The voice of banking

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BBA response to BCBS consultation document 'guidance on accounting for expected credit losses'

Introduction

The BBA welcomes the opportunity to comment on the BCBS draft guidance on accounting for expected credit losses ('the Guidance'). The BBA represents more than 200 banks from over 50 countries and has prepared this response on the basis of discussion within a working group focusing upon the implementation of IFRS 9 by UK banks. We have additionally contributed to the response submitted by the International Banking Federation and our members have also provided significant input to the International Institute of Finance response. This response focuses upon the issues which featured most heavily in our discussion of the draft guidance.

As the paper observes, the move to Expected Credit Loss (ECL) accounting is intended to improve credit loss recognition compared to the current incurred loss methodology, which was seen as "too little, too late", and follows the call by G20 leaders for accounting standard setters to strengthen the accounting recognition of loan loss provisions by "incorporating a broader range of credit information". Paragraph 10 explains that the guidance should be viewed as an over layering of IFRS 9 with Principles 17 and 18 of the Core Principles for Effective Banking Supervision.

The Guidance explains that these Principles emphasise that banks must have "adequate credit risk management process, including prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk on a timely basis, and covering the full credit life cycle (credit underwriting, credit evaluation and the ongoing management of the bank's portfolios). Additionally, adequate policies and processes must be in place for the early identification and management of problem assets and the maintenance of adequate provisions and reserves".

We agree in principle with the objective of seeking to achieve a high quality implementation of the impairment requirements of IFRS 9. We also acknowledge that the Basel Committee has a legitimate interest in supporting the consistent implementation of ECL frameworks to the extent possible across jurisdictions. We agree that consistency is more likely to be achieved through a single set of guidance accepted internationally. National guidance, by definition, would be unlikely to contribute to consistent implementation of IFRS on a global basis.

We also agree that it is sensible to leverage and integrate risk management, capital adequacy and ECL accounting measurement processes to the extent that it is compatible with meeting the different requirements and objectives of the differing regimes. Such alignment should ensure that financial reporting provides useful information reflective of risk management practices, and results in processes that are more likely to be efficient and sustainable.

We understand that the concern of the BCBS that if IFRS 9 is not implemented in a high quality manner, ECL recognition might not be as forward looking as envisaged by accounting standard setters, regulators and other stakeholders. We believe that a high quality implementation of IFRS 9 involves establishing the necessary linkage between credit risk management practices and ECL accounting in a way that ensures the accounting is responsive to changes in credit risk. However, we also believe that it is very important that the accounting is informed by credit risk management practices and that accounting practices around ECL do not develop in ways that are not meaningful in credit risk management terms. Some of our concerns expressed in this letter address areas of the guidance which, while aiming to improve standards of implementation, may inadvertently create divergences between accounting and credit risk management practices, and actually result in lower quality implementations.

Summary of key points on the draft guidance

Key points arising from the Guidance that we would highlight include:

- The merit, under Principle 1, in the Guidance recognising that information available can be of varying quality even for large international banks;
- The need, in Principle 2, to avoid absolute terms such as “maximum” which is arguably inconsistent with the overarching principle of proportionality and need for requirements to be capable of being operationalised;
- Aspects of the Guidance under Principles 3, Principle 4, and paragraphs A2, A7 and A27 (footnote 33) of the appendix that appear disproportionate, and capable of producing outcomes that are inconsistent with IFRS 9, and are therefore in need of revision (noting that national associations have fed into a longer list of issues in the IBFed response);
- The need for the Guidance on re-segmentation under Principle 3 to be substantially revised;
- The need to be clearer about whether the commentary is relating to credit risk practices or aspects of the underlying accounting standard which the Guidance is seeking to draw attention to or emphasise for the purpose of this guidance;
- The need, in various parts of the Guidance, to distinguish between retail and wholesale portfolios, given the very different credit risk management processes that apply;
- Acknowledging the Basel Committee’s expectation that internationally active and sophisticated banks should make little use of practical expedients, the need, under section 3 of the appendix, to recognise that there will be instances in which the appropriate use of practical expedients in accordance with the standard should not be seen as low quality implementation, even by the larger banks.

