Nationwide

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

30 April 2015

Comments on the Consultative Document: Guidance on accounting for expected credit losses

Dear Mr van Wyk,

We welcome the opportunity to comment on the BCBS's Consultative Document (CD) "Guidance on accounting for expected credit losses".

Nationwide Building Society is the world's largest building society with loans and advances to customers of £170bn. As a mutually owned business, we are run solely for the long term benefit of our members. Reflecting our heritage values as a UK building society, our balance sheet comprises primarily residential mortgages, but with substantial unsecured consumer lending portfolios and commercial real estate and registered social landlord loans.

We are members of the British Bankers' Association (BBA) and adhere to the BBA Code of Financial Reporting Disclosure. As such our regulator, the Prudential Regulation Authority (PRA), considers that Nationwide is a sophisticated institution in the business of lending and therefore, expected to deliver the '*highest quality implementation*' of an Expected Credit Loss (ECL) framework. We have contributed to BBA, PRA and other industry discussions on the CD and broadly support many of the points raised in the BBA's own comment letter.

We agree in principle with the objective of a high quality implementation of the ECL requirements of IFRS 9: *Financial Instruments* and we welcome the 11 principles that give additional guidance on the application of the standard and clarity on the supervisory requirements for sound credit risk practices that interact with ECL measurement.

In addition to this, we believe the main potential benefits of the proposed approach are:

- We fully support the approach of Principle 7 that a bank should have a sound credit risk assessment and measurement process that provides a strong basis for common systems, tools and data to assess credit risk and account for ECLs. In order to achieve this, banks will need to leverage and integrate, as far as possible, capital models and infrastructure with their accounting solutions.
- A consistent approach to the interpretation of IFRS 9 by sophisticated lenders will enhance transparency and enable fair presentation of performance to be reported on a more global basis.

We are however concerned that the current text has a number of points that need refinement to remove ambiguities and to aid an effective implementation of the principles contained in the standard. Therefore, we would highlight the following:

- The title and scope of the CD should be clarified. Although the document is entitled 'Guidance on accounting for ECLs', the intention is to span both credit risk management and financial reporting. Clarifying the intention in the title would help to reinforce the message that the guidance is not just for accountants. One of the titles suggested by the BBA is: *Sound credit risk practices and accounting for ECLs.* The CD also includes commentary on underwriting practice which is beyond the core purpose of the guidance.
- The structure of the document and clarity/language can be improved:
    - We believe there should be clearer signposting of the various elements of the text to differentiate between guidance on accounting and on risk management. We understand that the UK regulator is considering introducing an attestation process for compliance with GAECL and an independent audit review to identify whether models need revalidation. This in our view reinforces the need for clear signposting of accounting guidance to separate from other issues.
    - Some of the terminology used will create difficulties in demonstrating compliance. For example: proving a negative in Para A7 *'a bank must be able to demonstrate that these exposures have not experienced a significant increase in credit risk since initial recognition'*. It would be more helpful to be specific about the need to prove completeness of identification of exposures where credit risk has increased significantly.
    - Other examples include terms such as *'maximum extent possible'* rather than wording such as 'full appropriate use' which would recognise the need for judgement and proportionality (Para 21); *'all relevant information'* rather than 'relevant information' (Para 23); *'robust measurement of expected credit losses'* where using the term 'robust' in the context of controls would be more appropriate (Principle 10).
- Materiality and proportionality concepts should be included. We believe there should be a specific reference to the appropriate use of materiality and proportionality concepts for more sophisticated lenders in a high quality implementation (Para 12). This would allow an approach that is commensurate with the size, nature and complexity of an exposure, which would be appropriate provided there is sufficient governance and oversight.
- Regarding Forward looking indicators/macroeconomic factors in the context of significant deterioration, it is not clear from the text how Para A23 *'in a robust manner, banks will need to have a clear view – supported by persuasive analysis'* can be demonstrated in the context of accounting.
- We have a number of points on Significant deterioration of credit risk section:
    - The wording in Para A29 regarding transfers from Stage 1 to 2 that *'it is possible that a significant increase in credit risk could occur before lending exposures experience even a one-notch downgrade'* may be interpreted too literally, without applying sufficient informed judgement to the real significance to the change.

- Pricing: In our view there are practical implications regarding the rebuttable presumption that *'any increase of credit spread that would be charged for a particular loan is due to an increase in the bank's assessment of the credit risk of that exposure'*. In reality there are a number of considerations and it is difficult to demonstrate definitively the discrete credit element within an interest rate (Footnote 33 Para A27).
- We believe that the wording on re-segmentation should be clarified to reflect that changes in risk can lead to exposures within a portfolio moving through risk bands and loss allowance stages. In this case frequent re-segmentation of separate portfolios would be relatively rare. Continuous re-segmentation may not be desirable and may impact on comparability within disclosure (Para 48).

- We believe it would enhance clarity if points that are particularly relevant to either Retail or to Commercial/Wholesale are clearly headed and differentiated (e.g. Para 27).
- Regarding Default, we understand that there was no intention to revoke any separately agreed regulatory capital waivers in Para A5 (e.g. 180 days definition of default).
- Our perception is that the GAECL requirement to add an additional risk concentration overlay in Paras 24 (f) and 38 goes beyond the intention of the IASB standard setters. In our view these references should be qualified to make clear that this would be appropriate only if models do not adequately reflect the credit risks of the ECLs.
- In the use of practical expedients section we would point out the following:
  - There may be limited circumstances when the undue cost and effort may be appropriate for the larger entities (Para A49). For example, in a low materiality retail portfolio a 30 day past due practical expedient could be considered a proportionate approach.
  - We also have identified one sector (Registered Social Landlords) where the *'rare and appropriate'* conditions for the Low Credit Risk option may apply, although we recognise that this may not be practicable given the high hurdle of proof that would be required, compared with the benefits of the application of the option.
  - It may also be appropriate for sophisticated lenders to use the Low Credit Risk Exemption in developing ECLs for highly rated debt securities which are outside the scope of the guidance in the CD (Para 13).

We believe that if the current draft GAECL text is enhanced to address the above points, the revised text will better support a high quality, robust and consistent implementation of IFRS 9 across the financial services industry.

We thank the AEG for giving us the opportunity to participate in the debate.

Yours sincerely,

Anne Obey
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Nationwide Building Society