BARCLAYS

Robert Le Blanc
Chief Risk Officer

1 Churchill Place
London
E14 5HP

Tel +44 (0)20 7773 6633
robert.leblanc@barclays.com
barclays.com

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

Dear Sir/Madam,

BCBS GUIDANCE ON ACCOUNTING FOR EXPECTED CREDIT LOSSES ('Guidance')

We welcome the opportunity to comment on the draft Guidance and support the Basel Committee's overall objective to ensure a high quality and consistent implementation of an Expected Credit Loss ('ECL') accounting model in accordance with the applicable accounting framework. We believe it is important that Guidance issued by regulatory bodies in this regard is globally consistent and therefore would not support the development of additional, potentially inconsistent, guidance by national regulators. Our key points are set out below and our more detailed comments and references are contained in the attached Appendix.

- **Scope of Guidance on credit risk management practices:** We believe that the focus of the Guidance should be on credit risk management practices that are relevant to the implementation of IFRS 9, to enable impairment allowances to be determined in a consistent manner, rather than specifying how banks should more broadly manage risk. For example, appropriate pricing for risk and underwriting best practices at origination are not directly relevant to the calculation of ECL or the key driver for a significant increase in credit risk and should not therefore form part of this Guidance.

  In addition, care should be taken not to introduce a defined list of risk factors that may be viewed by preparers as a period-end checklist. It is correct that IFRS 9 does not specify how banks should manage risk and indicates that its requirements should be applied in a manner which reflects an entity's credit risk management practices. We recommend that the Guidance should make clear that the lists of risk factors given are illustrative and that an entity's consideration of the lists of risk factors should focus on those that are most relevant and meaningful to the ECL calculation of each portfolio. For example, not all factors listed in the Guidance are equally relevant to wholesale and retail portfolios. In addition we recommend that the credit risk factors should be regularly assessed to ensure they remain the most relevant risk drivers of ECL for each portfolio.

- **Proportionality of Guidance:** It would be beneficial to make it clear that all the Guidance should be applied commensurate with the size, nature and complexity (including materiality) of a financial institution's lending exposures, recognising that large banks will have some small portfolios and others that are less data rich.

- **Significant credit deterioration and compliance with IFRS 9:** There is a danger that the list of significant credit deterioration requirements in the Guidance Appendix might result in the recognition of lifetime expected loss impairment when there has not been a significant increase in credit risk. To remain in compliance with IFRS 9, and more generally ensure that the income statement presents relevant information on the results of the period, it is important that insignificant increases in credit risk do not trigger the recognition of additional impairment. For example, an increase or decrease in lending spreads is not always an indicator of a significant increase or decrease in counterparty credit risk because lending spreads can increase or decrease due to many factors such as liquidity, bank funding costs, competitive market pricing (e.g. price takers rather than price makers in some markets) and capital costs. A downgrade on a bank's internal credit scale might not be viewed as significant, since certain internal grades might exist to enable early tracking of small changes in credit risk as a matter of good credit risk management.

- **Frequency of Re-segmentation:** The Guidance could be read to suggest that portfolio re-segmentation should occur frequently. Under IFRS 9, segments should include exposures with similar risk characteristics at inception, therefore re-segmentation due to changes in credit risk should be relatively infrequent because such exposures should respond in a similar way. Re-segmentation may be appropriate in response to events unforeseen at inception, supported by reasonable assumptions that evidence appropriate correlation.

I hope you find our comments and suggestions helpful. Please contact Louise McSweeney (louise.mcsweeney@barclays.com +44 20 77732812) or Bill Hayward (william.hayward@barclays.com +44 20 7 1162443) if you have any questions or comments on any of the issues raised in this response.

Yours faithfully,

Appendix: DETAILED RESPONSE TO BASEL GUIDANCE ON ACCOUTNING FOR EXPECTED CREDIT LOSSES ('GUIDANCE')

