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13 January 2017

Mr. William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
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Dear Mr Coen

Discussion paper - Regulatory treatment of accounting provisions

Barclays welcomes the opportunity to comment on the Consultative Document (Regulatory treatment of accounting provisions – interim approach and transitional arrangements, "Consultative Document") and the Discussion Paper (Regulatory treatment of accounting provisions, "Discussion Paper").

We are supportive of accounting provisioning standards that require the use of expected credit loss (ECL) models rather than incurred loss models so that forward-looking assessments are incorporated in the estimation of credit losses.

We are also supportive of the implementation of transitional arrangements from the 1st of January 2018 for the impact of ECL accounting on regulatory capital for the following reasons:

1. Maintaining a level playing field between US GAAP banks and European IFRS 9 banks as both transition to new accounting standards for ECL.

   For example, IFRS 9 requires for the reporting of standalone entities that ECL are recognized for intra-group lending, financial guarantees and loan commitments between fully consolidated legal entities. Such intra-group exposures are significant for large banking groups, and include internal TLAC. Since US GAAP scopes them out, the Committee and national standard setters will need to neutralise this difference to achieve a level playing field in both the transitional and final treatment of ECL provisions under the regulatory capital framework.

2. Avoiding the contraction of lending to the real economy that could occur if European IFRS 9 banks were forced to reduce CET1 by the whole amount simultaneously on 1 December 2018.

3. Reducing the risk of exacerbating downturns in the real economy; the scale of the stress impact on bank lending capacity due to the inconsistency between IFRS 9 and the regulatory capital frameworks for both standardised (SA-CR) and internal ratings based approaches (IRB) for credit risks needs to be better understood and an appropriate response implemented.

In particular the impact on lending capacity due to migration of balances in to and out of IFRS 9 Stage 2 through a downturn needs to be addressed by regulators and policy makers if unintended impacts on the real economy are to be avoided.

Given the above we recommend that the impact of Stage 2 impairments on capital should be eliminated during a transition period in which Stage 2 balances should be treated as Stage 1 balances for regulatory capital purposes. In other words, for Stage 2 exposures, banks continue to calculate

ECL Stage 1 provisions during the transition period and the difference would be reinserted into CET1 regulatory capital.

In parallel we would also note:

1. Our concern that the current Discussion Paper does not consider the issues and inconsistencies created between the new IFRS 9 ECL framework and the existing IRB regulatory capital regime. The interaction between

    i. the changes in bank capital requirements since Basel II, and
    ii. the changes to ECL provisions under IFRS 9, and
    iii. the IRB framework

    is complex, and given the possible feedback effects from the banking sector into the real economy in a downturn, should be given due consideration.

2. Our concern that no impact data has been collected, either at the European or Basel Committee level, on the IFRS 9 impact on bank CET1 in a stress scenario. The absence of a quantitative understanding by regulators and policy makers of the impact of IFRS 9 on lending capacity in a downturn could leave them without the tools and framework necessary to prevent a magnification of a slowdown in the real economy.

We would like to reiterate the importance for banks to work towards a final regulatory capital framework in which uncertainties such as changes to accounting standards should be eliminated as much as possible. This emphasises the need for sufficiently long transitional periods during which the Committee can evaluate the quantitative changes in the levels of provisions and its sensitivity to regulatory capital ratios through additional impact studies.

Given the scope and scale of both the accounting changes to provisions and the reform of the regulatory capital framework as part of the G20 package of post-crisis reforms it seems appropriate to us to ask the Committee to look into any duplications in the capitalisation of risks and into unintended consequences such as pro-cyclicality.

Further detail on the points above and responses to the other items the Committee is seeking feedback on are set out in more detail in the attachment to this cover letter and the separate response we provide on the Consultative Document.

We hope that you find our comments and suggestions helpful. Please do not hesitate to contact Andrea Schnoz (andrea.schnoz@barclays.com, +6563087291) if you have any comments on any of the issues raised in this response.

