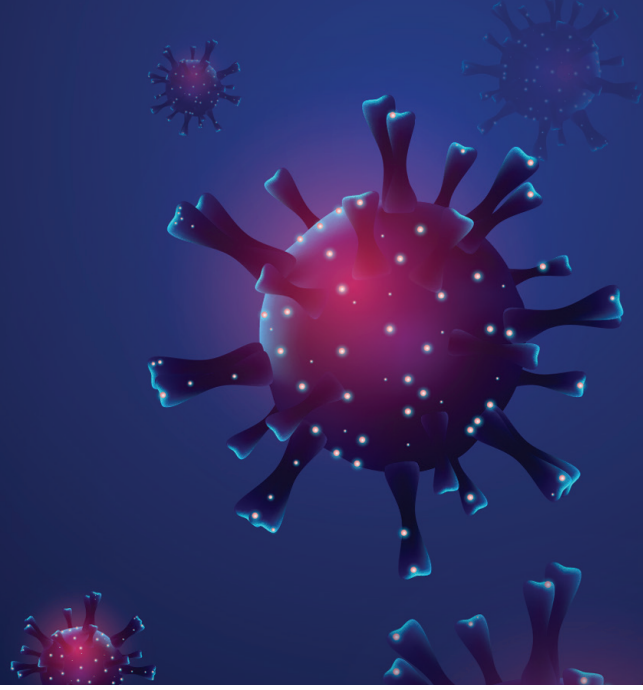
KPMG

Seek facts, derive insights



Automated solutions guiding us through uncertainty

The effects of the COVID-19 pandemic will have lasting impacts on organisations for the foreseeable future including credit providers. The ability to assess these impacts would aid organisations in making informed decisions to remain resilient and grow over uncertain periods. Credit providers are being asked by their Boards and Shareholders to determine the impacts of:

- Incorporating macro-economic relationships, and any qualitative factors (e.g. government assistance) within the risk of default
- An increased contractual period (or lifetime) due to restructures and/or the inclusion of payment holidays
- A slower pay down period due to relief provided by credit providers through payment holidays or reductions in interest rates, and/or increased drawdowns on revolving facilities by customers to gain access to cashflow to meet existing commitments
- Identifying a Significant Increase in Credit Risk, incorporating quantitative and qualitative factors as a result of changes in customer behaviour, requests for payment holidays, limit increases, changing economic conditions and
- A combined effect of a multitude of model changes.

Determining impacts on the Expected Credit Loss (ECL) due to evolving circumstances is laborious, manual and time-consuming and poses a high risk of error. There is a need for an automated, streamlined IFRS 9 ECL estimation process allowing for quick impact assessments. The automation enables improved governance and traceability, accelerates reporting and supports effective business decision making.

KPMG's IFRS 9 Risk and Impairment Solution (IRIS) can be specifically tailored for credit providers' current operating and model environment. IRIS was developed to provide users access to a single well-governed platform, where complex statistical models and impact assessments can be executed using an automated, seamless process. As a result of the accelerated processing of the analytics, the underlying risks can be analysed and understood allowing business to make proactive key strategic decisions to optimise growth or minimise risk.

IRIS automates the ECL estimation and parameter calibration process, provides visual reporting of the ECL process, identifies elements of data, assumption and model risk and quantifies the ECL impact of these risks. IRIS is deployed in a well governed, control-based environment where individuals can change multiple assumptions and quickly understand and visualise the impacts without risk of altering the final implemented models.

Multiple concurrent sensitivity assessments can be executed to assess the impacts of various changes to ECL inputs (e.g. data, assumptions or forward-looking views), collating these changes into a combined assessment of the ECL impact determined through the scenario analysis. An illustration of five potential impacts on the COVID-19 pandemic on ECL is set out as follows:

1. A GDP impact on the Probability of Default

If GDP decreases, you could expect a rise in defaults leading to a higher Probability of Default (PD) on both a 12 month and lifetime basis. Using different views of the economic recovery, the impact of these on PDs and hence ECL can be quickly assessed utilising IRIS.

