German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the Consultative Document "Guidance on accounting for expected credit losses" (BCBS 311)

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Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

On 2 February 2015, the Basel Committee on Banking Supervision (BCBS) published the consultative document "Guidance on accounting for expected credit losses". We gladly take the opportunity to deliver our opinion.

We believe that the following overarching principles resp. topics should form the basis for the contents of the guidance

1. We strongly believe that the regulatory guidance on the accounting for expected credit losses should be based on a set of **principles**.
2. The accounting model should be **built upon credit risk management practices and processes** but it should not drive the risk or reinterpret processes itself.
3. The guidance should acknowledge the **proportionality** principle and should not override the concept of **materiality** as applied by accounting standards.
4. It should be stated that banks can **build on** their implemented stable and robust **risk methodologies**.
5. The requirements regarding **segmentation** should be formulated in a **practice-oriented manner**.
6. **Differentiated application of principles** is necessary **for corporate and retail portfolios** due to different business and risk management practices.
7. The **usage of the practical expedients** of IFRS 9 should still **be possible**.
8. Due to forward looking information we strongly support IFRS 9's requirement of "considering all **reasonable and supportable information**".

The following are our detailed explanations on our principles/topics referred to above:

1. Paper should be principle-based

Generally, we strongly believe that the regulatory guidance on the accounting for expected credit losses should be based on a set of principles. A principle-based approach is best suited for the application within the broad range of different accounting frameworks, business models and sizes of banks and as such can be adequately applied by each institution in scope of the regulatory framework. While a rule-based approach with strict requirements would be difficult to align with the proportionality principle set out in the discussion paper, the aforementioned implementation is flexible enough to consider the characteristics of each institution. The paper should therefore concentrate on the established principles, while specific rules and examples for certain constellations should be removed as they create inflexibility and redundancies.

2. Accounting follows risk management

We think the paper would gain precision and clarity if passages, which state or address topics that are already covered by other laws, regulations or guidelines, would be removed or clearly identified by indicating the source of the requirement. Plenty of requirements are already part of international regulations (Basel III) and thereof derived national regulations (e.g. CRR). In those cases it is our interpretation, that the goal of this paper is not to overrule or to change those requirements, but to state issues for the sake of completeness.

While most parts directly address accounting-related subjects, some paragraphs define certain parts of sound risk management practice in general. In our view, this guideline shall not set out specific rules for credit risk management as such, but to describe the regulators view on the use of credit risk management systems for accounting purposes. In sum, the accounting should follow the risk management and not the other way round, i.e. it is set up on the existing risk management processes.

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

3. Proportionality and materiality

Due to the proportionality principle it should be stated that banks of different size and importance of their lending business are subject to different levels of requirements. We believe that the proportionality principle should not only apply to institutions of different size or complexity, but also to subsidiaries or branches and portfolios of banking groups. In addition, it is established practice and economic necessity to apply the materiality principle which allows to allocate costs and resources according to the materiality of a specific portfolio. These two principles are already applied in practice today and form a part of the regulatory framework, for example demonstrated by the possibility of a permanent partial use[1] in IRBA, and an accounting principle for useful information, for example in the IFRS Framework.

The guidelines should therefore be adjusted to reflect that the proportionality and materiality principle are implemented accordingly.

4. Use of stable and robust risk methodology

We support the general principles covered by the main part of the consultative document as we see them to be aligned with the principles underlying the current regulatory framework of Basel III and the European implementation in the Capital Requirements Regulation and Directive (CRR / CRD IV) as well as other supervisory requirements. The efforts of creating a strong and robust risk measurement and risk management environment – especially since Basel II – resulted in sophisticated models and processes for many financial institutions. The concept of robustness in this context leads to systems, which are stable, accepted, transparent, reliable and auditable. We believe the development and application of these models and processes to be well in line with the mentioned principles. In our view, this is particularly true e.g. for the implementations of highly sophisticated credit risk management systems within the banking industry (e.g. IRBA). Since the development of these models and processes has been accompanied by the demanding regulatory review process as well as internal requirements, we are confident that they are strongly aligned with the principles in the consultative document.

The development of these credit risk practices has covered all aspects of the underlying subject, from the analysis and establishment of necessary data acquisition over the identification of relevant risk drivers and the building of models to the regularly performed validation and reporting routines.

While we agree that some specific aspects of the relevant accounting rules may make adjustments necessary, we think that the measurement of expected credit losses for accounting purposes should be as consistent as possible with the standards set by risk management. Only a generally homogeneous approach can sustain a sound basis for the management of a bank including internal and external communication and reporting, risk-oriented planning and steering as well as the development of business models. All of these areas have to rely on consistent information and processes within both the accounting and the risk management view on the current status of the financial situation of the institution. Unnecessary deviations between these worlds should be avoided as they create additional complexity, which reduces understandability and comparability of financial statements, especially for external stakeholders.

An institution's pricing process generally incorporates credit risk information as one component, but also considers other inputs (e.g. business strategy, cross-selling or market sentiments). The already established principles of credit risk management make sure, that all information with relevance for credit risk is

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[1] For non-significant business units and asset classes that are immaterial in terms of size and perceived risk profile.

used during pricing. We therefore do not see any relevant factors to be discovered when looking at historical or hypothetical results of the pricing process.

The paper should therefore clarify that risk management practices should be the basis for the measurement of expected credit losses and that inconsistencies between risk and accounting should be as small as possible. The approved regulatory models and processes are adequate for the use in context of the accounting for expected credit losses, since they reflect the sophistication and characteristics of a bank's lending business. We also recommend removing the relevance of the pricing process for ECL accounting.

5. Segmentation

Based on the before mentioned description of bank´s status with regard to risk management processes and models under a sophisticated implementation which requires a segmentation reflecting the underlying portfolio's risk characteristics, we are convinced that existing bank's rating methodologies (e.g. for IRBA banks) and models to a large extent already address the requirement outlined in the IFRS 9 standard and the BCBS guidelines. CRR (article 169 and following) requires banks in the context of an adequate implementation of rating models, to identify the relevant risk drivers for different portfolios including their discriminatory power. Only if risk drivers proof to be risk relevant with respect to a certain portfolio they would be taken into account. Lending exposures are grouped into portfolios based on the selective risk characteristics. This approach is the centrepiece of a meaningful and adequate risk management process as on this initial portfolio segmentation all relevant further integrated risk management processes are based. The segmentation process is already subject to regular validation (according to regulatory processes once a year) to ensure that formerly chosen risk characteristics are still valid and to possibly include newly identified risk characteristics. In case of changes in the discriminatory power of variables and the appearance or disappearance of risk characteristics, segmentation is changed to maintain meaningful risk valuation. For the approved use of these rating systems, banks make sure that all relevant lending exposures are covered by this segmentation process and that portfolios are still large enough to allow sound statistical analyses.

Therefore, the paper should highlight that it is not necessary to investigate or establish additional criteria, when adequate modelling and model validation processes are in place, which are able to identify common risk characteristics and incorporate necessary adjustments. Furthermore, it should be stated that these risk management systems approved by supervisors fulfil the requirements of the paper's principles and as such can be used as a consistent basis for ECL measurement.

6. Differentiated application of principles for corporate and retail portfolios

The segmentation based on relevant risk drivers forms the basis of the development and implementation of the rating methodology. While the parameterization of the rating models in its nature has to be based on a portfolio basis, but the parameters, such as rating, LGD, CCFs, etc. for the portfolio in scope are applied on the level of single borrowers, using their specific risk factor characteristics i.e. the borrower specific rating, the borrowers exposure incl. its individual risk mitigating measures.

For retail customers the rating methodology in general is based on a data base reflecting the large number of customers. This may allow for modelling of statistically significant relations between risk factors and the estimated parameters while by nature the extent of borrower-specific information is limited. The application of a rating tool for a retail portfolio is usually an automated process allowing banks to handle the sheer number of borrowers while maintaining efficient processes.

For wholesale borrowers more information will in general be available for the specific borrower. Banks do have processes and staff in place to collect further relevant information as one part of the risk assessment of wholesale customers. The rating tool for a wholesale customer incorporates this more detailed information through specific quantitative and qualitative analyses within the rating tool. For this type of borrowers the statistical basis is less broad compared to retail customers. Generally, for wholesale customers the rating process is not executed automatically but rather needs an experienced credit officer to pass through the rating. Result of this integrated risk management and rating process will also be an individual rating for the individual wholesale customer.

As a result, a bank with sophisticated processes (e.g. IRBA bank) will in general have different rating approaches for different portfolios and will allocate an individual rating based on the specific risk characteristics to the customer. This rating (and the associated PD) should be taken as the relevant basis for the calculation of the ECL.

The paper should therefore clarify that the requirements have to be interpreted with respect to the specifics of each portfolio. This includes the established segmentation and differences between retail and wholesale approaches, what allows sophisticated banks to use their existing rating methods and base all further ECL measurement on the resulting individual rating for every customer. The characteristics of the available information should be considered adequately and it should be mentioned that high quality credit risk measurement is always tailored to the portfolio's specifics (i.e. for retail portfolios data basis together with limited extent of borrower-specific information and on the other hand for wholesale borrowers more specific in-depth analysis combined with a smaller statistical data basis). This still allows other banks to make their ECL measurement on a less granular basis (portfolio level).

7. Practical expedients

In certain cases, IFRS 9 allows the use of simplification rules such as the "low credit risk exemption", "more-than-30-days-past-due-rebuttable presumption" or the use of the 12-month-PD as a transfer criterion. With these rules, the IASB has explicitly recognised that the costs associated with the full application of the standard would, in certain constellations, be unreasonably high compared to the benefits. From our point of view, this *principle of undue cost or effort* is absolutely crucial to an adequate implementation of the standard and should be observed also with a view to the practical expedients. We refuse that the application of this central accounting implementing principle of IFRS 9 shall be virtually excluded for credit institutions. In addition, a general rejection through the qualification as "low implementation" would not be in line with the general overarching principle of the Basel Committee that frameworks of the Committee shall meet the principle of "Simplicity".[2]

Low credit risk exemption

The IASB has explicitly introduced the low credit risk exemption as a rule to establish an equilibrium between costs and benefits (IFRS 9.BC5.180). In contrast, the Basel Committee sees the application of this assumption regarding the low credit risk as an inferior implementation of the accounting standard and sets the hurdles for the application very high. We do not share the Basel Committee's rejection. In our opinion, this rule is justified both from a conceptional and a material point of view.

