ActiveViam for IFRS 9

ActiveViam's IFRS 9 solution delivers the ability to slice, dice, filter and segment loans to identify patterns such as probability of default and investigate the cause of a change in the potential default rating. This multi-dimensional analysis is essential not just for meeting the requirements of IFRS 9 but for making credit management a center for profit, especially at a time when credit default risk evolves so quickly.

INTRODUCTION

Credit management, a staple of investment banking, has come to include much more than simply monitoring potential defaults in a portfolio of bank loans.

The need to drill into minute details to precisely calculate the impact of non-performing loans and set aside enough capital to cover losses is especially essential as the global economy must deal with the 2020 Covid pandemic.

Already banks have set aside tens of billions of dollars in loan loss provisions to cover themselves.

Precisely classifying loan risk is key to mitigating excess provisions – before the loan even arrives at the impairment stage – and maximizing profitability.

Creating a systematic approach to IFRS 9 involves accessing granular level data as well as finance and risk working together to thoroughly parse the details of millions of loans – from default risk level and repayment schedule to loan sector and market forecasts.

IFRS 9 in Practice

The 2020 Covid crisis has revealed how difficult it could be for departments to figure out which loans may default more quickly than others and compressed the timeframe for which they need to hold provisions against non-performing loans. IFRS 9 has three categories for booking loan losses:

- Stage 1: Account for expected credit losses (ECL) for the first 12 months when a loan is originated or purchased.
- Stage 2: When a loan begins to show a "significant" increase in credit risk the bank must account for expected losses over the life of the loan.
- Stage 3: Once the loan is in fact impaired, the bank must account for expected losses over the life of the loan.

The ECL cannot wait since loan loss reserves are required to be put aside as soon as a loan is issued and the amount held against it eats into capital that could otherwise be invested.

Curbing "Significant Losses" Before They Occur

The "Signifcant Increase in Credit Loss" (SICR) is a fluid tenet of IFRS 9 based on both hard data and subjective analysis. The approach is very much contingent upon the individual bank's criteria of each loan and loan portfolio.

Choosing a flexible solution that can work with the changing times and implementing it to properly calibrate potential losses will allow the bank to optimize capital.
What's important here?

- Velocity – Analysts must frequently and proactively search to sort out a problem and move to find a nonperforming loan.
- De-siloed approach – Ability to track a chain of data, process it and sign off on it in one system creates a record and accountability.
- KPI's – a certain number or group of loans may provide an early indication of what loans may default.
- Management by exception – A solution that allows the user to create alerts and be notified on a limit breach.

ActiveViam for IFRS 9 delivers on all those features.

International Financial Reporting Standards (IFRS) are regulations issued by the International Accounting Standards Board (IASB). IFRS 9 focuses on financial instruments (debt/equity and derivatives) and went into effect in 2018. The 2020 Covid crisis has placed enormous pressure on the industry to account for loan provisions as the number of defaults rise.

The formula by which financial institutions must measure whether or not a loan will default is:

Expected credit losses (ECL) = Exposure at Default (EAD) * Probability of Default (PD) * Loss Given Default (LGD).

The part of the regulation related to SICR necessitates reclassification of a loan in the event of a market shift to identify loan losses before they happen. "Tagging" loans that fall within certain parameters and then performing multidimensional analysis is the most practical approach to accomplish that. Once a certain type of loan falls into arrears and requires reclassification, it makes it easy and fast to identify similar ones also at risk.

With the uncertainty introduced by SICR, it is especially important to have a solution that ensures you get the analysis right the first time and anticipate potential loan degradations, to avoid having to make costly adjustments.

IT, Finance and Risk: Collaboration is essential

Identifying default risk requires an increasing amount of data and the ability to drill down to granular level details. Working with pre-aggregated data at the sector or subsector is sub-optimal, as is waiting hours for a batch to complete as the loan book sinks further into arrears.

Credit risk solutions therefore must support more data, with the ability to perform daily analysis with maximum granularity.

Furthermore, when a bank introduces a new product, it needs to understand its customer base in order to offer the right price and calibrate the risk.

Collaboration is essential to performance. The IFRS 9 process is managed by the accounting and finance department but they need to collaborate with risk in order to fully meet the requirements. In order to properly measure the estimate of default risk, an organization should have a single source of truth in data and a platform to share insights. ActiveViam for IFRS 9 provides such a collaborative environment.

The ability to explain why the ECL is moving has a direct impact on profitability. When the PD for a given customer doubles from the loan inception, the bank needs to recognize higher provisions. Accounting department and risk alike need to drill below the aggregated data to examine and investigate the factors affecting a set of loans.

