



**Post implementation of IFRS 9**

Analysis of the impact on some  
Nigerian banks

November 2019



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# Glossary

<b>Abbreviation</b>	<b>Full Term</b>
<b>CBN</b>	Central Bank of Nigeria
<b>CET 1</b>	Core Equity Tier 1
<b>ECL</b>	Expected Credit Loss
<b>FLI</b>	Forward-looking Information
<b>GPPC</b>	Global Public Policy Committee
<b>IFRS</b>	International Financial Reporting Standard
<b>IRB</b>	Internal Ratings Based
<b>LGD</b>	Loss Given Default
<b>MES</b>	Macroeconomic Scenario
<b>PD</b>	Probability of Default
<b>SICR</b>	Significant Increase in Credit Risk

# Executive summary

After the first year of reporting, IFRS 9 has resulted in an increase in banks' provisioning levels on transition. However, what still remains unknown is the long term consequences of banks implementing differing IFRS 9 impairment provision modelling judgements. This includes but not limited to assumptions on the probability of default, cash/unsecured recovery rates, cure rates, collateral projections, estimation of EIR and re-default probabilities.

## Impact on the Nigerian banking industry

The scope of this study is restricted to the following commercial banks; Access Bank Plc (Access), First Bank of Nigeria Limited (FBN), Guaranty Trust Bank Plc (GTBank), United Bank of Africa Plc (UBA), and Zenith Bank Plc (Zenith). The FBN Holdings Plc group results were used for First Bank of Nigeria Limited where First Bank of Nigeria Numbers were not separately disclosed.

The initial impact of IFRS 9 on the banks' financial results showed some significant impact as many had expected. The banks recognised increases in total IFRS 9 provisioning of 72% to 160% at transition as at 1 January 2018 largely driven by full provisions on stage 3 exposures. This resulted in a direct reduction of retained earnings reserves.

A number of offsetting forces, such as the reduction in retained earnings, IFRS 9 transitional arrangements and other related regulatory adjustments, has resulted in some volatility between regulatory capital constituents.

By the end of the 2018 reporting period, most of these banks had reflected decreases in total IFRS 9 impairment provisions for loans and advances to customers of between 16% – 40%. The decrease that the banks experienced was partly driven by an improvement on

the quality of data, better understanding and improvement of impact areas of IFRS 9 but more especially due to the advance hit taken at transition.

It is clear that IFRS 9 has allowed the banks latitude to make differing judgements when modelling IFRS 9 impairment provisions. Notable examples of differing judgements are in terms of the SICR thresholds implemented, IFRS 9 impairment provision overlays/Post Model Adjustments, Macroeconomic scenarios structure and weightings, sensitivity analysis disclosures and revolving facility expected lifetime assumptions.

It is however not yet known how total IFRS 9 impairment provisions and impairment charges will behave during future periods of stress. Going forward, some considerations resulting from publicly available information within the Nigerian economy which includes but not limited to factors such as exiting recession, CBN regulation and interventions ( such as loan to deposit ratio, the CAR) may cause the banks to take in additional impairment overlays and post model adjustments as UK Banks did with respect to BREXIT. Furthermore, it is expected that banks take precautions and back-test/stress test their current IFRS 9 models and make relevant adjustments to the current models being used by the banks.



It is clear that IFRS 9 has given the banks latitude to make differing judgements when modelling IFRS 9 impairment provisions.



In summary, the following highlights are relevant from this study:

#### **Macroeconomic Inputs**

Most banks have used projections from data vendors while some have calibrated the macroeconomic inputs internally. Where this was calibrated internally, some disclosure on the methodology applied in determining the forecast may become necessary.

#### **Scenario Approach**

Most banks based their scenario approach on judgements. Banks could leverage on approaches already adopted by some big global banks like Barclays, HSBC and SCB going forward. These approaches includes Consensus Economic Scenario Approach or the Monte Carlo Simulation Approach.

#### **Risk Parameters**

Most banks did not disclose the methodology applied in the estimation of Expected Credit Loss. It is important that banks make further disclosure on the methodology applied. Common methodologies used by the banks include but not limited to transition matrix, run-off triangle, PD mapping to rating scales etc.

#### **Historical Data**

Most banks experienced challenges in the quality of data used in the implementation of IFRS 9. It may be important for banks to revisit their IFRS 9 implementation report and put in place processes and systems to reduce the data gaps experienced.

#### **Model Back-testing**

Some banks have commenced the process of back-testing the existing IFRS 9 models to test the level of predictability of the models. It may be important that the banks set up policies and processes that require the back-testing of the models that have been implemented.

Many banks experienced challenges in the quality of data used in the implementation of IFRS 9. It may be important for banks to revisit their IFRS 9 implementation report and put in place processes and systems to reduce the data gaps experienced.

# Comparability challenges

The Nigerian banking industry, in particular the large Nigerian banks, invested significant resources to keep up with financial reporting for IFRS 9. Despite the level of resources deployed, there are still certain aspects that makes comparisons between the banks challenging.

We expect that over time the differences in approaches will reduce following pressure and additional guidance from regulators and peer group assessments. In spite of this, it should not be expected that banks will follow identical approaches, as each has a unique credit risk profile.

Below, we noted the following key challenges experienced while performing the analysis on the banks' financial report for 31st December 2018.

## Use of IFRS 9 impairment provision overlays

Majority of the banks applied IFRS 9 impairment provision overlays relating to uncertainties that are based on management best estimates for significantly material individual loans.

Despite the fact that banks applied overlays especially for significant exposures, there were limited disclosures on the drivers of the overlays, the value of the overlays in relation to the impairment for the accounts involved and the outstanding balances which the overlays were applied on. However, disclosures in the banks' financial statements stated that the banks applied qualitative adjustments and overlays to reflect other characteristics of the market not captured at the date of the financial statements.

Further disclosures from the banks on impairment overlays were not captured in detail in the financial statements.

## Presentation of quantitative disclosure comparatives

The banks have not consistently presented comparatives in the quantitative disclosures included in the Credit Risk and Notes to the Financial

Statement sections of the Annual Reports.

In certain cases the 31 December 2017 balances (IAS 39) are shown alongside 31 December 2018 (IFRS 9) balances, which may not be comparable. In some other cases the 1 January 2018 balances (IFRS 9) are shown alongside 31 December 2017 (IAS 39) and 31 December 2018 (IFRS 9).

