

POSITION PAPER



WSBI-ESBG Common Response to the Basel Committee Consultation on Guidance on Accounting for Expected Credit Losses

WSBI (World Savings and Retail Banking Group)
ESBG (European Savings and Retail Banking Group)
Rue Marie-Thérèse, 11 - B-1000 Brussels

ESBG Transparency Register ID 8765978796-80

April 2015



WSBI



ESBG



1. General comments

We are grateful for the opportunity to share our views on the consultation on guidance on accounting for expected credit losses. We hope that our comments will be useful in the context of the continued development of the guidelines.

Although accounting and prudential reporting are inextricably linked, we are concerned that the guidelines as they are currently proposed would force preparers to apply the accounting standard IFRS 9 in a way that is contradictory to the underlying principles of the IASB and thus counter to the manner in which IFRS should be applied. We believe that it would be preferential if the Basel Committee followed the principles as set out by the IASB in regards to the accounting for expected credit losses for those entities which report according to IFRS 9. Straying from this application will cause inconsistencies in practice, which in turn could impact the relevance and reliability of the financial statements. There is a clear risk that banks under the Basel regime will end up reporting according to a different IFRS 9 to those banks that are not under the Basel regime and this would have a detrimental impact on comparability and investors' ability to interpret the financial statements.

We do not think that the Basel Committee should stray from its mandate within prudential regulation and move into accounting as the premises for accounting and prudential regulation are very different. We would support that the guidelines focus on how sound credit risk practices should interact with the expected credit loss accounting model, but we are concerned that the guidelines, in their current guise, go too far beyond this remit and introduce guidelines for the accounting models themselves.

The Basel Committee disagrees with the conclusion that some practical expedients should be allowed during the implementation phase. The use of practical expedients should not be equated to a lower quality implementation. Business models and other factors are very important and, in the case of a basic lending portfolio, using practical expedients will improve the financial statements as it will reduce unnecessary complexity. Banks may also consider using specific expedients as a backstop or for certain portfolios, banks may, for example, consider it appropriate to rebut the 30 days past due practical expedient for portfolios where 30 days past due is not considered representative of a significant increase in credit risk. We further believe that removing the possibility of utilising the practical expedient in IFRS 9 as well as the low credit risk exception may significantly increase costs during the implementation phase without providing a proportionate improvement to the provisions held by banks.

The text seems to imply that concepts not normally applied to accounting rules but rather on prudential rules should be considered within the guidelines. We are especially concerned about having to apply the concept of robustness to accounting rules (principles 2, 6 and 10). It is unclear to us how the concept of robustness can be applied together with the fundamental concept of neutrality. We are concerned that investors and other users will interpret the application of robustness as a move away from the presentation of true and fair financial statements as robustness would imply that preparers will hold additional allowances to those required by the accounting standard, thus introducing uncertainty regarding the reported numbers. We are also concerned that auditors' attestations may become unclear should they be expected to move away from the clearly defined concepts upon which accounting rules are founded. It is very important to ensure that the guidance can be applied in practice and that the output is auditable.

It would greatly improve the readability of the text if it clarified where a point within the Principles applies to risk management in general or when it applies specifically to impairment accounting. It



would also help if it clarified whether the Principles are applicable only under IFRS 9 or if they would apply whilst IAS 39 is still in place.

Some aspects of the paper are unnecessarily repetitive and therefore the Principles, and the overall paper, could be simplified. In particular, the same point regarding the use of forward-looking information is made numerous times. Additionally, greater clarity and consistency in the language used would improve the text

2. Detailed Comments to the text

Please find below detailed comments on specific sections of the consultative document.

Principle 5 on policies and procedures for the validation of an internal credit risk assessment model states in paragraph 58 (e) that a “Bank should appoint independent parties e.g. internal or external auditors) to conduct regular reviews of the model validation process”. We are concerned that moving the auditor’s role away from its traditional assessment of financial statements prepared according to accounting principles towards evaluation of processes and policies that are not based on the same fundamental concepts as accounting (e.g. neutrality) may damage the perception of the auditor as an independent reviewer. We do not believe that assurance of the credit risk model should fall within the scope of the auditor for these reasons.

Principle 8 on disclosures requires the loss allowance roll forward table to be provided separately for collective and individual allowances. It would help if the guidelines clarified how this would work if the allowance has components of both. That is, it would be helpful for preparers if there were clearer distinctions regarding the requirements around modelled results and judgemental overlays.

