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30 April 2015

Dear Sirs

Consultative Document – *Guidance on accounting for expected credit losses*

We appreciate the opportunity to comment on the Consultative Document – *Guidance on accounting for expected credit losses* (the Document) issued by the Basel Committee on Banking Supervision (the Committee) in February 2015. We have consulted with, and this letter represents the views of, the KPMG network.

We welcome the Committee's review of their existing guidance *Sound credit risk assessment and valuation for loans*, issued in June 2006 (the 2006 Guidance), to reflect lessons learned from the financial crisis and the anticipated transition to expected credit loss accounting models in most jurisdictions.

We believe that banking supervisors have an important role to play in overseeing quality implementation of accounting standards and that all stakeholders should work together toward this mutually-beneficial outcome. While the primary focus of banking supervisors, accounting standard setters and auditors may differ, there is common interest in high-quality financial reporting. In addition, as auditors, we share an interest with banking supervisors that banks have well-documented, quality processes and effective systems of internal control in place with respect to credit risk assessment and the development of related accounting estimates.

As a result, we agree with most of the principles contained within the Document. However, to better support those principles, we recommend enhancements to the draft guidance in the following areas:

- Objective
- Scope
- Consistency

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- Materiality
- Proportionality
- Guidance on IFRS 9 *Financial Instruments* (IFRS 9)
- Documentation
- Model validation
- Clarity of drafting
- Interaction with a financial statement audit

Objective

The Document acknowledges that, once finalised, it will replace the 2006 Guidance. We note that the 2006 Guidance was "*intended to provide banks and supervisors with guidance on sound credit risk assessment and valuation policies and practices for loans regardless of the accounting framework applied*". However, the objective of the Document as stated in paragraph 1, "*to set out supervisory requirements on sound credit risk practices associated with the implementation and ongoing application of expected credit loss accounting models*" appears narrower than the 2006 Guidance that dealt with the principles of sound credit risk assessment more generally. The title of the Document "*Guidance on accounting for expected credit losses*" may suggest an objective that is yet more narrow.

We recommend that the Committee clarify the objective and title of the Document and then reflect this objective consistently throughout the Document.

Similarly to the 2006 Guidance, the Document has to be read in the context of other guidance on credit risk management issued by the Committee. The *Principles for the Management of Credit Risk* were issued by the Committee in September 2000 and provide an overall framework for the supervisory guidance on management of credit risk. Some of those principles relate to credit risk assessment and the adequacy of provisioning and so are relevant to the topics discussed in the Document. Where the Document expands on concepts contained in other papers issued by the Committee we urge the Committee to cross-reference to those other papers and focus in the Document on incremental guidance only. Furthermore, by limiting the detailed discussion of a topic to a single source document the Committee would avoid needing to update multiple documents to effect changes or updates.

While paragraph 14 of the Document refers to "*separate papers on a number of related topics in the areas of credit risk, including credit risk modelling and credit risk management*", we believe the Committee's objective would be better supported if the Committee explained how the Document fits within the context of the Committee's existing papers.

Scope

The Committee should give more prominence to the following important statements about the scope of the Document by discussing them in a separate section on 'Scope':

- the guidance contained in the Document is intended only for 'internationally active banks' (currently in paragraphs 12 and 15); and

- certain types of exposures, such as debt securities, are outside the scope (currently in paragraph 13).

In addition, it would be helpful for the Committee to clarify what is meant by the following terms used in paragraph 13:

- "lending exposures" – e.g. whether they include balances resulting from reverse securities repurchase transactions, loan commitments, or financial guarantee contracts;

- "debt securities"; and

- "other bank exposures" as the paragraph gives debt securities as an example of items that are excluded from the scope of the Document.

Consistency

The Document refers in a number of places to consistency. Consistency is an important concept underlying both prudential reporting and financial reporting. However, it is also a concept open to different interpretations. For example, it can refer to consistency of processes or consistency of outcome, to reporting by different parts of the same organisation, to reporting by the same organisation over time, or to reporting by different organisations. We recommend that the Committee defines what it means by 'consistent'.

We support the principle of consistent interpretation of accounting standards, as discussed in paragraph 3 of the Document, but note that consistent interpretation of IFRS 9 will not necessarily result in consistent outcomes as the latter should reflect entity-specific facts and circumstances and reasonable judgment exercised by management. Therefore, outcomes may not, necessarily, be directly comparable from bank to bank.

We believe that the goal of consistent interpretation of the impairment requirements of IFRS 9 across different entities, not only those to which the Document applies, would be better promoted by stakeholders working together toward this objective rather than each stakeholder issuing separate interpretative guidance. Accordingly, we recommend that the Committee encourage the International Accounting Standards Board (IASB) – working with its IFRS Transition Resource Group for Impairment of Financial Instruments – to develop further guidance that will assist in consistent interpretation and application of IFRS 9. This would also help to prevent increased complexity of implementing IFRS 9 caused by the need to comply with multiple, and potentially inconsistent, guidance issued by different stakeholders.

IFRS 9's expected credit loss model, including determining 'significant increases in credit risk' and the measurement of expected credit losses, requires an entity to exercise more judgement than is required by its predecessor, IAS 39 *Financial Instruments: Recognition and Measurement*. As a result, we strongly support Principle 8 as we believe that appropriate disclosures, including explaining how judgment has been exercised, helps to drive consistency as it enables stakeholders to identify outliers more easily and preparers better to understand the best practices adopted by their peers. In addition, banking supervisors can play an important role in promoting consistent application during the period until the effective date of IFRS 9 (when disclosures become publicly available), for example, by providing a platform for banks to share their views on the application of certain key concepts such as 'significant increase in credit risk' or the definition of default.

Materiality

One of the primary objectives of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors in making decisions about allocating capital to the entity. The concept of materiality is important when discussing accounting requirements as immaterial matters are not relevant to such decision-making. Materiality is also relevant to the general aspects of credit risk management. Where the Document appears to be drafted without regard to materiality, we are concerned that the high implementation thresholds may potentially lead to very high implementation costs while achieving only insignificant incremental improvements to reporting over an approach that did consider materiality. This concern relates both to applying the guidance to immaterial exposures as well as to material exposures in a disproportionate and inflexible manner beyond the point necessary for management to ensure that the financial statements will 'give a true and fair view' in accordance with the relevant financial reporting framework.

For example, paragraphs A50 to A58 discuss the 'low credit risk' simplification under IFRS 9. We agree with the IASB's observation that "*for financial instruments with low credit risk, the effect of that simplification on the timing of recognition and the amount of expected credit losses would be minimal*" (IFRS 9.BC5.180). Consequently, we believe that appropriate application of this simplification by banks would not lead to a low-quality implementation of the expected credit loss model in IFRS 9 or less investor protection, and therefore encourage the Committee to re-consider its position on this issue.