Some banks disclosed the transition count from and to the various stages without disclosing the balances of the accounts that transited. While some other banks disclosed the transition values from and to various stages without disclosing the count of the accounts that transited. Some others did not disclose both transition of counts and balances between stages.

## Macroeconomic variable expectations

Most of the banks have only disclosed forecasted macroeconomic variables as averages over the forecast period.

Below are some of the disclosures of macroeconomic variable expectations of the banks selected for this review:

**Zenith Bank Plc** identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, the Bank estimated relationships between macroeconomic variables and credit risk.

The key drivers for credit risk for most exposures included GDP growth, benchmark interest rates and unemployment. For non-retail portfolios, the key drivers for credit risk were GDP growth and foreign exchange rate. For

exposures to specific industries and/or regions, the key drivers also included relevant commodity and/or real estate prices. While the key drivers of credit risk for the retail portfolios were GDP and foreign exchange rate.

Zenith had further disclosed that predicted relationships between the key indicators and default rates on various portfolios of financial assets were developed based on analysing historical data over the past 5 years. This was carried out using Principal Component Analysis and Vasicek Models.

**Guaranty Trust Bank Plc** relied on a range of forward looking information as economic inputs, such as GDP growth, unemployment rates, central bank base rates, crude oil prices, inflation rates and foreign exchange rates. The Bank currently forecast macroeconomic variables for 3 years and reassess for same every 6 months to reflect prevailing circumstances. Where the Bank has experienced non-linear relationships, a combination of macroeconomic variables is used in the model as the bank considers the weighted average of multiple economic scenarios.

The basis of the Bank's forecast is benchmarked on internal and external sources such as Business Monitor International (BMI), International Monetary Fund (IMF), and Nigeria Bureau of Statistics (NBS).

GTBank applied 3 scenarios for each risk parameter (PD, EAD, CCF and LGD) – Normal, Upturn and Downturn with the weighting 38%, 24% and 38% respectively.

For **United Bank for Africa Plc** each macroeconomic scenario used in the



expected credit loss calculation included a projection of relevant macroeconomic variables applying scenario weights. Macroeconomic variables analysed in the expected credit loss models included GDP growth rate, foreign exchange rates, inflation rate, crude oil prices and population growth rate.

The Bank applied at least 3 scenarios. The base case scenario is based on macroeconomic forecasts published by relevant government agencies. Upside and downside scenarios vary relative to the base case scenario based on reasonably possible alternative macroeconomic conditions. The Bank further disclosed that additional and more severe downside scenarios were designed to capture material non-linearity of potential credit losses in portfolios. Scenario design, including the identification of additional downside scenarios, occurs at least on an annual basis and more frequently if conditions warrant.

UBA designed the scenarios to capture a wide range of possible outcomes and weighted according to the best estimate of the relative likelihood of the range of outcomes that each scenario represents. Scenario weights took into account historical frequency, current trends, and forward-looking conditions and are updated on a quarterly basis. All scenarios considered are applied to all portfolios subject to expected credit losses with the same probabilities.

**Access Bank Plc** considered the following macroeconomic variable to adjust the probability of defaults: crude oil prices, inflation rates, interest rates, exchange rates and monetary policy rates.

The Bank built a regression model to explain and predict the impact of macroeconomic indicators on default rates. In determining the relationships, the bank used the bank's NPL as a proxy for historical default rates on a quarterly basis from 2007 to 2016. Best estimate, optimistic and downturn were the scenarios applied by the Bank.

**First Bank of Nigeria Limited** disclosed that it performed historical

analysis and identified the key macroeconomic variables impacting credit risk and expected credit losses for its portfolio. These variables and their associated impact on the PD, EAD and LGD vary by portfolio type. In addition, expert judgement has also been applied in this process.

The Bank applied three scenarios; upturn, baseline and downturn (30%, 40% and 30%) provided by the Moody's Analytics economic team on a quarterly basis for a period of about 30 years. Regression analysis are applied to test for the impact of the macroeconomic variables on the PD, LGD and EAD and also to allocate weights to the scenarios. However, expert judgement is also applied in the determination of the weights.

FBN applied the following macroeconomic variables in their modelling: GDP, Stock Index Price and Oil Price.

#### **SICR determination**

It was common amongst the banks that they relied on the days past due back stop in defining SICR.

However, some banks in their disclosures, did not disclose if they relied on notches movement of the credit ratings of its obligors in the determination of SICR.

**Zenith** determines that significant increase in credit risk of a particular exposure is deemed to have increased significantly since initial recognition if, based on the bank's quantitative modelling, the remaining lifetime PD is observed to have increased by more than a predetermined percentage/range.

The Bank considers the following in the determination of SICR;

- Using its expert credit judgement and, where possible, relevant historical experience
- The Bank also determines that the exposure has undergone a significant increase in credit risk based on particular qualitative indicators that it considers are indicative of such and whose effect may not otherwise



be fully reflected in its quantitative analysis on a timely basis. These include but not limited to forbearance, restructures and, significant changes in the economic conditions

- As a backstop, the Bank considers that a significant increase in credit risk occurs no later than when an asset is more than 30 days past due.

**Access** considers a financial instrument to have experienced a significant increase in credit risk when one or more of the following criteria have been met:

- The remaining Lifetime PD at the reporting date has increased, compared to the residual Lifetime PD expected at the reporting date when the exposure was first recognised.
- Deterioration in the credit rating of an obligor either based on the Bank's internal rating system or an international credit rating.
- The Bank also considers accounts that meet the criteria to be put on the watch list bucket in line with CBN prudential guidelines since they have significantly increased in credit risk.

For Corporate portfolio, if the borrower is on the watchlist and/or the instrument meets one or more of the following criteria:

- Significant increase in credit spread
- Significant adverse changes in business, financial and/or economic conditions in which the borrower operates





- Actual or expected forbearance or restructuring
- Actual or expected significant adverse change in operating results of the borrower
- A significant change in collateral value (secured facilities only) which is expected to increase the risk of default
- Early signs of cash flow/liquidity problems such as delay in servicing of trade creditors/loans

**UBA** assessment of significant increase in credit risk requires significant judgments. The Bank's process to assess changes in credit risk is based on the use 'backstop' indicators of 30 days past due.

