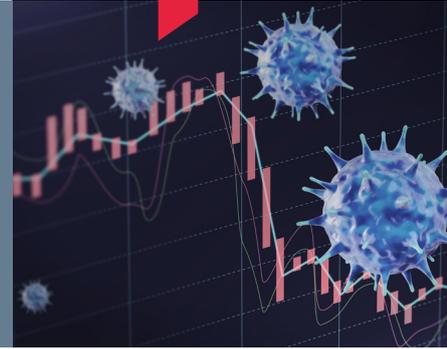


CORONA CRISIS: EFFECTS ON INTERNATIONAL ACCOUNTING AND REGULATORY REQUIREMENTS OF BANKS



In an unprecedented way, the worldwide spread of the coronavirus has led to an abrupt reduction in public life and economic activity. The various sectors and industries have been impacted with varying degrees of severity and in all cases more or less unprepared.

The effectiveness of government measures introduced at short notice at jurisdiction levels in the form of the provision of massive financial aid packages and the adaptation of legislation (e.g. with regard to a partial restriction of the obligation to file for insolvency) is currently difficult to assess, especially as the global spread of the virus is still in its early stages.

It is already foreseeable that, based on existing standards, the effects of the crisis will have a serious impact on international accounting and regulatory reporting by banks and financial service providers.

EFFECTS ON INTERNATIONAL BANK ACCOUNTING

In accordance with the multi-stage expected credit loss model, the existing IFRS 9 standards require large increases in expected credit loss provisions in the event of a significant deterioration in credit quality. The feared lack of liquidity at borrowers is therefore expected to accelerate the pace of expected credit loss provisioning: IFRS 9 provides relevant – albeit refutable – standard assumptions: in the event of 30 days' arrears a significant increase in the credit risk is generally assumed and a default of the loan agreement is assumed at 90 days. Both of these assumptions would be accompanied by a substantial increase in expected credit loss provisions.

On 25 March 2020 ESMA (European Securities and Markets Authority) issued a public statement on

„Accounting implications of the COVID-19 outbreak on the calculation of expected credit losses in accordance with IFRS 9“, which is also supported by the Committee of European Auditing Oversight Bodies (CEAOB). In Germany, the Banking Committee of the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) has also adopted the recommendations at short notice and the view of ESMA was substantiated in a technical note on 26 March 2020. Finally, on 27 March 2020, the IASB encouraged accounting experts to take ESMA's statement and other regulators' views into account when applying IFRS 9.

ESMA, flanked by the IDW (Institute of German Auditors) in Germany, requests for appropriate consideration of the comprehensive governmental measures that seek to stabilise economies, especially when applying the impairment provisions of IFRS 9. It suggests a careful assessment of individual cases when applying IFRS 9's rebuttable presumptions.

In other words, it should be assessed on a case-by-case basis whether there is a significant increase in the credit risk after 30 days that cannot be refuted taking into account the announced or initiated stabilisation measures. Sometimes, all facts and circumstances of the individual case should be included in the assessment, e.g. whether a borrower is only experiencing a short-term liquidity issue and thus a significant increase in the risk of default has not occurred.

Furthermore, ESMA recommends placing greater emphasis on the consideration of long-term stable scenarios and not place undue emphasis on short-term developments.

Finally, accounting experts should report on the expected effects of the coronavirus pandemic as transparently and appropriately as possible in the notes to the financial statements.

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EFFECTS ON REGULATORY RISK MANAGEMENT

In recent days, national and international banking regulators have also taken comprehensive measures to adapt the regulatory framework in order to maintain the functionality of the financial and banking market despite the effects of COVID-19.

- ▶ These include (1) packages of measures aimed at maintaining solvency and liquidity as well as the technical execution of e.g. trading and consulting transactions from the home office. These also include various relaxations in the assessment of credit risk and increased flexibility in the minimum requirements for capital and liquidity.
- ▶ In addition, (2) banks are required to provide significantly more detailed ad-hoc reporting to the regulators. Early and unsolicited information is to be provided about developments that are significant for the institutions with regard to COVID-19, such as significant changes in customer behaviour, a tightening of the liquidity situation or the expectation of significant losses from credit and market risks.
- ▶ Furthermore (3), the ECB and regulators also take measures to mitigate adverse developments in the money, capital and financial markets. These include, for example, a comprehensive package of monetary policy measures by the ECB or restrictions/prohibitions on short selling.

THESE SIMPLIFICATIONS ARE ACCOMPANIED BY SHORT-TERM CHALLENGES FOR THE INSTITUTIONS

As facilitating as the proposed measures may appear, the crisis-related interpretations and measures outlined above need to be embedded in the internal regulatory and accounting processes. First and foremost, this requires capacity for the necessary information processing and analysis. If, for example, the IDW determines that an „undifferentiated, automatic step transfer“ is not appropriate for the cut-off date of 31 March 2020 (and beyond), this is accompanied by a case-specific documentation requirement for those preparing financial statements.

The challenges of the institutions for a COVID-19-compliant handling of the requirements for bank organisation and management are therefore enormous. In crisis mode, additional tasks are usually done in very tight timeframes and with a significantly increased intensity of processing and need for control. On the other hand, personnel resources may only be available to a limited extent or only from home.

Due to a heightened risk of cyber-attacks, the availability and sufficient capacity of the IT infrastructure is to be continuously evaluated and tested. The reporting system for communication with the supervisory authority must be geared to the ad-hoc information needs of the supervisory authority, and corporate planning must also be adapted to short-term changes due to COVID-19.

Many other tasks require adequate processing capacity.

