ICAEW REPRESENTATION 68/15

GUIDANCE ON ACCOUNTING FOR EXPECTED CREDIT LOSSES

ICAEW welcomes the opportunity to comment on the Consultation Document (CD) *Guidance on accounting for expected credit losses* published by Basel Committee for Banking Supervision on 2 February 2015, a copy of which is available from this link.

This response of 30 April 2015 has been prepared on behalf of ICAEW by the Financial Services Faculty. As a leading centre for thought leadership on financial services, the Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City

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MAJOR POINTS

Welcoming the initiative

1. We welcome the opportunity to comment on the Consultative Document (CD), *Guidance on accounting for expected credit losses*. The introduction of accounting for expected credit losses in IFRS 9 *Financial Instruments* and the forthcoming *Accounting Standards Update* in US GAAP represent a significant change and challenge for preparers, investors, securities regulators and the auditors of lending institutions. We recognise that prudential supervisors and the wider regulatory community have expressed significant interest throughout the course of the development of these standards. Following the finalisation of the IFRS standard we acknowledge that prudential supervisors have opinions on how they expect it to be implemented and wish to make those views clear especially as they relate to the interaction between credit risk management principles and expected loss accounting.

2. We welcome the initiative taken by the Basel Committee to provide guidance on where supervisory principles for sound credit risk practices affect the accounting for expected credit losses (ECL). We consider that a single set of authoritative guidance that is applicable to banks across geographies is more likely to be effective in encouraging consistent implementation of IFRS 9 than similar efforts made at a national level.

More clarity needed between credit risk management and accounting guidance

3. We support the 11 principles setting out the ‘Supervisory requirements for sound credit risk practices that interact with expected credit loss management’. However, the document in fact includes guidance on both credit risk management and accounting. It is important that the Committee makes clear which aspects of the guidance relate to which topic in order to avoid confusion especially given the differing objectives of each framework.

4. Effective guidance in this area should encourage more consistent and higher quality implementation of IFRS 9 through alignment of credit risk practices and expected credit loss accounting where this is appropriate. Whilst we believe that producing guidance with these aims was and remains the Committee’s intention we urge the Committee to take note of our detailed comments which we believe will improve the effectiveness of the guidance in achieving its stated objective. Further clarity on aspects of scope, the Committee’s expectations regarding proportionality, materiality, consistency with IFRS 9 and the interpretation of modelling and segmentation will, in our opinion, lead to the guidance being considerably more effective than currently it is. Such drafting improvements are not merely cosmetic.

Guidance can only limit measurement differences so far

5. Whilst we believe guidance of this type can be of assistance in narrowing certain approaches to the standard, our firm view is that, due to the inherent judgement and uncertainty associated with expected loss, accounting guidance of this nature will not achieve conformity of measurement outcome across financial institutions. Whilst it may in many (but by no means all) cases be possible to source reliable and supportable forecasts of economic factors and accurate historical data sets that can be used in expected loss calculation, these calculations will nevertheless require very considerable expert judgement and we therefore expect the range of reasonable and supportable expected loss outcomes to be wide in many cases. This is partially acknowledged in paragraph 71 which states that “the guidance seeks to narrow different interpretations and practices in these areas of the accounting requirements, *to the extent possible*, through the application of consistent and sound credit risk practices” (our italics). It would be helpful if the Committee would acknowledge that - given the differences in accounting requirements between IFRS and the US and the fundamental concept of expected loss - it is not realistic to suggest that outcomes between banks can be aligned.

Bank supervisors are not accounting standard setters

6. We support the concept of a single set of high quality, global financial reporting standards for banks, other financial institutions and all listed companies. In order to promote this goal, it is important to avoid the creation of multiple interpretations of international standards for different purposes as this could, over time, seriously undermine the consistency of financial reporting between different jurisdictions or industries. IFRS 9 was developed after extensive consultation, due process and deliberation. We believe that if it is necessary to create further authoritative financial reporting guidance, it should be done through the IASB and its Interpretations Committee.

7. At the same time, we recognise the legitimate interests of banking supervisors in this area and support the use of their powers, to use different measurement bases for regulatory purposes and/or to provide more specific guidance for regulatory purposes. We also recognise that if prudential supervisors do require banks to use a narrower approach than IFRS 9 (but within the range of the standard) for the purposes of, for example, calculating regulatory capital, then the banks are likely to apply this in their financial statements when it does not create a conflict with the standard. This is an important distinction and the guidance should be clear that it is intended to cover regulatory reporting rather than necessarily providing authoritative interpretations of IFRS, which in our view could set a worrying precedent.

8. We do not object to the Committee indicating a preference for limited use of particular simplifications and practical expedients offered in IFRS 9, especially in circumstances where it believes that more extensive use would result in a lower quality implementation of the standard. But should such an approach be pursued we urge strongly that it should be applied only where there is a clear consensus amongst stakeholders that discouraging the use of options is very likely to improve the usefulness of information to investors resulting from applying the impairment requirements of IFRS 9. We suggest that the Committee also considers whether limiting the use of practical expedients will improve consistency of application across banks when they are, in practice, likely to develop their own policies rather than rely on the thresholds used in practical expedients.

9. We appreciate the efforts that have been made by the Committee not to introduce guidance that might conflict with IFRS 9. As detailed later in this letter, however, there are areas where the guidance might be read as being inconsistent with IFRS 9. We urge the Committee to make suggested changes so as to avoid such implications and to be as clear as possible about the interaction with IFRS 9. We would also encourage the Committee to ensure that in finalising the guidance the IASB is consulted, including signing off the end result to ensure that any changes do not undermine the Committee's efforts made so far to preserve the integrity of the standard.

10. A detailed in paragraph 12 below in addition to timely finalisation we recommend that the Committee also be explicit about the timely revision of the guidance. After the initial implementation review will be crucial to ensure that difficulties and inconsistencies are ironed out as soon as practicable. Going forward regular updates to the guidance will help financial institutions to follow best practice.

Guidance needs to be sufficient clear that it is verifiable

11. We note that the guidance was not written with the objective that the 11 principles are subject to external audit. However, we are aware some prudential supervisors (including the Bank of England) may choose to require such an approach or indirectly seek comfort from auditors as to a bank's compliance with the guidance. There is a separate debate to be had as whether requiring external assurance is likely to be beneficial or at least to consider whether audit may be more desirable in a few years' time after implementation issues have been ironed out. We consider auditability to be a secondary concern given it is not a focus for the Committee, but *verifiability* is important for preparers, particularly for boards of directors who are responsible for signing off the accounts and who need their own assurance over the information. Some of our observations and proposed changes to the guidance are therefore driven by a belief that if the resulting information is not verifiable (and hence auditable) then it is difficult for management and supervisors to be confident over whether the guidance has been followed properly (as well as compliance achieved with the standard).

Timely finalisation is important

12. Finally, notwithstanding our observations and proposed drafting changes we understand and appreciate the efforts made by the Committee to produce this guidance quickly in order to allow preparers time to take it into account in their implementation planning. We believe that its expedient finalisation remains important and suggest that the aim should be to deliver a final text as soon as practically possible. This is most likely to be achieved where it is clear that it represents best/good practice rather than defining required minimum standards. We have offered separate drafting amendments, discussed below, as a potential means to speed up the process.

Supplementary drafting comments are also provided

13. Our response to the guidance sets out high level major points, detailed above, together with more specific comments and proposed amendments that the Committee may find helpful in finalising their guidance. Together with our response we also submit a separate document for the Committee's

attention which is a collection of comments provided by members of our working party. The working party includes representatives of large audit firms as well as major banks. We request that the Committee carefully considers the detailed drafting suggestions included in that document as they are intended to improve the clarity and effectiveness of the guidance, not to undermine it. Clarity of drafting will make the guidance much more successful in practice.

14. We have also added additional audit related points at the end of this response in the Appendix.

DETAILED COMMENTS

Objective and scope

15. The objective of the guidance as stated 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', with the scope of the paper is stated as being limited to "those practices affecting the assessment and measurement of allowances under the applicable accounting framework." The second section of the document refers to "practices that interact with expected credit loss measurement" and contains guidance that does not relate to assessment and measurement of allowances. We believe that as currently constructed the guidance duplicates and in some cases provides alternative requirements in areas where guidance already exists elsewhere in regulation relating to topics beyond the scope of the paper. An example of this is paragraphs 56-58 setting out the requirements of principle 5 in relation 'internal credit risk assessment models' where new requirements around model validation and independent review of such activity are apparently being introduced. We would question whether models for accounting purposes should be subject to different requirements than for regulatory reporting, but if this is the intention it would be preferable to highlight the differences. If the intention is for the guidance to be consistent with the existing requirements, then cross referencing would be preferable. This will help ensure that the guidance is focused on the areas relating to expected credit losses and avoid falling out of date if other requirements are updated.

16. The guidance is intended to cover the credit risk practices for lending exposures only, with an acknowledgement that for other exposures "credit risk is properly considered in developing ECL estimates". It is not clear to what extent the Committee expects the application of those principles in managing credit risk exposures from non-lending exposures such as debt securities, lease receivables and unfunded lending exposures such as written loan commitments and written financial guarantee contracts. Our response is based upon the assumption that it should apply to all assets that meet the amortised cost definition within IFRS 9 with the exception of debt securities. We draw the Committee's attention to the fact that 'lending exposures' and 'debt securities' are not terms that are readily defined in existing Basel literature or IFRS and as a result there is the potential for significant confusion if the Committee is unable to clarify scope in this regard.

17. We note that the omission of 'debt securities' from the scope of the paper presents certain dilemmas for preparers, particularly as it relates to certain (often higher rated) assets such as sovereign debt. For example, were the 'low credit risk' threshold not to be used by a bank (including for example a central bank) on the basis that it represented a 'lower quality' implementation of the standard, then in many circumstances holdings in sovereign debt (issued either by the banks, host country or another country) would now or could in the future be transferred to lifetime loss measurement were a bank to apply the 'significance' test created for other lending exposures. We believe that by differentiating between different classes of credit exposure that require amortised cost measurement by reference to where the Committee's guidance applied, banks could run the risk of preparing financial statements that did not serve the needs of the users and/or were inconsistent with other banks where policy decisions in this area differed. Whilst we do not propose that the Committee draw 'debt securities' as defined within the scope of the paper (due to the additional work that would be required elsewhere in the paper), we encourage the Committee to consider this issue carefully, particularly in the finalisation of the guidance as it relates to the use of the 'low credit risk threshold'.

18. We note that the guidance when finalised is intended for banks applying ECL accounting models, which currently includes IFRS and US GAAP accounting frameworks. Given that the US GAAP ECL accounting requirements are not yet finalised, it is not clear whether it is the intention of the Committee to include an equivalent to Appendix A on IFRS 9 for the US GAAP requirements in the future. However, we note that Paragraph 15 of the guidance states that it expects internationally active banks to "limit their use of practical simplifications and/or practical expedients included in the relevant

accounting standards", which can be read as being applicable to the US GAAP ECL accounting requirements before they are published. We also note that any intended interaction between this guidance and any guidance issued by US authorities on the US GAAP ECL accounting requirements when finalised are unclear and therefore it is not possible for us to comment further in this area at this stage, bearing in mind that a number of UK banking institutions and their auditors may need to consider this guidance in the context of the requirements of both IFRS and US GAAP expected loss frameworks. Whilst it may not be the intention of the Committee to deal with these issues in this paper we believe that the Committee should give further consideration in this area as the US framework is finalised in order to ensure that any finalised guidance remains relevant and useful for practitioners dealing with both IFRS and US GAAP reporting.

Proportionality vs Consistency: quality of implementation

19. We agree with the Committee that internationally active banks and banks with more sophisticated lending businesses should strive for the highest quality implementation. We also support a 'proportionate approach' where the sophistication of credit risk management reflects the relative size and complexity of lending exposures, which we do not believe conflicts with such an implementation. Indeed, a high quality implementation will appropriately balance cost, time and quality to ensure that the resulting financial reporting meets the accounting requirements effectively and efficiently without introducing undue operational risks.