Yours sincerely,

Dipal Patel
Managing Director
Head of Finance Regulatory Policy

Appendix 1: Detailed comments on the Discussion paper – Regulatory treatment of accounting provisions

1. General remarks

We expect ECL accounting provisions under IFRS 9 to introduce significant additional pro-cyclicality and to reduce banks' CET1 capital levels in 2018 unless the Basel Committee ("Committee") introduces appropriate transitional arrangements and revises the regulatory capital framework thereafter.

We support the desire of standard-setters to move from IAS39 which, it is widely accepted, had the result of accounting provisions that were 'too little, too late' during the crisis. But, as we work through implementation, we believe that the pendulum has swung too much the other way, and that IFRS 9 will result in accounting provisions that are 'too much, too soon' because losses are recognised immediately upfront upon initial recognition; future downside scenarios, not just the most probable outcome, are included in loss estimates immediately.

From our internal loss history, a requirement to hold regulatory capital and in future ECL provisions simultaneously against unchanged credit risks exceeds the reserves we consider necessary to absorb through-the-cycle losses.

Additionally, under both the standardised approach for credit risks (SA-CR) and internal ratings based approaches (IRB) there is in our view overlap with ECL methodologies. We ask the Committee to review and appropriately revise the regulatory capital framework to address the overlap. We would like to emphasise that such a review is not only necessary for the SA-CR but also for the IRB where the same risks would otherwise be capitalised twice under ECL and the IRB formula. There, ECL beyond the solvency period of 1 year are capitalised through the maturity adjustment that yields significantly higher RWA for corporate, bank and sovereign exposures with maturities beyond one year.

Finally, level playing fields issues arise between IFRS and US-GAAP with respect to:

i) the scope of lifetime ECL accounting provisions. Although US GAAP requires immediate lifetime losses for in scope exposures, losses may be smaller than those required by IFRS because US GAAP permits the short contractual call option period, rather than the behavioural life, to be used for certain revolvers such as credit cards and overdrafts. Also, US GAAP does not require future downside economic scenarios to be included in the measurement of losses, and

ii) the definition of general and loan loss provisions that are currently in place under various prudential capital regimes

The Committee should address level playing fields issues with a combination of transitional arrangements and a long-term revision of the regulatory capital framework. Specifically, the impact of IFRS9 on CET1 capital ratios should be partially neutralised until 2021 when CECL becomes effective for all reporters under US-GAAP. In the meantime, the Committee would be able to finalise the current reforms of the regulatory capital framework and to agree on any further necessary revisions due to ECL provisions to be phased in from 2021.

2. General and specific provisions

Should the BCBS retain the distinction of general and specific provisions as a means to address inconsistencies in provisioning practices across jurisdictions and banks and, if so, whether and how the Committee should clarify the distinction between general provisions and specific provisions?

In our view, the distinction between general and specific provisions causes unnecessary complexity in the regulatory capital framework; it is correctly recognised by the Committee as a source of level playing field issues.

The practice of creating general provisions is on the decline as already IAS 39 prohibited the creation of general provisions due to the subjectivity involved in creating such estimates.

Instead, a reporting entity is required to carry out impairment reviews to determine the recoverability of the receivables and any associated allowance. The new impairment requirements under IFRS 9 are based on specific expected credit losses and should therefore be considered specific provisions under the existing regulatory capital framework.

Therefore, the BCBS should eliminate the distinction between general and specific provisions within the regulatory capital framework so that inconsistencies in provisioning practices can be addressed by the introduction of a regulatory expected loss calculation.

As a consequence, there would be no need for the Committee to clarify how to distinguish between specific and general provisions.

3. Regulatory expected loss

Comments are welcome on: (i) the need for an explicit regulatory EL charge in the SA; (ii) the approach to be taken for setting regulatory EL levels, including whether there should be a regulatory EL that is global by product type; (iii) whether regulatory EL should be highly granular (with subcategories for each type of loan and special treatment of defaulted assets) or less granular; and (iv) whether regulatory EL levels should be permanently established or subject to ongoing review and adjustment.

