Ladies and Gentlemen

A very good morning to you

I feel privileged to be here today with you all speaking at the opening session of this seminar on IFRS9. I am grateful to the Director and senior people of Afritac South for having taken on board a suggestion I made during the Steering Committee held in Mauritius in 2016 to host a seminar on IFRS9.

I wish to thank them for their commitment and dedication to improve in many ways the work of supervisors in Sub-Saharan Africa. Often we fail to appreciate the organisational efforts required to bring together so many participants and getting the experts to fly down to Mauritius to share their technical expertise. A big thank you to the organisers of this seminar.

I am sure IFRS 9 will be less of a conundrum at the end of this seminar for all the participants and they will gain a lot of insights about how best to implement IFRS9 in their own respective jurisdictions. I am looking forward to hear from the Bank of Mauritius participants in particular on how best we can implement IFRS9 in Mauritius as from next Monday.

This seminar on IFRS9 comes at an opportune time indeed though I would have wished it had happened earlier. The implementation of IFRS 9 is a major challenge not only for the banks but also for the Regulator as well. It is a race against time as January 2018 is only 9 months away. I am still unclear about the state of preparedness and extent of understanding about IFRS9 among the domestic and smaller banks and this makes me quite nervous. International banks present in Mauritius would lean on their group expertise.

At the outset, let me tell you that I am not an accountant and accounting was something I did not really like at college. So you would not expect me to talk to you about all the intricacies, subtleties and complexities of IFRS9. I am an economist by training. My interest in IFRS9 is very recent and confined to its implications for banking regulation.

To be honest, the first time I came across IFRS9 was at a meeting at the Bank with KPMG experts from South Africa sometime in late 2015 or early 2016. I was briefed about how KPMG in anticipation of the rolling-out of IFRS9 had to enlist the services of statisticians, economists, and econometricians. And the discussion, surprisingly, was not about accounting but about data, databases, and building models – a realm in which economists and econometricians, unlike accountants, generally excel.

The rest of my remarks will touch briefly on IFRS9 as a new accounting standard in replacement of IAS39, thereafter the initiatives of the Bank of Mauritius with regard to the implementation of IFRS9 will be reviewed and finally, I’ll end with a concluding note.

The circumstances which brought about IFRS9 are well known by now. Post GFC 2008, at the request of the G20 and the Financial Stability Board, the International Accounting Standards Board (IASB) stepped up its work to replace IAS39, which had started in the early 2000s, and in July 2014, the IASB released the new accounting standard IFRS9. There are 3 aspects of IFRS9 namely (1) classification and measurement of financial instruments; (2) Impairment; and (3)
Hedge Accounting. The main focus of my remarks will be on impairment.

Loan-loss provisioning under IAS39 was deemed to be too little too late as the incurred loss model required objective evidence of impairment, such as an actual loss event occurring, in order for provisions to be booked. The backward-looking incurred loss model was conflicting with the prudential regulation on credit risk management as enunciated in the BCBS core principles for effective supervision. IFRS9 expected loss model is forward-looking and more aligned to prudential regulation with regard to credit risk management.

The expected loss model computation will not only use historical loss experience data but also all information available whether current or future, including macroeconomic factors. Further, banks will have to start provisioning on the very day the loan is booked based on expected losses over a 12-month period, i.e. on Stage 1. Should credit risks increased significantly as a result of macroeconomic or financial factors relative to the initial recognition at stage 1, provisioning would increase accordingly based on lifetime expected losses computation. The move from stage 1 to stage 2 will depend on whether there is a significant change in credit risks. Stage 3 is where there is evidence of impairment.

Deloitte’s Global IFRS Banking Surveys have revealed that the Expected Credit Loss Model would substantially increase banks’ loan loss provisioning and severely impact on their regulatory capital. This direct impact on banks’ cost of capital would be amplified by massive changes in banks’ systems and processes, significant investment in people and IT infrastructure and a change in mind-set altogether at Board and Management level. It is very likely that banks would pass on these costs to borrowers and depositors.