The Bank, however, considers the following exception:

- The outstanding obligation is a result of an amount being disputed between the bank and obligor where the dispute is not more than 90 days.
- The outstanding obligation is an insignificant amount compared to the total amount due. Any amount of not more than 10% of the total amount due is considered insignificant. Only applicable where there is no significant increase in credit risk and analysed on a case by case basis.

**GTBank** considers the following in the determination of SICR;

- Deterioration in the credit rating of obligor/counterparty based on the Bank's internal rating system

or External Credit Assessment Institutions (ECAI) while qualitative factors consider information such as expected forbearance, restructuring, exposure classification by licensed credit bureau, etc.

- A backstop is typically used to ensure that in the (unlikely) event that the primary (quantitative) indicators do not change and there is no trigger from the secondary (qualitative) indicators, an account that has breached the 30 days past due criteria for SICR.
- The Bank further discloses that its transits all obligors with downward movement in credit rating of more than 3 notches or any movement into rating 7 are migrated to Stage 2.

**FBN** considers the following in the determination of SICR;

- Downward rating migration as at reporting date compared to initial rating at origination that exceeds a specified threshold.
- Significant increase in credit spread
- Significant adverse changes in business, financial and/or economic conditions in which the borrower operates
- Actual or expected forbearance or restructuring
- Actual or expected significant adverse change in operating results of the borrower
- A significant change in collateral value (secured facilities only) which is expected to increase the risk of default

- Early signs of cashflow/liquidity problems such as delay in servicing of trade creditors/loans
- Backstop of 30 DPD
- Short-term forbearance
- Significant modification to contractual terms
- Previous arrears within the last 3 months
- Negative credit bureau reports

# Financial results impact



# Financial results impact

There has been a significant impact on the banks' financial results since the transition to IFRS 9 on 1 January 2018. The banks followed a similar trend during the 2018 reporting period albeit at a decreasing rate, growing lending exposures slightly whilst reflecting larger decreases in the related IFRS 9 impairment provisions.

## Analysis

We analysed the aspects of the banks' financial results included in the banks' 2018 Annual Reports and Transition to IFRS 9 Reports (or equivalent) that were most impacted by IFRS 9 impairment. We also analysed the change in the banks' total impairment provisions on transition to IFRS 9 on 1 January 2018 as well as the subsequent changes during the 2018 reporting period.

At a total bank-level, we looked at the percentage change in impairment at transition, total impairment change at transition and the impairment charge between 31 December 2017 and 31 December 2018.

## Key Highlights

- Each of the banks experienced increases in total impairment provisions at the transition to IFRS 9 on 1 January 2018.
- Total IFRS 9 impairment charges in the 2018 reporting period were generally lower than the IAS 39 equivalent in the previous reporting period.
- The banks generally experienced increases in Loans and Advances Gross Carrying Amount during the 2018 financial year across both Retail and Wholesale portfolios.
- All the banks experienced total decreases in IFRS 9 impairment provisions relating to Loans and Advances Gross Carrying Amount during the 2018 financial year. This is primarily driven by the aggressive impairment approach at transition.

Each of the banks experienced increases in total impairment provision at the transition to IFRS on 1 January 2018.

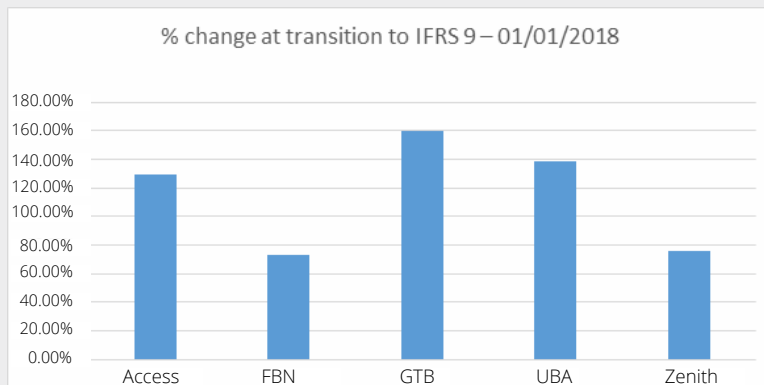


# Financial result impact

## Impact of Transition to IFRS 9

The banks elected to not restate comparatives and, as a result, adjusted total balance sheet impairment provisions at transition to IFRS 9 on 1 January 2018.

Each of the banks saw an increase in the total level of balance sheet impairment provisions from transitioning to IFRS 9. Generally, the banks experienced an average provisioning of about 115% with some banks provisioning as high as 160% while some banks were as low as 72%.

