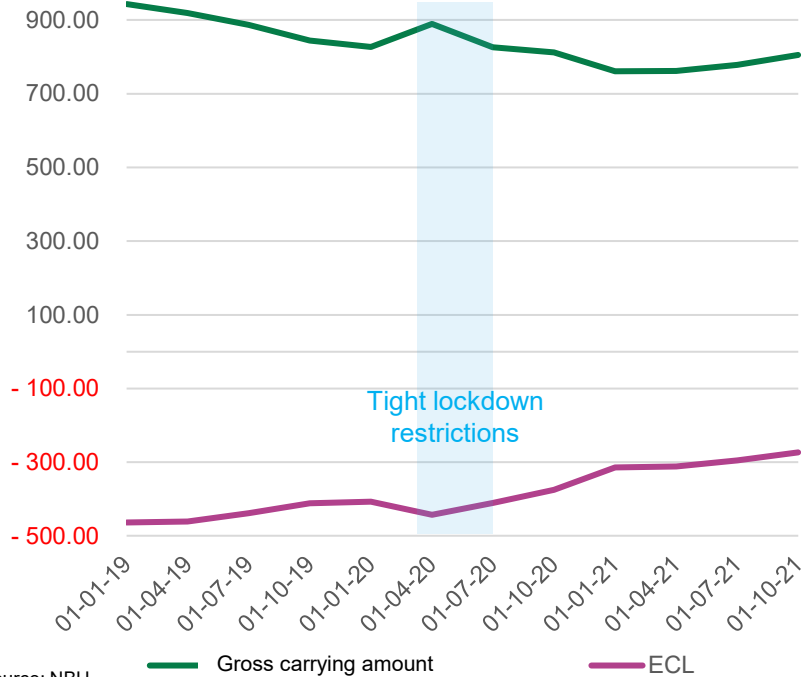
#### Temporary **reliefs** in credit risk calculation for supervisory purposes: NBU Resolution

- Special application of requirements of the Regulation on determining the credit risk due to Covid restrictions (March 2020)
- Approval of the banks' operating rules due to Covid restrictions (December 2020)



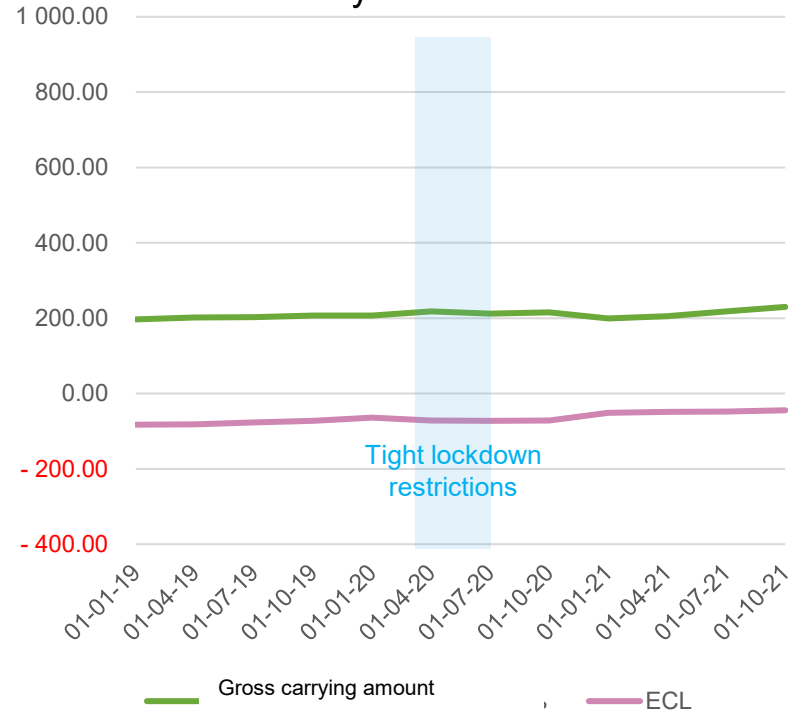
# Loan provisioning volumes are gradually declining

