REPERCUSSIONS OF THE TRANSITION TO THE IFRS SYSTEM, INCLUDING A TECHNICAL SYSTEM APPRAISAL.

The merry-go-round of regulatory changes is constantly turning, and continuously presents new challenges for banks. A further complication is added by the CRD IV since one section has been adopted as a regulation and is to be directly applied nationally without being implemented nationwide. In so far as they have not been directly incorporated into the CRD IV or at least been included in provisional regulations, national options generally do not apply.

Council Regulation (EC) 1606/2002 is the first major step towards international harmonisation of accounting. The national implementation occurred with the introduction of the Accounting Legislation Modernisation Act (Bilanzrechtsreformgesetz). Accordingly, since the beginning of 2007, capital-market orientated parent companies have been required to prepare consolidated financial statements in line with IFRS requirements. In regulatory reporting under supervisory law this development is being introduced with some delay. The current applicable provisional regulation of the German Banking Act[1] for the first time stipulates ascertaining the appropriate capital requirement level, based on the international IFRS accounting standards, only from the beginning of 2016. Such a provisional regulation does not provide for the current version of the CRD IV, so that a consolidated notification requirement based on IFRS may already exist as from 2013. On the other hand, the current draft version of the German Banking Act in the provisional regulation stipulates the obligation to use IFRS accounting as a consolidated notification basis from the beginning of 2014[2]. This acceleration of the obligation to apply the new standards considerably increases the flexibility requirements for the systems and data repository since IFRS-based figures are not usually available in the regulatory reporting environment provided by the system. Furthermore, the recent dependence on IFRS emerges through an additional change variable in the regulatory reporting procedure, which can be clearly seen, for example, in the form of the changes which have come into force through IFRS 9.

Against this background, two topical areas arise which require action in the near future. Firstly, the functional concept and identification of the consolidated equity requirements on an IFRS basis, and, secondly, the use of the system to prepare IFRS figures at group level.
Repercussions for the equity ratio may arise both through assessing the risk position

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1 Sec. 64h (4) German Banking Act (KWG)

2 Editorial note as per editorial deadline: It is planned that the Federal Ministry of Finance will, if necessary, enact this provisional regulation in a separate letter, should Sec. 64h(4) German Banking Act be discontinued.

and through the equity components themselves. Risk positions are potentially affected by changes if reliance is placed upon taking book values into account from a regulatory perspective. In regard to the basis for assessment under the solvability regulation (SolvV), the latter applies to the counterparty default risk positions, whether recognised in the balance sheet or not, as well as partially to currency risk positions. Derivative counterparty default risk positions are usually not affected, as most of the banks use the market valuation method.

The differences in the measurement result from, inter alia, different perspectives held by balancing in line with the German Commercial Code or in line with IFRS. Whereas, in the German Commercial Code, a policy of prudence prevails, through which, for example, undisclosed reserves can collect, the IFRS perspective tends to rely upon the present value or amortised cost. In addition, situations such as taking into account individual value adjustments are handled differently. Differences may also exist in the accounting requirement to divide structured products. While, for example, such a requirement may be avoided for a credit-linked note in the asset ledger from an IFRS perspective by making use of the fair value option, in regulatory reporting it is necessary to divide this product into the two components of security (balance sheet position) and the assignor of the credit default swap (off-balance sheet position). In all transactions for which the regulatory reporting representation differs from the IFRS perspective, problems essentially arise in allocating the book values.

In the assessment, analyses arise on the equity components. Such measurement effects, or the fact that allocations (having no effect on the balance sheet) are shown in the equity, can partially be eliminated by applying prudential filters. Nonetheless, the bottom line is differences which may have a positive or negative effect on the values of the equity components to be assessed. An impact upon the large loan exposure limits at group level may also arise from the latter. If the ceilings are reduced, theoretically additional large-scale loans may occur, for which no resolution of the shareholders' meeting is available at corporate level. Changes in the large-scale loans may, however, also arise based on the different assessment especially of asset ledger transactions. The large-scale loans are not affected by the latter, as a national regulation is at issue, which will continue to be determined based on the German Commercial Code. There is currently also no group notification of the large-scale loans. There is no general answer to the interesting question of the impact upon the equity ratio when IFRS is used as a basis for measurement to determine the appropriate equity base. The impact upon large loans can also not be assessed generally. The effect of the changeover depends too greatly upon the respective portfolio and the existing equity components. Sample calculations or other analytical methods should present a clearer picture of the effect here.

The second great challenge emerges from integrating the new requirements into the system. This is associated with the fact that the areas of balancing and regulatory reporting are generally seen to be independent of one another, as far as the system is concerned. The data is normally delivered, transformed and provided strictly in regard to the intended purpose. Consequently, compactions are carried out if necessary, on the required information, however at least a selection is made, i.e. data that is not relevant is separated out at an early stage. The above example of a CLN in the asset ledger shows, by way of example, that the number of data sets may depend upon the subsequent use of the information. The IFRS value would therefore, if necessary, have to be split up into multiple data sets for use in regulatory reporting, or adequately transferred. In addition, there is the fact that not all companies to be consolidated under supervisory law already prepare their figures in line with IFRS, as the bases of consolidation between IFRS and regulatory reporting usually differ. A harmonisation of the bases of consolidation may indeed dilute this problem, however not dispense with it entirely. The regulations on the formation of the bases of consolidation differ based on the different aims. The consequence of the latter may be that either IFRS is newly introduced as a measurement standard on the level of the supplying company or a suitable reconciliation needs to be implemented. Irrespective of the variant of the method used, a clear change emerges in the current procedure for preparing a notification at group level. The validation and any adjustment in the group reporting would, when applying the present consolidation process, in future lapse, as single entity reporting is carried out on a different measurement basis. If, moreover, a validation and any manually adjusted reporting is supposed to be carried out, at the single entity level reports both in line with German GAAP (in line with the German Commercial Code) and on an IFRS basis are to be prepared.

Besides the increased frequency of statutory amendments, resulting from the accelerated procedure carried out by the supervisory bodies or the greater density of regulations, the recent reliance upon the IFRS accounting standard is a factor resulting in increasing complexity. It is clear that highly flexible and completely integrated systems are needed for securing investment and the future in the area of regulatory reporting. This arises not only from a long-term perspective in regard to the costs of implementing projects for statutory innovations, but also from the perspective of internal credit risk management and overall bank management. Early awareness of the specific effects of new formalities, which in certain circumstances can even affect the business model, increases the leeway for suitable measures and, in the best case, creates a competitive edge.

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