We also suggest that the final version of the Guidance is provided to the International Accounting Standards Board so that they can confirm that it would not prevent a bank from meeting the requirements of IFRS 9, and that there is nothing in the guidance that is inconsistent with IFRS 9.

Materiality, neutrality and the nature of accounting judgements

We see merit in the Guidance stating explicitly that it should not be read as interpreting the accounting requirements and instead is seeking to place emphasis on elements viewed as being of particular significance for internationally active banks and those banks more sophisticated in the business of lending. We also see a need for the Guidance to include an explicit statement clarifying that it does not override the concept of materiality in an IFRS 9 context. While the Guidance refers to the need make estimates without bias, and the required neutrality of accounting information (e.g. paragraph 54), it would be much clearer if this was stated prominently up-front, and also referred to the need for the symmetrical recognition of gains and losses.

It is clearly within the responsibility of the regulator to establish standards and principles applying to banks' governance, systems, controls and processes. However, the effect of regulatory guidance on the exercise of accounting judgements needs to be carefully considered in view of the different objectives of regulatory and accounting standards, where differences in terminology could lead to misunderstandings about the intention of the guidance and inadvertently cause divergence in practices. We do not see this just as a matter of semantics. The use of different language, or inconsistent application of language, creates a risk of confusion and is likely to lead to less effective implementation.

UK Application

We understand that the UK PRA envisages that the Guidance could be used as a basis for audit attestation as to UK bank compliance with the guidance, or certain aspects of the guidance to be determined. We believe this would impose a higher standard on the implementation of the Guidance, and may lead to the use of the document as a checklist of requirements, as efforts are made to ensure compliance to the letter, notwithstanding that the Guidance is intended to be principles based. The comments in this response about the clarity of language and purpose are particularly relevant in this context.

Our detailed comments on the draft guidance are set out overleaf.

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Detailed comments on the BCBS consultation document 'guidance on accounting for expected credit losses'

Objective and scope

The opening paragraph on objective and scope reads:

- The objective of this paper 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. Such practices include all aspects of a bank's procedures for managing credit risk. However, for the purpose of this paper, the scope of credit risk practices is limited to those practices affecting the assessment and measurement of allowances under the applicable accounting framework.

We agree with this scope, and believe that this could be better reflected in the title of the guidance so that there can be no misunderstanding about its relevance and target audience. Since the intention is for the guidance to span both risk modelling and financial reporting, we would see merit in the final document being given a title which better reflected its substance. *'Sound credit risk practices and accounting for expected credit losses'* would be our suggestion.

The opening sentence of paragraph 7 states:

- Supervisors expect that a bank's credit risk practices will provide the basis for a high-quality, robust and consistent implementation of an ECL accounting model in accordance with the applicable accounting framework and support appropriate measures of capital adequacy.

Credit risk management processes are guided by Principles 17 and 18 of the Core Principles for Effective Banking Supervision and these emphasise the need for adequate processes and prudent policies. Accounting standard setters, on the other hand, have the objective of providing transparency by setting accounting standards which support the fair presentation of financial performance and position and see their role in financial stability terms as the provision of information that is a faithful representation and is relevant as the basis for informed market decisions.

While the two objectives should be complementary, they do differ. The accounting standards in their own right will result in earlier provisioning for credit losses. The Basel guidance is right in suggesting that the processes underpinning this should be robust, but not in implying (if this was intended) that supervisory considerations should result in the accounting measurement outcome being more 'robust' than otherwise would have been the case.

We would therefore recommend that the opening sentence of paragraph 7 be revised to read:

- Supervisors expect that a bank's credit risk practices will provide the basis for a high-quality, robust and consistent implementation of an ECL accounting *process* in *support of* the applicable accounting framework and appropriate measures of capital adequacy.

We note that paragraph 12 provides that, for less complex banks, supervisors may adopt a proportionate approach and that this *may* allow less complex banks to adopt approaches commensurate with the size, nature and complexity of their lending exposures. As this is a requirement under Basel Core Principles it is arguable that the Guidance should be expressed in terms of *should* at least insofar as lending institutions (as opposed to the supervisors themselves) are concerned.

