POSITION PAPER

WSBI-ESBG Comments on the BCBS regulatory treatment of accounting provisions consultative document and discussion paper

WSBI (World Savings and Retail Banking Group)

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WSBI ESBG

Thank you for the opportunity to comment on the BCBS consultation and discussion paper on the *regulatory treatment of accounting provisions*. We are confident that the below will prove quite useful to you and hope that the BCBS will take our comments into account. We will first present our thoughts on the consultative document and then the discussion paper

Consultative document Regulatory treatment of accounting provisions – interim approach and transitional arrangements

WSBI-ESBG members welcome the proposal for addressing the impacts on regulatory capital arising upon transition to the IFRS 9 impairment model. Considering the significance of the reasons for the transitional arrangements identified in chapter 3.1 of the document some members have stated their belief that the transitory period over which the impacts are to be spread should take five years. Also, members have opined, the add-backs to CET1 capital should be subject to a straight line amortisation starting with 100% in the first year.

Members have been vocal in their support of the dynamic approach as this has the potential to reflect future developments of volumes impacted by the transitional effects. The dynamic approach, should be designed such that it is able to react to a situation of deteriorating expectation for future economic developments, and, hence an increase in stage 1 and stage 2 provisions over the transitory period after the adoption of IFRS9. In our understanding, both Approach 2 and Approach 3, as described in the BCBS consultative document, have the capacity to reflect such future developments. With regards to Approach 3, members have suggested that it might be appropriate to recognise the dynamics of both the provisions stock and the proportional impact as a result of the ECL model.

We proposed that transitional arrangements should seek to avoid, or minimise, the need to calculate pro-forma provision numbers under either different rules (e.g. old IAS39) or for different reference dates (e.g. provisions as of date x if current ECL model parameters are applied). We understand the preferred Approach 3 (but also Approaches 1 and 2) does not involve such a parallel calculation since it considers all Stage 1 and Stage 2 IFRS 9 credit loss allowances as new, as opposed to the IAS 39 incurred loss provision, and adds them back to CET1.

We recognise the drawback identified in the document that incurred but not reported (IBNR) provisions under IAS 39 partly cover IFRS 9 Stage 1 and Stage 2 loss allowances. However, members have voiced the opinion that the advantages of the Approach 3 being fully dynamic prevail over the drawback. Members have suggested that, should the drawback be considered as an obstacle to adopting Approach 3 an adjustment of the dynamic approach could be considered, e.g. by reflecting the initial absolute difference between IFRS 9 Stage 1 and Stage 2 and IAS 39 IBNR provisions.

Members believe it would be helpful if the BCBS could also clarify interactions between the classification and impairment IFRS 9 requirements, i.e. whether in calculating the "impact from the adoption of ECL accounting" entities should:

(a) simply compare the amounts of "accounting provisions" against each other before/after transition to IFRS9 by ignoring that the underlying population of instruments subject to impairment may have significantly changed (e.g. some loans, due to failing the SPPI criterion, may be measured at fair value through profit or loss without being subject to impairment under IFRS 9 while they were measured at amortised cost and subject to impairment under IAS 39; or AFS debt securities under IAS

39 were measured at fair value through other comprehensive income and were subject to the incurred loss model with impairment amount based on fair value while under IFRS 9 expected credit losses will apply and, in addition, a portion of them may end up with amortised cost or fair value through profit or loss measurement); or

(b) take account of the fact that the population of instruments subject to the expected credit loss requirements of IFRS9 on 1 January 2018 may be significantly different from the population of instruments subject to incurred credit loss requirements of IAS39.

Discussion paper Regulatory treatment of accounting provisions:

A number of our members have informed us that under the existing regulation framework, applying also the definitions in EBA RTS on specification of the calculation of specific and general credit risk adjustments, they treat all IAS 39 credit risk provisions as specific for exposures under the standardised approach. This would also hold true under the IFRS 9 expected credit loss model, provided definitions did not change. However, members recognise that the current definitions are outdated and do not fit the IFRS 9 expected loss concept. Further, the definition may be subject to different interpretations which do not contribute to a level playing field. As a result, members have suggested that it may be prudent to change the definitions.

When reviewing the BCBS alternative proposal for a fundamental change to the current regulatory framework by introducing regulatory expected losses for the standardised approach members propose that any changes should be considered only after a comprehensive impact analysis has been carried out by the BCBS.

Our members are of the opinion that what should also be considered as a permanent solution is the full inclusion of provisions excess (under IRB or for all provisions if the expected losses concept was introduced also for the standardised approach) in the eligible capital calculation (i.e. without the existing 0.6% RWA cap).

The concerns that inclusion of the excess would significantly weaken regulatory capital by losing the loss absorption function is not shared by our members for a number of reasons. Firstly, the capital adequacy regulatory framework is based on 12-month expected but also unexpected losses. From this perspective the excess of provisions over 12-month expected would not significantly undermine the loss absorption function. Secondly, the accounting expected losses tend to overestimate the real economic loss because provisions are also calculated for future cash flows resulting from the credit margin. Credit margin covers the initial expected loss. Therefore the losses tend to be double-counted to this extent which becomes more prominent the longer maturity the assets have. We consider that recognition of the excess as Tier 2 rather than Tier 1 capital is a sufficient measure addressing potential issues in this area.

Conclusion

May I take this opportunity to thank you once more for this opportunity to express our opinions and assure you that should you have any questions or queries on any of the above we would be more than happy to discuss further.

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.

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About ESBG (European Savings and Retail Banking Group)

ESBG brings together nearly 1000 savings and retail banks in 20 European countries that believe in a common identity for European policies. ESBG members represent one of the largest European retail banking networks, comprising one-third of the retail banking market in Europe, with 190 million customers, more than 60,000 outlets, total assets of €7.1 trillion, non-bank deposits of €3.5 trillion, and non-bank loans of €3.7 trillion. ESBG members come together to agree on and promote common positions on relevant regulatory or supervisory matters.

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