A consequence of the rejection of the low credit risk exemption would be that a check for significant deterioration of the credit risk would have to be carried out even in case of a low credit risk (on which check

[2] See the paper of the Basel Committee: The regulatory framework: balancing risk sensitivity, simplicity and comparability.

the Basel Committee again puts extended requirements, cf. paragraph A26 and A27) and, as a consequence, measurement of lifetime expected losses may occur, although taken as a whole the credit risk is still a low one. In connection with this it has to be taken into account that application of the low credit risk exemption does not mean that no provision is made for the risk. Adjustments in the context of changed 12-month expected losses are still made invariably and transfer to bucket 2 (lifetime expected losses) also takes place if a significant increase of the credit risk occurs and which is beyond the low credit risk. The low credit risk exemption merely represents the IASB's judgement that within the area of application any deterioration of the credit risk occurring, taken as a whole, is not yet regarded as being significant because the absolute credit risks are low in the low credit risk area. Mandatory transfer to bucket 2 is justified only if a significant deterioration of the credit risk has occurred also taken as a whole.

Although it is true that credit risk deterioration may have occurred also within the low credit risk area, it is also true that the absolute default risk for these loans still is sufficiently low, so that making a provision for the risk in the amount of the loss to be expected during the remaining term appears to be inappropriate. It is not the primary focus of the standard to apply provisions for risks already on the balance sheet for loss risks under unlikely worst-case scenarios. The unlikely possibility of default in the case of high-quality assets should, in our opinion, be covered by the loss coverage potential of the equity and not by means of balance sheet risk provisioning.

Moreover, we would like to emphasise that, in our opinion, the low credit risk exemption for loans without access rating and/or without current rating is a viable approach to implementing the standard. This has to be looked at also against the background that many rating systems have been introduced only in recent years and hence access ratings are not available for the respective loans. The costs associated with the derivation of probabilities of default, if such derivation is possible at all, would for these transactions be unreasonably high compared to the benefits due to the low absolute default risks and the associated low effects on the amount of the impairment.

<u>30-days-past-due-rebuttable presumption</u>

IFRS 9.B5.5.11 provides the rebuttable presumption that in case of a 30-days-delay (30dpd) an increase in credit risk is assumed. However, information of delay are only permitted as single criterion if forward-looking information cannot be obtained without undue cost or effort. The Basel Committee emphasises that days overdue are lagging indicators and, therefore, believes a definition of the transfer criterion based essentially on 30dpd is inappropriate for banks. The Committee hence expects the credit risk to be detected already before a delay of 30 days occurs. Any significant use of the 30dpd regulation is understood as a very low quality implementation of the standard.

In our opinion, this view is too narrow and we emphatically point out that this interpretation may change entire business models. Implementation of the IFRS 9 in compliance with the standard already implies that primarily forward-looking information has to be used and that the 30dpd indicator comes into effect subsequently as a fallback indicator. The standard has defined narrow limits for the exclusive use of the 30dpd indicator already in the materiality principle. We, therefore, believe that wholesale rejection is not appropriate. There are very concrete areas of application for this simplification in the context of the proportionality principle or in the case of low materiality levels.

For example, business models with loans of a comparably low commitment but possibly high socio-political significance (subsidised loans to students, SME) would from a banks' point of view increasingly become unattractive if excessive amounts of information were to be produced, followed up and documented in addition to the delay status. This primarily affects banks with business models that at least to a certain

extent are based on the granting of such retail loans and/or on a public promotional mandate. Accordingly, application of the 30dpd should be permitted for these portfolios without regarding implementation of the standard generally as "very low quality".

In any case 30dpd should be eligible subject to the application of the principles of proportionality and materiality with regard to the size and inherent risks of such exposures.

<u>12-month-PD for assessing significant increase in credit risk</u>

Occurrence of a significant credit risk increase may within the meaning of an approximate solution according to IFRS 9.B5.5.13 be assessed based on the 12-month PD if there is no indication of any other result. According to paragraph A3, however, the following shall apply: "to assess whether a financial instrument should move to a lifetime expected credit loss (LEL) measure, the change in the risk of a default occurring over the expected life of the financial instrument must be considered." This is an unjustified tightening which unnecessarily clearly increases the complexity of implementation without any corresponding benefit. This is in particular true for the retrospective application of IFRS 9, as PD curves with lifetime PDs for the remaining terms would need to be provided retrospectively for each credit agreement, which then would each need to be compared to the current lifetime PD. In the case of a credit agreement with a term of e.g. 15 years that has a residual term of 10 years, the estimated lifetime PDs for 10 years, 9 years etc. down to one year would have to be determined retrospectively for the time of credit granting and then compared to the current lifetime PD at the time of first application and in subsequent years. Even the determination of current lifetime PDs is a demanding task. Therefore, the IASB has made a weighting and allowed easements within a certain context in the lending business. Typically, the lending business is conducted by banks. It is, therefore, necessary that the easements granted by the IASB are actually available to the banks and are not ruled out again by the Basel Committee. In many cases the required historical data to estimate the lifetime PDs retrospectively are not be available which will force credit institutions to build additional allowances for these portfolios temporarily based on current lifetime PDs until the "legacy exposures" will have been derecognised from the balance sheet. This might in actual fact compel the institutions, due to the retrospective application of the transfer criterion at the time of first application, to make the provisions for bad debts on the basis of the lifetime PD. This would have direct negative effects on the amount of equity and the fulfilment of prudential capital resources requirements and hence the lending business. Therefore, the use as a matter of principle of the 12-month PD as a transfer criterion taking account of the restrictions provided for in IFRS 9 is indispensable. This in particular applies for any retrospective implementation.

8. Reasonable and supportable information

In principle, we agree with the requirement from both IFRS 9 and paper that forward-looking information including macroeconomic factors also need to be incorporated in the assessment and the measurement of ECL for accounting purposes. Nevertheless a "crystal ball" does not exist and it is impossible to predict the future especially in extreme events with any degree of confidence.

Therefore, we strongly support IFRS 9´s requirement of "considering all reasonable and supportable information, including that which is forward-looking".

As forward looking information can be derived from different sources (e.g. deduction from historical data, individual assessment, etc.) and not all information may be relevant for every portfolio, a general principle should especially revert to relevant and reasonable forward-looking information, which is available without undue cost or effort according to IFRS 9.

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

Banks already have processes in place to identify which forward-looking information should be considered for inclusion in a model as it is proofed to have material predictive power. Normally, historical sensitivity of such factors should be analysed and can be taken as a basis for the future. Furthermore, processes might be required to take into account forward looking information that has not been relevant in the past but appears to be valid for the future. Processes for modelling and validation must be implemented accordingly.

From today´s point of view, especially the stress testing methodology that most advanced IRB banks have in place is a valid starting point (while maintaining an unbiased view) for the adjustment of parameters. Based on the sensitivity of specific ECL-relevant parameters with respect to (macroeconomic) risk factors and on relevant portfolio specifics, adjustments of PDs and LGDs due to forward looking information can already be made today and should be used consistently for ECL valuation.

In order to assure understandability, reduce model risk and allow for interpretation of both parameters and results, the number of input factors in a model has to be reduced to the most relevant. Since there is an arbitrary number of potential (macroeconomic) risk factors, it is not possible to individually test and argue the implementation or omission in a model for each of those. A negative selection of all possible factors on an individual basis is not adequate, because the entirety of all used risk factors has to be considered.

Overall, we think that paper should include in this principle that banks should make sure to have adequate processes in place to identify relevant and reasonable information, to decide objectively and transparently on the incorporation including specific backtesting processes. This analysis and judgment should be aligned with existing processes and the use of macroeconomic expectations in risk management. A general argumentation concerning single risk factors should not be necessary when relying on an overall consistent model design. In addition, we believe that it would be useful to anchor the consideration of "forward looking information including macroeconomic information" at one place instead of reiterating this requirement several times in different places slightly different. That would also allow a consideration of this kind of information in conjunction with the principle of proportionality that would be desirable.

Moreover, we believe that the structure of the paper could be reconsidered to group relevant aspects together. Such guidances could usefully be put in one place to avoid similar points being made slightly differently in different places. In addition, with respect to the use of forward looking information, we would like to annotate that in its consultative document the Basel Committee regularly uses the term "forward looking information and macroeconomic factors". Please clarify that this differentiation does not imply any additional requirements beyond the requirements of IFRS 9.

Based on our above mentioned principles and issues we would like to suggest the following wording for the 11 principles mentioned in the paper and the IFRS 9 topics in the appendix. The explanations for our proposals are written in *italic type*.

In case we have not mentioned certain issues above we will do this in our special comments according to the relevant paragraphs.

II. Special comments

1. Principles underlying this document

Principle 3: A bank should have a process in place to appropriately group lending exposures on the basis of shared credit risk characteristics.[3]

Addition of the footnote due to our principle 5 "Segmentation".

Principle 6: A bank's use of experienced credit judgment, especially in the robust consideration of forward-looking information ~~that is reasonably available~~ and macroeconomic factors that are both, relevant and reasonably available, is essential to the assessment and measurement of expected credit losses.

Amendment due to our principle 8 "Reasonable and supportable information".

Principle 7: A bank should have a sound credit risk assessment and measurement process that provides it with a strong basis for common systems, tools and data to assess ~~and price~~ credit risk, and account for expected credit losses.

Amendment due to our principle 2 "Accounting follows risk management".

Objective and scope *(paragraph 1-16)*

Paragraph 7:
We propose following changes due to our principle 2 "Accounting follows risk management".

"Supervisors expect that a bank's credit risk practices will provide the basis for a high-quality, robust and consistent implementation of an ECL accounting model in accordance with the applicable accounting framework and support appropriate measures of capital adequacy. This guidance provides banks with supervisory requirements surrounding how the ECL accounting model ~~interact with~~ should be based on a bank's overall credit risk practices and regulatory framework, but does not endeavour to set out regulatory capital requirements on expected loss provisioning under the Basel capital framework."

