Credit Risk:
Aligning Banks Risk Management perspectives with Accounting and Regulatory requirement

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Introduction

In the dynamic world of finance, managing risks effectively is not just a necessity—it's a hallmark of successful financial institutions.

Among the various types of risks, credit risk stands out as one of the most critical. But why is managing credit risk so vital, and how can financial institutions implement it effectively?

The Role of Credit Risk Management:

Effective credit risk management involves a series of systematic practices designed to mitigate potential losses.

This begins with the thorough assessment of a borrower's creditworthiness through a combination of quantitative and qualitative analyses. Financial institutions employ diverse strategies, including credit scoring models, risk rating systems, and detailed financial statement analysis. These methods help in identifying high-risk borrowers and adjusting lending terms accordingly.

The ongoing monitoring of credit exposures is crucial. By regularly reviewing outstanding loans and evaluating the economic conditions that could affect borrowers’ ability to repay, financial institutions can proactively manage their credit portfolios and take corrective actions *before* defaults occur.

Credit risk management involves identifying, assessing, and mitigating risk of defaults. This robust framework ensures financial institutions can maintain a healthy balance between risk and return.

Key Strategies for Effective Credit Risk Management:

Financial institutions can implement an effective credit risk management strategy by following several key steps:

1. **Comprehensive Credit Assessment:** Thoroughly assess the creditworthiness of potential borrowers. This assessment should include both qualitative and quantitative analysis, encompassing credit scores, financial statements, and market conditions.
2. **Diversification:** Avoid concentrating too much credit in a single sector or borrower. Diversifying the credit portfolio reduces the impact of defaults on the institution's overall financial health.

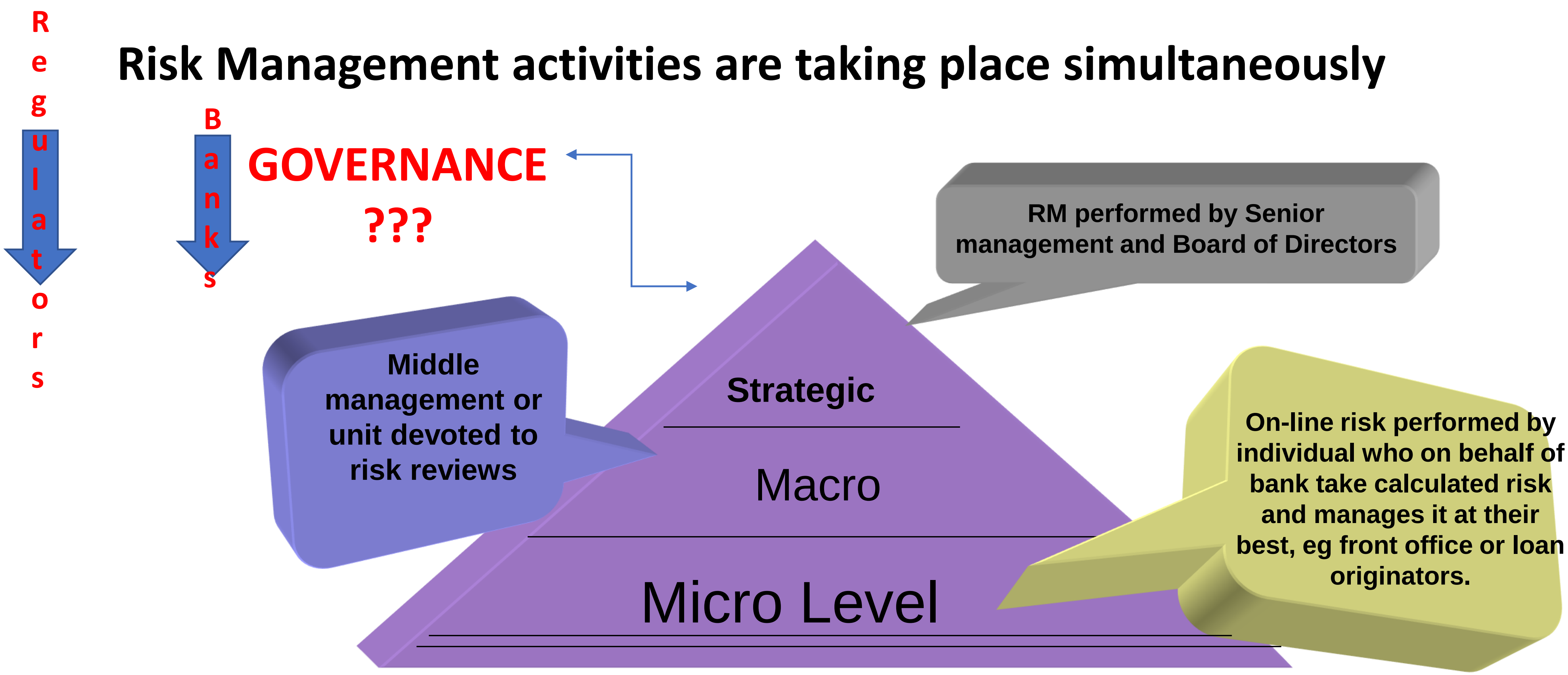
3. **Use of Advanced Analytics:** Leverage advanced analytics and machine learning models to predict credit risk more accurately. These tools can analyze vast amounts of data and identify patterns that human analysts might miss.

