Shane Buggle | Deputy Chief Financial Officer

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Submitted via website upload

Dear Committee members

Re: Consultative Document – Guidelines – Guidance on accounting for expected credit losses

Australia and New Zealand Banking Group Limited (ANZ) is listed on the Australian Securities Exchange. Our operations are predominantly based in Australia, New Zealand and the Asia Pacific region. Our most recent annual results reported profits before tax of A$10.3 billion (US$9.5 billion) and total assets of A$772 billion (US$676 billion).

We welcome the opportunity to comment on this Consultative Document. We agree with the Basel Committee on Banking Supervision (BCBS) that "*internationally active banks and those banks more sophisticated in the business of lending*" should be expected to deliver a high-quality, robust and consistent implementation of an expected credit loss ('ECL') accounting framework and support the themes of Principles 1-3, 5-9 and 11 which summarise sound credit risk practices. However, in our view the purpose of the guidance is unclear in that it does not establish a clear nexus between sound credit risk practices and a need for prudential supervisory intervention in the interpretation/application of accounting standards which are governed by jurisdiction specific corporations and securities legislation.

In our view, the proposed BCBS guidance should be limited to **supplementing** accounting standards and existing regulatory guidance on credit risk practices by focussing on the interaction between the two, including how common data and processes may be used for credit risk assessment, accounting and capital adequacy purposes and highlighting similarities and differences in provisioning concepts under prudential and accounting frameworks.

We are also concerned that the proposed BCBS guidance supplants the IASB's extensive multi-year due process that involved a wide range of stakeholders including preparers, auditors and users (including regulators) of financial statements. In our view, limiting/modifying the interpretation of an accounting standard and adding new disclosures to meet the wants of prudential regulators may have the unintended consequence of reducing the understandability, relevance, reliability and comparability of financial statements for their principal user group (shareholders).

In this context, we have the following key observations on the proposed guidance:

- **Objective and scope**

  The stated objective of the guidance is to "*set out supervisory requirements on **sound credit risk practices** associated with the implementation and ongoing application of expected credit loss (ECL) accounting models*".

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Consistent with the role of prudential supervisors, the stated objective implies that supervisory requirements focus upon **credit risk practices**. However the scope of the proposed guidance extends well beyond credit risk practices and, in particular the guidance in the Appendix, seeks to limit or modify the interpretation/application of IFRS 9 for ECL measurement. For example, paragraph A27 of the proposed guidance outlines six factors to be considered in assessing a significant increase in credit risk as compared to IFRS 9 B5.5.17 which outlines 16 factors to be considered, some of which are similar to the proposed guidance although expressed in different words implying potential differences in intended interpretation.

In our view, sound credit risk practices interact with ECL measurement under accounting standards however are (or should be) **agnostic** to the requirements of those accounting standards. Moreover, recognition and measurement of ECL in accordance with accounting standards is a financial reporting outcome of credit risk practices but is not a credit risk practice itself.

We therefore recommend that the guidance be refined to focus only on credit risk practices which are directly within the purview of prudential regulators. This may include commentary on the interaction with ECL accounting models including how common data and processes may be used for credit risk assessment, accounting and capital adequacy purposes and highlighting similarities and differences in provisioning concepts under prudential and accounting frameworks. However it would not extend to offering interpretative views on accounting standards.

- **Role of prudential supervisors vis-à-vis application of accounting standards**

  In the context that regulatory capital requirements on expected loss provisioning are addressed under the Basel capital framework (and as acknowledged in paragraph 8 are fundamentally different from the accounting requirements), the proposed guidance does not outline a clear basis for prudential supervision of the measurement of ECL for accounting purposes. While we agree that it is in the interest of all financial statement users and the public interest more generally for banks to deliver the highest-quality implementation of an expected credit loss ('ECL') accounting framework, we do not view prudential supervisors as having a **special** interest in this area that would justify the imposition of limitations or modifications of the interpretation/application of IFRS 9.

  Further, the introduction of a model where both accounting standard setters (through corporations and securities regulators) and prudential regulators participate in the interpretation/application of accounting standards creates the potential for divergent views and will increase the regulatory costs burden and potentially reduce comparability between those entities bound by any guidance issued by the BCBS and those that are not. To the extent that the BCBS believes that aspects of IFRS 9 are not sufficiently clear to facilitate consistent and/or robust application, we encourage engagement with the IFRS Interpretations Committee and the IFRS Transition Resource Group for Impairment of Financial Instruments (ITG) which exist to address such issues.

  We also note that the existing prudential supervisory framework allows prudential supervisors to take such action as considered necessary and/or appropriate in circumstances (including imposing greater capital requirements) where there is a gap between accounting provisions (however measured) and regulatory expected losses.