Paragraph 8:
The Basel Committee explains that the probabilities of default used for regulatory purposes always were "Through-the-Cycle". This statement is contradictory to our experience because the rating methods used in practice definitely include elements of a point-in-time view and hence in most cases are a hybrid of Point-in-Time (PIT) and Through-the-Cycle (TTC). The European Banking Authority (EBA) also has confirmed this observation in paragraph 177 of its currently discussed consultation paper EBA/DP/2015/01 ("Future of the IRB Approach"): "In practice, the rating systems are in most cases a hybrid of PIT and TTC approach".

At this point, we would also like to state that it is not possible to develop a "perfect" PIT method. It would, for example, also have to be able to predict radical political and economic changes, which is impossible in reality. Therefore, the said hybrid approach is in many cases the adequate, statistically more serious, model.

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[3] Since sophisticated IRBA rating systems require a segmentation of lending exposures reflecting the underlying risk characteristics, Principle 3 is implicitly fulfilled by banks using IRBA rating systems as a basis for ECL measurement. Hence, there is no need for a separate segmentation of the loan portfolio.

We, therefore, ask to adjust paragraph 8 accordingly due to our principle 1 "Paper should be principle-based". Most rating systems for regulatory purposes do not output strict through-the-cycle PDs.

"The measurement of expected losses for regulatory capital purposes may be a starting point for estimating ECL for accounting purposes; however, adjustments ~~will~~ may be required due to ~~fundamental~~ differences between the objectives of and inputs used for each of these purposes. ~~For example, the Basel capital framework's expected loss calculation for regulatory capital, as currently stated, differs from accounting in that the Basel capital framework's probability of default is through the cycle and is always based on a 12-month time horizon. Additionally, the Basel capital framework's loss-given-default reflects downturn economic conditions.~~ Where possible, banks should use established credit risk processes and models in order to ensure consistency between risk and accounting. This relates primarily to IRBA banks having already robust and sophisticated methodologies in place."

Paragraph 11:
We propose the following changes due to our principle 3 of proportionality/materiality:

While ECL accounting frameworks are new and different from current accounting frameworks and their implementation may ~~will~~ require an investment in both resources and system developments/upgrades, standard setters have given or are expected to give firms a considerable time period to transition to the updated accounting requirements. On that basis, the Committee has significantly heightened supervisory expectations that internationally active banks and those banks more sophisticated in the business of lending will have the highest-quality implementation of an ECL accounting framework. The amount of necessary investments will be highly dependent on the status and sophistication of the current credit risk management and will result from features of the ECL accounting, which are currently not part of the approved regulatory credit risk systems. Further, implementation costs or effort should be proportionate to the effects on accounting figures."

Paragraph 12:
We propose the following changes due to our principle 3 of proportionality/materiality:

"~~For less complex banks,~~ Consistent with the Basel Core Principles, the Committee recognises that supervisors may adopt a proportionate approach with regard to the standards that supervisors impose on banks and the conduct of supervisors in the discharge of their own responsibilities. This allows ~~less complex~~ banks to adopt approaches commensurate with the size, nature and complexity of ~~their~~ lending exposures, or the size, nature and complexity of entities (such as smaller banks, subsidiaries or branches of banking groups); or portfolios; in so doing, banks should consider the availability of robust data, especially for smaller portfolios or entities. At the same time banks should consider and apply the concept of materiality in accordance with accounting frameworks."

Paragraph 15:
According to the principle orientation and application of practical expedients we propose the following changes.

"This guidance includes an appendix relating to International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and which describes supervisory requirements specific to jurisdictions applying the IFRS ECL requirements. Nevertheless, the paper is intended to set forth supervisory requirements for ECL accounting that do not contradict the applicable accounting standards established by the IASB or other standard setters. Rather, the paper presents the Committee's

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

view of the robust application of those standards~~, including circumstances in which the Committee expects internationally active banks to limit their use of particular simplifications and/or practical expedients included in the relevant accounting standards~~."

Additional paragraph 15a should be included:
"The guidance of this paper has to be interpreted with respect to characteristics of the lending exposures for which ECL is calculated. The specifics of the available information should be considered adequately and high quality credit risk measurement should always be tailored to the portfolio's specifics."

Principle 1*: A bank's board of directors (or equivalent) and senior management are responsible for ensuring that the bank has appropriate credit risk practices, including effective internal controls, commensurate with the size, nature and complexity of its lending exposures to consistently determine allowances[4] in accordance with the bank's stated policies and procedures, the applicable accounting framework and relevant supervisory guidance. (paragraph 17-19).*

n/a

Principle 2*: A bank should adopt, document and adhere to sound methodologies that address policies, procedures and controls for assessing and measuring the level of credit risk on all lending exposures.[5] The robust and timely measurement of allowances should build upon those methodologies. (paragraph 20-32)*

Paragraph 21:
"We propose the following changes due to our principle 2 "Accounting follows risk management".

The Committee expects banks to maximize the extent to which underlying information and assumptions are used consistently within a bank to determine when credit should be granted and its corresponding terms; monitor credit quality; and measure allowances for both accounting and capital adequacy purposes. Using the same information and assumptions across a bank to the maximum extent possible reduces bias and encourages consistency in interpretation and application of the applicable accounting framework. Information and assumptions used should be reviewed and updated ~~each reporting period,~~ regularly in the course of the existing risk management processes (typically on a yearly basis unless evidence for more timely adjustments occurs. The rationale for changes in assumptions that affect the measurement of ECL should be well documented."

Paragraph 24:
We propose the following changes due to principle based character of the paper (our principle 1).

"At a minimum, a bank should adopt and adhere to written policies and procedures detailing the credit risk systems and controls inherent in the methodology and the separate roles and responsibilities of the bank's board and senior management. Though not an all-inclusive list, a robust and sound methodology for assessing credit risk and measuring the level of allowances, where relevant (subject to appropriate and proportionate application pursuant to paragraph 12), will:

[4] The term "allowances" includes allowances on loans and provisions on loan commitments and financial guarantee contracts.

[5] The term "lending exposures" includes loans, commitments and guarantees.

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

[...]

(f) document the inputs, data and assumptions used in the allowance estimation process (such as historical loss rates, PD/LGD estimates and economic forecasts), how the life of an exposure or portfolio is determined (including how expected prepayments have been considered), the historical time period over which loss experience is evaluated, and any qualitative adjustments. ~~Examples of factors that may require qualitative adjustments are the existence of concentrations of credit risk and changes in the level of such concentrations, increased usage of loan modifications, changes in expectations of macroeconomic trends and conditions, and/or the effects of changes in underwriting standards and lending policies;~~

[...]

(h) identify the situations that would generally lead to changes in ECL measurement methods, inputs or assumptions. ~~from period to period (eg the conditions when the time horizon over which expectations are to be formed would change; or the conditions under which an exposure originally monitored on a collective basis would be removed from the group for individual assessment);~~

(i) consider the relevant internal and external factors that may affect ECL estimates; ~~such as underwriting standards and industry, geographical, economic and political factors;~~"

Paragraph 24(k):
Due to the requirements to be taken into account when building a rating system, a bank is as a rule interested in considering comprehensively the data and information which are relevant to the assessment of the credit risk. This has to be proven by appropriate analyses when a rating method is inspected for acceptance.

Against this backdrop, we regard as inappropriate the demand for collecting historical data which must at least comprise a full credit cycle and then will be just the starting point for further estimates. We suggest to formulate this requirement as a goal to be strived for but not as a minimum requirement.

Even at large international banks, data histories, e.g. of ratings, let alone of lifetime PDs, for past applications are at present often available only very incompletely or only with significant disruptions. Upon and for a reasonable time after its introduction, this fact should be appropriately taken account of also in the final document with respect to the quality of the methodology, so as to rule out requirements which cannot be fulfilled, or inadequately high expenditure as, for example, incurred by manual subsequent data acquisition.

Paragraph 26:
We propose the following wording due to our proposal for a principle-based character of the paper.

"Management should consider ~~a wide range of~~ relevant facts and circumstances that are likely to cause ECL to differ from historical experience and that may affect the full collectability of cash flows."

Paragraph 27:
We propose the following changes due to principle-based character of the paper (our principle 1):

"In assessing and measuring the appropriate level of credit risk for ECL purposes, with respect to factors related to the character, capacity and financial resources of borrowers, the terms of lending exposures

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

and the values of assets pledged as collateral, or other credit risk mitigants, a bank should ~~assess~~ consider~~: (a)~~ its lending policies and procedures, including its underwriting standards and lending terms, that were in effect upon initial recognition of the borrower's loan, and whether the loan was originated as an exception to this policy. A bank's lending policy should include details of its underwriting standards, and guidelines and procedures that steer the bank's lending approval process.

~~(b) a borrower's sources of recurring income available to meet the scheduled payments;~~
~~(c) a borrower's ability to generate a sufficient cash flow stream over the term of the instrument; overall leverage level and expectations of changes to leverage;~~
~~(e) unencumbered assets the borrower may pledge as collateral in the market or bilaterally in order to raise funds and expectations of changes to the value of those assets;~~
~~(f) one-off events and recurring behaviour that may affect the borrower's ability to meet contractual obligations;~~
~~(g) the extent of a bank's adherence to best practices with respect to loan underwriting;~~
~~(h) timely evaluations of collateral value and consideration of factors that may impact the future value of collateral (bearing in mind that collateral values directly affect estimates of loss-given-default); and~~
~~(i) all other relevant information.~~"

Paragraph 28:
To underline the principle-based character of the paper, the paragraphs 28 (a) to (h) should be deleted.

Paragraph 29:
Basically, it has to be said that we do not believe overemphasis of scenario calculations as provided in the Guidelines to be expedient and, therefore, suggest cancellation (this, by the way, is not a requirement of IFRS 9). Should a complete cancellation not be taken into consideration, we ask for clarification in accordance with our proposed formulations. What is important to us is, on the one hand, to clarify in paragraph 29 that use of information e.g. from the stress testing (e.g. EBA stress test) is possible but, on the other, this shall be based on the expected and not on stressed macroeconomic developments (that usually is the base case).