20. This view appears to be included in certain aspects of the guidance. For example, the Committee considers that supervisors may adopt a 'proportionate approach' for less complex banks and in particular Principle 1 refers to credit risk practices being commensurate with the size, nature and complexity of lending exposures. However, as currently drafted, we are concerned that certain aspects of the guidance could be read as requiring highly sophisticated credit risk management and measurement techniques for all lending exposures irrespective of their size and complexity.

21. We note that the Committee makes the distinction between internationally active banks (those banks more sophisticated in the business of lending) and less complex banks. Whilst we understand that National Competent Authorities (NCAs) will form their own judgements when undertaking supervision activities, we believe that a lack of clarity on this area may lead to significant inconsistencies in practice both within and across geographies in the way that the guidance is applied. If the Committee does indeed have a higher expectation of compliance with the proposed guidelines for internationally active banks it would be beneficial if the Committee (or NCAs) could consider further what additional guidance could be provided to NCAs in order to help identify such banks. This will remove ambiguity for banks as to what kind of implementation and oversight is expected. Alternatively, broader acceptance of a proportional approach being taken in the application of the guidance would provide preparers, auditors and supervisors more latitude to apply the guidance appropriately regardless of the size and complexity of any institution that must be mindful of the Committee's guidance.

22. Even the largest, most complex and internationally active banks have lending portfolios for which full implementation of the guidance as drafted will not be appropriate due to data or modelling limitations similar to those faced in the context of assessing capital adequacy, for example on portfolios where A-IRB approaches are not permitted or required. Given that the appropriate expected loss accounting estimate will be required on a timely basis at least at every reporting date, we believe that the Committee should acknowledge that approaches commensurate with the size, nature and complexity of the lending exposures, as set out in Principle 1, applicable for all banks regardless of their size.

23. Additionally, whilst we agree with the objective of a high quality implementation of the accounting requirements and that costs should not be a key consideration, higher costs may not necessarily result in a higher quality implementation. For example, the use of complex models will not result in a better outcome when reliable and supportable data is limited. We are concerned that as currently drafted the guidance appears to require work to be undertaken in a number of areas that may represent 'undue cost and effort' and we would urge the Committee to take account of the suggestions made in that regard. Whilst we understand the Committee may wish to reinforce the principles by providing examples of good practices in a number of areas, we would ask that the Committee clearly acknowledges that whilst it is incumbent on preparers to select methodologies and modelling approaches that represent a high quality implementation of the standard, there will be circumstances where application of all aspects of the guidance will not be appropriate (or in some circumstances possible) and that this does not in and of itself imply a lower quality implementation of the standard. (For example, a very complex, data-

intensive modelling approach for a high quality mortgage portfolio that has experienced only immaterial defaults over the last 20 years would not result in a materially different outcome to a simpler approach and is likely to require many unsubstantiated estimates that could actually reduce the quality of the output.)

24. The Committee expects processes for both credit risk practices and financial reporting to be integrated and for improvements in one area to facilitate improvements in the other. According to the Committee, common processes, systems, tools and data that are used in the accounting and capital frameworks include credit risk systems, estimated PDs (with adjustment), past due status, loan-to-value ratios, historical loss rates, product type, amortisation schedule, down payments requirements, market segment, geographical location, vintage and collateral type along with information of a forward-looking nature. We doubt that this integrated process can be achieved if measurement principles of risk estimates differ for regulatory and accounting purposes (for instance if a one year PD for a given counterparty is not the same under the regulatory and accounting frameworks). Potential changes of measurement of risk estimates for regulatory purposes are not part of this guidance. Further, we note that both supervisors and auditors review the credit risk models implemented by banks but with reference to different frameworks and objectives. To make the process more efficient we encourage the Committee to consider the question of convergence and acknowledge that to the extent that convergence is not desirable or possible it should not be sought.

Consistency with IFRS 9

25. We note that representatives of the IASB are satisfied in general that the application of the Appendix A would not be prevent a bank from meeting the impairment requirements of IFRS 9 *Financial Instruments*. Given that the Committee will receive comments from constituents and may choose to make changes to the guidance we encourage the Committee to seek sufficient input from the IASB on the guidance before it is finalised.

26. Whilst we appreciate the time invested by the Committee in creating this guidance to an expedited timetable, we are concerned that some of terminology used in this guidance is inconsistent as between paragraphs and may be interpreted to be inconsistent with IFRS 9 terminology. Particular attention should be given to terms such as “robust” and “adequate” and their meaning as that is likely to differ from interpretation of terminology used in IFRS 9. Certain concepts and requirements are also discussed in different ways in a number of paragraphs which may lead to ambiguity as to what this guidance requires. These are not merely cosmetic issues; clarity of drafting will ensure the guidance is followed appropriately and efficiently by reference to terminology used in IFRS 9.

27. We have highlighted below a number of comments and proposed changes to language which would more closely align the guidance with IFRS 9.

- Paragraph 63 of the guidance states that “[i]n estimating ECL, banks may determine either a single amount or a range of possible amounts” and yet paragraph A2 states the estimate should “take into account the range of possible future scenarios.” Our understanding of IFRS 9 B5.5.41 is that a range of possible scenarios must always be performed (even if those scenarios are limited only to two, being a possibility that a credit loss occurs and the possibility that no credit loss occurs). We propose that the wording in paragraph 63 is refined so as to not give the impression that a bank can determine the loss allowance based on a single cash flow forecast, which could be construed as being based on the most likely recoverable cash flows, which would fail to recognise the risk of non-payment even when it is remote. We also note that paragraph A2 could be read as implying that a full probability weighted approach reflecting all possible scenarios is required in all cases which is not a requirement of IFRS 9. We would recommend that paragraph A2 is redrafted so it is aligned with IFRS 9.

- The guidance in paragraph A6 states that a bank should not undertake an exhaustive search for information that may affect the estimate of ECL but should use utilise information that is ‘reasonably available’. We note IFRS 9:5.5.17(c) clarifies what is reasonable by considering whether obtaining the information would lead to ‘undue cost or effort’. This appears to be in conflict with paragraph 60 of the guidance that states the costs for collecting data should not be avoided on the basis that a bank considers them to be excessive or unnecessary. Given our views on materiality expressed below, we consider that where exposures are immaterial, or in the case where obtaining the additional information leads to an immaterial marginal difference in the estimate of expected credit losses, the approach taken in IFRS 9 should prevail.

- In paragraph A8 the guidance uses the term ‘high credit risk’ when referring to certain originated exposures. Such a term is not used in IFRS 9 and raises the question as to what ‘high’ means given the different lending practices and risk appetites of banks. We believe the guidance was trying to highlight that higher credit risk on origination may be consistent with the expectation of greater volatility in credit risk over time and therefore a heightened risk that the loan could move from 12-month expected losses to lifetime expected losses, thus greater care being needed in monitoring changes in credit risk. If that is the case, we recommend that the Committee clarifies this in the guidance rather than introduce a new ‘high credit risk’ term that is not defined.

28. IFRS 9 does not define ‘significant increases in credit risk’ and given the wide range of institutions and an even wider range of products and jurisdictions for which IFRS 9 is applicable, we are pleased that the Committee has not sought to define ‘significant increases in credit risk’. However, we have a number of observations relating to the Committee’s guidance on the assessment of ‘significant increases in credit risk’ which we feel would benefit from further consideration and clarification, examples of these are detailed below.

29. Paragraph A3 states that in working out whether there has been a significant increase in credit risk PDs should be based on the risk of default over the expected life of the financial instrument (not just the next 12-months although IFRS 9 B5.5.13 acknowledges this may be a reasonable approximation of the change in the lifetime risk of a default occurring in limited circumstances). However, it is worth including or referencing the guidance in IFRS 9:B5.5.11 that consideration should be given to the remaining time to maturity when assessing whether there has been an increase in credit risk (given that all other things being equal, PDs reduce with the passage of time and thus a constant PD could imply a significant increase in credit risk).

30. Changes in pricing may in some circumstances be related to increased credit risk but that link is overstated in paragraph A15 which states that “any post-origination increase in credit risk is unlikely to be fully compensated by the interest rate charged”. Pricing methodologies generally take into account other factors such as strategic business considerations, funding costs and capital requirements. Additionally, the pricing for some products is not as sensitive as other products to movements in credit risk. We are also concerned that changes in pricing that do result from credit deterioration are often a lagging indicator (e.g. as a result of an observed uplift in defaults) and would encourage the committee to acknowledge this so as not to dilute the importance of the application of other credit risk management activities in the measurement of expected credit losses.

31. Footnote 33 to factor (a) of A27 seeks to add an additional rebuttable presumption around the ability to distinguish the reasons for changes in the credit spread within pricing. Given that other factors are included in pricing it would be difficult if not impossible to rebut the presumption. Therefore we are concerned that the footnote would result in lifetime expected loss being recognised where there may not be a significant increase in credit risk contrary to IFRS 9 5.5.3.

32. Paragraph A27 gives emphasis to seven other factors to be considered in addition to those factors that are included in IFRS 9:B5.5.17 (a)-(p) noting that “the presence of any of conditions (…) would suggest that there has potentially been a significant increase in credit risk” albeit some of the seven appear to overlap to some extent with those in IFRS 9. IFRS 9 lists factors that “may be relevant in assessing changes in credit risk”. We consider the guidance places weight that such factors are presumptively an indicator of an increase in credit risk which is not the approach for the comparable guidance in IFRS 9. We also note that some of the additional factors included in paragraph A27 contain phrases which are ambiguous. For example, the meaning of “an internal credit assessment summary indicator” and “deterioration of relevant factors” is unclear and thus subject to different interpretations. It would be helpful if the Committee could clarify the intentions in this paragraph and where possible align with the words in the standard to the greatest extent possible as this would assist both preparers and auditors as they seek to apply and audit compliance with the guidance.

Prescriptive modelling requirements and segmentation

33. The guidance specifies a series of expectations surrounding model validation that may be inconsistent with the organisational design within a bank. By prescribing an approach in this area, the paper does not appear to allow organisations to establish effective approaches that meet basic "principle"

requirements which may lead some organisations to dismantle existing effective structures to accommodate the requirements of the guidance.

34. IFRS 9 already anticipates a greater level of segmentation in determining ECL calculations. The guidance has extended this by suggesting that it anticipates frequent re-segmentation, and also that collective portfolios cannot straddle stage one and stage two – with the premise that if the assets are genuinely homogenous then a sign of deterioration would impact all assets in the pool. While we anticipate seeing banks create a number of pools to undertake the calculation taking account of geography (including region), industry grouping etc, we do not expect that frequent re-segmentation should be necessary.

35. The principle for segmentation is well expressed in paragraph 44 and 45 of the guidance, which explain that lending exposures should be grouped so that they share similar risk characteristics and are expected to react to changing risk parameters in a similar way. Such groupings should be sufficiently granular that changes in credit quality will lead to migration that effects the measurement of ECL.

36. ECL measurement should be based on credit risk management processes and it is also necessary for credit risk management that loan portfolios are segmented during model development into groups that share common main risk characteristics and these characteristics are used to differentiate loans accordingly. Therefore it should be expected that risk management models represent a good starting point for developing ECL measurement models, since they will differentiate loans based on the previously identified risk drivers.

37. While models will never be able to capture all risk drivers, they focus on ones that have proven to be relevant and predictive as well as reasonably stable over time. As a result, frequent changes in the segmentation should not be expected and could result in driving unnecessary differences between risk management and regulatory capital calculations and ECL measurement, losing the benefit of the model development and review process, including the benefit of historical data series, resulting in a lower quality implementation. Frequent re-segmentation will also hinder comparability of numbers from period to period impairing management’s ability to understand and explain the resulting financial reporting.

