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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
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15th July, 2016

Dear Sir/Madam:

Re: Consultation Paper: Guidelines on Prudential treatment of problem assets – definitions of non-performing exposures and forbearance

The IBFed¹ appreciates this opportunity to comment on the Basel Committee on Banking Supervision (BCBS) Guidelines on Prudential treatment of problem assets – definitions of non-performing exposures and forbearance.

General comments

The IBFed recognizes that the objective of the Basel Committee is to harmonize definitions of non-performing exposures and forbearance to ensure consistency of application, transparency, and the comparability of risk parameters amongst banks. The need for harmonization of definitions is further reinforced by the fact that rating agencies consider the non-performing assets ratio in their overall rating assessment. Harmonized definitions are therefore of interest and relevant to our members as well.

However, banks operate in unique environments and different practices have emerged due to individual accounting, regulatory and tax standards in different jurisdictions which could make it challenging to achieve harmonization. Furthermore, it may be appropriate to have regional differences given the enduring differences in the respective business and regulatory environments. Such practices

¹ The International Banking Federation (IBFed) was formed in March 2004 to represent the combined views of national banking associations from around the world. The countries represented by the Federation collectively represent more than 18,000 banks with 275,000 branches, including around 700 of the world's top 1000 banks which alone manage worldwide assets of over \$31 trillion. The Federation represents every major financial centre and its members' activities take place in every time zone. This worldwide reach enables the Federation to function as the key international forum for considering legislative, regulatory and other issues of interest to the global banking industry. For more information visit: www.ibfed.org

promote comparability amongst banks' most immediate peers, which may not have been fully captured in the survey conducted, given that only 39 banks (from 28 different regions) were surveyed.

For example, consideration of collateralization is not allowed in the evaluation of credit risk within IFRS 9 or in the existing EU regulation (it is taken into account only to calculate the impairment or the risk exposure), although it is expected to continue to often be a critical element of consideration within the U.S. under the CECL accounting standard.

The IBFed is concerned that the new definitions proposed by the draft Guidelines may unnecessarily increase credit quality disclosures, and instead of complementing existing disclosures and may lead to confusion as the reader may have difficulty distinguishing the differences between non-performing and credit impaired classifications.

Finally, the proposed definitions would require a certain amount of investment in internal processes and IT infrastructure, depending on how substantially the current practices vary from the proposed definitions. Given the lack of granularity in the proposal, it is challenging to fully assess any technological, operational and cost implications of implementation. In jurisdictions where only defaulted or credit impaired exposures are considered non-performing, the proposals will represent a material change which is expected to substantially increase the non-performing loans ratio.

With the above concerns in mind and given the ongoing complexity of the implementation of expected loss models, we would suggest that before issuing final proposals the Basel Committee further engages with the industry and the accounting standard setters to fully understand and assess the implications of the proposal on the accounting standards and regulatory capital rules.

Accounting implications

It should be clearly acknowledged in the Guidance that the accounting process is independent from the Guidelines, although we appreciate that in many cases the accounting classification and measurement results could be the same.

Overall, the IBFed members would like to communicate that there is lot of confusion about the implications of these Guidelines and their interaction with the relevant accounting frameworks. If approved, the proposed definitions will be a source of significant ongoing confusion among banks' investors. In the United States, for example, the troubled debt restructuring (which largely resembles forbearance) and the nonaccrual loan concepts have been in place for years. Investors will need significant ongoing education and reconciliation of figures produced for financial statement purposes to those reported in regulatory reports. A change in definition will render much of the historical data they rely on useless. Whether intended for financial reporting or not, bank investors will attempt to analyse the data and this will be a cause for confusion.

We also believe any change in definitions will inevitably cause confusion in how investors will understand IFRS 9 results and classifications. This confusion is driven largely by differences in understanding of the non-performing classification. In some jurisdictions, non-performing is considered synonymous with both "credit impaired" and "default" and associated with stage 3 assets in the forthcoming IFRS 9. The institutions in these jurisdictions relate the non-performing notion to the recognition of interest (stage 3 of IFRS 9 – credit impaired). The notion of non-performing is currently considered equivalent to defaulted in prudential terms and credit impaired in accounting terms.

In other jurisdictions, non-performing is not necessarily associated with credit impaired or defaulted status. In Europe, for example, where EBA Guidance on non-performing assets has been in place since 2015, the non-performing notion as defined by EBA (regulatory term) could be associated with both stage 2 or stage 3 IFRS 9 asset classifications since not all non-performing exposures will be defaulted. While exposures in stage 3 under IFRS 9 (exposures where the credit risk of a financial

asset increases to the point that is considered credit impaired) will be defaulted and therefore also non-performing in prudential terms, it cannot be assumed that all non-performing loans as defined by the prudential framework would be in stage 3 under IFRS 9.

Loans that are not defaulted but would be categorized as not performing according to paragraph 24 iii b under the prudential framework, will in most circumstances be in stage 2 (assuming there is a significant increase in credit risk which is the IFRS 9 criterion for moving loans in stage 2) until credit impaired, when they will be moved in stage 3.

To avoid any misunderstanding, we believe it should be clearly acknowledged that classification of an asset to Stage 2 is not considered an indication of default (from the prudential perspective). It is expected that most defaulted loans under prudential framework will be in stage 3. Exceptions may relate to loans that are no longer considered credit impaired but due to the probation period imposed by the regulatory framework, are still considered defaulted in regulatory terms.

In addition, we do not believe that the classification of an exposure as forborne should automatically be considered to be a driver for classification of an exposure to stage 2 (lifetime expected losses) under IFRS 9. Under IFRS 9, the criterion for classification of the exposure to stage 2 will be the “significance of the credit risk increase since origination”.

Given the existence of the probation period under the prudential framework and the symmetrical approach of IFRS 9, there will be stage 1 exposures that may be classified as forborne in prudential terms but that are no longer considered to have significantly increased risk since origination.

Therefore we believe that the interaction with the accounting frameworks has to be clarified to avoid any doubts.

The IBFed would welcome the opportunity to engage in dialogue with the BCBS with the objective to gain clarity and a common understanding of the implications of the proposals in the Basel Guidance, with the ultimate goal to avoid any possible unintended consequences.

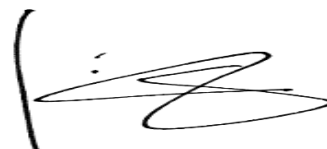
Yours sincerely,



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