Paragraph 29 should be cancelled as sensitivity analysis or stress testing results have no relevance to derive ECL figures used for IFRS 9 accounting requirements. At least, we propose the following amendment:

29. ~~Since~~The consideration of reasonable and supportable forward-looking information including ~~and~~ macroeconomic factors is one of various ~~a distinctive~~ features of an appropriate ECL model~~s and is~~ pertinent ~~critical~~ to the timely recognition of ECL. Hence, a bank should develop and document its process to develop appropriate scenarios potentially used in the estimation of ECL.[6] Processes and information considered for stresstesting may be used for these scenarios with the distinction that input factors are not stressed, but reflect the expectation of the bank.

For the process, banks should take into consideration ~~I~~in particular:

~~(a) a bank should demonstrate and document how ECL estimates would fluctuate with changes in scenarios, including changes to forward-looking information and macroeconomic factors and other relevant external information that may impact ECL estimates;~~
(a~~b~~) the bank should have ~~a~~ documented ~~process for determining~~ the time horizon of the scenarios and, if

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

relevant, how ECL is estimated in the period following that which is reasonably estimable;[7]
(be) scenarios may be internally developed or, for less sophisticated banks, may be vendor-defined. For internally developed scenarios, a bank should have a variety of experts, such as risk experts, economists, business managers and senior management, assist in the selection of scenarios that are relevant to the bank`s credit risk exposure profile. For vendor-defined scenarios, a bank should ensure that the vendor tailors the scenarios to reflect its own business and credit risk exposure profile, as the bank remains responsible for those scenarios;
(cd) backtesting should be performed, if sufficient and adequate data is available, to ensure that appropriate factors are considered and incorporated, in light of historical experience; and
(de) where reasonable and supportable market indicators of future performance (such as credit default swaps) are available, management should assess the consistency of such indicators with its own judgments, and support and document material differences.

Paragraph 30:

We propose the following wording due to our principle 8 "Reasonable and supportable information" and due to fact that Sensitivity analysis or stress testing results have no relevance to derive ECL figures used for IFRS 9 accounting requirements.

"While a bank needs not necessarily identify or model every possible scenario through complex scenario simulations, the Committee expects it to consider the full spectrum reasonable and supportable information that is relevant to the product, borrower, business model or economic and regulatory environment when developing estimates of ECL. In developing such estimates for financial reporting purposes, a bank should consider the experience and lessons from similar exercises it has conducted for regulatory purposes, although the Committee recognises that stressed scenarios developed for regulatory purposes are not intended to be used directly for accounting purposes and to be able to demonstrate the internal governance and discipline applied to ensure that such relevant information is used. Forward-looking information and related credit quality factors used in regulatory expected loss estimates should be consistent with inputs to other relevant estimates within the financial statements, budgets, strategic and capital plans, and other regulatory reporting."

Paragraph 31:

We propose the following changes due our principle 1 "Paper should be principle-based" and our principle 3 "Proportionality and materiality".

"For the purpose of assessing increase in credit risk in accordance with the ECL accounting models, a bank management should be able consider to demonstrate its adherence to sound underwriting practices in light of the applicable sound underwriting practices[8] and the price at which lending exposures are granted appropriately reflects inherent risks. Post-initial recognition increases in credit risk require a bank to reassess ECL and re-measure the amount of the allowance that should be recognized in accordance with the applicable accounting framework.

Examples of fact patterns potentially showing inadequate underwriting practices may include:
(a) the granting of debt to borrowers based on fragile income streams (that could become non-recurrent upon a downturn) or with no documentation or limited verification of borrower income sources;
(b) high debt servicing requirements as compared with the borrower's net available expected cash flows;
(c) flexible repayment schedules, including payment vacation, interest-only payments (eg bullet loans) or

[8] Such as the "FSB principles for Sound Residential Mortgage Underwriting Practices", April 2012.

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

~~negative amortisation features;~~
~~(d) for real estate financing, lending of amounts equal to or exceeding the value of the financed property or otherwise failing to provide a margin of collateral protection;~~
~~(e) increases in troubled debt restructurings and other concessions or modifications to lending exposures;~~
~~(f) circumvention of the classification and rating requirements, including rescheduling, refinancing or re-classification of lending exposures;~~
~~(g) undue increases in the volume of credit, especially in relation to the increase in the volume of credit by other lenders in the same market; and~~
~~(h) increasing volume and severity of delinquent, low-quality and impaired credit.~~"

Paragraph 32:
Paragraph 32 should be deleted because the paper should not create redundancies by explicitly repeating existing requirements (c.f. principle 2).

***Principle 3**: A bank should have a process in place to appropriately group lending exposures on the basis of shared credit risk characteristics.[9] (paragraph 33-48)*

Addition of the footnote due to our principle 5 "segmentation".

Paragraph 33:
We propose the following changes due to our comments concerning our principle 5 "segmentation".

"As part of its credit risk assessment process, the Committee expects that banks will ~~develop~~ have in place ~~and implement~~ comprehensive procedures and information systems to monitor the quality of their lending exposures. These include an effective credit risk rating system that captures the varying level, nature and components of credit risk that may be manifested over time, in order to reasonably ensure that all lending exposures are properly monitored and that ECL allowances are appropriately estimated."

Paragraph 34:
We propose the following changes due to our principle 2 "Accounting follows risk management" and principle 8 "Reasonable and supportable information".

"With regard to rating systems, the procedures should clearly specify the key factors, ~~including forward-looking information and macroeconomic factors~~ that form the basis for assigning ECL risk ~~measurement~~ measures and thus help support the monitoring, assessment and reporting of ECL for all lending exposures across the entire credit risk rating system.

Paragraph 35:
We propose to delete paragraph 35 due to our principle that the paper should not create redundancy by explicitly repeating existing requirements.

~~The credit risk rating process should include an independent review function. While front-line lending staff may have initial responsibility for assigning credit risk ratings and ongoing responsibility for updating the~~

[9] Since sophisticated IRBA rating systems require a segmentation of lending exposures reflecting the underlying risk characteristics, principle 3 is implicitly fulfilled by banks using IRBA rating systems as a basis for ECL measurement. Hence, there is no need for a separate segmentation of the loan portfolio.

~~credit rating to which an exposure is assigned, this should be subject to the review of the independent review function.~~

Paragraph 36:
We propose the following changes due to our principle 1 that the paper should be principle-based.

"The credit risk rating a bank assigns upon initial recognition may be based on a number of criteria, including product type, collateral type and amount, borrower characteristics and geography or a combination thereof depending on the level of sophistication of a bank. Credit risk ratings assigned may subsequently change on either a portfolio or an individual basis due to other relevant factors. ~~such as, but not limited to, changes in industry outlook, business growth rates, consumer sentiment and changes in economic forecasts (such as interest rates, unemployment rates and commodity prices) as well as flaws in underwriting identified after initial recognition.~~ The ECL estimates must be updated on a timely basis to reflect changes in credit risk ratings for either groups of exposures or individual exposures."

Paragraph 37:
We propose the following changes due to our principle 2 "Accounting follows risk management" and principle 8 "Reasonable and supportable information".

"The design of the credit risk rating system measurement system should ensure that a bank incorporates all relevant information, ~~including forward-looking information and macroeconomic factors,~~ into its credit risk assessment and rating processes both upon initial recognition and over time. In this context, an effective credit risk rating system will allow a bank to track changes in credit risk, regardless of the significance of the change, and consequent changes in credit risk ratings."

Paragraph 38:
Redrafting is proposed to ensure that paragraph 38 allows individual and collective assessment.

"The credit risk rating system must capture all lending exposures to allow for an appropriate differentiation of credit risk and grouping of lending exposures within the credit risk rating system, reflect the credit risk of all underlying exposures ~~individual exposures~~ and, when aggregated across all exposures, the level of credit risk in the portfolio as a whole."

Paragraph 40:
Due to our principle 2 "Accounting follows risk management" and principle 3 "Proportionality and materiality" paragraph 40 should be deleted.

It is demanded here that rating systems, among other things, shall take account of the expected financial capacity of the debtor during the expected term of his credit or credit portfolio with the bank. For traditional corporate financing which is not specialised lending, a debtor-related rating is usually performed which includes future-oriented features but is not specifically geared to the term of the debtor's commitment. In this respect, it also has to be taken into account that the requirement of paragraph 40 will hardly be satisfiable for very long-term traditional loans (e.g. a term of 20 years) because, in view of macroeconomic influences, such future-oriented estimates of financial capacity can hardly be reasonably made for a period of more than three years.

Paragraph 42:
We propose the following wording due to principle our principle 2 "Accounting follows risk management" and principle 3 "Proportionality and materiality".

"Credit risk ratings should be reviewed whenever relevant new information is received or a bank's expectation of credit risk has changed. Credit risk ratings assigned should receive a periodic formal review (e.g. at least annually or more frequently if required in a jurisdiction) to reasonably ensure that those ratings are accurate and up to date. ~~Credit risk ratings for individually assessed lending exposures that are either large, complex, higher-risk or credit-impaired should be reviewed more frequently than annually.~~"

Paragraph 44:
We propose the following changes due to our principle 2 "Accounting follows risk methodology" and principle 8 "Reasonable and supportable information".

"Lending exposures should be grouped such that exposures in the group share similar credit risk characteristics. ~~and are expected to react to the current environment, forward-looking information and macroeconomic factors in a similar way with respect to changes in the level of credit risk.~~ The basis of grouping must be reconsidered regularly to ensure that exposures within the group remain homogeneous in terms of their response to credit risk drivers. Grouping implemented upon initial recognition based on similar credit risk characteristics, and the responsiveness of credit risk to those characteristics, will not necessarily be appropriate subsequently, given that the relevant characteristics and their impact on credit risk may change through time."