Examples where the Document appears to be drafted without regard to materiality have been provided in the appendix[1].

[1] See comment (1) in the appendix to this covering letter

Proportionality

We support the Committee's assertion in Paragraph 12 that supervisors may "*adopt a proportionate approach*" and that this "*allows less complex banks to adopt approaches commensurate with the size, nature and complexity of their lending exposures*". However, we believe the Document would be improved by providing examples of how the requirements (for both credit risk management and implementation of the accounting models) might be adjusted to achieve proportionality for smaller, less complex banks as well as for smaller, less complex lending activities within internationally active banks. An example of an area where proportionality may be relevant is the "*undue cost and effort*" guidance discussed in paragraph A49.

Guidance on IFRS 9

Certain paragraphs in the appendix to the Document paraphrase guidance, or discuss concepts similar to those, contained in IFRS 9. In these cases, it is unclear whether the Committee intends for the guidance in the Document to be subtly different from IFRS 9 or whether the difference in language is not intended to convey any difference in meaning. In addition, certain paragraphs in the main body of the Document contain guidance that, as currently drafted, could be interpreted as being inconsistent with IFRS 9. Examples where the Document appears to paraphrase or provide guidance that could be interpreted as being inconsistent with IFRS 9 have been provided in the appendix[2].

The language used by the Committee will be analysed by supervisors and banks for many years to come as they endeavour to understand what the Committee intended and whether, and how, it may be different from the requirements of IFRS 9. We encourage the Committee to use the same language as that in IFRS 9 whenever it is the Committee's intention for its requirements to be the same. Conversely, where the Committee intends guidance in the Document to be incremental to that in IFRS 9, we recommend that the Committee state so explicitly.

In a number of places the Document seems to imply that the guidance on accounting for expected credit losses be applied on a real-time basis. However, while the management of credit risk may require many processes and controls to operate on a continuous basis, the measurement and disclosure requirements of accounting standards are intended for, and relevant principally to, periodic financial reporting. We have provided examples of such instances in the appendix[3]. We recommend that the Committee considers clarifying this distinction.

In addition, we believe that the Document should place more emphasis on the usefulness and validity of delinquency data and historic information because both are important and objective anchors from which expected credit losses are measured.

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[2] See comment (2) in the appendix to this covering letter
[3] See comment (3) in the appendix to this covering letter

Documentation

IFRS 9 requires significant judgment to be exercised by management and we support appropriate documentation of how this judgment has been exercised, including evidence that it has been made by those with appropriate experience and seniority within an organisation.

Consequently, we support the guidance in the Document that encourages well-documented methodologies and processes – e.g. paragraph 21 – and effective internal controls – e.g. paragraph 19 – particularly as they relate to a bank's use of experienced credit judgment.

Model validation

We support Principle 5 that "*a bank should have policies and procedures in place to appropriately validate its internal credit risk assessment models*". We also agree with the statement in paragraph 57 that "*a bank should have robust policies and procedures in place to validate the accuracy and consistency of its model-based rating systems and processes*".

However, the last sentence in this paragraph appears to require that a full, comprehensive validation of each model be performed on an annual basis. We believe that the cost of complying with such requirements will likely outweigh the benefits and that compliance with this requirement is likely to be inconsistent with a bank's existing processes in other areas. Instead, we believe the objectives stated above can be more efficiently and effectively achieved by conducting a periodic review – at least annually or more frequently if warranted – of each model to determine whether it is working as intended and whether the existing validation activities are sufficient. We support such an approach as it tailors the nature and extent of implementation activities to the related risks and benefits and recommend that the guidance in paragraph 57 is amended accordingly.

Clarity of drafting

In general, we believe that the Document is less clear than the 2006 Guidance and that the clarity and usefulness of the Document could be improved.

We recommend that the Committee:

- Reduce repetitions. We believe that the discussion of the same topics in several places obscures the principles and key messages of the Document.

- More precisely phrase its requirements and limit the use of descriptive words, or superlatives, that do not provide meaningful guidance. For example, paragraph 7 requires implementation of ECL to be *"high quality and robust"* – it is not clear what the difference is between *"high quality"* and *"high quality and robust"*. In addition, questions may arise whether, in instances where the word 'robust' is not used, the Committee believes that a lower standard is appropriate.

- Limit the provision of contextual information and background on the banking industry – e.g. paragraphs 5, 6 and 72. While these statements often provide context for the Committee's proposals, we believe the volume of these statements detracts from the Committee's objective.

Interaction with a financial statement audit

We support proposals in the Document that encourage banks to have well-documented, quality processes and effective systems of internal control for credit risk assessment and the development of related accounting estimates. Quality processes and effective controls help ensure that management has a sound basis for these significant estimates. They also facilitate the performance of a statutory audit.

However, an auditor's overall objectives in conducting an audit of financial statements is defined by the International Standards on Auditing and include expressing an "*an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework*"[4]. Accordingly, where, for example, the applicable financial reporting framework is IFRS and management prepares financial statements that are, in all material respects, in accordance with IFRS, an auditor may express an unqualified opinion on financial statements despite an entity not complying with guidance contained within the Document. This would be the case, for example, where the Document prescribes additional disclosures in addition to those required by IFRS 7 – e.g. paragraph 78 – or narrows the range of acceptable choices that can be made within IFRS 9.

Secondly, an auditor's objective with respect to auditing accounting estimates, including accounting for expected credit losses, is to obtain sufficient appropriate audit evidence about whether accounting estimates in the financial statements are reasonable in the context of the applicable financial reporting framework. In this context, we support the Committee seeking assurance from the IASB that its proposed guidance would not prevent banks from meeting the impairment requirements of IFRS 9, as outlined in footnote 3 on page 2 of the Document, and welcome the Committee's discussion on prudence in paragraph 63.

[4] ISA 200.11 *Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing*

We attach to this letter an appendix containing our detailed observations and comments on specific paragraphs of the Document. The appendix includes examples illustrating our recommendations on clarity of drafting above[5] and repeats examples discussed in this covering letter.

If you have any questions about our comments or wish to discuss any of these matters further, please contact Colin Martin or Chris Spall at +44 (0)20 7694 8871.

Yours sincerely

KPMG IFRG Limited

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[5] See comments (4) and (5) in the appendix to this covering letter

APPENDIX – DETAILED OBSERVATIONS

The following are our detailed observations relating to the Consultative Document (the Document). They include specific observations where we believe the Document conveys unclear messages or creates potential misunderstanding

This appendix is organised as follows:

- Part A: Observations relevant to a number of paragraphs
- Part B: Other observations for specific paragraphs

This appendix should be read in the context of the key messages expressed in the covering letter. For completeness, we repeat in this appendix comments made in the covering letter.