In contrast, paragraph 11 emphasises that the Basel Committee has "significantly heightened supervisory expectations" that internationally active banks and those banks more sophisticated in the business of lending will have the highest quality implementation of an ECL accounting model. While we do not disagree with this in principle, it needs to be recognised that there will be circumstances in which these banks will also have a need for a proportionate approach, consistent with Principle 1, which recognises that the credit risk practices underlying the implementation of an ECL accounting process will be commensurate with the size, nature and complexity of the each lending portfolio. We comment upon this further with regard to Principle 1.

Principle 1: Responsibility for appropriate credit risk practices

We agree with the clear statement that a bank's board and its senior management has responsibility for its credit risk practices, including effective internal controls, and the determination of allowances in accordance with the bank's stated policies and procedures, the applicable accounting framework and supervisory guidance.

We can also see logic in the expectation – and measure of proportionality – being commensurate with the size, nature and complexity of the lending exposures. This to our mind sends a clear and unambiguous signal that banking supervisors view an appropriate degree of sophistication as a prerequisite for engaging in complex business.

As noted above, we think this expectation should also follow into the ECL accounting processes since they should be based on these credit risk management practices. The text in paragraphs 11 and 12 should be modified to recognise this point. International banks can find themselves relying upon standardised models for a significant amount of their lending operations, with 15% not being unusual. While we appreciate that there may be a higher expectation upon them to bring their expertise to bear across an entire group's operations, their reliance upon the standardised approach is often necessitated by the stage of development of local credit risk management processes or the limited information available in certain markets. We see a strong case for this being accommodated in Principle 1.

Principle 2: Sound methodologies for assessing and measuring credit risk

We agree with the principle as espoused in the opening bold type and much of the supporting material providing guidance on what robust and sound methodologies for assessing credit risk and measuring the level of allowances can be expected to involve.

But we would disagree specifically with the expectation in paragraph 21 that banks maximise the extent to which underlying information and assumptions are used consistently to determine when credit should be granted and its corresponding terms. We also disagree with the explanation that using the same information and assumptions across the bank to the maximum extent possible reduces bias and encourages consistency in interpretation and application of the applicable accounting framework.

Our concern is twofold. First, the use of absolute language such as 'maximise' implies a proportionality and materiality override and we do not consider this to be consistent with the overriding Core Principles; if this is not the intention then the creation of this impression is unhelpful. Second, while we appreciate the benefit of the consistent use of underlying information and assumptions, language such as 'maximise' implies that that management overlay, judgement or discretion cannot be allowed at any point in the credit process or that bias introduced by regulatory requirements should be reflected in the accounting.

We therefore believe that this requirement would be better expressed in terms of *full appropriate use* being made of underlying information and assumptions on a consistent basis, recognising the differences between regulatory and accounting requirements. Such requirements also need to be viewed as being *within a framework permitting management overlay, judgement and discretion*.

We note that paragraph 22 says that different information or assumptions can be used across functional areas but do not believe this addresses the point. We also note that Principle 6 permits the use of management's experienced credit judgement but again do not believe this addresses the concern.

Paragraph 23 similarly refers to banks having in place suitable processes and systems to appropriately identify, measure, evaluate, monitor, report and control the level of credit risk and collect and analyse all relevant information affecting the assessment and measurement of ECL. We believe it would be useful to, refer to the words used in IFRS 9, that all reasonable and supportable information, including that which is forward-looking should be considered and that it is additionally necessary for the bank to document how it concluded that the information considered was relevant.

Paragraph 24 then provides 18 specific factors that would be included in a "robust and sound" methodology for assessing credit risk and measuring the level of allowances explaining that this is *not an all-inclusive list*. Given that banks will have portfolios of differing sizes and materiality it is unlikely that all 18 factors would equally apply. We therefore believe that it would be better to indicate that sound practice would *typically include* such factors. We would further note that the factors will not apply equally to credit risk assessment and ECL measurement.