38. However there may be risk drivers and risk events that are not captured in models. In some cases, a specific change of risks affecting a portfolio would be better dealt with by a management overlay, which may involve ad hoc segmentation based on the information available in relation to the new risk driver or event, or by refinement of the model without re-segmentation, rather than by re-segmentation. For example, the effect of a natural disaster or a material unexpected economic event may require the determination of which loans or portfolios are impacted and the expected impact through a management overlay process (top down) rather than re-segmenting existing modelled portfolios (bottom up).

The need to apply materiality

39. We understand that the guidance does not aim to override the concept of materiality as applied to financial reporting. The guidance would benefit if this was clarified and the notion of a “proportionate approach” expanded to recognise that the concept of materiality is also important and applies to all banks and not just less complex ones.

40. Financial reporting frameworks often discuss the concept of materiality in the context of preparation and presentation of financial statements. Materiality is considered at both the overall financial statement level and in relation to individual account balances, classes of transactions and disclosures. Materiality may be influenced by considerations such as legal and regulatory requirements and considerations relating to individual financial statement account balances and relationships. This process may result in different materiality considerations being applied depending on the aspect of the financial statements being considered. For example, the expected degree of accuracy of certain statutory disclosures, such as directors' emoluments, may make normal materiality considerations irrelevant.

Prudence and neutrality in financial reporting

41. The guidance notes in paragraph 63 that “the Committee expects that banks will exercise prudence, defined as exercising appropriate care and caution with determining the level of ECL and the allowances to be recognised for accounting purposes”. The guidance also refers to “prudent policies” in

paragraph 10 and in paragraph 14 where it states that “supervisors having a natural interest in promoting the use of sound and prudent credit risk practices”. Although the Committee refers to the exercise of prudence and neutrality we are concerned that the use of the term prudence in the guidance may be interpreted as a practice of over-cautious estimation of the downside which would be in conflict with the financial reporting objective of neutrality. The ECL model in IFRS 9 is designed with prudence in mind given it results in the recognition of a provision for expected losses at initial recognition. Therefore, including references to prudent practices and prudence in determining the level of ECL is redundant particularly given that IFRS 9 does not refer to prudence and the risk of the term being interpreted in a way that would be in conflict with the principle of neutrality.

Uncertainty over disclosures

42. Principle 8 states that disclosures beyond those required by accounting standards may be needed. It is not clear whether the Committee expects these disclosures to be included in the financial statements (and hence subject to audit) or not. Given the current objective of the IASB and securities regulators to streamline disclosures and the fact that many international active banks participate in the Enhanced Disclosure Task Force. We would encourage these agencies and groups to work together to ensure a consistent and measured approach taken by banks in providing credit risk disclosures beyond those required by accounting standards.

APPENDIX

Audit specific points

1. In addition to the comments above that relate to both preparers and auditors we make the following comments in relation to auditing specifically. As part of the audit approach for banks auditors review the design, implementation and operative effectiveness of a bank's risk management and internal control framework and assess whether they can rely on it to determine the audit procedures. We therefore welcome guidance for banks that will foster sound risk management practices and an effective internal control system for credit risk assessment and measurement. In addition auditors would support any guidance that assists them making an assessment of credit risk management practices as they relate to expected credit losses. However, we note that statutory audit opinions are expressed by reference to an accounting framework set out in international standards (local GAAP, IFRS or US GAAP) and therefore non-compliance with this guidance, not being part of those accounting frameworks, will not of itself lead to a qualified audit opinion being issued.

2. We note the Committee's initiative to introduce requirements for the validation of the banks' internal credit assessment models and the recommendations for the banks' regulators and their task to ensure that the proper policies and internal controls are in place for validation of the internal credit risk assessments models. We believe that an independent review of the model for ECL falls within the scope of audit services. When this review is performed by another auditor (external or internal) the statutory auditor will still need to review these findings in the course of the audit of ECL model for accounting purposes. Therefore we disagree with the footnote 22 on page 16 of the paper, stating that the independent review of the model validation process by the statutory auditor is a "non-audit service".

3. An effective implementation of expected loss accounting standards requires a consistent approach within banks supported by a consistent approach from auditors, prudential supervisors and securities regulators across multiple geographies. Where NCAs take different views on what they consider an effective high quality implementation, and/or require different levels of assurance from a banks' auditors on compliance with the guidelines, this runs the risk of creating geographical differences in interpretation that puts pressure on banks trying to apply a consistent approach throughout their organisation. We acknowledge that auditors across geographies must play their part in trying to minimise these differences, but our success with this will depend on NCAs taking as much of a consistent approach as they can. Following the finalisation of the guidelines we would hope national supervisors work together with the Committee to promote a consistent supervisory approach. We would welcome being part of that dialogue.

ICAEW REPRESENTATION
69/15

SUPPLEMENTARY DRAFTING SUGGESTIONS

GUIDANCE ON ACCOUNTING FOR EXPECTED CREDIT LOSSES

Following the ICAEW Representation 68/15 recently submitted to the Basel Committee, please find enclosed a set of Supplementary drafting suggestions.

This document does not form part of Representation 68/15 but rather it is a collection of drafting suggestions as provided by members of our working party. The working party includes representatives of the accounting and auditing profession and major banks.

The drafting suggestions do not represent the views of ICAEW but are intended to provide assistance in clarifying certain points within the guidance.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City

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For more information, please contact fsf@icaew.com

icaew.com

DRAFTING SUGGESTIONS

Para	Suggested Changes	Comments / Rationale
1 [2]	We recommend that the Committee give further consideration to the intended objective and scope of this guidance. If the intention is to remain consistent with paragraph 1, guidance that does not relate to the assessment and measurement of allowances should be deleted. Paragraphs that could be deleted include paragraphs 27, 31 and 58. A critical review of the text may also identify other areas which are not targeted at the objective.	The paragraph states that "the scope of credit risk practices is limited to those practices affecting the assessment and measurement of allowances…" We agree with this scope and suggest that text that duplicates existing regulatory guidance or that is more related to general credit risk management and underwriting practices is deleted from the final guidance so that it can better targeted at its objective.
9	Suggest removing the first sentence of paragraph 9. We recommend that the Committee removes these repetitions.	The first sentence of paragraph 9 is redundant. In effect it says that the Committee expects banks to apply ECLs to all exposures in the scope of the ECL model. Similar points are made on specifying that the guidance is applicable regardless of whether the bank is assessing credit risk or measuring ECL on an individual or collective basis in Principle 4; paras 9, 19(c), 24(b), 24(k), 36, 52, 53, 61, 86, A5, A9, A14, A52
10	We would suggest adding "in accordance with the objectives of the relevant accounting requirements" to the end of the penultimate sentence, and replace "produce a robust measurement of expected credit losses" with "meets the requirements".	It is not clear what the term "adequate" means in the context of compliance with accounting requirements. It is also not clear what "robust" means in relation to the measurement of allowances.
11 [12]	We recommend adding "commensurate with the size, nature and complexity of their lending exposures" to the end of the paragraph.	We believe that a high-quality implementation of ECL accounting should be by reference to Principle 1. Even the largest, most sophisticated banks are unable to apply the most advanced regulatory approaches to all portfolios due to lack of sufficient statistical data and other modelling limitations and similar considerations will apply to ECL accounting models. Additionally, the use of complex models may not result in a better outcome when reliable and supportable data is limited. The impact of increased complexity and costs may also be immaterial, for example, when lending is fully secured by high quality collateral.
12		Per paragraph 11
13	We suggest deleting 'such as debt securities' and more clearly defining what is meant by "lending exposures" in the scope of the guidance and "other bank exposures" which are not.	We believe that the reference to 'debt securities' (paragraph 13) does not work well for a document with international relevance. Neither IAS 39 nor IFRS 9 differentiate between loans and securities and some items held by banks as if loans may be legally securities and vice versa. As a result it is not clear to what extent the Committee expects the more detailed guidance to apply to non-lending exposures such as purchased securities and lease receivables and unfunded lending exposures such as written financial guarantee contracts. Given the general accounting principle that consistent accounting policies should be applied, it is doubtful how guidance intended to influence accounting policies could take items in the scope of IFRS 9 outside the scope of the guidance. However, we agree that much of the guidance should not be applicable to items which are subject to risk management that is different to that applied to lending exposures.

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14	We would suggest changing to "…failures is lending of poor credit quality…"	The third sentence in the paragraph could be read as a significant cause of bank failures is poor credit quality of the bank which we do not believe is the intention of the Committee
15	We would suggest adding a sentence to this paragraph that clarifies this point along the lines set out in the comments/rationale.	This paragraph may be the appropriate place to specifically acknowledge that accounting requirements do not apply to immaterial items and, since these supervisory requirements do not contradict the applicable accounting standards, they are not intended to change materiality decisions which are made by management.
19	(c) The third bullet point should be deleted or at the very least the word "requirements" should be deleted and "as noted in Principle 3" added to the end of the sentence. We recommend the committee consider the concept of materiality and re-phrase the guidance. We recommend that the Committee removes these repetitions.	(c) The document should be neutral as to whether allowances are determined individually or collectively. There are concerns that the current guidance on grouping of lending exposures in Principle 3 is not consistent with Principle 7 which encourages the credit risk assessment and measurement process to form the basis for common systems. This third bullet point seems to be mandating that assessment must be done at both the individual and collective levels, which may not be the case either because there is no other relevant information available at the collective level or because there is only a collective assessment which includes all relevant information. Such specificity is unhelpful. Guidance in the document is sometimes phrased without regard to materiality or cost of implementation, even if it could result in only marginal improvement to financial reporting. Examples of such guidance are listed below: 19(c) "….accurately rates differing credit characteristics…" 21 "The Committee expects banks to maximise the extent to which"….. "Using the same information and assumptions across a bank to the maximum extent possible"…. 30 "…the Committee expects it to consider the full spectrum of information"….. 38 "The credit risk system must capture all lending exposures"…. 41 "…tools for accurately assessing the full range of credit risk"… 48 "…to reasonably ensure that those groupings are accurate and up to date"… A28 "take full account" "any relevant regional differences" A29 "Accurate measurement of the drivers of credit risk…" Similar points are made on the need to consider "forward-looking information and macroeconomic factors" in paras 19(c), 24(b), 24(j), 24(l), 34, 40, 44, 50, 51, 52, 56, 59, 60, 69,A5, A23, A28(a).
P2	We suggest rewording the last sentence of the paragraph to "The measurement of allowances should build upon these methodologies". We recommend that the Committee removes these repetitions.	It is not clear what "robust" and "timely" mean in relation to the measurement of allowances. The intention should not be that allowances are required to be measured in a biased manner or that losses are recognised at an earlier stage than the recognition of reversals of losses. Similar points are made on the need for comprehensive documentation of methodologies, processes and key judgements exercised, including changes in assumptions in Principle 2 and paras 21,22, 24(g), 24(o),29(b), 32(b), 41,43, 58(c), 58(d), 59, 69, 77