Part A: Observations relevant to a number of paragraphs

1) Where the Document appears to be drafted without regard to materiality, we are concerned that the resulting high implementation thresholds may lead to potentially very high implementation costs while achieving only insignificant incremental improvements to reporting over an approach that did consider materiality. Examples are provided in the table below. We recommend the Committee consider the concept of materiality and re-phrase the guidance.

Para(s)	Extract(s) from the Document
19(c)	"*…accurately rates differing credit risk 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 that is relevant to the product, borrower, business model or economic or regulatory environment…"*
37	*"The design of the credit risk system should ensure…", "…allows a bank to track changes in credit risk, regardless of the significance of the change…"*
38	"*The credit risk rating 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 <u>full</u> account…"; "…<u>any</u> relevant regional differences…"*
A29	"*<u>Accurate</u> measurement of the drivers of credit risk…"*

2) Examples are provided in the table below where the Document appears to paraphrase IFRS 9 Financial Instruments (IFRS 9) or to provide guidance that could be interpreted as being inconsistent with IFRS 9.

   We encourage the Committee to use the same language as that in IFRS 9 whenever it is the Committee's intention for its requirements to be the same. Conversely, where the Committee intends guidance in the Document to be incremental to that in IFRS 9, we recommend that the Committee state so explicitly.

Para(s)	Observation(s)
32(a)	Under IFRS 9, where a financial asset has been derecognised as a result of modification and a new modified asset recognised in its place, the new asset generally attracts a 12-month expected credit loss (ECL) allowance (IFRS 9.B5.5.26). The guidance in paragraph 32(a) of the Document could be interpreted as requiring lifetime ECL for all modified assets as it does not distinguish between scenarios where the modification of a financial asset leads to its derecognition and those where it does not. We suggest that the Committee clarifies that guidance in this paragraph relates only to scenarios where modification of a financial asset does not result in its derecognition.
36, 40	Paragraphs 36 and 40 appear to indicate that a guarantee or a collateral should be taken into account in allocating exposures to credit grades. Such approach may not be consistent with IFRS 9 if the resulting credit gradings are used to assess whether credit risk of the exposure has increased significantly. This is because assessment of whether credit risk has increased significantly is based on the risk of default, without consideration of the size of any resulting loss. If it is intended for this paragraph to provide guidance similar to IFRS 9.B5.5.17(j) then we recommend that the language of IFRS 9 is used to aid clarity.
38	This paragraph may be read to indicate that even if all relevant risks have been assessed on an individual exposure basis, additional assessment is required on a collective basis to reflect the level of credit risk in the portfolio – e.g. to reflect the impact of correlation or concentration in a portfolio. However, IFRS 9.B5.5.3 only requires additional collective assessment where an entity is not able to identify significant changes in credit risk for individual financial instruments before those instruments become past due.
51, 59	Paragraphs 51 and 59 require banks to incorporate "*all reasonably available, forward-looking information and macroeconomic factors*" into ECL estimates,

Para(s)	**Observation(s)**
	whereas IFRS 9.5.5.17 also stipulates that information be "*supportable*". As drafted, the Committee's guidance may encourage banks to consider a wider-information set than is permitted under IFRS 9.
63	This paragraph suggests that banks may determine "*a single amount"* when estimating ECL, whereas IFRS 9.5.5.7 requires "*a probability-weighted amount*" and IFRS 9.5.5.18 requires an entity to "*consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low"*.
A3	This paragraph appears to paraphrase the requirements of IFRS 9.5.5.9 as well as the application guidance provided in IFRS 9.B5.5.13 to 14, but we believe that the requirements and application guidance provided in IFRS 9 are clearer.
A3	The second sentence says that 12-month ECL 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-month ECL in Appendix A to IFRS 9 refer to "*default events*" rather than "*loss events*".
A7	For exposures subject to 12-month ECL, 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 a requirement and instead requires that entities identify financial instruments for which credit risk has increased significantly.
A42	This paragraph refers to modification of "*contractual terms and resulting cash flows*", whereas IFRS 9.5.5.12 refers to modification of "*contractual cash flows*".
A43	This paragraph refers to "*transfers to LEL for obligors whose credit quality has significantly deteriorated*". However, an 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 the credit quality of the obligor – has increased significantly since the initial recognition of the exposure.

3) As discussed in the covering letter, examples of the Document implying that the guidance on accounting for ECL be applied on a real-time basis are provided below.

While such a real-time basis is appropriate for management of credit risk, requirements of accounting standards are relevant principally to the periodic financial reporting. We recommend that the Committee consider clarifying the distinction.

Para(s)	Extract(s) from the Document
Principle 2	*"The robust and timely measurement of allowances…"*
49	*"This requires that banks identify as early as possible any changes in credit risk and report increases in credit risk (also known as credit migration) through the allowance account."*
53	*"… to ensure that the allowance estimates incorporate timely recognition of changes in credit risk."*
84(d)	*"…uncollectability is recognised in a timely and appropriate manner through allowances or write-offs…"*
A2	*"The Committee expects banks to adopt an active approach to assessing and measuring 12-month ECL that enables changes in credit risk to be identified on a timely basis."*
A2	*"The methodology used to estimate 12-month ECL should be robust at all times and should allow for the timely build-up of allowances."*
A18	*"Banks must have a process in place that enable them to determine this on a timely and holistic basis…"*

4) As discussed in the covering letter, we believe that discussion of the same topics in several places may obscure the principles and key messages of the Document. We recommend the Committee improve the clarity of the Document by removing this repetition.

Parts of the document where we believe similar, or the same, points are repeated include:

Discussion point	Para(s)
The need for re-evaluation of groupings of exposures	44, 48, A34
The need for comprehensive documentation of methodologies, processes and key	Principle 2, 21, 22, 24(g), 24(o), 29(b), 32(b), 41, 43, 58(c), 58(d), 59, 69, 77

Discussion point	Para(s)
judgements exercised, including changes in assumptions	
The need to consider "*forward-looking information and macroeconomic factors*"	19(c), 24(b), 24(j), 24(l), 34, 40, 44, 50, 51, 52, 56, 59, 60, 69, A6, A23, A28(a)
Need for timely identification of changes in credit risk, including significant increases in credit risk	14, 19(c), 36, 48, 53, 59, A2, A9, A10, A18, A21
Specifying that guidance is applicable regardless of whether a bank is assessing credit risk or measuring ECL <u>on an</u> <u>individual or collective basis</u>	Principle 4, 9, 19(c), 24(b), 24(k), 36, 52, 53, 61, 86, A5, A9, A14, A52
A bank's methodology for assessing and measuring 12-month ECL should permit for timely build-up of allowances.	A2, A6, A52
Significant increases in credit risk may occur before a financial instrument becomes past due – i.e. delinquency is a lagging indicator	A20, A22, A23, A59

5) We believe the usefulness of the document could be improved if the Committee more precisely phrased its requirements and limited the use of descriptive words, or superlatives, that do not provide meaningful guidance. The table below provides some examples of such instances with the relevant words underlined.

