Deutsche Bank

EU Transparency Register ID Number 271912611231-56

30 April 2015

Mr. Rene van Wyk
Chair of the Accounting Experts Group
Basel Committee on Banking Supervision
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Deutsche Bank AG
Winchester House
1 Great Winchester Street
London EC2N 2DB

Tel: +44 20 7545 8000
Direct Tel +44 20 7545 1903
Direct Fax +44 20 7547 4179

Deutsche Bank's (DB) response to the Basel Committee on Banking Supervision consultation on Guidance for accounting for expected credit losses.

Dear Mr. van Wyk,

DB welcomes the opportunity to comment on the Basel Committee on Banking Supervision ("the Committee") Guidance on Accounting for Expected Credit Losses ("ECL") Consultative Document ("the Guidance").

Throughout the life of the International Accounting Standards Board's (IASB) impairment project we have consistently supported the effort to move from an incurred loss model to one which is based on expected losses. We therefore support the Committee's overall objective of setting out overarching principles to ensure that credit losses are recognised in accordance with accounting standards. We also agree the banking industry should have a high quality implementation of IFRS 9 and that the implementation of an ECL model for accounting purposes should build upon a firm's existing internal credit risk management practices.

Whilst we support the broad thrust of the principles outlined in the Guidance, we believe there are a number of areas where the Guidance could be clarified or enhanced. We believe the final Guidance should clearly state that its overarching principle is to have loan loss provisions that are inextricably linked to the application of expert credit risk management techniques, judgment and procedures. At the moment, the Guidance uses certain language and presents requirements that could unnecessarily restrict credit risk managers and limit the application of credit risk management techniques.

In particular, we are concerned that in a number of instances the Guidance does not explicitly state that forward looking information and other credit related data should be: relevant, reasonable and supportable with credit risk management techniques and the application of expert judgement. There are six areas where we believe the Guidance requires clarification to achieve its objectives:

1. **Forward Looking Information:** the use of forward looking information is a central element of determining impairment in accordance with IFRS 9. However, we believe it is important to focus on incorporating "relevant" forward looking information, not the "full spectrum". As Internal Ratings Based Approach (IRBA) Bank, we already incorporate a wide range of forward looking information into our risk management processes, which we believe should be the starting point for a high quality implementation of IFRS 9. We believe the Guidance should encourage and clearly state that existing risk management processes should be enhanced in order to meet the requirements of the Guidance.

2. **Significant Increase in Credit Risk:** the Guidance may be interpreted to require banks and auditors to give greater prominence and weighting to specific indicators to reflect on increase in credit risk, rather than considering all relevant information. We do not believe that this consistent with IFRS 9 B5.5.17 which requires consideration of all relevant factors and does not give prominence to any select factors.

3. **Proportionality and Materiality:** the proportionality principle should not be limited to less complex banks. Rather it should be applicable to any banks portfolios based on its materiality, relative size and lower complexity. The Guidance should include a new overarching paragraph that states clearly that the Guidance does not override the concept of materiality in IFRS.

4. **Scope of Guidance:** the Guidance should be focused on bank's general lending policies, procedures and underwriting standards at origination when assessing and measuring the ECL. It should not provide a specific list of items regarding various aspects of a borrower's circumstances, as there is already supervisory guidance addressing credit risk management practices themselves.

5. **Segmentation:** rather than emphasising re-segmentation, we believe that the Guidance should stress the need for appropriate governance and review of the model. Overall we believe that re-segmentation must be the result of a review of supportable evidence and would primarily be driven by the underlying model used to support the decision if a segment is no longer appropriate.

6. **Use of the term robust:** the use of "robust" accounting estimates is not aligned with IFRS 9 and should be adjusted accordingly. IFRS 9 B5.5.51 states an entity need not undertake an exhaustive search for information but shall consider all "reasonable and supportable" information that is available without undue cost and effort and that is relevant to the estimate of ECL.

In addition to our comments on these areas, we include some specific drafting suggestions in the attached Appendix, which could be useful to refocus the Guidance to ensure that banks apply expert credit risk management as the means to account for expected credit losses, rather than a checklist of approach of indicators as outlined in the Guidance.

Please do not hesitate to contact us if you have questions or wish to discuss these issues further.