### Corporate loans, blns of Hryvnias



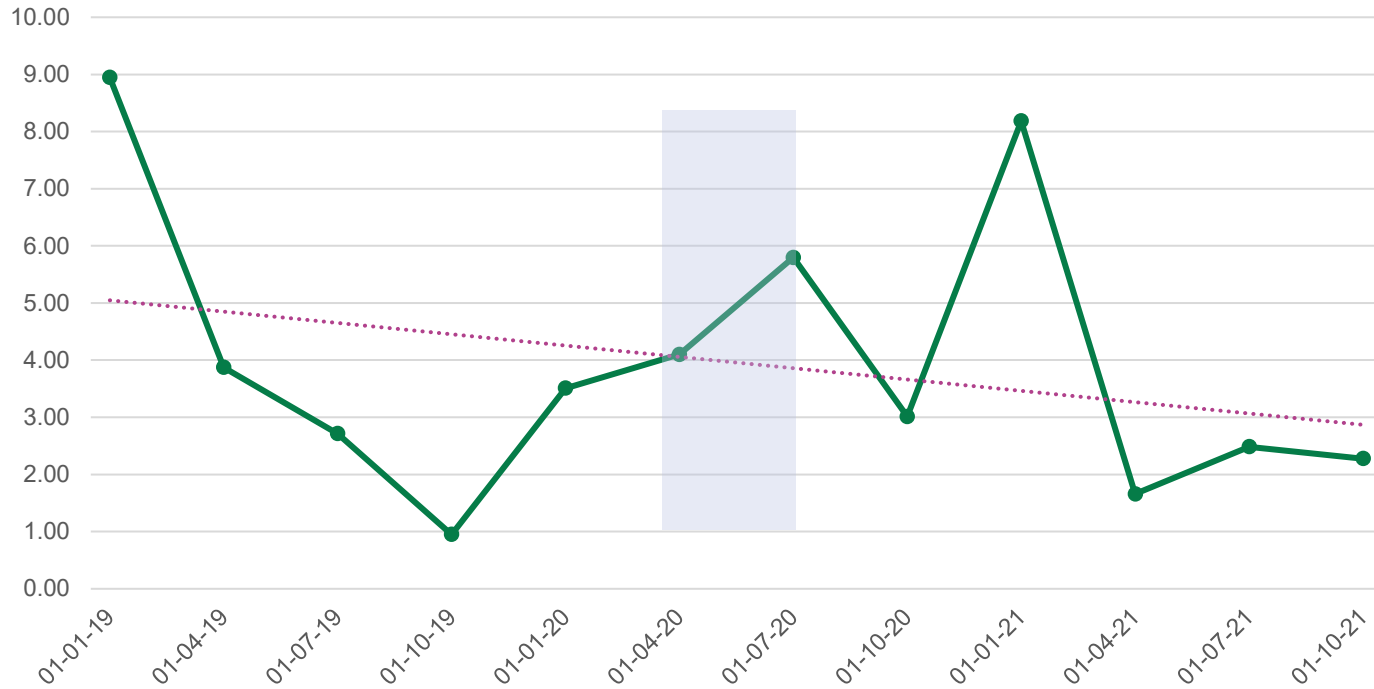
Source: NBU.