In summary, to address the above concerns, we recommend that the BCBS consider substantially rewriting the guidance to first clearly articulate the interest of prudential supervisors in the interpretation/application of accounting standards and the purpose of the proposed guidance in view of that interest. Each of the principles and underlying commentary/guidance should then be clearly linked to (and targeted at addressing) that purpose. Alternatively, if the BCBS does not accept our views as outlined above and instead elects to proceed with the guidance along the lines of the current proposals, we would like to raise the following matters:

- **Capital adequacy versus neutrality**

  The blending of the concepts of accounting for expected credit losses and capital adequacy throughout the guidance (in particular in Principles 4 and 10) impedes the clarity of the guidance insofar as the prudential concept of adequacy differs from the accounting concept of neutrality. Notwithstanding that the guidance acknowledges that the measurement of ECL for accounting purposes should be consistent with neutrality and neither understated nor overstated (e.g. paragraphs 54 and 63), we recommend the drafting be refined to more clearly distinguish between these concepts both up front and throughout the guidance.

- **Materiality**

  The concept of materiality is fundamental to preparing financial statements under IFRS, however the application of this concept to the guidance is not discussed in the Consultative Document. This could be read to imply that a materiality threshold should not be applied. In our view, this will create significant practical issues for both preparers and auditors. Accordingly, we believe any guidance issued by the BCBS on the interpretation/application of an accounting standard must be subject to the same materiality definition as set out in the IASB's *Framework for the Preparation and Presentation of Financial Statements.* That is, "information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements". This principle should be outlined up front in the guidance.

- **Use of simplifications and/or practical expedients**

  The BCBS considers that use of the following simplifications and/or practical expedients allowed under IFRS 9 is inconsistent with a high-quality, robust and consistent implementation of an expected credit loss ('ECL') accounting framework:

  - limiting the information set which an entity must consider in measuring ECL having reference to the following guidance from IFRS 9:
    - "*an entity shall consider the best reasonable and supportable information that is available, without undue cost and effort*"; and
    - "*an entity need not undertake an exhaustive search for information*";
  - the exception for "low" credit risk exposures; and
  - the 30-days-past-due rebuttable presumption.

  In the context that:

  - the IASB's primary objective is to develop a single set of **high quality**, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRS) based upon clearly articulated principles;
  - IFRS 9 was developed following a multi-year consultative process in which a wide range of stakeholders participated.; and
  - the impairment requirements of IFRS 9 are specifically designed to address perceived weaknesses in the existing (IAS 39) accounting model as it applies to financial institutions,

  we do not consider that the use of these simplifications and/or practical expedients necessarily indicates a lower quality IFRS 9 implementation. For example:

  - certain historical information simply may not exist at the date of transition to IFRS 9 (for example credit origination scores for a 20 year old mortgage facility) and the cost and effort involved in recreating it is unlikely to be justifiable on the basis of an improvement in the accuracy of the collective provision estimate;
  - the "low" credit risk practical expedient is entirely consistent with the principles of IFRS 9 and facilitates the efficient practical application of the standard without compromising quality given that for low credit risk (high credit quality) exposures there is unlikely to be any material difference between 12-month and lifetime expected credit losses; and
  - in relation to the more-than-30-days-past-due rebuttable presumption, we agree that past-due information is a lagging indicator of significant increases in credit risk and therefore arguably represents a lower quality credit risk management practice.

However, it may nevertheless be an appropriate backstop indicator for certain retail portfolios in circumstances where there are limitations around the ability of forward looking information to capture changes in consumer behaviour. More specifically, the use of the more-than-30-days-past-due rebuttable presumption may be a practical means of complying with IFRS 9 for retail portfolios where delinquency is the best available information for measuring portfolio deterioration and driving processes to manage credit (e.g. calling customers in the Collections department);

Additionally, we consider the requirement for judgements made in applying IFRS 9 to be consistent with the principles of the standard is a sufficient safeguard against the potential misuse of the simplifications and/or practical expedients (which appears to be the risk that the BCBS is trying to manage through its proposed limitations/modifications).

Finally, we also note that the use of simplifications and/or practical expedients may be appropriate in the context of materiality (refer to comments above).

Disclosure

The BCBS guidance on disclosures can be grouped into two broad categories which are addressed separately below.

1. *Proposed new disclosures*

   Examples of proposed new disclosures include:

   - disclosures addressing regulatory concepts such as those contemplated in paragraph 78; and
   - very granular disclosures (including sensitivity analyses) that go beyond the requirements of IFRS 9 such as those contemplated in paragraphs 75 and 76;

   In our view, it is inappropriate for prudential regulators to introduce new financial statement disclosure requirements outside of an accounting standard because this circumvents the IASB's extensive due process which seeks to balance the information needs of users with concerns about obscuring the understandability of financial statements and the high preparation costs that can result from lengthy disclosures.

   If the BCBS view additional disclosures as necessary to discharge prudential supervisory responsibilities, we recommend that such requirements should be:

   - very targeted/specific so as to clearly differentiate them from existing requirements;
   - housed in a regulatory return so as not to confuse financial statement users to whom the information is less/not relevant; and
   - subject to the concept of materiality.

2. *Repetition/summarisation of disclosure principles and requirements covered in accounting standards or prudential regulation*

   Examples of such disclosures include the general principles outlined in paragraphs 72, 73, 74 and 81 which to a large extent are general statements summarising concepts that are addressed elsewhere in accounting standards or prudential regulation.

   In our view, such general comments do not enhance the understandability or practical application of the underlying source requirements therefore we recommend that they are excluded from the final BCBS guidance.

Should you have any queries on our comments, please do not hesitate to contact me at shane.buggle@anz.com.

Yours sincerely

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