In addition, comments are welcome on the current regulatory treatment of accounting provisions under the IRB framework and also whether there are other alternatives that the Committee should consider for banks under the IRB approach.

EL charge in the SA

We agree with the BCBS that inconsistencies between accounting standards could be addressed by introducing a regulatory EL under the SA.

The BCBS explains that it was not fully clear whether the SA-CR risk weights already count part of regulatory expected losses in addition to unexpected losses and that the current SA relied on accounting provisions to cover EL.

The BCBS also mentions that the current SA relies on accounting provisions to cover a one-year EL as it can be seen in the example used to derive the illustrative standardised EL rates which is on page 11 of the Committee's Oct 2016 Discussion Paper.

It is important to note that the PD used in the above-mentioned example is an average PD that only allows the estimation of a one-year expected loss under non-stressed market conditions. On the other hand, both RWA under IRB and SA are calibrated to ensure that banks are sufficiently capitalised under a system-wide stress scenario.

We agree that the introduction of a regulatory EL under the SA will address the shortcomings of the incurred loss provisioning by requiring a minimum EL to be provided for. At the same time it will be important that excess life-time ECL provisions are available to offset RWA to avoid any overlaps with the existing RWA regime.

We tentatively support option 2.3.1 outlined by the Committee in the Discussion Paper on the regulatory treatment of accounting provisions notably

- the introduction of a standardised regulatory EL under the SA, effectively introducing a floor for accounting provisions in the context of capital ratio calculations,

- all accounting provisions are treated in the same way to calculate exposure values and regulatory capital, aligning with the IRB approaches, where the critical criterion for provisions to be recognised for regulatory purposes is the reduction of banks' CET1 capital,

- that the proposals are not intended to increase overall capital requirements for banks and that sufficient time is allocated to calibrate such a change on the basis of conclusive QIS results, and

- that the result could be a double-counting of a Pillar 1 credit risk element between standardised regulatory EL rates and relevant risk weights under the SA that the Committee will address through scaling factors or an alternative way to recalibrating the SA-CR.

For the introduction of the regulatory EL under the SA-CR we note the following points:

- A regulatory EL should be global by product type but consider EAD reductions or substitutions through credit risk mitigation techniques. Additionally, multipliers such as applied for lending to SMEs should for consistency purposes also be applied to regulatory EL rates

- For simplicity, a regulatory EL does not need to be more highly granular than the applicable risk-weights. If the Committee introduced more granular EL rates then the same should also be targeted for RWA

- Defaulted assets should be subject to a specific treatment: we agree with the points the Committee raise in footnote 22 of the Discussion Paper about the double-counting effects of introducing a regulatory EL amount on top of assigning risk-weights to defaulted assets.

<u>Defaulted exposures under the SA-CR</u>

The Committee should capitalise defaulted exposures either through

i) expected losses where a PD of 100% and LGD of 45% would be assumed and existing provisions are offset with LGD, or

ii) through RWA such as 150% of the remaining net exposure

No additive combination of these approaches should be applied as otherwise capital requirements would be double-counted.

From our perspective, option ii) is superior from a prudential capital perspective as any residual exposures at risk are subject to capital requirements. Option i) depends on the appropriateness of a standard LGD whereby it is possible that the level of provisions reduce the exposure to zero even though a bank holds residual risk.

<u>Regulatory treatment of accounting provision under the IRB framework</u>

The Committee refers to limitations in the IRB approaches where it is expected that IFRS 9 (stage 2 and stage 3) and CECL provisions will outweigh the IRB 12-month expected credit losses and excluded any policy considerations in its October 2016 Discussion Paper.

The Committee explains that the implementation of IFRS 9 and CECL is work in progress and the magnitude of a possible increase in accounting provisions is unknown so that this aspect will only be revisited after the public comment period ending on Jan 13th, 2017. We welcome the Committee's acknowledgment that the increase in the provisions resulting from a move from 12 month to lifetime expected credit loss is typically expected to be sizeable.