MOST SIGNIFICANT MATTERS

OBSERVATION (with Guidance refs)	PROPOSED SOLUTION	COMMENTS
1) **Scope of Guidance on credit risk management practices** a) The Guidance should focus on matters relevant to expected loss calculations, rather than all credit risk practices. b) IFRS 9 does not specify how banks should manage risk and indicates that its requirements should be applied in a manner which reflects an entity's credit risk management practices. Care should be taken not to introduce a defined list of risk factors that may be viewed by preparers as a period-end checklist. Consideration of risk factors should be clearly limited to those that are relevant and meaningful to Expected Credit Loss ('ECL') measurement.	a)Delete references to credit risk management guidance that is not clearly relevant to expected loss calculations e.g. para 27(a) &(g), 31 b) Make clear that the Guidance is not meant to be a period-end checklist. Rather credit risk management practices should be followed and designed to capture the risk factors that are most relevant and meaningful to the calculation of ECL for each portfolio and they should be regularly assessed to ensure they remain the most relevant drivers of ECL for each portfolio. [e.g. paras 27, 24(k),29(e) 21, A6,A27 A49]	a) Pricing and underwriting best practice at origination are not directly relevant to the calculation of expected loss or a strong indicator for a significant increase in credit risk. Lending spreads are set to ensure an appropriate return for all the risks taken on. Initial lending spreads and changes in lending spreads are impacted by many factors and not just credit risk and therefore new lending spreads are not often used as the primary driver to indicate a change in credit risk. For example lending spreads can increase due to liquidity risk, bank funding costs, competitive market pricing (e.g. price takers rather than price makers in some markets) and capital costs and are not solely due to the credit risk of the counterparty. Para 27 (a) & (g) concern the documentation of a banks lending approvals process and adherence to loan underwriting best practice. Para 31 requires demonstration that the price at which lending is granted appropriately reflects the risks. These should be deleted. b) It should not be necessary to apply all requirements to all exposures because all factors listed are not necessarily relevant to the calculation of ECL. The assessment and management of credit risk is focused on those factors that are most relevant to expected loss for each particular portfolio, taking into account loss correlation, available data sources and materiality. Credit practices should ensure these factors are regularly reassessed to ensure they remain the most relevant. The factors that drive ECL are dependent on the portfolio, for example; the availability of data is dependent on the sophistication of the market, there might not be sufficient correlation between a factor and credit loss or some factors might not be relevant to particular products. Advancements in credit methodology capture the most relevant factors and processes as practices are developed and will further develop in the future. IFRS 9 does not specify how

		banks should measure credit risk and indicates that its requirements should be applied in a manner which reflects an entity's credit risk management practices For example: i) the credit risk practices for wholesale and retail are quite different and therefore the ECL calculations, methodology and credit procedures will necessarily be different. ii) para 24(k) requires historical loss data over a full credit cycle – this might not be available in a new market or for new products iii) para 29 (e) requires comparison to market indicators (e.g. CDS spreads). This may not be part of existing credit risk management practices, for example, the credit risk management and ECL calculation of a loan to a large corporate might be based on the more specific information that a bank has from the corporate's forecasts, regular discussions on performance and ability to pay whereas the more general move in the CDS spreads for similar corporates is less relevant and not evaluated. iv) Para A6 and A49 imply that all credit factors available in the market need to be evaluated in the ECL calculation and all reasonable and supportable information should be used in the process of calculating ECL. In practice banks will use the most relevant and most correlated factors that could more materially alter the ECL outcome and not all potential data (see CDS example above). Therefore the Guidance should make clear that there is not an expectation that all available information is used in the models and that banks are not required to disclose which data / information they have not utilised in the ECL calculation.
2)Proportionality of Guidance Clarity is required that all the Guidance should only be applied commensurate with the size, nature and complexity (e.g. considering materiality)of lending exposures and that this applies equally to complex and less complex banks [para 12 and Principle 1]	Make clear in the scope (para 12), in all the Principles and in the Appendix that all the Guidance should only be applied commensurate with the size, nature and complexity (e.g. considering materiality) of lending exposures and that this applies equally to complex and less complex banks.	Larger banks will have some small portfolios and others that are less data rich. Risk management processes are designed to fit the product type and risk of material loss.
3) Significant credit deterioration There is a danger that the list of significant credit deterioration requirements (e.g. A27) in the Guidance Appendix might result in the recognition	Clarify that banks must have practices in place to assess and identify key factors in determining what constitutes significant deterioration. These factors will differ by product, portfolio, and geography. The	Para A27(a) footnote 33 might be read to imply that any increase in lending spreads is a significant increase in credit risk. Lending spreads can increase or decrease due to liquidity, bank funding costs, competitive market pricing (e.g. price takers rather than price makers in some markets) and capital costs and are