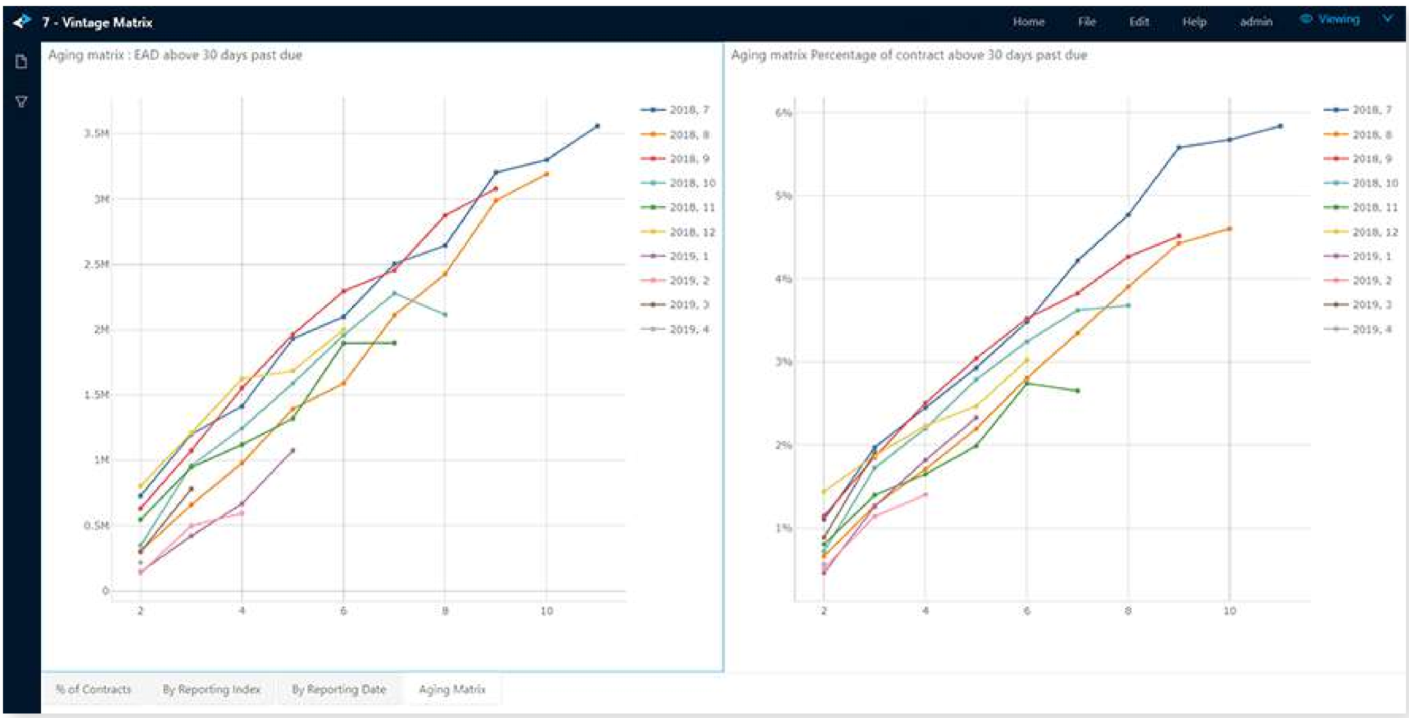
Optimizing the capital ratio

Running historical analyses using a matrix can help identify patterns of default quickly and easily. This also allows users to stress test a particular subset of loans such as a portfolio, or loans across a specific geography, borrower type, percentage rate or any other dimension. Ultimately this enables the bank to determine exposure at default (EAD), improve the loan approval process and inform policy changes.

As a true multidimensional solution, ActiveViam for IFRS 9 offers the ability to analyze current risk to a much finer degree as well as compare past and present loan performances to create scenarios for predictive analysis. ActiveViam for IFRS 9 provides the C-suite and board with a clear view of the present and of the possible futures, and ultimately the means to optimize the capital ratio for the whole organization to the highest level.

Key Takeaways

- IFRS 9 compliance requires technology that can manage large volumes of data faster than ever before
- Enabling collaboration between risk and accounting is essential to successful credit risk management
- Investing into advanced analytics to ensure loans are classified quickly and with complete accuracy can save millions of dollars every year for a mid-size bank and significantly improve its capital ratio.



Creating a "vintage matrix" with a clean set of data can accurately prove out the EAD as well as show the evolution of ECL per stage and reporting date by any chosen parameter.

For example, the yellow line are loans issued in December 2018. On point 6 of the x-axis, we see the evolution of those loans 6 months later (June 2019). We can see on the y-axis that 3% of loans issues in December 2018 are already 30 days past due, amounting to $2M.

Our clients include:

About ActiveViam

ActiveViam provides precision data analytics tools to help organizations make better decisions faster.

ActiveViam started in 2005 with the vision of leveraging in-memory technology to create an analytics platform where businesses could leverage the largest data sets without restrictions, keep them up-to-date in real time and use them to empower their decision makers.

Our goal at ActiveViam, is to let organizations not only make decisions faster, but better; to not only reach their data, but their potential; to not only see their data, but find their way into the future.

ActiveViam is a privately owned company with offices in Paris, London, New York and Singapore.

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