Sub-paragraph 24(k) requires banks to maintain sufficient historical loss data over "at least a full credit cycle" to provide a meaningful analysis of its credit loss experience. It is not clear why it is necessary for this purpose to maintain information over the full credit cycle to inform a point in time estimate, and questions arise as to the definition of the length of a full credit cycle. It may be that the guidance should require management to rationalise their approach and to document the suitability of the loss history applied to forming management's expectations at the reporting date. There is also a point here about the practicability of requiring re-segmentation where sufficient historical loss data is not available in the first instance and needs to be built up over time.

The factors listed in paragraph 27 would appear more relevant to wholesale rather than retail lending. In addition, as the paragraph is about lending practices rather than ECL measurement, it does not appear to be directly relevant to the objective of the guidance and may even detract from the understandability of the Guidance. We suggest that this should be deleted and a cross reference provided to any more comprehensive Basel guidance on loan origination.

Paragraph 29 also requires the 'back testing' of appropriate scenarios. This is the point at which we believe the guidance would place an unrealistic burden on management to prove or disprove forecasts which by definition are always going to be imperfect and of varying relevance to actual outcomes. We believe the guidance should focus on the back testing of PD and LGD model performance and the need to review continually whether the bank is considering the most relevant economic indicators when it comes to their impact on ECL.

We are unclear why the document needs to set out underwriting criteria in paragraph 31. The main purpose of the guidance should be to ensure that a bank's ECL measurement faithfully represents the credit quality, and management's expectations of credit losses, relating to the bank's loan portfolios. We believe it could helpfully point out that sound underwriting practices adopted by Banks will provide higher quality information on origination credit quality as a basis for ECL measurement. We note that paragraphs 27(a) & (g) and 31 require bank management to be able to demonstrate adherence to sound underwriting practices, but would question whether this should be listed as being relevant to the calculation of expected loss or assessment of whether there has been an increase in credit risk.

We would agree that the level of ECL would not usually decrease in the case of a restructuring, as outlined in paragraph 32(a), but believe that there may be exceptions to this. Loan extensions, for instance, can result in a lower ECL, and a reduced PD, though we would agree that the PD would be unlikely to return to its origination level.

Principle 3: Appropriate grouping of lending exposures

Paragraphs 33-42 appear unrelated to the Principle, but instead to the design of credit rating systems, and so could arguably be deleted or pared back since Principle 2 already addresses credit risk assessment. If the guidance is meant to be about the underlying credit rating systems, than the references to forward looking information should be deleted or the references to credit rating systems should be changed to the ECL measurement.

Paragraphs 46 and 47 imply that a pool of assets cannot have both 12 month ECL and lifetime ECL and therefore be split across Stage 1 and Stage 2. We do not believe this to be consistent with IFRS 9, specifically the worked example using exposure to a mining community to show that a portion of a segment can be moved to Stage 2. Re-segmentation would not be the right answer in this case as the approach that is needed is one which recognises that while there will inevitably be job losses, the lending institution will not have specific customer information on this and individual customers will be impacted to a varying degree.

Turning to paragraph 48, we are supportive of a requirement for checks on whether asset pools remain homogenous and for active consideration to be given to whether pools lose their shared characteristics. But we do not believe that frequent re-segmentation is inevitable and do not consider that the opening sentence established a realistic expectation in saying that the grouping of exposures should be re-evaluated and exposures re-segmented whenever relevant new information is received or a bank's expectations of credit risk have changed.

The Guidance emphasises re-segmentation as a key process in reflecting changes in credit risk characteristics in ECL measurement. While segmentation is an important tool in grouping loans according to credit risk characteristics, credit risk methodologies using statistical techniques, such as behavioural scores, rely on establishing stable segments in order to capture the necessary data for predictive models, and re-segmentation would be only one of a number of actions available to ensure that models continue to have predictive value. Re-segmentation would be a major change; however the disciplines around model development are such that re-segmentation should be relatively infrequent if models have been developed in a well-controlled manner. For less sophisticated approaches and smaller portfolios, there may be more reliance placed on re-segmentation, but data quality will remain a key factor. Accordingly, we believe that wording along the following lines would provide a more appropriate impression of what is required:

- The grouping of exposures should be re-evaluated and exposures should be re-segmented *in the event that* relevant new information or a bank's *understanding* of credit risk *renders the initial segmentation redundant.*

These revisions aim to address two different changes in the guidance. First, to reflect the need for controls over the significance of the new information received and second to reflect the fact that a change in credit assessment for part of a portfolio may not necessarily render the original segmentation inappropriate. It is the case that groupings will need to be assessed as part of model review and validation and changes made in accordance with the model governance process. This will help ensure there is in fact sufficient data to rebuild the models for new segments (aligned to the need for loss history as related above). In the meantime, judgmental overlays may be needed to supplement the models under certain circumstances.

