The new accounting standard IFRS 9 and its impact on how banks should provision for credit losses

المعيار المحاسبي الجديد (المعيار الدولي للتقارير المالية رقم 9) وتأثيره على كيفية قيام البنوك بتخصيص خسائر الائتمان

by

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Abstract

On Jan, 2018 the new accounting standard International Financial Reporting Standard 9 (IFRS 9) was implemented aiming in simplifying calculation of impairment and other financial measurements. The aim of this study is to examine the new accounting standard and its impact on how banks should provision for Expected Credit Losses (ECL) and its effect on other financial assets. The dissertation is based on qualitative approach where set of interviews with finance and corporate teams of banks and other entities have been contacted. Using semi-structured interviews, respondents were asked to answer the study questions and how banks should provision for expected credit losses under new accounting rule IFRS 9.

Knowing and observing new accounting rule is very important. Dissertation focuses on how the new accounting rule start approximating losses when loan is made which will help banks to avoid any bad news such as future recessions, political events, and sitting apart reserves to meet unexpected future losses. Moreover, IFRS 9 impacts many capital ratios such as Capital Adequacy Ratio (CAR) and Common Equity Tier 1 (CET 1).

The findings and results of the interview questions were that the new standard will impact the provision part of the banks but this impact will not be dramatic. Moreover, the impairment provision level will increase under IFRS9 around 25%. Under the new accounting rule there are requirement for issuing more equity, since more loans are unexpected to get back from the customers in this situation banks may need more capital to cover the expected losses. IFRS9 also can affect deal pricing under the new standard for risky customers may get higher price than normal customers. Banks in the UAE can take many strategies such as strong relationship, Tighter controls on new originations, and Revisions of Policies & Product characteristics in order to lower the expected provision.

ملخص

في يناير من عام 2018 ، تم تطبيق المعيار المحاسبي الجديد ـ المعيار الدولي لإعداد التقارير المالية 9 (المعيار الدولي للتقارير المالية 9) بهدف تبسيط حساب انخفاض القيمة والقياسات المالية الأخرى. تهدف هذه الدراسة إلى فحص المعيار (ECL) المحاسبي الجديد وتأثيره على الطريقة التي يجب على البنوك من خلالها توفير الخسائر الائتمانية المتوقعة وتأثيرها على الأصول المالية الأخرى. وتستند الرسالة إلى النهج النوعي حيث تم الاتصال بمجموعة من المقابلات مع فرق التمويل والشركات من البنوك والشركات الأخرى. أثناء إجراء المقابلات، طُلب من المشاركين الإجابة عن أسئلة الدراسة وكيف ينبغي للبنوك توفير الخسائر الائتمانية المتوقعة بموجب قاعدة المحاسبة الدولية الجديدة رقم 9 من معايير المحاسبة الدولية.

معرفة ومراقبة قاعدة المحاسبة الجديدة أمر مهم للغاية. تركز الرسالة على كيفية بدء القاعدة المحاسبية الجديدة في تقريب الخسائر عند تقديم القرض مما سيساعد البنوك على تجنب أي أخبار سيئة مثل الركود في المستقبل ، والأحداث السياسية ، والاحتياطيات الاحتياطية لمواجهة الخسائر المستقبلية غير المتوقعة. علاوة على ذلك ، يؤثر المعيار الدولي للتقارير المالية ويؤثر المعيار الجديد على بعض النسب رأس المال مثل نسبة كفاية رأس المال والمستوى المشترك 1

كانت نتائج أسئلة المقابلة أن المعيار الجديد سيؤثر على الجزء المخصص للبنوك ، لكن هذا التأثير لن يكون كبيرا. علاوة على ذلك ، سيرتفع مستوى مخصص انخفاض القيمة بموجب المعيار الدولي للتقارير المالية 9 بحوالي 25٪. بموجب القاعدة المحاسبية الجديدة ، هناك حاجة لإصدار المزيد من الأسهم ، لأن المزيد من القروض غير متوقعة للتحصيل من العملاء في هذه الحالة ، قد تحتاج البنوك إلى المزيد من رأس المال لتغطية الخسائر المتوقعة. قد يؤثر المعيار الدولي لإعداد التقارير المالية 9 أيضًا على تسعير الصفقات وفقًا للمعايير الجديدة للعملاء ذوي المخاطر وقد يحصل على سعر أعلى من المعتاد. يمكن للبنوك في الإمارات العربية المتحدة أن تتخذ العديد من الاستراتيجيات مثل العلاقة القوية ، وضوابط أكثر تشددًا على الأصول الجديدة ، ومراجعات السياسات وخصائص المنتجات من أجل خفض المخصصات المتوقعة.

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1.1 Background

This chapter will focus on general background of the research topic and different types of the accounting standards. Beside this, it will cover various research aims and concepts, will display the research objectives, and will review proves from multiple studies about the topic. Also, dissertation will discuss the main problem and how to disband it. Furthermore, significant of the study and motivation will be discussed in this part.

During financial crisis 2008 there were absence of appropriate risk assessment and loss provisioning for the pro-cyclical loan were "too little, too late" which refer that in the crisis era there were a vast systematic cost due to delay in recognition of credit losses on the lenders and banks. Because of this, the International Accounting Standards Board worked on introducing a new accounting standard IFRS 9 on financials instruments to smash such weaknesses. The IFRS 9 has substituted the past IAS 39 which was more complex and difficult to implement according to PWC. Before introduction of IFRS 9 in 1 Jan 2018 it was developed through three phases, phase one is "Classification and measurement", phase two is "Impairment", and last phase is "hedge accounting" (Seitz, 2019).

As stated by Sultanoglu (2018), the new accounting standard IFRS 9 was mandatory for all entities on 1 Jan 2018 and this standard was introduced with three stages, phase 1- measurement and classification of financial asset, phase 2 – three stage modeling for impairment, and phase 3-

hedge accounting. The stage 2 will have the biggest influence specifically on the banks because of the expected credit losses as there is early recognition of the loss allowances as it was stated by the IASB's Chairmen. The new impairment under IFRS 9 model will require to identify the provision for ECL before they happen and record them at each reporting period to reflect the variations in the credit risk since early recognition. Therefore, will lead to more transparent and accurate info for the financial report handlers.

On Jan 1, 2018 all the banks were freak out upon the mandatory adoption of the new accounting rule IFRS 9. But why? The new rule was introduced to make life easier for analysts, investors, and finance people, but why they are fearful from IFRS 9? This question will be answered later. The new accounting rule IFRS 9 was developed and introduced which refer that in the crisis era there were a vast systematic cost due to slowness in recognition of credit losses on the lenders and banks since the old standard IAS 39 was more complex and difficult in implication, a requirement of simpler and more prudent rule was voted out (Seitz, 2019). IFRS 9 aims several things such as identifying and measuring financials assets & liabilities and buying or selling non-financials items. Furthermore, it aims to provide useful data to users of financial statements for their valuations of vagueness of the firm's future cash flows, amounts, and timing (Seitz, 2019).

Why banks are afraid from the new standard? Banks are afraid from the new standard more than corporations since bank's financials are totally different from corporate's financials. Banks assets are loans given to customers and the liabilities are the deposits received from the customers. The new accounting rule IFRS 9 has changed the way a bank should record provisions. Provisions are recorded at the initial recognition of the financial assets, which means that a loan given to

customer at the same time the provisions are specified on the financials, even though there is expectation of getting back or collecting the financial assets in the future. The old standard IAS 39 was measuring the impairment allowances based on the "incurred loss model" wherein losses were recorded after the origination. Whereas IFRS 9 entails impairment allowances for all exposures from the time the loan is initiated based on the spoilage of the credit risk since early recognition of the financial assets (Ernst & Young 2018).

1.2 Problem statement

The way banks should measure provisions for Expected Credit Losses (hereafter ECL) varies from bank to bank, this means that there is possibility that not all the banks will calculate the correct anticipated ECL. Moreover, not all banks put strategies to reduce credit risks of IFRS 9. Why this topic was chosen because there were very few attentions to the new accounting rule especially for the financial institutions like banks whom were thinking that the new rule will make life easier in measuring impairments, whereas they were unaware of the consequences that this rule could cause. There are limited studies on the topic within the GCC context in overall and UAE in specific.

1.3 Aim and Objectives

The aim of the study is to examine the new accounting rule IFRS 9 and its impact on how banks should provision for Credit losses since this concept has been tariffing most banks since Jan, 1 2018 (On the adoption date of IFRS 9). To achieve the main aim there are some objectives to be investigated and these objectives are:

1- Understand the IFRS 9 in details and summarize main measurement and impairment.

2- Address IFRS 9 impact on Common Equity Tier 1.

3- Examine IFRS 9 effect on credit risk of the banks.

4- Investigate impact of the new accounting rule on capital.

5- Study eff

6- ects of the new accounting rule on the banks in the GGC countries.

7- What are the challenges that Banks face while implementing IFRS 9?

8- What are strategies and steps should banks take to reduce IFRS 9 effects.

9- what are the total ECL for the top 10 banks in the UAE?

1.4 Motivation of the study

Motivation of the study is discussing a new area that is hidden or not payed attention to it. Many studies about the new accounting rule (IFRS 9) and its impact on the provision were done in the Europe and other western countries unlike UAE and the GCC context there were very few topics about the new standard. This thing was a motivation to fill the gap and discuss this topic and concentrate on the UAE banks. Furthermore, due to daily economic changes and new updates of the accounting standards to fit new economic conditions, we have to be aware of these standards and study them very well before the implementation date.

1.5 Significant and Contribution

The study results will provide a good understanding of the new accounting rule IFRS 9 and its impact on various financial instruments such as equity, retained earnings, capital and on equity analyst. Research outcomes will help financial institutions to be aware of any new accounting

standard and study it before mandatory adoption. Moreover, it will support investors and analysts and will alert them for any sudden future effects on the financials of the companies and stocks. The concentration in the research is to know how banks in the UAE were settled for the IFRS 9, how they have to provision for the credit losses and what strategies they can take to manage IFRS 9 risks better. The study is presenting all this information to enhance areas which require enhancements. For instance, one area of enhancement is what banks should do to reduce the IFRS 9 risks.