As a bank with significant exposures under the IRB approach, the treatment of excess accounting provisions is an important aspect of transitioning to a regulatory capital regime under forward-looking ECL accounting provisions. We believe that the recognition of lifetime ECL accounting provisions without any amendments to the calibration of regulatory capital requirements results in excessive levels of capital held for a given risk exposure.

The IRB risk-weighted assets for credit risks have been calibrated to ensure that total Tier 1 and Tier 2 capital of 8% under the Basel 2 Framework exceed total credit losses at a confidence level of 99.9%. This calibration included both expected and unexpected credit losses as set out in the Explanatory Note on the Basel II IRB Risk Weight Functions published by the Committee in July 2005.

Under the Basel 3 Framework, the model-based probability that both expected and unexpected losses exceed the available capital resources would even be less than 0.01% given that banks have a minimum total capital requirement of 10.5% and also apply the asset value correlation factor for exposures with large financial institutions and other finance companies.

While the IRB framework uses 1 year probability of default as a key input to the model, it is important to note that it does not focus solely on risks within a 1 year horizon. The Committee's July 2005 Explanatory Note on the IRB regulatory capital framework shows the interplay between lifetime ECL and risk-weighted assets as follows:

- Risk-weighted assets cover total losses with a level of confidence of 99.9% whereby initially no distinction between expected and unexpected losses is applied. This distinction was only introduced by the Committee after a number of Basel 2 reiterations to recognise the availability of accounting provisions and write offs to absorb losses on nominal amounts. This required the elimination of one-year expected losses from the regulatory capital requirement expressed as RWA as otherwise banks would have had zero recognition for provisions and write offs in their capitalisation of credit risks

- Alternatively this can be expressed as the bank having sufficient capital to absorb losses on the 1 year horizon 99.9% of the time, where the 99.9%ile loss is defined as the VaR, and is the total capital that the bank needs to hold. This amount is split between a 1 year Expected Loss (EL) and a 1 year Unexpected Loss (UL), the sum of which equal the 1 year VaR

- The capital that the bank is required to hold is therefore keenly dependent on the shape of the distribution of 1 year losses. This distribution (and thus the value of the VaR) is defined by the correlation between borrower default and a systemic factor, where the correlation has been calibrated by the Committee to historical data

  - For the **wholesale distribution**, a further adjustment is made to recognize that the price of longer dated assets could migrate further over 1 year than shorter dated assets. The nature of the adjustment can be viewed as incorporating expected losses beyond the 1 year horizon but is equivalent to pushing the 99.9%ile loss higher and creating a more conservative distribution of 1 year losses for longer dated assets

  - For the **retail distribution**, the calibration was done against portfolios of assets with various maturities, and so the maturity effects that extend the 99.9%ile losses higher at the 1 year horizon are captured implicitly

- Due to the conditional PDs used which are conservatively estimated for a system-wide risk scenario and the maturity adjustments used to scale up the respective one-year VaR exposures, the provision of lifetime ECL unnecessarily increases the capital needed to support the same lending by requiring CET1 in excess of the 99.9%ile of the 1-year loss distribution

This can be illustrated with the below matrix of corporate PDs and maturities that demonstrates the effect of applying the maturity adjustment to PDs and LGD (assumed to be 45%):