We would in fact go further and suggest that good segmentation at inception should enable banks to avoid a need for frequent re-segmentation. IFRS 9 requires segments only to include exposures with similar risk characteristics at inception and if this is followed then re-segmentation due to changes in credit risk should not be frequent as the exposures should respond to changing circumstances in a similar way. Occasional re-segmentation will, however, be necessary when assets within a particular component of a segment demonstrate substantially different loss behaviour than was initially foreseen, for instance due to a rare event, perhaps including a natural disaster or critical change in government policy.

Rather than emphasise resegmentation as a process indicative of a high quality implementation, we believe the Guidance could usefully emphasise that where collective assessment is used, an appropriate methodology is used to ensure that the grouping reflects similar credit risk characteristics, and utilises methodologies which ensure that the grouping remains responsive to changes in credit risk characteristics, with appropriate model governance.

Principle 4: Adequacy of impairment allowances

We would agree that banks should implement sound and robust credit risk methodologies and see 'sound and robust' as setting a reasonable required standard for credit risk processes. We would not, however, consider the observation that this requires banks to identify "as early as possible" "any" changes in credit risk to be consistent with IFRS 9. While the standard identifies that it will result in earlier recognition than under IAS 39, it is in fact based upon appropriate measurement based on relevant information and data, and for this to be timely rather than 'early'. What would be fair to say is that the measurement of ECL for any individual exposure is not static since the PD will continually move.

We would also make the following points:

- Paragraph 51: for clarity it would be better for the second sentence to end with "…all reasonably available forward-looking information*, including* macroeconomic factors" in order to remove the possible interpretation that the macroeconomic factors are a further layer to be added.
- Paragraph 53: A question of consistency in interpretation arises with the wording of the requirement for banks to use their expertise to consider "the full spectrum of reasonable information relevant to the group"; *all reasonable and supportable information that is relevant* would align to the standard.

Principle 5: Internal credit risk assessment models

While this section is not particularly contentious it is questionable whether a section of this nature and length needs to be included in this document. Particular comments we would make include:

- Paragraph 57: we would say it is more the case that the *development* of models requires extensive judgement than their application since the application should be mechanical.
- Paragraph 58: the guidance provided is highly prescriptive and duplicative in nature; removing it would help keep the document focused.
- We would further suggest that in commenting upon the use of stress tests to assess model performance that it be fully recognised that model performance is likely to differ between gradual economic environments and stress conditions.

Principle 6: Experienced credit judgement and the use of forward-looking information

Paragraph 61 suggests that banks should be able to bring to bear their experienced credit judgement where e.g. it is not possible to demonstrate a strong link in formal statistical terms between individual types of information, the information set as a whole, and the credit risk of some exposures or portfolios. However, it is a requirement of IFRS 9 for information to be reasonable and supportable. Banks should, as a minimum, include forward-looking information where proven historical relationships exist and that, additionally, experienced credit judgement should consider additional indicators of credit risk for factors that are not already covered through underlying modelling and measurement processes. However, it will be important to demonstrate strong governance around this process to comply with IFRS 9, and we think it is more consistent with a high quality implementation for the guidance to emphasise this rather than encourage adjustments to financial statements which are open to a very high degree of uncertainty.

Principle 7: Sound credit risk process for common system, tools and data for pricing credit risk and accounting for expected credit losses

We note some duplication with other parts of the document, for example Principles 2 and 6.

Principle 8: Transparent and comparable public reporting for decision-useful information

Paragraphs 72-81duplicate some of the requirements that already exist within IFRS 7 (as amended by IFRS 9) and should in any case be reviewed in light of work expected to be undertaken within the EDTF framework. This could usefully be acknowledged within the Guidance.