EFFECTIVE TECHNICAL AND PERSONNEL SUPPORT BY BDO

Technical support: We maintain close contact with national and international standard setters and keep you informed about relevant developments in the field of national and international accounting and supervisory regulations. This not only includes an appropriate interpretation of the relevant accounting and supervisory standards, but also helps you to keep on top of an increasing volume of sometimes contradictory announcements from various regulators with different responsibilities.

Personnel and digital support: In view of the expiring busy season, our professionally experienced bank auditors are available and are well versed in preparing documentation suitable for supervisors – this can be done remotely so country borders and physical distancing does not adversely impact this.

Our data exchange platform, BDO Global Portal, is our platform for the secure transfer and sharing of data. With the ability to catalogue requirements, the efficient exchange of documents then takes place on private, secure websites to avoid any loss of data.

Our state-of-the-art explorative data analysis tools enable an improved risk assessment process, detailed substantive assessments and can be used to identify specific elements and information within a given data set.

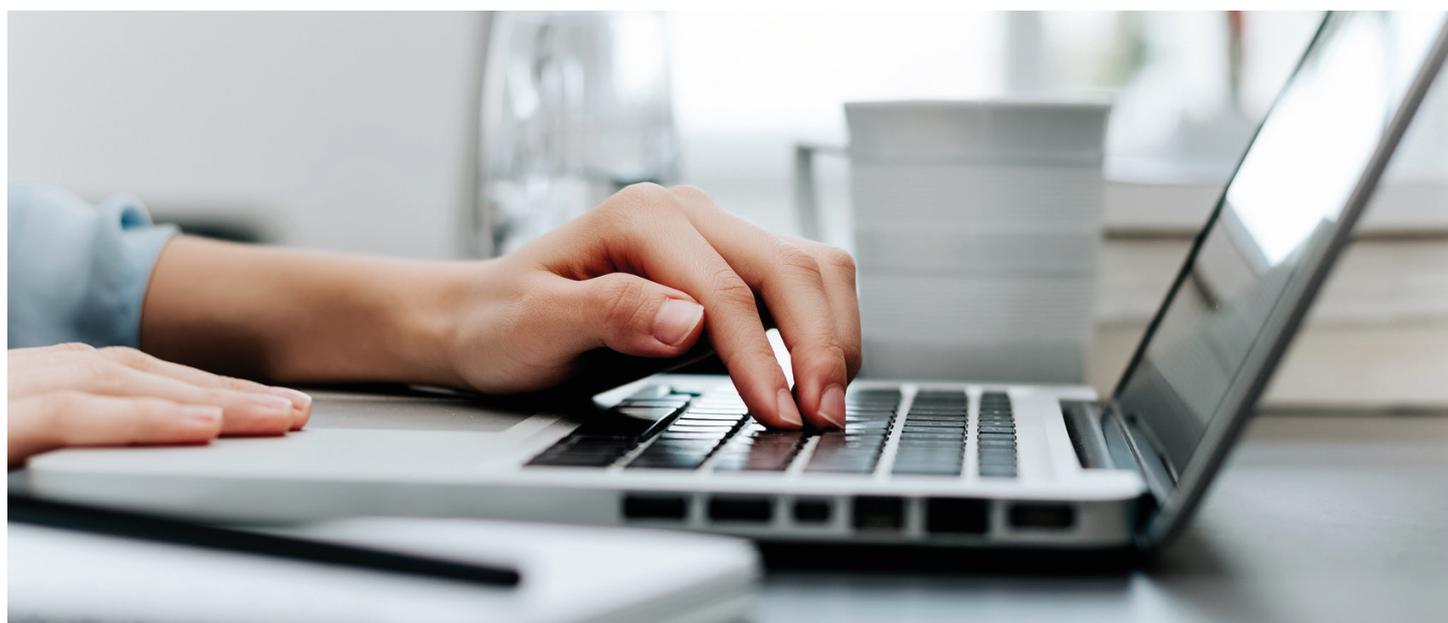
Data security is guaranteed: Information security in general and the security of our clients' data in particular are of the utmost importance to BDO. We have taken technical and organizational measures to adequately secure the data traffic between clients and BDO and to ensure the secure processing of data at BDO.

We transmit data exclusively in encrypted form and use up-to-date security mechanisms, such as Transport Layer Security (TLS) with encryption algorithms. We process data in Germany in our own data centre and in Europe in selected and tested cloud services.

IMPORTANT SOURCES OF INFORMATION

The following links provide more information on state and regulatory measures:

- ▶ **European Central Bank (ECB):**
<https://www.bankingsupervision.europa.eu/home/html/index.en.html>
- ▶ **Federal Financial Supervisory Authority (BaFin):**
https://www.bafin.de/DE/Aufsicht/CoronaVirus/CoronaVirus_node.html
- ▶ **European Banking Authority (EBA):**
<https://eba.europa.eu/eba-statement-actions-mitigate-impact-covid-19-eu-banking-sector>
- ▶ **European Securities and Markets Authority (ESMA):**
<https://www.esma.europa.eu/press-news/esma-news/esma-recommends-action-financial-market-participants-covid-19-impact>
https://www.esma.europa.eu/sites/default/files/library/esma32-63-951_statement_on_ifrs_9_implications_of_covid-19_related_support_measures.pdf
- ▶ **CEAOB:**
https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200325-ceaob-statement-covid-19_en.pdf
- ▶ **Institut der Wirtschaftsprüfer – German Institute of Auditors (IDW):**
<https://www.idw.de/idw/idw-aktuell/corona-virus--auswirkungen-auf-wertminderungen-von-finanzinstrumenten-nach-ifrs-9/122898>
- ▶ **IASB:**
<https://cdn.ifrs.org/-/media/feature/supporting-implementation/ifrs-9/ifrs-9-ecl-and-coronavirus.pdf?la=en>



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