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1. Introduction

EY’s biannual European International Financial Reporting Standards (IFRS) banking conference on 16 November 2017 in London was attended by representatives from some of the largest banks across Europe.

The discussions revolved around the ongoing challenges arising from changes to accounting and regulatory rules affecting the banking industry.

Much of the day focused on IFRS 9 *Financial Instruments*, with points of views from EY, banks and regulators, but also included a wider update on recent International Accounting Standards Board (IASB) developments. The presentations also covered IFRS 15 *Revenue from contracts with customers*, IFRS 16 *Leases and Brexit*, and the impact on financial regulation.

This document provides a high-level summary of insightful thoughts from discussions with leading professionals and peers across the European financial services industry, as well as the findings of real-time polls taken during the conference.

We hope that you find the contents of this report useful in planning for managing the forthcoming changes.
2. Update on IASB activities and other topical matters impacting banks

Tony Clifford, Partner, EY, outlined recent relevant activity by the IASB to provide clarity for the following:

- Long-term interests in entities accounted for using the equity method are subject to the IFRS 9 Expected credit loss (ECL) model, as clarified by the amendments to IAS 28 Long-term Interests in Associates and Joint Ventures
- ‘Two-way’ prepayment clauses of IFRS 9 as summarised in the EY publication IFRS Development – IASB issues an Amendment to IFRS 9
- The accounting for modifications of liabilities that do not result in derecognition
- Do derivative clearing members act as agents or principals? It depends on whether they are a party to a contract within the scope of IFRS 9 or IAS 39, but the IC did not consider triparty arrangements.
- Can puttable instruments be classified as held at fair value through other comprehensive income (OCI) without recycling by investors? No, the IC confirmed that for such classification the instrument needs to qualify for equity classification by the issuer.
- Can changes in the fair value of derivatives be reported in ‘interest revenue calculated using the effective interest rate method’, following the amendment to IAS 1 Presentation of Financial Statements, which comes into effect in 2018? According to the staff, no. The IC still was to debate this topic.

Tony summarised the IASB work programme, highlighting the discussion papers on Financial Instruments with the Characteristics of Equity and Dynamic Risk Management, due in the first and second halves of 2018, respectively, but also pointing out other projects, such as business combinations under common control and the definition of a business.

He also listed a number of areas where there were still challenges in interpreting IFRS 9, many of which are discussed in the EY publication International GAAP\(^2\), the latest version of which will be published in early 2018. He asked the audience for their views.

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Options or decisions to be made as at the date of initial application – assuming that IFRS 9 hedge accounting guidance is not adopted:

- Conclude on business models.
- Make elections or revocations of FVPL option.
- Determine whether recognising own credit in other comprehensive income (OCI) for fair value option (FVO) liabilities would enlarge an accounting mismatch.
- Make elections of eligible equities at fair value through other comprehensive income (FVOCI).
- Make elections of FVPL own-use non-financial contracts.
- Conclude whether or not, at the date of initial application of IFRS 9, to continue to follow hedge accounting under the requirements of IAS 39.
- Decide whether to defer or apply an overlay for IFRS 9 for eligible insurance activities.

Other workstreams to complete:

- Solely payment of principal and interest (SPPI) testing, and business-as-usual (BAU) procedures
- Expected credit loss (ECL) for intragroup loans, reverse repos, receivables, and so on
- Baselines for assessing significant increases in credit risk
- ECL, hedge accounting and transition disclosures
- ECL governance

Tony also set out the various challenges that banks still have to deal with before the end of this year.
Nic van der Ende, Senior Policy Officer at De Nederlandsche Bank and member of the Basel Committee of Banking Supervisors’ Accounting Expert Group talked about the interplay between the accounting for ECL and the regulatory treatment, as well as highlighting some of the supervisory challenges.

The audience were asked for their view on what is the best EL framework going forward, given the new IFRS 9 regime, for bank steering purposes.