4. **Continuous Monitoring:** Regularly monitor borrowers' financial health and market conditions. Early detection of potential issues allows for timely intervention and mitigation strategies.

5. **Strong Internal Controls:** Implement robust internal controls and governance frameworks. Ensure that credit risk policies are consistently followed and that any deviations are promptly addressed.

Risk Management:

Risk Management activities are taking place simultaneously



Regulatory Compliance:

Regulatory bodies impose stringent guidelines on credit risk management. Adhering to these regulations not only ensures compliance, but also enhances the institution's credibility and stability. Non-compliance, on the other hand, can result in hefty fines and reputational damage.

Regulatory Landscape and Compliance Challenges:

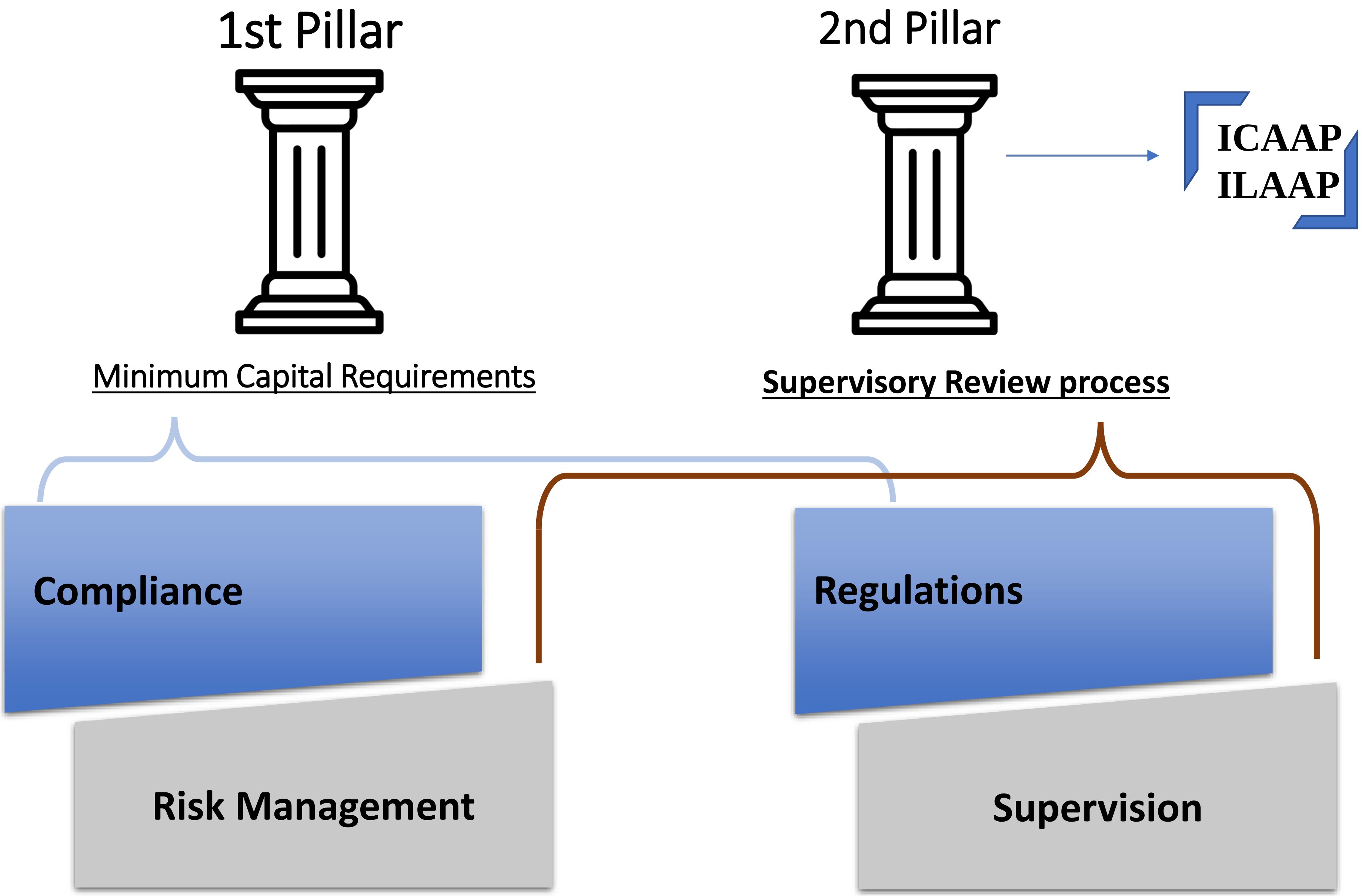
The regulatory landscape of the banking industry is shaped by a complex array of national and international regulations aimed at ensuring financial stability, protecting consumers, and preventing financial crimes.
In recent years, the regulatory requirements for banks have become increasingly stringent in response to the global financial crises and evolving financial risks. Key regulatory frameworks include the IFRS 9 and Basel III accord, also imposes comprehensive rules on risk management, reporting, and consumer protection

These regulations are designed to mitigate systemic risk and enhance the resilience of financial institutions

Compliance with these regulatory requirements presents several challenges for banks:

