

How to transform challenges of IFRS-9 into opportunities for CEE – view of MDBs

Dear Mr. Chairman,

Dear colleagues,

Ladies and Gentlemen,

Good morning. I am very pleased and honored to address the Regional Conference of the Banking Association of the Central and Eastern Europe (BACEE) in Budapest especially on its **35th Milestone Anniversary**.

Over the last five years of intensive reforms, **the International Investment Bank has successfully reasserted itself in the global financial community**. Among the **key elements of our success** so far has been our cooperation with our peer Multilateral Development Banks and commercial banking institutions, as well as our openness for dialogue and knowledge sharing. In this respect, **BACEE continues to provide a very efficient and useful platform** to share best practices and discuss global trends among banking experts from CEE and CIS regions. I would like to express special thanks to Istvan Lengyel, Secretary General of BACEE, who is doing his utmost to develop a proactive dialog among the members of international banking community.

Participation in the various BACEE networking events help us to better understand the sweeping changes in the CEE financial environment. The Association also gives us a chance to get close to the current needs of local commercial banks, which are our essential partners, and thereby, to enhance the outcome of our cooperation with these banks.

The International Investment Bank is an intergovernmental organisation with around EUR 8 billion invested since 1970, and was effectively relaunched in late 2012 when its shareholders – now including five EU member states from the CEE (namely the Czech Republic, the Slovak Republic, Bulgaria, Hungary and Romania), who now account for the largest share of our capital (49%) – adopted a new development strategy.

Since then, the **IIB has increased almost threefold its assets, reaching EUR 1 billion, with more than EUR 900 million** in new investments in the past four years. The Bank's **loan portfolio exceeded EUR 700 million**.

Since 2014, **IIB has attracted funds totaling around 300 million EUR from CEE countries including Romania, Slovakia, Hungary, Croatia, Bulgaria and Czech Republic**

Most notable, has been IIB's debt placements on the Slovakian and Romanian stock exchanges, which have helped to develop local financial infrastructure and the depth of local markets. For instance, IIB became the first issuer in Romania to place euro denominated debt on the Bucharest Stock Exchange, "a quasi-euro bond" using local Romanian infrastructure.

Under IIB's new Development strategy 2018-2022, **we plan to continue to develop local financial markets in Central and Eastern Europe through close cooperation with local financial regulatory authorities**.

The CEE is our priority region, both in terms of lending and borrowing activities. Within 9 months of 2017 alone, **the share of the CEE countries in our loan portfolio reached 41% up from 37% a year prior**. Moreover, **I am especially proud to say that Hungary, which returned to the IIB a year and a half ago, now accounts for a visible share in this portfolio of 6%**. In 2017, the Bank has significantly increased financing of Hungarian projects.

Amongst our recent activity we are proud to include our participation in the **Iford Holding Kft** purchase of the **Invitel** telecommunications group; the construction by Hungarian company **Hunent** of the green-field waterfowl slaughtering and meat-processing factory and our support for **MOL** Hungarian Oil and Gas Public Limited Company.

While the growth and development of the IIB gives us the opportunity to talk optimistically about the future, there are certain significant changes in the regulation of financial institutions on the immediate horizon line that could cause a significant revision of our optimistic outlook. I am of course referring to the new International Financial Reporting Standard 9.

Within the Multilateral Development Bank community, we perceive that not only will there **be serious changes** as to how financial institutions issue loans and account for them, but more importantly, we see the **very core of MDB's missions being limited** by IFRS9. Specifically, it is the mission of Multilateral Development Banks to support **underprivileged or disadvantaged** sectors of national economies and help them develop. One group in particular is the SME sector. Thus we are faced with a **dilemma**- how is it possible for MDBs to continue to fulfill their mission in the context of IFRS9. For this reason, at the end of September, the IIB took the initiative to organize a conference, designed to discuss within our peer group, the dilemmas and challenges that are facing us collectively.

The aim of the conference was **to harmonize our approach to solving these issues** and to share best practices in the area of implementation through discussion and dialogue. Apart from our colleagues from eight multilateral development banks who shared their preparations, we also invited representatives from **rating agencies, financial auditors, even a representative of the International Accounting Standards Board** to help us with our discussion. And we did indeed have both detailed, and at times, quite heated discussions.

Among the Challenges we discussed the following:

- **New classification & measurement requirements** – from our experience we avoided focusing strictly on impairment assessment. C&M is equally important as this is the main driver for the exposures subject to impairment. It actually should be the starting point for a well-balanced IFRS9 methodology;
- **Additional burden on capital**, due to the new forward looking approach on impairment assessment – expected credit loss;
- **Pressures on pricing**, especially on loans – immediate negative impact on the profit&loss statement will definitively affect banks' rules on pricing;
- **The need to develop and enhance business processes, decision making systems and IT solutions** in order to effectively manage the operational processes and financial reporting;
- **New pressures on the risk appetite** - in the face of additional pressure on capital and strengthening the requirements for IFRS9 provisions, MDBs will face the need to search a trade-off between risks and mission;
- **Incorporation of macroeconomic forecasts in our models** – data sources, reliability, back-testing, validation of models – all assessments will be highly sensitive to peaks and bottoms of economic cycles;
- **Duration of investments** – by definition MDBs are vulnerable to this factor as we target longer maturities.

There were challenges. However, **the focus should be on solutions and specifically how to help the banking society transform challenges into opportunities**. At IIB we are confident that overlapping between the introduction of new accounting standards – new rules of *the game* with the start of our new strategic cycle is more than a simple coincidence. **It is an opportunity to consolidate the operational niche and, generally speaking, an opportunity to reconfirm the role of MDBs in the world financial architecture**.

From an MDB point of view, the opportunities relate to the following trends:

- Acting counter-cyclical will become even more an obligation for MDBs – in this regard, we expect to see **a reinforced mandate in financing vulnerable, but vital economic sectors** in our member states – SMEs, green investments, RD&I (research, development & innovation), venture capital.
- Sovereigns will face an economic enigma – on one hand they will have to stimulate the increase of MDBs investments in critical sectors of their economies in order to fulfill their mission and development mandate, while on the other hand they face the reality of strong budgetary constraints limiting their appetite for any increase in paid-in capital. A balanced solution in our view, could

be to **rethink the role of callable capital**. In essence, it serves as a sovereign guarantee for MDBs borrowings on capital markets. Debt alleviates the budgetary effort and allows the leverage on paid-in capital, consequently fostering investments.

Nevertheless, turning these challenges into opportunities will require **significant investments** of time, money and education. Hence the reason why I now share this experience with you, as we believe that only through a **mature and comprehensive understanding** of all of the issues and challenges represented by IFRS9 can we, MDBs identify and reinforce the **development agenda** and role **of integrator** which is so critical in the context of today's reality of politically torn societies.

In conclusion, I would like reassure you that **we stand ready to step-up our development activities**, to address adequately ever evolving financial and economic challenges in the CEE region, and continue to generate genuine added value for our clients and shareholders.

I wish us all an intense and fruitful two-day dialogue on edgy ideas, insight, models and methods in the Central European banking industry!

Thank you!