

30 April 2015

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

Consultative Document (CD) - Guidance on accounting for expected credit losses

Standard Chartered PLC is an international banking group, listed on the London, Hong Kong and Bombay stock exchanges. It operates in 70 markets principally in Asia, Africa and the Middle East.

We welcome the opportunity to comment on the above CD. We are broadly supportive of the draft Guidance and believe that it will encourage a greater level of consistency in respect of the implementation of the credit impairment elements of IFRS 9 globally. We are committed to achieving a high quality implementation of IFRS 9 as a whole and consider this Guidance to be an integral part of that as it provides a potential mitigant to multiple differing interpretations. However, this does mean that the Guidance should be principles based in nature and should not seek to prescribe implementation requirements.

Given the extensive responses from other industry bodies to which we subscribe, we have restricted our response to focus on the following key thematic concerns that we have with the guidance as drafted:

- **Incorporating materiality and acknowledging that proportionality could also apply to smaller portfolios of larger banks**

In respect of guidance in applying IFRS 9, the document should be aligned to established accounting principles, and should not therefore be seen to override the core concept of materiality. In addition, the guidance should recognise that proportionality should also be available, where appropriate, for smaller portfolios within larger banks. We consider both of these concepts to be consistent with a high-quality implementation by ensuring resources are focused on higher risk portfolios.

- **Better aligning the language across the document and in Appendix A to that of IFRS 9 and to ensure the guidance is clearly principles based**

The guidance should use language that is consistent with IFRS 9 to avoid confusion on interpretation and to avoid instances where the guidance could be viewed as setting an unattainable standard of application.

- **Defining “significant credit deterioration”**

The guidance should not seek to provide a checklist approach to determining how “significant credit deterioration” is interpreted. How significant credit deterioration is assessed should reflect management judgement (with the necessary supporting processes) rather than being imposed. Where guidance is provided, it should reflect economic realities (for example, how pricing is established and when and how it changes) rather than being theoretical in nature.

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Standard Chartered Bank is authorized and regulated by the Financial Services Authority under FSA register no. 114276

- **Re-segmentation**

We do not believe that re-segmentation will need to be as frequent as envisaged by the guidance. Frequent re-segmentation would be required where many of the inputs are applied at a portfolio level rather than within the Probability of Default (PD) at an individual exposure level.

- **Tightening language and clearly defining terms**

Throughout the guidance there are a number of instances where relatively subjective language is deployed in respect of accounting guidance. While this type of language may be suitable for a regulatory framework, accounting guidance is generally more objective in its nature. Not only does this help from an implementation perspective, by helping to minimise instances of ambiguity and promoting a more consistent interpretation of the requirements, it also enables the requirements to be auditable.

These key themes are discussed further in the attached appendix, together with some suggestions on drafting.

Should you wish to discuss our comments further, please do not hesitate to contact me.

Yours sincerely



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A. Key thematic concerns

1. Clarification of the use of materiality and proportionality

We acknowledge that the Committee seeks high quality implementation of an expected credit loss (ECL) accounting model and therefore implementation should not be governed solely by cost considerations. However, in as far as the Guidance applies to the application of the ECL requirement of IFRS 9, it should also include some reference to materiality. This is not a mechanism for avoiding implementation for certain portfolios; rather it ensures that cost/effort is applied to those portfolios that could have a material impact. In determining what a material impact may be, it is also likely we would look at what potential the portfolio would have to generate a material impact (in times of stress for example). It is also important to note that the application of materiality is not a static exercise – portfolios are continuously reviewed to validate whether they are immaterial or not.

While we consider that the concept of materiality should be included within the Guidance we do not consider it appropriate for the Committee to define materiality – that remains the purview of the accounting standard setters.

The Committee should also provide guidance on addressing the interaction of materiality for accounting purposes and the concept of “proportionality” in Paragraph 12 which is only applicable to small banks. We recommend that all banks should be able to apply the concept of proportionality because even a large bank could encounter a situation where a particular loan portfolio does not warrant application of sophisticated risk models due to lack of available data or immateriality.

2. Aligning the language for consistency with IFRS 9

While we consider that the terminology used in the guidance is well intentioned – that is, is seeking to encourage a high quality implementation – we believe that it would be more helpful to users and preparers to better align the wording to that of IFRS 9. This would avoid (1) setting an unrealistically high bar in terms of implementation (together with the ability of auditors to provide an audit opinion on the same) and (2) introducing a degree of confusion in terms of application and implementation.