- One of the primary challenges is the sheer complexity and volume of regulations.
Banks must navigate a labyrinth of rules varying across jurisdictions, each with specific reporting standards and compliance timelines .
- This necessitates a significant investment in compliance infrastructure, including technology, processes, and personnel dedicated to monitoring and ensuring adherence to regulatory requirements.
- The cost of compliance can be substantial, particularly for smaller institutions that may lack the resources of their larger counterparts.
- Moreover, the dynamic nature of regulatory requirements means that banks must continually adapt their risk management frameworks. Regulatory bodies frequently update and introduce new regulations in response to emerging risks and economic conditions. **This requires banks to be agile and proactive** in their compliance efforts, regularly reviewing and updating their policies and procedures. The need for continuous adaptation can strain resources and impact operational efficiency, as **banks must balance compliance efforts with their core business activities**.

Regulatory Requirments' Transformation



“While bank boards and senior management are the first line of defense in managing and overseeing the cumulative sets of risks posed by rising rates, prudential regulation and supervision also have an important role to play"

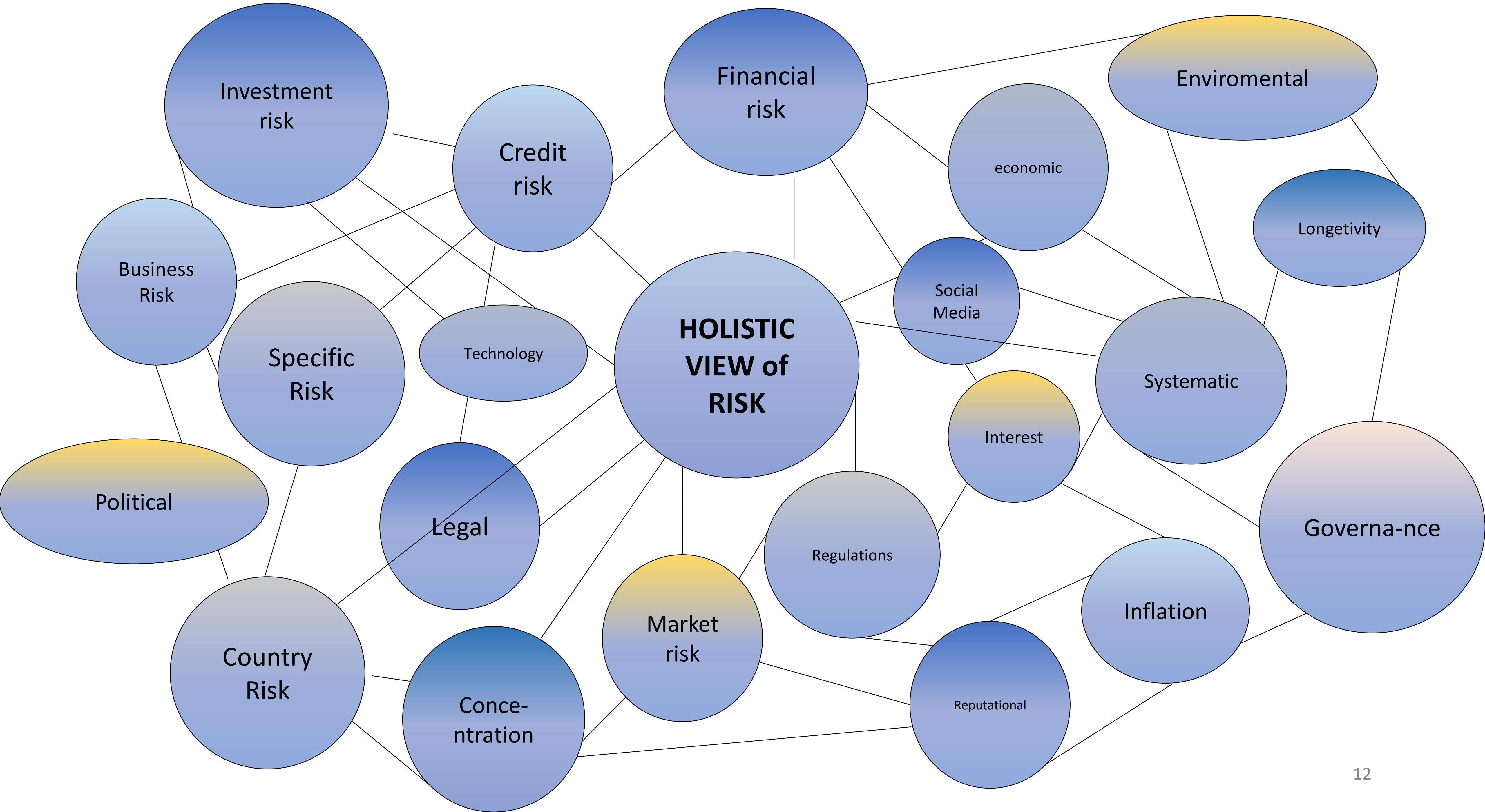
(*Hernandez de Cos, April 2023, Basel Committee on Banking Supervision*)