1.6 Thesis structure:

The research will cover several chapters. First of all, will be the introduction and background about the topic with the main aims and objectives. The second chapter identification and definition of the new and old standard and different phases of the new standard are briefed. Then different previous studies done in the Europe on the research topic have been summarized in the literature review part in the third chapter. Furthermore, chapter four summarizes and clarifies methodology and type of methodology used in this examination. After that, comes chapter five which includes results and outcomes of the study presented with support from different studies for each interview question. The last chapter is chapter six and contains conclusion along with summaries of findings and future research then followed by reference list.

CHAPTER 2: INTERNATIONAL FINANCIAL REPORTING STANDARD (IFRS): AN OVERVIEW

2.1 Introduction

This chapter will provide an overview about IFRS and International Accounting Standard (IAS). First, a short and understandable definition of IFRS will be briefed after that the variances among the old standard IAS 39 and new accounting rule IFRS 9. Then some details about the new rule are clarified and summarized.

2.2 What is IFRS?

A recent article by (CFI 2019) defined, IFRS is a shortcut of (International Financial Reporting Standards) that is a set of accounting rules and principles that specify how the accounting events and transactions have to be reported in the financial statements and it is not-for-profit organization entrenched to serve the public interest. These accounting rules are prepared in a clear way to sustain transparency and credibility in the financial world, which helps financial operators and investors to make good and informed financial decisions. These rules are instituted to improve understandable, high-quality and enforceable accepted accounting standards. IFRS is adopted worldwide by more than 120 companies in many different countries in Asia, Africa, and South America but the United States of America still not adopt it. It was released by International Accounting Standards Board and were decided to form a common language so that financials statements are easier to read and to be understood from company to company and from country to another country.

2.3 Why a global standard?

Why we need a global standard? Recent economies rely on the cross-border transactions since most of the financial transactions arise across borders. Another thing is that, many investors seek variety and investment prospects across the world and have subsidiaries in various countries. In the past, it was different for companies to trade or do transactions worldwide since each company had its own accounting standard which had added cost, ultimately risk, and complexity to firms preparing their financials to be understandable by many users. There are many benefits of the IFRS standards which are going to be presented in the following paragraph. The first benefit of IFRS is bringing transparency in order to help investors and other market contributor to make informed financial decisions. Another benefit is strengthening accountability in decreasing the data gab between the providers of capital and to people whom have hand over money. The third benefit of IFRS is providing economic efficiency by supporting investors to recognize the risks and chances around the world (Why global accounting standard? 2017).

2.4 What is IAS?

International Accounting Standard (IAS) is an older accounting standard that was issued by International Accounting Standards Board (IASB) which is based in London and were replaced in 2001 by International Financial Reporting Standard (IFRS). IAS was found in 1973 by the accounting committee called (IASC) International Accounting Standards Committee, and the aim of this standard was to make the financials reporting more understandable to the people around the world, encourage global investments and trade, increase transparency & trust in the financial reporting and also it is beneficial for the capital markets that are placed in different jurisdictions can make the most effectual capital flows that can advantage the market as whole and organizations (What International Accounting Standards 2019).

2.5 Three Editions of IAS

The three countries which still did not imply the IFRS mandate are U.S., Japan, and china. There are three editions of the IAS red book, blue book and green book. The first edition was the red book and it is still available but the information is not updated. The second edition is the blue book and it was printed in 2010 and it was placed before first of January of 2010. The last edition is green book and it is the latest version consolidated all the current and past standards. The solely problem with this standard was not all the companies listed and listed use it, so because of this issue the standard committee has issued IFRS to replace the IAS (What International Accounting Standards 2019).

2.6 What is IAS 39?

The International Accounting Standard 39 is an accounting rule that records rules for accounting and reporting for almost all financial instruments such as debt, equity securities (Shares, Treasury Bills, Bonds), receivables, loans, derivatives and many other financial assets. IAS 39 was released in 2003 by International Accounting Standards Board (IASB) and in 2014 it was replaced by the new standard IFRS 9 which become operative in Jan 2018. (IAS 39 Wikipedia, 2019) The classification of financial asset under IAS 39 are categorized into four main categories and they are loan and receivables, held to maturity financial instruments, financial asset at fair value through profit & loss, and available for sale financial asset (Silvia, 2019).

2.7 What is IFRS 9?

As stated by one of the biggest audit firm (PWC, 2017), IFRS 9 is the new accounting standard which is going to be implemented on 1 Jan 2018, some corporates have implemented it earlier. The new accounting rule concentrates on how should corporates account for their financial assets and liabilities? Why the new accounting rule? The new accounting rule was introduced answering that the old standard IAS 39 is too complicate and unreliable with the way corporates manage their risk and business and differentiates the recognition of the credit losses on receivables and loans when it is too late in the credit cycle.

2.8 Three segments of IFRS 9

The International Accounting Standard Board has developed IFRS 9 in three segments which are identifying measurement and classification of the financial assets, impairment and hedging. The releasing of each phase of IFRS 9 was upon completion, then the corporates had choice either to adopt it or wait until the mandatory adoption in 2018. The new accounting standard is based on the idea that measurement and classification of the financial assets should be at fair value, with the changes in fair value recognized in profit and loss as they arise (FVPL), or when other limitations arise to measure either at amortized cost or changes in fair value through other comprehensive income (FVOCI). (Financial Instruments Understanding the basics, 2017)

2.9 Impairment part of financial assets under IFRS 9

In this part we are going to concentrate on the impairment phase of the financials assets since the two other remaining phases are not related to the study. The impairment part concentrates on two areas of fundamental changes are receivables and loans including short-term trade receivables and investment in equity instruments. IFRS 9 will report mainly computation of the new model (Expected Losses) which will avoid risk of loan has been incurred and will focus on the risk that a loan will default. When the asset is originated or acquired for each asset there is an expected credit loss tied to it. Under the new model (Expected Credit Losses), corporate compute the allowance for credit losses by taking into account discounted basis for each default scenario and it is for a specific future period a cash shortfall that will incur multiplying by each probability of occurring. The sum of all the probabilities weighted results is allowance. (Financial Instruments Understanding the basics, 2017)

The IFRS 9 establishes three approaches in recognizing and measuring (Expected Credit Losses) such as general method that stratifies to receivables and loans, credit adjusted method (loans gained at deep discount because of their credit risk), and a simplified method that is essential for certain trade receivables called IFRS 15. For the short-term receivables which are within 12 months the impact of the ECL will not be high on the P&L. However, for the long-term receivables that are more than one year the ECL will be higher and will affect the P&L more. (Financial Instruments Understanding the basics, 2017)

There are three measurement and classifications models under IFRS 9 like amortized cost model, Fair Value Through Other Comprehensive Income (FVOCI), and Fair Value Through Profit and Loss (FVPL). In order to account for instruments at Amortized Cost (AC) or FVOCI two tests have to be met and they are (Business Model Test) and (the SPPI test). Applying these two tests may not always give us a straight forward results the outcomes occasionally can be shocking. When we talk about the failing of these tests means the asset has to be calculated at FVPL, however if one of these tests has passed the asset will be measured at FVOCI or Amortized Cost. (Financial Instruments Understanding the basics, 2017)

CHAPTER 3: LITERATURE REVIEW

3.1 Introduction

The new accounting rule IFRS 9 was a savior for most organizations and entities and a panic for others. It was a savior for organizations since it has presented simplified methods of measurements that are much easier in calculation, less complicated, and more accurate in measuring ECL comparing to the previous standard IAS 39. For some financial institutions like banks it become a panic since it is forcing them to provisions for credit losses that did not occur. In this section several previous studies done in Europe and other countries related to IFRS 9 along with the IAS 39 will be discussed.

Literature review in a simple way defined as summaries of previous studies done on the topic that a researcher is discussing and provide support for specific research questions. It is very important thing for the research since it gives the research foundation of knowledge, sharps the research focus, and helps in definition and selection of research problem. Furthermore, it helps in identifying the state of art of the problem study, and useful in guiding the methodology of the study. Also, it suggests other research approaches and procedures that can be used in matter realization, assists in explaining the findings of the study, and designate the conceptual framework of the research (Importance and Scope of literature review, 2019).

3.2 Differences between IFRS 9 & IAS 39

There are many studies that summarizes the variances between the old and new standard. As stated by Justin 2016, the new accounting rule IFRS 9 will force the banks to estimate the ECL when the loan is made and through the lifetime of the loan. This new role was a response due to the belief that during the crises the accounting standards has overstated it. The weakness of the previous rule was it delayed in recognizing the credit losses. Because of this, the new rule or approach will change the way how the bank should make provision for losses. Under the IAS 39 the loss is recognized after they occur. On the other hand, IFRS 9 forces banks to start approximating losses when loan is made and through the lifetime of it, thus will cover a wider range of assets. This can bring in any bad news such as any vast political events, future recessions, sitting aside capital to cover prospect losses.

As reported by Crossen & Wang (2016), the new accounting standard IFRS 9 has exchanged with the old standard IAS 39 aiming to increase with further transparency and beneficial data about the expected credit losses. The key differences between the two standards is the measurement and recognition of the impairment, the IAS 39 uses "incurred loss" model and IFRS 9 uses the forward-looking model (ECL). The advantages of IFRS 9 are addressing over intricacy of the many impairment models used under IAS 39 and reducing the timeliness of loss realization. IFRS 9 involves reporting loss allowance along with the expected credit losses at any time of reporting date to replicate the credit risk of financial instruments. Firms such as banks and insurance companies which are holding more of financial instruments like trade and lease receivables, investments in debt, and loans will be more affected by IFRS 9. Firms with low

receivables and investments should revise current impairment loss but will not be affected significantly by the new standard.

3.3 Challenges Firms may face while Implementing IFSR 9

While implementing the new standard IFRS 9 companies can face several challenges and these challenges are specified in the following paragraphs. As stated by Crossen & Wang (2016), there are three challenges that firms may encounter while implementing the new impairment method such as portfolio division, defining significant changes in credit quality, and enhancements essential for Probability Default (PD)/Loss Given Default (LGD)/ Exposure at Default (EAD) in order to reach IFRS-9 compliant ECL calculation. Each challenge will be explained in the coming paragraphs.