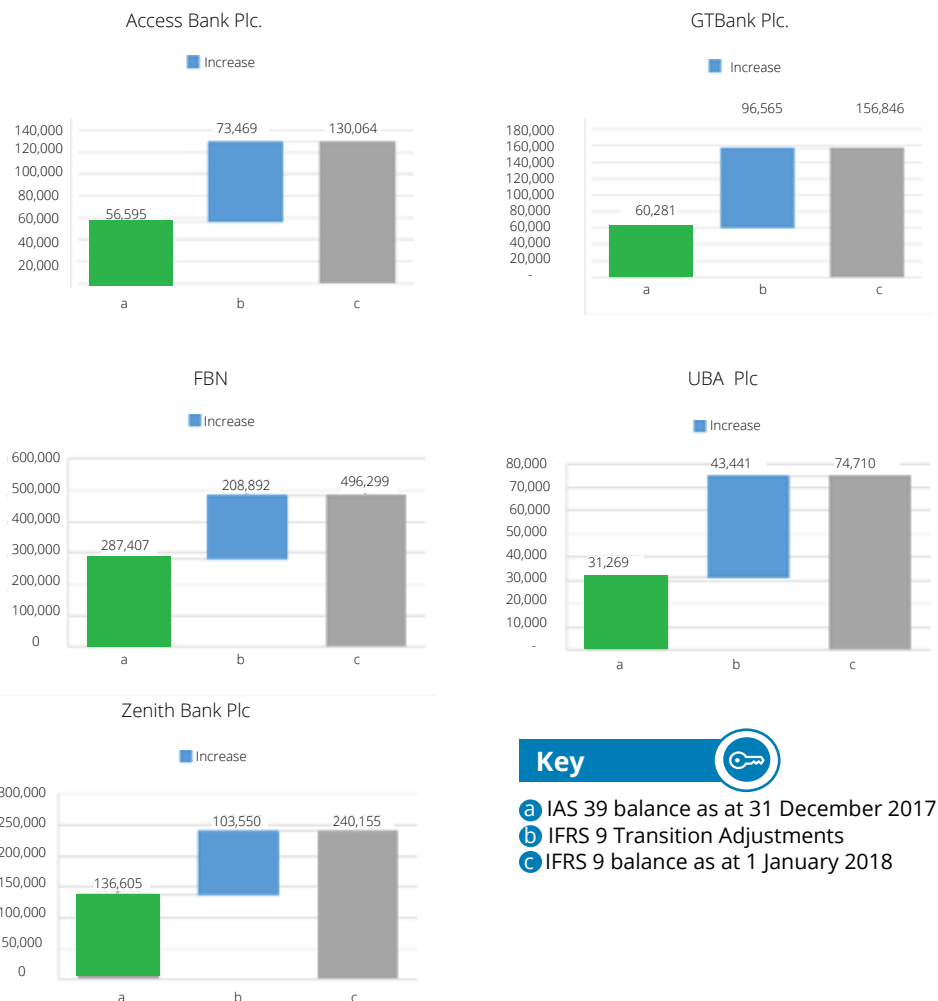


Source: Disclosures, 2018 annual reports (FBN disclosure was based on the FBN Group numbers as the bank's values was not disclosed separately)

### Breakdown of change in total impairment provisions at transition to IFRS 9

The below graphs depict the change in total balance sheet impairment provisions at the transition to IFRS 9 on 1 January 2018 as presented in the Transition to IFRS 9 Reports (or equivalent) and updated based on the 2018 Annual Reports. The increases were primarily driven by 12m ECL on Stage 1 exposure and Lifetime ECL on Stage 2 and 3 exposures.

Please note that the banks have not always consistently provided the same level of granularity for these disclosures.



**Key**

- a IAS 39 balance as at 31 December 2017
- b IFRS 9 Transition Adjustments
- c IFRS 9 balance as at 1 January 2018

# Financial results impact

## IAS 39 Vs. IFRS 9 impairment charge

### Change in total IFRS 9 impairment provisions and impact on IFRS 9 impairment charges

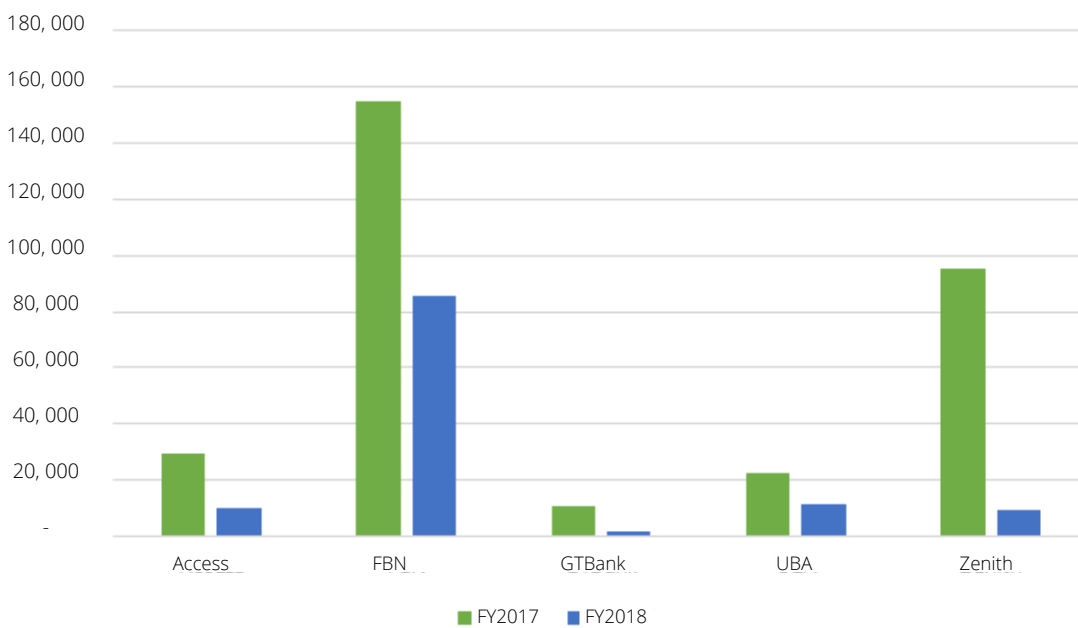
The below graphs compare the total income statement IFRS 9 impairment charge from the 2018 reporting period against the IAS 39 equivalent from the 2017 reporting period. It was generally observed that the banks experienced a drop in the impairment charges from their most significant financial asset – loans and advances to customers.

The purpose of presenting a comparison of the IFRS 9 impairment charge alongside historical IAS 39 impairment charges, is to highlight the portion of the change in total balance sheet impairment provisions

that have the direct impact of reducing retained earnings. Retained earnings is used as one the building blocks for regulatory capital resources before other regulatory adjustments. Therefore, comparing the banks' IFRS 9 impairment charge with historical IAS 39 impairment charges, provides an indication of the relative impact to regulatory capital resources from changes in credit risk dynamics under both of the different accounting standards.

Please note that it is otherwise not appropriate to directly compare the IAS 39 and IFRS 9 impairment charges, because of the incomparable basis used for calculating the impairment provisions.

### IAS 39 to IFRS 9 loan impairment charge comparison





# IFRS 9 impairment modelling judgement

The banks were required to make many judgments in constructing models to comply with the IFRS 9 impairment requirements. Differing approaches for certain key judgements may result in IFRS 9 impairment provisions behaving inconsistently, particularly during future periods of stress.

In this section, we categorise key aspects of the banks' IFRS 9 impairment modelling judgements based on whether similar or differing approaches have been followed.

## Analysis

We analysed the IFRS 9 impairment provision modelling judgements detailed in the banks' 2018 Annual Reports. The focus was on the IFRS 9 impairment provision modelling related detail, which was included in both the Credit Risk and Notes to the Financial Statement sections of the Annual Reports.

