ICAEW REPRESENTATION 02/17

Regulatory treatment of accounting provisions - interim approach and transitional arrangements – consultative document

ICAEW welcomes the opportunity to comment on the *Regulatory treatment of accounting provisions - interim approach and transitional arrangements – consultative document* published by Basel Committee on Banking Supervision on 13 October 2016, a copy of which is available from this link.

This response of 13 January 2017 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

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

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact fsf@icaew.com

icaew.com

MAJOR POINTS

1. ICAEW broadly supports the Basel Committee on Banking Supervision (hereafter referred to as "Basel" or "the Committee")'s aims of reviewing the regulatory treatment of accounting provisions in light of the introduction of new accounting standards (IFRS9 for accounting periods beginning on or after the 1 January 2018 and CECL for accounting periods beginning on or after 1 January 2020 for SEC filers and 1 January 2021 for all other entities).

2. ICAEW supports the development and application of robust prudential regulatory capital standards to banks and other financial institutions which aligns with its support of well-functioning capital markets and financial stability.

3. Given the complexity of both the expected loss accounting standards[1] and the prudential regulatory capital regime we support the Committee's initiative to examine the interaction between the two regimes to ensure that there are no unexpected or undesired outcomes arising from the adoption of the new accounting standards. The expected loss accounting standards could result in accounting that is volatile and pro-cyclical, particularly under stressed conditions and this means that it is necessary that the interaction with the regulatory requirements is well understood.

4. A range of stakeholders (regulators, analysts, investors, wider capital markets, users of financial statements, customers) need to have confidence in banks and other financial institutions and we welcome the opportunity to feed into the Committee's examination of the right way to align the accounting and regulatory regimes and also the decision as to whether there should be any transitional approach.

5. Whilst we support the Basel Committee examining this issue we believe that the timing of this exercise has not been very well scheduled. It is not aligned with the overall re-calibration exercise going on for both the standardised approach to credit risk and the internal ratings based (IRB) approach to credit risk through the analysis of variability of risk weightings. In addition, most organisations remain in the implementation phase of their IFRS 9 projects and so do not yet have final IFRS 9 impact numbers with which to support accurate regulatory Quantitative Impact Studies (QIS). The work on the US standard is even less progressed.

6. ICAEW supports proposals which encourage a level playing field amongst organisations both across jurisdictions and within an individual jurisdiction. It also supports the goal of comparability across and within jurisdictions and in its proposals the Committee should aim to ensure consistency and comparability wherever possible.

7. At a time when the variability of regulatory capital calculations is being examined more broadly through the Committee's other work, ICAEW would also make reference to its recent discussion paper[2] on assurance frameworks for Risk Weighted Assets (RWA). Expected loss accounting standards, coupled with the global variability in interpretation of the definitions of general and specific provisions, is likely to generate additional variability in RWA outcomes and further drive the need for RWA assurance.

8. ICAEW's aim in this response is to provide overall thematic observations on matters of principle and specific comments on each of the two papers (consultation paper and discussion paper) where relevant.

---

[1] Throughout this response we refer to expected loss accounting standards and mean both the IASB's IFRS9 requirements and the FASB's CECL requirements

[2] ICAEW discussion paper on RWA assurance frameworks https://www.icaew.com/en/technical/financial-services/inspiring-confidence-in-financial-services/banking-regulatory-ratios

Specific comments on the Consultation Paper (CP)

In addition to the over-arching thematic points made in the introductory section, ICAEW has the following specific points to make regarding the CP:

9. In principle, we support an approach to transition that provides some flexibility for firms and regulators to understand the dynamics of how the new accounting regime interacts with the prudential regulatory capital regime (and in particular the potential volatility and pro-cyclicality that might be exacerbated under stress testing conditions) and provides time for the regulators to determine the long term future approach.

10. We support the design of a transitional methodology that provides flexibility to respond to movements in provisions over the transitional period. Given the potential delay the Committee has identified in agreeing the outcome from the Discussion Paper then some form of transition is appropriate.

11. We support the proposal for firms to make full disclosure of their impacts on an adjusted and unadjusted basis, subject to the following observations:

    a) Whilst the Committee has not committed to making amendments to the long term capital treatment (see the Discussion Paper section), the end point position is currently uncertain and so the “unadjusted basis” may not represent what the actual capital position will be at the end of the transitional period; and

    b) The proposed full disclosure would make clear the range of different approaches adopted towards the prudential capital treatments for so-called General Provisions (GP) and Specific Provisions (SP) globally at the moment. Whilst some regulators (notably the European Banking Authority (EBA)) have sought to clarify how existing IAS39 provisions should map to so-called General Credit Risk Adjustments (GCRA) and Specific Credit Risk Adjustments (SCRA) this is not universal practice. There are a range of options for mapping the future IFRS9 provisions to GP/SP or GCRA/SCRA and if such an approach is not taken, then the current variability in approaches is likely to continue. If the Committee were to provide greater clarity then this would have the benefit of achieving a principle of consistency. It would have an impact on TLAC/MREL which would need to be considered and would help to flush out previous anomalies in the system.

Conclusions

12. In determining the future shape of the Global financial regulatory architecture, the overarching objectives should be to develop robust regulation to maintain confidence in the system, and to ensure it is within a consistent international framework. Our key concerns are to ensure that:

- The Basel Committee provides clarity over some of the ambiguous underlying principles that cover how the prudential regulatory framework interacts with the expected loss accounting standards;

- The proposals are considered within the context of the wider prudential regulatory capital changes being consulted on and agreed to avoid any stop-start behaviour;

- That level playing field and consistency issues both within and across jurisdictions are paramount; and

- Appropriate time is provided for transitional rules to support the overall goal of financial stability.