Para	Suggested Changes	Comments / Rationale
21 [24(j)]	1) The paragraph should be reformulated along the lines of Principle 7 so that the sound credit risk assessment and measurement process is expected to form the basis for accounting and capital adequacy purposes, but the differences between these requirements must be addressed to avoid bias. 2) Delete 'interpretation'.	Paragraph 21 states that the same information and assumptions should be used consistently for regulatory and accounting purposes to "the maximum extent possible". Similarly, paragraph 24(j) proposes the use of "forward-looking information that is reasonably available" whereas IFRS 9 uses the term "reasonable and supportable". We would prefer terms that are consistent with IFRS 9. As a result: 1) The paragraph could be read as requiring the forward looking adjustments needed for ECL accounting to be applied to lending decisions and in capital adequacy calculations or for the prudential capital adequacy inputs (e.g. 1 in 20 downturn LGDs) to be used for ECL accounting calculations which would in fact introduce bias rather than reduce it. 2) The reference to 'interpretation' is wrong in this context, since interpretation of the accounting framework is not related to the use of information and assumptions across the bank.
24 [80]	(a) The wording should refer to a 'process designed to equip'. (b) Suggest replacing 'macroeconomic' with 'economic'. (c) Consider deleting or modifying to only catch groupings created for ECL accounting only. (f) Suggest deleting "Examples of factors that may require qualitative adjustments are the existence of concentrations of credit risk and changes in the level of such concentrations, increased usage of loan modifications, changes in expectations of macroeconomic trends and conditions, and/or the effects of changes in underwriting standards and lending policies" in light of IFRS 9 requirements as risk concentrations are not directly relevant to the assessment of ECL. (h) More helpful might be to refer to the triggers that might prompt a reassessment of the methods, inputs or assumptions. (j) & (k) Add "where applicable" to front of sentences since this is only applicable for loss rate approaches. (q) Last sentence should be deleted. It is not a requirement since it could lead to double counting for factors already included in the models. It should be made clear that such judgemental overlays are only relevant for factors not included in the models and there should be clear governance as to when they are required, how they are calculated and that they are removed when no longer required.	(a) A method cannot include a process that 'equips'. A method can only be designed to achieve an outcome and cannot on its own guarantee that outcome, as that will be dependent on execution. (b) The statement that macroeconomic factors 'may be at the local level' is a contradiction and even the reference to 'regional' is questionable, given that 'macroeconomic' is normally defined as relating to a national economy. (c) Where collective evaluations are based on the same underlying groupings used for risk management and capital adequacy calculations, this seems unnecessary. (f) This sub paragraph indicates that a qualitative adjustment might be necessary for "changes in expectations of macroeconomic trends and conditions". We do not see how qualitative adjustments due to credit concentration are consistent with the requirements of IFRS 9. (h) Any approach that describes the situations in which methods, inputs or assumptions would need to change would be uninformative, since it would merely be when they are no longer appropriate. (j) & (k) Where PD, LGD, EAD components are determined, this will already be on a validated, statistical basis. (q) Refers to 'collective allowances', while paragraph 80 states that the Committee expects the reconciliation of the allowance account to be provided separately for "collective and individual allowances", implying those that are measured collectively or individually. However, the example given in paragraph IG 20B of the Implementation Guidance of IFRS 9 refers to lifetime losses that are assessed collectively and individually, implying those that are determined to require lifetime ECLs on a collective or individual basis. Did the Committee intend to add a new requirement? Note, also, that if a measurement overlay is used to include forward looking information, then the allowance for an individual asset would be measured partly individually and partly collectively. Splitting out these two components would not seem to be very informative. The concept of a 'collective allowance' makes more

Para	Suggested Changes	Comments / Rationale
		sense in the context of IAS 39 than IFRS 9.
26	Suggest adding “consistent with usual model development practices” to the start of the sentence.	It should be made clear that the approach to considering and applying information for ECL models is no different to other modelling requirements, i.e. that the expectation is not that more factors than are necessary for the model to work well are needed.
27 [28(h)]	This paragraph could be deleted without any impact on the ECL guidance. At the very least the relevance to ECL should be explained and point 27 (i) deleted (it can be made clear that this is a non-exhaustive list if retained). Given the other guidance that all factors should be considered, the point of highlighting particular factors in 28(h) is unclear, although this is the only point with direct relevance to ECL and perhaps could be retained in the next paragraph.	Relevance of paragraphs 27 and 28 to ECL is not clear. These seem to be matters to consider in lending decisions and not ECL. It is also not helpful to suggest banks assess “all other relevant information”.
28	This paragraph could be deleted without any impact on the ECL guidance. At the very least the relevance to ECL should be explained and point 27 (i) deleted (it can be made clear that this is a non-exhaustive list if retained). Given the other guidance that all factors should be considered, the point of highlighting particular factors in 28(h) is unclear, although this is the only point with direct relevance to ECL and perhaps could be retained in the next paragraph. (e) Consider removing the reference to ‘charge-off’.	Relevance of paragraphs 27 and 28 to ECL is not clear. These seem to be matters to consider in lending decisions and not ECL. It is also not helpful to suggest banks assess “all other relevant information”. (e) “Charge-off” is a mere accounting concept and is not a factor that affects the bank’s ability to recover amounts due.
29 [P4]	(a) Consider adding “or components of the ECL calculation” to this paragraph. (b) We would prefer that this term (‘reasonably estimable’) be deleted as it creates a further level of complexity in introducing a threshold of what is a period that reasonable (and conversely an unreasonable) in the estimation of future cash flows given the estimation of future credit losses overall is inherently a judgement. If considered necessary, the point can be rephrased to refer to banking having a policy for extending economic scenarios beyond the period directly covered by economic forecasting. (c) Consider deleting “for less sophisticated banks” and moving this point to Principle 4 to keep all the guidance on forward looking information in one place. (d) Suggest clarifying this point to ensure it is not read as suggesting backtesting of economic scenarios themselves.	(a) Where a risk component approach is used, how the risk components change as a result of forward looking factors should be understood and documented. It seems excessive in this situation to require a link to the ECL estimate itself which is the product of the risk components. (b) This sub-paragraph talks about documenting the process for determining the time horizon, including “how ECL is estimated in the period following that which is reasonably estimable” and then in a footnote, indicates that the term “reasonably estimable” is not included in IFRS 9. While we understand the Committee’s aim in this paragraph, the wording may be misleading without the context that has been explored in the US discussions. (c) We feel that the sophistication of a bank is not relevant to whether or not is uses external experts in developing forward looking economic scenarios. It is the quality and independence of the forecasting that is important and its governance and not whether it is internally or externally produced. (d) Purpose of backtesting must be clear about whether factors have a correlation with different outcomes. There is no point in testing whether or not the forward looking economic scenarios actually occurred.
30 [64, footnote 19]	Consider adding “consistent with usual model development practices” to the first sentence and modify “full spectrum of information” with “that is reasonable and supportable”. Delete reference to “regulatory” and “other regulatory reporting” in the last sentence.	ECL accounting does not require complex stochastic modelling of different possible economic scenarios. In developing the modelled correlations, it should be clear that ECL models is no different to other modelling requirements, i.e. that the expectation is not that more factors than are necessary for the model to work well are needed. We agree that stressed economic scenarios are not the best estimate scenarios used for accounting. However, this is made less clear by the use of the phrase “regulatory

Para	Suggested Changes	Comments / Rationale
		expected loss estimates should be consistent with inputs to other relevant estimates …" and other regulatory report.
31	The paragraph should be deleted from the guidance.	Paragraph does not relate to ECL measurement but sound underwriting practices.
P3	We propose that the principle should refer to "processes" and "groupings".	There are likely to be different groupings for different purposes, for example, groupings building on risk management processes and Basel models and other groupings to be responsive to information that is not included in existing risk management processes and Basel models (e.g. forward looking information).
33	1) We propose amending "will develop" to "have developed". Also "that ECL allowances are properly estimated" in the last sentence should be included in a new last sentence that captures "The credit rating system and other parts of the credit risk assessment process may form important components of the ECL measurement process." 2) Could delete since guidance about credit risk rating systems is general guidance not directly relevant to ECL measurement. If retained, consider moving the whole section to Principle 7 and reword all the references to "credit risk rating system" to ECL measures or otherwise clarify that including forward looking elements is not expected in the underlying credit ratings system but may be an additional factor to consider if ratings are also used to derive ECL.	1) In accordance with Principle 7, banks should already have comprehensive credit risk assessment processes and the accounting should merely build on these rather than implying that monitoring is only necessary for the accounting. 2) Several P3 paragraphs relate to credit risk ratings which seems to not fit with Principle 3 (may fit better in Principle 7 since credit risk ratings may be a way of providing a strong basis for common systems). More importantly, these paragraphs imply that the credit ratings used for risk management and which may underlie Basel risk components should include forward looking elements. The forward looking considerations are only needed for the accounting.
34	Same as in 33(1) 1) These paragraphs could be deleted or should at least be modified to delete "form the basis for assigning credit risk ratings and thus" to decouple the credit risk ratings from the forward looking considerations that need to be added for accounting only. Given the need to incorporate forward looking information in the accounting but not in the regulatory capital, it seems of limited value to require that the rationale for this difference should be documented.	Same as in 33(1) 1) This paragraph could imply that the credit rating system used for credit management should incorporate forward looking information. While such information needs to be incorporated for ECL measurement, the accounting requirements should not drive risk management to this extent. It is difficult to understand why there should be expected to be consistency between credit risk ratings when the system is used for accounting and regulatory capital purposes. The same underlying system can be used, but there need to be adjustments given their different purposes. This seems better described in paragraphs 65-68 and so could be deleted here.
35	Same as in 33(1) Suggest deleting	Same as in 33(1) We believe this paragraph is about risk management generally and not relevant for this section.
36	Same as in 33(1) 1) If retained, these paragraphs should be redrafted to state that where credit risk ratings are used as the basis for ECL accounting, they must be responsive to changes in credit risk and additional information may be needed for accounting purposes in order to include forward looking information. 2) The paragraph should also be amended to make it clear that the use of 'portfolio' in this context is closer to the 'bottom up' assessment in IE 38.	Same as in 33(1) 1) This paragraph is more about credit risk management than ECL and it also implies that credit risk ratings must be used for ECL. While they can be used as part of the underlying information, this is not an accounting requirement and may in any case be more applicable to wholesale rather than retail lending. The credit risk system need not incorporate forward looking information since this would result in the accounting requirements driving risk management. 2) This paragraph also refers to a series of factors relevant to subsequent assessment that should be equally relevant for the initial

Para	Suggested Changes	Comments / Rationale
		assessment. This wording implies that forward looking information is not used in the initial assessment. Also, while significant increases in credit risk may be assessed on a portfolio basis, it would be unusual to assess credit ratings on a portfolio basis unless the change in conditions affects the whole portfolio. For instance, when a top down approach is used to assess deterioration, as set out in IE 39 of the Implementation Guidance to the standard, it would be unlikely that all floating rate borrowers or an arbitrary 20% of such borrowers would be downgraded.
37	Same as in 33(1) If retained, these paragraphs should be redrafted to state that where credit risk ratings are used as the basis for ECL accounting, they must be responsive to changes in credit risk and additional information may be needed for accounting purposes in order to include forward looking information. We also note that the guidance considers an effective credit risk rating system as one that allows a bank to "track changes in credit risk, regardless of the significance of the change…" We agree such a system would certainly be effective but do not agree that a system that does not update for every increment of credit risk is not effective.	Same as in 33(1) Paragraphs are more about credit risk management than ECL and also imply that credit risk ratings must be used for ECL. While they can be used as part of the underlying information, this is not an accounting requirement and may in any case be more applicable to wholesale than retail. The credit risk system need not incorporate forward looking information since this would result in the accounting requirements driving risk management. Credit risk ratings may not form the basis of the accounting in any case, for example, for retail loans.
38	Same as in 33(1) "individual" should be deleted to ensure that it is possible for collective as well as individual assessment to be made.	Same as in 33(1) This paragraph can be read as preventing collective assessments.
39	Same as in 33(1)	Same as in 33(1)
40	Same as in 33(1) 1) If retained, these paragraphs should be redrafted to state that where credit risk ratings are used as the basis for ECL accounting, they must be responsive to changes in credit risk and additional information may be needed for accounting purposes in order to include forward looking information. 2) If it is the Committee's intention that his paragraph is use to provide guidance similar to paragraph B5.5.17(j) of IFRS 9 then we recommend that the language of IFRS 9 is used to aid clarity.	Same as in 33(1) 1) Paragraph is more about credit risk management than ECL and also implies that credit risk ratings must be used for ECL. While they can be used as part of the underlying information, this is not an accounting requirement and may in any case be more applicable to wholesale than retail. The credit risk system need not incorporate forward looking information since this would result in the accounting requirements driving risk management. Credit risk ratings may not form the basis of the accounting in any case, for example, for retail loans. 2) We are unclear what guidance the last sentence of this paragraph provides in relation to the impact of guarantee or collateral on debtor's paying capacity. If it is intended for this paragraph to provide guidance similar to paragraph B5.5.17(j) of IFRS 9 then we recommend that the language of IFRS 9 is used to aid clarity.
41	Same as in 33(1) 1) This paragraphs could be deleted or should at least be modified to delete "form the basis for assigning credit risk ratings and thus" to decouple the credit risk ratings from the forward looking considerations that need to be added for accounting only. Given the need to incorporate forward looking information in the accounting but not in the	Same as in 33(1) 1) This paragraph could imply that the credit rating system used for credit management should incorporate forward looking information. While such information needs to be incorporated for ECL measurement, the accounting requirements should not drive risk management to this extent. It is difficult to understand why there should be expected