Yours sincerely,

Daniel Trinder
Global Head of Regulatory Policy

Appendix

Topic 1 - Forward Looking Information

The use of forward looking information is a central element of determining impairment in accordance with IFRS 9. Paragraph 5.5.4 of IFRS 9 asks reporting entities to consider "all reasonable and supportable information, including that which is forward-looking." We agree that banks should use the most complete dataset that is available, however we believe there should be limits to the extent to which banks must search for information. B5.5.51 of IFRS 9, states that an entity does not need to undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost and effort and that is relevant to the estimate of Expected Credit Losses (ECL).

As an IRB Advanced Approach Bank, we already incorporate a wide range of forward looking information into our risk management processes, which we believe should be the starting point for a high quality implementation of IFRS 9.

For example, in our wholesale loan portfolios, we reflect forward looking information as part of our client rating process. This focuses on changes to the client's industry outlook, changes to a client's forward looking cash flow projections with respect to its debt service capability, on assessing changes to a client's strategy or future business objectives. We also monitor clients for any changes in their future prospects to determine if there is a need to migrate them to a watch list or potentially to a loan workout.

In our retail loan portfolios we have automated credit scoring procedures in place which consider the behaviour of retail clients as a method of incorporating forward looking information. Some of the relevant information we use in behavioural scoring includes assessing a client's use of its current accounts, information from external credit bureaus and information specific to a clients domicile. While we are currently analysing if any modifications will need to be made to ensure that the current approaches comply with the IFRS 9 requirements, we believe that the current approaches are a solid basis for incorporating forward looking information and should be used as a starting point in our analysis.

The Guidance should clearly state that existing risk management processes, as those highlighted above, which already incorporate macroeconomic and forward looking information should be the starting point for financial institutions applying a high quality implementation of IFRS 9 and in accordance with the principles outlined in the Guidance. We do not see benefit in banks being required to establish a new process to meet the requirements of the Guidance.

In addition to the comments above, we believe it is important for the Guidance to focus on requiring banks to use "relevant" forward looking information, not the "full spectrum". It is our view that the use of relevant forward looking information will lead to a high quality implementation of IFRS 9. We therefore provided some suggestions for the Committee to take on board when discussing the further development of this Guidance.

Paragraphs 26, 30, 59 and 60 – Whilst we agree with the overall sentiment in Principle 2 and 6, we are concerned with some of the language outlined in Paragraphs 26, 30, 59 and 60 which implies that we would be expected to conduct exhaustive searches of all forward looking information. We believe this requirement in the Guidance creates a higher standard than IFRS 9. As mentioned above, IFRS 9 Paragraph 5.5.4 only requires entities to consider "all reasonable and supportable information, including that which is forward-looking." In addition Paragraph B5.5.51 states that a reporting "entity need not undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost and effort and that is relevant to the estimate of ECL". Therefore we believe it is important for the Guidance to recognise that a bank is allowed to use its experienced credit judgment to determine exactly what forward looking information is deemed relevant or not. We therefore recommend the following changes to Paragraphs 26, 30, 59 and 60:

> 26. Management should consider ~~a wide range of~~ the relevant facts and circumstances that are likely to cause ECL to differ from historical experience and that may affect the full collectability of cash flows.
>
> 30. While a bank need not necessarily identify or model every possible scenario through complex scenario simulations, the Committee expects it to consider the ~~full spectrum of~~ information that is relevant to the product, borrower, business model or economic and regulatory environment when developing estimates of ECL. ~~In developing such estimates for financial reporting purposes, a bank should consider the experience and lessons from similar exercises it has conducted for regulatory purposes, although the Committee recognises that stressed scenarios developed for regulatory purposes are not intended to be used directly for accounting purposes.~~ Forward-looking information and related credit quality factors used in regulatory expected loss estimates should be consistent with inputs to other relevant estimates within the financial statements, budgets, strategic and capital plans, and other regulatory reporting.
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> 59. Banks should have the necessary tools to ensure a ~~robust~~ reasonable and supportable estimate and timely recognition of ECL. Information on historical loss experience or the impact of current conditions may be limited or not fully relevant to lending exposures currently held by the bank or expectations of future conditions. In that context, a bank must use its experienced credit judgment to thoroughly incorporate the expected impact of all reasonably available and relevant forward-looking information and macroeconomic factors on its estimates of ECL. A bank's use of its experienced credit judgment must be documented in the bank's credit risk methodology.
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> 60. The Committee understands that it is challenging and costly to incorporate forward-looking information and macroeconomic factors into the estimate of ECL and that ECL estimates will inherently have a significant degree of unavoidable subjectivity. Nevertheless, in the Committee's view, consideration of relevant forward-looking information and macroeconomic factors is essential to the proper implementation of an ECL accounting model, and therefore these costs should not be avoided on the basis that a bank considers them to be excessive or unnecessary.