We summarised certain key aspects of the banks' IFRS 9 impairment provision modelling judgements where generally similar approaches have been followed.

We further summarised aspects of the banks' IFRS 9 impairment provision modelling judgements where more pronounced differences were noted and categorised some of the approaches where applicable.

Analysis in this section was strictly based on the available information in the Banks' financial statements.

## Key Highlights

- There is alignment in the application of certain key areas of IFRS 9 impairment modelling judgments, such as for the applicable definitions of default, the application of backstops in determining SICR, the approach to curing periods, and the structure of forward-looking macroeconomic variables.
- There are divergences in the application of certain key areas of IFRS 9 impairment modelling judgments, such as for the setting of SICR thresholds (combination of quantitative, qualitative and backstop information), the use of IFRS 9 impairment provision overlays; macroeconomic scenario approach and weightings and the application of sensitivity analysis.

There are divergences in the application of certain key areas of IFRS 9 impairment modelling judgments, such as for the setting of SICR thresholds (combination of quantitative, qualitative and backstop information), the use of IFRS 9 impairment provision overlays...





# Regulatory capital impact

The initial impact of IFRS 9 on regulatory capital resources has been limited and further reduced by the IFRS 9 transitional arrangements. However, going forward there may be greater volatility in capital resources as the levels of IFRS 9 impairment provisions change and the transitional relief phases out.

## Analysis

We analysed the regulatory capital disclosures included in each banks' 2018 Annual Reports to understand the impact of IFRS 9 on the regulatory capital position of the banks. In particular, we looked at the interaction between IFRS 9 provisions, regulatory capital and the dependency on the regulatory credit risk measurement approach associated to the exposures for which the provisions relate.

To understand the extent of the impact of the IFRS 9 transitional arrangements we analysed the key disclosures in the annual report, where the banks provided the key capital metrics and ratios before and after the impact of the IFRS 9 transitional arrangements.

## Key takeaways

The increase in the banks' IFRS 9 impairment provisions at transition on 1 January 2018 had a detrimental impact on regulatory capital ratios, although, this was moderated with the introduction of a relieve-based transitional arrangements for treatment of Expected Credit Loss by the Central Bank. The transitional arrangement requires that the IFRS 9 impact be spread over a four (4) year period ending 31 December 2020 thereby making the impact not substantial.

The banks applied the standardized approach and it was observed that the increases in IFRS 9 impairment provisions reduced regulatory capital upon transition.

The banks disclosed an adjusted day-1 capital adequacy. The adjusted day-1 capital adequacy computed reflect reliefs given by the CBN for Banks to account for the IFRS 9 adjustment to capital as follows:

Period	Provision to be written back
Yr 0 (1/1/18)	4/5 of adjusted day one impact
Yr 1(31/12/18)	3/5 of adjusted day one impact
Yr 2 (31/12/19)	2/5 of adjusted day one impact
Yr 3 (31/12/20)	1/5 of adjusted day one impact
Yr 4 (31/12/2021)	Nil



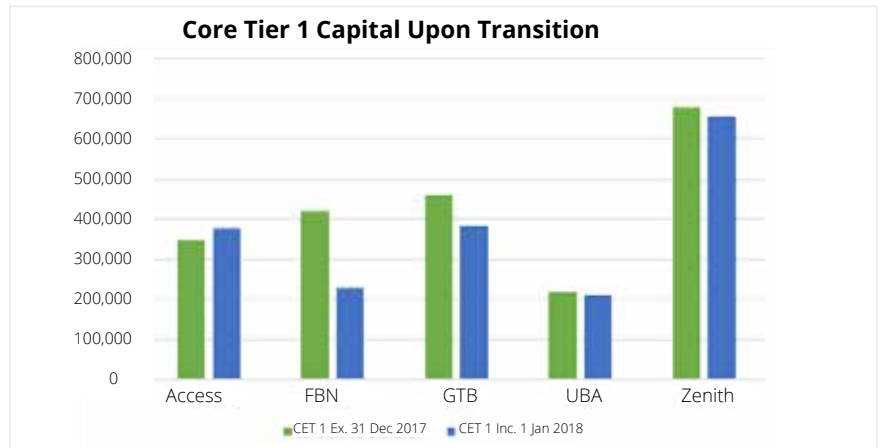
# Regulatory capital impact

## Introduction and transition to IFRS 9

### Transition to IFRS 9

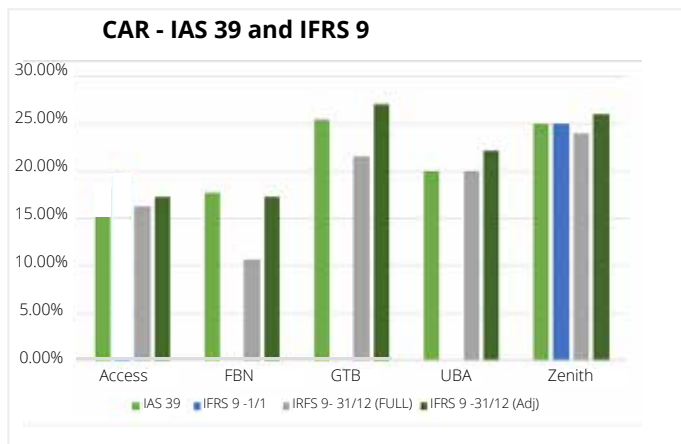
All the banks experienced increases in IFRS 9 impairment provisions after the transition from IAS 39 on 1 January 2018. The increased level of IFRS 9 impairment provisions notably impacted a number of elements used in the banks' regulatory capital ratio calculations. However, the regulatory pronouncement by the Central Bank of Nigeria resulted in a mild impact.