Para	Suggested Changes	Comments / Rationale
	regulatory capital, it seems of limited value to require that the rationale for this difference should be documented. 2) We would clarification from the Committee on what is meant by "full range of credit risk".	to be consistency between credit risk ratings when the system is used for accounting and regulatory capital purposes. The same underlying system can be used, but there need to be adjustments given their different purposes. This seems better described in paragraphs 65-68 and so could be deleted here. 2) We are unclear what is meant by "the full range of credit risk". Does the Committee intend for this to cover to all sources of risk or all possible outcomes?
42	Same as in 33(1) 1) If retained, these paragraphs should be redrafted to state that where credit risk ratings are used as the basis for ECL accounting, they must be responsive to changes in credit risk and additional information may be needed for accounting purposes in order to include forward looking information. 2) If the Committee meant that the bank should carry out a formal review as often as it reports to shareholders, paragraph 42 could be revised to: "e.g. at least annually or more frequently if the bank issues interim financial statements". 3) Paragraph 48 could be perhaps reworded to say the groupings should be reviewed when significant circumstances change. It would be helpful if these expectations were harmonized using consistent language.	Same as in 33(1) 1) Paragraph is more about credit risk management than ECL and also implies that credit risk ratings must be used for ECL. While they can be used as part of the underlying information, this is not an accounting requirement and may in any case be more applicable to wholesale than retail. The credit risk system need not incorporate forward looking information since this would result in the accounting requirements driving risk management. Credit risk ratings may not form the basis of the accounting in any case, for example, for retail loans. 2) Does the wording "if required in a jurisdiction" refer to where the entity reports to shareholders more often than once a year? If so, in practice, entities may have some discretion as to the frequency with which they prepare interim financial statements, so 'if required' is not quite right. Or does the Committee expect a formal review once a year unless banking regulatory requirements would require a formal review more often? 3) Similarly, paragraph 48 indicates that "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". Paragraph A18 discusses the need for timely transfer to LEL as soon as credit risk has increased significantly. How this is consistent with paragraph 42 and 48 that seem to indicate an annual review might be sufficient?
43	Reference along these lines could be added to the paragraph.	Paragraph could usefully acknowledge that where the groupings are already used for risk management and regulatory capital purposes, they will already be subject to appropriate review and documentation.
44	1) We propose that this section be re-drafted to clearly differentiate groupings which are already used for risk management and regulatory capital purposes which have been created under proper model governance, review and validations where frequent re-groupings are likely to drive unnecessary differences in the common systems set out in Principle 7 from ad hoc groupings that may be needed to incorporate forward looking information for accounting purposes. However, it should also be clear that any judgemental overlay process for ECL must be properly controlled and governed so that it is clear why the overlay is needed and when it will be removed. 2) To be consistent we propose this amended to be in line with IFRS 9:5.5.53 so they share	1) Groupings must be appropriate to their purpose and where their primary purpose is risk management and regulatory capital, forward looking information may not be a relevant driver. While the appropriateness of the groupings will be reviewed regulatory as part of model review and validation, it is not expected to change frequently since this could adversely impact the historical data series and otherwise reduce the quality of the model. Where additional groupings are needed for accounting purposes, then forward looking information may be a more relevant driver. Groupings may be needed for models or for judgemental overlays where the factor is not capable of being modelled or is not yet in the models. Much of the current text is likely to be more relevant to

Para	Suggested Changes	Comments / Rationale
	'similar risk characteristics'.	judgemental overlays than models since models are more likely to be recalibrated or otherwise adjusted to deal with new information rather than being completely rebuilt under different groupings. 2) We note paragraph 44 refers to grouping exposures based on them being 'homogenous'. In practice loans will never be homogenous.
45	Same as in 44 We would welcome the Committee clarifying this paragraph in line with the comment or it can be deleted as the point is already addressed.	Same as in 44 We feel that this paragraph is unclear. Presumably it means that the groups should be sufficiently granular that increases in credit risk in some sections of the group should not be obscured, but that point is already made in the next paragraph. In any case, IFRS 9 requires that groupings share similar risk characteristics and this language should be used consistently.
46	Same as in 44 1) This paragraph could be read as essentially requiring constant re-grouping of collective assessments, which would not be practicable. Risk management will require the identification of shared risk characteristics to determine groupings and this should not be expected to change frequently. Top down as well as bottom up determination of collective allowances is permitted by IFRS 9. 2) The second sentence should refer to "information obtained that would indicate" changes in credit risk after initial recognition (see paragraph 48) and logically would follow that paragraph.	Same as in 44 1) Paragraphs 46 and 47 should include references to scenarios where collective assessment of whether there has been a significant increase in credit risk leads to recognition of lifetime ECL only for a portion of a portfolio. Without such clarification, the statement: "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" could be interpreted as not permitting recognition of lifetime ECL on a portion of a portfolio (IFRS 9.B5.5.6).
47 [A27]	Same as in 44 1) Consider amending these paragraphs to say that "a portion of the group or a sub-group" should migrate or will transfer…"	Same as in 44 1) Paragraph 47 states that when the credit risk increases on a group basis, the entire group should migrate to a higher credit risk rating. Combined with the assertions made in paragraph A27, this implies that the whole group should subsequently be measured on a lifetime ECL basis. This is supported by paragraph A35, which states "the Committee expects that, in instances where it is apparent that one or more exposures in a group have experienced a significant increase in credit risk, the relevant group or subgroup will transfer to LEL measurement of ECL". We feel that this is in conflict with the standard and believe that this is not the intention of the Committee as the collective assessment is required to be made collectively. It would also not be consistent with the top-down approach shown in Example 5 of the Implementation Guidance to IFRS 9, in which only 20% of floating rate loans are deemed to be measured on a lifetime ECL basis.
48	Same as in 44	The same change recommended in paragraph 44 should be made to paragraph 48 so segmentation should arise when they no longer share similar risk characteristics. Currently paragraph 48 could be read as requiring re-segmentation frequently given paragraph 44 refers to exposures being homogenous and paragraph 48 refers to re-segmentation 'whenever relevant new information is received or a bank's expectations of credit risk have changed.'

Para	Suggested Changes	Comments / Rationale
P4	We suggest that references to the Basel Core Principles are deleted, unless the Principles are to be amended.	We feel that Principle 4 is clumsily worded. How could ECLs calculated under IFRS 9 and US GAAP both be said to be 'consistent' with what the Basel Core Principles describe as 'adequate'? We note that the Basel Core Principles refer to "If […] provisions are deemed to be inadequate for prudential purposes (e.g. if […] the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital". The 'losses expected to be incurred' originally envisaged by the Core Principles were presumably regulatory 12m ECLs, and the text was drafted to reflect an incurred loss accounting model. If, alternatively, these expected losses are taken to refer to lifetime ECLs, then the wording would seem incompatible with the phased recognition model in IFRS 9 that starts with 12m ECLs and also conflicts with the IFRS 9 accounting for purchased or originated credit-impaired financial assets. Instead, this sounds more like the FASB lifetime ECL model.
50	We suggest that the paragraph is amended to be aligned with IFRS 9 wording.	This paragraph states that "the information set considered must go beyond historical and current data, to include forward-looking information and macro-economic factors", while IFRS 9.B5.5.52 indicates "in some cases, the best reasonable and supportable information could be the unadjusted historical information depending on the nature of the historical information and when it was calculated, compared to circumstances at the reporting date and the characteristics of the financial instrument being considered." Further, IFRS 9.B5.5.30 states that "the estimate of expected credit losses does not require a detailed estimate for periods that are far in the future – for such periods, an entity may extrapolate projections from available, detailed information.
51 [59]	As drafted the Committee is requiring banks to incorporate more information than it is required by IFRS 9, which requires an entity to measure expected credit losses in a way that reflects "reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions" (IFRS 9.5.5.17). We would welcome the Committee to amend the paragraph wording to be aligned with IFRS 9 wording.	Paragraph 51 requires the "ECL estimates should always incorporate the expected impact of all reasonable available, forward-looking information and macroeconomic factors" and paragraph 59 states that "a bank must use its experienced credit risk judgement to thoroughly incorporate the expected impact of all reasonable available forward-looking and macro-economic factors on its estimates of ECL".
52	We question whether the Committee meant to write 'simple techniques such as averages…' – if this is the case we suggest amending this paragraph to align with this	We feel that the reference to 'simple averages' is hard to understand. We would expect any average would at least be weighted by the size of the loans or defaults.
53 [P6]	This paragraph could be deleted or alternately we propose "different potential scenarios" be replaced with "a wide range of possible economic circumstances". Add "and supportable" to "reasonable information and refer to "relevant to the drivers of credit risk to the group…"	We are not clear what the paragraph adds to the commentary for Principle 6. ECL accounting does not require complex stochastic modelling of different possible economic scenarios. While this is not to limit the possibilities considered, it would be compliant to determine a single, internally consistent scenario which represents the best estimate. Such an estimate would, by definition, not be overly optimistic (or pessimistic) and will need to be reasonable and supportable to avoid being "purely subjective".

Para	Suggested Changes	Comments / Rationale
		Text should be aligned with IFRS 9 and it should be clarified that it is information about the drivers of credit risk that is relevant (not all the information possibly available).
54	Consider adding "including" before "when assessing…"	Paragraph could be read as implying that estimates should only be unbiased when considering collateral.
58	1) This paragraph could be deleted and replaced with a cross reference to existing CRR articles or related guidance. Any ECL specific commentary could then be added which would clearly stand out, perhaps these might relate to forward looking perspectives. 2) We suggest providing an explanation of what is meant by "plausible stresses" or else delete the reference.	1) We believe that this paragraph duplicates, to a great extent, existing guidance on model validation (for example, Articles 188-191 in CRDIV Regulations). As a result it is unclear whether this paragraph introduces additional specific points relating to ECL. 2) We questions why there is reference to "plausible stresses". Does this mean that the model can accommodate relatively stressed assumptions, or is there a suggestion that stressed assumptions form part of the calculation of ECLs (which in our opinion conflicts with the standard)
P6	We suggest amending to "especially in the consideration of reasonable and supportable forward looking information and macroeconomic factors".	The forward looking information and macroeconomic factors and their impact on ECL should be reasonable and supportable. The use of judgment should not be expected to result in unsubstantiated outcomes.
59 [51]	We propose deleting "thoroughly" and amend "all reasonably available" to "reasonable and supportable forward looking information and macroeconomic factors".	The words "thoroughly" and "all" may imply unreasonable expectations. See also comments made for paragraph 51.
60 [61]	1) Could consider combining paragraphs 60 and 61 or delete the comment about "significant degree of unavoidable subjectivity". 2) Propose amending sentence to align with IFRS 9 requirements.	1) Unavoidable subjectivity can be avoided by meeting the requirements for the information and its impact to be reasonable and supportable. This support may be by formal statistical links but could be reasoned and supported judgement. 2) This paragraph proposes that "costs should not be avoided on the basis that a bank considers them to be excessive or unnecessary" whereas IFRS 9.B5.5.51 suggests "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 expected credit losses".
61 [60]	Same as in 60(1)	Same as in 60(1)
62	We propose adding a full stop and deleting the text after "experienced credit judgement".	We believe there is no IFRS 9 requirement to consider the point in the credit cycle in developing macroeconomic forecasts and it seems unlikely that this could be reasonable and supportable.
63	1) Propose amending sentence to align with IFRS 9 requirements. 2) Suggest replacing "in the latter case" with "in either case".	1) This paragraph states "In estimating ECL, banks may determine either a single amount or a range of possible amounts" whereas IFRS 9.B5.5.7 requires that expected credit losses reflect a probability-weighted amount and IFRS 9.B5.5.18 requires an entity to "consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low". 2) In all cases, the estimate should be appropriate as defined.
64 [30]	We would welcome the Committee clarifying either paragraph 30 or 64 as indicated but only	Same as in 30. We believe this paragraph is making the same