Paragraph 63: We would like to advise the Committee to remove the word "prudence" from the text, because it implies that there is a conservative bias. This is not consistent with the estimate of ECL being neutral, i.e. neither being overstated or understated:

> 63. In estimating ECL, banks may determine either a single amount or a range of possible amounts. In the latter case, the Committee expects that banks will exercise ~~prudence~~, ~~defined as exercising~~ appropriate care and caution when determining the level of ECL and the allowances to be recognised for accounting purposes to ensure that the resulting estimate is appropriate (i.e. consistent with neutrality and neither understated nor overstated).

Paragraphs A23 and A24 – We believe that paragraphs A23 and A24 will require a higher standard of implementation and support than that required by IFRS 9. This is explicitly not the intention of this Guidance and should therefore be removed from the text. The wording in Paragraph A23 suggests a direct correlation between macroeconomic development and credit risk which would not be realistically supported in practice or could not be universally extrapolated with the degree of accuracy suggested in the paragraph text. In addition, the suggestion in Paragraph A24 that this could be performed at the individual exposure level is also another requirement we do not believe is realistic other than macroeconomic information already incorporated as a part of the existing client rating review process.

~~A23. For example, within retail portfolios adverse developments in macroeconomic factors and borrower attributes (such as the sector from which they earn their primary income) will generally lead to an increase in the objective level of credit risk long before this manifests itself in lagging information such as delinquency. Thus, the Committee believes that, in order to meet the objective of IFRS 9 in a robust manner, banks will need to have a clear view – supported by persuasive analysis – of the linkages from macroeconomic factors and borrower attributes to the level of credit risk in a portfolio. This will be obtained through analysis of data for the past, adjusted using experienced credit judgment for differences between historic, current and forward-looking information and macroeconomic factors.~~

~~A24. The Committee expects analyses of this kind to be also performed for large, individually managed exposures. For example, for a large commercial property loan, banks must take account of the considerable sensitivity of the commercial property market in many jurisdictions to the general macroeconomic environment, and use information such as levels of interest rates or vacancy rates to determine whether there has been a significant increase in credit risk.~~

Topic 2 – Significant Increase in Credit Risk

IFRS 9 does not define significant deterioration in credit risk, but leaves it to the respective banks to individually develop definitions, which have to be disclosed under IFRS 7 to allow users to understand the bank's approach. IFRS 9 B5.5.17 provides a non exhaustive list of factors which banks should consider (in addition to considering other relevant information) in determining whether there has been a significant increase in credit risk. We fully support this approach as it allows banks to leverage existing credit risk management practices and reflect risks inherent in the portfolios.

However, paragraph A27 of the Guidance provides six factors which banks must 'pay particular attention to' and make a determination of whether there has been a significant increase in credit risk. These six factors appear to be similar, but are not all inclusive to those included in IFRS 9. B5.5.17. Similarly, paragraph A28, which states that macroeconomic factors should also be taken into account in the assessment of whether there has been a significant increase in credit risk, is also already included as a factor in IFRS 9.

As currently drafted, the Guidance in Paragraphs A27 and A28 may be interpreted as requiring banks and auditors to give greater prominence and weighting to those six specifically listed indicators, rather than considering all relevant information. We do not believe that this is consistent with IFRS 9. B5.5.17 which requires consideration of all relevant factors and does not give prominence to any select factors.

Furthermore, we do not believe that the "rebuttable presumption" in Footnote 33 fully appreciates that loan pricing includes other factors which are not indicators of an increase in a client's credit risk. For example, loan pricing will change based on liquidity, the bank's own cost of funds, profit margin, the bank's risk appetite and its strategy. As a result, a bank may price a loan differently from one period to the next, not because the credit risk has increased, but because liquidity in the market has changed, its cost of funding increases or a bank may be seeking to exit a business that is no longer its core strategy. The rebuttable presumption as stated in the Guidance refers to "any increase in credit spread", which would be impossible to rebut unless we can specifically distinguish increases in credit spread from changes in gross margin due to other factors to an auditable standard. Therefore we believe Paragraph A27 should be amended to refer to the factors in IFRS 9. B5.5.17.