### Retail loans, blns of Hryvnias



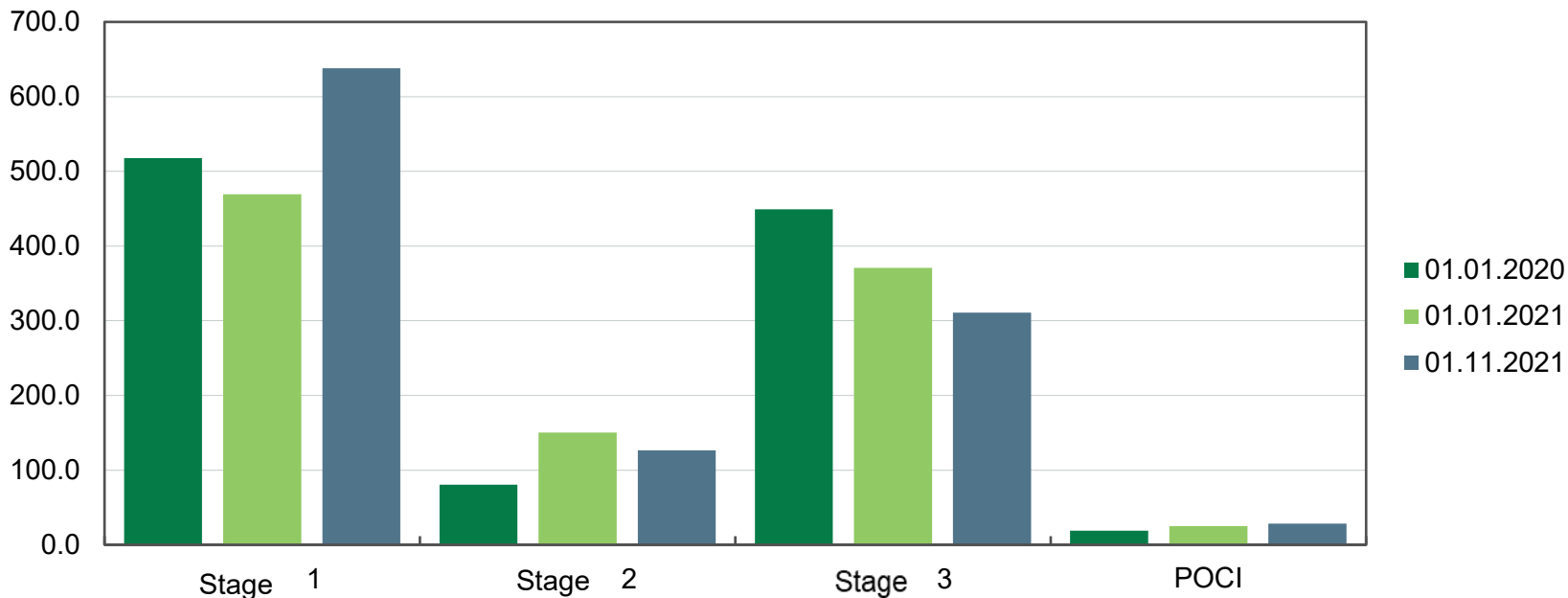
## Loan loss provisioning expenses are seasonal with the overall declining trend

Banks' impairment costs on the client loans, blns of Hryvnias



## The amount and share of loans at the 3<sup>rd</sup> stage of impairment are decreasing

**Loan portfolio\*** by stages of impairment according to IFRS 9 (as of reporting date), blns of Hryvnias

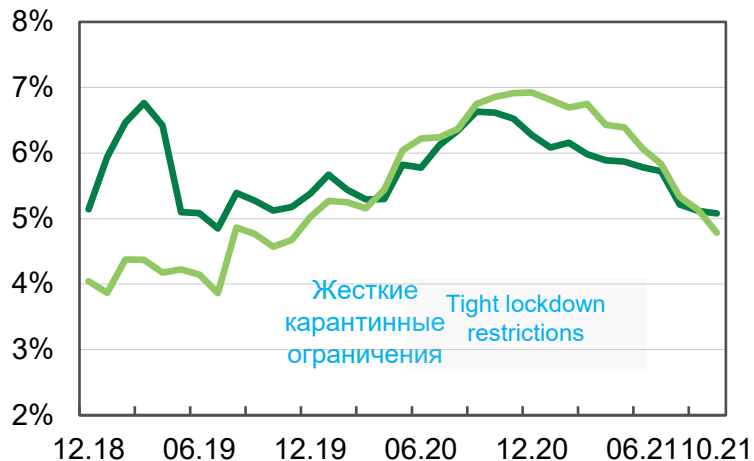


\* Excluding interbank transactions

Источник: НБУ.