Paragraph 46:
We propose the following changes due to our principle 5 "segmentation".[10]

"Exposures should ~~must not~~ be grouped ~~in such a way that increase in the credit risk of a~~ on the basis of shared risk characteristics so that the credit risk of a significant part of exposures is not masked by the performance of the segment as a whole. In general, it is expected that a bank's normal credit risk management and independent review functions will review and, as necessary, revise models and ECL applications, among other things to ensure that the ECL allowance is appropriately updated from initial measurement. Where changes in credit risk after initial recognition affect a significant part of exposures ~~only some exposures~~ within a group persistently over time, those exposures must be segmented out of the group into relevant subgroups, to ensure that the ECL allowance is appropriately updated."

Paragraph 48:
We propose the following changes due to our principle 5 "segmentation".[11]

"The grouping of exposures should be re-evaluated in connection with a bank's ongoing review of [underlying ratings and] models as stated by IFRS 9 BC5.142; consideration should be given whenever necessary as to whether new information received or the bank's expectations of credit risk have changed in such a way that re-segmentation would yield the most appropriate basis for ongoing risk management in response to such new information or change in expectations ~~and exposures should be re-segmented whenever relevant new information is received or a bank's expectations of credit risk have changed~~. The group of exposures assigned should receive a periodic formal review (e.g. at least annually or more frequently if required in a jurisdiction) to reasonably ensure that those groupings are accurate and up to date."

[10] It should be noted that the guidance set out in para 46 not relevant for banks that determine significant increase in credit risk based on IRBA ratings systems. The same applies for para 47.

[11] It should be noted that the guidance set out in para 46 not relevant for banks that determine significant increase in credit risk based on IRBA ratings systems.

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

Principle 4*: A bank's aggregate amount of allowances, regardless of whether allowance components are determined on a collective or an individual basis, should be adequate as defined by the Basel Core Principles, which is an amount understood to be consistent with the objectives of the relevant accounting requirements. (paragraph 49-55)*

Paragraph 51:
We propose the following changes according to our principle 8 "Reasonable and supportable information".

"Individual assessments of credit risk may be appropriate in many circumstances, such as when an exposure is closely monitored or for large-value loans. Regardless of the nature of the assessment, ECL estimates should always incorporate the expected impact of all <u>relevant and</u> reasonably available forward-looking information and macroeconomic factors. This might require exposures (even those that are initially assessed individually using primarily historical and current information) to be placed in a group with shared credit risk characteristics and assessed collectively using a top-down approach to consider forward-looking information and macroeconomic factors that could not be assessed on an individual basis. Such collective assessment could allow identification of relationships between risk factors, as affected by forward-looking information and the ensuing cash shortfalls that may not be apparent at the individual exposure level. When exposures are assessed both individually and collectively in this way, banks should be careful to ensure that there is no double-counting.

<u>Paragraph 52:</u>
Change due to our principle 8 "Reasonable and supportable information".

"In addition to historical information and current conditions, forward-looking information and macroeconomic factors are also critical when estimating future cash shortfalls, for a group of exposures or an individual exposure. Methodologies for the determination of the cash flow shortfalls may start with simple averages of a bank's net loss experience on loans with shared credit risk characteristics over a relevant credit cycle, progressing to more complex techniques, such as migration analysis or models that estimate ECL. All methodologies should require appropriate adjustments to historical loss estimates for changes in factors that affect repayment, in particular due to forward-looking information and macroeconomic factors <u>where relevant and reasonably available."</u>

Principle 5*: A bank should have policies and procedures in place to appropriately validate its internal credit risk assessment models. (paragraph 56-58)*

<u>Paragraph 56:</u>
Change due to our principle 8 "Reasonable and supportable information".

"Credit risk assessment and measurement may involve models and assumption-based estimates for risk identification and measurement. Models may be used in various aspects of the credit risk assessment and measurement process at both the individual transaction and overall portfolio levels, including credit scoring, credit risk estimation or measurement, stress testing, measurement of allowances for accounting purposes, and capital allocation. Credit risk assessment and measurement models ("models") often consider the impact of changes to borrower- and credit risk-related variables such as changes in PDs, LGDs, exposure amounts, collateral values, rating migration probabilities and internal borrower ratings based <u>on relevant and reasonable</u> historical, current and forward-looking information and macroeconomic factors."

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

Paragraph 57:
Here, validation at least once a year is required of all models involved in ECL-based determination of credit risk provisioning. Given the requirements of the current EBA Draft RTS on assessment methodology for IRB models of 12 November 2014 (Article 11), this should be stated in a more differentiated fashion.

a. *Quantitative back-testing at least once a year (cf. CRR Art. 185 b)*
b. *Complete validation needs to be performed at least once a year only where the models cover a material portion of the portfolio.*

Paragraph 58(b):
The Basel Committee demands a validation unit which shall be independent of the development of the model. Apparently, the Committee assumes that the objectivity of the validation will be impaired if those employees who have developed the models after that also verify the quality of these models. Although in our opinion both functions in principle have the same interest to have valid models, we cannot deny that such conflicts of interest are potentially conceivable. However, to us they seem substantially less likely and distinct than those between lending and the credit risk control unit. Moreover, it has to be considered that validation concepts and internal control systems have been in use at the banks for years and compliance with them is being monitored on a regular basis by internal revision and the supervisory authorities.

For us, it is indispensable, analogous to the design on the part of the IRB, that the credit risk control unit is involved both in the design and implementation and the validation and change of the models. This unit has the necessary expertise not only to develop methods commensurate with the risk and reasonable in economic terms but also to assess the efficacy of these models. Moreover, there are interdependencies between development and validation of the models that necessitate constant exchange between the employees responsible for these two tasks. On the one hand, findings result from validation which can be used to further develop the methods. On the other, qualitatively appropriate validation cannot take place without practical findings from development. We believe that the fact that validation is involved in development does not mean it cannot preserve its independence.

Hence, paragraph 58 should be deleted. At least, the following sentence in the second bullet should be deleted: "The unit should also be independent of the model development process".

Principle 6*: A bank's use of experienced credit judgment, especially in the robust consideration of forward-looking information ~~that is reasonably available~~ and macroeconomic factors, that are both relevant and reasonably available is essential to the assessment and measurement of expected credit losses. (paragraph 59-64)*

Change of principle 6 due to our principle 8 "Reasonable and supportable information".

Paragraph 59:
Change due our principle 8 "Reasonable and supportable information".

"Banks should have the necessary tools to ensure a robust estimate and timely recognition of ECL. Information on historical loss experience or the impact of current conditions may be limited or not fully relevant to lending exposures currently held by the bank or expectations of future conditions. In that context, a bank must use its experienced credit judgment to thoroughly incorporate the expected impact of all relevant and reasonably available forward-looking information and macroeconomic factors on its estimates

of ECL. A bank's use of its experienced credit judgment must be documented in the bank's credit risk methodology."

Paragraph 60:
Change due our principle 8 "Reasonable and supportable information".

"The Committee understands that it is challenging and costly to incorporate forward-looking information and macroeconomic factors into the estimate of ECL and that ECL estimates will inherently have a significant degree of unavoidable subjectivity. Nevertheless, in the Committee's view, consideration of relevant and reasonable forward-looking information and macroeconomic factors is essential to the proper implementation of an ECL accounting model ~~and therefore these costs should not be avoided on the basis that a bank considers them to be excessive or unnecessary~~."

***Principle 7**: A bank should have a sound credit risk assessment and measurement process that provides it with a strong basis for common systems, tools and data to assess and ~~price~~ credit risk, and account for expected credit losses. (paragraph 65-71)*

Change of principle 7 due to our principle 2 "Accounting follows risk management".

Paragraph 68:
Delete paragraph 68 completely due to our principle 2 "Accounting follows risk management".

~~Credit risk practices should not be static and should be reviewed periodically to ensure that relevant data available throughout a banking organisation are captured and that systems are updated as the bank's underwriting or business practices change or evolve over time.~~

Paragraph 69:
Deleted due to our principle 2 "Accounting follows risk methodology".

"~~When assessing the adequacy of credit risk systems, a bank must consider the required elements of an ECL accounting model.~~ ECL accounting models require a bank to consider forward-looking information and macroeconomic factors, along with current conditions and historical data. As explained in paragraph 64, because banks are increasingly considering forward-looking information and macroeconomic factors for risk management and capital adequacy purposes, the Committee expects banks to leverage and integrate these processes to the extent possible when developing their processes for estimating ECL for accounting purposes. ~~Nevertheless, f~~ For banks that calculate expected losses under the Basel capital framework, the Committee acknowledges that adjustments will be needed to these expected loss calculations when estimating ECL for accounting purposes and expects that these adjustments will be well documented."

Paragraph 70:
Delete paragraph 70 with the example completely due to principle 1 "paper should be principle-based".

~~Common processes, systems, tools and data that are used in assessing credit risk and measuring ECL for accounting purposes and expected losses for capital adequacy purposes include credit risk rating systems, estimated PDs (with adjustment), past-due status, loan-to-value ratios, historical loss rates, product type, amortisation schedule, down payment requirements, market segment, geographical location, vintage, and collateral type, along with information of a forward-looking nature.~~

Principle 8*: A bank's public reporting should promote transparency and comparability by providing timely, relevant and decision-useful information. (paragraph 72-81)*

Paragraph 73:

Due to our principle 1 "Paper should be principle-based" and principle 3 "Proportionality and materiality" paragraph 73 should be deleted.

The Basel Committee asks banks to disclose information beyond required financial statement disclosures if such information is necessary to reasonably describe the credit risk exposure.

The impression might arise here that IFRS 9 does not specify information in the list of the disclosure requirements which needs to be supplemented here. However, IFRS 9 already requests comprehensive information including considerations regarding depth of detail, so that the reader can get a reasonable picture (cf. IFRS 7.35B et seq.). To avoid possible uncertainty regarding interpretation and for the purpose of consistency, we suggest to cancel paragraph 73.

Paragraph 74:

According to our principle 1 "Paper should be principle-based" we propose the following:

"Management will need to apply judgment to determine the appropriate level of aggregation versus disaggregation of data disclosed, such that disclosures continue to adhere to accounting requirements, and provide insights into the entity's exposure to credit risk. ~~for users to perform relevant peer group comparisons.~~"

Paragraph 75:

We propose to delete paragraph 75 due to our principle 2 that the paper should not create redundancy by explicitly repeating existing requirements.