A27. While it is neither possible nor desirable for universally applicable criteria to be developed, the Committee emphasises that ~~the presence of any of conditions (a)–(f) below would suggest that there has potentially been a significant increase in credit risk. Banks should take~~ particular care <u>should be taken by banks</u> to avoid the risk of a significant increase in credit risk not being acknowledged promptly when it is, in fact, present. In forming their assessments, banks should pay particular attention to the factors <u>outlined in IFRS9 B5.5.17</u>~~listed below:~~

~~(a) a discretionary decision by management such that, were an existing loan newly originated at the reporting date, the element of the price of the loan that reflects the credit risk of the exposure would be higher than it was when the loan was actually originated as a result of the change in credit risk since inception;33~~
~~(b) a decision by management to strengthen collateral and/or covenant requirements for new exposures that are similar to exposures already advanced because of changes in the credit risk of those exposures since initial recognition;~~
~~(c) a downgrade of a borrower by a recognised credit rating agency, or within a bank's internal credit rating system;~~
~~(d) for performing credits subject to individual monitoring and review, an internal credit assessment summary indicator that is weaker than upon initial recognition;~~
~~(e) deterioration of relevant factors (eg future cash flows) for an individual obligor (or pool of obligors); and~~
~~(f) expectation of forbearance or restructuring.~~

~~A28. In addition, the assessment of whether there has been a significant increase in credit risk of a lending exposure should take full account of the more general factors below:~~
~~(a) deterioration of the macroeconomic outlook relevant to a particular borrower or group of borrowers. Macroeconomic assessments must be sufficiently rich to include factors relevant to sovereign, corporate, household and other types of borrower. Furthermore, they must address any relevant regional differences in economic performance within a jurisdiction. See principle 6 in the main section of this guidance for additional considerations for forward-looking information and macroeconomic factors; and~~
~~(b) deterioration of prospects for the sector or industries within which a borrower operates.~~

Topic 3 – Materiality and Proportionality

Two related areas that we believe the Committee should revisit within the Guidance are Materiality and Proportionality, given their impact on bank practice. Below we provide some additional recommendations of where we believe the Guidance could be further improved.

Materiality
The concept of materiality is a fundamental principle of all financial reporting. The IASB Conceptual Framework QC11 states that, "Information is material if omitting or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity". A similar concept exists in IAS 8.5 with its definition of materiality, omissions or misstatements of items are material if they could, by their size or nature, individually or collectively; influence the economic decisions of users taken on the basis of the financial statements. Therefore we believe that a new overarching paragraph should be added into the final document that states clearly that the Guidance does not override the concept of materiality in IFRS.

Materiality as defined under IFRS, should also apply to the Guidance i.e. a material portfolio of highly rated loans should be subject to the principles in this Guidance even if the current P&L impact of any provisioning would be immaterial in the financial statements.

Materiality is also a useful tool in understanding how to allocate risk management resources within a bank. It would not be consistent with a high-quality implementation if resource allocations failed to take into account the materiality of portfolios. More unique and complex portfolios should have more resources allocated to them, whilst less complex portfolios should have less resources allocated to them. An approach that fails to take into account materiality at any level, would lead to increased operational risk and a low quality implementation, as risky portfolios would receive the same level of attention as those of lower complexity.

For this reason we believe the materiality thresholds applicable under IFRS should also be applied to the Guidance and materiality thresholds should be dynamically monitored as the relative size and riskiness of portfolios may change over time.

Proportionality

While we welcome the allowance for a proportional approach for less complex banks as outlined in Paragraph 12, we do not believe the approach to proportionality is far reaching enough. The Guidance does not allow more complex banks to apply a similar approach for their smaller, less complex portfolios. We believe a pre-requisite for the development of a high quality model and output is the use of statistically sound data sets, and often for smaller less complex or immaterial portfolios these data sets do not exist.

Larger and more complex banks often have small locations or small portfolios and face similar issues in developing appropriate models and processes as less complex banks. Hence we believe that the proportionality principle should not be limited to less complex banks only, rather it should be applicable to any banks portfolios based on its materiality, relative size and lower complexity. We therefore propose to amend Paragraph 12 as follows:

> 12. ~~For less complex banks,~~ Consistent with the Basel Core Principles, the Committee recognises that supervisors may adopt a proportionate approach with regard to the standards that supervisors impose on banks and the conduct of supervisors in the discharge of their own responsibilities. This allows ~~less complex~~ banks to adopt approaches commensurate with the size, nature and complexity of ~~their~~ lending exposures, or the size, nature and complexity of entities (such as smaller subsidiaries or locations of banking groups); in so doing, banks should consider the range and availability of data available to those subsidiaries or locations).