Banks	Regulators and supervisors
<u>Effective bank governance and risk management practices</u> • Risk Management Function and the role of senior management and the board. • Respond promptly to any material developments such as rapid growth of a bank’s balance sheet, an excessive reliance on a limited set of revenue or funding sources, ineffective asset-liability management, a growing number of misconduct incidents, changes in the economic environment (expected changes in interest rate or economic growth)	<u>Robust Regulatory Standards and Strong Supervision supported by proactive cross-border cooperation</u> • Being aware of the financial implications of assets reclassifications (Transfer of debt securities between classification category). • Further guidance on how to assess the relative stickiness/ price sensitivity of Non Maturity Deposits (NMD’s) . • Developing a more holistic approach to exercise stress testing, that takes into account all the elements that are outside the scope of the current conducted approach; all the direct impacts of changes in interest rates to exposures in the banking book, the constant balance sheet assumptions, the interplay between capital and liquidity, to get a more comprehensive view of the potential impact of rising interest rates on banks’ safety and soundness. • Require banks to hold additional liquidity Requirements (HQLA) if they deemed that risks faced by such banks are not sufficiently captured by Pillar 1, or depending on the characteristics of such assets; on the basis of a higher exposure to interest rate risk.

Exponential Risk
New Era Risk

Interconnectedness of Risk

Supervisors and Management must take into consideration the interconnectedness of all inputs of risk items (their individual Impact on the institution along with their collective effect), when evaluating and reviewing risk policy, Appetite, and counter Methodes.


Investment risk
Credit risk
Financial risk
Enviromental
economic
Longetivity
Business Risk
Specific Risk
Technology
HOLISTIC VIEW of RISK
Social Media
Systematic
Interest
Political
Legal
Regulations
Governa-nce
Market risk
Inflation
Country Risk
Conce-ntration
Reputational

1-Define Risk

2-Risk defenition must be multidimentional

3-Otherwise Organizations and nations now find themselves increasingly vulnerable to a risk “domino effect.” A single risk, affecting a single company or country, that triggers other risks over time — both within the entity itself and beyond

4-Effective integrated risk analysis defines a common language and framework for a wide variety of risk factors and their potential financial impact.

Strategies for Enhancing Compliance:

The increasingly stringent regulatory environment in the banking sector necessitates robust strategies to ensure compliance. Banks must adopt a multifaceted approach to address the diverse and complex requirements imposed by regulators:

1- Implementation of Robust Risk Assessment Tools:

Effective risk assessment tools are essential for identifying, measuring, and managing risks within a bank. These tools enable institutions to comprehensively understand their risk exposure, facilitating informed decision-making and proactive risk mitigation. Robust risk assessment involves both quantitative and qualitative analyses. Quantitative tools like statistical models and risk metrics allow banks to measure potential losses and the likelihood of various risk events. These tools include value-at-risk (VaR), stress testing, and scenario analysis, which help assess adverse market conditions' impact on the bank's portfolio.

2- **Development of Comprehensive Internal Policies and Procedures:**

Comprehensive internal policies and procedures form the backbone of an effective compliance framework. These documents provide clear guidelines on identifying, assessing, managing, and reporting risks, ensuring consistency and accountability across the organization. Policies should cover all aspects of risk management, including credit, market, operational, and liquidity risks. They should also address compliance with specific regulatory requirements, such as capital adequacy, liquidity ratios, and anti-money laundering measures.

3- **Leveraging Technology for Regulatory Reporting and Monitoring:**

Technology plays a pivotal role in enhancing regulatory reporting and monitoring capabilities. The adoption of advanced technologies, such as artificial intelligence, machine learning, and blockchain, can significantly improve the efficiency and accuracy of compliance processes. For example, AI-powered analytics can automate data collection and analysis, enabling real-time monitoring of transactions and identification of suspicious activities. Machine learning algorithms can detect patterns and anomalies that may indicate potential compliance breaches or fraudulent activities.

4-Importance of Staff Training and Awareness Programs:

A strong compliance culture is built on the foundation of well-informed and vigilant employees. Staff training and awareness programs are critical for fostering this culture and ensuring that all employees understand the importance of compliance and their roles in maintaining it. Regular training sessions should cover key regulatory requirements, internal policies, and best practices in risk management. These programs should be tailored to the needs of different employee groups, from front-line staff to senior management, ensuring that everyone is equipped with the knowledge and skills necessary to perform their duties effectively

5-Balancing Profitability and Risk Management In the banking sector:
striking a balance between profitability and risk management is both a critical challenge and a fundamental necessity. Effective risk management is essential for sustaining long-term profitability, as it protects the bank from potential losses while enabling it to capitalize on opportunities.

6-Aligning Risk Management Strategies with Business Objectives:
Banks must align their risk management strategies with their overall business objectives to achieve a balanced approach. This alignment ensures that risk management is not seen as a hindrance to profitability but as an integral part of the business strategy. One way to achieve this is by integrating risk management into the strategic planning process. This involves identifying the key risks that could impact the bank's strategic goals and developing risk mitigation plans that support these goals

7-Risk-Based Pricing and Decision-Making Models:
Risk-based pricing is a strategy that allows banks to price their products and services according to the level of risk involved. This approach ensures that higher-risk activities are appropriately compensated, which helps maintain profitability while managing risk. For example, loans extended to borrowers with lower credit scores should carry higher interest rates to compensate for the increased risk of default. Similarly, investment products with higher risk profiles should offer greater potential returns to attract investors

8- Enhancing Capital Allocation Efficiency:
Efficient capital allocation is essential for balancing profitability and risk management. Banks must allocate capital to different business units and activities based on their risk profiles and potential returns. This ensures that adequate capital buffers support higher-risk activities, while lower-risk activities are not overcapitalized. Effective capital allocation helps in optimizing the bank's overall risk-adjusted return on equity.