- 54% Basel framework 'through the cycle'
- 22% 'Point in time' framework
- 14% Hybrid
- 10% I don't know

Nic reflected on the current movement for convergence between the accounting for ECL and the prudential expected loss (EL) framework. This is exemplified by the reference in a Basel Committee document to accounting methodologies, found in the Basel Committee Banking Supervision (BCBS) publication *Guidance on credit risk and accounting for ECL (GCRAECL)*.

But, whilst IFRS 9 narrows the gap between accounting and the prudential EL concept, differences remain. Given the disparity between jurisdictional practices and the fact that other Basel standards are currently being finalised, global convergence should not be expected any time soon.

It was observed that this demonstrated a shift in views since the same question was asked during the June 2016 conference where the point-in-time framework was the most popular with 48% of the votes compared with 16% in favour of the Basel framework.

- Whilst a supervisor can be expected to challenge the policies and procedures that govern a banks ECLs, they should not instruct the calculation of this amount. It was suggested by some that the role of the supervisor should be considered in light of recent European developments, including the treatment of nonperforming loans (NPLs) and the proposed prudential backstops, and it was noted that the application of this guidance was subject to interpretation.

- Nic discussed the importance of a robust audit and the auditors’ approach to ECL. He explained that because of the challenge presented by data quality and model complexity, a robust internal governance structure must be in place and tested by the auditors. He highlighted the role that Basel has taken in guiding this, including the support provided to the development of the two Global Public Policy Committee (GPPC) papers.

- Lastly, there was a message to those charged with governance to encourage proactive engagement with supervisors to raise any material problems and issues early so as to avoid unwanted surprises.
Mario Quagliariello, Head of Risk Analysis at the European Banking Authority (EBA) provided an overview of the 2018 EU-wide stress test, covering timelines, key features and explaining how the methodology incorporates IFRS 9.

Mario referred to the fact that the draft methodological note was published in June 2017 for discussion with the industry. The EBA subsequently received over 1,000 comments by banks, which have been thoroughly analysed and used to amend the final methodological note and templates. He explained that the final methodological note was due to be published in the coming days with the templates to follow before the end of 2017.

The sample will include 49 banks, of which 34 are from Single Supervisory Mechanism (SSM) countries; Mario confirmed that the methodology for sample selection is consistent with that applied in 2016 and will have the following characteristics:

- It will be conducted at the highest level of consolidation.
- It will cover circa 70% of total banking assets in the Eurozone (EZ), non-EZ countries and Norway.
- For inclusion, banks have to have a minimum of €30 billion in assets.
- Competent authorities can request to include other institutions in their jurisdiction provided that they have a minimum of €100 billion in assets.
- Banks under European Commission restructuring plans can be included subject to the common methodology and static balance sheet assumption.
- It will use bottom-up projections that will be based on banks’ own estimates, whilst remaining subject to conservative constraints.
- There will be a static balance sheet assumption.
- There will be one adverse scenario.
- The stress will be based on market risk shocks and include a new stress on level 1 and level 2 instruments.
- Net interest income will be recognised for all assets but capped for nonperforming assets and floors will be removed on interest expense.
- It will include other income and expenses as part of the projection whilst remaining subject to conservative constraints.

In respect of IFRS 9, the following requirements and assumptions will be implemented:

- Results for a single base and stress scenario will be required
- Perfect foresight must be assumed resulting in assets moving to stage 2 in year one if applicable
- Simplification backstops to determine stage can be used
- Cures shall be permitted from stage 2 only
- Maturing assets will be replaced with assets originating in the same stage
- All projections shall be carried out on the basis of the applicable accounting valid on 1 January 2018

3 The final EU-wide stress test methodological note was published on 17 November 2017.
The audience were asked how they expect the impact of IFRS 9 Credit risk methodology in the adverse scenario to compare to 2016.

<table>
<thead>
<tr>
<th>Impact Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower than the impact of the 2016 methodology (IAS 39)</td>
<td>5%</td>
</tr>
<tr>
<td>In line with the 2016 results</td>
<td>16%</td>
</tr>
<tr>
<td>Higher than in 2016</td>
<td>79%</td>
</tr>
</tbody>
</table>

He then talked through the proposed timeline as published in October 2017.