We also believe Paragraph 24 should be referenced to the proportionality principle as per our revision to Paragraph 12 above.

> 24. At a minimum, a bank should adopt and adhere to written policies and procedures, subject to the proportional approach as described in paragraph 12, detailing the credit risk systems and controls inherent in the methodology and the separate roles and responsibilities of the bank's board and senior management. Though not an all-inclusive list, a robust and sound methodology for assessing credit risk and measuring the level of allowances will:

Paragraphs A46 and A49, as currently drafted, state that the use of such practical expedients is consistent with a low-quality implementation of the standard and cost should not be an excuse for avoiding developing IT systems. As such, we believe that the Guidance as drafted would not allow auditors and regulators to adopt a proportionate approach to smaller locations or smaller portfolios of more complex banks. As we note above, we believe that it would not be consistent with a high-quality implementation if resource allocations did not take into account the size or even materiality of portfolios. More unique and complex portfolios should have more resources allocated to them, whilst less complex and smaller, less material portfolios should logically have less resources allocated to them. Consequently, without revision to these paragraphs we believe the use of proportionate techniques will not be accepted by regulators or auditors if we lack the ability to build statistically significant data sets.

> A46. IFRS 9 includes a number of practical expedients, intended to ease the implementation burden for a wide range of companies in recognition of the fact that IFRS 9 will be used by a variety of entities, including firms outside the banking industry. The Committee regards many of these practical expedients as inappropriate for use by internationally active banks and those banks more sophisticated in the business of lending, particularly because – given their business – the cost of obtaining relevant information is not considered by the Committee to be

likely to involve "undue cost or effort". However the use of practical expedients may be consistent when adopting a proportional approach as outlined in Paragraph 12.

A49. IFRS 9 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 Committee expects that banks will not read these statements restrictively. Since the objective of the IFRS 9 model is to deliver fundamental improvements in the measurement of credit losses, the Committee expects banks to develop systems and processes to use all reasonable and supportable information needed to achieve a high-quality, robust and consistent implementation of the approach. This will potentially require costly upfront investments in new systems and processes but the Committee considers that the long-term benefit of a high-quality implementation far outweighs the associated costs, which should therefore not be considered undue. However the Committee recognises that banks will need to adopt approaches commensurate with the size, nature and complexity of ~~their~~ lending exposures, or the size, nature and complexity of group entities (such as smaller subsidiaries or locations of banking groups); in so doing, banks should consider the range and availability of data available to those group subsidiaries or locations).

Topic 4 – Scope of Guidance – Credit Underwriting Practice and Interaction with Accounting for ECL

As stated above, we believe that the focus of the Guidance should be on how ECL models should build on existing credit risk management practices. Paragraph 27 (b) - (i) contains a list of specific factors related primarily to the borrower's circumstances that should be assessed by the bank in measuring and assessing ECL. We believe that the guidance in paragraph 27 should be focused on considering a bank's general lending policies, procedures and underwriting standards at origination when assessing and measuring the ECL, as there is already supervisory guidance addressing credit risk management practices themselves. We therefore recommend the following revisions to paragraph 27:

27. In assessing and measuring the appropriate level of credit risk for ECL purposes, with respect to factors related to the character, capacity and financial resources of borrowers, the terms of lending exposures and the values of assets pledged as collateral, or other credit risk mitigants, a bank should ~~assess~~ consider~~:~~

~~(a)~~ its lending policies and procedures, including its underwriting standards and lending terms, that were in effect upon initial recognition of the borrower's loan, and whether the loan was originated as an exception to this policy. A bank's lending policy should include details of its underwriting standards, and guidelines and procedures that steer the bank's lending approval process, for the purposes of making this assessment.