Expected Credit Loss: Basel IV vs IFRS 9

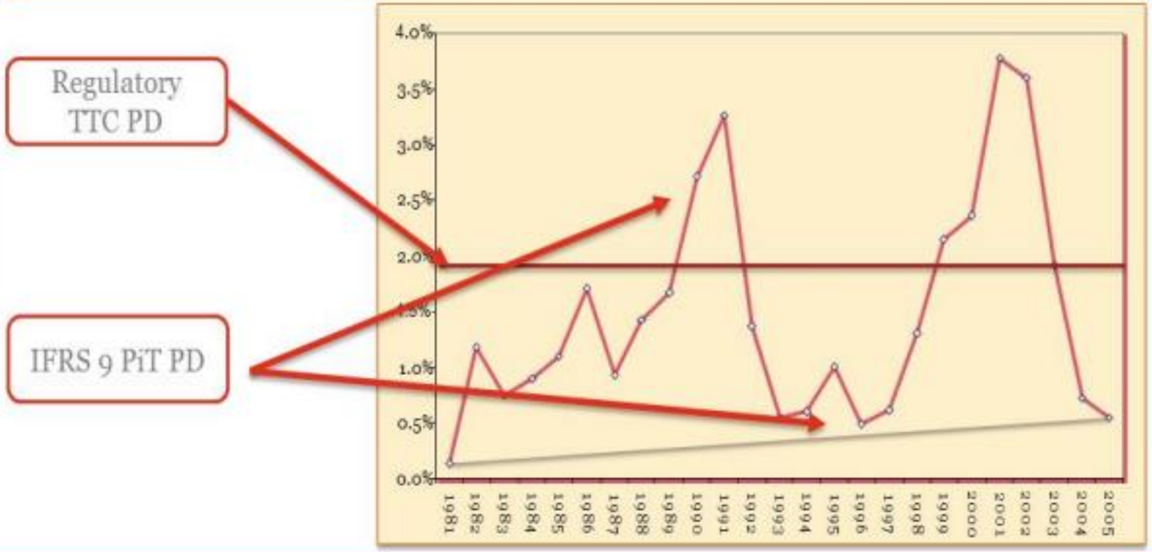
Comparison between Basel vs IFRS9

Where IFRS9 intersects with Basel IV

Impairments – Credit Risk

Hard to reconcile both!

Regulatory PD	IFRS 9 PD
Through the cycle ('TTC')	Point in time ('PiT')



	Basel IV	IFRS
PD	Point-in-time for impairments Through-the-cycle for capital determination	Point-in-time
	Floor regulations 0,03% Art. 163 Abs. 1 CRR (with Basel IV 0,05%)	No floor is available
LGD	Dependent on economic cycle Art. 181 Abs. 1b C	Workout LGD
	Direct & indirect costs Art. 5 Abs. 2 CRR	Only direct costs
	Risk free (interest) rate plus markup	Effective rate

Firstly, let’s understand the similarities:

- Both Basel and IFRS9 require banks to estimate the lifetime ECL of financial assets, reflecting the total loss expected throughout the loan’s life. This is a shift from the “incurred loss” model, where provisions were made only when losses became evident.

- Both frameworks use a forward-looking approach, incorporating past events, current conditions, and future forecasts to assess credit risk. This leads to more timely recognition of potential losses, enhancing financial stability

Now, let’s delve into the **divergence**:

Scope:

•Basel: Basel primarily focuses on credit risk exposures held by banks, setting minimum capital requirements based on risk-weighted assets. Credit risk is only one of the components influencing capital needs.

•IFRS9: Whereas IFRS9 primarily regulates financial reporting, dictating how ECLs are measured and recognized in financial statements. This directly impacts reported profits and losses.

Measurement:

•Basel: Basel offers two approaches – “Standardized” and “Internal Ratings-Based” (IRB). The standardized approach relies on external credit ratings and predefined risk weights, while IRB allows banks to use their internal models for more precise risk assessment.

•IFRS9: Provides more flexibility but also demands more sophistication. Banks can select from various measurement models, including “Probability of Default” (PD), “Loss Given Default” (LGD), and “Effective Interest Rate” (EIR).

Timing:

•Basel: Recognizes 12-month ECL for regulatory capital purposes, focusing on near-term default risks. This is distinct from lifetime ECL measurement.

•IFRS9: Recognizes lifetime ECL in the profit or loss statement at each reporting date, reflecting the complete expected loss picture.

Implications:

•Basel: There is less volatility when it comes to provisions, but may not fully capture evolving risks. The standardized approach, while simpler, can be less accurate for complex financial instruments.

•IFRS9: Increased provisioning, leading to potentially higher volatility in reported earnings. However, it provides a more transparent and forward-looking view of credit risk.