Paragraph 73 talks in terms of it being important that banks consider “not only financial statement disclosures, but also any additional disclosures needed to fairly depict a bank’s exposure to credit risk, including its ECL estimates, and to provide relevant information on a bank’s underwriting practices”. We guess this is written in this way so as to indicate that the latter may be reported other than in the financial statements and would welcome confirmation of this. If this is not the case then the sentence most likely would warrant clarification.

As it stands, Principle 8 is broader than ECL and as such may be adequately stated in Basel Core Principle 28. It would be useful to include a statement to the effect that this confirms that Principle 28 necessitates the disclosure of how a bank has established ECL

Principle 9: Supervisory evaluation of the effectiveness of a bank’s credit risk practices

No comment.

Principle 10: Robust measurement of expected credit losses

Principle 10 states that a supervisory authority must ensure it is satisfied that a bank is able to determine a robust measurement of the accounting level of expected credit loss. The existing 'Sound Credit Risk and Valuation of Loans' guidance refers to a "reasonable" measure. We see this as a significant change, especially given how regulator might view "robust" in the context of accounting measurement. In other contexts, the term robust seems to equate to "in compliance with required rules at all times", which imposes a high hurdle. It also mixes two typical areas of accounting - being (a) the existence of adequate control environment (where you could understand language of "robust") and (b) a faithful representation of a measure of impairment, since factors such as materiality should apply for accounting. It is difficult to see how robust would be addressed in accounting valuation terms and may go beyond an appropriate level of oversight (i.e. robust processes and methods to determine a faithful representation of ECL impairment under IFRS 9).

Paragraph 84(e) should be amended to read that "regardless of the method used to determine ECL, the bank's internal processes for measuring ECL take full account of the *credit risks that the bank has taken on*.

Principle 11: Credit risk practices and capital adequacy

No comment.

Appendix: Supervisory requirements specific to jurisdictions applying IFRS

We are supportive of the long list of issues on the appendix provided in the IBFed and IIF responses and believe that these need careful consideration given the status that is likely to be given to this aspect of the guidance. The notes below are intended to augment these and to concentrate on aspects where members have related to us that they believe the guidance would be particularly difficult to operationalise unless significantly revised. This would appear to have particular relevance in the UK given the intention as we understand to bring implementation of IFRS 9 and application of the Basel guidance into the scope of the dialogue between auditors and the regulatory authority.

1. Loan loss allowance at an amount equal to 12-month ECL

Paragraph A1 explains that "a bank will measure ECL for all lending exposures, and that a nil allowance will be rare". In this regard, it might be worth explaining that while a PD of zero should not arise, it would be possible for LGD to be zero for a highly collateralised position at the point of realisation. More generally, it is arguable that the guidance written here implies that materiality should not apply.

We would suggest that paragraph A2 be rewritten to ensure consistency with IFRS 9. So, while we support the idea that the measurement of ECL will continually reflect changes in the probability of default, this is not the same as requiring "a timely build up".

Paragraph A5 together with footnote 29 suggest that "significant increases in credit risk" should be regarded as one of the "unlikeliness to pay" criteria and hence meet the definition of "default" under the Basel framework. As the significant increase in credit risk is assessed by using the probability of default, an increase in credit risk itself cannot be considered as default or the circularity of language will result in the PD models not operable. There is a need therefore to ensure that the guidance does not somehow become circular.

Paragraph A7 requires banks to be able to demonstrate that credit risk exposures included in stage 1 have not experienced a significant increase in credit risk since initial recognition.

This changes the onus of the criterion in IFRS 9 to identify significant increase in credit risk, which could result in outcomes that are inconsistent with IFRS 9. In addition, such a requirement would be very difficult to apply in practice, as it is very challenging to prove that exposures have not experienced a significant increase in credit risk since initial recognition. We believe a better approach would be for the Guidance to emphasise the importance of demonstrating strong controls for detecting early signs of credit deterioration since initial recognition.

2. Assessment of significant increases in credit risk

We are unsure that Paragraph A15 is right in saying that "any post-origination increase in credit risk is unlikely to be fully compensated by the interest rate charged". Since pricing is often banded, small changes in credit risk may be within the original pricing bands. This is particularly the case for retail and SME lending.