Core Equity Tier 1 including and excluding the CBN IFRS 9 transitional arrangements – 1/1/2018

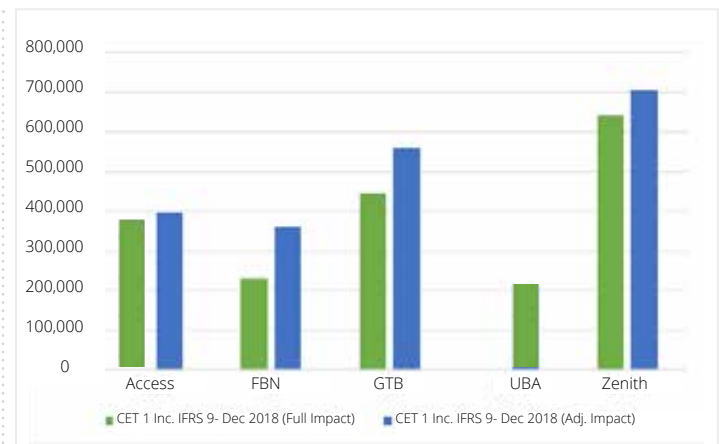


Most banks did not disclose transitional Tier 1 capital as at 1/1/2018. However, we have applied the Tier 1 as at 31/12/2018.

### Tier 1 Capital – CAR (IAS 39 and IFRS 9)



### Tier 1 Capital – Full Impact and CBN Adjusted Impact



### Tier 1 Capital - Full and Adjusted Impact

### Transition to IFRS 9

The IFRS 9 transitional adjustment arrangements by the CBN helped to largely eliminate a possible negative impact from transition to IFRS 9.

From the above, some of the banks did not disclose transition numbers for Tier 1 Capital. However, most of the banks disclosed the difference in the impact to Tier 1 Capital between full impact and adjusted impact.

The charts above show the difference in the impact between full impact and the

# Financial results impact

## Regulatory view of provisions

The initial impact of IFRS 9 on regulatory capital resources has been limited and further reduced by the IFRS 9 transitional arrangements. However, going forward there may be greater volatility in capital resources as the levels of IFRS 9 impairment provisions change and the transitional relief phases out.

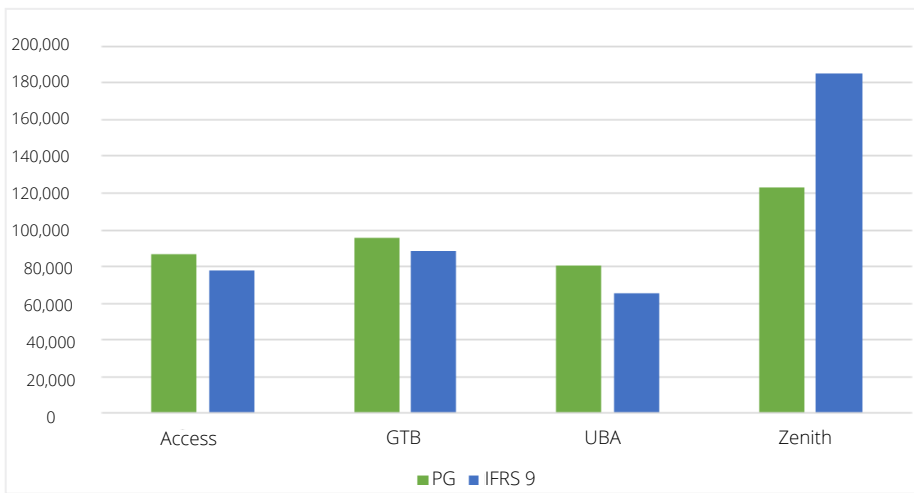
### Comparison of total IFRS 9 impairment provisions with the equivalent regulatory view

The IFRS 9 impairment provisions recognised in the statement of financial position at 31 December 2018 (“accounting view”) differ from the IFRS 9 impairment provision amounts applied for regulatory purposes (“regulatory view”). The below graphs depict the difference between the accounting and regulatory views of the banks’ total IFRS 9 impairment provisions, which is used to calculate the provision

misalignment to regulatory capital.

The prudential guideline impairment is at variance with the expected credit loss (ECL) model required under IFRS 9. As a result of the differences in the methodology/provision, there will be variances in the impairments allowances required under the two methodologies.

The difference between the prudential provisioning and IFRS 9 ECL provision (31 December 2018) is shown below:



**FBN financial statements did not disclose the regulatory impairment. Hence, it was not included in the analysis above**



# IFRS 9 impairment modelling judgement

## Alignment in approach

### Introduction

The banks are broadly aligned in their application of certain key areas of IFRS 9 impairment modelling judgments detailed in the banks' annual reports.

This includes IFRS 9 impairment modelling judgements such as the:

- applicable definition of default;
- approach to determining SICR;
- approach to curing periods; and
- macroeconomic variables modelled.

### Area: Definition of default

#### Observation:

The banks are applying definitions of default for IFRS 9 that are mostly aligned with the regulatory arrears definition and unlikelihood to pay indicators. IFRS 9 also introduces a 90 days past due rebuttable presumption to serve as a backstop, except for where it can be justified otherwise. However, the banks have a policy to only rebut on this definition only when there is reasonable and supportable evidence.

### Area: SICR - approach

#### Observation:

#### Qualitative

There is a consistent application of information that an exposure has undergone a significant increase in credit risk based on particular qualitative indicators that it considers are indicative of such and whose effect may not otherwise be fully reflected in its quantitative analysis on a timely basis such as actual/ expected forbearance, restructuring, direct debt cancellations, term extension, exposure classification

by licensed credit bureau, early signs of cash flow/ liquidity problems.

#### Backstop

Consistent use of 30DPD backstop across the banks. There is an exception with First Bank that observes 90DPD for specialized facilities.

### Area: Curing period

#### Observation:

Stage 2 to 1 – i.e. when an exposure no longer meets the criteria for SICR:

“Cured” facilities within Stage 2 are monitored for a probationary period of 90 days to confirm if the credit risk has decreased sufficiently before they can be migrated from Stage 2 to Stage 1.

Stage 3 to 2 – i.e. when an exposure no longer meets the definition of credit-impaired:

“Cured” facilities within Stage 3 are monitored for a probationary period of 180 days before migration from Stage 3 to Stage 1. The decrease in risk of default is reflected in the obligor's Risk Rating which is a critical input for Staging.

### Area: Macroeconomic variables modelled

#### Observation:

Common macro-economic variables observed.

The following common macro-economic variables were identified across the respective banks' key economies:

- GDP growth rate
- Unemployment rate
- Interest rate
- Foreign exchange rate
- Inflation rate
- Crude oil prices

“Cured” facilities within Stage 3 are monitored for a probationary period of 180 days before migration from Stage 3 to Stage 1.