Use of Collateral:

•Basel: This allows for the consideration of collateral in assessing credit risk.

•IFRS 9: Requires a more holistic view, considering the impact of collateral on expected credit losses.

Implications for Financial Institutions and Investors

The adoption of Basel and IFRS9 has significant implications for financial institutions and investors:

•Increased Capital Requirements: ECL recognition under IFRS9 often leads to higher provisions, impacting capital ratios and potentially restricting lending activity.

•Enhanced Risk Management: Both frameworks necessitate robust risk management practices and sophisticated modeling capabilities to accurately estimate ECL.

•Greater Transparency: Improved disclosure provides investors with a more comprehensive understanding of credit risk and potential losses.

•Impact on Valuation and Investment Decisions: ECL estimates can influence asset valuations and investment decisions, requiring careful consideration by investors.

Challenges and the Road Ahead: Embracing the Future of ECL

Implementing both Basel III and IFRS9 presents several challenges for banks:

•Data Availability and Quality: Accurate ECL calculations require robust data and sophisticated modeling techniques.

•System Upgrades and Integration: Existing systems may require significant upgrades to accommodate the new frameworks.

•Human Resources and Expertise: Banks may need to invest in training and hiring personnel with expertise in ECL modeling and interpretation.

Despite these challenges, embracing the future of ECL offers several benefits:

•Improved Risk Management: Accurate ECL estimates enable better risk management and capital allocation decisions.

•Enhanced Financial Stability: Stronger capital adequacy helps in safeguarding the financial system from potential credit losses.

•Greater Investor Confidence: Improved transparency and disclosure of risk can boost investor confidence in banks.

BCBS finalised the Basel III post crisis reforms (called as Basel IV) in Dec'17 (BCBS D424) after addressing a number of shortcomings with the pre-crisis regulatory framework. The changes as per the new guidelines include revision in Standardised Approach (SA) & Internal Rating Based (IRB) approach for credit risk, Credit Valuation Adjustment (CVA) risk, operational risk, leverage ratio framework and SA based more risk sensitive new capital floor (or output floor).

Revised framework helps to restore the credibility in RWA calculation by:

- Reducing the excessive variability of risk-weighted assets (RWAs)
- Enhancing the robustness and risk sensitivity of the SA for both credit & operational risk
- Restricting the use of IRB approaches
- Implementing the finalized leverage ratio
- Applying revised and robust capital floor

The committee introduced transitional arrangements to implement the new standards. This will be done per the jurisdictions and adjustment by the financial institutions.

Basel reforms :impact on credit risk

The Basel 3 reform introduces several changes to both the Standardized (SA) and the Internal Ratings Based (IRB) approach.
Under IRB, a bank calculates its capital requirements using internally developed models. The reform is expected to result in both **increases and decreases of capital requirements** depending on the bank's existing regulatory approaches and **portfolio quality.** The changes in the final framework aim, among other things, to enhance comparability by aligning definitions and taxonomies between the SA and IRB approaches and to make the SA more risk-sensitive. In particular, the final reform introduces new asset classes or divides the existing ones, and revises the eligibility and/or the scope of the IRB approach for certain asset classes, leading to a reduced use of the IRB approach.

Changes overview

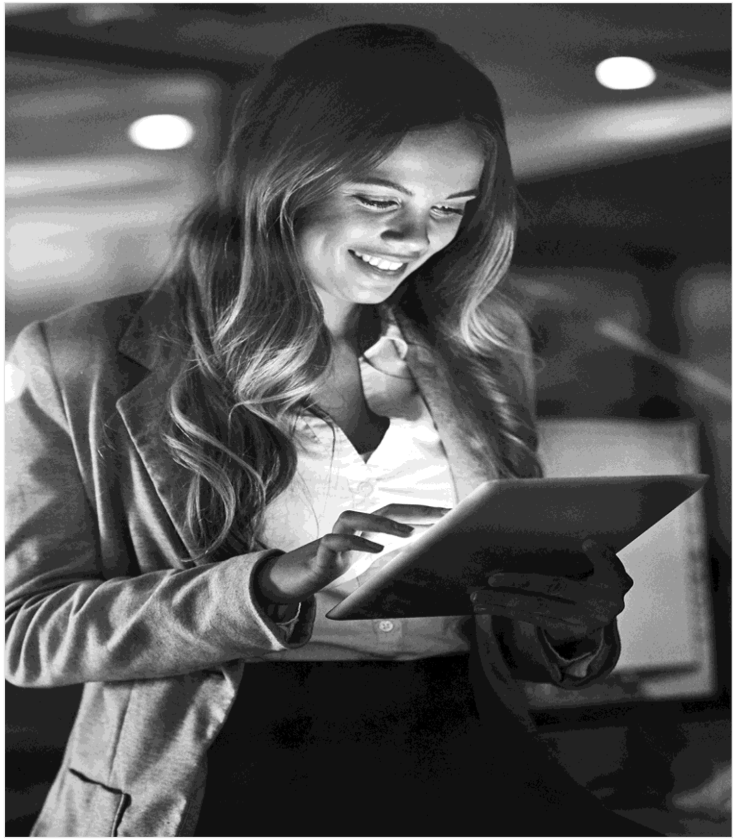
Category	Previously	Basel IV
SA RW: Residential Real Estate (RRE)	• 35%	• Based on Loan to value (LTV) for general RRE, income producing RRE (IPRRE) • Based on loan splitting approach for general RRE
SA RW: Commercial Real Estate (CRE)	• 100%	
SA RW: Retail exposure	• 75%	• Transactors: 45% • Revolvers: 75%
SA RW: Off balance sheet exposure	• 20% & 50% Credit Conversion Factor (CCF) for commitments with original maturity up to 1 year & over 1 year respectively; if not eligible as Unconditionally Cancellable Commitment (UCC)	• 40% for commitment unless qualify for lower CCF
IRB: PD flooring	• 0.03%	• Revolvers: 0.10% • Rest: 0.05%
AIRB: LGD & EAD flooring	• None	• LGD: 0%-50% • EAD: 50% of the off balance sheet exposure using applicable CCF in SA
IRB: RWA flooring	• 1.06 scaling factor	• SA based flooring. Gradually increases from 50% to 72.5% in 5 years' time