Clarification regarding which points are more relevant to retail or wholesale portfolios would be very helpful, as would more recognition that different methodologies will need to be applied to different portfolios.

Paragraph 12: It is not clear to which banks this paragraph is aimed. It would help preparers if the Basel Committee could provide clearer guidance in regards to this paragraph. For purposes of consistency the paragraph should also include small portfolios for larger banks when applying the principle of proportionality and materiality.

Paragraphs A4-5: We do not understand why the Committee is trying to force a linkage between the prudential and the accounting definition of default. The *raison d'être* of financial and regulatory reporting are not identical and the extent to which they are linked should reside with banks to decide, based on their internal policies and practices. Attempting to force concepts from one area onto another will not result in an overall improvement of the reporting in either area.

Paragraph A7: This paragraph states that if a bank uses the low credit risk practical expedient, the bank must also “be able to demonstrate that these exposures have not experienced a significant increase in credit risk since initial recognition”. Since an update of the ECL is required each reporting period, the burden to verify that there has been no significant increase in the credit risk level for those instruments which are considered low credit risk at the reporting dates is unrealistic. Such a requirement would certainly lead to both undue cost and effort.

Paragraph A 12: This paragraph needs to clarify that splitting portfolios is only necessary if different risk profiles emerge, in order to avoid misinterpretations.



Paragraphs A27-29: Some of the indicators included in these paragraphs are impossibly strict and would require banks to change their classification before any real credit risk deterioration is perceptible. This is particularly true for the statement included in footnote 33 whereby the Basel Committee proposes a rebuttable presumption that all changes in pricing is an indicator of a change in credit risk. There are a very large number of external and internal factors that could cause a price rise and that are impossible for the institution to prove. Changes to external demand could for example drive a price change where the underlying factor is not a change in the credit risk of the product itself but rather a need for the specific characteristics of the product due to unrelated reasons (e.g. a shortage of supply in the overall market due to changes in the pricing strategy of a competitor). The price change here would not be driven by a change in the credit risk of the product but rather a change in supply that is most likely not announced in the market, making it impossible for the bank to prove that the price change is not due to a credit risk change.

Paragraph A46-49: The practical expedients proposed to ease the implementation burden will not hinder banks from completing a high-quality implementation. Removing the option to use the practical expedients will, however, significantly increase implementation costs without resulting in any large increases in benefit, and we therefore ask the Committee to at least undertake further research prior to promoting a restriction of these.



About WSBI (World Savings and Retail Banking Institute)

WSBI brings together savings and retail banks in all continents and represents the interest of circa 6,000 financial institutions with total assets of USD 14 trillion and serving some 1 billion customers in 80 countries worldwide (2013 figures). As a global institution, WSBI focuses on international regulatory issues that affect the savings and retail banking industry. It supports the aims of the G20 in achieving sustainable, inclusive and balanced growth and job creation around the world, whether in industrialised or less developed countries. WSBI favours an inclusive form of globalization that is just and fair, supporting international efforts to advance financial access and financial usage for everyone. It supports a diversified range of financial services that meet customers' transaction, savings and borrowing needs responsibly. To these ends, WBI recognizes that there are always lessons to be learned from savings and retail banks from different environments and economic circumstances. It therefore fosters the exchange of experience and best practices among its members and supports their advancement as sound, well-governed and inclusive financial institutions.



World Savings and Retail Banking Institute - aisbl
Rue Marie-Thérèse, 11 ■ B-1000 Brussels ■ Tel: +32 2 211 11 11 ■ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ■ www.wsbi.org

About ESBG (European Savings and Retail Banking Group)

ESBG brings together savings and retail banks of the European Union and European Economic Area that believe in a common identity for European policies. ESBG members support the development of a single market for Europe that adheres to the principle of subsidiarity, whereby the European Union only acts when individual Member States cannot sufficiently do so. They believe that pluralism and diversity in the European banking sector safeguard the market against shocks that arise from time to time, whether caused by internal or external forces. Members seek to defend the European social and economic model that combines economic growth with high living standards and good working conditions. To these ends, ESBG members come together to agree on and promote common positions on relevant matters of a regulatory or supervisory nature.

ESBG members represent one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of €6,749 billion, non-bank deposits of €3,415 billion and non-bank loans of €3,685 billion (31 December 2013).



European Savings and Retail Banking Group – aisbl
Rue Marie-Thérèse, 11 ■ B-1000 Brussels ■ Tel: +32 2 211 11 11 ■ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ■ www.esbg.eu