Para	Suggested Changes	Comments / Rationale
	retaining one.	comment as para 30. Only one is necessary and, in either case, it should be clear that the stressed economic scenarios are not the best estimate scenarios used for accounting, but that the process used for linking forward looking information with risk components may have a common basis.
69	1) We would welcome clarification on the basis for calculation ECL for regulatory purposes and financial reporting purposes. 2) We propose deleting "well documented" and replace with "the nature of these differences is understood".	1) It would be beneficial if the guidance was clearer when it expects the basis for calculating ECL for regulatory purposes and financial reporting differences to be different (e.g. point in time versus through the cycle PDs). This would help implementation and encourage the use of common data and processes only where it is appropriate. 2) The last sentence could imply detailed reconciliations are required on say a monthly basis between the expected loss calculations and the ECL calculations.
71	Suggest moving this paragraph after paragraph 4.	We believe this paragraph would fit better in the Objective and Scope section.
75	1) This paragraph could be deleted. Otherwise: 2) Propose deleting "Given that management and users have differing objectives" 3) We suggest the wording be amended to "to highlight policies, definitions and judgments made that are integral to the estimation…"	1) To the extent the guidance duplicates disclosure requirements in the accounting framework, we believe it is unnecessary to repeat. To the extent the guidance attempts to include additional disclosures, we propose a more formal collaborative process between users and preparers, such as through the EDTF initiative. 2) We do not believe it is correct that management and users have different objectives in terms of providing transparent disclosure and its relevance to the paragraph is unclear. 3) The bank's basis for grouping lending exposures into portfolios with similar credit characteristics is not a 'policy' or 'definition' – it is a judgment made in making an estimate.
76	Same as in 75(1)	Same as in 75(1)
77 [79]	Same as in 75(1) 1) We propose deleting this paragraph or at least make it clear that it is only applicable for accounting groupings that are different from those that underlie the common systems under Principle 7. By extension, we also propose deleting "for exposures on which ECL are measured on an individual basis" from paragraph 79. 2) We recommend that process documentation is dealt with under Principle 3.	Same as in 75(1) 1) It is unclear why disclosure principles should differ depending on whether allowances are determined on a portfolio or individual basis and collective assessments may not be integral to all methodologies. 2) Paragraph 77 also requires a 'documented process' which we believe duplicates Principle 3.
78	Same as in 75(1)	Same as in 75(1)
79	Same as in 75(1) 1) Propose deleting "for exposures on which ECL are measured on an individual basis"	Same as in 75(1) 1) It is unclear why disclosure principles should differ depending on whether allowances are determined on a portfolio or individual basis and collective assessments may not be integral to all methodologies.
80 [24(q)]	Same as in 75(1) 1) We propose removing the reference to "recoveries of amounts previously written off" and make this a separate disclosure recommendation. 2) We suggest replacement of 'that this will be provided separately for collective and individual allowances' with 'that lifetime loss allowances will be provided separately for those exposures assessed individually and	Same as in 75(1) 1) We believe that the statement that "recoveries of amounts previously written off" should be an item in the allowance reconciliation is incorrect under IFRS. A write-off is a de-recognition event and the accounting for a recovery will not involve the allowance account. 2) Paragraph 24 (q) refers to 'collective allowances', while paragraph 80 states that

Para	Suggested Changes	Comments / Rationale
	collectively'.	the Committee expects the reconciliation of the allowance account to be provided separately for "collective and individual allowances", implying those that are measured collectively or individually. However, the example given in paragraph IG 20B of the Implementation Guidance of IFRS 9 refers to lifetime losses that are assessed collectively and individually, implying those that are determined to require lifetime ECLs on a collective or individual basis. Did the Committee intend to add a new requirement? Note, also, that if a measurement overlay is used to include forward looking information, then the allowance for an individual asset would be measured partly individually and partly collectively. Splitting out these two components would not seem to be very informative. The concept of a 'collective allowance' makes more sense in the context of IAS 39 than IFRS 9.
81	We suggest that the reference to 'product concentrations' is deleted or amended accordingly.	We questions whether product concentrations etc. should have been referred to before paragraph 81 in principle 8? We believe the requirement would be better positioned if the requirement to disclose came before the requirement to regularly review. Also, product concentrations seem to be a separate issue from ECLs.
P9		
82	(b) We propose "and forward-looking information and macroeconomic factors" is deleted or at least moved to its own point that is clearly about ECL for accounting only. (c) Point could be deleted or rephrased along the lines "the bank's processes for identifying increases in credit risk on a timely basis ensuring ECL allowance estimates are adjusted accordingly". We would also welcome clarification for the emphasis on "riskier exposures". (f) We propose deleting "has been exercised in a robust manner" – as we believe 'properly documented' would be sufficient. (g) We propose deleting "provided to the regulators".	(b) We are unclear whether the intention is that forward looking information would be included in the underlying processes for identifying, classifying and monitoring credit risk. This could drive significant differences in current credit risk processes for information that only needs to be considered for accounting purposes. (c) It is unclear the relation between risk appetite and the identification of riskier exposures, meaning those that increase in credit risk after origination, which is when it is relevant to ECL measurement. It is unclear why the timely identification of changes in credit risk is emphasized for "riskier" exposures when it is already required by the draft Guidance for all exposures (see paragraphs 42, 48 and 87). (f) It is unclear how it can be ascertained that management judgement has been exercised in a robust manner. (g) It is unclear why the forecasts should be provided to the regulators (unless they are requested)
P10	We propose replacing "produce a robust measurement of expected credit losses" with "meets the requirements".	It is not clear what "robust" means in relation to the measurement of allowances.
84	(a) We propose deleting "timely". Instead the Committee could include that the procedures should result in outcomes that are sensitive to changes in cash flow estimates, etc. (b) We propose deleting "collectively assessed". (c) We believe the meaning of this requirement is unclear. We would welcome further clarification from the Committee or propose it is deleted. (e) We propose that this point is deleted or perhaps clarify that the bank's internal processes for measuring ECL are built on sound credit risk assessment (along the lines of Principle 7).	(a) It is unclear why the procedures should be 'timely' other than to meet the reporting deadlines. (b) We believe the guidance should be indifferent to whether allowances are assessed individually or collectively. (c) The reference to the allowance being appropriate in accordance with the relevant accounting requirements and in relation to the total credit risk in the bank's portfolio, implies that the allowances could be appropriate in accordance with relevant accounting requirements and yet not be appropriate in relation to the total credit risk exposure. We do

Para	Suggested Changes	Comments / Rationale
		understand how this can be correct. (e) It is unclear how this would be assessed.
89 [88]	We propose that this paragraph is deleted.	We believe this point is appropriately addressed in paragraph 88.
90 [88]	We propose that this paragraph is deleted or alternatively add this as a point (d) within paragraph 88	We believe this point is appropriately addressed in paragraph 88.
A1	In line 5, we recommend revision to "exposures, and that (unless the exposure is fully secured by collateral) a nil allowance will be rare" and that footnote 26 is deleted. The warning in footnote 26 that valuation of collateral may change over the life of the loan, would warrant an entire paragraph in the main text, that an ECL model requires continued monitoring of collateral values. 2. We recommend that the word 'impairment" in the first line is deleted.	1.Contrary to what is written in A1, nil allowances will not be rare where the exposures are adequately collateralized, such as for much mortgage lending. This should be addressed in the main text rather than explained in the footnote, for two reasons: a) As many exposures will be fully collateralized, a nil allowance will be quite common. b) The message in the second half of the footnote: "as valuation of collateral may change over the life of the loan" seems too important to be relegated to a footnote. 2. It should be noted that IFRS 9 is not 'the impairment standard'.
A2	1. We recommend that the committee replace with "reasonable and supportable forward looking information". 2. We recommend that last sentence to be amended to say: "The methodology used to estimate 12 month ECL should be responsive, allowing for the timely recognition and measurement of changes in loss expectations."	1. As per paragraph 53, IFRS 9 does not require stochastic modelling using different economic scenarios and it would not be possible to assert that "<u>the</u> range of possible future scenarios" has been reflected. 2. The last sentence may imply an allowance that is not unbiased. We agree that banks should adopt an active approach to managing credit risk, but note that paragraph A2 implies the active approach relates to the timeliness of measuring 12-month expected losses. As IFRS 9 only requires measurement at the reporting date this paragraph implies measurement of 12-month expected losses needs to be more frequent than at each reporting period end. Similarly paragraph A18 states that an exposure must be "transferred to LEL measurement as soon as credit risk has increased significantly" which could imply a continuous monitoring of credit risk for accounting purposes as opposed to "if at the reporting period an exposure has increased significantly it must be transferred to LEL". As noted in our covering letter the reference to a 'range of possible future scenarios' should be reconciled with the IFRS 9:B5.5.41 to reflect that at a minimum the range of possible scenarios may be limited to two scenarios.
A3	The beginning part of the paragraph could be deleted. If the intention is to emphasise that there are circumstances that mean the change in risk of a default occurring over the next 12 months is not a reasonable approximation, this could be clearly noted without stating that the risk of default occurring over the expected life of the financial instrument <u>must</u> be considered.	IFRS 9 itself is clear on the meaning of 12 month ECL so it may not be necessary to provide this emphasis. The emphasis on considering the risk of default occurring over the expected life of the financial instrument seems to misquote IFRS 9. Per 5.5.9 entities use the change in the risk of default occurring over the expected life of the financial instrument instead of the change in the amount of expected credit losses. Per B5.5.13 the change in risk of default occurring over the next 12 months may be a reasonable approximation of the change in the lifetime risk of a default occurring. It is unclear whether this paragraph prohibits the use of 12-month ECL to assess whether there has been a significant increase in credit risk. The first sentence in this para appears to indicate that a risk of default over the expected life must be used. However, the following sentence

Para	Suggested Changes	Comments / Rationale
		seems to say that in some case use of 12-month ECL may be appropriate. IFRS 9.B5.5.13states that "for financial instruments for which default patterns are not concentrated at a specific point during the expected life of the financial instrument, changes in the risk of default occurring over the next 12 months may be a reasonable approximation of the changes in lifetime risk of default occurring." The second sentence says that 12-month expected credit losses are losses "due to loss events that could occur in the next 12 months". However, the first sentence of this paragraph and the definition of '12-months expected credit losses' in Appendix A to IFRS 9 refer to "default events" rather than "loss events".
A4 [A5]	We recommend that the last two sentences of paragraph A5 and footnote 29 are deleted or make it clear that these two sentences set out potential differences between the Basel definition of default and significant increase in credit risk for IFRS 9. Ie, replace "Furthermore" with "In addition, in order to consider whether there has been a significant increase in credit risk, …"	Taken together with footnote 29, these paragraphs could imply that a significant increase in credit risk is akin to the unlikeliness to pay criteria in Basel. It is unclear whether the last two sentences in paragraph [A5] are intended to provide guidance on significant increase in credit risk or add to the list of elements provided in Basel, in particular by including forward-looking information in the Basel definition of default. This lack of clarity could result in stage 2 being defined as default and all Basel PD models needing to be recalibrated to predict loans going into stage 2 rather than the current Basel definition of default. We assume that such circularity of definition is not the intention of these paragraphs.
A5	Same as in A4	Same as in A4
A6	We recommend adding "in accordance with normal model development disciplines" to the start of the paragraph. 2. We recommend that reference should be added to "undue cost and delay" in order to clarify use of the term "reasonably". 3. We would prefer to see consistent language being used with reference to 'reasonable' and 'supportable'.	1. The "all" and emphasis on actively incorporating information could be read as overriding normal model development practices which consider a wide range of information in model development but include only information that is shown to impact the result in the final model. 2 We note IFRS 9 clarifies what is reasonable by considering whether the obtaining the information would lead to 'undue cost and delay'. Given the wording in IFRS 9 we propose that the same term should be used in this guidance. 3. Similar to our comment above on paragraph 21 we note 'reasonable' is not accompanied with 'supportable', yet 'supportable' is referred to in paragraphs A19 and A49. We doubt the difference in language is intentional.
A7	We would recommend that the last sentence is deleted or modified to say: "If the credit risk on a financial asset has not increased significantly since initial recognition, the loss allowance is measured at an amount equal to 12 month expected credit losses."	For exposures subject to 12-months expected credit losses, this paragraph introduces a requirement that "a bank must be able to demonstrate that these exposures have not experienced a significant increase in credit risk since initial recognition". IFRS 9 does not contain such requirements and instead requires that entities identify financial instruments for which credit risk has increased significantly.
A8	1. We recommend that the first and last sentences should be deleted or that these sentences are moved to other guidance on underwriting/credit risk management practices. 2. We recommend clarifying that lifetime ECL allowances are only required when there has been a significant increase in credit risk and realign the wording in the paragraph with IFRS 9.	1. High credit risk is not defined and it may be inappropriate for accounting guidance to include assumptions about loan origination and recommendations for sound underwriting and credit risk management practices in the IFRS 9 appendix. 2. Paragraph A8 notes that loans with a higher risk have a greater volatility of credit risk and have a more readily rapidly decline in credit quality.
A9	1. We recommend that the word "robust" be deleted or changed to "will allow timely	1. As drafted and including the word "robust" this