Changes for standardized approach

Retail exposure excluding real estate

- Transactors are obligors in relation to facilities such as credit cards and charge cards where the balance has been repaid in full at each scheduled repayment date for the previous 12 months.
- Obligors in relation to overdraft facilities would also be considered as Transactors if there has been no drawdown over the previous 12 months.

Regulatory retail (non-revolving)	Regulatory retail (revolving)		Other retail
	Transactors	Revolvers	
75%	45%	75%	100%



- **Transactors/Revolvers for the overdraft:** The part of the definition mentioned in BCBS D424, "….no drawdowns over the previous 12 months." technically enables the following possibilities:
  - Scenario-1: An account can be tagged as Transactors if it has drawn certain amount prior to 12 months and keep paying only interest, but has not drawn down any additional amount over the previous 12 months. OR,
  - Scenario-2: An account can be tagged as Revolvers even if it uses the overdraft & pay back in full in a same day before applying any interest/charges (interest is applied on daily basis in general for overdraft facility, unlike the credit card where interest is applied on due date in a month) .
- In Scenario-1, the account is relatively a risker one like a revolving credit card/charge card account as maintaining a positive balance for more than 12 months. Preferably this should be treated as Revolvers.
- In Scenario-2, ideally the account is less risky and should be treated as Transactors if the day end balance is '0". As per the definition, technically, the account to be tagged as Transactors only if the borrower should not use the overdraft facility in the last 12 month at any point of time (no drawdown), which is not a very different from an inactive account. It can be more in line with credit card/charge card definition if day end balance is considered to define Transactors/ Revolvers indicator for overdraft facilities.
- National supervisors and financial institutions may need to determine the prudent criteria for the same.

Off balance sheet exposure

- A 40% CCF will be applied to commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF.
- A 10% CCF will be applied to commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness.

Exposures type	CCF
Direct credit substitutes, forward asset purchases, forward deposits and partly paid shares and securities, unsettled financial asset purchases.	100%
Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs)	50%
Commitments, unless they qualify for a lower CCF	40%
Self-liquidating trade letters of credit arising from the movement of goods	20%
Commitments that are unconditionally cancellable (UCC) at any time by the bank without prior notice	10%

Changes for internal rating based approach

- PD is the max (one-year PD associated with the internal borrower grade to which the pool of retail exposures is assigned, 0.10% for qualifying revolving retail exposure (QRRE) revolvers and 0.05% for all other exposures).
- The LGD floor for residential mortgages is fixed at 5%, irrespective of the level of collateral provided by the property.
- The LGD floors for partially secured exposures in the "other retail" category should be calculated according to the formula set out in BCBS D424.
- Banks EAD estimates must be developed using 12-month fixed-horizon approach.

Loan type	PD	LGD		EAD
		Unsecured	**Secured**	
Mortgages	0.05%	NA	5%	EAD subject to a floor that is the sum of • On-balance sheet exposures and; • 50% of the off- balance sheet exposure using the applicable CCF in the SA
QRRE transactors	0.05%	50%	NA	
QRRE revolvers	0.10%	50%	NA	
Other Retail	0.05%	30%	Varying by collateral type: • 0% financial • 10% receivables • 10% commercial or residential real estate • 15% other physical	

Two novelties introduced in the reforms are

(i) the specific treatment of Income Producing Real Estate (IPRE) mortgage loans to account for the higher risks associated with such exposures, where there is material dependence on the cash flows from the underlying properties ,

(ii) and (ii) the loan-splitting approach. This loan-splitting approach divides mortgage exposures into secured and unsecured. For properties ineligible for loan-splitting, a more risk-sensitive fallback treatment based on the Exposure-to-Value (ETV) ratio will be applied. Both approaches require much more data gathering and processing compared to the current SA approaches. National jurisdictions are allowed to choose either the loan-splitting approach or the whole-loan approach for residential and commercial real estate, although it is currently anticipated that most jurisdictions will opt for the loan-splitting approach.

On the opposite direction, the removal of the IRB approach for 'equity' exposures leads to a decrease in the RWA for this exposure class. Under the revised SA framework, the risk weight for 'equity' exposures is expected to drop to 250%, from the current risk weight of 370%. This is particularly interesting for banks that currently apply the Danish compromise method to risk weight participations in their insurance undertakings (rather than fully deducting them from equity).