of lifetime expected loss impairment when there has not been a significant increase in credit risk. To remain in compliance with IFRS 9, and more generally ensure that the income statement presents relevant information on the results of the period, it is important that insignificant increases in credit risk do not trigger the recognition of additional impairment.	importance of the word 'potential' indicators in A27 needs to be emphasized and the factors listed in the Guidance should only be taken into account if they result in a significant deterioration in credit risk. [para A27]	not solely due to the credit risk of the counterparty. A downgrade on a banks internal credit scale might not be viewed as significant and more internal grades might exist to enable earlier tracking of small changes in credit risk as a matter of good credit risk management (para A29&32).
4) Frequency of re-segmentation The Guidance (para 48) could be read to suggest that portfolio re-segmentation should occur frequently. Under IFRS 9, segments should include exposures with similar risk characteristics at inception, therefore re-segmentation due to changes in credit risk should be relatively infrequent because such exposures should respond in a similar way. Re-segmentation may be appropriate in response to events unforeseen at inception, supported by reasonable assumptions that evidence appropriate correlation.	Clarify that re-segmentation should not occur frequently. Re-segmentation may be appropriate in response to events unforeseen at inception, supported by reasonable assumptions that evidence appropriate correlation. Segmentation should reflect underlying management of credit risk and practices within the loan population.	

OTHER MATTERS

OBSERVATION	PROPOSED SOLUTION	COMMENTS
1) **Annual model validation** The model validation Guidance (para57&58) does not make clear that the sophistication of the model validation and governance should be designed to appropriately reflect the risk of material model error.	Amend paras 57&58 to make clear that the sophistication of the model validation and governance should be designed to appropriately reflect the risk of material model error. One would expect more sophisticated processes and more focus on the more material and more complex models compared to the more straight forward less material models. Appropriate controls should exist to detect potential material model error which may trigger the need for a more frequent review.	The Guidance requires an at least annual validation of models and specifies what this requires (e.g. model inputs including data quality, model design and model output including sensitivity analysis and back testing). For less material models it may not be appropriate to apply the same depth and scope of review. The amount of time invested in validating models must be reflective of the associated model risk.
2) **Definition of default** Para A5 requires that the definition of default is adjusted to 'incorporate current conditions and forward-looking information'. This information is relevant to the probability of default and the assessment of significant credit deterioration but not the definition of default itself. Para A4: it should be noted that the definition of default for regulatory purposes permits competent authorities to replace 90 days with 180 days for certain exposures such as residential mortgage or public sector entities and this has not been reflected in Para A4.	Delete from para A5 'and adjusted to incorporate current conditions and forward-looking information'. Update para A4 to include that the definition of default for regulatory purposes permits competent authorities to replace 90 days with 180 days for certain exposures such as residential mortgage or public sector entities.	
3) **Frequency of data update** Para 42 requires credit rating to be updated at least annually but para 21 requires information and assumptions to be updated at each reporting period. These seem inconsistent.	The Guidance should clarify that data and assumptions should be updated as frequently as necessary to ensure that the ECL reported at each accounting reporting period is materially up to date.	
4) **Collective assessments are not always required** Para A35 states that IFRS 9 requires collective assessment as well as individual assessment and is not therefore consistent with IFRS 9.	IFRS 9 B5.5.1. states that collective assessment may be necessary and therefore Para A35 of the Guidance needs to be amended to reflect this. Collective assessment is not always necessary when it is possible to model at an individual exposure level.	

5) **Transition** It is not clear how the Guidance applies on transition to IFRS 9.	The Guidance should clarify that it does not apply on transition, given the transitional exemptions in IFRS 9, and that all data may not be available from origination, which may have been over 30 years ago for example. Clarify that the approach to transition should reflect a best effort to establish whether there has been a significant increase in credit risk and that it should be aligned to an entity's risk management practices. The transitional provisions of IFRS 9 should also be referenced.	
6) **Disclosures** The Guidance specifies additional disclosure requirements to those included in IFRS 9.	Rather than specify additional disclosure requirements in this Guidance, we would encourage the Committee to engage with other disclosure initiatives – principally, the Enhanced Disclosure Task Force (EDTF). This will ensure that any incremental disclosures and best practices are detailed in a single place as far as possible and that the process by which such disclosures are generated benefits from the governance and stakeholder engagement developed by the EDTF in recent years.	
7) **Drafting** In general the structure and wording of the document could be enhanced with less repetition.	The concepts of using forward looking factors (e.g. macroeconomics) and segmentation are frequently repeated in the document. Consider having a single section on forward looking factors and a single section on segmentation that are clear and concise.	