To get a clear understanding of the effect of influencing factors it is important to explain underlying assumptions of ECL-estimates quantitatively and qualitatively. In this connection the Basel Committee on Banking Supervision considers a sensitivity analysis which is not clearly defined and in our opinion goes far beyond requirements of the standard. Therefore, we propose to delete this paragraph. At least, we propose the following amendment:

"[...] The Committee expects quantitative and qualitative disclosures, taken together, to provide a clear picture to users of the main assumptions used to develop ECL estimates~~, and the sensitivity of ECL estimates to changes in those assumptions~~ [...]"

Paragraphs 76 to 80:

Moreover, regarding to our comments on paragraph 73 we suggest to cancel paragraphs 76 to 80.

Principle 9*: Banking supervisors should periodically evaluate the effectiveness of a bank's credit risk practices. (paragraph 82-83)*

Paragraph 82:

Paragraph 82 (d) to be deleted since the process of pricing should not comingled with credit risk management action. This relates to our Principle 2 "Accounting follows risk management".

***Principle 10**: Banking supervisors should be satisfied that the methods employed by a bank to determine allowances produce a robust measurement of expected credit losses under the applicable accounting framework. (paragraph 84-85)*

n/a

***Principle 11**: Banking supervisors should consider a bank's credit risk practices when assessing a bank's capital adequacy. (paragraph 86-90)*

n/a

Special comments on the annex

Paragraph A2:
Due to our Principle 2 "Accounting follows risk management" we propose the below mentioned changes.

In our opinion, the requirements regarding the design and extent of scenario simulations formulated in IFRS 9 are sufficiently concretised (IFRS 9.5.5.18, IFRS 9 B5.5.41, B5.5.42). Taking account of the BCBS's objective to achieve a robust calculation, we would like to have it clarified that requirements beyond the IFRS 9 standard are not made.

"~~The Committee expects banks to adopt an active approach to assessing and measuring 12-month ECL that enables changes in credit risk to be identified on a timely basis.~~ In accordance with principle 6 of the main section of this guidance, estimates of the amount and timing of 12-month ECL should reflect management's experienced credit judgment, and take into account the range of possible ~~future scenarios~~ outcomes.[12] The methodology used to estimate 12-month ECL should be robust ~~at all times~~ and should allow for the timely build-up of allowances at the reporting dates."

Paragraph A3:
Occurrence of a significant credit risk increase may within the meaning of an approximate solution according to IFRS 9.B5.5.13 be assessed based on the 12-month PD if there is no indication of any other result. According to paragraph A3, however, the use of a 12-month PD is, contrary to the provisions of the standard, permitted only in exceptional cases, with the consequence that the banks would have to give reasons when using a 12-month PD. Such an interpretation runs contrary to the standard. The application of the 12-month-PD according to the IFRS 9 should not be restricted. This applies especially for the required retrospective application.The paragraph should be changed in accordance with the provisions of the standard:

"[...]The committee also emphasises ~~that, to assess whether a financial instrument should move to a lifetime expected credit loss (LEL) measure, the change in the risk of a default occurring over the expected~~

[12] For this purpose, complying with the requirements of IFRS 9 (IFRS 9.5.5.18, IFRS 9 B5.5.41 and B5.5.42) regarding the range of possible future outcomes is considered sufficient.

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

~~life of the financial instrument must be considered. In some circumstances, IFRS 9 allows the risk of a default occurring over the next 12 months to be used to make this assessment; however, this may not always be appropriate, and particular attention is drawn to the examples set out in IFRS 9, paragraph B5.5.14.~~to draw particular attention to the examples set out in IFRS 9, paragraph B5.5.14. In such cases the change in the risk of a default occurring over the expected life of the financial instrument may be a more appropriate basis."

Paragraph A4:
Using the definition of default provided in the Basel framework to determine the provision for risks in accordance with IFRS 9 is common practice already today under IAS 39 and increases the consistency of implementation at the banks.

Paragraph A5:
Principle 2 demands maximal methodological consistency, among other things between the accounting and the determination of regulatory own funds. On the other hand, the Guidelines formulate additional requirements that cause parallel data warehouses and methodological inconsistencies. An especially serious example is the requirement of extended default criteria in paragraph A5 according to which the Basel default criteria are not sufficient and should be supplemented with other criteria ("... should be supplemented with other elements ..."). Here, the question is anyway which factors that have not already been taken into account for regulatory purposes in consideration of a default are meant. We also see a danger that the consistency of accounting and risk management in accordance with IFRS 9. B5.5.37 which the IASB strives for will be unnecessarily foiled by such demands.

Due to our principle "Accounting follows risk management and supplementing the well-established indicators for a default (according to current regulatory requirements) we propose the following amendment:

"In accordance with the Basel capital framework, a default event occurs when either of the criteria in paragraphs A4 (a) and (b) is met or both are met. In this context, the "unlikeliness to pay" criterion of the debtor is regarded as a primary indicator, while the 90-days-past-due criterion is a backstop. ~~Furthermore, the list of elements provided in the Basel framework as indications of unlikeliness to pay should be supplemented with other elements that affect the borrower's ability or willingness to meet the contractual obligations, as identified on either an individual or a collective basis, and adjusted to incorporate current conditions and forward-looking information. The inclusion of those other elements is aimed at capturing indicators of credit risk that precipitate eventual cash shortfalls.~~"

Paragraph A6:
Deletion due to our principle "Relevant and reasonable information" and "Accounting follows risk management".

"In formulating the estimate of the amount equal to 12-month ECL, it is important to consider all relevant and reasonably available information that affects credit risk, especially forward-looking information and macroeconomic factors. A bank should exercise its experienced credit judgment to consider both qualitative and quantitative information that may affect the bank's expectations of credit risk. ~~IFRS 9 provides that an entity need not undertake an exhaustive search for information when measuring an amount equal to 12-month ECL; nevertheless, banks should actively incorporate information that may affect the estimate of ECL and a bank should not exclude or ignore information that is reasonably available.~~ The Committee expects that a bank will consider all relevant information that is reasonably available, without bias, and is known to materially affect the assessment and measurement of credit risk. In particular, for the measurement of an amount equal to 12-month ECL to be sufficiently sensitive to all relevant sources of

credit risk, it is necessary that forward-looking information that is reasonably available and relevant macroeconomic factors are considered in the estimate. This will permit allowances to build over time in response to changes in credit risk and better reflect the inherent credit risk associated with lending."

Paragraph A8

Where "high risk exposures" are incurred, subsection A8 demands that the decision-making and governance processes be disclosed when these commitments are prolonged. From our point of view, the introduction of new disclosure regulations that exceed the requirements of IFRS 7 cannot have been the intention of the present paper. Therefore we suggest the following amendment:

"[...]Where a bank has a policy that allows it to extend high-risk lending exposures, the Committee expects that the rationale for extending these exposures and associated governance process will be well documented ~~and disclosed~~, and the bank will be in adherence to sound underwriting practices and implement commensurately robust credit risk management practices."

Paragraph A11:

Deletion due to our principle 5 "Segmentation" and principle 3 "Materiality".

The sub-clause "and the grouping of financial instruments does not obscure information" might be misunderstood to mean a general assumption by the supervisory authority that the banks might be interested in obscuring information. We ask to have this part of the paragraph clarified or deleted. All in all, it has to be said that it is a regular feature of the rating systems in banks to optimally separate the risks, not least by means of optimal grouping and segmenting of the portfolios within a rating system. From our point of view, therefore, the paragraph provides little added value to the validation standards already provided in the CRR. The paragraph should be adjusted as follows:

"Where a collective assessment is performed, exposures within that group ~~must~~ should share similar credit risk characteristics. Banks may use different methods to group exposures for the purpose of collectively assessing credit risk and measuring ECL, and more sophisticated credit risk assessment models may combine several characteristics. Banks must be able to demonstrate that their methodology for grouping exposures is sound, that the individual exposures within a group are expected to respond to changes in the credit risk drivers relevant to the group in a consistent way~~, and that the grouping of financial instruments does not obscure information~~. When grouping exposures banks shall take into account the materiality of the exposures and the possibility of creating homogeneous groups."

Paragraph A12:

Banks will need sufficient granular databases in order to identify common risk factors. However banks will need to balance the granularity with the size of portfolios on which statistical information could be considered relevant and reliable and to ensure that risk management is properly reflected.

It will also depend whether the bank is under the standardized or IRB approach. The IRB banks may use the existing segmentation and rating grids as a sound basis since both of them have already been validated either by supervisors or by internal processes and as such, considered as consistent and homogenous on the basis of prudential regulation and sound credit risk management practices.

There are different ways to link ECL accounting to credit risk management. For example, when using PD/LGD models for IFRS 9 purposes, some banks are contemplating a model where assumptions and calibration of parameters will be considered at collective level (based on Basel portfolios) and subsequently assigned to the individual exposure level. The PDs will in this case be derived at collective level but the

transfer criteria and measurement of the allowances will be at individual client level so exposures can be moved between buckets at individual level using specific risk factors. However, other banks may not have such a degree of detailed information at an individual level so additional collective assessments for transfer will be needed at a portfolio/subportfolio level. In any case, the AEG should take into account that re-estimation of statistical parameters would be unmanageable if portfolios/subportfolios change frequently.

Therefore, rather than suggesting that re-segmentation is necessary, which assumes a particular method of application which may not be appropriate, the paper should highlight the importance of ensuring that the grouping of exposures and the inputs to the accounting ECL models are risk sensitive so that the level of aggregation applied should be expected to be responsive to the underlying credit conditions and behaviour of the borrower. This would be more consistent with the ability to build on the Basel modelling process, including its governance and validation processes.

Paragraph A17:
Deletion due to our principle "Relevant and reasonable information".

