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IFRS9 Modelling Approaches for Retail Portfolios

IFRS9 is a new accounting regime for credit losses that comes into force in 2018. It will require significant effort from lending institutions to enhance current processes to comply with the need to have a forward looking (macro-economic) view of impairment. This paper presents two approaches – building on banks IRB model framework - that meet the IFRS9 requirements.

One approach uses Partial Least Squares regression to decompose historic segment level information to determine economic effects in isolation and modelling these separately. This builds on approaches already used within many advanced banks to forecast losses at a portfolio level and potentially has lower data requirements.

A second approach, building on work of previous authors (Belotti, Crook 2009), looks to incorporate macro-economic effects within models for PD and LGD directly in a way that is compliant with IFRS9 regulation and re-uses IRB model outputs. The survival model used is a discrete time ordinal logistic regression approach. This solution requires account level history but more naturally accounts for statistical estimates of parameters based on volumes of observations.

The paper explores how these models should be assessed against the criteria for accuracy, transparency and ease of maintenance.