# Loan loss provisioning for the performing loans is gradually decreasing

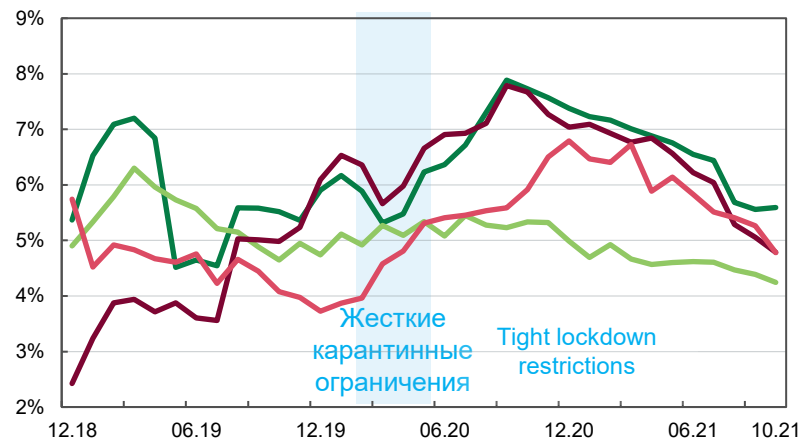
## Provisioning for the performing retail loans in Hryvnia



— Credit risk under prudential requirements  
— ECL under IFRS 9

Source: NBU.

## Provisioning for the performing corporate loans



— Credit risk under prudential requirements, UAH  
— Credit risk under prudential requirements, FX  
— ECL under IFRS 9, UAH  
— ECL under IFRS 9, FX



- After sharp increase during the crisis, provisioning for the performing **retail** loans is gradually decreasing
- After sharp increase in 2020, provisions for the FX **corporate** loans still remain high

# The amount of provisions and NPLs has been effected by the NPL write-off policy

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With the support of the World Bank, NBU developed

## The Regulation on identifying the criteria for the write-off of the impaired financial assets of the Ukrainian banks using the credit loss allowance for the expected credit losses (April 2020)

- The main criteria for writing off the impaired financial assets are developed under IFRS 9 and on the basis of international practice
- Banks may set other criteria if they don't contradict IFRS 9



After the approval of the general criteria for the write-off, the banks were encouraged to write off impaired assets from the balance sheet. At the same time, losses are not recognized



**Some aspects of IFRS 9  
requirements application to  
recognition and measurement**

## For IFRS 9 implementation a number of operational and methodological issues had to be resolved

1. Conceptual changes in developing and implementing the chart of accounts by the banks
2. P/L of Day 1
3. Approaches to interest/dividend recognition on FVPL financial assets
4. Developing the methodology of accounting for the FVOCI debt financial assets
5. Developing the methodology of interest income recognition for AC and FVOCI financial assets at the 1<sup>st</sup> and 2<sup>nd</sup> impairment stages if they are passed due and at the 3<sup>rd</sup> impairment stage.
6. Accounting for the financial asset modification
7. POCI assets measurement and accounting
8. Partial write-off of the financial assets
9. Special issues of the financial guarantees measurement and accounting