# IFRS 9 impairment modelling judgements (cont'd)

## Divergence In Approach

### Introduction

There is a divergence in the impairment modelling judgements used in the application of certain key requirements of IFRS 9 detailed in the banks' annual reports.

This includes IFRS 9 impairment modelling judgements such as the:

- The setting of SICR thresholds;
- Use of IFRS 9 impairment provision overlays;
- Macroeconomic scenarios approach and weightings;
- Application of sensitivity analysis; and

#### Area: Setting SICR threshold

##### Observation:

The banks are generally applying a combination of relative and absolute PD thresholds, although there are also instances of the application of the internal rating method in specific portfolios.

### ACCESS

The Bank has considered by comparing the lifetime PD at reporting date and the lifetime PD at initial recognition. The Bank also considers a downgrade in the internal rating and CBN prudential classification for "watchlist".

### FBN

The Bank set the following threshold in the determination of SICR:

Downward rating migration as at reporting date as compared to the rating at initial recognition while also considering other factors like backstop (30DPD for non-specialized facilities and 90DPD for specialized facilities) and other qualitative factors.

### GTBank

The Bank considers deterioration in the credit rating of obligor/counterparty

based on the Bank's internal rating system or External Credit Assessment Institutions (ECAI) while qualitative factors consider information such as expected forbearance, restructuring, exposure classification by licensed credit bureau, etc. The Bank also applies the backstop of 30DPD in the determination of SICR.

### UBA

The Bank process to assess changes in credit risk is based on the use of "backstops" indicators. The bank applies the 30DPD rebuttal in the determination of SICR.

### ZENITH

The Bank applies a relative approach testing if based on the Bank's quantitative modelling, the remaining lifetime PD is determined to have increased beyond a specific percentage and also applies the 30 days past due backstop in setting the SICR threshold. Other qualitative factors are also considered.

#### Area: IFRS 9 impairment provision overlays/PMAs

##### Observation:

The banks have implemented different IFRS 9 impairment provision overlays, although the majority of which is to capture market information that might not be captured by the macroeconomic variables applied in the modelling. In most cases, it is based on using expert credit judgements

### ACCESS

The Bank disclosed that it applies overlays as adjustments to capture all characteristics of the market as at the measurement date.

### FBN

It was not clear how the Bank applied overlays in the ECL modelling.





**GTBank**

The bank disclosed that it applies overlays as adjustments based on expert judgement to capture all characteristics of the market as at the measurement date.

**UBA**

The Bank set the following threshold in the determination of SICR:

Downward rating migration as at reporting date as compared to the rating at initial recognition while also considering other factors like backstop (30DPD for non-specialized facilities and 90DPD for specialized facilities) and other qualitative factors.

**ZENITH**

Zenith Bank applies overlays and overrides mainly for individually material loans where the Bank possess significant information on and the impact of macroeconomic scenarios have not been adequately captured in the credit risk modelling.

**Area: Macroeconomic scenario approach and weightings**

**Observation:**

The following three key areas in relation

to the banks' Macroeconomic Scenarios are covered below:

- Scenario approach: The banks' scenarios applied in the modelling.
- Forecast horizons: The period of years into the future covered by the banks' MES; and
- Probability weightings: The structure of the banks' MES and associated probability weightings as at 31 December 2018.

**ACCESS**

**Scenario approach**

The Bank considers three scenarios: optimistic, best-estimate and downturn

**Forecast horizons**

The Bank uses the Bank's Economic Intelligence - this currently monitors and forecasts certain macro-economic indicators. These indicators are GDP growth rate, inflation rate, crude oil prices and the foreign exchange rate. The Bank also applies regression in the forecast of the variables. However, the forecast horizon was not clear in the 2018 annual report

**Probability weightings**

The Bank allocated weights to the

scenarios as stated below:

Best estimates:	75%
Downturn:	12.5%
Optimistic:	12.5%

**FIRST BANK**

**Scenario approach**

The Bank considered three scenarios: upturn, baseline and downturn.

**Forecast horizons**

The Bank disclosed forecast of macroeconomic variables for 5 years (2019 to 2023). The macroeconomic variables include GDP, stock index price and oil prices (USD per barrel). However, the Bank still considered other forward-looking information like regulatory, legislative and political changes.

**Probability weightings**

The Bank assigned weights of the possible outcomes of each scenarios based on statistical regression analysis and expert judgement taking into account a range of possible outcome each chosen scenario is representative of.



The Bank allocated the following weights to the scenarios:

Base:	40%
Upturn:	30%
Downturn:	30%

## GTBank

### Scenario approach

The Bank applied three economic scenarios; normal, upturn and downturn. For the normal scenario macroeconomic variables used for the purpose of the forecast were obtained from external sources while the Upturn and Downturn scenarios are derived based on historical trend analysis and management's unbiased estimates of forward-looking macroeconomic indicators.

### Forecast horizons

The forecast horizon is for three years (2019 to 2021) on exchange rate, inflation rate, unemployment rate and GDP growth rate.

### Probability weightings

The weightings applied to the multiple economic scenarios are Upturn - 24%; Normal - 38%; and downturn - 38%. The bank treats the weight as an area of judgement.

## UBA

### Scenario approach

Scenarios are designed to capture a wide range of possible outcomes and weighted according to the best estimate of the relative likelihood of the range of outcomes that each scenario represents.

### Forecast horizons

Macroeconomic variables applied in the ECL calculation includes GDP growth rate, foreign exchange rate, inflation rate, crude oil prices and population growth rate. The forecast horizon was not clear in the 2018 annual report.

### Probability weightings

Scenario weights take into account historical frequency, current trends, and forward looking conditions and are updated on a quarterly basis. The weights was not clear on the 2018 annual report.

## ZENITH

### Scenario approach

The bank considers three scenarios

base, downturn and upturn scenarios. Forecast horizons

The Bank disclosed projections for two years (2019 and 2020) for two macroeconomic variables – foreign exchange rate and GDP growth rate for the three economic scenarios. This was based on the analysis of historical data for the past 5 years.