<table>
<thead>
<tr>
<th>Milestone</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Launch of the exercise</td>
<td>January</td>
</tr>
<tr>
<td>First submission of results to the EBA</td>
<td>Early June</td>
</tr>
<tr>
<td>Second submission to the EBA</td>
<td>Mid July</td>
</tr>
<tr>
<td>Final submission to the EBA</td>
<td>Late October</td>
</tr>
<tr>
<td>Publication of results</td>
<td>By 2 November</td>
</tr>
</tbody>
</table>

Mario explained that for 2018 only, the timelines for final submissions have been extended in recognition of the challenges for banks to perform the stress test, whilst trying to finalise IFRS 9 implementation. This would also allow banks to base the stress test on information reviewed by auditors.

Before closing the session, the audience were asked how ready their bank is for the 2018 EU-wide stress test (IFRS 9 component only)?

<table>
<thead>
<tr>
<th>Readiness</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>High level of confidence</td>
<td>4%</td>
</tr>
<tr>
<td>Completed the majority of work with some outstanding items</td>
<td>17%</td>
</tr>
<tr>
<td>Plan to undertake most work in Spring 2018</td>
<td>55%</td>
</tr>
<tr>
<td>Yet to scope fully and plan</td>
<td>24%</td>
</tr>
</tbody>
</table>
5. Commercial impacts and business’ response to IFRS 9

Yolaine Kermarrec, Partner, EY, discussed how banks are considering, or could consider, responding to the commercial implications of IFRS 9.

Impairment

Yolaine highlighted the key findings from the EY IFRS 9 Impairment banking survey which was published in August 2017.

- The expected loan loss provision increases on transition to IFRS 9 are largely driven by retail portfolios, such as credit cards, because of higher credit risk sensitivity and the inclusion of the undrawn component in the exposure at default used for the ECL calculation.
- For most respondents, the expected impact of applying multiple economic scenarios (MES) on transition is expected to be less than 10%. This impact could differ significantly in stressed times, and it is also very product- and geographic-specific.
- The day one estimate of the IFRS 9 Impact on common equity tier 1 (CET 1) capital ratio is expected to be below 0.25% for the majority of banks, with an excess EL often offsetting part of the increase in accounting provisions for internal ratings-based (IRB) portfolios.
- Many banks anticipate that IFRS 9 could amplify pro-cyclicality.

Yolaine then referred to the occasional paper published by the European Systemic Risk Board (ESRB) on the financial stability implications of IFRS 9, published in July 2017.4 According to their analysis, IFRS 9 could tend to concentrate the impact of credit losses on profit and loss (P&L) and CET1 at the very beginning of deteriorating phases of the economic cycle, thus raising concerns of potential pro-cyclicality.

She talked about the importance of building a structured monitoring approach to monitor the IFRS 9 impacts and building management information (MI) to enable business decisions.

The audience were asked whether banks were making decisions to reduce the impact of IFRS 9 on provisions, capital or their volatility.

<table>
<thead>
<tr>
<th>Decision</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, some significant business decisions made already</td>
<td>7%</td>
</tr>
<tr>
<td>Yes, to a limited extent</td>
<td>25%</td>
</tr>
<tr>
<td>Not yet, but we’re actively assessing our potential business’ response</td>
<td>25%</td>
</tr>
<tr>
<td>No, all our energy is focussed on being compliant by the IFRS 9 starting line</td>
<td>32%</td>
</tr>
<tr>
<td>No, IFRS 9 is not a big deal</td>
<td>11%</td>
</tr>
</tbody>
</table>

Yolaine next listed a number of drivers of provisions, their impact on capital and their volatility: stage 2 migration; probability of default and counterparty rating; cyclical or counter-volatile industries and countries; undrawn balances, lifetime, loss given default and data quality.