Output floor

The introduction of the output floor represents one of the most significant changes under the Basel 3 Reform.

It limits the capital benefits for banks using internal models to calculate the regulatory capital across all risk types. The risk-weighted exposures produced by these banks should not fall below 72.5% of the risk-weighted exposures that would apply based on standardized approaches (gradually to be phased-in, starting at 50% in 2025). This would result into an estimated impact of 6.8% on European banks' minimum Tier 1 capital requirement.

Data:

under the Basel 3 Reform, banks will have to source new data attributes. While some may opt to make minimum technology updates to meet the new requirements, we view the reform as an opportunity to launch a broader capital technology transformation. RWA calculations depend on data management, modelling, and reporting, all of which could lead to increased RWA and capital requirements if not optimally calculated and deployed. By improving accuracy and processes, banks could lower RWA requirements under either approach. This can be done across all possible dimensions, but credit risk is usually key. Banks should clearly understand their RWA drivers, the evolution over time and the critical data fields, in order to define actions to mitigate the RWA impact (e.g., by correctly registering all collaterals in the system, challenging data quality issues, etc.).

Board of Directors & Senior Management
How should react ?
Impact of IFRS9 &Basel iv on Credit Portfolio

the strategic repercussions will be so significant—requiring banks to rethink:

1. risk appetite.
2. portfolio strategy
3. commercial policies

Otherwise banks will have to manage the impact reactively after the event.

To get ahead, banks should identify it’s strategic actions in these areas:

1. Adjusting portfolio strategy to prevent an increase in P&L volatility

IFRS 9 will make some products and business lines structurally less profitable, depending on the economic sector, the duration of a transaction, the guarantees supporting it, and the ratings of the counterparty. These changes mean that banks will need to review their portfolio strategy at a much more granular level than they do today.

- Economic sector. The forward-looking nature of credit provision under IFRS 9 means that banks will need to reconsider their allocation of lending to economic sectors with greater sensitivity to the economic cycle.
- Transaction duration. The more distant the redemption, the higher the probability that the counterparty will default. Under IFRS 9, stage 2 impairments are based on lifetime ECL—the expected credit losses resulting from all possible default events over the expected life of the financial instrument—and will therefore require higher loan-loss provisions.

- Collateral. Unsecured exposures will be hit harder under the new standard. Collateral guarantees will help mitigate the increase in provisions for loss given default under IFRS 9, particularly for exposures migrating to stage 2
- Counterparty ratings. IFRS 9 imposes heavier average provision “penalties” on exposure to higher-risk clients, so counterparty ratings will have a direct impact on profitability. Industry observers expect provisioning for higher-risk performing clients to rise sharply once the new framework is in place.

banks should steer their commercial focus to sectors that are more resilient through the economic cycle.

2. Revising commercial policies as product economics and profitability change

- IFRS 9 will reduce profitability margins, especially for medium- and long-term exposures.
- To offset this negative impact on profitability, banks can adjust their commercial strategies by making changes in pricing or product characteristics:
  - Pricing. When possible, banks should contractually reach agreement with clients on a pricing grid that includes covenants based on indicators that forecast the probability of migration to stage 2, such as the client’s balance-sheet ratio and liquidity index. If a covenant is breached, the rate would increase.
  - Product characteristics. Banks could adjust maturity, repayment schedule, loan-to-value, providing incentives to relationship managers and clients to shift to shorter-term products, and introducing new products.

3. Reforming credit-management practices to prevent exposures from deteriorating

Banks need to enhance performance monitoring across their portfolio and dramatically increase the scope of active credit management to prevent credit deterioration and reduce stage 2 inflows. Different approaches can be used to do that, including an early-warning system or a rating advisory service.

4. Rethinking deal origination to reflect changes in risk appetite

IFRS 9 will prompt banks to reconsider their appetite for credit risk and their overall risk appetite framework (RAF), and to introduce mechanisms to discourage credit origination for clients, sectors, and durations that appear too risky and expensive in light of the new standard.

5. Providing new training and incentives to personnel to strengthen the commercial network

As a result, they will need to be trained in new skills such as financial restructuring, workout, and capital management to help them deal with troubled assets effectively.

The RMs should be evaluated and compensated on an appropriate risk-adjusted profitability metric

Conclusion:

Lastly, both Basel and IFRS 9 aim to address credit risk and Expected Credit Loss, but from different perspectives and with different objectives.

Basel focuses on regulatory capital adequacy, allowing flexibility in the use of internal models.

In contrast, IFRS 9 adopts a forward-looking approach, emphasizing timely recognition of credit losses in financial statements.

As we move forward, convergence between Basel III and IFRS9 becomes a desirable goal to reduce complexity and ensure consistency in ECL calculations. Continuous innovation in modeling techniques and data analysis will further help in refining the accuracy and effectiveness of ECL estimations.

"MORE THAN A DECADE OF BANKING SYSTEM STABILITY AND STRONG PERFORMANCE BY BANKS OF ALL SIZES MAY HAVE LEAD BANKS TO BE OVER CONFIDENT AND SUPERVISORS TO BE TOO ACCEPTING "

"FEAR COMPLACENCY"