12 January 2017

EBF_024874

BCBS Consultative document: Regulatory treatment of accounting provisions - interim approach and transitional arrangements

Key points:

- The transition period should not be introducing any phasing before there is clarity on how the prudential framework will be amended long-term.
- For jurisdictions applying IFRS 9, the transition regime should apply from 2018. In the period from 1 January 2018 to 31 December 2019 a bank should include in CET 1 capital an adjustment amount of 100 % (coefficient 1).
- Should the final framework be in place by 2020, the phasing as envisaged by the Basel Committee could then be adopted which would make more sense given that the phasing-in would take place on the basis of a real impact.
- As for the approach to the calculation of the transitional adjustment amount, the EBF supports alternative 3 given its dynamic approach and conceptual relevance.

European Banking Federation aisbl

Brussels / Avenue des Arts 56, 1000 Brussels, Belgium / +32 2 508 3711 / info@ebf.eu
Frankfurt / Weißfrauenstraße 12-16, 60311 Frankfurt, Germany
EU Transparency Register / ID number: 4722660838-23

www.ebf.eu

EBF position:

[EBF response to the Consultative document: Regulatory treatment of accounting provisions: Interim approach and transitional arrangements]

The current regulatory capital regime requires capital to cover for unexpected losses within a one year time horizon which also requires calculation of one year regulatory expected losses (EL). To avoid that capital is required for losses already covered by accounting provisions, the capital framework is designed in a way that allows recognition of accounting provisions for regulatory purposes to a certain extent.

Given the fundamental change in the accounting framework as well as the simultaneous changes made to the regulatory framework since 2009 in response to the financial crisis, the interaction between accounting and capital regime should be revisited to address any overlapping measures and ensure their proper interaction.

Given that the understanding of the impact of the new accounting standards on capital ratios and the interaction and overlaps with the prudential measures will require a holistic review and time and extensive dialogue between regulators and industry to ensure its proper functioning, the EBF strongly supports the introduction of a transition period.

The EBF believes that the transition period should not be introducing any phasing before there is clarity on how the prudential framework will be amended in a long term. Under a possible adverse scenario, accounting losses will be front loaded under expected loss models to a far greater extent whereas the timing of the materialization of the losses and its final amount will be unchanged. This is one of the reasons for the impact to be neutralized until an appropriate permanent solution is finalized. Unless retaining the existing framework unchanged was decided upon as the long-term solution, the industry would be transitioning to an incorrect end point. This could lead to unavoidably misleading disclosures and end-users basing their analysis on inaccurate information.

If the Basel Committee changes the prudential framework they would be faced with unwinding any existing transitional amendments and potentially implementing another transitional regime to recognise the impact of the longer-term solution, resulting in unwarranted volatility in banks' capital ratios. We therefore believe that offsetting the impact of the changes to the accounting standard until the finalization of the revision is a more appropriate solution.

Moreover, the EBF strongly advocates that, for jurisdictions applying IFRS 9, the transition regime should be implemented from 2018 when the new accounting standard applies. It should consist in a total freezing of the incremental impact of an expected loss model in the financial statements until at least 2020 where the corresponding US accounting standard (CECL) applies. It is crucial to ensure a level playing field (LPF) between jurisdictions that apply new EL accounting impairment models that come into force with two different timelines. A level playing field would not be achieved with a phasing mechanism introduced during this period.

The introduction of a minimum 2 year offsetting period will ensure LPF and also provide sufficient time to analyse the impact and revise the prudential framework to calibrate the potential volatility. The first years of live running of IFRS9 will serve entities, auditors, regulators and supervisors to achieve a sensible and relatively homogeneous calibration of the triggers and thresholds to move assets from stage 1 to stage 2. In the meantime, offsetting the impact in capital of this initial volatility in provisions is desirable, at least until a stable implementation is in place.

Should the final framework be in place by 2020, the phasing as envisaged by the Basel Committee could then be adopted which would make more sense given the phasing would take place on the basis of a real impact.

Accordingly, the EBF proposes that at least in the period from 1 January 2018 to 31 December 2019 a bank should include in CET 1 capital an adjustment amount of 100 % (coefficient 1).

As for the approach to the calculation of the transitional adjustment amount, the EBF supports alternative 3 given its conceptual relevance. The dynamic approach will allow for a more realistic quantification of the IFRS 9 impact taking into account any change to the size of the portfolios as well to the economic outlook. It would also consider the effects of volatility introduced to own funds from the accounting model which would not be the case with any static model.

In order to address the drawbacks of the current option 3, further enhancements could be explored, for instance, adding back to CET 1 lifetime expected loss provisions not related to assets in regulatory default for both IRB and STA approach. This will be conceptually sounder as we believe the increase of provisions is mainly expected due to the LTEL.

Given that the Basel framework is built on a 12-month horizon adding back to CET 1 a portion of the provisions equal to the lifetime expected loss will also address the overlap as further explained in our response to the Discussion Paper and could provide a rationale for developing a permanent solution.

Finally, to avoid diversity in practice the definition of specific and general credit risk adjustments should be clarified in the context of expected loss models.

The EBF will be pleased to exchange views with the BCBS on any of the above aspects in more detail.

About EBF

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.1 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth.

www.ebf.eu **@EBFeu**

For more information contact:

Denisa Mularova
Senior Policy Adviser
Accounting & Banking Supervision
d.mularova@ebf.eu
+32 2 508 37 66