2. Loss Given Defaults Impacts

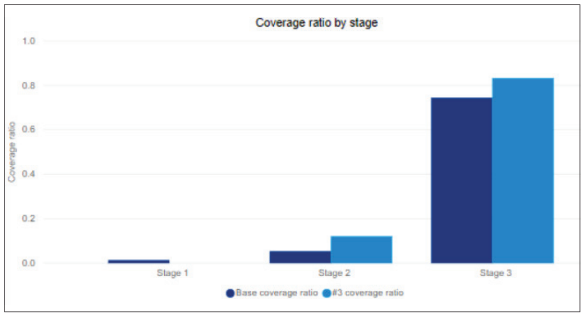
A change in asset values or asset related macro-economic conditions could result in a lower expected collateral value supporting the credit facility. A lower collateral value may result in higher losses experienced on default of a facility. This, in turn, would cause the Loss Given Default (LGD) parameter to increase due to lower recovery values. Ultimately, you could assess the impact of changes in collateral value on the ECL, by adjusting the indices off which collateral values are forecasted.

3. Migrate Stage 1 accounts to Stage 2 (SICR reclassification) and impact of Government funding

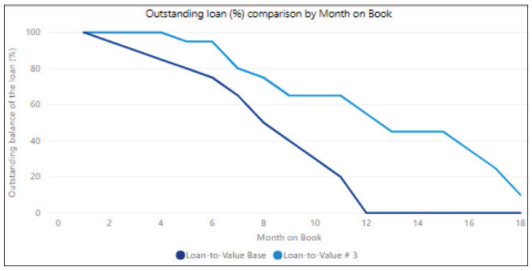
With the increase in default rates, there could be an increase in the migration of accounts to Stage 2 due to a significant increase in risk since origination. These accounts would no longer reflect 12-month losses, but rather reflect all possible default events over their lifetime.

To determine the impact of these migrations, the solution enables an easy mechanism to transfer exposures for e.g. that are within a high-risk industry or high-risk customer segment, to Stage 2. For example, migrate the 'small business' loan portfolio or aviation industry segments into Stage 2 and determine the ultimate impact of these migrations on the ECL.

Note: The impact of varying levels of government assistance should be considered prior to performing the SICR assessment.



4. Exposure at Default Impacts

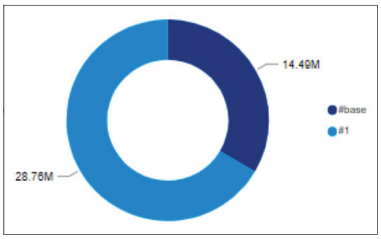


Due to liquidity constraints, borrowers are expected to draw down on existing facilities to meet their obligations which could place upward pressure on the Exposure At Default (EAD) estimates.

The EAD profile should change to reflect larger drawdowns on revolving facilities and a slower pay back periods due to payment holidays. To allow for a potentially longer facility lifetime, adjustments are made to the amortisation assumptions and updates are made to reduce the extent of prepayments. The IRIS solution allows an easy recalibration of the parameters based on the updated assumptions, and hence enables quick impact assessments considering a myriad of assumption changes.

5. Scenario impact analysis combination PD, SICR, EAD, LGD

The scenario analysis assesses your ECL's sensitivity to changes in multiple key modelling assumptions run in combination as the individual impacts of changes to the ECL are not necessarily additive. The ECL is recalculated based on the selected combined assumption changes by updating the assumptions that feeds into the IFRS 9 parameters through a simple user interface. This provides you a holistic view of the impact on the ECL of the effects of COVID-19 and hence could be an input into a likely impact on the financial statements.



Conclusion

KPMG can assist you in embracing automation, providing solution-driven insights through a well-governed platform tailored to your business models. IRIS can assist credit providers to run real time scenario impact assessments to model the continual evolving impacts of COVID-19. Take charge of your business by proactively managing market change through decisive action driven by analytical insights.

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