In addition, the Document contains repeated use of the word *"appropriate"*. As it is assumed that procedures have to be *"appropriate"*, we recommend the Committee explain what the word "appropriate" means in the context of the specific requirement being discussed.

Para(s)	Extract(s) from the Document
7	*"…will provide the basis for a <u>high-quality, robust</u> and consistent implementation of an ECL accounting model…"*
17	*"…to oversee that the bank has <u>appropriate</u> credit risk practices…"*

Para(s)	Extract(s) from the Document
	"…an <u>appropriate</u>, systematic and consistently applied process…" *"…implement and update <u>suitable</u> policies and procedures…"*
Footnote (fn) 10	*"…should maintain <u>appropriate</u> records…"*
19(b)	*"… supervisory reports are <u>appropriate</u> in accordance with the applicable accounting framework and relevant supervisory guidance…"*
19(c)	*"…an <u>effective</u> process which ensures that all relevant information, including forward-looking information and macroeconomic factors, is <u>appropriately</u> considered in assessing and measuring ECL."* *"…but also, when necessary to <u>appropriately</u> measure ECL…"*
Principle 2	*"The <u>robust</u> and timely measurement of allowances should build upon those methodologies."*
24	*"<u>At a minimum</u>, a bank should adopt…"* *"Though not an all-inclusive list, a <u>robust</u> and <u>sound</u> methodology for assessing credit risk…"*
24(a)	*"…include a <u>robust</u> process that equips the bank…*
24(b)	*"…include criteria to <u>duly</u> consider the impact…"*
24(k)	*"A bank should maintain <u>sufficient</u> historical loss data over at least a full credit cycle…"*
26	*"Management should consider a <u>wide-</u>range of facts and circumstances…"*
32(a)	*"Regardless, the methodology should drive a <u>robust</u> assessment and measurement of ECL such that…"* *"…any decrease in the reported allowance level due to improved quality should be <u>well</u> supported by <u>strong</u> evidence."*
32(b)	*"The methodology should enable <u>appropriate</u> identification of purchased or originated credit-impaired lending."*

Para(s)	**Extract(s) from the Document**
	"Such updates should be <u>properly</u> *supported and documented…"*
39	*"…a bank should* <u>clearly</u> *define each credit risk rating…"*
43	*"…(*<u>such as</u> *by instrument type, industry/market segment, geographical location, vintage,* <u>amongst other bases</u>*)…"*
50	*"A* <u>robust</u> *assessment of allowances takes into account…"*
52	*"All methodologies should require* <u>appropriate</u> *adjustments…"*
58	*"…a* <u>sound</u> *model validation framework should include…"*
58(b)(iii)	*"…the findings and outcome of model validation are reported in a* <u>promp</u>*t and timely manner…"*
58(c)(ii)	*"This entails* <u>close</u> *monitoring of key model assumptions against actual portfolio behaviour to ensure that the model serves its intended purpose, and that key model changes over time are documented with* <u>comprehensive</u> *explanations and justification."*
58(d)	*"Banks should ensure that the model validation process is* <u>comprehensively</u> *documented."*
Principle 6	*"… especially in the* <u>robust</u> *consideration of forward-looking information…"*
59	*"Banks should have the necessary tools to ensure a* <u>robust</u> *estimate … may be limited or not* <u>fully</u> *relevant to lending exposures currently held by the bank … a bank must use its experienced credit judgment to* <u>thoroughly</u> *incorporate the expected impact of all reasonably available forward-looking information..."*
82(a)	*"…the bank's internal credit risk review function is robust and* <u>appropriately comprehensive</u> *in scope;"*
82(f)	*"…management judgement has been exercised* <u>in a robust manner</u> *and…*
84(a)	*"…the procedures used by a bank to measure ECL are* <u>robust</u> *and timely…"*
86	*"Therefore, supervisors should be* <u>especially vigilant</u> *when reviewing management's estimates…"*

Para(s)	Extract(s) from the Document
A6	*"…it is important to consider all reasonably available information that affects credit risk, especially forward-looking information…"*
A7	*"IFRS 9 expects a bank to monitor and measure significant increases in credit risk for all financial instruments measured at 12-month ECL"*
A15	*"…as a consequence, a bank must carefully consider…"*
A19	*"In broad terms, it includes information on macro-economic conditions…"*
A27	*"Banks should take particular care to avoid the risk of a significant increase in credit risk…"*
A29	*"Accurate measurement of the drivers of credit risk and reliable calibration of the linkages between those drivers and the level of credit risk, are both critical, as…*
A32	*"The Committee stresses that thorough consideration and full weight must be given to factor which…"*
A33	*"…particular care should be taken in this situation to ensure that…"*
A39	*"The Committee expects banks to develop ways of robustly reviewing the quality of their approach…"*
A41	*"…they should pay particular attention to the need to consider…"*
A62	*"…banks should pay particular attention to their measurement of 12-month ECL allowance to ensure that ECL are appropriately captured …and that the Committee expects particular attention to be paid to ensuring…"*

Part B: Other observations for specific paragraphs

Objective and scope

Para(s)	Observation(s)
1, 10, 13	As discussed in the covering letter, paragraph 1 states that for the purpose of this paper the scope of credit risk practices is limited to those practices affecting "*the assessment and measurement of allowances under the applicable accounting framework*". This

Para(s)	Observation(s)
	message is re-iterated by paragraphs 10 and 13. This appears narrower than the 2006 Guidance that deals with the principles of credit loss more generally. In addition, a number of principles discuss credit risk practices which fall outside this scope, including: • Principle 7 refers to systems and tools to "*price credit risk*"; • Principle 8 seems to relate to all public reporting rather than only reporting related to credit risk and ECL; • Principles 9 and 11 seem to be much wider in scope; • Paragraph 16 suggests the proposals will "*promote consistency in the … assessments of capital adequacy*"; and • Paragraph 18 discusses a bank's "*adopt[ion] and adhere[nce] to best practices with respect to sound underwriting*".
3	As discussed in the covering letter, we support the principle of consistent interpretation of accounting standards as discussed in this paragraph, but note that consistent interpretation of IFRS 9 would not necessarily result in a consistent outcome as the latter should reflect entity-specific facts and circumstances and reasonable judgment exercised by management. Therefore, outcomes may not necessarily be directly comparable from bank to bank. We recommend that the Committee defines what it means by *"consistent"*.
5, 6	As discussed in the covering letter, we recommend the Committee limit the provision of contextual information and background on the banking industry. While these statements often provide context for the Committee's proposals, we believe the volume of these statements contained in the Document distracts from the Committee's objective.
10	Paragraph 63 defines the term prudent as "*exercising appropriate care and caution when determining the level of ECL and the allowances to be recognised for accounting purposes to ensure that the resulting estimate is appropriate (i.e. consistent with neutrality and neither overstated nor understated)"*. As this definition of prudent is not relevant to the term's use in paragraph 10, which suggests that banks must have "*prudent policies and processes*", we recommend that the Committee define what is meant by the term *"prudent"* in the context of this paragraph.