Business responses that banks are considering include:

- Strengthening of underwriting standards – leverage, covenant, collateral, size and tenor
- Adjusting the product, industry, client, country and maturity mix
- Product pricing better informed by more granular risk data, and including credit-related repricing triggers post origination
- Reducing the undrawn component on credit cards when this does not impact the client franchise
- Increasing the use of financial guarantees, hedges and securitisations
- Strengthening early-warning sign, watch-list and pre-arrears collection processes
- Improvement of data quality and reduction of proxies
- Adjustment of internal hurdle rates, return on equity per product and return on risk weighted assets (RWAs)

She next reflected on the interplay between IFRS 9 and the fundamental review of the trading book (FRTB). Certain banks are cautious of avoiding the unintended impact of their IFRS 9 business model decisions on the boundary between the trading book and banking book for regulatory capital calculation purpose. This is largely driven by the general presumption in BCBS 352, that instruments held as accounting trading assets or liabilities are trading book instruments.

Strategic IFRS 9 business model decisions observed include:

- Amending business models before IFRS 9 first-time adoption to avoid any inconsistencies that could question existing trading book and banking book classification
- Segregating certain portfolios
- Increasing the use of financial guarantees, hedges and securitisations
- Strengthening early-warning sign, watch-list and pre-arrears collection processes
- Improving data quality and reduction of proxies
- Adjusting internal hurdle rates, return on equity per product, and return on risk weighted assets (RWAs)

Classification and measurement

Yolaine discussed the management actions already observed to reduce some of the unintended P&L volatility resulting from IFRS 9 on non basic lending arrangements including:

- Separation of embedded derivatives from the host contracts via separately tradable contracts, mostly observed in aircraft financing and shipping
- Removal of SPPI-toxic features from the host contracts
- Enhancement of governance around the use of standardised contracts and new product approval

The audience were asked whether they have already amended contract terms as a result of IFRS 9 Classification and measurement (C&M).

| Yes, already amended before 2017 | 6% |
| Yes, only since this year | 10% |
| No, but plan to do so before IFRS 9 becomes effective | 16% |
| No, because of immaterial impact | 68% |

The audience were asked whether they had made a strategic IFRS 9 business model decision in light of the interplay with FRTB.

| Yes | 26% |
| No, but plan to do so | 10% |
| No, interplay with FRTB not deemed material | 38% |
| No, interplay not explored yet | 26% |
Conrad Dixon, Head of Global Accounting Policy at HSBC, discussed the challenges represented by the disclosure requirements, and what might be most helpful and informative disclosures on transition to IFRS 9.

Conrad explained that transitional disclosures are evolving and will continue to do so. He presented the buildup of disclosures from pre-transition through to the 2018 annual report, noting the guidance that is available for banks to help them determine which disclosures should be considered to be included in each reporting framework through the first year of IFRS 9.

Conrad highlighted the challenge of striking a balance between providing timely forward looking information, whilst leveraging a wider range of existing credit risk information that is timely, whilst not overly complex or judgemental, and allows for comparability between banks for stakeholders, including investors. He also emphasised the importance of a robust control framework to ensure that disclosures are reliable.

He then explored some of the options when considering the timing and means of providing transition information to stakeholders. The possibilities he outlined included:

- Including within the 2017 annual financial statements so the information is all in one place and gets to the market quickly. However, this may distract from the IAS 39 information and requires the right control framework to be in place to provide the information with sufficient rigour.
- Including in a separate transition document made available between the 2017 year end financial statements and first quarter reporting. However, this will require resources in an already busy period.
- Including in the first quarter reporting. However, this may detract from the first quarter reporting of performance and there may be questions over the optimal presentation layout.
- Including at a later date. However, questions over whether this is too late for market expectations arise.