		Maturity (in years)				
PD	SP Rating	1	2	3	4	5
0.02%	AAA-AA	8.03%	12.88%	17.74%	22.59%	27.44%
0.05%	A+	11.89%	17.85%	23.81%	29.77%	35.73%
0.10%	A, A-	19.79%	27.55%	35.31%	43.08%	50.84%
0.15%	BBB+	26.26%	35.20%	44.14%	53.08%	62.02%
0.20%	BBB	31.83%	41.63%	51.43%	61.23%	71.03%
0.30%	BBB-	41.15%	52.15%	63.14%	74.14%	85.13%
0.40%	BB+	48.81%	60.59%	72.37%	84.15%	95.94%
1.20%	BB,BB-	83.88%	97.44%	111.01%	124.58%	138.15%
2.15%	B+	104.07%	117.51%	130.94%	144.38%	157.81%
4.45%	B	133.77%	146.54%	159.32%	172.09%	184.87%
8.65%	B-	175.30%	187.67%	200.03%	212.40%	224.77%
18.65%	C	232.21%	243.23%	254.25%	265.28%	276.30%
100.00%	D			Defaulted		

If the combined RWA for UL and 1-year EL only covered the losses for a period of 1 year then the RWA for credit risks would be restricted to column 1.

The impacts of maturity adjustments on corporate RWA are as follows:

- sizeable for lower PDs (higher ratings) as these exposures are not expected to default in the first year but are comparably more likely to default afterwards, and
- less sizeable for higher PDs (lower ratings) as such exposures are more likely to default in the first year and therefore the change in fair value due to rating migration is smaller.

We appreciate that the Committee recommended that accounting standard setters consider modifying provisioning standards to incorporate forward-looking assessments in the estimation of credit losses, but we do not believe this was in order to correct for deficiencies in the regulatory framework. We expect lifetime ECL to have a significant impact on CET1 resources while the interaction between IRB framework and ECL provisions are complex and require due consideration given the possible feedback effects from the banking sector into the real economy in a downturn.

There are three broad responses the Committee could consider to the introduction of ECL within the accounting frameworks:

i) Do nothing: We would expect this to lead to a system-wide increase in the amount of capital held, since the implementation of lifetime ECL will directly affect the availability of CET1 capital resources before the application of regulatory requirements. We do not believe such an outcome is warranted, nor would it be consistent with the approach the Committee has otherwise taken with respect to other elements of its RWA reform programme.

ii) Recalibrate the regulatory framework to recognise any excess ECL accounting provisions: Aside from the prolonged uncertainty this would create regarding the final level and design of regulatory requirements, we do not expect this to be a feasible course. We note it would be challenging to properly reflect the technical differences between the IFRS and US GAAP approaches to ECL, and to ensure the regulatory framework could be applied in a comparable manner by banks reporting under other accounting frameworks.

iii) Take account of the additional resources required to comply with ECL and reflect them through capital resources or as an adjustment to RWA. This could be achieved by a reduction of credit RWAs by an amount equal to 12.5*(excess of eligible provisions above the regulatory expected loss) or a reduction in the capital requirements for credit losses by an amount equal to the excess of eligible provisions above the regulatory expected loss.

We recognise the current rules allow for some recognition of surplus provisions through Tier 2 capital, subject to caps based on a proportion of RWAs. But this would effectively lead to a situation where the 'worst-of' regulatory expected loss and accounting ECL provisions applied to banks. Furthermore, the limited inclusion in Tier 2 is incongruent as the ECL provisions are built through CET1.

A simple adjustment would be to allow the inclusion of provisions that are surplus to regulatory EL in CET1 capital without any limitations. Although for most large, internationally-active banks, credit risk forms the dominant part of regulatory capital requirements, we do recognise there could be concerns regarding the ability of such resources to absorb other losses (i.e. market risks, operational risks and items that give rise to capital deductions).