Para(s)	Observation(s)
12	As discussed in the covering letter, we support the assertion that *"supervisors may adopt a proportionate approach with regard to the standards that supervisors impose on banks"* and that this *"allows less complex banks to adopt approaches commensurate with the size, nature and complexity of banks"*. However, we believe the Document would be improved by providing examples of how the requirements (for both credit risk management and implementation of the accounting models) might be adjusted to achieved proportionality for smaller, less complex banks as well as for smaller, less complex lending activities within internationally active banks.
12, 15	As discussed in the covering letter, we recommend the Committee gives more prominence to the statement that the guidance contained in the Document is intended only for 'internationally active banks' by discussing it in a separate section on 'Scope'.
13	As discussed in the covering letter, we recommend that the statement *"credit risk practices for other bank exposures, such as debt securities, are outside the scope of this paper"* be given more prominence by being discussed in a separate section on 'Scope'. In addition it would be helpful for the Committee to clarify what is meant by the following terms: • *"lending exposures"* – e.g. whether they include balances resulting from reverse securities repurchase transactions, loan commitments, or financial guarantee contracts; • *"debt securities"*; and • *"other bank exposures"* as the use of the expression *"such as"* indicates that there are other items outside of the scope of the Document.
14	As discussed in the covering letter, this paragraph refers to *"separate papers on a number of related topics in the areas of credit risk, including credit risk modelling and credit risk management"*. We believe the Committee's objective would be better supported if the Committee explained how the Document fits within the context of the Committee's existing papers.

Supervisory requirements for sound credit risk practices that interact with expected credit loss

Principle 2: *A bank should adopt, document and adhere to sound methodologies that address policies, procedures and controls for assessing and measuring the level of credit risk on all lending exposures. The robust and timely measurement of allowances should build upon those methodologies.*

Para(s)	**Observation(s)**
24	It is unclear what the words *"at a minimum"* signify. If there is additional relevant and specific guidance to add to this sentence, then add it. If there is not, then it seems that these three words can be deleted.
24(b)	We recommend the Committee re-phrase the statement "*goes beyond historical and current information*" for consistency with the rest of the Document and with IFRS 9 – e.g. *"considers forward-looking information and macroeconomic factors"*.
24(f)	It is unclear why or how the existence of concentrations in credit risk or changes in their level should affect estimating the loss allowance.
24(h)	It is unclear why a bank would try to "*identify the situations that would generally lead to changes in ECL measurement methods, inputs or assumptions from periods to period*". We recommend that the Committee provide a rationale for this guidance.
24(i)	We do not believe this point provides useful guidance given its generic nature.
24(o)	We disagree that all tasks that *"act as an input or output to the credit risk assessment and measurement process"* must be performed by personnel who are *"independent of the bank's lending activities"*. As indicated in paragraph 35, lending staff and management may prepare or collate data and be a valuable source of knowledge and expertise – although any such information must be subject to validation or review by finance or control functions independent of the lending function.
27	It is unclear what is meant by "*character*" and "*capacity*" of the borrower.
27(a), (g)	These paragraphs seem out of place as they do not describe input into credit risk assessment which seems to be the topic discussed by paragraph 27
27(i)	We recommend the Committee delete *"all other relevant information"* as its inclusion in a list of *"factors"* a bank should assess is meaningless.
28	We recommend that the Committee explain how the following factors relating to business model affect the incentives or willingness of borrowers to meet their obligations, or a bank's ability to recover amounts due: (a) *"competition"*; *(b) "trends in the institutions overall volume of credit risk"*;

Para(s)	Observation(s)
	(c) *"The business model of the institution and overall credit risk profile of its lending portfolio"*; (d) *"Credit concentrations to borrowers or by product type, segment or geographical market"*; and (f) *"the experience, ability or depth of lending management and staff"*. In addition, where factors listed are similar to guidance provided elsewhere in the document, we recommend that the Committee draw a clearer link between these concepts. For example *"(b) Trends in the institution's overall volume of credit risk"* may be referring to increases in the volume of credit as a result of inadequate underwriting practices, as discussed in paragraph 31(g).
28(f)	It is unclear what is meant by the term "*depth*" with respect to "*lending management and staff*".
31	The statement *"post-initial recognition increases in credit risk require a bank to reassess ECL and re-measure the amount of the allowance that should be recognised in accordance with the applicable accounting framework"* seems out of place in a paragraph discussing underwriting practices.
31(g)	We suggest that the Committee explains what is meant by the term *"undue"* in the phrase *"undue increases in volume of credit"*, and how it would provide evidence of inadequate underwriting practices. Further, this paragraph seems to imply that as long as a bank increases its loan book at the same pace as other lenders there is less risk that its underwriting practices are inadequate. However, there may be circumstances in which all lenders within the same market introduce more lenient underwriting policies and processes.
32(a)	It is unclear why regularly updated cash flow estimates would "*improve the estimation of ECL*". In addition, updated estimates of cash flows should be "*properly supported and documented*" for all exposures, not just those for purchased or originated credit-impaired assets.
32(a)	In the phrase, *"a bank may expect full repayment"* the term *"expect"* may cause confusion since ECL reflect probability-weighted expectations, not merely a single scenario. It seems that *"expect"* here refers to a most likely (or similar) estimated outcome, in which case we would recommend that the Committee re-phrase the guidance.

Principle 3: *A bank should have a process in place to appropriately group lending exposures on the basis of shared credit risk characteristics.*

Para(s)	Observation(s)
42	This paragraph appears to provide inconsistent guidance on how often credit risk ratings should be reviewed, as follows: • "*whenever relevant new information is received or a bank's expectation of credit risk has changed*"; • Periodically "*to reasonably ensure that those ratings are accurate and up to date*"; and • "*more frequently than annually*" for large, complex, higher-risk or credit impaired exposures. We recommend the Committee clarifies the guidance.

Principle 4: *A bank's aggregate amount of allowances, regardless of whether allowance components are determined on a collective or an individual basis, should be adequate as defined by the Basel Core Principles, which is an amount understood to be consistent with the objectives of the relevant accounting requirements.*

Para(s)	Observation(s)
52	This paragraph states that *"methodologies for the determination of the cash flows may start with simple averages of a bank's loss experience on loans with shared credit risk characteristics over a relevant credit cycle, progressing to more complex techniques"*. It is not clear whether the expression *"start with"* means that this is a technique that can be applied to some portfolios or by some banks, while a more sophisticated technique may be applied to/by others, or whether it describes the first step in the assessment process. If the former then this paragraph appears to be inconsistent with paragraph 50.