In view of the impact on regulatory capital and the limited time remaining to 1 January 2018, the Basel Committee on Banking Supervision released a statement on 31 March 2017 on the interim regulatory treatment of accounting provisions and standards. The statement, while encouraging the use of the Expected Credit Loss Model noted its significant impact on regulatory capital and banks’ provisioning practices in ‘qualitative and quantitative ways’. The BCBS would also “thoroughly review the longer-term regulatory treatment of provisions” and that “jurisdictions may adopt transitional arrangements to smooth any potential significant negative impact on regulatory capital arising from the introduction of ECL accounting.”

Initiatives taken by the Bank of Mauritius

The Bank is also in the process of adopting IFRS9 and we have been working closely with our external auditors to review systems and processes at the Bank. At this stage, it is still work-in-progress.

With regard to the Bank’s supervisory role in overseeing that banks meet the deadline of 1 January 2018, a meeting was held with External Auditors of banks in March 2016 to gauge their state of preparedness and the comfort was given to the Regulator that they will lean on their group support and expertise to assist banks in transforming their systems and processes to meet the requirements of IFRS9. The External Auditors were told that the Bank would not wish to see the same accounting firm providing consultancy and advisory services to the client on the one hand and concurrently be the one validating and auditing the model on the other hand. In this respect, the central bank envisages to hire the services of an accounting firm to carry out the validation exercise on its behalf as it might not have the expertise to do so as early as January 2018.

Subsequently in April 2016, the Bank of Mauritius requested banks to submit an IFRS 9 implementation roadmap vetted by their external auditors. A follow-up letter was issued in November 2016 to request banks to submit an IFRS 9 action plan with defined timelines, provide
quarterly progress reports on the implementation status, and to make a presentation to the Bank covering various aspects of their institution’s state of preparedness. As of date, out of 23 banks, 20 have made presentations at the Bank on their IFRS 9 implementation plans. The remaining banks are scheduled to make presentations shortly.

It is observed from the information submitted by banks that subsidiaries of the international banks were, as expected, better prepared than others to implement IFRS9 given the technical expertise available at Group level. Domestic and smaller banks have hired the services of accounting firms to assist them in the implementation of IFRS 9.

The main challenges faced by banks are the unavailability and poor quality of historical credit loss data - under IAS39, banks have been delaying provisioning on non-performing loans by evergreening or restructuring these loans -, the absence of good databases, inadequate IT systems and lack of skilled and well-trained human resources.

The Bank of Mauritius has directed banks to embark on a trial run from this year with a view to assessing the likely impact of IFRS9 implementation on their profitability.

Given that IFRS 9 is also applicable to the non-bank deposit-taking institutions, the latter was also requested to submit to the Bank an implementation plan and to make a presentation on their state of preparedness.

Internally, the Bank of Mauritius has constituted a team of supervisors which is tasked to periodically review implementation progress of IFRS 9.

Concluding note

At this juncture, we are cautiously optimistic that we shall be able to roll-out the implementation of IFRS9 on the due date but lots of uncertainties remain. We have started very late in the process of implementation, i.e., in 2016, when we should probably have done so as early as beginning 2015.

Cleaning of the data and constituting a long-enough historical database at the required granularity for deriving meaningful model results remains the single biggest challenge. Furthermore, it is highly likely that banks within the same jurisdiction would apply the new accounting rules differently through their own different methodologies and approaches to ECL modelling – some may be closer than others to the “true” or “correct” ECL Model. The challenge for the supervisor would be to have superior knowledge to be able to assess the data quality as well as which approaches to ECL modelling would yield the correct numbers.

The Deloitte’s global banking survey of IFRS 9 in 2016 had a question on the state of readiness for IFRS 9 by the deadline of 1 January 2018 and almost 50 per cent of the respondents said that “they do not have enough technical resources to deliver their IFRS 9 project” and almost 25 per cent of the respondents did not think that “there will be sufficient skills available in the market to cover shortfalls.”

The worst case scenario is that the Bank ends up, after 1 January 2018, with the subsidiaries and branches of international banks successfully implementing IFRS9 while the domestic and smaller banks are unable to do so.

Thank you for your attention.