### Probability weightings

The bank disclosed that the ECL calculated was a probability-weighted estimate of credit losses. The Bank allocated the following weights to the scenarios:

Best Case:	40%
Worst Case:	30%
Baseline:	30%

## Area: Sensitivity analysis

### Observation:

The sensitivity analyses performed by the banks can be allocated into 2 categories:

### ACCESS

The Bank ran a sensitivity analysis on the PD and LGD for the following assets;

### Corporate Loans

In establishing sensitivity to ECL estimates for corporate loans, the bank considered four variables (GDP growth rate, Crude Oil Price, Inflation and US exchange rate were considered). Of these variables, the bank's corporate loans reflect greater responsiveness to GDP growth rate and crude oil price.

### On balance Sheet Exposure

**GDP growth rate:** Given the significant impact on companies performance and collateral valuations

**Oil price:** Given its impacts on purchasing power, demand as well as overall health of the economy

The sensitivity was tested on the impact on profit or loss based on a 10% change in the key assumptions (the responsiveness of the ECL estimates to the variation of macroeconomic variables).

### Off balance Sheet Exposure

**GDP growth rate:** Given the significant impact on companies performance and collateral valuations

**Oil price:** Given its impacts on purchasing power, demand as well as overall health of the economy

The sensitivity was tested on the impact on profit or loss based on a 10% change in the key assumptions (the responsiveness of the ECL estimates to the variation of macroeconomic variables).

## FBN

The Bank carried out sensitivity analysis on the most significant assumptions affecting ECL allowances:

The Bank specifically tested sensitivity using a 5%+/- on oil price and GDP to observe the impact on the financial statements

## GTBank

The Bank disclosed sensitivity analysis on the ECL model on the following:

- 1% Increase / Decrease in GDP growth rate over forecasted GDP growth rate
- 2% Decrease / Increase in inflation rate over Inflation rate forecast
- Decrease / Increase in USD/NGN exchange rate by N5 over the forecasted exchange rate
- Increase / Decrease in Crude Oil Price over forecasted Crude Oil Price
- Increase / Decrease in the PD by 5% with all other parameters remaining constant as at 31 December 2017
- Increase / Decrease in emergence period by 1 month as at 31 December 2017

## UBA

The Bank carried out sensitivity analysis on the probability of default and loss given default. This sensitivity was based on a 1% increase/ decrease in the PD and LGD with all things remaining constant. This was estimated for the year ended 31 December 2018 and 31 December 2017.

## ZENITH

The Bank adopted both single factor and multifactor stress testing approaches (sensitivity and scenario based) in conducting stress testing within the risk areas of credit risk on the probability of default, loss given default and macroeconomic variables. This sensitivity was based on increase/ decrease in the





# Appendix

# References

Bank	Document Name	Internet
Access Bank Plc	Access Bank Plc 2018 Annual Report	<a href="https://www.accessbankplc.com/AccessBankGroup/media/Investors/Quarterly-Reports-2019/FY-2018-Financial-Statement.pdf">https://www.accessbankplc.com/AccessBankGroup/media/Investors/Quarterly-Reports-2019/FY-2018-Financial-Statement.pdf</a>
First Bank of Nigeria Limited	First Bank of Nigeria Limited 2018 Annual Report	<a href="https://www.fbnholdings.com/wp-content/uploads/2019/04/FBN-Holdings-Plc-2018-Annual-Report.pdf">https://www.fbnholdings.com/wp-content/uploads/2019/04/FBN-Holdings-Plc-2018-Annual-Report.pdf</a>
Guaranty Trust Bank Plc	Guaranty Trust Bank Plc 2018 Annual Report	<a href="https://www.gtbank.com/uploads/annual-reports/2018-annual-report/GTBank_AnnualReport_2018.pdf">https://www.gtbank.com/uploads/annual-reports/2018-annual-report/GTBank_AnnualReport_2018.pdf</a>
United Bank for Africa Plc	United Bank for Africa Plc 2018 Annual Report	<a href="https://www.ubagroup.com/nigeria/wp-content/uploads/sites/3/2019/03/UBA_Plc_2018_Annual_Reports_and_Accounts_NSE_15-">https://www.ubagroup.com/nigeria/wp-content/uploads/sites/3/2019/03/UBA_Plc_2018_Annual_Reports_and_Accounts_NSE_15-</a>
Zenith Bank Plc	Zenith Bank Plc 2018 Annual Report	<a href="https://www.zenithbank.com/media/2747/zenithbankgroup2018-fye-full-financial-statement.pdf">https://www.zenithbank.com/media/2747/zenithbankgroup2018-fye-full-financial-statement.pdf</a>
Central Bank of Nigeria	<p>The Central bank of Nigeria letter to all banks &amp; discount houses on the transitional arrangements treatment of IFRS 9 expected credit loss for regulating purposes by banks in Nigeria dated: October 18, 2018</p> <p>The Central bank of Nigeria guidance notes on regulating capital</p>	<p><a href="https://www.cbn.gov.ng/out/2018/bsd/circular%20on%20transitional%20arrangement%20treatment%20of%20ifrs%209%20dated%20october%202018,%20%202018.pdf">https://www.cbn.gov.ng/out/2018/bsd/circular%20on%20transitional%20arrangement%20treatment%20of%20ifrs%209%20dated%20october%202018,%20%202018.pdf</a></p> <p><a href="https://www.cbn.gov.ng/out/2015/bsd/1.revised%20guidance%20notes%20on%20regulatory%20capital.pdf">https://www.cbn.gov.ng/out/2015/bsd/1.revised%20guidance%20notes%20on%20regulatory%20capital.pdf</a></p>



# Contacts



**Oduware Uwadiae**  
Partner & West Africa  
Business Process Solutions Leader  
Tel: +234 (0) 805 601 8887  
Email: [ouwadiae@deloitte.com.ng](mailto:ouwadiae@deloitte.com.ng)



**Uyi Izekeor**  
Partner  
Actuarial & Quantitative Solutions  
Tel: +234 805 659 8428  
Email: [uizekor@deloitte.com.ng](mailto:uizekor@deloitte.com.ng)



**David Michael**  
Senior Consultant  
Actuarial & Quantitative Solutions  
Tel: +234 705 055 4353  
Email: [midavid@deloitte.com.ng](mailto:midavid@deloitte.com.ng)

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