29 April 2015

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sir/Madam

Consultative Document: Guidance on accounting for expected credit losses

We are responding to your invitation to comment on the Consultative Document on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of those firms who commented on the Consultative document. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We recognise that the Basel Committee is responding to the request to provide guidance early on in the IFRS 9 implementation process. The guidance on accounting for expected credit losses ('the guidance') covers accounting for certain aspects of expected credit losses ('ECLs') under IFRS 9 as well as broader regulatory expectations of credit risk management. This response only addresses the accounting for expected losses under IFRS 9 and the work of the auditor. We are not making comments on any other aspect of the document.

We recognise that regulators desire consistency between banks in determining expected credit losses for regulatory monitoring purposes and that the role of the regulator is to issue regulatory guidance. While the regulators can, as part of this role, seek to limit acceptable choices under International Financial Reporting Standards ('IFRS') for regulated entities, they must be careful not to contradict IFRS unless they desire to create differences between IFRS financial reporting and regulatory financial reporting.

We observed that there are a number of paragraphs in the guidance where the wording may not be entirely consistent with IFRS 9. Examples of where the wording may be inconsistent with IFRS 9 are included in Appendix 1.

Given that the Basel Committee is providing guidance on IFRS 9 for regulatory purposes we believe it is important that the wording in the guidance does not contradict the wording in IFRS 9. If, however, the Basel Committee is seeking to contradict the wording used in IFRS 9 it is very important that it acknowledges in the guidance why it is seeking to make such changes for regulatory reporting purposes. The Basel Committee should be aware that such changes will create differences between the guidance and IFRS 9.

Prudence

We note the use of the term prudence in the guidance. We understand that the International Accounting Standards Board ('IASB') has recently agreed to reintroduce prudence into the Conceptual framework of IFRS and that prudence will be defined in the framework as the exercise of

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caution when making judgments under conditions of uncertainty and that the exercise of prudence should be consistent with neutrality and should not allow the overstatement or understatement of assets, liabilities, income or expenses. We believe it important that the guidance uses the same definition of prudence as the IASB and would recommend that the guidance explicitly states that prudence has the same definition as IFRS.

We also note the use of the term "balanced" in the guidance. We assume that balanced is consistent with neutrality. As the IFRS conceptual framework uses the term neutrality we would recommend that the Basel Committee use the term neutrality, as defined in IFRS, rather than balanced in the guidance. We would welcome greater emphasis on neutrality in the guidance with commentary as to when it might be appropriate to release provisions as well as when one should increase provisions. For example, if there is an overall improvement in macroeconomic forecasts leading to a reduction in lifetime expected credit losses, to meet a neutrality view, provisions should be released.

Practical expedients

The guidance limits the acceptable methods or choices available to a bank when implementing and applying IFRS 9, even though these methods or choices are acceptable under IFRS 9 for example by limiting the use of practical expedients. As auditors of banks, we would not object (e.g. by qualifying our audit report) to the appropriate use of a practical expedient or method of assessing credit risk that is specifically allowed by IFRS 9 for financial reporting purposes.

Consistency

Paragraph 3 of the guidance notes that, "the Committee recognises that differences exist between ECL accounting frameworks, across jurisdictions. The revised guidance does not intend to drive convergence between these accounting frameworks, but does aim to drive consistent interpretations and practices, where there are commonalities and when the same accounting framework is applied."

We understand from discussion with Basel Committee members this wording to mean consistency with regards to credit risk governance and frameworks within an entity and not consistency across the banking sector. We recommend the guidance states this clearly. We believe actual credit risk frameworks/governance will vary across banks depending on the markets they operate in and the nature of their business.

Materiality

IFRS 9 5.5.17 states that "An entity shall measure expected credit losses of a financial instrument in a way that reflects .... reasonable and supportable information that is available without undue cost or effort at the reporting date...." Materiality will be a key part in implementing IFRS 9 such as when considering all relevant data or the use of some practical expedients. We recommend the guidance states that the use of materiality is appropriate and that the guidance uses the same definition of materiality as in IFRS. This could take the form of a statement at the start of the document that the guidance that follows is subject to the normal principles of materiality, as defined by IFRS, that apply to financial reporting.

Disclosures

IFRS 9 sets out requirements for disclosure in the financial statements and we understand that the Enhanced Disclosure Task Force ('EDTF') will also be issuing further disclosure guidance under IFRS 9. We believe the disclosure requirements included in the guidance which are over and above

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the requirements of IFRS will be required for regulatory reporting only. It would be helpful if the guidance clarified this point.

Work of the auditor

We note that in both principle 5 and principle 10 reference is made to the work of the external auditor. An audit is performed in accordance with auditing standards for the purpose of giving an opinion on the financial statements as a whole and these auditing standards direct the procedures an auditor is required to perform to give such an opinion. Any additional procedures which the external auditor is required to perform by the guidance would be outside the scope of their audit work. It would be helpful if the guidance made this point to ensure a consistent understanding in this regard by national regulators.