Para	Suggested Changes	Comments / Rationale
	recognition of changes in credit risk to be reflected in the allowance”. 2. Presumably what this paragraph is trying to say is that if the credit risk is considered to have increased, then this should be reflected in the 12 m ECL measurement before the increase is sufficiently significant that the allowance is measured on a lifetime basis. This could be achieved by deleting “taking into account the migration of credit risk”.	could imply a biased or unsymmetrical implementation. 2. The wording ‘taking account of the migration of credit risk’ is confusing since it implies that the 12m ECL requirement should anticipate ‘migrations’ to a lifetime ECL measure, which would not be consistent with the standard. Further, only exposures can ‘migrate’, credit risk cannot.
A11	We recommend deleting the wording “and that grouping of financial instruments does not obscure information”.	It may be that demonstrating that a grouping does not obscure information is an impossibly high hurdle. We think it should be sufficient that the group meets the criteria in IFRS 9 to share risk characteristics.
A13	We would consider not retaining the whole paragraph as it could be referenced to Principle 4 (which may be amended as indicated above) retained. If a sentence on groupings is required, we recommend that it should be redrafted along the lines that “Banks should not obscure information about significant increases in credit risk by grouping financial instruments with different risk characteristics.”	This paragraph could be read as requiring individual assessments as there may be groupings made on the basis of shared risk characteristics but they may not all have identical credit risk.
A15	We recommend that if the paragraph is to be retained, the second sentence should be changed to: “Where post-origination credit risk has increased to such an extent that it is unlikely to be compensated by the interest rate charged, this is likely to represent a significant increase in credit risk.” We recommend also considering the consistency with A29 which, rightly, recognises that changes in PD might have different significance depending on the starting point.	This paragraph seems assume that pricing methodologies are solely focussed on credit risk rather than incorporating a range of other factors such as the general price of credit risk, changing capital requirements, competitiveness considerations, etc. It also does not seem to take adequate account of the instance where loans may be originated at fairly wide credit grades for the same pricing. Therefore it seems to be overstating the link between pricing and credit risk when concluding that “any” post-origination increase is significant. It also does not seem to be aligned to the understood meaning of “significant”.
A20	We recommend the committee to remove these repetitions.	Similar points are made in paragraphs A22, A23, A59 regarding significant increases in credit risk may occur before a financial instrument becomes past due (i.e. delinquency is a lagging indicator)
A22	We recommend that the wording “to be used on its own” should be added after “appropriate” to the last sentence.	Last sentence could imply that delinquency data should not be used in ECL. Given that this information is used as part of the underlying credit risk management and as part of the framework for the regulatory requirements, this seems to overstate the point that is just that delinquency information is backward looking and should not be used on its own.
A23	1. We suggest these paragraphs (A23 and A24) should not be retained and if retained, the sentence “(such as the sector from which they earn their primary income)”, should be changed “supported by persuasive evidence” to “banks will need to obtain reasonable and supportable information about the linkages…” and add “One way of doing this is to “ to the last sentence. 2. It is not clear what the use of this word is supposed to mean in his context. Could “objective” just be deleted?	1. These paragraphs seem to be quite detailed and specific. If interpreted as requirements, they could impair bank’s ability to determine how best to apply forward looking information and could also imply that unintended consequences such as requiring customers to re-verify their affordability factors, which may not be legally possible or commercially reasonable. For instance: In paragraph 23 “supported by persuasive evidence” may be interpreted as a different standard of proof than the “reasonable and supportable” as required by IFRS 9. 2. The word ‘objective’ in ‘objective’ level of credit risk’ may not be correct – it is the nature of credit risk that it is never objective.
A24	Same as in A23.	Same as in A23.
A27	1 & 2. We recommend replacing “any of conditions (a) to (f) below” with “ IFRS 9 B5.5.17.	1. It is unclear why these particular points, which are included in IFRS 9 B5.5.17 (although worded

Para	Suggested Changes	Comments / Rationale
	and deleting points (a) to (f). If that is not acceptable, at a minimum delete footnote 33 and amend "change in" to "a significant increase in credit risk since inception" in point (a). .	differently), have been singled out for particular attention. It would be more consistent with high quality implementation if banks were advised to consider all the indicators in IFRS 9. Some of the points that are included are unclear (e.g. what is "an internal credit assessment summary indicator" or "deterioration of relevant factors"?) and they appear to add nothing to the existing guidance in IFRS 9. Perhaps more importantly, point a and footnote 33c do not recognise that banks' pricing methodologies typically consider a range of factors, such as general price of credit or other factors such as economic, commercial or regulatory factors. Credit risk is only one factor that influences pricing. Pricing is a lagging indicator since the deterioration on the previous lending will have to be identified before it can be factored into the credit spread within the pricing. Given the nature of pricing, it will be difficult to rebut such a presumption and 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 (and if it is, it is because the increase in credit risk on the existing loans has already been identified). Therefore it could be interpreted that the footnote would result in lifetime expected loss being recognized where there is no significant increase in credit risk, and is not compliant with IFRS 9. 2. Further, the rebuttable presumption refers to "any increase in credit spread", which would be impossible to apply if the bank cannot distinguish increases in credit spread from changes in gross margin due to other factors. Hence, as worded, the test is unworkable. The paragraph adds 7 other factors to be considered on the top of those factors that are included in IFRS 9:B5.5.17 (a)-(p) noting that "the presence of any of conditions (…) would suggest that there has potentially been a significant increase in credit risk". IFRS 9 lists factors that "may be relevant in assessing changes in credit risk". We consider the guidance places weight that such factors are presumptively an indicator of an increase in credit risk which is not the approach for the comparable guidance in IFRS 9. Where the credit risk element of loan when priced is 'higher' than that of a loan previously originated we do not consider that this always evidence that that there has been a significant increase in credit risk. Similarly, where a loan is priced "lower" we do not consider this is evidence that there has been a significant decrease in credit risk. Given this we believe the paragraph could be amended to reflect that the credit risk component should be 'significantly higher' from the credit risk element when previously originated.
A28	Suggest "full account" is deleted and replaced with "consider to the extent information is available without undue cost and effort". .	This paragraph may imply that factors that are not relevant (or reasonable and supportable) should be taken into account. See comments in Principle 6 with regard to regional differences.
A29	1. Consider explaining the conclusion that readers are expected to draw from the last sentence or replace with a statement from IFRS 9 B5.5.15 that credit analysis is multifactor and holistic. 2. What is possibly meant to be said here is that some grades or rating categories can span a	1. It is possible that a significant increase in credit risk could occur before lending exposures experience even a one notch down grade. This is reasonable because credit risk analysis is multifactor and holistic. However, it is not clear what the point of the statement in its context. Is it that notches should not be used for transfer (which would unduly restrict implementation

Para	Suggested Changes	Comments / Rationale
	large range of PDs so that there can be a large increase in PD within a single grade. Possible wording might be, "a small change in the grading can be associated with a large increase in the probability of default." If this was the Committee's intended meaning, we recommend that the second half of the paragraph starting with "It is also necessary" is replaced by "Depending on how finely graded is a bank's exposure grading system, it is possible that a significant increase in credit risk might occur before an exposure is downgraded." Alternatively, if the Committee was concerned that loan gradings may not reflect all the information required to make an individual assessment, the wording would have to be completely different. As we have already noted in the cover letter, the guidance would be much clearer, if those sections appropriate to loans assessed individually were separated from those that relate to a collective assessment. In any event, the term 'a notch' should be avoided, or else defined.	approaches) or that credit rating processes must be sufficiently frequent to pick up changes in credit risk or that more than notches should be considered (or that an approach based on mechanically comparing notches should also incorporate credit judgement, which may be impractical for large volumes of retail loans)? *2*. The statement that "small changes in credit quality can be associated with a large increase in the probability of default" is contradictory – we question how credit quality would be defined if this statement were true. The wording later in the paragraph that "it is necessary to look beyond how many "notches" a rating downgrade entails because the change in PD for a one notch-movement is not linear"… reads oddly, since (as already stated in this paragraph) the IFRS 9 ECL model is based on relative rather than absolute increases in credit risk, and so a non-liner gradation system would seem to provide what is needed. There would only be a problem if a one notch movement was based on a linear and absolute change in PD. Also in paragraph A29, a 'notch' can be read to refer to the smallest gradation used by the credit rating agencies, in which case it is unclear what would be meant by "it is possible that a significant increase in credit risk could occur before lending exposures experience even a one-notch downgrade". In what circumstances would a decline smaller than one notch be significant? Or is the Committee trying to make the point that a loan grading system may not provide all the information necessary to assess whether there has been a significant increase in credit risk, i.e. where this will need to be assessed on a top down portfolio basis?
A30	Consider expanding A29 to capture the idea in IFRS 9 B5.5.9 so both ideas are illustrated in paragraph A29.	The paragraph may be incomplete because it does not also acknowledge that the pricing of instruments based on their original credit rating will also take into account the propensity for the rating to change therefore its sensitivity of default probability,
A31	1. The section could be deleted since the point is adequately addressed in the main document. At the minimum, change last sentence to refer to an appropriate governance process and delete the rest of the sentence.	1. It is difficult to see how any governance process can reliably <u>validate</u> judgements let alone that negative factors are counterbalanced by positive ones. All forecasts are just that and cannot be verified in hindsight. Applying forward looking factors is equally important for measurement and transfer and there is already a lot in the guidance on forward looking information and its governance. Also paragraph A31 seems to mix statistical significance and the IFRS 9 significant increase criterion, and the point it makes would be clearer without this potential source of confusion.
A32	We would recommend deleting this paragraph since the points about credit rating processes being sensitive to risk are already set out in a lot of detail in Principle 3.	Given that determining significant deterioration will involve some comparison of current probability of default with probability of default at origination, it does not seem logical to assert that any change in internal credit rating results in significant deterioration as this paragraph appears to do. As the lowering of a credit rating does not necessarily equate to a significant increase in credit risk we question whether an alternative example may better illustrate the point
A33	We would recommend that the committee consider deleting "differences in the seniority of individual exposures".	Since determination of whether there has been significant deterioration is about the change in the risk of default occurring rather than the