Principle 5: *A bank should have policies and procedures in place to appropriately validate its internal credit risk assessment models.*

Para(s)	Observation(s)
57	As discussed in the covering letter, we believe the objectives stated in Principle 5 and the second sentence of this paragraph, can be more efficiently and effectively achieved by conducting a periodic review – at least annually or more frequently if warranted – of each model to determine whether it is working as intended and whether the existing validation activities are sufficient. We support such an approach as it tailors the nature and extent of implementation activities to the related risks and benefits and recommend that the guidance in this paragraph is amended accordingly
58	We recommend the Committee explicitly identify the "*regulatory requirements for validation of internal credit risk models*" being referred to in this paragraph.
58	It is not clear why the concepts of "*governance*", "*clear roles and responsibilities*", "*documentation*", and "*independent review*" are being discussed in the document only in the context of model validation as they are equally applicable to all credit risk practices. If this guidance exists elsewhere in relation to credit risk management, we recommend the Committee remove this discussion from paragraph 58 and refer to pre-existing guidance, or discuss these topics once, at the beginning of the Document.
58(b), **fn 22**	This paragraph requires that an independent party be *"responsible"* for review of the model validation process. Where external auditors have been engaged to undertake an audit of financial statements, we believe it is unlikely that they could perform this role without impairing their independence under independence requirements, such as those issued by the International Federation of Accountants, to the extent this appears to be taking on management responsibility for controls. Therefore, we recommend the Committee replace *"external auditors"* with 'external parties'. In addition, to avoid any misunderstanding, we suggest the Committee re-phrase footnote 22 to make clear that an external auditor engaged to undertake an audit of financial statements cannot be responsible for review of model validation if, and to the extent, that the relevant independence requirements prohibit such services.

Principle 6: *A bank's use of experienced credit judgment, especially in the robust consideration of forward-looking information that is reasonably available and macroeconomic factors, is essential to the assessment and measurement of expected credit losses.*

Para(s)	Observation(s)
60	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 or effort and that is relevant to the estimate of expected credit losses*". As discussed in the covering letter, we recommend the Committee consider the concept of materiality when discussing accounting requirements.
61	We believe that a requirement to "*demonstrate*" that relevant information has a link to the credit risk of particular loans or portfolios may be an impracticable standard given that the link is based on judgemental inference. As a result, we recommend that the Committee replace *"demonstrate"* with 'support' or 'provide an explanation as to how'.

Principle 7: *A bank should have a sound credit risk assessment and measurement process that provides it with a strong basis for common systems, tools and data to assess and price credit risk, and account for expected credit losses.*

Para(s)	Observation(s)
65 - 71	The meaning of the term *"common"* as well as what processes, systems and tools the term is referring to within these paragraphs are unclear. The paragraph appears to suggest that a bank is expected to use the same credit measurement system for accounting and regulatory purposes but it is not clear why such an approach would always lead to a cost-effective solution.
71	The first sentence should be amended to include a clear commitment to the desirability of consistent interpretation where the same accounting framework applies or similar concepts exists within different accounting frameworks.

Principle 8: *A bank's public reporting should promote transparency and comparability by providing timely, relevant and decision-useful information.*

Para(s)	Observation(s)
72	As discussed in the covering letter, we recommend the Committee limit the provision of contextual information and background on the banking industry, such as *"the 2007–09 financial crisis highlighted the importance of high quality disclosures, as investors*

Para(s)	Observation(s)
	criticised financial institutions for failing to provide sufficient relevant information on complex issues and risk management practices".
75	We recommend that the Committee explain the relevance of the statement "*management and users have differing objectives*" in the context of developing ECL estimates.
78	It is unclear whether the Committee intends the additional disclosure referred to in this paragraph – i.e. the disclosure of *"similarities and differences in the methodology, data and assumptions used in measuring ECL for accounting purposes and expected credit losses for regulatory purposes"* to be included in the financial statements. We suggest the Committee require these disclosures to be included in regulatory reporting – e.g. Pillar 3 – as IFRS 7 already requires disclosure of quantitative and qualitative information that allows users of financial statements to evaluate the amounts in the financial statements arising from expected credit losses.
80	For banks applying IFRS 9, we do not agree that recoveries of amounts previously written off should be reflected in the reconciliation of the loss allowance since a recovery of an amount written off has no effect on the loss allowance.
81	"*The Committee expects management to regularly review its disclosure policies to ensure that the information disclosed continues to be relevant to its risk profile, product concentrations, industry norms and current market conditions. In doing so, a bank should aim to provide disclosures that are consistent over time and facilitate comparisons with its peers"*. These sentences should be amended to make clearer that the review may require a bank to change the content or form of disclosures compared to previous years.

Supervisory evaluation of credit risk practices, accounting for expected credit losses and capital adequacy

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

Para(s)	Observation(s)
84	This paragraph is internally repetitive and repeats other paragraphs in the Document. It is not clear why a supervisor should place an emphasis on the specific points mentioned, rather than all the principles and guidance contained within the Document.

Principle 11: *Banking supervisors should consider a bank's credit risk practices when assessing a bank's capital adequacy.*

Para(s)	Observation(s)
86	It is not clear why the matters in this paragraph are highlighted as being more relevant to banking supervisors than other guidance in the document. The reasoning in the last two sentences has little merit as: • the ability to estimate ECL is always subject to limitations (as with most predictions about the future); • if ECL is and can be based on collective experience – i.e. across groups of similar loans – then it is not true that the ability to estimate ECL during the earlier life of a loan is necessarily more limited; and • ECL during the earlier life of a loan may often be quite low and be validated based on information obtained during the underwriting process – whereas greater uncertainty arises as the loan progresses during its life and new events and circumstances may impact recoverability and increase credit risk.
87	It is unclear what *"fundamental requirements previously described"* is referring to or why certain requirements, but not others, are *"fundamental"*.