First challenge is business segmentation, companies allocate portfolios based on the risk characteristics, business lines and product types when impairment calculation is held. Under IFRS 9 companies must group financial assets based on the common credit characteristics that similarly respond to the macroeconomic factors and current environment. Some of these characteristics are date of initial recognition, credit risk ratings, geographical location, industry, underlying collateral, and remaining term to maturity. The revaluation and re-segmentation of the group arise when the group is new, and pertinent data occurs like economic conditions. (Crossen & Wang, 2016)

The second challenge is identifying substantial changes in the credit quality. A real economic loss arises when current expected losses beat initial expectation. When there is

significant increase in the credit risks and the lifetime expected credit, losses are calculated for financial assets, it is going to be easier for investors and analysts to identify any future economic losses. Firms in order to decide credit deterioration and theorize reasonable and accurate information that are not costly and do not need efforts and then contrast the two calculations, risk of default at reporting date and risk of default at the date of initial. (Crossen & Wang, 2016)

Furthermore, companies can do significant risk assessment test on a group or subgroup of financial assets, if the evidence at individual level is not available until now. There are not any specific approaches for measuring changes in risk under IFRS 9, but the standard provides simplified operational approaches designating financial instruments into two stages. First stage is, substantial increase in risk occurs when the financial instrument is 30 days past-due, this gauge is not ultimate, but it is supposed to be the last point. The second stage is for the financials assets that have low risk, firms can recognize a 12 months allowance. (Crossen & Wang, 2016)

The third challenge is the expected credit risk calculation. Banks must modify the expected credit loss calculation to fulfill with the IFRS 9 impairment necessities. Some entities might use in-house models and procedure stress testing and regulate the prediction for the forwarding-looking scenario other than the stress scenario. Entities need sole or various economic scenarios in order to calculate the expected credit losses since the first step of the adjustment is approximating the forward-looking. The most difficult challenge is to incorporate the macroeconomic factor forecast (GDP growth, unemployment, interest rates) into the ECL calculation and PD/LGD/EAD modeling. The new amended models must mirror how changes in the factors could impacted losses and defaults in the past. (Crossen & Wang, 2016)

3.4 Five Strategic Action banks can take to go ahead with IFRS 9

In order for the banks to go ahead with the new standard they have to take several strategies to help them implement the standard in transparent and more accurate way. Conforming to Maji et al. (2017), few years ago European Banks have been preparing for the implementation of the new accounting standard IFRS 9, this accounting standard which is going to change the way of calculating or measuring impairment of financial instruments, the standard presents three stages for impairments modeling. Banks should be aware of the influences of IFRS 9 and had better to be prepared for the consequences accordingly. Banks are facing the risk of overseeing the strategic repercussions of the IFRS 9. The repercussions will be very significant that will lead banks to rethink about the commercial policies, portfolio strategy, and risk appetite.

Banks may suffer from IFRS 9, if they did not take any action before it comes to enforcement, since after the adoption will be difficult to manage the impacts and supervisors may lose senior in doing so. Moreover, banks will face different business and strategic challenges in implementing IFRS 9 such as big changing to their business model and will influence areas such as IT, Treasury, Wholesale, global markets, retail, risk management and accounting. Banks who were earlier planned for these changes will have an enormous benefit over those which whom still have to understand the IFRS 9 impacts on their business and they are not prepared for it yet. (Maji et al., 2017)

The authors have pointed out several strategic actions in five areas to help banks to go ahead with the new standard. These strategic actions in five areas are credit management, deal

origination, commercial policies, portfolio strategy, and people management. These five strategic actions will be summarized in the following paragraphs. (Maji et al. 2017)

The first area is remodeling the credit-management exercises to avoid the exposures from weakening. Banks should monitor all their portfolios and greatly rise the room of the credit management in order to avoid credit deterioration and decrease stage 2 flows. There are several approaches can be used to increase credit-management room like rating advisory system or early warning-system. The early-warning system is produced in way that monitors the facility and ensures that it will not reach the deterioration level or migrating to stage 2. When there is a deterioration in the debtor's short-term liquidity, the credit officer should take several mitigation actions, like opening short-term facility to resolve liquidity matter. Furthermore, the relationship manager realizes the flagged position and suggests helpful actions and then contact the client to converse a group of strategies. (Maji et al. 2017)

The second area is rating advisory service. Banks might advise client to sustain good credit quality, suggest client various solutions to healthier terms on new facilities, decrease their liability to move to stage 2. Moreover, banks can offer rating simulation tool to help relationship managers and credit officers to present how clients could avert their ratings from deteriorating or improve their ratings, and this offer can be provided on fee-based service. This tool has to have scenarios and macroeconomic outlook to predict how various economic sector possibly will improve, roll of actions in sustaining clients' rating in circumstances like liquidity problems, decreasing profitability, and decline in revenues. The second strategic action area is deal origination. This area is arguing that IFRS 9 will force banks to rethink about the deal origination to mirror

fluctuations in risk appetite framework and to introduce a way or techniques to depress credit origination for sectors, clients, and period that appear to be too chancy and costly in view of IFRS 9. (Maji et al.,2017)

The third area is commercial policies. For the profitability strategy due to the capital consuming for the persuaded by higher level of provisioning for stage 2, IFRS 9 will decrease profitability margin for the long-term and medium exposures. For some exposures with poor guarantees or low-rated clients will need advanced provision for stage 2 movement. Measurement of provision for lifetime expected credit losses for the long-term loans that are more than ten years might be set up to 15 to 20 times higher than stage 1 provisions which states expected credit losses for 12 months. (Maji et al., 2017)

Moreover, to reimburse this negative effect on the profitability, banks can do changes in the product or pricing characteristics in order to amend the commercial strategies. For the pricing strategy banks should set up a deal with client that in case the receivables migrated to stage 2, so there is breach in covenant, so the pricing should be higher to recompense for the further cost of stage 2. For sure the compensation will be different for each short- and long-term loans. For the product characteristics, banks can amend repayment, maturities, schedule, loan-to-value, break clauses, and pre-amortization period to cut the effect of IFRS 9 on their profitability. Moreover, banks can go toward short-term loans and lower amortization by providing incentive to RMs and clients to swing to short-term products or by familiarizing new products. (Maji et al. 2017)

The fourth area of strategic action is portfolio strategy. To avoid any P &L volatility banks have to adjust portfolio strategy for clients. Some business lines and products will be affected by IFRS 9 and will be less profitable, depending on several factors such as ratings of the counterparty, length of the transaction, economic sector, and guarantees supporting it. These factors will require banks to review their portfolio approach at much higher scale than they do today. (Maji et al. 2017)

The last area of strategic action is people management. This area is basically focusing on training and strengthening skills of relationship managers. When the performing loans move to stage 2, banks commercial networking should take some new responsibilities. Relationship managers have to be more accountable for monitoring loans that are at risk deterioration level and advising reduction actions to stop loans from moving to stage 2. To help relationship managers effectively managing the troubled assets they should be qualified in new skills like workout, financial restructuring, and capital management. Moreover, providing training programs for the RMs and evaluating them based on the appropriate risk-adjusted profitability metric like economic value added (Maji et al., 2017).

3.5 IFRS 9 impacts on credit risk of the banks

Many studies showed how the new standard will affect credit risk of the banks by using different methods such as stress tests. One of the studies was reported by Kund & Rugilo (2018), identified that the new accounting standard IFRS 9 affects credit risk of the banks a study was done in assessing the release of the IFRS 9 and its impact on the financial stability using the stress tests. The pervious standard IAS 39 was reporting the credit losses when the losses were incurred which led to the recessions and Global Financial Crisis. Then the International Accounting

Standard Board (IASB) has urgently released a revised standard IFRS 9 to protect the businesses and investors from the sudden shock in the economy. The new standard aim is concentrating on the forward looking of the credit losses and realizing the losses over lifetime of the loan, this strategy will lower the sudden increase in the losses.

One important point is that the early recognition of the credit losses will help banks to decide the amount of the earnings to be retained in the retained earning equity part. The authors in this article basically first thing summarized the differences between the IAS 39 and IFRS 9 which will not be covered in this literature since it was mentioned in the prior paragraphs. The late accounting standard will increase reporting of credit losses in the same time will influence the bank's capital. (Kund & Rugilo, 2018)

Beside that reporting low capital can lead banks to take several actions in order to report the financials in a good health to the public. For example, banks can be forced to sale their assets in order to increase the capital level. The stress tests are used to measure the forward-looking estimations of the bank's capitalizations and its aim is to assure the banks solvency. The dataset for the stress test was from 2014 to 2018 provided by European Bank Authority (EBA), for 43 different banks. The stress test results will let us to examine the implication of new ECL impairment pattern on the financial stability based on the loan portfolios of key European banks. These stress scenarios explain how banks are affected by impairment model in crisis situations. (Kund & Rugilo, 2018)

3.6 Principles for banks sat by Basil Committee

Several principles were sat by Basil Committee for banks to guide them. As reported by Edwards & Gerald (2016), summarized the new accounting shift and why it is more accurate and advanced than the previous accounting standard. The new standard IFRS 9 requires companies to report for the ECL based on the available information without any extra cost and use historical, recent and for the first-time predicting data. Basel Committee on Banking Supervision have set some principles for the banks and supervisors some of these principles are summarized in the next following paragraphs.

