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Basel Committee on Banking Supervision
Centralbahnplatz 2
4051 Basel
Switzerland

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Good day,

Re - Regulatory treatment of accounting provisions – interim approach and transitional arrangements.

The Banking Association of South Africa ("BASA"), would like to thank you for the opportunity to comment on the consultative document on the regulatory treatment of accounting provisions.

We support in general, the Committee's proposal to retain the current regulatory treatment of accounting provisions, for an interim period, however instead of adding back the excess of accounting provisions over the regulatory expected losses to Tier 2 capital, it is proposed that the excess accounting provisions be considered for CET1 add-back.

We agree with maintaining the similar approach, in particular, we support the Committee's suggestion to allow local jurisdictions to extend their existing approaches to categorising provisions as general or specific provisions measured under the applicable expected credit loss (ECL) model. This is important given the limited time, until the effective adoption date of IFRS 9 by various jurisdictions.

BASA also supports the introduction of transitional arrangements. We believe that a comprehensive review of the interlinkages between the prudential framework and the treatment of accounting provisions is warranted. This approach will also allow for greater flexibility, where certain entities within a group, may be impacted more than others giving the existing regulatory regime and the ability to minimise any systemic risk.

Our detailed comments are as follows:

- We would recommend that before a transitional period is established, impact studies should be conducted to understand the impact on capital. Given the current state of individual macroeconomics, careful consideration should be given to the impact it may have on growth going forward (as it may remove capital set aside to support lending activities).

- Sufficient flexibility and timing should be allowed for further changes to the methodologies/period as more information becomes available to ensure that more transparent reporting takes place.

Registration Number : 1992/001350/08 A non-profit company under the Companies Act 2008
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- It is unclear how the solo versus the consolidated group transition should be treated where different accounting and regulatory regimes exist.

- The impact on P3 disclosure and existing common disclosure templates should be considered. In addition, during a transitional period, it should allow for adjusted templates once the transitional period has ended. Consistency across all foreign subsidiaries (cross border) needs to be considered.

- One of the key objectives of the updated Basel framework is to facilitate an even playing field however the European Commission has published a number of amendments to the Capital Requirements Regulations ("CRR"). One of these amendments covers "transitional arrangements for the impact of IFRS9". The amendment effectively allows for a five year transitional period to account for the impact of IFRS9. This is a more lenient approach than the BCBS proposal.

- Impact on capital instruments issued under a Basel III regime. Will the maximum distributable amount (MDA), where restriction on discretionary payments is activated, take into account transitional adjustments? This should be incorporated in local legislation where relevant.

- The adoption of "Approach 2", is a pragmatic approach which is not overly complex and which provides a more dynamic result.

- "Approach 2" is preferable over "Approach 1" as it is sensitive to changes in impairment stock during the first few years post the implementation of IFRS9. Abnormal volatility in impairment stock can be expected in the initial years post implementation as banks refine their IFRS9 credit policies and models. This may render a bank's initial estimate of required impairment stock less useful as a reference for a multi-year phase-in calculation.

- Our members do not favour "Approach 3", as in our view this approach is likely to lead to an over-estimation of the impact of IFRS9 – this is due to the underlying assumption that stage 3 impairments under IFRS9 are more or less equivalent to IAS39 impairments, while stage 1 and 2 impairments under IFRS9 is responsible for the increase in impairments. The over-estimation is, in our understanding of the proposal, likely to be broadly equal to a bank's performing portfolio impairments, which is not negligible.

- Instead of adding back the excess of accounting provisions over the regulatory expected losses to Tier 2 capital, it is proposed that the excess accounting provisions be considered for CET1 add-back. This would assist in reducing the variability in capital levels as well as between the same tiers of capital across different banks as a result of varying modelling assumptions used in accounting provisioning. (We have assumed that under the transitional arrangements, the Tier 2 add-back would be phased in on the same basis as the phase in of CET1 deductions).

- We support a retention of the non-distinction between general provisions and specific provisions however, we believe that eliminating divergence by introducing a universal definition of "general" and "specific" provisions would be preferable over the current treatment of provisions.

- Under the Expected Credit Loss (ECL) framework, we believe that it would be sensible to treat impairments associated with an existing regulatory classification of "bad loans" (either defaulted assets or, in future, a standardised definition of non-performing loans (NPLs) as specific provisions. This seems preferable over creating additional definitions).

- We believe that in the longer term there is merit in aligning the standardised and IRB approaches due to the fact that the standardised approaches will potentially play an increasingly important role going forward. Consideration will however need to be given to the additional data and calculation abilities required to bring standardised expected losses (EL) estimates into the regulatory capital calculation. Decisions regarding the granularity and appropriate levels to assess regulatory EL should be made with a cost benefit analysis in mind. Our preference would be that unexpected losses (UL) and EL portfolio segmentations / drivers should be aligned. A distinction should be made between EL on performing and defaulted assets.

- We are supportive of the introduction of a regulatory EL for the standardised approach; calculated as a factor (as provided by the Basel Committee) of the relevant gross exposure values similar to the current risk weights.

- Consideration should be given to the development of a lifetime regulatory EL concept, to further align with accounting standards. This could be considered as a longer term project.

- Given the support for the introduction of a regulatory EL as a minimum credit loss standard and a non-distinction between general provisions and specific provisions, a revision to the definition of exposure value for the purpose of risk weighting is supported by some members. We further support a revised definition to "exposure value" for assets under standardised approach being exposure gross of provisions, partial write-off and discounts.

- The committee may consider recalibrating the multiples applied in risk weighting assets under the standardised approach given the proposed changes to the capital add back.

We trust that the Committee will find the above comments valuable in its further deliberations on this matter and extend an invitation to you to contact us should you require any further information.

Yours sincerely

G Haylett
Prudential Division