The preferred option for some of the banks is to publish a separate transition document. Whether this would have publicaly available assurance from auditors is still being debated.
Conrad explored some of the key considerations for determining what information should be included in the transition disclosure:

- Management will need to exercise judgment in weighing up the needs and expectations of the users, with the bank’s ability to produce consistent and reliable information within an adequate control framework.
- Content and granularity will be steered by materiality and relevance.
- Looking to the IFRS 7 Financial Instruments: Disclosures for the transitional disclosures would be a good starting point, and therefore providing:
  - Changes in measurement category and carrying amount of financial instruments
  - Changes in fair value designations of financial assets and liabilities, both those required and those elected
  - Information to permit the reconciliation of impairment allowance under IAS 39 Financial Instruments: Recognition and Measurement and provisions under IAS 37 Provisions, Contingent Liabilities and Contingent Assets to ECLs under IFRS 9
  - Qualitative information on how the classification requirements were applied
  - Whilst these disclosures work in the context of the full set of financial statements, they may otherwise need to be accompanied by additional information.

- It will also be helpful to consider the Enhanced Disclosure Task Force (EDTF) recommendations, which aim to help investors understand the initial impact of IFRS 9 and allow for comparisons. These are recommending banks to:
  - Provide the mandatory disclosures as soon as practicable
  - Include additional information to explain the opening position (stage allocation, changes by product or business and simplified approaches on transition)
  - Provide segmentation appropriate to explain ECLs with a focus on concentrations and specific areas of emerging risks
  - Provide the basis of any restated comparative information

Conrad then discussed some ideas generated from industry discussions on what good transition disclosures might look like:

- Summary information and KPIs that are anchored to comparable information and metrics, such as the proportion of stage 2 assets that are 30 days past due, ECL coverage by stage, by sector or segment; specific segment concentrations and write-off policies
- Credit risk information presented using IFRS 9 concepts and focused on outcomes to enhance comparability
- Qualitative and quantitative information to explain the differences between IFRS 9 and IAS 39 noting that whilst no direct reconciliation is possible, a graphical or tabular estimated reconciliation may be useful
- Explanation of methodologies, assumptions and estimation techniques that focuses on comparing the outcomes using simple metrics aligned with management information and other disclosures
- Description of the key judgements and estimates involved in ECL measurement, including assumptions about the future and other significant sources of uncertainty
In respect of the use of forward-looking information, Conrad made some suggestions for what an estimation of uncertainty disclosure might look like, using principles set out in the recent UK Financial Reporting Council guidance and taking forward-looking information as an example:

- How forward-looking information has been incorporated
- Quantification of which exposures are most at risk and the link to concentrations
- Main sources of material estimation uncertainty with clear and specific descriptions
- Quantification of key assumptions for the central scenario
- Approach to estimating ‘non-linearity’ and its effect on ECL if material
- Base disclosure on information used by key management personnel

Looking ahead, he also noted that the application of sensitivity and scenario analysis continues to present some challenges and there is not yet any clarity in respect of what is practical and might be most useful. This is an area of disclosures expected to be further developed across the industry.

He concluded by asking the audience how challenging it will be to deliver high-quality IFRS 9 related disclosures.

- Very challenging: 30%
- Hard work: 56%
- Take it in our stride: 8%
- Yet to assess: 6%
7. IFRS 9 auditor expectations

Tara Kengla, Partner, EY discussed auditor expectations related to IFRS 9 implementation and explained the main areas of audit focus.

The most important point that she highlighted was the critical need for banks to have a robust system of internal controls supported by sufficient documentation, emphasising that this is expected for all banks and not only those which need to satisfy the Sarbanes Oxley Act requirements.

The following were the main expectations that she highlighted with respect to implementation:

- End-to-end process maps should be prepared by management.
- Management controls over data quality are key.
- Model documentation must be clear and validation results understood.
- Information technology (IT) system controls should not be overlooked.
- C&M decisions and documentation must be in place by 1 January 2018.
- Management should have a clear plan for cutover and conversion to 1 January 2018 and IFRS 9 go live, with appropriate controls and documentation. This should be well documented so that data is not lost and transitions disclosures can be made.