The first principle is managers and directors should ensure that banks have a suitable credit risk practice counting and efficient internal control in order to identify adequacy allowance according with bank's policies. Another principle is banks should adhere to good methodologies that controls credit risk measurements on all lending exposures. The amount of allowance should be regular with the objective of the accounting framework. The third principle is banks should have procedures set up to confirm models exercised to calculate the expected credit losses. The fourth principle is banks should have sound credit risk assessment that affords strong basis for tools, data and common system to report for expected credit losses. The last principle is that banks supervisor occasionally should assess usefulness of bank's credit risk exercise. (Gerald & Edwards, 2016)

The BCBS expects that banks always will report for the ECL and zero or (Nil) ECL is rare since expected credit losses is a probability-weighted amount and prediction of future provisions notified by management's credit decision that the possibility of risk occurrence should always be

reflected in the financials. Central banks and other authorities can encourage high excellence bank implementation performs through several activities with key stakeholders. (Gerald & Edwards, 2016)

First important activity is inspiring supervisory contribution in symposium and industry in the discussion about the IFRS9 and their execution. Another key activity is banks should periodically update their records in order to help supervisory to keep an eye on their ECL execution strategies and give them time to understand their implementation challenge. The third key activity is encouraging to discuss the IFRS 9 during meetings with Board of Directors, audit Committees and Risk. The fourth key activity is inspiring auditors to better understanding the IFRS 9 and the supervisors should better grasp auditors' roles and arrange meeting with them when appropriate. By inspiring this could be an improvement in the goodness of bank auditors' practice. (Gerald & Edwards, 2016)

Also, encouraging the banks in our jurisdiction to implement the Enhanced Disclosure Task Force (EDTF's) 2012 suggested disclosure and ECL recommended disclosure of 2015 (during the movement period) along with ECL disclosures required by IASB when the IFRS 9 is adopted. Furthermore, working with banks accounting standards setters, auditors, the BCBS, and investors to reach prudential objectives and substantial transparency goal while decreasing the cargo regulatory related to the ECL provisioning. (Gerald & Edwards, 2016)

3.7 Three stages of financial asset classification

The financial assets are classified into three phases by IFRS 9 referring to a study these phases are explained and briefed. According to Sultanoglu (2018), financial assets are classified in three stages based on the relative credit risk at a reporting date. The stage-1 comprises (Performing) it is financial asset that bears low credit risk at reporting date. In this stage entities are required to calculate the loss allowance at amount equivalent to 12 months, the equation is as follows (ECL= 12 months PD * LGD) and the interest revenue is computed from the gross carrying amount before the ECL adjustment.

The second stage is (Under-Performing) it is decadent financial assets since initial recognition with lack of objective proof of credit loss occasion. In the stage-2 when the financial asset moves to stage-2 there is requirement for calculating the lifetime ECLs, the interest revenue still will be computed from the gross carrying amount before the ECL adjustment. (Sultanoglu, 2018)

The third stage is stage-3 which is compromises of (Non-Performing) the group of financial assets that have target proof of default at the reported date. In the third stage the interest revenue will be computed from the net amount (Difference between ECL and gross carrying amount of financial assets). (Sultanoglu, 2018)

3.8 Impact of IFRS 9 on Equity analyst

There are some studies that explain the impact of IFRS 9 on equity as well on equity analyst. As reported by Radstrom & Eriksson (2019), the new accounting standard IFRS 9 which

is effective on Jan 2018, with the aim to provide higher accounting quality, since the old accounting rule IAS 39 was more complicated by practitioners. The study question was what consequences does IFRS 9 have on the equity analysts. The research was contacted by surveying the equity analysts of European Banks. The survey was contained 35 questions and it was sent out to 145 equity analysts covering the 50 largest banks in the Europe.

The survey result was stating that the expected credit losses model under IFRS 9 involve difficulties for the equity analyst. There were three themes of implications recognized, like comparison, complexity and time aspect. The survey results were that the IFRS 9 provide useful information, however it's also provides multiple issues which provide consequences for equity analysts, and impairment levels considered a small portion of the financial statements of the banks so therefore is not important for stock valuation. Another issue was addressed is that more time is required for the equity analyst to withhold the implications of IFRS 9 since it is a new standard and need more time to be understood and settled or it is a complex standard by nature. (Radstrom & Eriksson, 2019)

3.9 Impact of IFRS 9 on equity & capital

In the earlier paragraphs several IFRS 9 impact on different financials instruments were mentioned. Added to the prior studies there was another study which identifying new rule impact on financial assets. Under the new standard bank must report higher impairments which will lead to less left over of capital to distribute to shareholders and staff bonusses. Also, the earnings will be affected, bank bonds and share price will be more volatile. Giving the alert to the possible capital loss for banks provisioning for ECL, the basil committee is recommending some options

for banks in adopting the new accounting rules counting a three-five-year phase-in period. (Justin, 2016)

In addition, Basil Committee is presently checking these options. After implementing the new rule, the European Banking Authority found that the provisions rose by 18%. Deloitte said that the under IFRS 9 the impairment charges could increase across all asset classes by 25%. Furthermore, Fitch rating said that the impact of the expected credit loss accounting on the regulatory capital ratios is unknown and in some cases it could be substantial. Banks argued that they have fewer information and guidance form the regulators to completely recognize the new standard effect on the capital and earnings, which is unsatisfying thing. (Justin, 2016)

3.10 Impact of IFRS 9 on CET 1 & Capital Ratio

Likewise, the interview that was conducted for this research detecting new rule impact on Common Equity Tier 1 and Capital ratio. A study was contacted by Sultanoglu (2018), in clarifying measurement and recognition of allowances for credit losses based on the new impairment model in the IFRS 9 and observe the anticipated possible quantitative and qualitative influences of this movement in the European Banking Industry and parallel it with the Turkish Banking Industry.

For the study surveys were executed by EBA (European Banking Authority) who is accountable for execution of IFRS 9 by the EU banks also big four audit firms pointing at examining the level of readiness. The survey result showed that impairment provisions are anticipated to rise by 13%-18% on average and Common Equity Tier 1 (CET1), and total capital

ratio go down by 45-75 basis points (bps) and 35-50 bps, correspondingly. On the other hand, the two studies that were done in Turkey showed different results. They resulted that the total amount of the provision going to decrease by 4.1% and 33 bps and 21 bps positive effect on the CET1 and total capital adequacy ratio on average, correspondingly. The core objective of impairment under IFRS 9 is to begin calculation of Expected Credit Losses model that mirror the variations in the credit quality of financial instrument like developments over its remaining expected lifetime. (Sultanoglu, 2018)

3.11 Effect of IFRS 9 on banks in the GCC countries

A publication was presented by one of the biggest audit firm in the world KPMG (2018), specifying the impact of IFRS 9 on the banks in the GCC countries and analyzing changes that happened to the measurement and classification of the financial assets, and realization of ECL on the banks. KPMG has chosen 56 banks across the GCC countries and selected Key Performance Indicators (KPIs) of these 56 banks. The results of KPIs were comparison between 2017 (year-ended December) and 2018 (quarter-ended 31 March). The publication presents different KPIs, but in this paper we will concentrate on the ECL before implementation of IFRS 9 and after the implication of the new standard on the UAE banks.

The report has shown the results for top ten banks in the UAE and made comparison between them. Three banks (Dubai Islamic Bank) DIB, Abu Dhabi Islamic Bank (ADIB) and Sharjah Islamic Bank (SIB) had adopted the FIRS 9 earlier than the other banks. After the IFRS 9 adoption the ECL on the day one of the implication of IFRS 9 recorded ECL for the 10 banks around US$3.3 billion. Out of 10 banks 8 of them the provision has increased by more than 10

percent. Furthermore, the ECL effect on the equity day one was in the range 3.0 to 12.0 percent, which in the same time had influence on the Capital Adequacy Ratio (CAR) on the 10 banks. (KPMG, 2018)

3.12 Regulations of UAE central bank for the IFRS 9

Regulation highlights of the central bank of the UAE on the new accounting standard IFRS 9. The central bank of the UAE has highlighted several regulations on the adoption of IFRS 9, in this part of the literature review these regulations will be summarized for the benefit of the reader. (KPMG, 2018) These regulations are briefed in the below pullet points:

1- There are three stages for the IFRS 9 which are stage 1,2,3, the two stages are part of the performing book but the last stage belong to the impairment with specific provision.

2- The first stage attracts 12 months loss estimates while the second and third stage receives the lifetime losses. However, banks will estimate loss for the impaired assets for the current practices.

3- Banks should figure out the connection between the macro-economic factors and obligors characteristic specifically in the real estate and construction sector in measuring SICR furthermore to days past dues and movements in other internal ratings.

4- It is suggestable that the measurement theorized variations in the credit risk at counterparty and individual credit level except it is done on product level. (pertinent only in the retail exposures).

5- The UAE central bank assumes that financial assets which are more than 30 days past due it has to be well-thought-out highly increased credit risk.

6- There has to be an eye on the restructured loans and these current restructured facilities should be categorized in the stage 2. Moreover, any other restructured exposures that is uncollateralized and needs a bullet payment (Onetime payment) after a period of longer/or equal to three years should at lowest categorized at stage 2 exposures.

7- Banks are anticipated to advance probability weighted ECL approximations in contradiction of a series of macro-economic situations.

8- Additionally, if the general or specific provisions as per central bank of the UAE requirements, is higher than impairment allowance under IFRS 9, the differences should be moved to impairment reserve as part of the retained earnings. In case of the revers scenario, IFRS 9 provision is higher than the UAE central bank requirements, the IFRS 9 provision will be documented as normal. (KPMG, 2018)

3.13 Benefits of reporting 12 months ECL in stage 1

There are some benefits of reporting ECL in stage 1 for a period of 12 months. The benefit of reporting 12 months ECL in stage-1 is reducing overstatement of the profit which will lead to less distribution out of dividends to shareholders. This will outcome in retaining more capital for the banks and will protect them from any economic worsened. In contrast, it will bring more expected credit losses for the banks compared to the old standard IAS 39 which will affect profit and loss statement and capital adequacy of the banks. The capital adequacy is very important for the banks and most banks should pertain a specific level of the capital to distribute dividends and to avert being enforced to raise equity, selling assets and reducing new lending. (Sultanoglu, 2018)

Moreover, the fall in the profit will consume Common Equity Tier 1 and CET1 ratios. Common Equity Tier 1 is a good indicator of capital Adequacy ratio, according to basil III capital requirements good portion of CET 1 is (4,5%) and minimum of (7%), so lower values of CET 1 will impact the banks and force them to either sale the assets or reduce new lending which will affect the economy negatively. Specifically, for the banks have large portions of the loans in the stage-2 and stage-3 are expected to report higher level of provision. (Sultanoglu, 2018)

3.14 Credit risk provisioning on the bank's capital ratios, CAR, TIER 1, CET 1

Additionally, the impact of provisioning on Common Equity Tire 1, there are other ratios also affected like CAR and TIER. As stated by Blazekova (2018) the new accounting standard IFRS 9 has impacts on many things such as financial position, ratios, revelations with its connection to ECL and stress testing. The paper aim was to identify the credit risk provisioning on the bank's capital and on the bank's capital ratios such as CAR, TIER 1, CET 1, and leverage in order to stay away from any future capital surprises for the banks. Banks are facing reduction in the capital due to the new reporting of the provision (ECL) and this reduction is worsening the equity ratios like CET 1. These unknown changes could cause lower down the banks' capital which can lead to a strict capital necessity assigned by supervisors.