Para	Suggested Changes	Comments / Rationale
		change in the amount of expected loss (IFRS 9 4.4.9), it is not clear that differences in seniority should affect the decision.
A34	1. We would recommend that the committee consider deleting this paragraph or clearly redrafted to address judgemental overlays where changing economic conditions that are not adequately addressed in the models may need to be included by an ad hoc grouping which will need to be properly governed. 2. The wording should refer to "shared risk characteristics" as used in the standard. Hence "remain homogenous" in paragraph A 34 would be written as "continue to share risk characteristics".	1. Please see the comments on paragraphs 44-48 where grouping has already been extensively discussed. This paragraph seems unnecessary and could be read as essentially requiring individual assessments since it is not possible to otherwise ensure an increase in credit risk of an individual exposure could not be masked – homogenous groupings are unlikely to be identical. 2. Generally, the word "homogenous" is too strong when considering exposures managed on a portfolio basis. The best that can probably be achieved is that a portfolio will be 'reasonably homogenous'
A35	1. & 2.We would recommend that the committee consider aligning the paragraph with IFRS 9. Given the comments on paragraphs 40-48 it may be more useful to suggest that there may be circumstances, particularly relating information that cannot be readily included in the models, where an adjustment by way of a collective overlay may need to be applied to individually or collectively assessed financial instruments but that in those circumstances the Committee expects a properly governed process so it is clear why the adjustment is necessary and when it will be removed.	1. It appears that this paragraph misrepresents IFRS 9 B5.5.1 which says that it may be necessary to perform the assessment on a collective basis, rather than that it is required. The last sentence does not seem to be clear – if it is apparent that an exposure has experienced a significant increase in credit risk, than it must be possible to identify it. It is unclear whether this paragraph is intended to prevent individual assessments or collective assessments or is actually suggesting situations when judgemental overlays 2. The paragraph refers to "the relevant group or subgroup" that needs to be transferred to LEL whereas paragraph A36 refers to the "proportion of the group". We are unsure of the relationship between these paragraphs. We question whether the proposed guidelines are trying to align with the 'bottom up' and 'top down' approaches in IFRS 9:IE38 & 39.
A36	1. We would recommend that the committee consider aligning the paragraph with IFRS 9. Given the comments on paragraphs 40-48 it may be more useful to suggest that there may be circumstances, particularly relating information that cannot be readily included in the models, where an adjustment by way of a collective overlay may need to be applied to individually or collectively assessed financial instruments but that in those circumstances the Committee expects a properly governed process so it is clear why the adjustment is necessary and when it will be removed. 2. We suggest this is rewritten as "Consistent with paragraph IE 39 of the Implementation Guidance to IFRS 9".	1. It appears that this paragraph misrepresents IFRS 9 B5.5.1 which says that it may be necessary to perform the assessment on a collective basis, rather than that it is required. The last sentence does not seem to be clear – if it is apparent that an exposure has experienced a significant increase in credit risk, than it must be possible to identify it. It is unclear whether this paragraph is intended to prevent individual assessments or collective assessments or is actually suggesting situations when judgemental overlays may be required. 2. IE39 is not part of IFRS 9 and should not be given such prominence in the guidance.
A37	We recommend that paragraph A37 is simplified to say, '"Significant" should not be equated with statistical significance". Meanwhile, in paragraph A31 we suggest the deletion of "the deterioration in a particular factor is statistically very small (judged in relation to past data on it), or"	The wording of paragraph A37 can be improved. It is obvious that the 'significant' notion in IFRS 9 has nothing to do with the notion of significance in statistics. But the next clause, "meaning that the assessment should not be based solely on quantitative analysis" is a non-sequitur. The point is not about qualitative versus quantitative analysis, but that 'significant' has nothing to do with statistical significance.
A39	We would recommend deleting "robust". Rather than suggest how review could be performed, just refer to the need for model review as noted in the main part of the document. This model review will consider whether the factors being used need to be changed.	It is unclear how such a review would be "robust". Given that the transfer is not based on a defined event, it will be difficult if not impossible to determine with hindsight whether or not the transfer has occurred at the "right" point, particularly where forward looking assumptions have been applied. While the

Para	Suggested Changes	Comments / Rationale
		suggestion is not written as a requirement, it may be unrealistic. Rather the whole IFRS 9 modelling approach will be subject to the model review and validation process and this may be sufficient for the point.
A40	We would recommend that the committee consider removing reference to bias from the paragraph and then consider whether it adds anything to the section on the use of 30 days past due criterion. If it does not, then the whole paragraph can be deleted.	We do not agree that the use of practical expedients would introduce bias. As a matter of principle, we do not agree that the use of practical expedients is representative of the quality of the implementation of IFRS 9. The IASB introduced these simplifications where it was considered that their use would be consistent with the principles of the standard. Their inclusion avoids each entity wishing to apply the simplification having to prove that the impact is immaterial, which is often impractical. While attempting to restrict their use arguably does not result in the guidance being incompatible with IFRS 9, the rationale should not be linked to bias or to a lower quality implementation.
A41	We would recommend that the committee consider deleting "of this kind".	Our understanding of IFRS 9 is that whether an entity assesses a significant increase in credit risk on a collective or individual basis that either approach should lead to the same measurement outcome. Consequently we are confused that paragraph A41 states that a use of a practical expedient that in the Committee's view introduces bias by delaying the recognition of LEL can be overcome by using a collective assessment to "correct for identified bias".
A42	We would recommend that the committee consider aligning the paragraph with IFRS 9.	This paragraph refers to modification of "contractual terms and resulting cash flows" whereas IFRS 9.B5.5.12 refers to modification of "contractual cash flows".
A43	We would recommend that the committee consider rewording this paragraph in line with our consideration.	This paragraph refers to "transfers to LEL for obligors whose credit quality has significantly deteriorated". However, and entity may have multiple exposures to a single obligor, only some of which are measured at lifetime ECL. This is because an exposure is subject to transfer if its credit risk – rather than that of the obligor – has increased significantly since the initial recognition of the exposure.
A44	We would recommend that the committee consider rewording or providing an example of what is intended.	It is not clear what is meant by "relevant forward-looking implications of the modifications for the credit quality of the exposure (taking into consideration the credit quality of the obligor).
A45	The duplication and inconsistency with A42 can be reduced by deleting the sentence or at least restate it along the lines of A42 The section would flow better if this paragraph were merged with A42 and A43.	It is misstating IFRS 5.5.12 to suggest that banks need to obtain evidence that the credit risk has not increased and it is difficult if not impossible to prove such a negative. Rather, as already noted in A42, the assessment of credit risk is made by reference to the risk of default occurring at origination (based on the original terms) with that at the reporting date (based on the modified contractual terms). The paragraph notes that a borrower would have to demonstrate consistently good payment behaviour for a loan to move from LEL to 12m ECL. It may be beneficial to also include examples relating to wholesale lending where other factors may be indicative of a transfer from LEL to 12m ECL, such as recapitalisation, changes in the seniority of debt.
A46	The paragraph would benefit from references to proportionality (as modified by the comments discussed in paragraph 11 above) and materiality (as suggested in the comments on paragraph 15 above).	Please see comments for para A40 regarding our disagreement that the use of practical expedients is inappropriate. While we agree that cost should not be used as an excuse for obtaining reasonable and supportable

Para	Suggested Changes	Comments / Rationale
		information, equally there are situations where the inability to obtain sufficient information to develop complex models is not available at any cost. As noted above, the guidance does not override materiality judgements made by management and it is not consistent with a high quality implementation to introduce unnecessary complexity and operational risk.
A48	We would recommend that the committee consider deleting “exceptions from the core requirements of the Standard” and “and disclosed”.	We question the statement that the practical expedients are “exceptions from the core requirements of the standard”. They have been included in the standard since they represent implementation methods which are considered to appropriately apply the requirements. Therefore they are consistent with applying the standard and not an exception from the requirements. Given this, we would consider that their use should not be disclosed as it cannot be material.
A49	1. We would recommend that the committee consider adding “The Committee does not expect cost and operational risk to be introduced where this does not contribute to a high-quality implementation” to the end of the paragraph. 2. The Committee might consider amending the final sentence to “This will potentially require costly upfront investments in new systems and processes and acquisition or calculation of historical loss information, but the Committee….”	1. The paragraph should also acknowledge that unnecessary cost and complexity, which will increase operational risk at no benefit to the quality of implementation, is not intended by the Committee. *2.* This paragraph appears to draw a distinction between “reasonable and supportable” information and information that can be obtained without undue cost or effort in the third and fourth sentence respectively. This is inconsistent with IFRS 9.B5.5.49 which defines “reasonable and supportable” information as information which is “reasonably available at the reporting date without undue cost or effort”.
A50	We would recommend that the committee consider adding “for their lending business” after “banks”.	We are uncertain as to whether the intention for this paragraph is not to apply to debt securities. The proposed guidance considers the low credit simplification as a practical expedient. We disagree. The IASB decided to allow rather than require this simplification (IFRS 9:BC5.183) “to reduce the operational costs and make the model more cost effective” noting that such an approach should be available so it more aligned with a bank’s internal credit risk systems (IFRS 9:BC5.180). Given the IASB’s stated reason for introducing the simplification we do consider the use of such an approach should be rare and is associated with a low-quality implementation.
A51	We suggest A50 and A51 are combined as follows: A51. The Committee regards the low-credit-risk exemption as merely an operational simplification to avoid considering whether there has been a significant increase in credit risk. The Committee expects banks to continue to assess all exposures for changes in credit risk and recognise changes in 12-month ECL through the allowance where there is not a significant increase in credit risk. However, the Committee recognizes that the initial credit risk of a loan is important in determining the significance of any increase in credit risk since, if this is not considered, a change in absolute terms in the risk of a default occurring could 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 which would be contrary to IFRS 9 B5.5.9..	It should be clarified that it is only the use of the “low credit risk exemption” as an operational simplification to avoid tracking that is of concern to the Committee and not the consideration of whether a loan is low credit risk at initial recognition in determining whether an increase in credit risk is significant. It also appears that paragraph A52 requires an assessment of credit risk to be made in all situations so that 12 month ECL allowance can be determined regardless of whether there is a significant increase in credit risk. This implies that the Committee is indicating that they consider that the operational simplification of avoiding tracking is <u>never</u> appropriate. If this is the intention, paragraph A51 and A52 should be clarified and A53 – A58 deleted: If tracking is always required, then the additional guidance and disclosure requirements would never apply and are superfluous.
A52	A51. The Committee regards the low-credit-risk exemption as merely an operational simplification to avoid considering whether there	.

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	has been a significant increase in credit risk. The Committee expects banks to continue to assess all exposures for changes in credit risk and recognise changes in 12-month ECL through the allowance where there is not a significant increase in credit risk. However, the Committee recognizes that the initial credit risk of a loan is important in determining the significance of any increase in credit risk since, if this is not considered, a change in absolute terms in the risk of a default occurring could 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 which would be contrary to IFRS 9 B5.5.9..	
A53	Delete as would not apply if tracking is always required.	If tracking is always required, then the additional guidance and disclosure requirements would never apply and are superfluous.
A54	Delete as would not apply if tracking is always required.	If tracking is always required, then the additional guidance and disclosure requirements would never apply and are superfluous.
A55	Delete as would not apply if tracking is always required.	If tracking is always required, then the additional guidance and disclosure requirements would never apply and are superfluous.
A56	Delete as would not apply if tracking is always required.	If tracking is always required, then the additional guidance and disclosure requirements would never apply and are superfluous.
A57	Delete as would not apply if tracking is always required.	If tracking is always required, then the additional guidance and disclosure requirements would never apply and are superfluous.
A58	Delete as would not apply if tracking is always required.	If tracking is always required, then the additional guidance and disclosure requirements would never apply and are superfluous.
A59	Consider redrafting the last sentence to only refer to the use of the more than 30 days past due rebuttable presumption rather than to significant reliance on past due information.	Past due information is included in credit scoring and is included in Basel credit components such as PD. As such the last sentence could imply that even credit scores and PDs cannot be considered in determining transfer because they include some past due information and often this is a significant component. This would go beyond just discouraging the use of 30 days past due as the sole transfer criteria. As noted above, we do not agree that the use of exemptions which are included in the standard should be a reflection on the quality of implementation.