If you have any questions on this letter, please contact Paul Fitzsimon, PwC Global Chief Accountant (+1 416 869 2322) or Gail Tucker (+44 117 923 4230).

PricewaterhouseCoopers

Yours sincerely,
PricewaterhouseCoopers

Appendix 1- Inconsistency of Language between the Basel Guidance and IFRS 9

We have set out below examples of where the wording in the guidance is inconsistent with IFRS 9. As noted in our letter the guidance should be clearer when the wording is meant to narrow acceptable interpretation of IFRS 9 and should only contradict IFRS 9 if it is intended to create differences from IFRS for regulatory purposes.

- The factors in assessing a significant increase in credit risk in paragraph A27 of the guidance are inconsistent with IFRS 9 B5.5.17. Although the Basel Committee guidance notes that the committee expects banks to consider each of the 16 classes of indicators in IFRS 9, the guidance highlights six factors (A27 (a)-(f)) to which banks should pay particular attention. Some of these six factors appear to cover the same points as the indicators in B5.5.17 (a) to (p), but use different words and some do not seem to relate to the indicators in B5.5.17 (a) to (p).

- Paragraph A6 states that: "In formulating the estimate of the amount equal to 12-month ECL, it is important to **consider all reasonably available information that affects credit risk <u>especially</u> forward-looking information** and macroeconomic factors" . We recommend using the same wording as is in the standard. For example; IFRS 9 B 5.5.2 "when reasonable and supportable information that is more forward-looking than past due information is available without undue cost or effort, it must be used to assess changes in credit risk." or paragraph 5.5.4 "**considering all reasonable and supportable information, <u>including</u> that which is forward-looking**", or B 5.5.16 "An entity shall consider reasonable and supportable information that is available without undue cost or effort and that is relevant for the particular financial instrument being assessed."

- Paragraph A7 deals with financial instruments measured at 12 month ECL and states that "...a bank must be able to demonstrate that these exposures have **not experienced** a significant increase in credit risk since initial recognition." This is different from IFRS 9 that focusses instead on exposures that **have experienced** a significant increase in credit risk. Paragraph IFRS 9 5.5.4 notes "The objective of the impairment requirements is to recognise lifetime expected credit losses for all financial instruments for **which there have been** significant increases in credit risk since initial recognition". Also it is unclear if the above wording in A7 is intended to apply only when the 'low credit risk' exemption is used or in all cases.

- Paragraph A22 states that "Delinquency data are generally backward-looking, and the Committee believes that they will seldom be appropriate in the implementation of an ECL approach by banks". This is inconsistent with IFRS 9 B5.5.3 which notes "depending on the nature of the financial instruments and the credit risk information available for particular groups of financial instruments, an entity may not be able to identify significant changes in credit risk for individual financial instruments before the financial instrument becomes past due. This may be the case for financial instruments such as retail loans for which there is little or no updated credit risk information that is routinely obtained and monitored on an individual instrument until a customer breaches the contractual terms".

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- Paragraph A35 of the guidance states that if one or more exposures in a group have experienced a significant increase in credit risk an entity should transfer the "group or sub-group" to lifetime ECL. This is inconsistent with paragraph IE39 of IFRS 9 which gives an example of a top down approach. In this approach only a **percentage** of a group is deemed to have had a significant increase in credit risk (and so is transferred to lifetime ECL) and not the whole group or sub-group. We understand this difference is likely to be particularly relevant as certain banks are considering pushing down as much information as possible (including forward looking information) to individual loan level Probability of Defaults ('PD's') and to use these to determine if the individual exposures should transfer to lifetime ECL. Under this approach a significant increase in credit risk (and hence a transfer to ECL) will likely occur on some exposures in a group or sub-group rather than to the subgroup or group as a whole. This approach could be seen as inconsistent with paragraph A35 of the guidance.

- Paragraph A40 of the guidance states that the 30-days past due expedient should be "rarely used by banks" and paragraph A60 states that "the Committee has a strong expectation that a bank will not fall back on the 30-days rebuttable presumption unless it has demonstrated that all forward-looking information that was considered potentially relevant had no substantive relationship with the level of credit losses". This is inconsistent with IFRS 9 B5.5.19 which states that 30 days past due "may be presumed to be the latest point at which lifetime expected credit losses should be recognised even when using forward looking information".

- In paragraphs A50-A52 on use of the low credit risk exemption, paragraph A50 refers to using this exemption only in "rare and appropriate" circumstances and paragraph A51 refers to its use only when "it is evident its use would have a minimal effect on the timing of ECL recognition and the measurement of ECL". IFRS 9 has no such limitation. Paragraph A52 states that "even when a bank assigns a low credit risk rating to an exposure (or group of exposures), management should still assess whether credit risk has increased significantly" This is inconsistent with IFRS 9 5.5.10 that states that when credit risk is low at the reporting date "an entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition.....". Paragraph A58 also states a bank may choose an external rating grade that has a lower PD than investment grade that arguably conflicts with B5.5.23 that states investment grade is an example of an instrument that may be considered low credit risk.

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