The European Banking Authority checked the impact of the IFRS 9 on the capital by assessment and the result was that the new standard affect CET1 in a negative way and higher comparing to total effect on capital ratio. Moreover, the smaller banks have identified lower increase in the provisions compared to larger banks, but the profit/loss recognition is highly

probable because of the new impairment method. The critical thing about IFRS 9 is that it identifies losses prior parallel to the old standard IAS 39. The author has presented a table showing the comparison of deficit and surplus before the implementation of the new standard and observed that the most affected instrument due to increase in provision is reflected in the retained earnings. (Blazekova, 2018)

Another figure was presented by the author to display the standardized Approach (SA). The SA has a direct effect on the CET 1 capital and also SA institutions hurt from the reduction in the CAR (Capital Adequacy Ratio) compared to IRB (Inter-Rating based Approach) institutions. After presentation of different data, the author had summarized that the IFRS 9 reasons decline of the capital base of the banks. There are several differences between the institutions like the one that use SA and IRB Approaches. (Blazekova, 2018)

3.15 Study on Loan Loss Provisions

As stated by Peterson & Erick (2017), banks are financial institutions that collect money from people as deposits and lend them to investors, governments and other individuals which this will increase the credit risk in case the second party may not pay back. To avoid credit risks banks do not distribute all the funds they keep cushion to take in expected loss on bank loans. The research examined the link between the bank provisioning and capital regulation and other countercyclical policy pursued banking certifying solvency and reliability during exertion period.

Beside this the paper summarized different areas such as LLP (Loan Loss Provisions) regulatory changes during the Basel I, II, III and capital adequacy necessities. Also, there is a discussion about ethical income smoothing and aspects affecting income smoothing behavior. At the end discusses some challenges in LLP research and recommend some guidelines for the future research. Under Basel I banks are obligatory to retain regulatory capital equivalent at minimum to 8% of risk-weighted assets and the LLP (reserves) will account for 1.25% of the risk-weighted assets in Tier 2 capital. (Peterson & Erick, 2017)

After several years launch of Basel I, it was revised to become Basel II. Basel II is classified based on three pillars, the first pillar identifies methodologies to calculate minimum capital need, the second pillar involves the supervisions of banks have to ensure that the bank capital is proportional with level of risk banks take, and the third pillar supervisors and managements have to specify the loan loss provisions of the bank before it materials or before it occurs. (Peterson & Erick, 2017)

They have done studies on the banking sectors and the level of LLP's each bank uses in different countries and found that in the Philippine during the expansion economy banks either low-capitalized or well-capitalized keep lower LLP's c. Furthermore, another study was done in the Middle East and North Africa (MENA) by comparing the LLP's of the Conventional and Islamic Banks. The study resulted that Islamic Banks have LLP less than Conventional banks. Several other studies have been done in different countries and the author used different recent journals to support his research. (Peterson & Erick, 2017)

3.16 Differences between IFRS 9 and GAAP 326 (US based standard)

In this study the researcher has compared between the International Financial Reporting Standard and General Accepted Accounting Standard (GAAP). GAAP is used by public companies in the United States, it is known that US is one of countries that is using GAAP, so in this part of literature a comparison between the two standards will be summarized from a study. Different accounting boards such as IFRS 9 and GAAP 326 have one major aim which is to forecast for future positions for the financial instruments. In the old accounting standard, it was reported for the incurred loss only, but after the mandatory implementation of the IFRS 9 most of companies should report for the all financials instruments that have experienced substantial rise in the credit risk. The authors in this article analyzed the impact of the new loss provisioning method on the comprehensive bond information. The interesting thing about these new rules are they help analysts and investors to recognize the economic value of the financial instruments by using expected losses. (Kruger et al., 2018)

Moreover, the paper has shown the link between the GAAP 326 and IFRS 9 in loan loss provisioning and studying the impact of these rules on the bond data for period between 1991 and 2013 in which these rules still were not applied. Beside this, the paper will examine procyclical decrease in Tier 1 capital because of loan loss provision and how establishments or entities should mitigate these effects dependence on many aspects like significant increase in credit risk criterion, portfolio quality, and portfolio investment strategy. (Kruger et al., 2018)

The authors did several tests to reach to the following mentioned results. First result was that the GAAP 326 decreases the eligible regulatory Common Equity Tier 1 more the IFRS 9.

Another result was that Significant Increase in credit risk criterion is dependent to trade-off impact as a conservative method (low α) leed to higher capital requirements. Furthermore, the introductions of the two standards IFRS 9 and GAAB 326 will may lower down the variation and procyclicality between entities and institutions. During downturns there were elevated number of threshold excesses, the IFRS 9 is further procyclical than GAAP 326 and would have generate lower capital of 1.45% during the recessions and 2.21% in the Global Financial Crisis (GFC) 2008. Banks are required to have adequate Tier 1 capital, so both accounting policies (IFRS9 & GAAP 326) will force banks to retain higher Tire 1 capital comparing to the old standard. In the discussions part authors have provided some factors to decrease provisions and procyclical effect on the income and regulatory capital deduction. (Kruger et al., 2018)

3.17 Challenges & benefits of CECL under GAAP

Under GAAP the ECL is called Current Expected Credit Losses (CECL), and it has some benefits and challenges which are identified in the following study. While the US businesses use GAAP accounting standards, and it had released the new accounting standard Current Expected Credit Losses (CECL) in June 2016 to report any future expectation losses. According to Walker (2019), since 1970 the calculation of the credit loss accounting was based on the incurred loss approach, but after the financial crises Financial Accounting Standard Board (FASB) issued the CECL in order to avoid any future deterioration in the P&L. (Walker, 2019)

The Current Expected Credit losses entails financial entities to record the allowances for credit losses for leases, loans, and other financial assets upon acquisition and the allowances should mirror the credit losses which may arise over the contractual life of the assets. If we compare the

old standard which only reflect the current losses while the new standard CECL represent both current and future losses of a particular financial asset. Since the CECL provide a forecasted credit loss of the organization which can prevent any future deterioration that may affect the organization financials. (Walker, 2019)

The article discussed the procyclicality consideration under both standards old and new. The procyclicality of CECL was higher during the 2007-2009 recession, the author estimated loss allowances using CECL method and integrating modern macroeconomic forecasts. He had noted the allowances under CECL based on some forecasts would not be increased pointedly comparative to the incurred loss methodology till the begging of 2007. Thus, loss allowances during first quarter of 2007 until third quarter of 2008 would have improved crucially through this period. (Walker, 2019)

Moreover, there are two sides of CECL methods that temper procyclicality of loss allowances. The first approach is the that entities are free to choose their own rules and viewpoints in interpreting the term (reasonable and supportable). The second approach is that forecasting is not for the periods that forecasting will not be supportable. When the entity cannot develop any reasonable forecast, it might use the unadjusted historical loss data. (Walker, 2019)

3.18 IFRS 9 impact on the hedging behavior of corporate treasurer

Another IFRS 9 impact was impacting the hedging accounting of corporate treasurer. As stated by Gumb & others (2018), that do IFRS 9 and the IAS 39 affect the hedging behavior of

corporate treasurer in France. This research was contacted by interviewing around 48 French corporate treasurers who are working in different firms' sizes and sectors and 3 more interviews were contacted with the representative of four big audit firms who are professionals in accounting instruments.

Who are the corporate treasurers? They are basically who employing the hedging policies in buying and selling the derivatives and they see if the corporation is able to face its financial obligations specially in term of liquidity. The author in this research figured out that accounting standards can affect managers economic decisions and increases the volatility of earnings. Since 2005-2006 the French firms were mandatory to display their consolidated financials based on IAS/IFRS instead of French GAAP. These new accounting standards have changed the presentations rules of derivatives (e. options, swaps, forward exchange contracts). Before 2005 the derivatives were appeared in the off-balance sheet financials, then after mandatory IAS/IFRS they were reported on the balance sheet at their fair value either by (mark-to-model) or (mark-to-market) market value. (Gumb et al., 2018)

The distinction in the fair value can lead to the instability in the balance sheet and P&L during the life of the instrument. To avoid this volatility the standard setter provided a substitute called "Hedging Accounting". The author has summarized each treasurer interview regarding the adoption of the IFRS 9 and IAS 39 and how it could impact the financials some of the treasurers mentioned that the adoption of the accounting policies affects the statements positively and some of them said that these standards did not affected their behaviors. The interviews have questioned the treasurer whether the accounting standards affect the treasurers' hedging decisions. However,

the findings were that these accounting rules can have influence on two things the activity of the treasurer and treasurer relationship with professionals in variety fields such as control, finance and audit. (Gumb et al., 2018)

3.19 Loan loss reserve (IAS 39) & Expected Credit loss (IFRS 9)

Moreover, as it was mentioned earlier there are variances among the old standard IAS 39 and the new standard IFRS 9 in calculating ECL. There are tons of studies explaining the differences between the old and the new standard. Another study done by Seitz (2019), which addressed and used in her research historical data to use expected credit loss (ECL) and how it will behave compared to loan loss reserve under IAS 39. The ECL for provisions is made-up to be more forward-looking and for the IAS 39 well-thought-out to be more "too little, too late". In the study stage-based stimulation method was used to approximate the ECL components which are loss given default, exposure at default, and probability of default. Testing the ECL by using the data from European bank from 2005-2014 and develop it on all the ECL components constructed on the real-world expectations, and under the new ECL model the reserves can be estimated, and last thing is checking the sensitivity of the amount.