Possible alternative approaches would be:

- Allowing provisions that are surplus to regulatory EL to count towards CET1 only insofar as they are meeting credit risk requirements; or

- Applying an offset to the RWAs on the specific items associated with the surplus provisions – in effect, accepting that the risk is being capitalised directly through the numerator of the capital ratio rather than adding to the denominator.[1]; or

- Applying a scalar to RWA in the same way as it is discussed for the SA-CR under the proposal to introduce a regulatory EL. The Committee state that it was not its intention to increase capital requirements significantly by introducing an EL under the standardised approach. The same should in our view apply under the IRB approaches where a scalar could be applied to RWA to compensate for the additional levels of provisions available to absorb credit losses

4. Treatment of general and excess provisions

Comments are welcome on whether general and excess provisions should continue to be included in Tier 2 capital, for example as an incentive for banks to make adequate provisions, or whether inclusion in Tier 2 is becoming less important than before, given that the focus of stakeholders is increasingly on CET1. Comments are also sought on whether inclusion in Tier 2 for general and excess provisions that are for losses that are already expected could weaken regulatory capital because the provisioned amount may not be available to absorb other losses that subsequently materialise elsewhere in the bank on a going- or gone-concern basis.

The Committee is also seeking feedback on whether general or excess provisions could potentially be recognised in other parts of the regulatory capital framework, in particular under Pillar 2, thus reducing the amount of additional capital required as a result of the supervisory review process based

[1] Credit RWAs on each item would be equal to max{0; unadjusted RWAs – remaining provisions on the exposure that have not already been offset against regulatory EL x 12.5}.

on a bank's internal capital adequacy assessment process. Comments are welcome as to whether, how, and under what circumstances it may be appropriate for provisions to be recognised under Pillar 2.

The Committee, further, seeks feedback on the implications of the inclusion of general and excess provisions in Tier 2 for the purposes of calculating Total Loss-Absorbing Capacity (TLAC). Comments are welcome on the appropriate regulatory capital treatment of ECL provisions established prior to or during the resolution process.

Excess provisions should either be reinserted into CET1 capital or used to reduce risk-weighted assets as explained in further detail above. If the Committee has reservations about the potential weakening of the eligible regulatory capital then the reduction of risk-weighted assets should be the preferable approach.

The Committee asked whether the inclusion in Tier 2 is becoming less important than before, given that the focus of stakeholders is increasingly on CET1. We would not consider Tier 2 capital less important as banks hold 2% of the minimum total capital requirements in the form of Tier 2. However, excess ECL provisions are expected to be more volatile than incurred provisions and therefore we expect banks to prefer issuing Tier 2 capital instruments as opposed to relying on excess provisions.

Should the Committee decide to not recalibrate capital requirements to compensate for potential excess ECL provisions then it would alternatively be sensible to maintain the add back to Tier 2 capital and eliminate the quantitative restrictions that apply under both the SA-CR and IRB. Such an approach would also make the inclusion in TLAC possible where banks would have a restriction of issuing 33% of the minimum TLAC requirement through long-term debt so that G-SIBs have the required recapitalisation capacity in place.

The use of excess provisions to cover Pillar 2 capital requirements under the ICAAP and supervisory stress testing scenarios could work if such are imposed on banks to cover credit losses that are not already capitalised under Pillar 1. This should however only apply to excess provisions which are not used to meet Pillar 1 requirements.

As mentioned though it is our preference for the Committee to consider a congruent Pillar 1 solution that amends capital requirements for credit risks to the extent that banks have excess provisions. This will make sure that CET1 capital ratios will be comparable in the future which is one of the key objectives of the Committee for the ongoing reforms of global regulatory capital standards.

5. Level playing field

Variations exist between accounting standards for provisioning that could result in meaningful differences in provisions and capital across jurisdictions. Comments are welcome on how best the Basel Committee should seek to level the impact of accounting differences, and as to which approaches could level the playing field (eg introduction of regulatory EL minima, setting of a common minimum provisioning requirement, enhanced add-backs to Tier 2 capital, or clarification of the distinction between specific and general provisions) in a manner appropriate for meeting the objectives of the regulatory capital framework.

Both IASB and FASB have adopted provisioning standards that require the use of expected credit loss (ECL) models rather than incurred loss models. IFRS 9 will take effect on 1 January 2018 while the US-GAAP standard on current expected credit losses (CECL) will take effect on 1 January 2020 for public companies and 2021 for all other banks.