~~(b) a borrower's sources of recurring income available to meet the scheduled payments;~~

~~(c) a borrower's ability to generate a sufficient cash flow stream over the term of the instrument;~~

~~overall leverage level and expectations of changes to leverage;~~

~~(e) unencumbered assets the borrower may pledge as collateral in the market or bilaterally in order to raise funds and expectations of changes to the value of those assets;~~

~~(f) one-off events and recurring behaviour that may affect the borrower's ability to meet contractual obligations;~~

~~(g) the extent of a bank's adherence to best practices with respect to loan underwriting;~~

~~(h) timely evaluations of collateral value and consideration of factors that may impact the future value of collateral (bearing in mind that collateral values directly affect estimates of loss-given-default); and~~

~~(i) all other relevant information~~

Paragraph 31 (a) - (h) provides a list of potentially inadequate underwriting practices. However, we note that this topic is already covered by other bodies of regulation and prudential supervision. Rather than providing a list of the possible inadequate underwriting practices, we believe that the Guidance should focus on the analysis of the link between increases in credit risk (considering its underwriting practices) and accounting for ECL under IFRS.

> 31. For the purpose of assessing increase in credit risk in accordance with the new accounting standards, a bank ~~management~~ should consider ~~should be able to demonstrate~~ its ~~adherence to sound~~ underwriting practices in light of the applicable sound underwriting practices and the price at which lending exposures are granted ~~appropriately reflects inherent risks~~. Post-initial recognition increases in credit risk require a bank to reassess ECL and re-measure the amount of the allowance that should be recognized in accordance with the applicable accounting framework. ~~Examples of fact patterns potentially showing inadequate underwriting practices may include:~~
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> > ~~(a) the granting of debt to borrowers based on fragile income streams (that could become non-recurrent upon a downturn) or with no documentation or limited verification of borrower income sources;~~
> > ~~(b) high debt servicing requirements as compared with the borrower's net available expected cash flows;~~
> > ~~(c) flexible repayment schedules, including payment vacation, interest-only payments (eg bullet loans) or negative amortisation features;~~
> > ~~(d) for real estate financing, lending of amounts equal to or exceeding the value of the financed property or otherwise failing to provide a margin of collateral protection;~~
> > ~~(e) increases in troubled debt restructurings and other concessions or modifications to lending exposures;~~
> > ~~(f) circumvention of the classification and rating requirements, including rescheduling, refinancing or reclassification of lending exposures;~~
> > ~~(g) undue increases in the volume of credit, especially in relation to the increase in the volume of credit by other lenders in the same market; and~~
> > ~~(h) increasing volume and severity of delinquent, low-quality and impaired credit.~~

Paragraph 32 appears to repeat the IFRS 9 requirements in relation to restructured loans and credit impaired loan purchases and requires banks to have procedures in place to comply with IFRS 9 in these two specific areas. We therefore believe Paragraph 32 can be deleted.

Topic 5 – Segmentation

We agree with the statement in paragraph 46 that exposures must not be grouped in a such a way that an increase in the credit risk of particular exposures is masked by the performance of the segment as a whole; clearly this would not be consistent with a high quality implementation of an ECL model. We are concerned that the requirements as drafted in Paragraphs 46, 47 and 48 of the Guidance would imply that there must be frequent segmentation and re-segmentation of portfolios. As an effect of this frequent re-segmentation portfolios could be created for which statistical data cannot be verified appropriately.

In segmenting portfolios, based on shared credit risk characteristics, we typically require granular databases to identify common risk factors. At the same time we need to balance the need for granularity with the size of portfolios on which relevant and reliable statistical data exists, to ensure that risk management is properly reflected.

It is important to note that in the initial phase of development of models, an assessment of the risk drivers for the underlying exposures is made by credit risk management considering these shared credit risk characteristics. Furthermore, all models are subject to our internal governance procedures which require senior management review and approval of the model at inception. This process is further supported by ongoing regular reviews to ensure that the model remains appropriate considering the underlying risks of the portfolio and changing economic conditions. While re-segmentation may be employed by credit risk management as one of the measures to ensure that the allowances are appropriate, there may be others – such as the regular re-calibration of ECL parameters (such as Loss Given Default), which is calculated separately for portfolio with different credit risk characteristics.

Rather than emphasising re-segmentation, we believe that the Guidance should stress the need for appropriate governance and review of the model. Overall we believe that re-segmentation must be the result of a review of supportable evidence and would primarily be driven by the underlying model used to support the decision if a segment is no longer appropriate.

In relation to segmentation we believe that paragraphs 46-48 should be amended in the Guidance to better reflect risk management practices.

