

Commonwealth Bank

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

Submitted via <http://www.bis.org/bcbs/commentupload.htm>

Re: Guidance on accounting for expected credit losses – consultative document

Dear Chair and Members of the Basel Committee

Commonwealth Bank of Australia (CBA) is pleased to comment on the Basel Committee on Banking Supervision's (BCBS's) consultative document *Guidance on accounting for expected credit losses* ("the Guidance"). CBA is the largest bank in Australia and it is important that we raise issues and propose solutions on significant accounting changes.

In our case, feedback was provided to the International Accounting Standards Board (IASB) when IFRS 9 *Financial Instruments* was developed and we would expect that any further guidance on accounting for expected credit losses (ECL) should be provided by the IASB.

CBA does not support the BCBS providing guidance in this area and in particular does not support the additional supervisory requirements set out in the Appendix to the Guidance. We have outlined our reasons below, having regard to specific issues arising from the Principles and the Appendix as well as general views on the Guidance.



1. General Themes

CBA has in place sound credit risk practices to manage credit risk and measure impairment allowances in accordance with International Accounting Standards and Australian Prudential Standards.

The Guidance sets out 11 principles for sound credit risk practices associated with the implementation and ongoing application of ECL accounting models. CBA generally supports the high level principles, however is concerned that some of the detailed guidance underpinning these principles is inconsistent with International Accounting Standards. In particular, the qualitative characteristics of financial statements outlined in the IASB's framework of understandability, relevance, reliability and comparability are called into question.

Materiality concept

The Guidance does not currently acknowledge the accounting concept of materiality. This may result in banks incurring excessive implementation costs for no material improvement in precision. In a number of areas, the Guidance reinforces that costs should not be avoided even if banks consider them unnecessary or excessive. This contradicts IFRS 9 B5.5.15 which states that *"an entity shall consider the best reasonable and supportable information that is available, without undue cost and effort"* and that *"an entity need not undertake an exhaustive search for information"*.

The ECL model under IFRS 9 is inherently judgemental and will involve the use of expert judgement in both the implementation and application of ECL models. It is reasonable that banks should be able to utilise the guidance on materiality to focus efforts in the areas that are likely to have a material impact on the impairment provision or expense. Three areas where materiality should be incorporated are:

- the range of forward looking information used in the allowance model;
- the use of practical expedients; and
- the requirement to collect and analyse all historical information.

Extent of forward looking information

The Guidance emphasises the need to factor in forward looking information when estimating ECL. Whilst we agree it is necessary to consider such information, in our view the expectations in the Guidance appear to be excessive and the use of forward-looking information is over emphasised. For example, the Guidance raises the expectation that all forward-looking information, regardless of the cost, be obtained.

In contrast, IFRS 9 only requires consideration of reasonably available information which may materially affect the resulting impairment provision. Restricting the range of forward looking information considered to that which is likely to materially impact the impairment provision is necessary for the ECL model to be practically implemented.

In addition, the Guidance does not appear to place sufficient focus on this assessment being performed as at the reporting date and being a point in time assessment as opposed to a through the cycle assessment.

2. Feedback on Principles

CBA generally supports the high level principles however would recommend they are revised and incorporated into existing prudential standards. One key concern with the Principles is that the detailed guidance is inconsistent with International Accounting Standards, for example Principle 4 has a requirement for allowances to be "adequate" and Principle 8 has introduced additional disclosure that is not required by accounting standards.

Adequacy of Allowance for ECL

Inclusion of the requirement for expected credit loss allowances to be adequate in Principle 4 ("A bank's amount of allowances,..., should be adequate") suggests that additional provisions should be held on top of the provision calculated in accordance with IFRS 9. That is, the ECL provision must not be understated. This is inconsistent with accounting guidance that reliable information must be neutral, that is free from bias. The IASB Framework does allow preparers to exercise prudence in the preparation of financial statements; however this should not result in the overstatement of provisions.

Disclosure

We note that the disclosure required by Principle 8 differs to that required by IFRS 9. Two additional disclosure requirements that are particularly onerous, but which also have potential to confuse the financial statement users includes:

- Quantitative information on how changes in forward looking information and macro-economic factors have affected the ECL estimates, and
- An explanation of the similarities and differences of the accounting and regulatory capital ECL models.

Both of these disclosures are complex and could result in users of the financial statement taking the information out of context. For example, the forward looking data could be seen as a forecast.

3. Feedback on Appendix

The Appendix to the Guidance outlines supervisory requirements for Banks reporting under IFRS, and provides very detailed guidance on the implementation and application of the IFRS 9 ECL model. CBA firmly believes that any guidance on accounting standards should be issued by the IASB and we do not support the BCBS providing guidance in this area. Detailed comments on the use of practical expedients and the guidance on significant increase in credit risk are detailed below.

Use of practical expedients

The IASB in developing IFRS 9 included practical expedients in applying the ECL model that were intended to be available for all entities, including internationally active banks. This was specifically outlined as part of IFRS 9's basis of conclusions. This conclusion was formed by the IASB after following due process, which consisted of outreach with regulators, banks, corporates, auditors and others and fieldwork performed by participants.

The Appendix to the Guidance seeks to restrict the use of these practical expedients by internationally active banks, on the basis that using these exemptions would be considered a low quality implementation. We disagree with this statement, and believe the use of these practical expedients is an operational simplification, that will still deliver a high quality implementation.

Removing this choice will result in internationally active banks bearing a greater cost in implementing and maintaining ECL model. It will also lead to inconsistencies with other banks, reducing overall comparability within the industry.

Low credit risk

In relation to the “low credit risk” exemption, the IASB proposed this to reduce the operational costs and observed that for financial instruments with low credit risk, the effect of this simplification on both the timing and amount of ECL would be minimal. Therefore applying this exemption is consistent with the materiality concept discussed above and would still be considered a high quality implementation. We note that this exemption is likely to be applied to high quality liquid asset portfolios held by banks for liquidity purposes and these are outside the scope of the BCBS’s guidance.

More-than-30-days-past due rebuttable presumption

In relation to the “more-than-30-days-past due rebuttable presumption” the IASB clarified that the objective of the rebuttable presumption was not an absolute indicator of when lifetime credit losses should be recognised, but served as a useful backstop for when there has been a significant increase in credit risk. Similarly, we would not view this as the only indicator for material loan portfolios, and would generally use the presumption as a useful backstop to other indicators of increased credit risk (including forward looking indicators). For immaterial loan portfolios, we believe it is appropriate to use the 30 days past due rebuttable presumption as a primary indicator.

Inconsistencies between the guidance and IFRS 9

We note that paragraph A27 of the Guidance contains six factors that should be particularly focussed on in determining whether there has been a significant increase in credit risk. In relation to these factors, we note that they are not consistent with those contained in paragraph B5.5.17 of IFRS 9. The inconsistencies include changes in wording, only being a subset of the range of factors set out in the standard and adding new factors in. In our view whilst it may be appropriate for the Guidance to highlight certain factors as being of particular importance, those factors should be taken directly from IFRS 9.

4. Concluding Remarks

In conclusion we strongly encourage the BCBS to reconsider issuing Guidance on accounting for expected credit losses. We propose that any guidance to be issued on the topic be the responsibility of the IASB and follow the IASB's normal due process.

Please do not hesitate to contact me should you wish to discuss any of the matters we have raised in this letter.

Yours sincerely,

A handwritten signature in black ink, consisting of a stylized 'M' followed by a long horizontal line that ends in a small flourish.

Michael Ford