The author cited, it is difficult to foresee whether the ECL model has addressed the problems that led to the earlier financial crises to occur, so in this case the researcher has computed the loan loss reserves (LLR) of the historical data and then analyze their sensitivity to clear up how IFRS 9 may possibly apply to future crises. The structure of the research was designed in two steps: 1) The ECL under IFRS 9 was developed for the period of 2005-2014. 2) Then the comparison approximations between ECL and reserves under IAS 39 for the same term using set

of sensitivity tests and descriptive studies. The study result was, the simulated ECL reserves are not higher in comparison to IAS 39 reserves nevertheless it depends on the input parameters and expectations. (Seitz, 2019)

CHAPTER 4: RESEARCH METHODOLOGY

4.1 Introduction:

This research paper is based on the qualitative method, which mainly focus on the group discussions, participations/observations, and individual interviews (DeFranzo, 2011). Qualitative method is appropriate for the exploratory research, for example when the researcher needs some in-depth information about individual experience, opinions, thoughts, trends and to dig deeper into presented issue. Usually qualitative method can result with few respondents and to focus on a setting issue, and also serves source of motivation to produce such hypotheses for following quantitative projects. On the other hand, the quantitative method requires measurements, what exactly to measure in order to expose patterns -for example- emotion, motivation, cognition, and behavior. Furthermore, quantitative method involves several approaches such as surveys and structured interviews and as will behavioral observation (Fransworth, 2019).

4.2 Advantages of Qualitative method

As it was mentioned earlier that the research methodology was used in this paper is qualitative method. Interviews can be done in different ways such as over the phone, Emails, and face to face. Some people who do not have time they prefer through emails or phones and others prefer face to face. There are many advantages of face to face interview, like it can be recorded for sure with the permission of the interviewee. Also, interviewer can get advantage of social cues, examples of social cues are intonation, body language, and voice which can give interviewer more verbal answers to the questions. Moreover, the termination of this type of interview is easier comparing to others since it shows when the interviewer shuffling the paper and turning of the recorder (Opdenakker, 2006). In addition, it can provide open new topic areas that are not initially

38

considered and detailed picture about the topic can build up (Advantages and Disadvantages of Qualitative Data Analysis, 2008).

4.3 Disadvantages of Qualitative method

Beside the advantages of qualitative method there are disadvantages as well. Some of these disadvantages are collection the data for this kind of methodology is more time-consuming comparing to quantitative data collection. As well, it depends mostly on the skills of the researcher. Sometimes it is difficult to make systematic comparison as such when people give responses that are highly independent. In addition, it is usually not easy to reach high number of people since fewer people are studies this subject as an example (Advantages and Disadvantages of Qualitative Data Analysis, 2008).

4.4 Primary Source: Interviews

The report was supported by some interview's discussion with senior managers of finance and corporate banking team, to answer the research questions and present new information about the expected credit losses calculation and IFRS 9 impact in general on the reporting provision in the banking sector. The first team was the finance team of Dubai Islamic Bank (DIB) consisted of five senior managers each manager was responsible of preparing financial of DIB. For example, one of them was responsible of preparing income statement, another one cash flow, third one balance sheet, fourth one concentrating on equity part, and the last one was the manager of the team. They were working together and upon preparing the financial they were responsible of other duties. The second team was the senior managers of corporate team and consisted of five managers

and investors handling different teams such as private sector in Dubai, private sector in Sharjah & other Emirates, private sector in Abu Dhabi, public sector and Sukuk team.

The primary source which was used in this research paper is interviews. Why I chose interviews? To answers the research questions in more appropriate way, and while interviewing you can ask them more details and further clarifications on the points that you have. Beside the interview answers some hard copies presentations and documents were prepared by senior managers to guide the finance team and relationship managers in the importance of the new standard and how they can take several actions to reduce the risk of IFRS 9 were shared. Table 4.4 below provides a summary of the primary data sources and details about each team and the number of responses alongside with type of interviews. Basically, the below table summarizes total interviews, 10 were for both teams finance and corporates and the other 10 were through LinkedIn application sending questions to them through direct message, this point was mentioned to give justification that I have tried to reach different organizations, only one respondent through LinkedIn application seems to have idea about the standard while the others did not. Therefore, in addition to the 10 interviewees from DIB the analysis will be based on one respondent from other institutions.

Table 4.4 Summary of Primary Data Sources

Interviews				
Interview Number Total 10	*Participant Group*	*Interview Type*		*Method of Data Capture*
	Context	Face-to-face	LinkedIn	
5	Finance Team	5 Face-to-face	5 By LinkedIn	10 Notes taken
5	Corporate Team	5 Face-to- face	5 By LinkedIn	10 Notes taken

4.5 Limitation of the Methodology

There is a limitation for the primary source of data which it is, difficulties in reaching other organizations. The answers to the research questions were provided by one organization only which is Dubai Islamic Bank (DIB). Referring to Saunders & Townsend (2016), they have used only one organization to conduct their research. I believe that other organizations responses are important to give the research richest information and data about the topic but unfortunately it was not easy to meet them due to the overload work they had, due to this several emails were sent to them after connecting with them through LinkedIn application. Moreover, searching of different people from different organizations with different positions were done through LinkedIn application to answer the interview questions unfortunately end up with few responses and were

that they do not have a lot of information about the new standard and their organization did not discuss with them this matter. Only one employee from Abu Dhabi Accountability Authority answered the interview questions through sending an email which are going to be discussed in the upcoming paragraphs. Moreover, there were limited access to the data not everything was shared with us during the interview time with both teams.

Moreover, since the topic is new for some institutions, thus the data collection for the research was a challenge. This thing was noticeable when the interview was contacted, most of the interviewers said this topic is new for us because we had not taken it seriously before the implementation and were supposed to adopt IFRS 9 earlier. Consequently, hearing a lot of the negative impact of this standard on banks whom wanted to adopt it on the mandatory date.

4.6 Secondary Source: Journals & Articles Analysis

The secondary source of data is relying on different publications, books, journals, records, hard copies presentations prepared by Dubai Islamic Bank Finance Team, and google scholar. Different journals from different websites were used in this research paper. Moreover, some good publications from different audit firms were summarized to explain the new rule and differentiate if form the previous accounting rule. Also, each article was analyzed and summarized individually to extract the findings from it.

4.7 Interview Questions

Apart from the interview questions the finance team in general has explained financial of the bank and how it is different from the corporates or other entities financials. In order to know why this standard is affecting particularly the banks most in contrast of other companies. There were 10 interview questions to find answers for the research topic. Only ten main questions where chosen to avoid repetition and concentrate on the main subjects and areas. The interview questions were selected based on the previous literatures on IFRS 9 and other published reports. Most questions were addressed by the biggest audit firm such as KPMG and PWC pointing out to the important of knowing IFRS 9 impact before adoption. The finance team has deliberated and presented different topics to explain how the new accounting rule will affect the reporting of provision in the banking sector and how this thing will affect the banks in the UAE, GCC countries, and worldwide whom are adopting the new standard. The research questions are presented below in polit points:

1- *In your point of view, how the IFRS 9 will impact the financial statements of the banks in a positive or negative way, and Why?*

2- *There is expectation that the provisions level will increase under IFRS 9, to what extent it may increase and how it may affect the financial statements?*

3- *Under the new accounting rule is there any requirement for issuing more equity? Why?*

4- *As it was mentioned that the new accounting standard will increase the provision level, is there any possibilities that this can affect the capital levels and deal pricing?*

5- *Do you think bank should estimate and book forward-looking expected loss over the life of the financial facility? And why?*

6- *To what extent the bank was prepared before the implementation of the new standard?*

7- *In your point of view why should bank monitor the ongoing credit-quality deterioration?*

8- *Did IFRS 9 led the banks to introduce different approaches and models to estimate expected credit loss? Can you mention one model?*

9- *What is the IFRS 9 impact on the retained earnings of 1 January 2018?*

10- *Is there any other things bank should do in order to lower the expected provision?*

5.1 Introduction:

Results part will present answers to the interview questions along with other steps Banks can take to manage IFRS 9 risks better and more other information about the impact of the IFRS 9 on other financial assets. In the following paragraphs before answers of each question different topics will be presented for future other researchers benefit and additions to previous studies were done in Europe and other western countries. The answers were collected from different team's finance and corporates as it was declared earlier. All found results will be presented and supported by other studies as well since not all the answers were rich and affluent.

5.2 Differences between Banking & Corporate financials

The first paragraph will summarize how banking financials are different from corporate financials. The banking financials and other entities financials, their financials are different since their core business is different. The corporate revenue is based on the goods and services that they provide, however the bank activity is to get money from people as (Deposits) and to invest this money in different types of investments and get profit on lending, so basically banks income is the profit generated from lending money to people or investing in different activities such as Sukuk or leasing.

If we have a close look into the Dubai Islamic Bank (DIB) financials 2018 the main part in the balance sheet is assets (Islamic financing and investing assets) which is AED 144B loans given to different entities (retails and companies), deposits that the DIB got for financial year 2018 is

AED 155M and DIB has lend it to customers AED 144M leaving some caution for the future in case any customer come back and ask for his/her money. For the Caution (Part of Money kept as reserve in case customer withdrew his/her money or liquidated his/her deposits) there is a ratio for this caution, this ratio is roughly between 15% to 20% for most banks in the UAE to keep part of the deposits they got for the future requirements. The next paragraphs will summarize interview's answers.

5.3 The interview answers

Question 1: In your point of view, how the IFRS 9 will impact the financial statements of the banks in a positive or negative way and Why?

Various responses to the first question were given by different teams. Around 20% of finance team said it will impact the provision part of the banks but this impact will not be dramatic. Remaining 80% said that the effect of the new standard will be manageable, only it will require good calculation of ECL. On the other hand, the corporate team about 100% were frightened from the new standard and they said this will impact the portfolio of each relationship manager (RM) and will pressure them to follow up with customers and monitor their loans more than pre implementation of the standard. Referring to Sultanoglu (2018), that the IFRS 9 will bring more Expected credit losses for banks compared to the old standard IAS 39 which will affect P & L statement.

While respondents from LinkedIn was that the impact of IFRS 9 will be negligible on the equity of the banks and this is due to the fact that as mandated by Central Bank of UAE banks are required to build in provision and a certain extent the general provision is carried in the financial

reports of all banks. Although his answer is more in contrast, I support the corporate team point of view that IFRS 9 will pressure Relationship Managers.

Question 2: There is expectation that the provisions level will increase under IFRS 9, to what extent it may increase and how it may affect the financial statements?