# NBU also provided additional support to the banks in the IFRS 9 implementation process

NBU approved the Resolutions 1/ 12.01.2018 and 29/ 28.03.2018

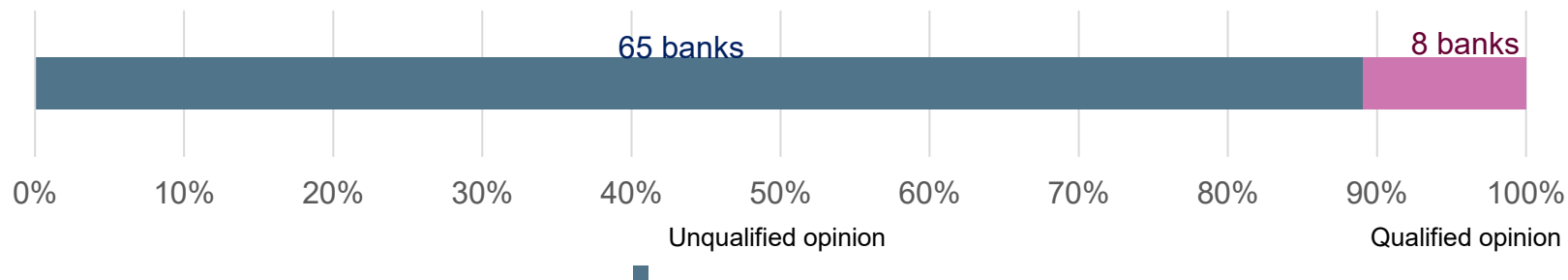
From 01.01 2018 till 30.06.2018 NBU temporarily had not been applying sanctions to the banks for violating the regulatory requirements (economic ratios), statistical (regulatory) reporting requirements, if these violations were **related** to reclassification or change of estimate of the financial instruments under **IFRS 9**



This approach alleviated pressure and helped banks to transition to IFRS 9.



## The results of the external audit of the banks' 2018 financial statements proved the successful implementation of IFRS 9 (in general)



### Qualifications are related to:

- ✓ expected credit losses measurement (6)
- ✓ absence of opening balance adjustments at the beginning of 2018 (1)
- ✓ significant concentrations of “large exposures” (1)
- ✓ recognition of results from loans modifications (1)



**65 banks** of 77 have “**positive**” **audit report** which contains unqualified audit opinion, **8 banks** (10% of total number) have **qualified audit opinions** which contain **qualifications** concerning management decisions on judgments about credit risks assessment that would improve financial statements indicators to some extent.

NBU has the **unqualified audit opinion**.

# Not all focal issues of the IASB post implementation review are relevant for the Ukrainian banking system



Approaches to classification
Business models
SPPI-test
Equity instruments and OCI
Financial liabilities and own credit risk
Modification to contractual cashflows
Effective interest rate methos
Transition

Plans and intentions of the organization vs. real practice
Covenants and conditions leading to the SPPI-test breach
Fair value measurement of the equity instruments in the absence of developed active markets (BC 5.18)
- definition - modification materiality criteria - the status of results of material modification - fair value of the “new” financial assets - accounting for modification of assets which were already written off
POCI - assets

1. Classification and measurement
2. Business model for managing financial assets
3. Contractual cash flow characteristics
4. Equity instruments and other comprehensive income
5. Financial liabilities and own credit
6. Modifications to contractual cash flows
7. Amortised cost and the effective interest method
8. Transition
9. Other matters

# IFRS implementation is the ongoing process...

... like mining...



*У кожного в руках тяжкий залізний молот,  
І голос сильний нам згори, як грім, гримить:  
"Лукайте сю скалу! Нехай ні жар, ні холод  
Не спинить вас! Зносить і труд, і спрагу, й голод,  
Бо вам призначено скалу сею розбити."*

*У каждого в руках железный тяжкий молот  
И голос сильный сверху, словно гром, гремит:  
"Скалу крушите! Пусть ни жар, ни холод  
Не остановит вас! Снесите жажду, труд и голод.  
Ведь вам начертано сию скалу разбить".*

*And everyone holds heavy iron hammer,  
And loud voice from above sounds like a raging thunder:  
"Thou split this rock! Allow no cold, nor heat  
To stop you! Suffer pain, and thirst, and hunger,  
Because you are to break this rock apart!"*

Іван Франко «Каменярі»  
"Stonebreakers" by Ivan Franko



And a lot of work has already been done!