Tara also reminded the audience about the two GPPC papers related to IFRS 9 that were issued in June 2016 and July 2017. She specifically referred to the second paper that focused on the audit committee’s role in assessing the effectiveness of the auditor’s response to risks of material misstatements presented by the estimate of ECLs. The paper includes nine questions that the audit committee should ask the auditors in relation to how they will audit IFRS 9. Tara noted that the key point for the audience was that the quality of the documentation and the robustness of management’s system of internal controls will play a large part in what the auditor can do and say to answer those questions. She highlighted these questions as a useful reference list of the areas where auditors will focus and the changes, which may be seen in the composition of the audit team and in some audit approaches.

With respect to the main areas of audit focus, Tara specifically discussed testing procedures expected to be performed on the IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors disclosures for year-end 2017. She also explained the procedures expected in 2018 and beyond, specifically around data (including the use of proxies), models, information systems, the use of multiple economic scenarios, and MI expected for the assessment of staging.
8. Revenue recognition and leases: are banks ready for the change?

Fabio Fabiani, Partner, EY, discussed the expected impacts of IFRS 15 and IFRS 16 for banks, focusing on the results of two surveys that EY is conducting on the application of these new standards.

Revenue recognition

Fabio reminded the audience that the disclosure of the expected impact of IFRS 15 is one of the common enforcement priorities for the European Securities and Markets Authority (ESMA) for 2017. He then illustrated the key results so far of the EY survey on the IFRS 15 readiness status of financial institutions, currently in progress. From this, the early indications are that the majority of banks are not expecting to disclose a material quantitative impact from the application of the new revenue recognition standard. Only 16% of respondents expect a material impact and this is only in respect of the presentation of revenue (changing from gross to net or vice versa). This was consistent with the results of the polling question where Fabio put the same question to the audience.

<table>
<thead>
<tr>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, on the impact on retained earnings</td>
<td>4%</td>
</tr>
<tr>
<td>Yes, on the impact on presentation (gross vs. net)</td>
<td>0%</td>
</tr>
<tr>
<td>Yes, on the impact on both retained earnings and presentation</td>
<td>7%</td>
</tr>
<tr>
<td>No, we will provide a statement that the impact is not expected to be material</td>
<td>80%</td>
</tr>
<tr>
<td>Not decided yet</td>
<td>9%</td>
</tr>
</tbody>
</table>

Fabio reminded the audience that, even in these circumstances, it is still expected that preparers will run a validation exercise and will document their conclusions.

Fabio highlighted some of the key areas where respondents have indicated a possible impact from the application of IFRS 15. These include the following:

- **Customer trade execution**, where there may be multiple performance obligations in the contract and the presentation of revenue (gross versus net) may change on the basis of the revised principal vs agent guidance in IFRS 15.

- **Credit cards**, where the identification of the customer (the merchant or the cardholder) may impact the timing of recognition of revenue, on the basis of when the performance obligations in the contracts are satisfied, including those arising from loyalty programs.

- **Insurance trail commissions**, where some respondents consider all performance obligations (written, verbal or implied) satisfied once they have distributed the insurance contract. Therefore, they are considering anticipating the recognition of revenue that is expected to be generated by future renewals of that contract. Fabio reminded the audience that this is an area of judgement and it is expected that entities would have sufficient historical information to estimate the amount of revenue that is highly probable and will not result in a significant reversal in the future.
Fabio then focussed on the disclosure requirements of IFRS 15, which require the disaggregation of revenues into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Whilst almost half of the reporters expect to increase the number of categories of revenue compared with IAS 18 Revenue, there is still approximately one-third of reporters that are expecting to disclose no more than three categories of revenue. Fabio suggested that this was considered to be a relatively low number given the requirements of the new standard. Most respondents indicated that the disaggregation will be driven by the type of goods and services, and only one entity is expecting to provide a quantitative breakdown of revenue recognised at a point in time versus revenue recognised over time, with a majority still undecided.

**Leases**

Fabio reminded the audience of the key requirements of the new accounting standard for leases, that will be effective in 2019. The standard will introduce a single on-balance sheet accounting model for all lease contracts from a lessee's perspective, with some exceptions. He focused on the judgmental areas of the new standard, including establishing the length of a lease when there are extension or termination options, where preparers will have to consider the probability that those options will be exercised.