The second question was a little bit challengeable. The provision after the implementation of the new accounting standard for sure will increase said the 40% of the finance team members, but this increase would be different for each bank reliable on the credit deterioration and for the companies would not be affected significantly. In contrast 60% of corporate team members said that the provision will increase much more than before under the new standard. The main concept is when there is more bad customers who are delaying in payments, banks have to report higher provision, and unlike if customers are good and pay on time banks will report lower provision so basically it depends on the how good the customer is in payment said by finance team around 50% were agreed with this point. The impact on the financials will be dependable on how good or bad loans each bank has. Distributed surveys by 4 big audit firms to 91 banks resulted and estimated increase in impairment provision will be 25% for most European Banks (Sultanoglu, 2018).

On the other hand, the LinkedIn respond was that the amount of general provision will depend upon the quality of the asset book. The one-time provision adjustment permitted to equity helped banks to absorb a significant amount of impairment provisions on the existing book hence any further charge to the profit and loss account in the coming years will only be a function of the way UAE economy is progressing. In my opinion, early provision recognition will help banks to be well prepared for any future recession.

Question 3: Under the new accounting rule is there any requirement for issuing more equity? Why?

The third question has presented that all the equity instruments under the new accounting rule will be measured at fair value said by finance team. When more and more loans are unexpected to get back from the customers, here banks may need to get more capital to cover the expected losses, so in these situations yes may banks resort to issue more equity. Around 60% of corporate team agreed with the same answer and the remaining 40% of finance team united in opinion with the corporate team. As stated by Sultanoglu (2018), that fall in the profit will result in consuming more CET1 ratio, lower common equity tier 1 will affect the banks and push them to either reduce new lending or sale the assets which at the same time will affect the economy negatively.

One of the respondents through LinkedIn pointed out that, there is no requirement of issuance additional equity, however if there has been an erosion of equity due to implementing IFRS 9 banks will be required to capitalize it by further issuance of equity. I believe since IFRS 9 will lead to consume Common Equity Tire 1 which is mostly consisted of common equity, and it is capital measurement which help banks and financial institutions to be protected from any financial crises, there is possibility of issuing more equity under the new standard.

Question 4: As it was mentioned that the new accounting standard will increase the provision level, is there any possibilities that this can affect the capital levels and deal pricing?

After mandatory implication of IFRS 9 on Jan, 2018 it has affected the regulatory capital ratio, but this impact was not substantial. The regulatory capital ratio is capital requirement for the banks to have as it is vital by the financial regulator. Deal pricing is pricing given to the customer

for the amount of loan that it has been acquired. According to the corporate team 100% said that, since they are responsible for giving loan to corporates deal pricing may change under the new standard for risky customers may get higher price than normal customers. On the other hand, 20% of finance team did not agreed with the concept and said we do not think provision level would affect the deal pricing. Otherwise, the remaining 80% agreed with the corporate team concept. Because of, probability of default of each customer and to what extend the customer is committed in their payments.

Otherwise, LinkedIn respondent was opposite the above concept, they said that banks have priced credit risk into the current pricing model no further impact on pricing is expected as a result of implementing IFRS 9. Whereas I think dealing price is always related to the customer credit risk rating, if the customer has healthy ratings by either Moody's or Bloomberg then they will get good dealing price and vice versa for unhealthy rated customers.

Question 5: Do you think bank should estimate and book forward-looking expected loss over the life of the financial facility? And why?

As stated by finance team 100% of them agreed that, it is always better to estimate the forward-looking expected loss for all clients in order to know if this firm will continue the concept of going concern or it will collapse and get bankruptcy. Forward-looking estimation of the expected credit loss can help analysts and investors to have a clear image of any company. Beside that 100% of corporate team has agreed with the same concept as well. I believe forward-looking forecast is very good for all most all organizations to help them draw the future of the company and help them to avoid risks that could exist in the future. According to Kund & Rugilo (2018),

IFRS 9 aim is to focus on the forward-looking of the credit losses and recognizing the losses over lifetime of loans and other receivables, by implementing forward-looking strategy will reduce the sudden and unexpected increase in the losses.

LinkedIn respond was that, ECL or expected credit loss module required to be followed by IFRS 9 is estimating future probabilities of default and impairment losses based on past experience to a certain extent this would enable the reader of financial statements to determine the amount of provision for impaired assets carried in the books based on past experience. While some people might contain that futuristic estimation of losses is not appropriate, I would contend it is better to be prudent and book your losses at the earlier available instance rather than wait for the actual loss to hit the profit and loss account.

Question 6: To what extent the bank was prepared before the implantation of the new standard?

Finance along with corporate team said Dubai Islamic Bank was one of the top banks to adopt the standard earlier than other banks in the UAE, since the measurement and impairment were difficult to be calculated so they have adopted it later said by finance team. Some presentations, hard copies awareness, and training were provided for some employees at DIB (Especially Relationship Managers & Analyst) so to help them understand the new rule better and be aware of its consequences. Furthermore, knowing about IFRS 9 will give them better understanding of how each company financial has turned out and what movement in their financial happened. One of the strategic actions in order to go ahead with the new standard is people management, and it is basically strengthening and training skills of relationship managers (Maji, Natale, Pepanides, Risso and Schröck 2017).

While LinkedIn respondent was that, most of the banks had historical data to support the ECL model and estimate the expected credit losses on account of implementing IFRS 9 and they don't think that there was any significant impact on the twelve-month loss since the current central bank guidelines require banks to recognize credit losses once an account is past due 90 days. By interviewing different people from different organizations through LinkedIn, there was an identification that most of finance people do not have any idea about IFRS 9 which explains that they were unaware before the implementation and some of them after implementation.

Question 7: In your point of view why should bank monitor the ongoing credit-quality deterioration?

This is very good question pointed out by corporate team. Total of 70% of finance team said, controlling and monitoring the ongoing credit-quality deterioration will give us hints and alerts to show unhealthy relationships since it will affect the productivity. Also, 30% of corporate team pointed out to the same argument and said it is very important thing for us as business people to have good relationships and good customers that have very rich top and bottom lines to increase the bank's productivity. Furthermore, the bad relationships consume time and work on following up their payments and monitoring their account on daily basis. Also, credit monitoring will save banks from the fraudulent activities. Banks have to examine all their portfolios and deeply rise the room of the credit management to avoid credit weakening and decrease stage 2 flows (Maji, Natale, Pepanides, Risso and Schröck 2017).

Referring to the one of the LinkedIn respondents, banks should monitor ongoing credit quality due to changing market dynamics and conditions hence it is important for banks to assess the impact of global economic activity and its impact on sectors within the economy. In my opinion, the ongoing monitoring credit quality will help banks identify riskiness of some customers and whether to continue the relationship with risky customer or they have to end up these relationships.

Question 8: Did IFRS 9 led the banks to introduce different approaches and models to estimate expected credit loss? Can you mention one model?

Limited access got to this question since the finance team said they cannot share the calculation equation since it is something internal and confidential. As it was mentioned by finance team that the calculation of the ECL was a big challenge for them and they had to take in concentrate a lot of Macro economic factors. Out of 100%, 50% of finance team said that a new model was developed inside the bank to help us get accurate percentage of ECL for the bank financial. On the other hand, the 50% of corporate team said that we are looking at financials of companies and the ECL figures are calculated already and the general method is mentioned as PD* EAD* LGD. They have computed ECL based on the provided equation by IFRS 9 and remodeled this equation internally to help them estimate the ECL better. More clarification is given in the below section (Calculation of ECL).

LinkedIn answer to this question was that, most of the banks used bespoke Bank specific models to estimate the impairment losses depending upon the composition of their respective credit portfolios and historical expected losses for each of them. The models used by all the

banks are almost the same that is to estimate the expected credit loss is based on probability of default and the loss given default adjusted for any Collateral values. While this is the broad approach banks would tweak their respective models based on the composition of their portfolio.

Question 8: Calculation of ECL

For the pervious standard (IAS 39), companies report the losses when they occurs (Incurred Losses Method) they had to report them in the income statement, but under the new standard (IFRS 9) they have to report for the expected credit losses that going to happen in the future (Forward-Looking method) even if there are no losses they have to predict the losses and report them in the P & L. The calculation of ECL is based on the Macro economic factors such as increase in oil price, Real estate prices of Dubai and Abu Dhabi and hotel room occupancy they put some probabilities of default for each customer and calculate the ECL based on expectation and future Forward-Looking. The expected credit loss (ECL) equation can be written as:

$$ECL = PD \times EAD \times LGD$$

Where *PD* is the probability of default, *EAD* is exposure at default and *LGD* is the loss given default. Each part is calculated separately then multiplied by each other.

According to the DIB finance team the new accounting rule has pros and cons, but in their point of view the cons are more than the pros. The DIB finance team before preparing the financials under the new accounting rule, they had a good preparation for the new standard IFRS 9. Furthermore, some excellent and concise details about the new model were presented to most DIB teams especially the corporate teams. As stated by finance team, our aim was to direct and educate

the relationships managers about the new accounting rule impact on financials of banks and corporates, so when they come to read any financial, they are conscious of the new rule influences on some financial assets and liabilities instruments.

The calculation of the probabilities is done by a system developed by the DIB finance team through a consultant statistic, it is similar to any statistics system as it was stated by finance team. The pervious standard was not helping the investors in identifying the future outlook of each company but with IFRS 9 the process is smoother and it is easier for them to assume future losses for each company. This new standard is useful for the investors so they will know better in which company they can invest and put money in. In the past people have invested blindly and they got huge amount of losses, but now there are more awareness and investors do analysis before investing in a particular financial asset.

Question 9: What is the IFRS 9 impact on the retained earnings as of 1 January 2018?

There was a KPMG publication provided by the finance team showing different changes in the retained earnings for top ten banks in the UAE before implementation of IFRS 9 and after the implementation of the new standard. Table 5.3 is presenting the fluctuation in the retaining earnings after the adoption of IFRS 9 for top ten banks in the UAE. As the below figure shows that the highest impact was on the RAKBANK retained earnings and lower impact of IFRS 9 was on ADIB retained earnings. Differentiation of the impact is relied on how each bank has calculated and what data exactly they have used in calculation. In general, the numbers show that IFRS 9 had reduced the retained earnings and impacted it negatively and moderately.