> 46. Exposures must not be grouped in such a way that an increase in the credit risk of particular exposures is masked by the performance of the segment as a whole. In general, it is expected that a bank's normal credit risk management and independent model review functions will review and, where necessary, revise models and ECL applications, among other things to ensure that the ECL allowance is appropriately updated from initial measurement. ~~Where changes in credit risk after initial recognition affect only some exposures within a group, those exposures must be segmented out of the group into relevant subgroups, to ensure that the ECL allowance is appropriately updated.~~
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> ~~47. Where it is assessed that the level of credit risk has increased on a group basis (which assessment includes consideration of forward-looking information), the entire group should migrate to a higher credit risk rating, indicative of lower credit quality. In addition, a bank should consider the potential effect on other groups or individual exposures held by the bank. This may in some cases require a bank to also perform a credit risk assessment on an individual basis.~~
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> 48. The grouping of exposures should be re-evaluated in connection with a bank's ongoing review of credit risk models as stated by IFRS 9 BC5.142 and exposures should be re-segmented whenever relevant new information is received or a bank's expectations of credit risk have changed and the grouping is no longer deemed to be appropriate. ~~The group of exposures assigned should receive a periodic formal review (e.g. at least annually or more frequently if required in a jurisdiction) to reasonably ensure that those groupings are accurate and up to date~~.

Topic 6 – Use of the Term Robust

Although we understand the use of "robust" in the Guidance in relation to credit risk management processes and controls, we are concerned about the use of the word robust in the context of accounting estimates. We also do not believe the use of robust accounting estimates is aligned with IFRS 9. IFRS 9 Paragraph 5.5.51 states that an "entity does not need to undertake an exhaustive search for information but shall consider all reasonable and supportable information that is available without undue cost and effort and that is relevant to the estimate of ECL". Therefore, we believe it is more appropriate to replace the use of "robust" with "reasonable and supportable". As there are several paragraphs where robust is used in this context, we have listed those paragraphs we suggest are revised below (except paragraphs already highlighted above):

> Principle 2: A bank should adopt, document and adhere to sound methodologies that address policies, procedures and controls for assessing and measuring the level of credit risk on all

lending exposures. The ~~robust~~ reasonable, supportable and timely measurement of allowances should build upon those methodologies.

Principle 10: Banking supervisors should be satisfied that the methods employed by a bank to determine allowances produce a ~~robust~~ reasonable and supportable measurement of expected credit losses under the applicable accounting framework.

50. A ~~robust~~ reasonable and supportable assessment of allowances takes into account relevant factors at the reporting date that may affect the collectability of cash flows over the life of a group of lending exposures (or a single lending exposure). The information set considered must go beyond historical and current data, to include forward-looking information and macroeconomic factors.

58. (c) Validation scope and methodology
The validation of internal credit risk assessment models is a systematic process of evaluating the model's performance on a current and forward-looking basis. This includes the model's ~~robustness~~ appropriateness, consistency and accuracy as well as its continued relevance to the underlying portfolio. Validation can help to identify potential limitations of a model, lead to prompt remediation and offer insights into how improvements could potentially be achieved in future models.

58. (c) *(ii) Model design*
For model design, there is a need to ensure that the underlying assumptions of the models are relevant. This entails close monitoring of key model assumptions against actual portfolio behaviour to ensure that the model serves its intended purpose, and that key model changes over time are documented with comprehensive explanations and justification. Validation should demonstrate that the underlying theory of the model is conceptually sound, recognised and generally accepted. From a forward-looking perspective, validation should also assess the extent to which the model, at the overall model and individual risk factor level, can accept plausible stresses in the economic environment and/or possible changes to portfolio business profile or strategy without significantly reducing model ~~robustness~~ appropriateness.

82. Banking supervisors have policies that call for the prudential review of a bank's lending and credit risk assessment functions on a periodic basis and for recommending improvements where necessary. Supervisors should be satisfied that:

> (f) management judgment has been exercised in a ~~robust~~ reasonable and supportable manner and is well documented; and

A2. The Committee expects banks to adopt an active approach to assessing and measuring 12-month ECL that enables changes in credit risk to be identified on a timely basis. In accordance with principle 6 of the main section of this guidance, estimates of the amount and timing of 12-month ECL should reflect management's experienced credit judgment, and take into account the range of possible future scenarios. The methodology used to estimate 12-month ECL should be ~~robust~~ reasonable and supportable at all times and should allow for the timely build-up of allowances