"The IFRS 9 approach to impairment assessment and measurement is demanding in its requirements for data, analysis and use of experienced credit judgment, particularly regarding whether an exposure has suffered an increase in credit risk and the measurement of required 12-month and lifetime ECL. Strong governance, systems and controls must be placed around these processes. Unless adequate systems and processes are already in place, banks will need to implement systems that are capable of handling and systematically assessing the ~~large amounts of~~ entire set of information that will be relevant and reasonably available ~~required~~ to judge whether or not particular lending exposures or groups of lending exposures exhibit a significant increase in credit risk, and to measure LEL where that is the case. Ensuring that the approach is consistent across entities within a group is important. For example, processes should be in place within a bank to ensure that forecasts of economic conditions in different jurisdictions and economic sectors are reviewed and approved by an entity's senior management, and that the process, controls and economic assumptions around developing forecasts are consistent across the entity (i.e. at the jurisdictional level and the group level)."

Paragraph A19:
Deletion due to our principle "Relevant and reasonable information".

"As noted in the IFRS 9 Application Guidance, the range of information that will need to be considered in making this determination is wide. In broad terms, it includes relevant and reasonably available information on macroeconomic conditions, and the economic sector and geographical region relevant to a particular borrower or a group of borrowers with shared credit risk characteristics. A critical feature is the required use relevant, ~~of reasonable~~ reasonably available and supportable forward-looking information, in addition to information about current conditions and historical data."

Paragraph A23:
Should be deleted due to our principle "Accounting follows risk management" and the principle "paper should be principle-based"

Paragraph A24:
Here, analyses are required of the macroeconomic influence on major, individually controlled commitments at the individual level. The example provided of a big commercial property loan is obviously to a large extent based on the lending object's ability to generate income and the sensitivity between the real

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

estate market and macroeconomic influencing factors. With that, the example probably falls into the category of income-generating specialised lending where, for credit rating, usually the factors mentioned in paragraph A24 are taken into account also to a large extent across the term of the financing (e.g. also in the context of simulation calculations). For traditional corporate financing which is not specialised lending, debtor-related ratings are usually made which also include an individual look at the company's prospects. For this case, adjustment of the lifetime risk assessment due to macroeconomic influences on the basis of a suitable homogeneous collective basis should be fully sufficient. Hence, para A24 should be deleted due to principle "Accounting follows Risk Management" and the principle "paper should be principle-based".

Paragraph A26:
We suggest to delete the paragraph due to principle "paper should be principle-based" and the principle "paper should not create redundancy by explicitly repeating existing requirements".

Here as well, it is ensured already in the rating developments that all relevant risk drivers are used in the rating process. From our point of view, these principles also apply to the identification of credit deterioration or improvement in the context to the determination of the transfer criterion. In our opinion, specification by means of this paragraph is not additional guidance but might create the impression that this is not happening at the moment. This would, however, be a contradiction to the basic approach – reviewed by the supervisor – to the model development of rating systems. We suggest to delete the paragraph.

Paragraph A27:
Factors deleted due to principle "paper should be principle-based".

"While it is neither possible nor desirable for universally applicable criteria to be developed, the Committee emphasizes that ~~the presence of any of conditions (a)–(f) below would suggest that there has potentially been a significant increase in credit risk.~~ banks should take particular care to avoid the risk of a significant increase in credit risk not being acknowledged promptly when it is, in fact, present. ~~In forming their assessments, banks should pay particular attention to the factors listed below:~~
~~(a) a discretionary decision by management such that, were an existing loan newly originated at the reporting date, the element of the price of the loan that reflects the credit risk of the 28 exposure would be higher than it was when the loan was actually originated as a result of the change in credit risk since inception;~~
~~(b) a decision by management to strengthen collateral and/or covenant requirements for new exposures that are similar to exposures already advanced because of changes in the credit risk of those exposures since initial recognition;~~
~~(c) a downgrade of a borrower by a recognised credit rating agency, or within a bank's internal credit rating system;~~
~~(d) for performing credits subject to individual monitoring and review, an internal credit assessment summary indicator that is weaker than upon initial recognition;~~
~~(e) deterioration of relevant factors (eg future cash flows) for an individual obligor (or pool of obligors); and~~
~~(f) expectation of forbearance or restructuring.~~"

Paragraph A 28:
Examples deleted due to principle "paper should be principle-based".

"~~In addition, the assessment of whether there has been a significant increase in credit risk of a lending exposure should take full account of the more general factors below:~~
~~(a) deterioration of the macroeconomic outlook relevant to a particular borrower or group of borrowers.~~

~~Macroeconomic assessments must be sufficiently rich to include factors relevant to sovereign, corporate, household and other types of borrower. Furthermore, they must address any relevant regional differences in economic performance within a jurisdiction. See principle 6 in the main section of this guidance for additional considerations for forward-looking information and macroeconomic factors; and~~
~~(b) deterioration of prospects for the sector or industries within which a borrower operates~~."

Paragraph A29:
The assumption of the paragraph that minor deterioration of the credit quality might cause a major rise in the probability of default appears to be inconsistent if one sees credit quality as more or less the same as the probability of a default. We suggest to clarify this section of the text.

The final statement of the paragraph, that the credit risk might significantly increase but the rating not be downgraded, is conceivable at best as a theoretical exceptional case ("It is possible that a significant increase in credit risk could occur before lending exposures experience even a one-notch downgrade".). However, this is not the case if a sufficiently granular rating scale and efficient rating systems exist. The statement suggests that even transactions without a rating change need to be systematically checked beyond the rating process for the occurrence of a significant increase of the credit risk. We believe this procedure is inappropriate and therefore advocate for cancellation of this text passage.

Therefore and due to principle "paper should not create redundancy by explicitly repeating existing requirements", we suggest the following amendment:

"Accurate measurement of the drivers of credit risk, and reliable calibration of the linkages between those drivers and the level of credit risk, are both critical~~, as small changes in credit quality can be associated with a large increase in the probability of default~~. IFRS 9 requires banks to look beyond the change in the absolute credit risk and when determining whether there is a significant increase in credit risk to consider the change in probability of default since initial recognition relative to the probability of default occurring as assessed upon initial recognition. A given change in the probability of a default occurring has a different significance depending on the risk of a default occurring as measured upon initial recognition. ~~It is also necessary to look beyond how many "notches" a rating downgrade entails because the change in PD for a one-notch movement is not linear (for example, the default probability over five years of an exposure rated BB is around three times that of one rated BBB, based on current data and analyses applicable to certain jurisdictions). It is possible that a significant increase in credit risk could occur before lending exposures experience even a one-notch downgrade.~~"

Paragraph A30:
To be deleted as a consequence of eliminating the above paragraphs.

"There are some circumstances in which an adverse movement in specific factors ~~listed in paragraphs A27–A28 above~~ might not be indicative of a significant increase in credit risk. For example, it may be the case that the default probability of an exposure rated AA is low, and not much greater than one rated AAA. However, very few bank loans are of such apparently high credit quality – and, as illustrated in paragraph A29, the sensitivity of default probability to rating grade increases strongly as rating quality declines."

Paragraph A32:
The statement is not correct that a decision in favour of the downgrading of an internal rating would have been unlikely without the fact of a significant credit deterioration. A rating may well be downgraded with-

out a significant increase of the credit risk having occurred. Therefore, existence of a significant credit deterioration can be determined only based on an individual judgement. We reject a general assignment to stage 2 of loans the rating of which has become worse.

We suggest to delete the paragraph due to the principle "accounting follows risk management" and the principle "paper should be principle-based". Discretionary decisions as mentioned in para A32 are an integral component of the rating systems. Hence, such action is fully considered in PD-changes derived from the rating grading. To ensure this, such discretionary decisions are monitored on an ongoing basis.

Paragraph A35:
IFRS 9 is misquoted, implying that collective assessments must be performed instead of that they may be necessary.

Paragraph A38:
It should be clearly stated in the final document that a comparison of past lifetime PD estimates upon credit granting with the lifetime PDs estimated on the balance sheet date makes sense economically only if the comparison is made for congruent periods of time, i.e. in concrete terms the residual term until the balance sheet data (e.g. this is just implied in IFRS 9 B5.5.11). Hence only the lifetime PD expectations upon credit granting which lie in the future, as seen from the balance sheet date, are the basis for the comparison. The same also applies if the 12-month PD were used for the comparison, so that the 12-month PD upon credit granting expected at the balance sheet date is to be compared to the current 12-month PD.

Paragraph A43/44:
We disagree with statements in paragraph A43 since IFRS 9 sets out specific requirements with regards to modifications. Those accounting rules prevent preparers from hiding credit deteriorations by modifications or renegotiations of the contractual terms and conditions. Hence, paragraph A43 should be deleted.

"~~Modifications or renegotiations can mask increases in credit risk, resulting in ECL being underestimated, and delaying the transfer to LEL for obligors whose credit quality has significantly deteriorated, or can inappropriately result in a move from LEL measurement back to 12-month ECL measurement~~"

Due to this, para 44 is also to be deleted. The factors pointed out in this paragraphs need to be considered independently of whether a loan has been modified or not.

"~~When determining if there is a significant increase in credit risk for a modified lending exposure, the Committee expects a bank to demonstrate whether such modifications or renegotiations have improved or restored the ability of the bank to collect interest and principal payments compared with the situation upon initial recognition. In developing ECL estimates, a bank should also take into account whether the modification or renegotiation has improved or restored the ability of the bank to collect interest and principal payments as compared with the situation prior to modification. Consideration should also be given to the substance of modified contractual cash flows as well as relevant forward-looking implications of the modifications for the credit quality of the exposure (taking into consideration the credit quality of the obligor). Factors to consider include, but are not limited to, the following;~~
~~(a) whether the modification or renegotiation of the contractual terms and resulting cash flows is economically beneficial to the obligor, compared with the original, unmodified contractual terms, and how the modification economically affects the obligor's ability to repay the debt;~~
~~(b) whether factors can be identified that support a bank's assessment of the obligor's ability to repay the~~

Comments on the Consultative Document "Guidance on ac-counting for expected credit losses" (BCBS 311)

~~debt, including circumstances leading up to the modification, and future prospects of the obligor as a result of the modifications, considering current conditions, macroeconomic forecasts, and prospects for the sector/industry within which the obligor operates, the obligor's business model, and the obligor's business (management) plan that outlines the obligor's expectation on its future performance, financial resilience and cash flows; and~~
~~(c) whether the obligor's business plan is feasible, realisable and consistent with the repayment schedule of interest and principal under the modified contractual terms of the lending exposure.~~"

Paragraph A45:
We believe the text part "a customer would need to demonstrate consistently good payment behaviour over a period of time before the credit risk is considered to have decreased" can be deleted because this is described verbatim already in the corresponding IFRS standard. Therefore, the text part does not provide additional guidance to the standard.

