European Banking Federation

Chief Executive

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30th June 2016

Mr Olivier GUERSENT
Director General
DG Financial Stability, Financial Services and Capital Markets Union
European Commission
Email: Olivier.Guersent@ec.europa.eu

Subject: Interaction of accounting and prudential frameworks – IFRS 9 impact on capital

Dear Mr Guersent,

Any increase of provision balances on the adoption of IFRS 9 will reduce shareholders' equity and could have a negative impact on CET1 ratios. CET1 ratios could be expected to decrease without any corresponding change in the level of risk, risk appetite, the bank's strategy, management or level of losses.

Further increases in capital requirements can only further curtail banks' capacity to finance the economy. Increased capital requirements are expected to have an adverse impact on banks' lending practices and pricing. Banks can adjust to higher capital requirements either by raising fresh capital – a scenario that after the earlier considerable efforts by banks in Europe in this regard is not feasible – or by deleveraging.

The prudential framework has been strengthened since the beginning of the financial crisis resulting in a more resilient financial sector. Prudential measures have already been introduced that mitigate some of the concerns that instigated the IASB revision of the impairment model. The regulators have stated in other consultation proposals that they do not intend to significantly increase overall capital requirements. However, the impact on capital ratios resulting from IFRS 9 has not yet been taken into account in the overall calibration of the capital framework. The prudential rules need to be recalibrated to offset the changes of the new accounting model before 2018 to avoid double counting and ensure a level playing field regardless of the underlying accounting regime.

As a follow up to a meeting between EBF and representatives of DG FISMA of 17 June 2016, we are enclosing an EBF paper that describes the interaction between the accounting and regulatory frameworks, explaining the source of "double counting" stemming both from the different time horizons for expected losses under the accounting and prudential framework as well as measures adopted by prudential regulators since 2008 aimed to address the same risks. The EBF also outlines a proposal for prudential treatment of expected losses that could be applicable under both IRB and STA approaches. The EBF proposal is consistent with the overall prudential framework, which relies on a 12 month time horizon.

The EBF proposal could be applicable both at the international and European level. The EBF prefers a global approach, however, we understand there is little chance that any form of global solution will be in time for 2018. To enhance a level playing field between banks under IFRS 9 and those under national GAAPs, we would urge the European Commission to adopt a sound technical solution addressing the “double counting” within the upcoming CRR revision that would be in place by the end of 2017.

However as we understand that the European Commission would prefer to await a global solution, we would suggest that an interim measure is introduced within the CRR. The EBF is suggesting that the difference between the life time expected credit loss provisions and 12 months expected credit loss provision in stage 2 is added back to CET1 for a period of 3 years under both IRB and STA approaches (“freeze in period”).

This will enhance a level playing field with US and other internationally active banks that are not under IFRS and provide time to enable regulators to take into account the impact of the revised accounting frameworks into the calibration of the prudential requirements.

The EBF stands ready to discuss other options to offset the IFRS 9 impact on own funds but suggests, for operational reasons, to exclude those which would require a parallel running of IAS 39 and IFRS9 during the transitional period.

Finally, we would like to suggest that the impact of any global proposal is carefully analysed. In the absence of an appropriate global solution that could be adopted in EU legislation by 1 January 2021, we would request that an appropriate solution is adopted for European banks.

We will be very happy to discuss our proposals in more detail and work with the regulatory community to ensure a sound, principle-based and operational solution that would provide for a level playing field.

Yours sincerely,

Wim MIJS

Cc: Mr Erik Nooteboom
Mr Didier Millerot
Mr Klaus Wiedner