There are, however, differences between IFRS 9 and CECL whereby IFRS uses three stages depending on the performance of assets to determine the amount of ECL provisions to be set aside while CECL require lifetime ECL provisions for all assets.

While the differences between IFRS and US-GAAP could lead to level playing field issues if not addressed properly, we agree that there might be other accounting standards that require different credit provisioning methodologies.

As a bank reporting under IFRS, we focus on the differences between IFRS and US-GAAP which apply to the majority of globally active banking groups to which the Basel standards apply. Although US GAAP requires immediate lifetime losses for in scope exposures, losses may be smaller than those required by IFRS because US GAAP permits the short contractual call option period, rather than the behavioural life, to be used for certain revolvers such as credit cards and overdrafts. Also, US GAAP does not require future downside economic scenarios to be included in the measurement of losses.

Given that, the first priority should be for the Committee to make it indifferent for a banking group as to whether it reports under IFRS and US-GAAP. The only available approach to achieve this would be to make any excess accounting provisions available to either reduce risk-weighted assets or added back to CET1 capital.

If this is addressed then with secondary priority it would also be sensible to introduce a minimum regulatory EL which will not only support a level playing field but also make the SA-CR more comparable to IRB. However, in this context, it will be important that any increases in capital requirements which will arise from a minimum regulatory EL will be compensated through a scaling factor which needs to be calibrated on the levels of provisions before the application of the new ECL approaches.

To achieve a level playing field, the Committee should not only consider the differences between accounting standards in various jurisdictions but also analyse differences in access to capital markets and the option to securitise originated credit risks such as residential mortgages and consumer credits.

For example, according to the European Banking Federation, in the European Union, banks provide 70% of the finance required by the economy, with capital markets supplying the remaining 30%, whereas in the United States the proportions are reversed, with banks funding 30% and the capital markets 70%.

Such differences in the structure and development of financial markets should ideally be considered in a final regulatory framework so that lending in regions and countries whereby banks have comparably heavier balance sheets are not unduly disadvantaged by regulatory capital requirements.

6. Complexity and simplification

The Committee is interested in views on whether and how to simplify either the current regulatory treatment of provisions or an approach that would use regulatory EL minima.

Comments are also welcome on whether it would be preferable to have an alternative simplified approach that relies largely upon accounting determinations of provisions subject to some minimum requirement (such as one-year provisions for performing loans and lifetime provisions for deteriorated, impaired or defaulted loans) with a deduction from CET1 capital when the accounting provisions do not meet the minimum, but otherwise eliminates add-backs to Tier 2 capital and the distinction between specific and general provisions.

As mentioned further above, the elimination of the distinction between general and specific provisions would simplify the regulatory capital framework and eliminate some of the current level playing field issues.

At the same time, we believe that the introduction of an alternative simplified approach that relies on accounting provisions subject to regulatory minimum requirements will introduce new complexities and seems conceptually weaker than defining a quantitative EL under the SA-CR against which provisions can be measured. We would maintain that add backs are necessary under a congruent CET1 methodology to support comparability of capital ratios which is a key objective of the Basel reforms of regulatory capital standards.

7. Burden

Efforts to simplify the treatment of provisions could lead to a lower regulatory burden over time but may require upfront changes. Comments are welcome on whether it is preferable to limit the number of changes to the regulatory treatment of provisions to reduce the immediate burden, or preferable to introduce modifications to the treatment to achieve a less burdensome longer-term outcome.

We agree that there is a trade-off between upfront changes versus a simpler longer-term regulatory regime. In general, it would be our preference to be granted phasing-in arrangements that only start once any revisions of the regulatory framework are finalised.

As such, it would be desirable that the Committee not only considers the necessary changes and scalars to the SA-CR but - should the levels of additional provisions warrant it - also consider any scalars under the IRB approaches at the same time. To avoid uncertainty and volatility in capital ratios, it would in our view be necessary to finalise the standard and then to start phasing in. This will allow banks to plan ahead but also to make this change process less burdensome.