Appendix - Supervisory Requirements specific to jurisdictions applying IFRS

Loss allowance at an amount equal to 12-month ECL

Para(s)	Observation(s)
A1, fn 26	The statement *"an example where a bank may have a nil allowance is for fully collateralised loans"* should be amended consistent with IFRS 9.IE23 – i.e. indicate that in such a case the loss allowance may be very small and therefore approximately nil. It may be more appropriate to highlight the risk of a bank inappropriately

	concluding that no loss allowance is required for a loan that it believes is fully collateralised. See next comment.
A1, fn 26	This paragraph states, *"a bank should be cautious when developing estimates of collateral value"*. We do not believe that 'caution' is an objective of IFRS 9 and suggest that this injunction is either deleted or amended to remind banks that they should have processes and controls over updating the value of collateral and probability-weighted estimates of recoverable cash flows, which would consider possible future changes in the value of collateral. See preceding comment.
A3	The last two sentences of this paragraph do not relate to 12-month ECL but instead to assessing whether there has been a significant increase in credit risk – therefore they should be removed from section 1 of the Appendix and inserted into section 2.
A4	This paragraph requires the definition of default for accounting purposes to be guided by the definition used for regulatory purposes. However, as noted in the discussion paper recently released by the EBA[6] there are differences in the way the regulatory definitions are applied. Paragraph 23 of the EBA discussion paper states, "*the application of the definition of default has been recognized as one of the areas that largely contribute to the discrepancies in the RWA calculation. … As the definition of default sets the basis for the IRB Approach, and in particular for the estimation of risk parameters, it is considered essential to increase the harmonisation in that area*". We recommend the Committee considers whether the requirement for a bank to be guided by the regulatory definition of default will enhance consistency of application of IFRS 9. Also, we recommend the Committee provide guidance on how banks are expected to deal with changes in regulatory rules or definitions.
A4(b)	The paragraph states that the default definition provided by the Basel capital framework includes *"an objective indicator based on a material delinquency status equivalent to the rebuttable presumption in IFRS 9, paragraph B5.5.37"*. We note that the Committee's definition of default includes an exception for retail and non-central government public sector entities (PSE) obligations[7]. We are concerned that paragraph A4 may be read to imply that banks may substitute the 90-day rebuttable presumption in IFRS 9 with a longer delinquency period merely because a longer delinquency period has been permitted for regulatory purposes. We recommend that the Committee clarify that, in accordance with IFRS 9.B5.5.37, default for IFRS 9 purposes does not occur later than 90 days past due unless an entity has reasonable and supportable information to corroborate a more lagging default criterion.

[6] EBA Discussion Paper, *Future of the IRB Approach* (March 2015)
[7] Footnote 89, *International Convergence of Capital Measurement and Capital Standards* (June 2006), "In the case of retail and PSE obligations, for the 90 days figure, a supervisor may substitute a figure up to 180 days for different products, as it considers appropriate to local conditions".

A4, A5	To improve the organisation of the Document, we recommend that the Committee inserts a sub-heading 'definition of default' above those two paragraphs to separate them from the guidance provided in the section *"Loss allowance at an amount equal to 12-month ECL"*. In addition, we recommend that the Committee include guidance reminding banks that they: • consider whether default should be deemed to occur at an earlier delinquency date than 90 days past due; • not artificially delay recognition of default by including a 'grace period'; and • have documented policies outlining how 'days past due' is calculated.
A4, A5	The Basel definition of default seems to imply that default occurs when there is a significant increase in credit risk. This is because it states that an asset is in default when there is *"account-specific provision resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure"*[8]. Using this element of the regulatory definition for IFRS 9 purposes would be inconsistent with IFRS 9 because: • when there is a significant increase in credit risk a financial asset moves to stage 2 – i.e. lifetime ECL; • IFRS 9.B5.5.21 prohibits aligning the timing of such a move to the entity's internal definition of default; and • it would be circular – i.e. it would require transfer to stage 2 if there is a significant increase in the probability of a transfer to stage 2 occurring. Therefore, we recommend that the Committee clarify that this element of a regulatory definition of default cannot be used in the definition of default used under IFRS 9.
A5	In practice, we do not believe that it would be possible to identify default on a collective basis. Also, we recommend that the Committee explain how forward-looking information can help in the identification of default.
A7	The statement that *"IFRS 9 expects a bank to monitor and measure significant increases in credit risk for all financial instruments measured at 12-month ECL"* is not

[8] Para 453, *International Convergence of Capital Measurement and Capital Standards* (June 2006)

	logical since if there were a significant increase in credit risk, then the financial instrument would have a loss allowance equal to lifetime ECL.
A8	The guidance in this paragraph seems to be in the wrong place. Where the guidance relates to: • credit risk management practices, it should be in the main body of the Document rather than the Appendix. • assessing whether there has been a significant increase in credit risk, it should be included in section 2, rather than section 1, of the Appendix.
A8, fn 30	'High' is the opposite of 'low'. We are therefore confused by the assertion that high credit risk should not be understood as the opposite of low credit risk as defined by the IASB. If the Committee means merely that *"high credit risk"* does not mean all exposures that do not exhibit low credit risk, as described in IFRS 9, it should say that instead.
A9	This paragraph should be removed because the relevant accounting principles in IFRS 9 are more accurately and concisely explained in paragraph A10. We do not believe that the Committee's expectation is grounded in IFRS 9.

Assessment of significant increases in credit risk

Para(s)	Observation(s)
A15	The statement *"it follows, then, that any post-origination increase in credit risk is unlikely to be fully compensated by the interest rate charged, and, as a consequence, a bank must carefully consider whether there has been a significant increase in credit risk. If so, the lending exposure would be subject to LEL measurement"* should be edited so as to remove the misleading impression that assessment and lifetime ECL measurement is required only if the increase in credit risk is not fully compensated by the interest rate charged. IFRS 9.B5.5.7 requires that the assessment is made based on changes in credit risk since initial recognition, irrespective of whether a financial instrument has been re-priced to reflect an increase in credit risk.
A16, A17	These paragraphs discuss general issues related to credit risk assessment, ECL models and IFRS 9. The content seems out of place in a section purportedly focused on *"assessment of significant increases in credit risk"*. We recommend that these paragraphs are moved to more appropriate locations – e.g. a separate section on measurement of ECL.

A18	IFRS 9.B5.5.8 requires recognition of an impairment gain or loss and updating the loss allowance at the reporting date. Therefore, we disagree with the Committee's interpretation that "*the IFRS 9 objective stated above [paragraph A14] means that timely determination of whether there has been "significant" increase in credit risk subsequent to the initial recognition of a lending exposure is crucial*" and suggest that the statement be deleted.
A21	We do not understand the meaning of the statement *"banks will need to ... be able to quantify the credit risk in each of their exposures or portfolios"*. It would be helpful if the Committee were to clarify what type of quantification is envisaged and why banks need to be able to so quantify.
A27	We recommend the Committee clarify that the list provided in this paragraph illustrates 'an increase in credit risk' rather than *"a significant increase in credit risk"*. Also, it would be helpful if the Committee cross-referred to IFRS 9.B5.5.17, which provides a "*non-exhaustive list of information that may be relevant in assessing changes in credit risk*" containing 16 similar conditions that are then discussed in more detail. As discussed in the covering letter, we recommend the Committee be explicit when they provide incremental guidance.
A27(a)	It is unclear what "*a discretionary decision by management*" refers to and how it is relevant to an assessment about whether the loan would be priced differently if originated at the reporting date.
A27(a), fn 33	We disagree with the Committee's expectation that a bank would adopt a presumption that *"any increase in the credit spread that would be charged for a particular loan is due to an increase in the bank's assessment of the credit risk"*. This presumption ignores the fact that changes in credit spread may be impacted by factors other than credit risk – i.e. risk of default – such as changes in loss given default or the risk premium for unexpected credit losses. The presumption may not reflect reality, appears to introduce bias into the accounting for expected credit losses, and is potentially inconsistent with the requirement of IFRS 9 to recognise lifetime ECL when there has been a significant increase in credit risk. The Committee proposes that the presumption apply *"when the entity is unable to distinguish this element of pricing [viz. the element of the price that reflects the credit risk of the loan] from others"*. This may exacerbate the problems highlighted above as the presumption may apply in a large number of cases and be impossible to rebut. In addition, if a bank is unable to distinguish between different elements of a loan's pricing, it may not be able to identify a *"credit spread"* as distinct from other elements of pricing above a risk-free rate.

