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Comments from: Rosa Lastra, D. Bholat, K. Sen, S. Markose & A. Miglionico
Comments on: Prudential Treatment of Problem Assets

The Bank of England published on Friday (22 April) a working paper written by David Bholat, Rosa Lastra Kallol Sen, Sheri Markose and Andrea Miglionico addressing this issue under the title of:

"Non-performing loans: regulatory and accounting treatment of assets"

http://www.bankofengland.co.uk/research/Pages/workingpapers/2016/swp594.aspx

Combining economics, law and accounting, the paper considers divergences in the definition of NPLs across countries, accounting regimes, firms and data sources. The paper is premised on the assumption that asset quality (the Cinderella in the bank's balance sheet when it comes to meaningful cross-border comparisons) is and remains key for sound banking. For international assessments and stress tests to be meaningful systems of loan classification must be comparable. From the point of view of setting standards, divergence is manifested in several ways, not just across jurisdictions, across time and across entities, but also in the different priorities that accountants and regulators have. A general tendency/propensity towards forbearance can easily be disguised on the grounds of divergence. The paper also analyses the incurred v expected loss approach, IFRS. 9 and the trade-off between provisions and capital.