According to the one of the LinkedIn respondents, most of the Financial Institutions reported a negative equity or no change in equity due to recognition of one-time expected credit loss. I believe after reading some publications there were some bank's retained earnings affected by IFRS 9 and others did not.

Table 5.3: IFRS 9 impact on the Retained Earnings on 1 January 2018

Bank	Retained Earnings as of 31 December 2017 before implementation of IFRS 9	After implementation of IFRS 9	Retained earnings after impact of adopting IFRS 9
ADCB	3,037.4	411.1	2,626.3
ADIB	898.7	0.2	898.6
CBD	824.9	107.9	717.0
DIB	1291.5	80.7	1,210.8
ENBD	6,854.8	595.3	6,259.5
Mashreq	4,602.5	379.1	4,223.4
RAKBANK	435.1	264.1	171.0
UNB	3,224.4	246.6	2,977.8
FAB	3,007.6	753.2	2,254.4
SIB	251.0	80.4	170.7

❖ The amounts presented in the table are in (US$ Million)
❖ Source:https://assets.kpmg/content/dam/kpmg/ae/pdf/IFRS9-transition-impact-on-banks-in-the-gcc-uae.pdf

Question 10: Is there any other things bank should do in order to lower the expected provision?

The last question answer is yes, there are a lot of steps can be taken by relationship managers and credit analysts who are handling the corporate relationship in order to reduce the IFRS 9 risks said by finance team as well corporate team. Around 50% of corporate team managers said this new accounting rule is affecting the P & L significantly and most banks unfortunately are hiding this impact to show their financial clean and healthy, but this is not a good indication. Since the investors would be exposed to high and hidden risks when investing in these companies. there are many strategies that any bank can take in order to reduce the IFRS 9 risks and these strategies are summarized in the upcoming paragraphs. Furthermore, there are other impact of IFRS 9 on capital, share price and P&L statement, which are summarized after the strategies.

In addition to above the respondent from LinkedIn was that, "bank can reduce the impact of impairment provisions by managing collections better this would reduce the impact of impairment on account of recognition of 12-month losses". It is important to note that expected lifetime losses can only improve over a period of time and that would be really a function of the inputs going into the model determined by the bank. I agree with this point and believe that lowering expected provision can be achieved by managing collections since bad collections or slow collection will increase provision.

5.4 Strategies to manage IFRS 9 risks better

As maintained by DIB finance team, there are many strategies DIB or other banks in the UAE can take to manage IFRS 9 risk better. These strategies are portfolio strategy, Revisions of

Policies & Product characteristics, Tighter controls on new originations, and strong relationship management. In the following paragraphs each strategy will be summarized separately.

The first strategy is portfolio strategy, in this strategy bankers should revise portfolio strategy in conjecture with economic cycle and they can increase loan exposures in sectors that are resilient and decrease exposures to sectors that are not resilient. Moreover, concentrating to increase secured exposures with high quality collateral and develop early warning indicators and portfolio health. Also, make sure loans do not move to 30 days past due and provide rating advisory services to better allow corporate clients to sustain healthy credit rating.

The second strategy is Revision of Policies & Product Characteristics. It is always a good thing to control organization that have low rating and poor guarantees. Another thing is considering risk-based-flexi pricing in order to reflect the credit risk increase in loans. Furthermore, the target has to be toward originating the short-term maturities and amortization schedules, and in creating new products (short-term) that allow early redemption and rescheduling. The remaining strategies which are tighter control on the new originations and strong relationship management will be summarized in this part.

For the third strategy several steps have to be taken such as building dynamic limits allocation and management systems that reflects macro-economic cycle. As well, specify sub-segments with each segment that have promising outlook to diversify portfolio risk. Additionally, banker should reconsider the portfolio appetite for risk and announce mechanism to discourage

credit originations for clients in sector and durations that appears too risky and expensive in light of IFRS 9 standard.

The fourth and last strategy is related to the relationship management and relation with the customers. Basically, this strategy concentrate on what actions should relationship mangers take to reduce IFRS 9 risks. There are several guides for relationship managers (RM) to reduce risks of the new standard such as RM will be held responsible for any weakening credit facilities in their portfolio. In addition, all the RM should be well trained in areas of workout and capital management and financial restructuring to help them manage the disordered assets. Beside this the RM to be more responsible in surveillance loans at risk of deuteriation and suggesting mitigation plan to avoid stage 2 migration. These were some strategies that most of UAE banks can follow or they are following to reduce the IFRS 9 risks in the upcoming years and in the future.

5.5 IFRS 9 impact on share price and P&L

Referring to the one of DIB presentation the IFRS 9 will have a dramatic impact on the P&L statement and in line with International Accounting Standard Board (IASB) intention and regulators, it produces business-wide challenges for financial institutions and corporates. The Expected Credit Losses will have a straight and quantifiable effect on the profit and loss statements and indirect but material on broad range factors contributing to shareholders value. Financial assets that are experienced increase in credit risk from initial recognition will need lifetime loss provisions, this thing in turn will put high pressure on P&L. Due to this, it is very important to efficiently and effectively manage the ECL risk for financial assets on the book and financial assets

that are currently originated. A journal discussed that European Banks said 75% volatility of profit and loss will increase and 30% growth in impairment cost anticipated.

5.6 IFRS 9 impact on the capital

Before the new standard people have invested mindlessly in different businesses without understanding sequences of the old standard (IAS 39). I believe the new standard IFRS 9 will give some alerts and transparency of the health of each company or entity. Many studies have presented impacts of IFRS 9 on the capital. In January,1 2018 a big number of European Banks noticed the effect of the new standard on their capital (Khan & Damyanova 2018). The new rule suggests all banks to hold capital against the expected credit losses for all the financial assets regardless of the asset current quality. High level of provision affected the most critical element of banks which is retained earnings along with Common Equity Tire 1. As it was reported by European Banking Authority for banks that the CET1 has dropped by 45 basis points for almost all the European banks.

CHAPTER 6: CONCLUSION

6.1 Introduction

The aim of this study was to examine the new accounting standard and its impact on how banks should provision for Expected Credit Losses (ECL) and its effect on other financial assets. In addition to this chapter, the present thesis consists of 5 chapters which can be summarized in the following paragraphs.

Chapter 1: The first chapter provided a general background about the topic, aim and objectives, problem statement, and significance and motivation of the study.

Chapter 2: The second chapter summarized definition of the old standard (IAS 39) and the new standard (IFRS 9) along with reasons why we need a global standard. Moreover, the three phases of IFRS 9 which are measurement and classification of financial assets, Hedging, and impairment were briefed.

Chapter 3: The third chapter presented the literature review and discussed the relevant previous studies on how banks should provision for ECL in the Europe and other countries. The chapter is basically about the studies done in the Europe studying the new accounting rule impact on the banks specifically on provisions, Common Equity Tier 1, capital, retained earnings as well as equity analysts. Furthermore, different challenges that may face companies while implementing

the new rule along with the strategic action's banks can take to go ahead with the IFRS 9. Also, the effect of IFRS 9 on the banks in the GCC context was summarized.

Chapter 4: The fourth chapter has discussed the methodology that used in the study paper. The methodology which used in this study is quantitative, 10 interview questions were answered to explain the research topic. The interviews were done with two teams corporate and finance team of one organization which is Dubai Islamic Bank. Furthermore, interview questions were sent to different finance and investor people on LinkedIn application.

Chapter 5: In the fifth chapter results and answers that were provided by both teams are briefed and supported by previous studies. The study main question was how banks should provision for ECL and IFRS 9 impact on financial institutions. Different answers were given by both teams and end up that not all banks calculate provisions ECL in the same way they use different equations and internal systems to calculate ECL, so each bank provision for ECL in different way. The provision level will increase under the new rule and will be different for each bank reliable on the credit deterioration.

6.2 Implications of the Findings

The current study provides several practical implications for banks and investors. Firstly, the findings provided in the study will help banks and other financial institutions to know how to be prepared for any new accounting standards and take actions and strategies. Secondly, the present study identifies the importance of learning the impact of the new accounting standards on the

financial assets (Financial assets are Cash, stocks, bonds, mutual funds and bank deposits) of any type of institutions including banks. Thirdly, the study will provide financial institutions with a better understanding and guidance on the importance of monitoring the ongoing credit deterioration and what should be done in order to lower expected provisions. Finally, the findings of this study will help investors to have clear picture of the financial position of each institution, which will help them to undertake right investment decision.

6.3 Recommendations & Suggestions

The study provides some suggestions for the banks and other financial institutions. First, it is always better to study any new accounting rule before implementation this will help organization to understand the risks and rewards that they are going to face in the future. Second, banks and other financial institutions should present provisions on their financials in a way that will not harm investors because hiding provisions may impact the investors negatively and lose their investments. Finally, following up receivables collection on daily bases to lower provisions and retain a strong P&L statement.

6.4 Limitation of the study

Like any other studies, the current study is not free from limitations. First, limited access to the data provided by the interviewees since most information were internal and confidential. Another thing was very few responses got on the LinkedIn application and most responses were that they do not have any idea about the topic and recommending other people tried to reach them but again no responses. Furthermore, using only one organization in answering the interview questions.

6.5 Future Research

For the future studies, IFRS 9 will show the P&L statement in a bad and unattractive shape for all investors and analysts since banks have to report more provision under the new standard. The future study can be focusing on how controlling the provision amount that have to be reported on the P&L statement. How to shape the P&L in a way that looks very transparent and more accurate.

Moreover, there is a new accounting standard namely IFRS 16 which is going to be implemented on 1 January 2019. This standard focus on changing the lease accounting for the tenants and necessitating all tenants to account operating lease liability on their balance sheet. The concept behind this standard is to bring more transparency to the company's assets and liabilities and help investors and analysts to better analyze the company and as well as the stock. Presently the operating liabilities are not reported on the balance sheet so analysts and investors have to guess what is it when they are evaluating the firm's covenant. This new standard is going to affect mostly companies that have intensive handlers of real estate tenancy agreements. (What does IFRS 16 mean for landlords 2018) IFRS 16 will affect the liability part of the balance sheet especially for the retailers and it will triple the dept part. Moreover, IFRS 16 rule will impact retailers' firms so it is better to study it well and identify significant points about it.

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