Paragraph A46:
We do not agree with BCBS' conclusion that the use of practical expedients set out in IFRS 9 would inevitably result in an "inappropriate" implementation of the IFRS 9 Impairment Model. ("low quality implementation"). For reasoning this statement, we refer to our comments to each specific expedient in the paragraphs A49 to A62 below.

"IFRS 9 includes a number of practical expedients, intended to ease the implementation burden for a wide range of companies in recognition of the fact that IFRS 9 will be used by a variety of entities, including firms outside the banking industry. ~~The Committee regards many of these practical expedients as inappropriate for use by internationally active banks and those banks more sophisticated in the business of lending, particularly because – given their business – the cost of obtaining relevant information is not considered by the Committee to be likely to involve "undue cost or effort".~~"

Paragraph A 49:
Changes due to principle "Relevant and reasonable information" and "Proportionality / Materiality".

"IFRS 9 states that "an entity shall consider the best reasonable and supportable information that is available, without undue cost and effort" and that "an entity need not undertake an exhaustive search for information".[13] The Committee expects that banks will not read these statements restrictively. Since the objective of the IFRS 9 model is to deliver fundamental improvements in the measurement of credit losses, the Committee expects banks to develop systems and processes to use all relevant, reasonably available and supportable information needed to achieve a high-quality, robust and consistent implementation of the approach subject to the proportionality principle as explained in paragraph 12. ~~This will potentially require costly upfront investments in new systems and processes but the Committee considers that the long-term benefit of a high-quality implementation far outweighs the associated costs, which should therefore not be considered undue.~~"

Paragraphs A50-52:
The Basel Committee regards application of the simplifying assumption regarding the low credit risk as an implementation of the accounting standard of just low quality. We do not share this view and cannot understand why different benchmarks are applied to banks and other industries, especially as we believe this regulation is justified. The absolute default risk for these loans can still be regarded as sufficiently low, so that making provisions for the risk in the amount of the loss to be expected during the remaining

[13] IFRS 9, paragraph B5.5.15.

term appears to be inappropriate. This statement is true irrespective of whether the accounting entity is a bank or a company of another industry.

We would like to emphasise that, in our opinion, the low credit risk exemption for credits without rating upon receipt and/or without current rating is a viable approach to implementing the standard. This has to be looked at also against the background that many rating systems have been introduced only in recent years and hence ratings upon receipt are not available for the respective loans. The costs associated with the derivation of probabilities of default, if such derivation is possible at all, would for these transactions be unreasonably high compared to the benefits due to the low absolute default risks and the associated low effects on the amount of the impairment.

Therefore, we propose to delete paragraphs A50-52.

~~A50. IFRS 9 introduces an exception to the general model in that, for "low credit risk" exposures, entities have an option not to assess whether credit risk has increased significantly since initial recognition. It was included as a practical expedient to provide relief from tracking credit risk for high-quality financial instruments such as highly rated debt securities. Although use of the low-credit-risk exemption is provided as an option in IFRS 9, in the Committee's judgment use of this exemption by banks would reflect a low-quality implementation of the ECL model in IFRS 9. The Committee expects that it would be used by banks only in rare and appropriate circumstances, since the Committee views lending activities as the core of the bank's business.~~

~~A51. The Committee regards the low-credit-risk exemption as merely an operational simplification that should be used by banks only in cases where it is evident that its use would have a minimal effect on the timing of ECL recognition and the measurement of ECL, as compared with when the expedient is not used. Nonetheless, some banks may consider that certain classes of exposures exist that are of such high credit quality that they will not exhibit significant increases in credit risk.~~

~~A52. In that context, the Committee expects that a significant increase in credit risk will always result in an exposure moving to LEL measurement, and for good-quality implementation of IFRS 9 any rare use of the low-credit-risk exemption must be accompanied by clear evidence that credit risk as of the reporting date is so low that a significant increase in credit risk since initial recognition could not have occurred. Accordingly, despite the exemption that exists in IFRS 9 for low-credit-risk exposures, the Committee expects that, even when a bank assigns a low credit risk rating to an exposure (or group of exposures), management should still assess whether credit risk has increased significantly. Even when a bank concludes that credit risk has not increased significantly for an individual exposure or group of exposures, it must continue to assess those exposures for changes in credit risk and recognize changes in 12-month ECL through the allowance.~~

~~We disagree with the expectation to prepare as set out in paragraphs A.50 to A52. This is since we consider assets with investment grade quality as being far away from the point of a potential default. Hence, according to the aim of the ECL-model a 12months EL provision would be appropriate to adequately cover the inherent risk of a default.~~

Paragraph A54:
Deleted since in our view, the time horizon of the expected change in business conditions is not a key driver in the assessment of whether credit quality has significantly deteriorated.

~~I FRS 9 does not provide definitions of "near" and "longer" term; thus, in those rare situations where a bank uses this practical expedient, a bank should establish its own internal definitions of "near" and "longer" term. The border between "near term" and "longer term" should be determined in a way that does not limit the weight of the evaluation on the "strong capacity" to meet the contractual cash flow obligations criterion (point (b) in paragraph A53) in the overall assessment of the borrower's credit risk.~~

Paragraph A55:
This BCBS requirement would be typically impracticable. For IRBA banks it may be adequate to rely on robust rating systems and processes considering all relevant and reasonably available information to assess an asset's PD.

"The notion of low credit risk does not refer to an entity's assessment of low credit risk in the context of its own risk appetite and the strategy of the business. Rather, the credit quality of lending exposure should be assessed on the basis of a global market~~ perspective which takes account of all terms and conditions of the contractual relationship~~.[14]"

Paragraph A56:
Deleted due to reasoning above on paragraph A54.

"The Committee expects banks' public disclosures to provide full information on the criteria applied in order to identify low-credit-risk exposures and classes of financial instruments to which it applies~~, and in particular the Committee recommends that information be provided on the internal definitions adopted for "near" and "longer" term~~."

Paragraph A56:
With respect to paragraph A57, we would like to point out that, although it is correct as regards concept that credit deterioration may have occurred within the investment grade area, it is also true that the absolute default risk for these loans can still be regarded as sufficiently low, so that making provisions for the risk in the amount of the loss to be expected during the remaining term appears to be inappropriate. This statement is true irrespective of whether the accounting entity is a bank or a company of another industry. This should be clarified.

Paragraph A59:
The Basel Committee emphasis that days overdue are lagging indicators and, therefore, believes a definition of the transfer criterion based on 30 days past due is inappropriate for banks. Any significant use of this provision is understood as a very low quality implementation of the standard.

With the practical expedients included in the standard, the IASB has explicitly recognised that the costs associated with the full application of the standard would, in certain constellations, be unreasonably high compared to the benefits. From our point of view, this principle of undue cost or effort is absolutely crucial to an adequate implementation of the standard and should be observed also with a view to the application of the practical expedients. This applies in particular also where the expected financial impact is to be regarded as not material. We emphatically point out that this otherwise very blanket view (for both the

[14] For example, some banks' target market is high-risk individuals or businesses. For those banks, their highest credit quality customers will often be considered high-risk customers by other market participants even if the banks themselves consider them to be low credit risk in relation to the full range of their borrowing customers.

low credit risk exemption and the 30 dpd rule), coupled with the very excessive or restricting requirements, may challenge entire business models, which may even be of a socio-political significance (e.g. subsidised loans to students, SME etc.).

In our opinion, these simplification rules have very well be justified their authorisation, in particular to assess significant credit deterioration in the retail business. We reject a blanket designation as "very low quality implementation" and this should at least be relativized.

We would also like to emphasize that it is not the intention of institutions to use these practical expedients to materially modify the level of allowances or mask significant credit deterioration that could be material. Instead of the generally made strong restriction for the users, we would suggest to clearly differentiate between retail and wholesale. Given that the approaches to retail and wholesale credit management and assessment are very different, it should be clarified which points are particularly relevant to wholesale credit risk or retail credit risk. We agree that the 30 days past due rebuttable presumption may be not a particularly useful metric for wholesale loans, which tend to be reviewed on an individual basis. But for retail business this criterion may be an appropriate and useful indicator.

For example, business models with loans of a comparably low commitment but possibly high socio-political significance (subsidised loans to students, SME) would from a banks' point of view increasingly become unattractive if excessive amounts of information were to be produced, followed up and documented in addition to the delay status. This primarily affects banks with business models that at least to a certain extent are based on the granting of such retail loans and/or on a public promotional mandate. Accordingly, application of the 30dpd should be permitted for these portfolios without regarding implementation of the standard generally as "very low quality". This should be clarified in this section. We, therefore, suggest to delete the last sentence ("The Committee would view significant reliance on past due information (such as using the more than 30 days past due rebuttable presumption as a primary indicator of transfer to LEL) as a very low quality implementation of an ECL model"). At least, the paragraph should be amended as followed:

"[...] ~~The Committee would view~~ A significant reliance on past-due information (such as using the more-than-30-days-past-due rebuttable presumption as a primary indicator of transfer to LEL) ~~as a very low-quality implementation~~ may be seen as a low quality implementation of an ECL model. However, if retail portfolios are not material in terms of exposure size or if a material impact on the financial situation of the group is not to be expected, than the use of the more-than-30–days rebuttable assumption can be an appropriate implementation that is proportionate to the risk of such retail exposures. Furthermore, there could be justified cases, in which the use of the more-than-30–days rebuttable assumption may be appropriate."

Paragraph A60

This paragraph should be clarified in a way that it is not required demonstrating that all forward-looking information that is potentially relevant had no substantive relationship with the level of credit losses if it is a retail portfolio and if a material impact on the financial situation of the group is not to be expected. In our opinion this approach would not be proportionate to the risk of such portfolios.