There are a number of examples of this across the document:

- Paragraph 24(f) – we do not believe the use of overlay adjustments to reflect concentration risk is in compliance with IFRS 9. We believe this reference should be deleted.
- Guidance paragraphs 30 and 53 – references to “full spectrum” of information rather than the use of information which is “reasonable and supportable” imply the need for an exhaustive search. We suggest amending this to replace “full spectrum” with “reasonable and supportable”. Likewise paragraph 53 should be amended to remove “full spectrum” and replacing it with “reasonable and supportable”.
- Paragraph 59 – “reasonably available” should be replaced with “reasonably supportable” financial information.

- Appendix paragraph A23 – in respect of linkage of macro-factors, we consider the requirement for “persuasive analysis” to be much more stringent – perhaps to an inoperable degree – than the requirements of IFRS 9. We would suggest deleting “persuasive analysis” and instead replacing with “analysis through reasonable and supportable factors.

3. Definition of “significant credit deterioration”

Given the intention of the Committee to draft principles based guidance rather than a series of prescriptive requirements, we consider that some of the language and drafting around “significant credit deterioration” could be read as a checklist and/or requiring specific actions in particular circumstances.

Examples of this are:

- Appendix 1, paragraph A27:

We are concerned that the language of A27 means that the listing of conditions in (a)-(f) may be read as encouraging a “checklist” approach. Our preferred option is that the paragraph be deleted in its entirety as it does not appear to provide additional guidance/insight compared to the similar listing in IFRS 9 B5.5.17(a)-(p). If the paragraph was to be retained, the language should be moderated to be less definitive that the conditions would, on their own, reflect significant credit deterioration.

- Appendix 1, footnote 33 to paragraph A27

We believe that linking changes in pricing to defining “signification deterioration” is a very theoretical concept while the reality of pricing changes in very different. While initial credit quality does represent one of the inputs into pricing, it is not the only element (liquidity, profit, amongst other are also included) and often it is not a discretely identifiable component. Post initial recognition, pricing can change for any number of reasons and again the credit component may not be discretely identifiable. Given the language in footnote 33, which requires that where changes in pricing cannot be identified to specific components it is assumed to be credit driven, that practically means that all increases in pricing would be considered “significant deterioration”. This application would not only generate significant volatility into the income statement, reducing the quality of the information provided to users, but would also be counter to economic reality. It should also be acknowledged that the application of the guidance is symmetrical – therefore as prices are reduced loans should flow back to stage 1.

We suggest that footnote 33 as well as the paragraph a) in A27 be deleted

4. Segmentation

Although the implementation of IFRS 9 will introduce a greater degree of segmentation than under IAS 39, we do not expect there to be regular re-segmentation exercises undertaken following initial implementation. The reasons for this are broadly two-fold: (1) many of the forward looking attributes can be applied at an individual loan level by modifying individual PDs. While all risk drivers can never be captured within models, PDs can be adjusted to incorporate the more relevant factors which would be expected to be reasonably stable over a period of time; (2) too frequent re-segmentation is likely to introduce excessive granularity which may

lead to a less robust series of models and would also reduce year on year comparability. To the extent that risk drivers are not captured in the models, their impact should be assessed according to their materiality and proportionality as to whether re-segmentation would generate improved information.

We would suggest that paragraph 48 be re-drafted to reflect the principle that re-segmentation should only occur where it would lead to more decision-useful information for the users and appropriately reflect risk management.

5. Tightening language and clearly defining terms to avoid ambiguity, which will promote a more consistent interpretation.

Throughout the document a number of terms are used which are relatively subjective in nature when considered in an accounting context as opposed to a regulatory one. While we understand the sentiment behind the use of terms such as “robust” or “sound”, we believe it would encourage greater consistency of interpretation if either less subjective terms were used or definitions were clearly set out in the guidance.

B. Other issues

1. Limitation of the use of practical expedients

We do not consider that the use of practical expedients is contrary to a high quality implementation of IFRS 9 and believe that in some instances it would enhance the implementation. This is particularly the case where limitations in the availability of information would make the use of practical expedients more efficient without compromising the quality of the outcome.

2. Recognising that risk management is different across Retail and Wholesale portfolios

The Guidance does not currently acknowledge that risk management practices differ across Wholesale and Retail portfolios and applies a “one size fits all” approach. For example, the factors outlined in paragraph 27 appear to be more relevant to wholesale lending than retail.