**Division Bank and Insurance**
Austrian Federal Economic Chamber
Wiedner Hauptstraße 63 | P.O. Box 320
1045 Vienna
T +43 (0)5 90 900-DW | F +43 (0)5 90 900-272
E bsbv@wko.at
W http://wko.at/bsbv

| Your ref., Your message of | Our ref., person in charge | Extension | Date |
|---|---|---|---|
| | BSBV 189/Horvath | 3141 | 12th Jan 2017 |

## BCBS Consultative Document and BCBS discussion paper in regard to Regulatory Treatment of accounting provisions

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as legal representative of the entire Austrian banking industry, appreciates the possibility to comment on the above cited consultation document and would like to submit the following position:

### I. General Remarks

According to the Consultation Paper of the BCBS it is planned to introduce a level playing field for the allowance of balance sheet value adjustments in the regulatory own funds of banks. In this context it is taking into consideration to implement a standardized regulatory expected credit loss (ECL) in the standardized approach for credit risk.

We would like to point out that pursuant to the prevailing opinion in Austria due to the national implementation of Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings there already exists the legal requirement to account a general value adjustment for credit risks according to the local GAAP (in addition to IFRS).

On the basis of this accounting transaction these general risks are deducted from CET 1 capital. As a result, we regard the pursued level playing field of the BCBS as already fulfilled. The same is maybe true for other European countries due to the national implementation of the above mentioned European Accounting Directive 2013/34/EU.

However, the introduction of a regulatory ECL is connected with a significant additional effort for institutions using the standardized approach for credit risk. This is mainly due to the fact that these institutions do not have enough exact statistical data in the area of their receivables for calculating an excepted credit loss. Hence, in principle these smaller institutions would be disadvantaged by an introduction of this concept.

## II. Specific Remarks

Against this background we would ask the Basel Committee to take into account the following principles with regard to their planned new concept:

- For institutions using the standardized approach for credit risk there should not be stipulated a regulatory ECL. As mentioned above, as a rule these smaller banks do not have enough exact statistical data in the area of their receivables for calculating an excepted credit loss in all their portfolios.
- In any case the differentiation between general and specific credit risk adjustment in the standardized approach for credit risk has to guarantee that the reduction of CET 1 is not calculated on the basis of excessive parameters. The proposal of the BCBS that the ECL is calculated on the basis of a one-year-probability of default seems acceptable. Generally we support the proposal of the Basel Committee that for institutions using the standardized approach for credit risk the amount that exceeds the one-year-probability of default can be classified as Two Tier Capital in the 2nd stage of IFRS.

We consider that the BCBS should also clarify interactions between the classification and impairment IFRS 9 requirements, i.e. whether in calculating the "impact from the adoption of ECL accounting" entities should:

(a) simply compare against each other the amounts of "accounting provisions" before/after transition to IFRS9 by ignoring that the underlying population of instruments subject to impairment may have significantly changed (e.g. some loans, due to failing the SPPI criterion, may be measured at fair value through profit or loss without being subject to impairment under IFRS 9 while they were measured at amortised cost and subject to impairment under IAS 39; or AFS debt securities under IAS 39 were measured at fair value through other comprehensive income and were subject to the incurred loss model with impairment amount based on fair value while under IFRS 9 expected credit losses will apply and, in addition, a portion of them may end up with amortised cost or fair value through profit or loss measurement); or

(b) factor in the fact that the population of instruments subject to the expected credit loss requirements of IFRS9 on 1 January 2018 may be significantly different from the population of instruments subject to incurred credit loss requirements of IAS39.

<u>Approaches for a structuring of a transitional arrangement</u>

We are supportive of a dynamic approach of addressing the differences between IFRS 9 and IAS 39 credit risk provisions upon transition to the IFRS 9 expected credit loss impairment model. The dynamic approach has the potential to reflect future developments of volumes impacted by the transitional effects. The dynamic approach should be designed such that it is able to react to a situation of deteriorating expectation for future economic developments, and, hence an increase in stage 1 and stage 2 provisions over the transitory period after the adoption of IFRS9. Further, the transitional arrangements should seek to minimise operational complexities resulting e.g. from the need to calculate pro-forma risk provision numbers under the original IAS 39 rules over the transitory period after IFRS 9 has become effective.

*<u>Ad Discussion paper Regulatory treatment of accounting provisions:</u>*

Under the existing regulation framework Erste Group, applying also the definitions in EBA RTS on specification of the calculation of specific and general credit risk adjustments, treats all IAS 39 credit risk provisions as specific for its exposures under the standardised approach. This would also hold under the IFRS 9 expected credit loss model provided definitions did not change. However, we recognise that the current definitions are outdated and do not fit for the IFRS 9 expected loss concept. Further, the definition may be subject to different interpretations which do not contribute to a level playing field. As a result, the definitions should be changed in our view.

As regards the BCBS alternative proposal for a fundamental change to the current regulatory framework by introducing regulatory expected losses for the standardised approach our bank believes that any changes should be considered only after a comprehensive impact analysis has been carried out by the BCBS.

In our opinion what should also be considered as a permanent solution is the full inclusion of provisions excess (under IRB or for all provisions if the expected losses concept was introduced also for the standardised approach) in the eligible capital calculation (i.e. without the existing 0.6% RWA cap). We do not share the concerns that inclusion of the excess would significantly weaken regulatory capital by losing the loss absorption function. First, the capital adequacy regulatory framework is based on 12-month expected but also unexpected losses. From this perspective the excess of provisions over 12-month expected would not significantly undermine the loss absorption function. Second, the accounting expected losses tend to overestimate the real economic loss because provisions are also calculated for future cash flows resulting from the credit margin. Credit margin covers the initial expected loss. Therefore the losses tend to be double-counted to this extent which becomes more prominent the longer maturity the assets have. We consider that recognition of the excess as Tier 2 rather than Tier 1 capital is a sufficient measure addressing potential issues in this area.

We ask you to give our remarks due consideration.

Yours sincerely,

Dr. Franz Rudorfer
Managing Director
Division Bank and Insurance