He then reminded the audience that the Basel Committee has now clarified that the right-of-use asset should be 100% risk-weighted. On the basis of a desktop review of the 2015 annual reports for a sample of large European banks, focussed on the disclosure of the minimum lease payments under non-cancellable leases, EY has estimated that this may result in an average reduction of 15bp on the CET1 ratio.

He then discussed some of the results of the EY survey on the IFRS 16 implementation status of financial institutions, currently in progress. The survey shows that more than one third of respondents have completed the high-level impact assessment and 7% of the entities have already completed the detailed impact assessment for their real-estate portfolio. This shows a clear distinction between the real-estate portfolio, generally more controlled and with more data and information available, and other assets (primarily IT equipment and vehicles) where completeness of the population and data availability are proving more challenging and entities may also have to re-assess whether the contract is a service arrangement or a lease. With respect to data, this is one of the key attention areas in the implementation of the new leases standard. The polling question asked to the audience shows that the majority of respondents are still in the process of assessing data quality and completeness, with only 10% satisfied in that respect.

With regard to transition options, the majority of respondents to the EY survey have indicated a preference for the modified retrospective approach and, in applying that, most expect to measure the right-of-use asset at an amount equal to the lease liability. Whilst this method is operationally simpler and in most instances minimises day one capital impact, it may have an impact on future profitability where the right-of-use asset (and therefore its depreciation) is higher than applying the full retrospective approach.

Fabio concluded his presentation by showing the expected cost of implementation of the new standard. Over half of respondents to the EY survey expect to spend more than €0.5 million and approximately one third more than €1 million, with most of the cost consumed by changes to IT systems and data cleaning and remediation.
9. Brexit and financial regulation

Andrew Pilgrim, Director, EY, provided commentary on the status of the Brexit negotiations ongoing between the UK and the EU and the important issues that financial services firms need to look out for.

- Of critical importance for many is whether the negotiations successfully move on from phase one issues (money, people and Northern Ireland) to phase two (a framework for a future relationship) following the EU Council meeting mid December.
- A move to phase two would give hope that the UK and EU might come to a new agreement delivering some level of reciprocal market access. This would include implementation of a transitional agreement that would maintain the status quo for UK and EU market access (e.g., passporting rights) for an additional period of around two years.

- The speed at which some firms implement their Brexit plans may be impacted by the timing of any such implementation period, as well as the underlying confidence. Supervisors in both the UK and EU are both heavily scrutinising firms’ plans and preparing for a busy 2018 as firms fully engage in implementation.

Jana Währisch, Partner, EY, highlighted some of the key implementation challenges for those banks who plan to, or are considering establishing a presence in Germany for their European Economic Area (EEA) trades and clients.

- For local reporting purposes, every bank would need to prepare financial statements in accordance with German external reporting requirements (German GAAP) that have fundamental differences compared with IFRS.
- In respect of regulatory reporting requirements, some of the things to consider are:
  - Most local German reports are prepared in German, only. This also applies to guidelines and supporting documentation published by the Deutsche Bundesbank (Bundesbank) or the Federal Financial Supervisory Authority (BaFin).
  - Local German reports still need to be populated with German GAAP figures (e.g., ‘balance sheet statistics’ cannot be filed with IFRS figures).
- Some reports have concepts that are unique to Germany (e.g., gone or going concern risk-bearing capacity report).
- Some reports are very granular in nature. For example, the Million Exposure report includes all exposures in excess of €1 million, which need to be reported on a quarterly basis to Bundesbank.
- Some reporting deadlines are very close to previous month’s end (e.g., ‘balance sheet statistics’ on the sixth banking day after previous month end).
- The regulators increasingly expect the implementation of a reconciliation framework with defined processes and controls among financial, regulatory and internal reports.
10. EY contacts

If you would like to discuss any of the areas raised in this report, please see below for a list of EY IFRS professionals. Alternatively, please do not hesitate to speak to your normal EY contact.

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