A27(e)	We do not believe that *"paying particular attention"* to the *"deterioration of relevant factors"* is helpful guidance. We recommend that the Committee delete, or expand upon, this statement.
A29	It is unclear what is meant by "*small changes in credit quality can be associated with a large increase in the probability of default*". This paragraph talks about using credit ratings as part of the assessment of significant increase in credit risk. However, there is a failure to address this topic systematically. The guidance should indicate that if credit ratings are to be used to assess significant increases in credit risk, then they should be calibrated against or aligned with absolute risk of default. Ratings that reflect other factors related to creditworthiness – e.g. loss given default, value of collateral – as well as probability of default (PD) may not be suitable. Also, it will be necessary for a bank to consider whether its ratings are intended to reflect absolute levels of PD or other relative credit quality criteria – e.g. to what extent do deteriorations in macroeconomic circumstances lead to downgrades from higher ratings to lower ratings as absolute PDs increase on exposures versus exposures staying within current rating grades, but the average PDs of those ratings bands increasing because exposures are ranked using criteria that are not anchored to absolute PDs.
A30	It is unclear what is meant by the statement "*as illustrated in paragraph A29, the sensitivity of default probability to rating grade increases strongly as rating quality declines*". In addition, there is no illustration in paragraph A29.
A32	We disagree with the statement that "*if a decision is made to lower the internal credit rating for an exposure, it is unlikely that such an action would have been taken by the decision-maker had the deterioration not been perceived as significant*". It may be the case that the exposure was at the bottom of a grade and has simply shifted to the top of the next grade. In practice, application of this strict interpretation may discourage banks from down-grading exposures when appropriate. Also, it may discourage banks from using more sophisticated credit rating systems with more granular rating categories.
A35, 36	It is unclear what *"group or subgroup"* is being referred to when paragraph A35 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 even though it is not possible to identify this on an individual exposure basis*". We recommend the Committee use terminology that is consistent with paragraph A36 – i.e. "*the portion of the group that has increased significantly in credit risk should be subject to LEL measurement*".

A40	We disagree with the Committee's observation that IFRS 9's practical expedients "*have the potential to introduce a significant bias*". Please also see our observations on A46, A50-A58 below. With regard to the 30-day rebuttable presumption, IFRS 9.B5.5.19 already clarifies that the 30-day rebuttable presumption is "*not an absolute indicator that lifetime ECL should be recognised, but is presumed to be the latest point at which lifetime expected credit losses should be recognised*".

Use of practical expedients

Para(s)	Observation(s)
A46, A50 – A58	As discussed in the covering letter, we agree with the IASB's observation in IFRS 9.BC5.180 related to the 'low credit risk' simplification that "*for financial instruments with low credit risk, the effect of that simplification on the timing of recognition and amount of expected credit losses would be minimal*". Therefore we disagree with the Committee's statement that "*use of this exemption by banks would reflect a low-quality implementation of the ECL model in IFRS 9*". It is unclear whether the Committee intends to greatly limit or entirely prohibit banks' use of the 'low credit risk' simplification. For example: • A50 states that the use of the exemption *"would reflect a low-quality implementation of the ECL model in IFRS 9"* and would be used *"only in rare and appropriate circumstances"*; • A51 suggests that it is *"merely an operational simplification"* with *"minimal effect"*; • A52 refers to *"rare"* use but also states *"a significant increase in credit risk will always result in an exposure moving to LEL measurement"*. The latter statement appears to indicate that the simplification can never be used; • A53 provides a definition of low credit risk – suggesting that the simplification is available for use; and • A54 to A58 provide further guidance on the simplification's expected use.

	We encourage the Committee to consider the concept of materiality when finalising their proposals, and clarify their position on whether banks may use the 'low credit risk' simplification. The Committee might also consider differentiating its discussion between exposures to different types of counterparties. In particular, it would seem very difficult to demonstrate that loans to retail counterparties could meet the definition of 'low credit risk' in IFRS 9. This is because, after initial recognition of such loans, the lender does not usually have up-to-date, detailed information on the credit risk and prospects of each borrower, so it may not be possible to demonstrate that the low credit risk definition is satisfied for each borrower.
A49	As discussed in the covering letter, we believe IFRS 9's concept of 'undue cost or effort' is an example of an area where proportionality may be relevant – i.e. how the guidance in the Document might be adjusted to achieve proportionality for smaller, less complex banks as well as for smaller, less complex lending activities within internationally active banks.
A52	We recommend that the last sentence, which does not appear to relate to the 'low credit risk' exemption, is deleted or moved to a more appropriate location.
A57	We encourage the Committee to consider the objective of this paragraph and clarify the wording for the following reasons: • The message is inconsistent. This paragraph seems to argue that external ratings are less appropriate for use in assessing low credit risk than internal rating grades, but then requires additional analysis when there are "*optimistic internal credit ratings, as compared with external credit ratings*". • When external credit ratings meet the requirements in IFRS 9, their use would enhance comparability among banks. • Neither internal, nor external, credit ratings are "*an exact measure of the probability of default occurring*". Also, the paragraph does not address acknowledged issues with using external ratings. For example: • external credit ratings may not have been updated to reflect circumstances and expectations at the reporting date; and • the definitions and criteria used to determine external credit ratings may not comply with the requirements of IFRS 9.

A59	We are not convinced that the requirements in this paragraph "*to ensure that credit risk increases are detected well ahead of exposure becoming past due or delinquent*" is possible for all portfolios. For example, this may not be possible for short-term loans where there may not be enough time between initial recognition and maturity for increases in credit risk to be identified *"well ahead"*. In addition, it would be helpful for the Committee to clarify that the requirement is to identify 'significant increases' in credit risk rather than *"increases"*.