Footnote 33 of paragraph A27 introduces a rebuttable presumption that any increase in credit spread is due to an increase in the credit risk of the exposure, unless otherwise proven. It is important to appreciate that the pricing methodologies of banks typically consider many factors, such as the general price of credit, or other factors such as economic, commercial or regulatory factors. Therefore, in most cases, it would be difficult, if not impossible, for banks to rebut such a presumption as it is unclear whether any increase in credit spread of future loans is actually relevant to the assessment of credit risk on the current loans. In addition, pricing is a lagging indicator in the context of assessing significant increase in credit risk on an existing portfolio of loans as the increase would have been identified via other methods before it can be reflected in a change in pricing. We believe that the rebuttable presumption, as drafted, would cause the recognition of lifetime expected credit losses without a significant increase in credit risk, resulting in outcomes that are not in accordance with IFRS 9.

It would seem that IFRS 9.B5.5.1 has been misquoted in paragraph A35, as it implies that collective assessment must be performed instead that it may be necessary.

3. Use of practical expedients

While we agree that changes in credit risk should still be reflected in the ECL for financial instruments with low credit risk, it is unclear from the current drafting why applying the low-credit risk exemption would result in a low-quality implementation. Paragraphs A51 and A52 could be read to imply that significant increase in credit risk should be assessed without considering whether the initial credit risk of the loans were low as a significant increase in credit risk will always result in exposures moving to LEL. This does not seem compliant with IFRS 9. B5.5.9. Without considering the initial credit risk, a given change, in absolute terms, in the risk of a default occurring will be more significant for a financial instrument with a lower initial risk of a default occurring compared to a financial instrument with a higher initial risk of a default occurring. Therefore the initial credit risk of the loan must be taken into account in assessing whether there has been a significant increase in credit risk, and this aspect of IFRS 9 should not be seen as merely an operational simplification.

Paragraphs A59, A60 and A61 state that:

- The Committee would view significant reliance on past-due information (such as using the more-than-30-days-past-due rebuttable presumption as a primary indicator of transfer to LEL) as a very low-quality implementation of an ECL model;
- …the Committee has a strong expectation that a bank will not fall back on the 30-days rebuttable presumption unless it has demonstrated that all forward-looking information

that was considered potentially relevant had no substantive relationship with the level of credit losses; and

- The Committee expects that any assertion that the more-than-30-days-past-due presumption is rebutted on the basis that there has not been a significant increase in credit risk will be accompanied by a thorough analysis clearly evidencing that 30 days past due is not correlated with a significant increase in credit risk.

We fully appreciate the Basel Committee view that 30 days past due should not usually be viewed as adequate as the sole criterion for determining that significant credit deterioration has taken place. We note that IFRS 9 states clearly that an entity cannot rely solely on past due information when determining whether credit risk has increased significantly if reasonable and supportable forward looking information is available without undue cost and effort. Furthermore, the standard imposes a rebuttable presumption that credit risk has increased significantly when contractual payments are 30 days past due, as a safeguard against the overuse of delinquency information, which would seem important in situations where there is limited information available, for instance for smaller banks and simpler portfolios. We believe that the appropriate use of the 30 days past due criterion in accordance with the standard should not be seen as low quality. Its use may be particularly valid in situations where there is very limited information available due to local market conditions; this can be the case for the operations of large international banks or smaller banks with simple portfolios. We also believe that there are situations in which management should be able to make reasonable cost/benefit decisions, informed by materiality of the amounts, for example portfolios in run-off.

We agree with the Basel Committee that internationally active and sophisticated banks should carefully consider and be prepared to justify that use of practical expedients. Banks should only make use of them where this can be demonstrated to be consistent with the objectives and requirements of the standard. We suggest that it would be appropriate for the Basel Committee, in reinforcing this message, to emphasise that implementations that do not make use of practical expedients will generate a higher level of trust and confidence in the users of financial statements, and that clear disclosure should be provided where they are used to demonstrate why the use of the expedient provides a better outcome than not using them.